



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
1100 Commerce St., Mailstop 4920DAL  
Dallas, TX 75242

September 11, 2008

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ORG

ADDRESS

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 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.

Letter 3610 (04-2002)  
Catalog Number 34801V

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,

Vicki L. Hansen  
Acting, Director EO Examinations

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

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> ORG		<b>Year/Period Ended</b> June 30, 20XX and June 30, 20XX

**LEGEND**

ORG - Organization name      XX - date      City - city      State - state      CO-1, CO-2, CO-3 - 1<sup>st</sup>, 2<sup>nd</sup>, & 3<sup>rd</sup> COMPANIES

**ISSUE:**

- 1) Whether the organization ORG still qualifies for tax exempt status under 501(c)(7) as an social and recreational club.
- 2) Whether the organization qualifies under a different tax exemption under Section 501(a).

**FACTS:**

ORG (ORG) was incorporated in State on August 30, 19XX. ORG was originally granted tax exemption November 17, 19XX as a title holding company under 501(c)(2). ORG had requested that they be changed from a 501(c)(2) to a 501(c)(7). ORG requested the reclassification because of the policy listed in Private Letter Ruling No. where organizations holding title to and maintaining sorority houses and also engages in social activities should not be 501(c)(2) but 501(c)(7). They provided information showing that in prior years they were providing social events for their members and received their funds from the membership dues of members. Their request was granted and they were reclassified to a 501(c)(7) on July 27, 19XX.

ORG's membership at the time of the reclassification was the alumnae of the CO-1 and any alumnae of other chapters of CO-2. Funding was only addressed in Article Four-Subscribers of the Constitution and Bylaws of the ORG - Revised and Amended October 20, 19XX, which stated: "Any alumna member of CO-2 Sorority may subscribe to pay (\$\$) or more to the Corporation. The subscription fee for Active chapter members starting In September 19XX will be (\$), total of which must be paid before she may become a voting member."

The original Articles of Incorporation filed with the reclassification request stated: "The purpose for which said corporation is formed is not for profit, but to promote the cause of education and social intercourse, and to provide a place of meeting and residence of its members: to receive, hold and disburse gifts, bequests and other funds for said purpose; to purchase, own and maintain suitable real estate and buildings for its purpose and to do all things necessary and incident thereto."

The purpose listed in Article three-Purpose of the Constitution and Bylaws of the ORG- Revised and Amended October 20, 19XX states: "Section 1 The purpose for which said corporation is formed is to promote the cause of education and social intercourse, to provide a place of meeting and residence of its members, to buy, sell, build, repair and alter, own and control a ORG for the use and benefit of the active and alumnae chapters of CO-2 Sorority, located and existing in the City of City and State of State. Section 2 To secure by subscription, loans or otherwise raise money to finance the purchase, building, erection and maintenance of the same."

The answers to the four questions specifically for 501(c)(7) organizations on the Form 1024 application for exemption were: 1) Have you entered or do you plan to enter into any contract or agreement for the management or operation of your property and/or activities, such as restaurants, pro shops, lodges, etc? **No**; 2) Do you seek or plan to seek public patronage of your faculties by advertisement or otherwise? **No**; 3) Are nonmembers other than guests of members permitted or will they be permitted to use the club facilities or participate in or attend any function or activities conducted by the organization? **No**; and 4) Does your charter, bylaws, other governing instrument, or any written policy statement of your organization contain any provision which provides for discrimination against arty person on the basis of race color, or religion? **No**.

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The Constitution and Bylaws of the ORG- Revised and Amended April 18, 20XX Article Four- Membership states; "Section 1 All alumnae of CO-1 shall become lifelong members of the house Corporation. Section 2 Initiated alumnae members of any CO-2 chapter other than CO-1, may become a member of the corporation upon request by the Board of Trustees to serve on the Corporation board. Her membership will last for the duration of her service as a trustee." None of the article of this revision addresses membership/subscription dues. The stated purpose of the organization in the April 18, 20XX revised bylaws remains the same as in the October 20, 19XX bylaws.

