



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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EIN:

Person to Contact:

Identification Number:

Contact Telephone Number:

In Reply Refer to:

Legend

O = organization

D = date

O

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:

O 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.

As a result of a recent audit of your organization's activities and Forms 990, 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 agreeing to this revocation.



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You are required to file Form 1120, U.S. Corporation Income Tax Return. Form 1120 must be filed by the 15<sup>th</sup> 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,

Marsha A. Ramirez  
Director, EO Examinations

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
<b>Name of Taxpayer</b> O		<b>Year/Period Ended</b>

**ISSUE: REVOCATION OF EXEMPT STATUS**

**FACTS:**

O was formerly known as the N. According to IRS records, the club was granted exemption from income tax as an organization described in IRC 501(c)(7) in 1968.

The organization filed Forms 990 and 990-T for the years ending.

O acts as manager of the F, the building that houses the facility and bar and restaurant used by the club. The facility is owned by the surrounding cities. The owners of the facility believe that it should be a community resource and as such, be available for events such as wedding receptions, and trade shows. When such events are held, O operates the bar and keeps the revenue generated by the bar. This management contract provides the club with \$ \_\_\_\_\_ annually.

O also conducts tournaments open to members and nonmembers. The organization did not keep track of the amount of member and nonmember income for the bar/kitchen. No bar income was reported on Form 990-T.

O also conducts charitable gambling. It operates one pull-tab booth in a restaurant. It does not conduct any gambling at the facility. All gambling was reported on Form \_\_\_\_\_ as unrelated business income. O does not make any donations to its own general fund. It makes its required donations to a separate entity which operates a junior organization.

**LAW:**

Internal Revenue Code (IRC) section 501(c)(7) provides for the exemption from Federal income taxes for Social Clubs. Income Tax Regulation section 1.501(c)(7)-1 states that if a Social Club makes its social and recreational facilities available to the general public it will not qualify for tax-exempt status. However, Revenue Procedure 71-17 as amended by Public Law 94-568 provides certain gross receipts safe harbors; i.e. Social Clubs may receive up to 35% of their total gross receipts, including investment income, from sources outside of their membership without jeopardizing their tax-exempt status. Within this 35% limit, no more than 15% of a club's gross receipts may be derived from nonmember use of the club's facilities and/or services or from other activities not furthering social or recreational purposes for members. If these standards are exceeded, a Social Club will not qualify for exemption pursuant to IRC section 501(c)(7).

The Committee Reports for Public Law 94-568 (Senate Report No. 94-1318 2d Session, 1976-2 C.B. 597) state 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 memberships 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 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

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total receipts.

Additionally, activities conducted by a social club need to further its exempt purposes. Traditional business activities are traditional those that further a social club's exempt purposes. Nontraditional business activities do not further the exempt purposes of a social club even if conducted solely on a membership basis. Activities that are not in furtherance of a social club's exempt purpose are referred to as nontraditional business activities. A social club is prohibited from conducting more than an insubstantial amount of nontraditional business activities. The prohibition against the conduct of nontraditional business activities applies equally to business with members and nonmembers.

**GOVERNMENT'S POSITION:**

The gambling activity carried on by O is a nontraditional business activity. The selling of pull-tabs at a location separate from the facility where the social and recreational activities are carried out does not promote the social and recreational purposes of the club.

Charitable gambling was reported on Form 990-T for the years ending.

Thus, nontraditional business activities are more than insubstantial and also the club consistently exceeds 35% of gross receipts from nonmember sources. (Examination found that the total gross receipts for the year ending May 31, 2005 were greater than the amount reported on Form 990 because only the amount transferred to the general fund from the bar was reported on Form 990. The actual gross receipts for the prior and subsequent years are also likely to be greater than reported on Form 990 by about \$100,000. This will not change the fact that the 35% threshold is greatly exceeded.)

Also, the management agreement with Q is a nontraditional business activity which generated \$5,000 in the year ending.

Additionally, O kept no records of nonmember use of its facility. When the arena or upper level was used for events, as encouraged by the owners of the facility, O operated the bar. No records of these events are available.

The bar/restaurant was open to nonmembers in connection with events and no records of nonmember income were kept.

Analysis of the bank deposits made by the bar and the deposit slips of the bar finds that it is reasonable to conclude that at least 16% of the gross receipts of the bar were the result of nonmember income for the year ended.

Because of the substantial amount of nontraditional income and because the club consistently receives more than 35% of its gross receipts from sources outside the membership, O no longer meets the requirements of IRC 501(c)(7). The taxpayer's exempt status should be revoked, effective D.

As a taxable entity, the organization is required to file Form 1120, U.S.

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer O		Year/Period Ended

Corporation Income Tax Return for the periods open under statute.

**TAXPAYER'S POSITION:**

The taxpayer's has indicated agreement by signing Form 6018 and filing Forms 1120 for the years ending.

REDACTION LEGEND

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
<b>Explanation of Items</b>		
<b>Name of Taxpayer</b> O		<b>Year/Period Ended</b>

- O = organization
- D = effective date of revocation
- N = former name of O
- Q = unrelated civic organization

**Internal Revenue Service**

**Department of the Treasury**  
30 East 7th Street, #1130-B  
St. Paul, MN 55101

Date:

O

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 revocation 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 revoking your 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