



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
Attn: Mandatory Review, MC 4920 DAL  
1100 Commerce St.  
Dallas, TX 75242

501-07.00

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Release Number: 201405026

Release Date: 1/31/2014

LEGEND

ORG- Organization name

Address- address

ORG

ADDRESS

Date: October 23, 2008

Employer Identification Number:

Person to Contact/ID Number:

Contact Numbers:

Voice

Fax

**CERTIFIED MAIL – RETURN RECEIPT REQUESTED**

Dear :

In a determination letter dated January, 19XX you were held to be exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(7) of the Code. Accordingly, your exemption from Federal income tax is revoked effective April 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(7) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On September 4, 20XX you signed Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under section 501(c)(7) of the Code.

You have filed taxable returns on Form[s] 1120, *U.S. Corporation Income Tax Return* for the year[s] ended March 31, 20XX and March 31, 20XX with us. For future periods, you are required to file Form 1120 with the appropriate service center indicated in the instructions for the return.

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 contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Vicki L. Hansen  
Acting Director, EO Examinations

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>		<b>Year/Period Ended</b>
ORG		20XX03

**LEGEND**

ORG - Organization name      XX - Date      State - state

**ISSUE(S):**

Does the ORG qualify for exemption under Internal Revenue Code (IRC) section 501(c) (7)?

**FACTS:** The ORG (hereafter referred to as ORG) has been in existence since the 19XX's. They filed papers to incorporate under Section 402 of the Not-for-profit Corporation Law in the State of State on March 18, 19XX. The purpose of ORG as stated in the by-laws is to "own, maintain and operate a golf and country club."

ORG operates a 9-hole golf course open to members and the public. The income received by ORG includes membership dues, greens fees, cart rentals, restaurant & bar sales, pro shop sales, and miscellaneous income including interest and rebates received on credit cards. The members pay an annual fee and in return receive free greens fees and admittance to member only tournaments and events. The public may use the course upon paying greens fees. ORG also offers discounted greens fees to the public through the Capital Region Golf Card. This card is purchased for \$ at participating clubs and entitles the holder to buy one 18 hole round and get one free. Cart rental fees of varying amounts (based on member vs. nonmember and 18 holes vs. 9 holes) are charged to both members and the public.

ORG operates a pro shop, bar and a restaurant, all of which are open to both members and the general public. ORG currently has a license issued by the State State Liquor Authority to sell alcoholic beverages at its facility. The license type is OP – On Premises Liquor. An On Premises Liquor license is a full liquor license with no restrictions as to the sale of alcoholic beverages for on premises consumption. This differs from a club license where alcoholic beverages can only be sold to members of ORG. ORG has no such restriction.

ORG advertises on the website that they are a semi-private club, open to the public and available for corporate tournaments, group and family outings and league play.

ORG offers lessons with the PGA professional on staff. They offer private lessons, playing lessons and junior clinics. These lessons are available to members and the public.

The income attributable to non-members is unknown because ORG did not comply with the record keeping requirements of Revenue Procedure 71-17. The members' dues cover the cost of greens fees so all of the greens fees reported on the Form 990 return are from non-members. Only a portion of the income from cart rentals, restaurant & bar, and pro-shop sales are from non-members. The exact portion of non-member sales is unknown for 20XX. The newly hired golf pro began keeping track of the number of member and non-member rounds in 20XX. In 20XX, approximately % of all rounds played from April – July were non-member rounds. As per Revenue Procedure 71-17, without records of non-member sales, all income from cart rentals, restaurant & bar, and pro-shop sales can be assumed to be from non-members as in the following analysis:

**TABLE DELETED**

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ORG		20XX03

The same analysis was done of the income reported in the 20XX and 20XX tax years. The results are shown in the table below:

**TABLE DELETED**

A closing conference was held following the conclusion of the examination on 7/24/XX with the Treasurer of ORG to discuss the facts and disposition of the case.

