DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TE/GE: EO Examination
625 Fulton Street, Room 503
Brooklyn, NY 11201

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: **200534023**
Release Date: 8/26/2005
TE/GE:EO

UIL: 501.07-00

Date: March 17, 2005

Redaction Legend
X = organization
D= date

Taxpayer Identification Number:

Person to Contact:

Identification Number:

Contact Telephone Number:

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:

X fails to meet the requirement for exemption under IRC 501(c)(7). IRC 501(c)(7), as changed by the Tax Reform Act of 1969 provides for the exemption of clubs organized and operated 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 the benefit of any private shareholder.

Public Law 94-568 states that it is intended that social clubs should be permitted to receive up to 35 percent of their gross receipts, including investment income, from sources outside of their membership without losing their exempt status. Within this 35 percent amount, not more than 15 percent of the gross receipts should be derived from the use of the social club's facilities or services by the general public.

As a result of a recent audit of your organization's activities and Form 990 for the period ended December 31, 2000, it was determined that your organization has exceeded the safe harbor limitations on non-member income as outlined in Public Law 94-568.

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 D. You have executed the Form 6018-A agreeing to this revocation.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for all years beginning after D.

You are required to file Form 1120, U.S. Corporation Income Tax Return. Form 1120 must be filed by the 15th day of the third month after the end of your annual accounting period. A penalty of $20 a day is charged when a return is filed late, unless there is reasonable cause for the delay. However, the maximum penalty charged cannot exceed $10,000 or 5 percent of your gross receipts for the year, whichever is less. This penalty may also be charged if a return is not complete, so please be sure your return is complete before you file it.

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 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling or 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 yours,

R.C. Johnson
Director, EO Examinations

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Name of Taxpayer		Year/Period Ended

FACTS:

The (was granted exemption as a 501(c)(7) social club. Per the Service's master file, ruling date exemption was granted December . The organization did not have a copy of their determination letter. They are incorporated with the State of [redacted] and file a biannual report.

History of Formation of the Organization

The organization sent a memorandum to the Service dated January , with enclosures (letter dated January which the organization asked for clarification concerning liability of the for collection and payment of tax on dues and initiation fees imposed by section 4241 of the Internal Revenue Code.

correspondence stated that a group of individuals living in and near were interested in building a golf course which they will make available to the public. planned to pattern its organization after a neighboring golf course. organization was originally defined as a profit-type corporation formed under the name of Shares of stock of a par value of $[redacted] each in this corporation will be sold to raise funds to purchase land and construct thereon a golf course, necessary buildings, and other recreational facilitates. The corporation will be the sole owner and operator of the golf course and other recreational facilities and will charge permit fees for the use of the golf course and other facilities. The stockholders, acting through their directors and officers, will have the sole control of these operations, including the amounts to be charged as permit fees.

The permits will be sold to anyone, whether an owner of stock in the corporation or not, and will be sold to all persons at the same price. In other words those owning shares of stock in the corporation will pay the same amount for a permit as will a person who does not own stock.

Prior to the Service's determination that was a 501(c)(7), based on the information submitted to the Service, it was indicated that the : was organized under laws of the State of for the purpose of operating golf courses, swimming pools, tennis courts, children's playgrounds, and facilities for all other types of lawful recreational activities in the State of , and to engage in all services, including the serving of food and beverages, necessary for the operation and management of such golf courses, swimming pools, tennis courts, playgrounds, and other recreational facilities.

The bylaws provided for the fixing by the board of directors of permit fees to be charged any family or person desiring the use of facilities on a one-day, six-day, or yearly basis. The articles of incorporation provide that the capital stock of the corporation shall be $ consisting of shares of common stock with a par value of $[redacted] per share. Any person desiring to purchase stock in the corporation may do so. However, the bylaws clearly stated that ownership of stock should never have a requirement in connection with the purchase of one-day, six-day, or yearly permits to use the club's facilities. It also provided in the bylaws that the board of directors may refuse that each permit issued shall be considered a license, with a statement to that effect on each permit.

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It was on the basis of that information furnished and included on the Service's correspondence to dated , it was originally concluded that the does not qualify as a social, athletic, or sporting club or organization within the meaning of section 4241 of the code, and that the amounts paid to the club as daily, weekly, or yearly fees, are not subject to the tax imposed by section 4241(a)(1) of the Code. Furthermore, the Service concluded that, since the purchase of a share of stock in the corporation is not a requirement for membership in a social, athletic, or sporting club or organization, the amount paid for such stock is not subject to the tax on initiation fees imposed by section 4241(a)(2) of the Code.

