



**DEPARTMENT OF THE TREASURY**

Internal Revenue Service  
TE/GE EO Examinations  
1100 Commerce Street MC 4920 DAL  
Dallas, TX 75242

**TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION**

Date: DEC 07 2017

Number: **201911009**  
Release Date: 3/15/2019

Person to Contact:  
Identification Number:  
Contact Telephone Number:  
In Reply Refer to:  
EIN:

UIL: 501.03-00

LAST DATE FOR FILING A PETITION  
WITH THE TAX COURT:

**CERTIFIED MAIL - Return Receipt Requested**

Dear :

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(7) of the Internal Revenue Code (IRC). Your exemption from Federal income tax under IRC section 501(c)(7) is hereby revoked effective April 1, 20XX.

Our adverse determination was made for the following reasons:

You have not established that you are operated substantially for pleasure and recreation of its members or other non-profitable purposes and no part of the earnings inures to the benefit of private shareholder within the meaning of IRC section 501(c)(7).

You have made your services, use of recreational and social facilities available to the public. You have exceeded the non-member income test for tax year ending March 31, 20XX.

You failed to comply with the record keeping requirements of Revenue Procedure 71-17.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending March 31, 20XX and for all years thereafter.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under IRC section 7428.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. We can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for our assistance, which is always free, we will do everything possible to help you. Visit [taxpayeradvocate.irs.gov](http://taxpayeradvocate.irs.gov) or call 1-877-777-4778.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

A handwritten signature in black ink that reads "Maria Hooke". The signature is written in a cursive, slightly slanted style.

Maria Hooke  
Director, Exempt Organizations Examinations

Enclosures:  
Publication 892



Department of the Treasury  
Internal Revenue Service  
Tax Exempt and Government Entities  
Exempt Organizations Examinations

Date:  
August 16, 2017  
Taxpayer Identification Number:

Form:

Filing Period(s) Ended:

Person to Contact / ID Number:

Employee ID:  
Contact numbers:  
Telephone:  
Fax:  
Manager's Name / ID Number:

Manager's Contact Number:

Response due date:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

**Why you are receiving this letter**

We've enclosed a copy of our audit report, Form 886-A, *Explanation of Items*, explaining that we propose to revoke your tax-exempt status as an organization described in section 501(c)(7) of the Internal Revenue Code.

**If you agree**

Please sign the enclosed Form 6018, *Consent to Proposed Action*, and return it to the contact person shown at the top of this letter (unless you've already provided us a signed Form 6018). We'll issue a final adverse letter determining that you aren't an organization described in section 501(c)(7).

**If you disagree**

1. Request a meeting or telephone conference with the manager shown at the top of this letter.
2. Send any information you want us to consider.
3. File a protest with the IRS Appeals office. If you request a meeting with the manager and/or send additional information as stated in 1 and 2, above, you'll still be able to file a protest with IRS Appeals office after the meeting or after we consider the information.

The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally. If you file a protest, the auditing agent may ask you to sign a consent to extend the period of limitations for assessing tax. This is to allow the Appeals office enough time to consider your case. For your protest to be valid, it must

In lieu of Letter 3618

contain certain specific information, including a statement of the facts, applicable law, and arguments in support of your position. For specific information needed for a valid protest, refer to Publication 892, How to Appeal an IRS Decision on Tax-Exempt Status.

Fast Track Medication (FTM) referred to in Publication 3498 generally doesn't apply now that we've issued this letter.

4. Request technical advice from Office of Associate Chief Counsel (TEGE) if you feel the issue hasn't been addressed in published precedent or has been treated inconsistently by the IRS.

If you're considering requesting technical advice, contact the person shown at the top of this letter. If you disagree with the technical advice decision, you will be able to appeal to the Appeals office, as explained above. A decision rendered in a technical advice memorandum as to your exempt status, however, generally is final and binding on Appeals.

**If we don't hear from you**

If you don't respond to this proposal within 30 calendar days from the date of this letter, we'll issue a final adverse determination letter.

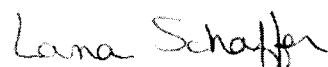
**Contacting the Taxpayer Advocate Office is a taxpayer right**

You may also be eligible for help from the Taxpayer Advocate Service (TAS). TAS is an independent organization within the IRS that can help protect your taxpayer rights. We can offer you help if your tax problem is causing a hardship, or you've tried but haven't been able to resolve your problem with the IRS. If you qualify for TAS assistance, which is always free, we'll do everything possible to help you. Visit [www.taxpayeradvocate.irs.gov](http://www.taxpayeradvocate.irs.gov) or call 877-777-4778.

