

Internal Revenue Service

Release Number: 200735028

Release Date: 8/31/07

Legend:

Org= Name of Organization

NUM= EIN Number

Date1= Effective Date

JUN 06 2007

UIL: 501.07-01

ORG

Person to Contact:

Identification Number:

Contact Telephone Number:

In Reply Refer to: TE/GE Review Staff

EIN: NUM

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:

ORG 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 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.

Public Law 94-568 amended IRC 501 to reflect a twofold change under IRC 501(c)(7). First, it makes it clear that a social club may receive some investment income without losing its exempt status. Second, it permits a higher level of income from nonmember use of club facilities than was previously allowed.

In addition, Public Law 94-568 defines gross receipts as those receipts from normal and usual activities of a club including charges, admissions, membership fees, dues, assessments, investment income, and normal recurring capital gains on investments, but excluding initiation fees and capital contributions. Public Law 94-568 also 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. Thus, a social club may receive investment income up to the full 35 percent amount of gross receipts. If a club receives unusual amounts, of income, such as from the sale of its clubhouse or similar facility, that income is not to be included in the 35 percent formula; that is, unusual income is not to be included in the gross receipts of the club.

Your organization has exceeded the safe harbor limitations on non-member income as outlined in Public Law 94-568. As a result, it has been determined that you are not operating as a social club within the meaning of section 501(c)(7).

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 Date1.

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 Date1, if you have not already done so. You have executed the Form 6018 agreeing to this revocation.

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 writing to: Local Taxpayer Advocate Office. 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 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Exhibit A
Name of Taxpayer ORG		Year/Period Ended

Legend:

ORG = Name of Organization

Date1 = Effective Date

STATE = Name of State

ISSUE:

Revocation of 501(c)(7) organization

FACTS:

The organization does not meet the requirements under IRC 501(c)(7).

The organization conducts motocross races on an ongoing basis in which non-members participate as both racers and spectators. Gate fees are charged to non-members. Race fees are charged to all racers including members and non-members with the exception of member racers who have earned "free" races through hours worked at facility.

The organization did not keep records per Rev. Proc. 71-17. The non-member income from this activity generates net profits for the organization. The organization has nonmember income in excess of 15% of total income.

The organization's website states, "We are a non-profit organization, no one is paid! If we did not run races, we would not be here, and it is that simple!" Also on the website in the Q & A section, it states, "All that is needed to race at ORG's events, is an AMA card and a District card from any district within in the US.

LAW:

REG §1.501(c)(7)-1(a) states 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 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. 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.

REG §1.501(c)(7)-1(b) states 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 non-profitable 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.

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However, an incidental sale of property will not deprive a club of its exemption. [Reg. §1.501(c)(7)-1.]

INTERNAL REVENUE MANUAL 4.76.16.6.3, 501(c)(7) states organizations can receive up to 35% of their gross receipts, including investment income, from sources outside their membership without losing their exempt status. Within the 35%, not more than 15% of gross receipts should be derived from the use of the social club's facilities or services by the general public (nonmembers).

INTERNAL REVENUE MANUAL 7.25.7.3(2) states the organization and operation of a club in a manner which constitutes a subterfuge for doing business with the public is inconsistent with the term "club" as used in IRC 501(c)(7) and disqualifies it from exemption.

Revenue Procedure 71-17¹, 1971-1 CB 683 Sec 1 states where a club makes its facilities available to the general public to a substantial degree, the club is not operated exclusively for pleasure, recreation, or other non-profitable purposes.

A significant factor reflecting the existence of a nonexempt purpose is the amount of gross receipts derived from use of a club's facilities by the general public. As an audit standard, this factor alone will not be relied upon by the Service if annual gross receipts from the general public for such use is \$2,500 or less or, if more than \$2,500, where gross receipts from the general public for such use is five percent or less of total gross receipts of the organization. This is the minimum gross receipts standard.

