



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE/GE: EO Examinations

625 Fulton Street, Room 503

Brooklyn, NY 11201

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

January 15, 2008

Number: **200817064**

Release Date: 4/25/2008

LEGEND

ORG = Organization name

XX = Date

UIL: 501.07-01

Address = Address

ORG

ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Dear :

This is a final determination regarding your exempt status under section 501(c)(7) of the Internal Revenue Code (IRC). Recognition of your exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(7) is retroactively revoked to January 1, 20XX because it is determined that you have not established that you are observing the conditions required for the continuation of an exempt status.

We previously provided you a report explaining the proposed revocation of your tax-exempt status. At that time, we informed you of your appeal rights. By signing Form 6018, *Consent to Proposed Action*, you indicated that you accept our determination to revoke your organization's exempt status.

We have determined that you fail to qualify for exempt status under any other subsection of IRC 501(c).

You are required to file Federal income tax returns on Form 1120-H. These returns should be filed with the appropriate Service Center for all years beginning January 1, 20XX. We have secured Form 1120-H tax returns for the years ended December 31, 20XX and December 31, 20XX.

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.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
TEGE EO Examination
1100 Commerce Street
Dallas, TX 75242

ORG
ADDRESS

Taxpayer Identification Number:

Form:
990-EZ

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 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		
ORG		12/31/XX

LEGEND

ORG = Organization name XX = Date

ISSUES

Does ORG qualify for tax exempt status under IRC section 501(c) (7)?

FACTS

ORG was granted exemption under 501(c) (7) prior to Section 528 being added to the Internal Revenue Code. ORG was established March 21, 19XX. The organization was established as stated in the bylaws: "to provide for maintenance, preservation, and architectural control of the residence lots and common area within the subdivision, and to promote the health, safety, and welfare of the residents within the subdivision." may do the following:

- a) Care for vacant unimproved and unkempt lots in said subdivision
- b) Association may enforce charges, restrictions, conditions, and covenants existing upon and created for the benefit of said property over which the association has jurisdiction
- c) The association may improve, beautify and maintain parks, parkways esplanades rights-of-way easements and other public areas
- d) May construct and maintain recreational facilities
- e) The association may perform any and all lawful things and acts which this association may perform any and all lawful things and acts which this association at any time and from time to time shall in its discretion, deem to be to the bests interests of said property and the owners of the buildings sites thereon and shall pay all costs and expenses in connection therewith
- f) Any powers and duties exercised by said association relating to maintenance, operation, construction, or reconstruction of any facilities provided for herein may be contracted
- g) The association may provide for garbage and rubbish collection and disposal;
- h) The association may provide police protection for the property if the directors deem it advisable
- i) The association may acquire by gift, purchase or otherwise own, hold, enjoy, lease, operate maintain, and convey sell lease transfer mortgage or otherwise encumber dedicate for public use or otherwise dispose of real or personal property in connection with the business of this association
- j) The association may assess and collect taxes on property submitted to the jurisdiction of this association and shall be restricted in such function as provided in the agreements under which such property is submitted
- k) The association may expend the monies collected by this association from assessments or charges and other sums received by this association for the payment and discharge of all property costs, expenses, and obligations incurred by this association in carrying out any or all the purposes for which this association is formed

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- l) The association may borrow money for the purpose of carrying out the corporate affairs if the directors deem such advisable.

LAW

Section 501(c)(7) of the Code provides for the exemption from Federal income tax of clubs organized 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.

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 non-profitable 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.

Revenue Ruling 58-589 sets forth the criteria or tests for determining whether an organization qualifies for exemption from Federal income tax under section 501(a) of the Internal Revenue Code of 1954 as an organization described in section 501(c)(7) of the Code. The ruling states that an organization must establish that it is a club both organized and operated exclusively for pleasure, recreation, and other non-profitable purposes and that no part of its net earnings inure to the benefit of any private shareholder or individual. To meet the first requirement, there must be an established membership of individuals, personal contacts, and fellowship. A commingling of the members must play a material part in the life of the organization.

Revenue Ruling 69-635 states that 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.

Revenue Ruling 55-716 states an organization formed for the purpose of furnishing television antenna service to its members is not entitled to exemption from Federal income tax under section 501(c)(7). Income is derived from membership fees and service charges. Funds are expended for equipment, maintenance and miscellaneous expense. The only activity of the instant organization is the operation and maintenance of a television antenna system providing television services to its members in their homes. Furthermore, fellowship does not constitute a

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material part of the life of the organization, since the services do not afford an opportunity for personal contacts and fellowship among members receiving such services. Revenue Ruling 70-32 states that a flying club providing economical flying facilities for its members but having no organized social and recreation program does not qualify for exemption under section 501(c)(7) of the Code. The club was organized to own and operate aircraft suitable for business or personal use by its members, to enable its members to improve their flying abilities, and, through the ownership, operation, and maintenance of flying equipment, to provide economical flying facilities for its members. Membership is open to all persons who are interested in flying. The sole activity of the club involves the ownership, operation, and maintenance of the aircraft for use by the members. There is little commingling among members for social or recreational purposes. In order for a club to meet the requirements for exemption under section 501(c)(7) of the Code, there must be an established membership of individuals, personal contacts, and fellowship.