You can find all forms and publications mentioned in this letter at our website at [www.irs.gov/formspubs](http://www.irs.gov/formspubs).

If you have any questions, you can contact the person shown at the top of this letter.

Sincerely,



Acting Group Manager 7938  
for  
Maria Hooke  
Director, Exempt Organizations  
Examinations

Enclosures:  
Form 886-A, Audit Report  
Form 6018  
Exhibits  
Publications 3498 and 892

Form <b>886-A</b> (May 2017)	Department of the Treasury – Internal Revenue Service <b>Explanations of Items</b>	Schedule number or exhibit
Name of taxpayer	Tax Identification Number (last 4 digits)	Year/Period ended 20XX

**ISSUE 1:** Whether the \_\_\_\_\_ is still qualified to be exempt under Section 501(c)(7) of the Internal Revenue Code(IRC)?

**ISSUE 2:** Whether the revocation of the \_\_\_\_\_ tax-exempt status should be applied retroactively to tax year beginning April 1, 20XX?

**FACTS:** \_\_\_\_\_ (the "Club") obtained its exempt in September 19XX. The Club was created for the common purpose for pleasure and recreation to operate a golf course described in IRC § 501(c)(7). The course is 9-holes with several pine trees.

The Club did not provide records per Rev. Proc 71-17 to indicate nonmember income from the gaming, restaurant, Club rental and tournaments at the facility. The calendar for Club rental was not available due to computer malfunction.

Forms 990 for the years ending March 31, 20XX, 20XX, and 20XX showed the following for green fees and membership fees.

	Gross Receipts
Year of Audit	
20XX	
Green Fees	0
Membership Fees	0
Total	0
20XX	
Green Fees	0
Membership Fees	0
Total	0
20XX	
Green Fees	0
Membership Fees	0
Total	0

Form <b>886-A</b> (May 2017)	Department of the Treasury – Internal Revenue Service <b>Explanations of Items</b>	Schedule number or exhibit
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**BYLAWS:**

The Bylaws were revised November 14, 19XX. To be a member the person must be a legally competent person of good reputation who pays the required membership. Green fees paid before paying for membership will not be credited toward the membership. Each member shall be entitled to one vote upon each matter at a meeting of members. Family memberships are limited to two (2) votes. It states there is no fee for Social members.

**FACILITIES**

The Club has a building with a bar and restaurant along with the 9-hole golf course.

*Entry*

Observed the registration process and the video camera. Upon entering the \_\_\_\_\_, there are plaques of contributions labeled "\_\_\_\_\_ " at \$0 to \$0 all the way up to "\_\_\_\_\_ " up to \$0, lost and found, toys for children, calendar, snacks, restrooms and one office. There are no signs or notifications of "members only" or "visit three times notifications" to encourage membership. No key card system.

*Bar, eating and kitchen areas*

The \_\_\_\_\_ has a 0 chair U-shaped bar. Bar area serves pizza and other snacks. Two toaster ovens for pizza. Storage area near bar is for bottled water and pop. There is another storage fully stocked with a variety of beers. The bar stores liquors that take up four shelves from ceiling to wall. The \_\_\_\_\_ has 0-person capacity. There are several menus shown in on the website which describes a full kitchen. In the eating area, there is an ATM machine, Juke Box and Pull Tab machine. The kitchen contains 1-Fridge full of beer. Full professional kitchen more refrigerators, ovens, grill, freezers.

*Patios*

The Club has two patios one screened in one is not. They each have approximately 0 heated lamps and several tables in each. One has a grill for the "Grill your own steak or burger" days. These are the days when there is no staff. These are the Men's and Ladies nights on Wednesday and Thursdays. (Exhibits A, B, & E)

**CLUB OPERATIONS:**

The Club charges a membership fee of \$0 for Social members in contradiction to its Bylaws. People within \_\_\_\_\_ and 0-mile radius use the \_\_\_\_\_ golf course and Club called the "The \_\_\_\_\_ ". The website shows the golf course and the \_\_\_\_\_ hours. It states the golfers may register and rent carts at any time. In the winter, the \_\_\_\_\_ is open \_\_\_\_\_, and \_\_\_\_\_ in the winter \_\_\_\_\_ to close; the kitchen is open \_\_\_\_\_ to \_\_\_\_\_.

The Club uses the honor system for self-registration. The website instructs golfers to use the registration process located at the \_\_\_\_\_ door. The instructions ask for the name, date, fee and amount be put on the registration form and dropped in the registration box. There is a video

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camera located at entrance to monitor the registration area. The carts are located to the West of the Club with gas and keys. Instructions to check the carts for flat tires before use. Anyone can use carts on the course.