The current activities of the ORG as determined by the interview and examination, is to provide a house for the CO-1, so that the women of the sorority may choose to live in the house instead of the university dorms. The residents of the house are women of the sorority that are going to school at CO-3 and are not members of the ORG. These residents pay rent to the ORG through their payment of room and board to CO-3.

The house is use by the sorority for the social interaction of the sorority's members instead of the ORG members. Some of the sorority members also live in the house as indicated above. This constitutes non member usage of the facility. Occasionally the members of the ORG can use the house for family and other social functions generally when the house is not occupied during either the holiday breaks or over the summer. When a member asks to use the house it is for her personal party. These are not social events sponsored by the ORG. The ORG itself does not organize social activities for its members. It manages and provides the house for the sorority's use but it is not part of the sorority and the undergraduate sorority members are not members of the ORG.

Information was given in a letter from the current Treasurer of the ORG dated July 25, 20XX, which states:

- A. "All alumnae of CO-1 are eligible to become lifelong members of the CO-1 ORG Corporation. Initiated alumnae members of other chapters of CO-2 are also eligible to become members of the Corporation upon request of the Corporation Executive Board.
- B. The purpose of the organization is not for social enrichment, but instead to provide a place of meeting and of residence to members of CO-1 Chapter. Furthermore, the Corporation is responsible to buy, sell, build, repair and alter, own and control the ORG for the use and benefit of the active and alumnae members of CO-1.
- C. The CO-1 ORG Corporation receives its income from the undergraduate members of CO-1. Residents of the ORG pay room & board fees in addition to a Building Fund. Non-residents of CO-1 Chapter contribute toward the Building Fund as is incorporated into each member's chapter dues. The Building Fund is used by the Corporation for the maintenance and repair of the ORG."

off-campus housing, which includes the sorority houses, is only open to the upperclassmen. students must live on campus the first two years. The upperclassmen that decide to live in the ORG pay their room and board fees to CO-3. CO-3 pays room fees to the ORG for the women in residence for the semester. For the women who are also on one of the food plans, the board fees are also paid to the ORG from the University. (Example from current year [20XX-20XX] lease agreement: The Occupants pay to CO-3 the sum of \$\$ for room and \$\$ for board to be forwarded to the Corporation for each semester. Meals shall be provided only during the regular scheduling of classes at CO-3.) These funds from the rent and food plans constitute non member income to the ORG.

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All of the undergraduate members of CO-1 pay dues to the sorority. A part of the dues is given to the Building fund of the ORG. The ORG is not a division of the sorority. The members of the sorority are not members of the ORG until they graduate whereupon they become lifetime members of the ORG.

ORG also receives interest income from its money market account and savings. They believed that they have been following Section 512(a)(3)(B)(i) and Section 170(c)(4) by setting aside the interest to be used for educational purposes. The educational purposes were to send their board members to classes on managing and coordinating an exempt organization.

For the tax year ending June 30, 20XX, the ORG's income consisted of the room and board payments from CO-3 (\$), portion of sorority dues designated to the CO-2 building fund (\$), interest income (\$), and a donation from an alumna (\$). Of the total income of \$, the donation was the only income from a member of the organization. ORG's nonmember income for the tax year ending June 30, 20XX is % (\$\$).

Using the tax return that was filed for the tax year ending June 30, 20XX, the ORG's income consisted of the room and board payments from CO-3 and the portion of sorority dues designated to the CO-2 building fund (\$), interest income (\$), and a donation of (\$). The donation may be from an alumna as the donation received the pervious year was reported in the same manner. Of the total income of \$, if the donation was from alumnae (member(s) of the ORG), then \$ or % is from nonmembers.

**LAW:**

Section 501(a) of the Internal Revenue Code provides an exemption from federal income taxation for organizations described in section 501(c)(7). Section 501(c)(7) describes clubs "organized 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."

Section 1.501(c)(7)-1 of the Income Tax Regulations provides: "(a) 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.

(b) 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. However, an incidental sale of property will not deprive a club of its exemption.

