



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201219032**
Release Date: 5/11/2012
Date: February 17, 2012
UIL Code: 501.07-00
501.07-05
501.07-06
501.32-00

Contact Person:
Identification Number:
Contact Number:
Employer Identification Number:
Form Required To Be Filed:
Tax Years:

Dear

This is our final determination that you do not qualify for exemption from federal income tax as an organization described in Internal Revenue Code section 501(c)(7). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

You must file federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your federal income tax status and responsibilities, please contact IRS Customer Service at

Letter 4040 (CG) (11-2005)
Catalog Number 47635Z

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933.
The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



**DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224**

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: January 12, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = state
C = date
D = area
E = cities
F = river
G = area
h = dollar amount

UIL:

501.07-00
501-07-05
501-07-06
501.32-00

Dear

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(7). The basis for our conclusion is set forth below.

Issues

Do you qualify for exemption under section 501(c)(7) of the Code? No, for the reasons described below.

Facts

You are a B nonprofit corporation incorporated on C. Your Restated Articles of

Letter 4034 (CG) (11-2005)
Catalog Number 47628K

Incorporation provide that you are:

(1) a non-profit corporation or guild for artistic or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual or member,

(2) a club for pleasure, recreation, and other nonprofit purposes, substantially all of the activities of which are for such purposes and no part of net earnings of which inures to the benefit of any private shareholder or member, pursuant to the requirements of 26 U.S.C. §501(c)(7).

You describe yourself as the longest, continuous craft guild west of the F, providing a creative outlet for people living in the G area. Your members work year round to create unique and interesting crafts for sale at your bi-annual craft show and sale. You state your primary purpose to be the promotion of your membership.

You are operated on a membership basis, with your governing board being elected from your membership. You have four classes of members: general, associate, life and honorary. Members are required to stay current on dues. As you have indicated in your newsletters to members, those who do not pay current dues could lose voting rights, may not be able to show at the annual shows, and may not be included in the directory given out at the shows. This directory is a roster, on paper and via your web site, that includes each member's name and contact, business name and respective medium (painting, sewing, woodcrafts, etc). The member roster is presented at each annual show. In addition to this benefit, members may also pay an extra fee to have their businesses linked directly through the online roster available on your web site, enabling visitors to click through to their business web site through yours.

You listed the following activities (with the approximate percentage of the organization's time listed next to the activity):

Shows and Meetings – 85%

You conduct monthly membership meetings which include a business meeting, training sessions for upcoming shows, and speakers of interest. The meetings also offer a venue for the sharing of idea and materials, education, refreshments, and fellowship with other members.

You conduct two annual craft shows in which your members display and sell their crafts. All sales are processed through you, with each member receiving their portion of sales proceeds after the event, minus a 15% commission to cover operating costs. Admission to the events is free and the events are open to the public.

You rent the building, pay for advertising through flyers and radio, secure insurance, provide necessary materials and supplies and pay any applicable taxes. In return, members work necessary positions during the shows to ensure the event runs smoothly while bringing in 'high quality handcrafted items for display and sale.'

You have a waiver form members must complete prior to show sales. This form stipulates members agree that all funds received from you are contractor fees and each member is responsible for reporting said income and paying applicable taxes. This waiver also describes the various positions members are required to fill at each show, methods for determining prices of merchandise, and for tracking and maintaining inventory. Members are instructed to 'not discuss guild business while working the show'.

You control and manage inventory and proceeds of sales in the following manner. Each item for sale has a price tag with a personalized member number and corresponding inventory sheet. When purchased, the tag is removed and retained by you. After the show, the tags are separated by member, and sales totaled. You retain 15%, and your treasurer then writes each member a check for the remainder of their individual sales.

Programs and Community Presentations – 5%

You have a monthly meeting nine times annually. After the business portion of each meeting, you permit individuals from the community to participate in presentations on topics of relevance to the community. Past programs have included discussions on home break-ins and mail theft, how to make the community a safer environment, future road developments, identify theft, and how to prepare for a dry summer.

You plan to initiate a "Crafter of the Month" program in which one member will be featured each month to briefly discuss their special crafting talents. The member will offer a short presentation on how they do what they do.

Community Donations – 4%

You distribute funds and goods to local charitable organizations and to individuals in need, such as local fire departments and Boy Scout troops.

Scholarships – 3%

You award one thousand dollars scholarship annually to a graduating senior in the local area. Selections are based on community involvement, school participation, and academic performance.

Community Events – 3%

Your members are often invited to participate in numerous craft fairs, community functions, and events around the city. These are usually hosted by local schools, churches and charities. Portions of profits are often donated to the host entity by participating members.