The website advertises to golfers, members and the public to have all their special events at the . The website is very informative with pages labeled Home, Golf Course, , Tournaments & Events, Membership and Gallery. You can take a virtual tour of the course and the . You can sign up for a tournament or rent out the . You can call the Club Manager or email your request. The Club's website never states it is a private club on their website: .com. (Exhibits A-F.) There is no indication on the website that this is a private club.

In addition to the golf and bar the Club sells pull-tabs. It sells at 0 different sites in the area including its own bar. The total gross income from the gaming sales is \$0.

#### MEMBERSHIPS:

The Club has six classes of membership:

Family Golfing Membership: This includes all children through the summer following high school graduation. \$0

Adult Single Golfing Membership \$0

Social Membership: For non-golfing supporters of the Club \$0

Student Membership: For any high school or college students/parents are not members \$0

Long Drive Family Membership: For those living outside of a 0-mile radius from the Club \$0

Long Drive Single Membership: For those living outside of a 0-mile radius from the Club \$0

The Membership list for the 20XX tax period totaled 0 members for all types of members. The highest membership cost is for family of \$0 The lowest cost for a social member is \$0.

#### DEMOGRAPHICS:

This is a highly rural area. has a population of 0 per the 20XX census. The chart below shows the population of and distance to the surrounding towns. The closest public golf course is in , population of 0. It is 0-holes located within 0 miles of . The total population for the 0-mile radius below is 0.

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## CHART DELETED

### FORM 990 TAX PERIOD ENDING MARCH 31, 20XX.

The correct gross income of \$0 was computed. The program expenses of \$0 was reported.

The Form 990, Part III, line 4a states: “ /CLUB HOUSE PROVIDED TO THE PUBLIC TO PROVIDE A PLACE TO SOCIALIZE AND INERACT WHILE AT THE GOLF COURSE. REVENUE AND EXPENSES RELATED TO THIS PROGRAM HELP TO MAINTAIN THE CONDITION OF THE GOLF CLUB AND GOLF COURSE.”

Part III, Line 4b, states: “9 HOLE GOLF COURSE THAT ALLOWS THE PUBLIC TO PLAY AND LEARN THE GAME OF GOLF. THE REVENUE AND EXPENSES ASSOCIATED WITH THIS PROGRAM HELP TO MAINTAIN THE CONDITION OF THE GOLF COURSE.”

Part III, Line 4c, states: “THE GAMING PROGRAM IS AVAILABLE TO THE PUBLIC IN THE NAME OF THE TAX EXEMPT ORGANIZATION TO HELP WITH THE UPKEEP OF THE CLUB HOUSE AND COURSE EXPENSES ARE TO HELP WITH THE GAMING COST INCURRED.”

### EVENTS:

does not have a community center in the city. Anyone can rent the for an event. When the space is rented, it is for the bar and the restaurant area; there are no partitions. The Form 990 states the Club is providing social interaction for the community. The website lists all the golfing events held at the Club and the opportunity for the public to rent the Club. The website .com lists several social clubs or events. The City has several non-profit organizations: to name a few. Some of the clubs are available for rental from the public. There is a community garden and a . Also, there is the ( ). provides live plays and performances for the community. The city has a diverse amount of activities for the public. (Exhibit E, .)

### MINUTES

Per the minutes of the board meetings, the Club has been struggling to keep the cash flow above its expenses. It has increased the members' dues in the past years. Because surrounding areas have golf courses, it is in competition for the rural members in the area. There was a three-page analysis regarding the pricing of the food in the restaurant to lower the to achieve a higher profit. There was also discussion of the kitchen manager receiving a percentage tied to the gross net profit of the restaurant.



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**LAW:**

IRC § 501(c)(7) - Clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all 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.

REGS, §1.501(c)(7)-1. Social clubs (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 § 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. [Reg. §1.501(c)(7)-1.]

REVENUE PROCEDURE 71-17, 1971-1 C.B. 683, describes the record-keeping requirements for social clubs exempt under IRC 501(c)(7) with respect to nonmember use of their facilities; it sets forth guidelines for determining the effect of gross receipts derived from public use of the club's facilities on exemption and liability for unrelated business income tax.

**GROSS RECEIPTS TEST / PUBLIC LAW 94-568**

§ 501(c)(7) was amended in 1976 by Public Law 94-568 to provide that § 501(c)(7) organizations could receive some outside income without losing their exempt status. Senate Report No. 94-1318 (1976), 2d Session, 1976-2 C.B. 597, explains that a social club is permitted to receive up to 35 percent 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 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 (nonmembers). In effect, the latter modification increases from 5 percent (Rev. Proc. 71-17, 1971-1 C.B. 683) to 15 percent the proportion of gross receipts a club may receive from making its club facilities available to the general public without losing its tax-exempt status.