Section 501(c)(7) of the Internal Revenue Code was amended in 1976 by Public Law 94-568 to provide that section 501(c)(7) organizations could receive some outside income without losing their exempt status. The legislative history provides that the decision as to whether substantially all of the organization's activities are related to its

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exempt purposes is to continue to be based upon all of the facts and circumstances. It is intended that these organizations are permitted to receive up to 35 percent of their gross receipts, including investment income, from sources outside their membership without losing their tax-exempt status. It is also intended that 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. S. Rep. No. 1318, 94th Cong., 2d Sess. 4 (1976).

The Senate Report at 1976-2 C.B. 599 provides, in part, "Gross receipts are defined for this purpose as those receipts from normal and usual activities of the club (that is, those activities they have traditionally conducted). . ." [emphasis added]

Section 501(c)(2) of the Internal Revenue Code describes 501(c)(2) Title Holding Corporations as: "Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under this section..."

Section 1.501(c)(2)-1 of the Income Tax Regulations provides: "(a) A corporation described in section 501(c)(2) and otherwise exempt from tax under section 501(a) is taxable upon its unrelated business taxable income. For taxable years beginning before January 1, 1970, see §1.511-2(c)(4). Since a corporation described in section 501(c)(2) cannot be exempt under section 501(a) if it engages in any business other than that of holding title to property and collecting income therefrom, it cannot have unrelated business taxable income as defined in section 512 other than income which is treated as unrelated business taxable income solely because of the applicability of section 512(a)(3)(C); or debt financed income which is treated as unrelated business taxable income solely because of section 514; or certain interest, annuities, royalties, or rents which are treated as unrelated business taxable income solely because of section 512(b)(3)(B)(ii) or (13)..."

(b) A corporation described in section 501(c)(2) cannot accumulate income and retain its exemption, but it must turn over the entire amount of such income, less expenses, to an organization which is itself exempt from tax under section 501(a).

#### **ORGANIZATION'S POSITION:**

As stated in a letter from the current treasurer: "The purpose of the organization is not for social enrichment, but instead to provide a place of meeting and of residence to members of CO-1 Chapter. Furthermore, the Corporation is responsible to buy, sell, build, repair and alter, own and control the ORG for the use and benefit of the active and alumnae members of CO-1." And "All alumnae of CO-1 are eligible to become lifelong members of the CO-1 ORG Corporation. Initiated alumnae members of other chapters of CO-2 are also eligible to become members of the Corporation upon request of the Corporation Executive Board."

When revocation was discussed based on the activities and income sources, the Organization did not give an additional position concerning the proposal to revoke the tax exempt status.

#### **GOVERNMENT'S POSITION:**

An organization's activities and income must substantially be from the members of the organization for it to qualify under Section 501(c)(7). If a substantial amount of the income comes from nonmember sources then organization cannot be exempt under Section 501(c)(7).

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This organization's nonmember income is from room, board, a portion of sorority dues and interest income. An organization whose income is more than % from non members and more than % from activities other than social, cannot be exempt under Section 501(c)(7). ORG's nonmember income for the tax year ending June 30, 20XX is %. For the tax year ending June 30, 20XX, the nonmember income is between % and %. For both years they have exceeded the limit of % of income from nonmembers. The income was from nonmember activities that were not the organization's exempt function. The nonmember income far exceeds the % nonmember income amount.

**CONCLUSION:**

ORG does not provide social activities for its members nor is it supported solely by membership fees, dues, and assessments from its members. ORG regularly derives more than % of its gross receipts from sources outside the membership, and it does not provide activities that are for social or recreation purposes for its members. ORG no longer qualifies as a social club under 501(c)(7).

ORG does not qualify for exemption under 501(c)(2) as a Title Holding corporation because it serves food to the residents of the house and it does not turn over its income at the end of the year as required by a 501(c)(2) organization.

ORG no longer qualifies for tax exemption under Internal Revenue Code Section of 501(a) as it cannot meet the qualifications under any of the Sections of 501(c).

Accordingly, it is determined that ORG is not an organization described in section 501(c)(7), and is not exempt from income tax under IRC § 501(c)(7), effective July 1, 20XX. This organization is required to file Form 1120 for all tax periods beginning after June 30, 20XX.