



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: **February 21, 2019**

Number: **201925020**
Release Date: 6/21/2019

Person to Contact:
Identification Number:
Contact Telephone Number:

UIL: 501.03-00

In Reply Refer to:
EIN:

CERTIFIED MAIL – Return Receipt Requested

Dear :

This is a final revocation letter as to your exempt status under section 501(c)(7) of the Internal Revenue Code. The Internal Revenue Service's recognition of your organization as an organization described in section 501(c)(7) is hereby revoked effective August 1, 20XX.

We have made this determination for the following reasons:

Your organization does not meet the criteria in Revenue Ruling 58-589, 1958-2, CB 266. Although you do not make your social and recreational facilities available to the public, your organization derives all its income from the rental of real property, and none from social activities for its members. A club which engages in business, such as renting its real property is not fulfilling the requirements for exemption under IRC section 501(c)(7).

Public Law 94-568 provides that social clubs are permitted to receive up to 35% of their gross receipts from sources outside of their membership without losing their tax-exempt status and that within that 35%, not more than 15% of gross receipts should be derived from the use of a social club's facilities or services by the general public.

Your investment income is derived from rental of the fraternity house owned by . Based on information on the Form 990-EZ, this is the only activity carried on by the fraternity.

As such, you failed to meet the requirements of I.R.C. section 501(c)(7), in that you failed to establish that you are operated exclusively for an exempt purpose.

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 July 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 section 7428 of the Internal Revenue Code.

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. Please contact the clerk of the respective court for rules and the appropriate forms regarding filing petitions for declaratory judgment by referring to the enclosed Publication 892. Please note that the United States Tax Court is the only one of these courts where a declaratory judgment action can be pursued without the services of a lawyer. You may write to the courts at the following addresses:

United States Tax Court
400 Second Street, NW
Washington, DC 20217


US Court of Federal Claims
717 Madison Place, NW
Washington, DC 20005

U. S. District Court for the District of Columbia
333 Constitution Ave., N.W.
Washington, DC 20001

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS 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, TAS will do everything possible to help you. Visit www.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,

Maria Hooke 

Maria Hooke
Director, EO Examinations

Enclosure:
Publication 892



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

Date:
September 12, 2018
Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact:

Employee ID:
Telephone:
Fax:
Manager's Contact Information:

Employee ID:
Telephone:
Response Due Date:

CERTIFIED MAIL – Return Receipt Requested

Dear _____ :

Why you're receiving this letter

We 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 Internal Revenue Code (IRC) Section 501(c)(7).

If you agree

If you haven't already, please sign the enclosed Form 6018, Consent to Proposed Action, and return it to the contact person shown at the top of this letter. We'll issue a final adverse letter determining that you aren't an organization described in IRC Section 501(c)(7) for the periods above.

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 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 IRS 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 IRS Appeals Office enough time to consider your case. For your protest to be valid, it must 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 Determination on Tax-Exempt Status.

Fast Track Mediation (FTM) referred to in Publication 3498, The Examination Process, generally doesn't apply now that we've issued this letter.

4. Request technical advice from the Office of Associate Chief Counsel (Tax Exempt Government Entities) 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 IRS Appeals Office, as explained above. A decision made in a technical advice memorandum, 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

The Taxpayer Advocate Service (TAS) is an independent organization within the IRS that can help protect your taxpayer rights. TAS 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, TAS will do everything possible to help you. Visit www.taxpayeradvocate.irs.gov or call 877-777-4778.

For additional information

You can get any of the forms and publications mentioned in this letter by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676).

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

Sincerely,

Maria Hooke
Director, Exempt Organizations
Examinations

Enclosures:
Form 886-A
Form 6018

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number	Year/Period ended July 31, 20XX

ISSUE

Whether _____ continues to qualify for exemption under Internal Revenue Code (IRC) §501(c)(7)

FACTS

_____, hereinafter referred to as _____, is a corporation organized in the state of _____ that was granted exemption under IRC §501(c)(7) in March 19XX. The club's fiscal year ends on the last day of July.

_____ purposes as stated in its Articles of Incorporation is as follows:

The particular objects for which this corporation is formed are to promote the intellectual, moral and social welfare of its members to accumulate funds with which to purchase and own real estate for the purpose of erecting and maintaining thereon a fraternity chapter house; to rent, mortgage, or sell said real estate of any part thereof as allowed by law; and for all other objects pertaining to the organization and maintenance of a college fraternity consistent with the statute under which this corporation is formed.

The organization's Form 990 states the primary exempt purpose is to provide fraternity housing for students.

_____ reported the following revenue on its Form 990-EZ for the year ended July 31, 20XX. Percentage of each type of overall revenue by type is also indicated below:

<u>REVENUE TYPE</u>	<u>AMOUNT</u>	<u>% of TOTAL</u>
Contributions / Gifts	0	0.0%
Investment Income	0	0.0%
TOTAL	<u>0</u>	<u>0.00%</u>

Investment income is derived from rental of the fraternity house owned by _____. Based on information on the Form 990-EZ this is the only activity carried on by the fraternity.

LAW

§501(c)(7) of the Internal Revenue Code exempts from income tax clubs organized for pleasure, recreation, and other non-profitable 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.

§1.501(c)(7)-1(a) of the Federal Tax Regulations states that 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

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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.

§1.501(c)(7)-1(b) of the Federal Tax Regulations states 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, 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.