The Senate Report also states that it is not intended that these organizations should be permitted to receive, within the 15 percent or 35 percent allowances, income from the active conduct of

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businesses not traditionally carried on by these organizations. In cases where an organization's nontraditional income would cause the organization to exceed the 15 or 35 percent allowances, consideration should be given as to whether the organization continues to be substantially operated for IRC § 501(c)(7) purposes.

According to the Committee Reports, where a club receives income from other sources (non-traditional or unusual), including income from the sale of its clubhouse or similar facility, that income is not to be included in the formula; that is, such income is not to be included in either the numerator or the denominator for purposes of computing the 35 or 15 percent allowances.

The Committee Reports provide that gross receipts include, charges, admissions, membership fees, dues, assessments, investment income (such as dividends, rents, and similar receipts), and normal recurring capital gains on investments, but excluding initiation fees and capital contributions.

Where college fraternities or sororities charge membership initiation fees but not normal dues, such fees will be included in their gross receipts, notwithstanding that initiation fees are ordinarily excluded (Senate Report 94-1318, 2d Session, 1976-2 C.B. 599.).

**TAXPAYER'S POSITION:** The organization had a conference with the group manager. Correspondence was received from POA after that conference. The organization indicated it wants more time to show that it receives most its income from members.

**GOVERNMENT'S POSITION:**

The organization is no longer qualified to be exempt under IRC section 501(c)(7) because more than 35% of its gross income is from non-members and it receives more than 15% of its income for use of the facilities from non-members.

As provided in Public Law 94-568 an organization exempt from tax under IRC section 501(c)(7) can't receive more than 15% of the income for use of the facilities from non-members and not more than 35% of its income can come from non-member sources.

**15% GROSS RECEIPTS TEST**

The 15% test pertains to the use of the golf course and the building. The chart below shows the income reported on the Forms 990 from tax periods ending 3-31-20XX to 20XX for use of the golf course. The green fees are the amounts charged non-members to use the course. All years are greater than the 15% set by Public Law 94-568. The trend is 0%, 0% and 0% from 20XX to 20XX, respectively.

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	Gross Receipts	Green fees%
Year of Audit		
20XX		
Green Fees	0	
Membership Fees	0	
Total	0	0%
20XX		
Green Fees	0	
Membership Fees	0	
Total	0	0%
20XX		
Green Fees	0	
Membership Fees	0	
Total	0	0%

The Forms 990 for the tax periods ending March 31, 20XX to 20XX were used to determine the percentage of green fees paid by nonmembers and the membership dues. The total of these is divided by the green fees to determine what percentage of the income is from non-members. The Income Statement for the tax period ending March 31, 20XX was provided and used to verify the Form 990 figures.

The organization has income from membership dues, green fees for golfing, cart shed rent, cart rent, gaming, rental of the \_\_\_\_\_, and tournament. Below is the 15% test done with the Treasurer's income records with the calculated percentage for 20XX. The records confirm an exceeded amount of the 15% test to be 0%.

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## CHART DELETED

Power of Attorney (POA) sent correspondence of check payments made by the members in the facility. The calculation of 0% computed by the POA exceeds the 30% calculation made by the Examiner. (Exhibit H)

### \*\*CALCULATION OF NONMEMBER GAMING INCOME

## CHART DELETED

The following chart shows the total gross income from all sources. Public Law 94-568 provides that no more than 35% of the gross income should come from non-member sources. As shown on this 0% is from non-members. Because this is more than the 35% allowed by the law the organization does not qualify to be exempt under IRC section 501(c)(7).

## CHART DELETED

The Club does not meet the 35% test.

Based on the facts of the examination, the Club does not qualify for exemption because the operations were more than substantial for nonmembers. From April 1, 20XX to March 31, 20XX, the Club has received more than 35% of its income from non-members and of that more than 15% was for use of the facilities. The Public Law 94-568 and Senate Report No. 1318 amended IRC § 501(c)(7) as of October 20, 19XX provide that to be exempt under IRC § 501(c)(7) a club is limited to receiving 15% of its income for use of club facilities from nonmembers. This organization substantially exceeded the 15% limitation from nonmember income for three consecutive years.