The letter further stated that those owning permits would have no voice in the affairs of the corporation or the golf course or other facilities unless they own a share or shares of stock in the corporation.

Furthermore, your letter stated you wished an opinion on the following questions:

1. Will the amount paid for shares of stock in this corporation be subject to the tax imposed by Section 4241 of the Internal Revenue Code?
2. Will the permit fees be subject to the tax imposed by Section 4241?

Emphasis was added, that this would not be a club in the ordinary sense of the word, even though the word club appears in the name of the corporation. There was going to be no "members," no membership fees, no initiation or initiation fees, and no dues.

An earlier letter from the Service dated October was sent to . The correspondence was a follow-up to a telephone conversation relative to the application of club dues tax to amounts paid for the purchase of stock in a golf and country club organization. On behalf of , you asked if a corporation were formed, separate and apart from the club proper, for the purpose of purchasing real estate on which the Club House and a golf course were to be built, whether the stock sold to members of such corporation would be construed as fees subject to the tax imposed by Section 4241 of the 1954 Code.

The Service concluded that it was immaterial whether the applicant has any hope or expectation of a return of his payment upon resignation, death, or other cir circumstances, nor is it material to which he pays the money. If the purchase of a share of stock in a land-holding corporation is a necessary precedent to membership in the club, the amount paid for the share of stock is an initiation fee.

In answer to question, it was determined that if a separate entity completely divorced from the club organization purchases real estate and leases it to the club proper, under certain circumstances such action would be acceptable. However, prior to the formation of the land-holding corporation and the club organization as separate entities, it was suggested that a complete statement of the plans and intent of the groups be submitted for consideration to our National Office (Rulings and Determinations).

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It is apparent from the later information submitted, the Service ruled that . . was exempt under 501(c)(7) on or near December ____. There were no caveats found, since a copy of the original determination letter was not available for review.

Today, ____ operates, as a membership organization comprised of approximately [redacted] members. Stock membership of $[redacted] is still required by all new members.

has a clubhouse that is operated by a full-time person, who hires additional staff as needed for banquets or special events for both members and nonmembers. A proshop manager runs the proshop and collects all income from proshop and on the greens, including dues from membership and green fees paid for tournaments, cart rentals, etc.

Upon the Form 990 examination of period ending , it was discovered that the women's auxiliary had provided cash wages to individuals working in the clubhouse that included both supplemental wages to individuals already on Forms W-2, as well as, and unreported wages to others. bookkeeper and manager were not aware of this. Thus, payments to cleaning person and few other individuals should have received information returns, Forms W-2. In addition, select employees received free family membership for usage of club during ____ Amounts were not originally included as wages on Forms W-2.

Tournaments were held annually. Prizes were paid in . and for winners in one particular tournament, whom were whole-in-one recipients. The prize amounts should have been reported on information returns, Forms 1099-Misc. for both and .

has filed and paid income taxes on Forms 990-T, unrelated business income. The organization has exceeded the 15/35% limitations pertaining to gross receipts from nonmembers, and investment income.

Form 8868, Application for Extension of Time to File an Exempt Organization Return, was requested for the Form 990-T through August . .

As a result of this examination, the 15/35-percentage rule was explained to your organization, which applies to a 501(c)(7) social club. Revenue Procedure 71-17 was provided for additional record keeping requirements.

Also, has indicated their desire to revoke their exempt status as a 501(c)(7) social club and become a corporate for-profit entity subject to tax. Furthermore, does not wish to be bothered by the nebulous recordkeeping requirements segregating membership income from nonmembership income, as illustrated in Rev. Proc. 71-17.

LAW:

Treasury Regulations 1.501(c)(7)-1 states that the exemption provided by section 501(a) for organizations described in section 501(c)(7) 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 inures 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.

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).

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.

TAXPAYER'S POSITION:

Your organization has agreed that you have not met the 15/35% requirement, and are not operating in a nonprofitable purpose.

Your organization has made its intention to formally revoke its exempt status and change to a for-profit entity filing taxable returns, Forms 1120 (Corporate U.S. Income Tax Returns).

Plan of Dissolution is included as an attachment. Your representative is in the process of forming new organizing instruments under the name of
where it is expected that legal documents for both corporations would be filed in the Office of the Secretary of State on September

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SERVICE'S POSITION:

Your organization no longer qualifies as a 501(c)(7) social club. For the period ending), your receipts for public use (green fees) included $. Thus, no more than 15% of gross receipts from nonmember use of club facilities and/or services were acceptable.