Public Law 94-568 provides that social clubs are permitted to receive up to 35% of their gross receipts from sources outside of their membership without losing their tax-exempt status and that within that 35%, not more than 15% of gross receipts should be derived from the use of a social club's facilities or services by the general public.

Tax exempt organizations are subject to income tax on their net unrelated income. For most tax-exempt organizations, Internal Revenue Code section 512(a)(1) is the controlling code section with respect to unrelated business income ("UBI").

Section 512(a)(1) of the Internal Revenue Code states that except as otherwise provided in this subsection, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

Section 512(b) of the Code states that the modifications referred to in subsection (a) are the following: Section 512(b)(1): There shall be excluded all dividends, interest, payments with respect to securities loans (as defined in subsection (a)(5)), amounts received or accrued as consideration for entering into agreements to make loans, and annuities, and all deductions directly connected with such income

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Section 512(b)(2) of the Code states that there shall be excluded all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income.

Section 512(b)(3)(A) (i) of the Code states that there shall be excluded all rents from real property. For social clubs described in IRC 501(c)(7) (along with a few other code sections, not relevant here), UBI is governed by Internal Revenue Code section 512(a)(3), "Special rules applicable to organizations described in paragraph (7), (9), (17), or (20) of section 501(c)".

Section 512(a)(3)(A) states that in the case of an organization described in paragraph (7) of section 501(c), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), both computed with the modifications provided in paragraphs (6), (10), (11), and (12) of subsection (b). (Please note that the modification which excludes rental income from UBI is found in paragraph (3) of subsection (b), not in paragraphs (6), (10), (11) or (12) of subsection (b)).

In *Spokane Motorcycle Club v. United States*, 222 F.Supp. 151, the court ruled that refreshments, goods, and services furnished to members of a charitable, nonprofit corporation from business enterprise net profits constituted benefits inuring to individual members, and, therefore, corporation was not exempt from federal income tax. Judge Powell further stated, "But it is clear that when a club, otherwise exempt, engages in a business from which it derives profits from outside sources wholly disproportionate to its nontaxable purposes, and such profits inure to the benefit of its members in the nature of permanent improvements and facilities, it loses its exempt status under the definitive provisions of the statute. It should be noted that to be exempt from taxation, the club must not only be organized exclusively for pleasure, recreation and other non-profitable purposes, but it must be operated exclusively for those purposes as well."

In *Aviation Club of Utah v. Commissioner of Internal Revenue*, 162 F.2d 984, the court upheld the position taken by the tax court in a previous ruling whereby the income received by the club from non-exempt activities was so disproportionate to the income received from exempt purposes that the club lost its exempt status. Judge Murrah invoked the same concept as that in *Spokane Motorcycle Club v. United States*, whereby if a club engages in a business from which it derives profits from outside sources wholly disproportionate to nontaxable purposes, and such profits inure to the benefit of its members in the nature of permanent improvements and facilities, the club loses its exempt status. In Revenue Ruling 68-119, 1968-1 C.B. 268 an equestrian social club that holds an annual one-day steeplechase meet which is open to the general public is found to be tax-exempt under IRC 501(c)(7). In this case, the club is said to derive a small amount of income from nonmembers in excess of expenses attributable to their participation and attendance. If any profit results, it is turned over to charity. Other club activities are supported by member dues. Therefore, the ruling holds, the income from non-members does not inure to the club's members.

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In Revenue Ruling 58-589, 1958-2, CB 266 states the following: Section 1.501(c)(7)-1 of the Income Tax Regulations relating to the exemption of social clubs under section 501(a) of the Internal Revenue Code of 1954 reads as follows:

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

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 activity by a social club such as the solicitation by advertisements or otherwise of public patronage of its facilities may be averse to the establishment of an exempt status.

Therefore, to qualify for income tax exemption, a social club should not advertise its facilities for nonmember patronage since this would be prima facie evidence it was engaging in business. Likewise a social club should not engage in any type of business activity for profit which is designed to increase or which could result in an increase in net earnings inuring to the benefit of any shareholder or individual. Net earnings may inure to members in such forms as an increase in services offered by the club without a corresponding increase in dues or other fees paid for club support or as an increase in the club's assets which would be distributable to members upon the dissolution of the club.

TAXPAYER'S POSITION

The organization has not responded to correspondence or phone calls and as such its position on the proposed revocation is not known.

GOVERNMENT'S POSITION

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer	Tax Identification Number	Year/Period ended July 31, 20XX

The Club is not supported solely by membership fees, dues, assessments, and revenue from member use of club facilities, as contemplated by Treasury Regs. §1.501(c)(7)-1(b). In Revenue Ruling 68-119, 1968-1 C.B. 268 an equestrian social club that holds an annual one-day steeplechase meet which is open to the public is found to be tax-exempt under IRC 501(c)(7). In this case, the club is said to derive a small amount of income from nonmembers more than expenses attributable to their participation and attendance. If any profit results, it is turned over to charity. Other club activities are supported by member dues. Therefore, the ruling holds, the income from non-members does not inure to the club's members. In the case Alpha Upsilon most of its income is from unrelated, non-member income and therefore this Revenue Ruling does not apply.

The Club does not meet the criteria in Revenue Ruling 58-589, 1958-2, CB 266. Although the club does not make its social and recreational facilities available to the public, it derives all its income from the rental of real property and none from social activities for its members. A club which engages in business, such as renting its real property is not fulfilling the requirements for exemption under IRC section 501(c)(7).