For 20XX, the organization had total expenses of \$0 to operate the Club. If only the members were paying for expenses, each member would pay about \$0 in a year. If it wanted to keep the dues at \$0, it would need 0 members. The population in a 0-mile radius is 0. There is a public course within 0 miles. The chances of the Club being able to increase membership dues or the number of members is very limited. Its minutes already indicate it was struggling to operating with the non-member income it already has. These factors show that the Club would not be able to survive without the large amount of non-member income that it receives.

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The idea of exempt status by social and recreational clubs is that the members will pool their money to operate the club. Rev. Proc. 71-17 requires for social clubs exempt under IRC § 501(c)(7) to keep track of amounts paid by members for their guests' use of the club. The organization did not have any of the required records so it is assumed that the non-members paid their own fees and were not guests of the members. This requirement is for use of the club facilities.

The Club did not comply with Treas. Reg. § 1.501(c)(7)-1(b) because it made the Club available to the general public by solicitation of advertisement for public patronage of its facilities. Before the proposal of revocation, facts and circumstances was performed. Facts and circumstances was conducted by using a three-year trend to consider an inadequate record notice.

The additional nonmember income from outside the facility exceeded § 501(c)(7) requirements. The Club has outside gaming income at several vendor locations. The gaming license is for social recreation at the Club for its members and guests. The Club received more than 35% of its income from non-member sources. It does not meet the 35% gross receipts test for the tax period ending March 31, 20XX.

The total income was \$0 of that \$0 is from gaming income. The gaming income is 0% of the Club's income. Of the Club's income, gaming income is 0% from non-members. The Club is under the misconception they are a social club for the public versus a private club. Even if the organization could establish that its members paid for 0% of the use of the facilities it still would not qualify to be exempt because over 35% of its income is from non-members. The sale of pull-tabs to the public would always have them over 35% non-member income. But the organization cannot maintain its facilities without the pull-tab income so it will always be over the 35% from non-members. This confirmed the inadequate records notice was not the appropriate recommendation. Normally, there should never be an inadequate records notice for an organization exempt under IRC § 501(c)(7) because Rev. Proc. 71-17 is required.

The analyzed 15% Gross Receipts computation concluded: The public is supporting the Club because the income from use of facilities is over the 15% allowance is maintaining the golf course and the upkeep of the Club as stated by the Form 990. This is inurement to the 0 members. Some of the 0 memberships are for family at \$0. All 0 members regardless of the type of membership should be paying approximately \$0 to support the facility income of \$0 or 0 members for 20XX. Logical and financial analysis would not see this price for a membership or spending per member in the facility to be realistic.

**ISSUE 1: Whether the** **is still qualified to be exempt under §**  
**501(c)(7) of the Internal Revenue Code(IRC)?**

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The Club does not qualify to be exempt under IRC § 501(c)(7) because it receives more than 35% of its total income from nonmembers and it receives more than 15% of the income for use of the facility is from nonmembers. The Club does not meet the requirements to be exempt under § 501(c)(7) of the Code, Public Law 94-568, Treas. Reg. § 1.501(c)(7)-1(b) and Rev. Proc 71-17.

**ISSUE 2: Whether the revocation of the tax-exempt status should be applied retroactively to tax year beginning April 1, 20XX?**

The Form 990 statements filed for 20XX to 20XX show the Club has consistently exceeded the 15%/35% limitations for income from nonmembers. Since the first year under examination is the year ending March 31, 20XX, it is the Government's position that the exempt status should be revoked back to April 1, 20XX.

**CONCLUSION:**

The Club as an organization described under § 501(c)(7) should be revoked, effective, April 1, 20XX because it did not operate within the provisions for exempt purposes. The Club exceeded the amount of allowable nonmember income for three consecutive years therefore, no longer qualifies to be exempt.

Per § 277 of the Internal Revenue Code (Code), a non-exempt organization that is a membership organization is allowed a deduction for expenses that relate to the operation of the organization for its members. § 277(a) states that "In the case of a social club or other membership organization which is operated primarily to furnish services or goods to members, and which is not exempt from taxation, deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members shall be allowed only to the extent of income derived during such year from members or transactions with members (including income derived during such year from institutes and trade shows which are primarily for the education of members)".

When completing the Form 1120, the organization must divide the income and expenses between the member and nonmember activities. If there is a loss from the membership activity it cannot be used to offset the income from the nonmember activities. A loss on the member activity can be carried forward to a later year to be taken against member income.

Form 1120, U.S. Corporation Income Tax returns are due no later than the 15th day of the 4<sup>th</sup> month following the close of their tax year.

The Club will file the annual Form 1120 beginning in the tax year April 30, 20XX through March 31, 20XX, and in all future tax years. The exempt organization will submit Forms 1120 for tax years ending March 31, 20XX, March 31, 20XX to the Revenue Agent.