In *Chattanooga Automobile Club v. Commissioner*, 182 F. 2d 551 (6th Cir. 1950), the United States Court of Appeals 6th Circuit held that to be exempt under the Act of Congress, a club must have been organized and operated exclusively for pleasure, recreation, and other non-profitable purposes. The court further specified that the words "other non-profitable purposes" must be construed as coming within the same classification as pleasure and recreation. In addition, there must be at least some sort of commingling of members to constitute a club. The court held that the two automobile clubs petitioning the court were not exempt under section 101(9) of the Internal Revenue Code of 1939 as a social club because the members of these clubs did not commingle.

In *Keystone Automobile Club v. Commissioner*, 181 F. 2d 402 (3rd Cir. 1950), the United States Court of Appeals 3rd Circuit defined the word "club" to include some type of mingling of people together as well as a common object. In this case, the court held that the Keystone Automobile Club was not exempt under section 101 paragraph 9 of the Code for a number of reasons one of which was because they saw no evidence of the commingling of members.

GOVERNMENT'S POSITION

A club whose sole purpose is to:

- 1) Maintain marina and common area for property owners use
- 2) Pay taxes and insurance on marina, tennis courts and common area
- 3) Maintain tennis courts, entry gates, post boxes and general appearance of subdivision

is not a social club. A social club must be organized for pleasure or recreational purpose in order to qualify for tax-exempt status under IRC section 501(c)(7). The Treasury Regulations extend tax-exempt status to those clubs, organized for recreational purposes, which are supported by membership dues and assessments.

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TAXPAYER'S POSITION

The taxpayer's Position is not known at this time.

CONCLUSION

According to the above mentioned facts, ORG does not qualify for exemption under IRC 501(c) (7).

ALTERNATIVE ISSUE

ISSUE

Does ORG meet the requirements for recognition as a homeowners' association as described in IRC section 528?

FACTS

ORG was granted exemption under 501(c) (7) prior to Section 528 being added to the Internal Revenue Code. ORG was established March 21, 19XX. The organization was established as stated in the bylaws: to provide for maintenance, preservation, and architectural control of the residence lots and common area within the subdivision, and to promote the health safety, and welfare of the residents within the subdivision. As stated on the form 990, the purpose of ORG Association is:

- 1) Maintain marina and common area for property owners' use.
- 2) Pay taxes and insurance on marina, tennis courts and common area.
- 3) Maintain tennis courts, entry gates, post boxes and general appearance of subdivision.

LAW

Internal Revenue Code section 528 provides an elective exemption for certain homeowners' associations. IRC § 528 exempts from income tax any dues and assessments received by a qualified homeowners' association that are paid by property owners who are members of the association, where the assessments are used for the maintenance and improvement of association property.

Treasury Regulation §1.528-2 states that in order for an organization to meet the requirements of IRC section 528, the organization "must be organized and operated primarily for the purpose of carrying on one or more of the exempt functions of a homeowners' association." Exempt

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functions include “the acquisition, construction, management, maintenance, and care of association property.”

Treasury Regulation §1.528-5 requires that at least sixty percent of a homeowners’ association’s gross income be that of exempt function income as defined in §1.528-9.

Section 1.528-6 of the regulations requires that at least ninety percent of a homeowners’ association’s expenditures must be “qualifying expenditures”. Examples of qualifying expenditures may include the following:

1. “salaries of an association manager and secretary;
2. paving of streets;
3. street signs;
4. security personnel;
5. legal fees;
6. upkeep of tennis court;
7. swimming pools;
8. recreation rooms and halls;
9. replacement of common building, facilities, air conditioning, etc.;
10. insurance premiums on association property;
11. accountant’s fees;
12. improvement of private property to the extent it is association property; and
13. real estate and personal property taxes imposed on association property by a State or local government.”

Treasury Regulation §1.528-9 excludes from federal income tax, receipts considered exempt function income. Examples of exempt function income include dues and assessments for the purposes of-

1. “paying the principal and interest on debts incurred for the acquisition of association property,
2. paying real estate taxes on association property,
3. maintaining association property,
4. removing snow from public areas, and
5. removing trash.”

GOVERNMENT’S POSITION

Based on the facts and circumstances of the organization, we recommend the organization elect recognition under IRC section 528.

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TAXPAYER'S POSITION

The taxpayer's Position is not known at this time.

CONCLUSION

As a result of our examination of your Form 990 for the period ended December 31, 20XX, we have determined that your organization does not qualify as an exempt homeowners association described in IRC section 501(c)(4). We recommend ORG elect recognition under IRC Section 528 as a qualified homeowner's association. As part of election under IRC 528 you will need to file Form 1120-H, *U.S. Income Tax Return for Homeowners' Associations* for the year ended December 31, 20XX.