



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

1100 Commerce Street
MS:4920:DAL
Dallas, Texas 75242

December 22, 2008

Number: **200915061**

Release Date: 4/10/2009

LEGEND

ORG = Organization name

XX = Date

UIL: 501.07-01

Address = address

ORG
ADDRESS

EIN:

Tax Period Ending: December

Identification Number:

Contact Telephone Number:

In Reply Refer to: TE/GE Review Staff

Dear _____ :

This is a Final Adverse Determination as to your exempt status under section 501(c)(7) of the Internal Revenue Code.

Our adverse determination was made for the following reasons: The ORG fails to meet the requirement for exemption under IRC §501(c)(7). The organization is not operating exclusively for pleasure, recreation, and other non-profitable purposes. The organization is operating similar to a commercial business. Gross receipts generated from non-members and general public use of the facilities exceeds the limit set forth by Public Law 94-568.

Section 1.501(c)(7) of the Income Tax Regulations defines social clubs as clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder or general public. Public Law 94-568 provides that social clubs may receive up to 35 percent of their gross receipts, including investment income, from sources outside of their membership without losing their tax-exempt status. It is also intended that within this 35 percent amount not more than 15 percent of the gross receipts should be derived from nonmember use of the club's facilities.

As a result of a recent audit of your organization's activities and Forms 990 and 990-T for the period ended December 31, 20XX, the organization does not meet the requirements under Section 501(c)(7) which requires income from non-member use of the club's facilities to not exceed 15 percent of their gross receipts. Total nonmember income was 36 percent for the tax period ending December 31, 20XX, which substantially benefits the general public and is more like a commercial entity than a non-profit organization.

Based on the above, we are revoking your organization's exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code effective January 1, 20XX. You have agreed to the revocation of your 501(c)(7) status by the signing of Form 6018 on September 26, 20XX.

You are required to file Federal income tax returns on Form 1120. You have properly provided us Form 1120 for tax periods ending December 31, 20XX and December 31, 20XX, and we will submit them for processing.

You have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling the Office of the Taxpayer Advocate at or by writing to:

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

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

Sincerely,

Vicki L. Hansen
Acting Director, EO Examinations



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
1100 Commerce Street
Dallas, Texas 75242

July 22, 2008

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear _____ :

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018
Report of Examination
Envelope

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended
ORG EIN:		December 31, 20XX

LEGEND

ORG = Organization name XX = Date Country = country

ISSUE:

Does ORG continue to qualify for exemption under IRC 501(c)(7) given that its level of nonmember income (gross receipts) for the period under examination exceed the 15% limit allowed by Public Law 94-568?

FACTS:

ORG (ORG) is tax-exempt under section 501(c)(7) for the furtherance of it's exempt purpose to provide a social ORG organization for pleasure, recreation, and other non-profitable purposes within the meaning of section 501(c)(7) of the Internal Revenue Code.

ORG was founded in 18XX for "literary purposes, mutual improvement and the promotion of social intercourse." The ORG was organized with an educational and social mission. The ORG was first created as the first women's organization in the Country. Men were accorded privileges in 19XX. You were incorporated in the District of Country on March 25, 19XX and recognized by the Service as a Social ORG, exempt under section 501(c)(7) of the Code, in October 19XX.

Your specified and primary purposes, per your Articles of Incorporation are "to function as a social ORG, which shall be the establishment, maintenance and management of a ORG for literary and educational purposes, mutual improvement and promotion of social intercourse.

The organization's activities include the operation and maintenance of a facility for ORG members, restaurant, hall rentals, various programs and events throughout the year. Your organization has non-member income from hall rental and reciprocal members.

Your organization reported the following sources and amounts of revenue on Forms 990 for the period ending December 31, 20XX.

	20XX12	Key
CONTRIBUTIONS		
PROGRAM SERVICE REVENUE		
MEMBERSHIP DUES & ASSESSMENTS		
INTEREST ON SAVINGS		
RENTAL INCOME		A
GROSS SALES OF INVENTORY		A
TOTAL NONMEMBER INCOME		B
TOTAL INCOME		C
NONMEMBER % - A/C		
NONMEMBER & INVESTMENT % - B/C		

During the examination for tax year 20XX, your non-member income was 35% from Gross Receipts and 1% from Investment Income.

During the prior examination for tax year 20XX, Letter 1656 dated February 27, 20XX was provided to your organization. The letter advised you of some deficiencies to include limits imposed by Public Law 94-568, which states "Organizations exempt under Section 501(c)(7) may lose their exempt status if they

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receive gross receipts from non-member in excess of 35% of total receipts. Also, within this 35% limit, no more than 15% of gross receipts may be derived from non-member use of the ORGs facilities." Your organization responded with an action plan adopted by the Board of Governors which expressed your commitment to monitor and ensure that your non-member receipts were reduced to satisfy Public Law 94-568.

LAW:

Section 501(c)(7) of Code describes organizations such as social clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to benefit of any private shareholder.