Total gross receipts for) were $. Thus, 30% from nonmembers exceeded the 15% limitation. (An organization may maintain its exemption under IRC 501(c)(7) if an organization receives 35% of its gross receipts form investments.) Investment income was minimal, thus, there was no problem in meeting the 35% requirement.

If a club exceeds the 15/35% test, then it can maintain its exempt status only if it can show through facts and circumstances that "substantially all" of its activities are for "pleasure, recreation and other nonprofitable purposes."

Your organization is unable to show that substantially all of s activities are for "pleasure, recreation, and other nonprofitable purposes." In addition, the organization wishes to discontinue recordkeeping requirements for nonmember and membership income.

's) exemption should be revoked retroactively for the period beginning ____

Forms 6018, Consent to Adverse Action, are enclosed for an agreement to the revocation action (beginning January Please have a current officer or your power-of-attorney sign and return both of the enclosed copies of Forms 6018 by September

Regarding further disposition of your assets, ; Articles of Incorporation (Article IV) states, "that such certificates shall be nonassignable and nontransferable but shall be redeemable by this corporation under such conditions and terms as prescribed in the bylaws."

In the event of dissolution of a 501(c)(7) social club, assets are dispersed among its members (including the amounts paid for their shares of stock).

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Liquidating distributions to club members after sale of club assets are consistent with exemption under IRC 501(c)(7) and do not constitute inurement. **Rev. Rul. 58-501, 1958-2 C.B. 262.** Tax consequences of a distribution by an exempt social club of cash or property to its members are unrelated to the tax consequences upon the members. Consequently, such a distribution may not affect a club's Internal Revenue Code 501(c)(7) exempt status, yet, creates taxable income to its members under code section 301.

In addition, a club's exemption under IRC 501(c)(7) is not adversely affected if it redeems stock held by a member and the amount paid, although in excess of the original cost to the member, reflects the value of the underlying assets of the club. **Rev. Rul. 68-639, 1968-2 C.B. 220.**

Furthermore, the statute prohibits exemption if any part of the organization's net earnings inures to the benefit of any private shareholder. The term "shareholder" includes a member of an organization, as was illustrated in *West Side Tennis Club. v. Comm.*, 111 F. 2d 6 (2d Cir. 1940).

Inurement includes the following:
Overt distributions such as dividends and bonuses; unreasonable salaries to officers; excessive purchase price or rent of facilities under circumstances other than arms' length transactions; income from nonmember sources used to reduce cost of providing services to members; higher disproportionate payments for services and use of facilities by nonvoting members than voting members; difference in dues or fees does not result in inurement if there is a reasonable basis for the difference, such as where the classes of members have different rights to use of club facilities or club assets.

The Service has determined that your organizatio[n] -- longer qualifies as a 501(c)(7) beginning January 1. [th]rough current date. Delinquent U.S. Corporate Tax Returns (Forms 1120) have been solicited for the following periods:

Your organization is open to both members and nonmembers. The Host-Guest relationship is further defined in Rev. Proc. 71-17, 1971-1 C.B. 683, which nonmembers who use a club's facilities will be assumed to be guests of the members.

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Since a social club may derive up to 15% of its gross receipts from nonmember use of club facilities and/or services without jeopardizing its exempt status. It is important to distinguish nonmember use from member use of the facilities and services. An issue arises is whether an individual or a group is a true guest of a member. This is important because income from bona-fide guests is treated as member income.

Records need to be maintained to substantiate various scenarios if a group consists of eight or less people and one person in the group is a member. Then, the nonmembers are guests provided the member or members' employer pays. Or, if 75% of a group consists of nonmembers, then, assume the nonmembers in the group are guests provided the member or member's employer pays. Nonmember use does not fall within either of the parameters. The club must maintain books and records of each use and amount of income even if the member pays.

CONCLUSION:

The exempt 501(c)(7) status of the _____ should be revoked, since you are not operated primarily for the benefit of your members and wish to discontinue recording requirements pertaining to membership and nonmembership income.

Please file delinquent Forms 1120 for _____. Mail the returns to this office: Ste[illegible]

Publication 892 and Pub 1 are included regarding your appeal rights. [In addition, more detailed procedures are available in Revenue Procedure 99-28 that covers procedures for early referral of exempt organization issues to appeals under Internal Revenue Code Section 7123.]