**LAW:**

Internal Revenue Code (IRC) section 501(c)(7) provides exemption from income taxes for "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." [IRC §501(c)(7)]

The Treasury Regulations further provides that "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(a)] A social club that opens its facilities to the public is deemed to be "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 ORG is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption." [Reg. §1.501(c)(7)-1(b)]

Revenue Ruling (Rev Rul) 58-589, 1958-2CB 266 examines the criteria for determining whether an organization qualifies for exemption under IRC section 501(a) as an organization described in section 501(c)(7) of the Code. This ruling states "It is clear under the foregoing regulations that a club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, etc., may not be considered as being organized and operated exclusively for pleasure, recreation or social purposes. It is equally clear that activities by a social club such as the solicitation by advertisements or otherwise of public patronage of its facilities may be adverse to the establishment of an exempt status."

This ruling was made prior to the enactment of P.L. 94-568 in 1976 which changed the term "exclusively" to "substantially all". This change, as incorporated in the IRC allows for an insubstantial amount of income from activities that do not further ORG's exempt purposes. These activities which constitute an unrelated trade or business include the use of ORG facilities by the general public. Senate Report No. 94-1318 (1976), 2d Session, 1976-2 C.B. 597, at page 599 explains that a social club is permitted to receive up to 35% of its gross receipts, including investment income, from sources outside of its membership without losing its tax-exempt status. It is also intended that within this 35% not more than 15% of the gross receipts should be derived from the use of a social club's facilities or services by the general public (nonmembers). While the reports mandate the application of a "facts and circumstances test" in the event that gross receipts from nonmember and/or investment income reach the prohibited levels, they do not specify any of the relevant facts and circumstances that should be considered. However, the Court of Appeals has indicated some factors to consider in determining exempt status. (Pittsburgh Press Club v. USA, 536 F.2d 572, (1976)) Factors to consider in applying this test include:

- The actual percentage of nonmember receipts and/or investment income.
- The frequency of nonmember use of club facilities. (An unusual or single event (that is, nonrecurrent on a year to year basis) that generates all the nonmember income should be viewed more favorably than nonmember income arising from frequent use by nonmembers).

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- The number of years the percentage has been exceeded. (The record over a period of years is also relevant. The high percentage in one year, with the other years being within the permitted levels, should be viewed more favorably to the organization than a consistent pattern of exceeding the limits, even by relatively small amounts).
- The purposes for which ORG's facilities were made available to nonmembers.
- Whether the nonmember income generates net profits for the organization. Profits derived from nonmembers, unless set aside, subsidize ORG's activities for members and result in inurement within the meaning of IRC 501(c)(7).

[\*Treasury Reg. §1.501(c)(7)-1 has not been updated to reflect P.L. 94-568 which changed "exclusively" to "substantially all".]

**GOVERNMENT'S POSITION:**

Based on the examination, the organization does not qualify for exemption as a social club described in IRC §501(c)(7). ORG permits unrestricted use of its facilities by the general public and advertises to that effect. ORG has an open liquor license allowing them to serve the public without a restriction to serve club members only. Year over year, ORG receives more than the insubstantial part of its gross receipts allowed by the Code from outside its membership. The amount of greens fees collected for public use of ORG's facilities averaged % for the 20XX - 20XX tax years. This is considerably higher than the 15% allowed and shows a pattern of frequency and reoccurring use by the public. ORG also receives nonmember income from the cart rentals, restaurant & bar sales, and pro shop sales, but the exact amount of income from these activities is indeterminable because they did not comply with the record keeping requirements of Rev Proc. 71-17. The facts of the case show that it is operating in a manner consistent with a for-profit business.

**CONCLUSION:**

The organization does not qualify for exemption from federal income tax under IRC § 501(c)(7). Accordingly, the organization's exempt status is revoked effective April 1, 20XX.

Form 1120 returns should be filed for the tax periods ending on or after March 31, 20XX.