Status of non-members:

1. It will be assumed for audit purposes that nonmembers are the guests of the member, provided payment for such use is received by the club directly from the member/s or the member's employer for the following:
 - a. where a group of eight or fewer individuals, at least one of whom is a member uses the club facilities.
 - b. where 75 percent or more of a group using the facilities are members
2. In all other situations, a host/guest relationship will not be assumed but must be substantiated. The club must maintain books and records of each such use and the amount derived therefrom. This requirement applies even though the member pays initially for such use. In each instance the record must contain the following information:
 - a. The date,
 - b. The total number in the party;
 - c. The number of nonmembers in the party;
 - d. The total charges;
 - e. The charges attributable to nonmembers;
 - f. The charges paid by nonmembers;

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Exhibit A
Name of Taxpayer ORG		Year/Period Ended

- g. Where a member pays all or part of the charges attributable to nonmembers, a statement signed by the member indicating whether he has been or will be reimbursed for such nonmember use and, if so, the amount of the reimbursement:
- h. Where the member's employer reimburses the member or makes direct payment to the club for the charges attributable to nonmembers, a statement signed by the member indicating the name of his employer; the amount of the payment attributable to the nonmember use; the nonmember's name and business or other relationship to the member; and the business, personal, or social purpose of the member served by the nonmember use. (The use of club facilities must serve some personal or social purpose of the employee-member or some direct business objective of the employee-member; the mere use of club facilities for the accommodation of the member's employer does not serve a business, personal, or social purpose of the member.) If a large number of nonmembers are involved and they are readily identifiable as a particular class of individuals, the member may record such class, rather than all of the names; and
- i. Where a nonmember, other than the employer of the member, makes payment to the club or reimburses a member and a claim is made that the amount was paid gratuitously for the benefit of a member, a statement signed by the member indicating the donor's name and relationship to the member, and containing information to substantiate the gratuitous nature of the payment or reimbursement

Failure to maintain such records or make them available to the Service for examination will preclude use of the minimum gross receipts standard and audit assumptions set forth in this Revenue Procedure.

TAXPAYERS POSITION:

Taxpayer requested to no longer be classified as an IRC 501(c)(7) organization. Taxpayer has filed Form 1120 for the tax years ended Date1.

Board member, with Treasurer agreement stated the organization does not comply with the operational requirements of a 501(c)(7) organization per the initial field interview with agent. In particular, Board Member and Treasurer stated the organization receives approximately 90% of its income from non-member sources. Officer stated the organization could not survive without the significant non-member income from the organization's motocross racing events.

Agent notes that officer is currently the President of the organization.

AGENTS POSITION:

Agent could not confirm through the examination that the organization received approximately 90% of its income from nonmember sources due to the organization not keeping records that separated member vs nonmember income. However, agent did confirm that a minimum of 34% of the total income was from nonmember sources. See attached analysis.

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Agent also determined the organization could not show that “substantially all” of the activities were for “pleasure, recreation and other non-profitable purposes”.

The facts and circumstances agent considered included:

1. Frequency of use of the club facilities by nonmembers. The organization has ongoing motocross races in which nonmembers participate. During the year under examination, the organization conducted 8 race days. The website contained the statements “If we did not run races, we would not be here, and it is that simple!” and “All that is needed to race at ORG’s events, is an AMA card and a District card from any district within in the US”.
2. Whether the nonmember income generated net profits. Agent found that the nonmember income generated a net profit for the organization on each race day through agent’s analysis of the race day balance sheets.

Agent noted in the bylaws Article VII, Section 7 stated, “All persons entering the club property on the day of an event, either ORG or rentals, will be considered an associate member for that day only. Their membership will expire at the end of the day”. Per IRM 7.25.7.3(3), consideration should be given whether the organization is a business operation rather than a club when the initiation charges or dues are so low that one time or transient use of the facilities by the general public are encouraged. The gate fee for nonmembers on race day is \$10. This would constitute a low “associate membership” fee which encourages public use on race day.

Per the website, All that is needed to race at ORG’s events is an AMA card and a District card from any district within the US. Also, on the website is the statement, “ORG” is an organization of riding enthusiasts, specializing in Motocross racing. We have our own track, just west of STATE and hold many events there during the year”. ORG is listed for June 10-11, and August 26-27. This statement appears to be prima facie evidence that the organization is inviting the public to participate in the organization’s activity.

CONCLUSION:

Agent recommends revocation of the exempt status of the organization due to non-compliance with the requirements for a 501(c)(7) organization. The issues agent found are as follows::

1. Nonmember use of facility on an ongoing basis for motocross racing events in which nonmembers are not bona-fide guests of members.
2. Nonmember income is greater than 15% of total income.
3. Nonmember income generates profits for the organization.
4. Operation of a club in a manner which constitutes a subterfuge for doing business with the public on race days.



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
2801 Eastern Boulevard
York, PA 17402

JUL 13 2006

ORG

Taxpayer Identification Number:

Form:

990

Tax Year(s) Ended:

December 31

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:

Taxpayer Advocate Service

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,

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