Revenue for the last four completed fiscal years and the total percentage of all revenue over that period includes the following (numbers approximated):

Member dues and fees:	\$13000	2.6%
Sales:	\$480000	96%
Advertising:	\$5000	1%
Gifts/other:	\$2000	.4%

Over that same period approximately 78% of your total expenses consisted of payments back to members for sales. The remainder was attributable mostly to show expenses, taxes and advertising.

Law

Section 501(c)(7) of the Code provides for the exemption from federal income tax of clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1(a) of the Regulations states that the exemption provided by section 501(a) of the Code for an organization described in section 501(c)(7) of the Code applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its net earnings inure to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

Section 1.501(c)(7)-1(b) of the Regulations states that a club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or other products, is not organized and operated exclusively for pleasure, recreation and other nonprofitable purposes, and is not exempt under section 501(a) of the Code. Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business

and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption.

Rev. Rul. 69-527, 1969-2 CB 125

A social club formed to assist its members in their business endeavors through study and discussion of problems and other activities at weekly luncheon meetings does not qualify for exemption under section 501(c)(7) of the Code. The organization was formed and has been operated to study and discuss business and financial problems; to interchange among its membership business and financial information in order to create and encourage efficiency in business and finance; to assist its members in the expansion and development of their individual trades, businesses, and professions by encouraging the direct interchange of patronage among members; and to assist its members in extending and establishing new trade, business, and professional contacts.

Rev. Rul. 69-635 1, 1969-2 CB 126

An automobile club whose principal activity is rendering automobile services to its members but has no significant social activities does not qualify for exemption under section 501(c)(7). The principal activity of this organization is the rendering of automobile services to its members. Most of the services offered are of a type generally available to motorists on a commercial basis. The rendition of such services is not in the nature of pleasure or recreation within the meaning of the statute.

Public Law 94-568, 1976-2 C.B. 596, provides that a social club may receive up to 35 percent of its gross receipts, including investment income, from sources outside its membership without losing exemption. Within this 35 percent amount, not more than 15 percent of the gross receipts should be derived from the use of a social club's facilities or services by the general public.

Application of Law

You do not meet the requirements of section 501(c)(7) of the Code, because substantially all of your activities are not for pleasure, recreation, or other nonprofitable purposes. You are formed primarily to benefit individual members by facilitating the sale of their products through the conduct of two annual craft shows, open and advertised to the general public. As seen in Section 1.501(c)(7)-1(b) of the Regulations, when a club engages in business it is not organized and operated exclusively for pleasure, recreation and other nonprofitable purposes. Your sales activities are more than incidental and, therefore, preclude exemption under section 501(c)(7) of the Code.

Your income results from business done with the general public and you are not supported solely by membership fees, dues, assessments, or income derived from the social activities of your members. By receiving over 90% of your revenue from nonmembers in the four tax years preceding the submittal of your application for tax

exemption, you fail the membership income tests set forth by Public Law 94-568. You do not meet the facts and circumstances exception for this income test as this source of income is regular and substantial.

By collecting and afterward distributing sales proceeds to your members based on the sales of their show items your income is inuring directly to insiders. Per Section 1.501(c)(7)-1(a) of the Regulations exemption under 501(c)(7) does not apply to any club if any part of its net earnings inure to the benefit of any private shareholder.

Similar to the organizations in Revenue Rulings 69-527 and 69-635, you are formed and operated not for social and recreational purposes, but as a service to your members in helping them promote, market and sell their products. While you hold monthly meetings among your members, which does constitute a level of comingling, you describe your purpose as the promotion of your membership. Members are treated as contractors for the purposes of selling their items at your shows and receive direct benefits of being included in a directory detailing their products and including business contact information. Nearly all of your income is derived not from member dues but from sales to the general public, with a significant portion given back to members. You list no scheduled social or recreational events outside of monthly meetings and there is no requirement for members to attend these meetings – paying dues is the only requirement of members to stay in good standing. Your two annual shows provide a convenience to your members to sell their products while retaining a significant portion of the proceeds, you do not primarily serve a social or recreational but a business purpose and do not meet the qualifications under 501(c)(7).

Applicant's Position

You state that your income does not inure to the benefit of its members. You state that the shows give you the net income necessary to meet your expenses and support your scholarship fund.

Service Response to Applicant's Position

When funds received by an organization are turned over to insiders, in this case your members, in a more than insubstantial or material manner, this constitutes inurement. Members directly benefit from your earnings by retaining portions of sales minus your commission and from payment of advertising of their products through your two shows.

Conclusion

Based on the facts provided above, we hold that you do not meet the requirements for tax exemption under Section 501(c)(7) of the Code. You are formed to promote your members and their products while operating primarily for business rather than social or recreational purposes. You lack a significant level of comingling among members and your net earnings inure to insiders. Further, nearly all of your income is derived from non-members, failing the membership income test for a 501(c)(7) club.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter.

We will consider your statement and decide if that information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. To be represented during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter to you. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

Enclosure, Publication 892