Treas. Reg. 1.501(c)(7)-1(b) states that a club which engages in business, such as making its social and recreational facilities available to the general public is not organized and operated exclusively for pleasure, recreation and other non-profitable purposes, and is not exempt under section 501(a). Solicitation by advertisement or otherwise 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.

IRC 512(a)(3)(A) states that the term "unrelated business taxable income," as it applies to social clubs exempt under section 501(c)(7), means the gross income (excluding any exempt function income), less the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), both computed with the modifications provided in paragraphs (6), (10), (11), and (12) of subsection (b).

IRC 512(a)(3)(B) defines the term "exempt function income" to mean the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid. Such term also means all income (other than an amount equal to the gross income derived from any unrelated trade or business regularly carried on by such organization computed as if the organization were subject to paragraph (1)), which is set aside

- (i) for a purpose specified in section 170(c)(4), or
- (ii) in the case of an organization described in paragraph (9), (17), or (20) of section 501(c), to provide for the payment of life, sick, accident, or other benefit,

including reasonable cost of administration directly connected with a purpose described in clause (i) or (ii). If during the taxable year, an amount which is attributable to income do set aside is used for a purpose other than that described in clause (i) or (ii), such amount shall be included, under subparagraph A, in unrelated taxable income for the taxable year.

Revenue Ruling 66-149 provides that a social club is not exempt from Federal income tax as an organization described in section 501(c)(7) of the Code if it regularly derives a substantial part of its income from nonmember sources such as, for example, dividends and interest on investments.

Prior to its amendment in 1976, IRC 501(c)(7) required that social clubs be operated exclusively for pleasure, recreation, and other non-profitable purposes. Public Law 94-568 amended the "exclusive" provision to read "substantially" in order to allow a 501(c)(7) organizations to receive up to 35 percent of its gross receipts, including investment income, from sources outside its membership without losing its tax exempt status. The Committee Reports for Public Law 94-568 (Senate Report No. 94-1318 2d session, 1976-2 C.B. 597) further states;

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- (a) 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. This means that an exempt social club may receive up to 35 percent of its gross receipts from a combination of investment income and receipts from non-members, so long as the latter do not represent more than 15 percent of total receipts.
- (b) Thus, a social club may receive investment income up to the full 35 percent of its gross receipts if no income is received from non-members' use of club facilities.
- (c) In addition, the Committee Reports state that where a club receives unusual amounts of income, such as from the sale of its clubhouse or similar facilities, that income is not to be included in the 35 percent formula.

Revenue Procedures 71-17 sets forth the guidelines for determining the effect gross receipts derived from use of social club's facilities by the general public have on the club's exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954.

Revenue Ruling 81-69 states that a social club, in determining its unrelated business taxable income under ITC 512(a)(3), may not deduct losses incurred on sales of food and beverages, in certain situations, from its net investment income.

Public Law 94-568 provides that social clubs may receive up to 35 percent of their gross receipts, including investment income, from sources outside of their membership without losing their tax-exempt status. It is also intended that within this 35 percent amount not more than 15 percent of the gross receipts should be derived from nonmember use of club facilities.

GOVERNMENT POSITION:

As a result of our examination of your Form 990 for period ending December 31, 20XX we have determined that your organization no longer qualifies as an exempt social ORG described in the Internal Revenue Code section 501(c)(7). Your non-member revenue exceeds the percentage allowed by law. Your total gross receipts to include investment income were 36% for tax year ending December 31, 20XX. Whereas, Revenue Procedure 71-17 and Public Law 94-568 allow a maximum of 15% of non-member income from gross receipts and a maximum of 20% of investment income with a total of 35%.

We propose a revocation of your exempt status under section 501(c)(7) of the Internal Revenue Code effective January 1, 20XX.

TAXPAYER'S POSITION:

The organization agrees with the revocation and completed Form 1120 for tax year ending December 31, 20XX and December 31, 20XX. The organization signed Form 6018-A on September 26, 20XX. The organization declined to have a closing conference.

CONCLUSION:

For organizations exempt under IRC 501(c)(7), the term unrelated business income encompasses gross income after first excluding all exempt function income. Exempt function income consists essentially of amounts derived from dues, fees, charges, or similar amounts of gross income, and constitutes amounts paid by members as consideration for providing such members, dependents and guests with goods, facilities, or services in the furtherance of the organization's exempt purpose. The hall rental and any incurred expenses included to the general public do not constitute exempt function income. This activity

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was not made for the purpose of providing such member with the benefits associated with ORG membership.

Treas.Reg. 1.501(c)(7)-1(b) states that any organization which engages in business, such as making it's social and recreational facilities available to the general public, is not organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, and is not exempt under section 501(a).

The organization failed to meet the 15 percent limitation on gross receipts derived from the use of a social ORG's facilities or services by the general public, as required by Public Law 94-568.

Your organization no longer qualifies for exemption under section 501(c)(7) of the Code as your non-member revenue exceeds the percentage allowed by law. Therefore, your exempt status under section 501(c)(7) of the Internal Revenue Code should be revoked effective January 1, 20XX.

Should this revocation be upheld you are required to file Form 1120 for all future periods, whether or not you have taxable income.