



Department of the Treasury  
Internal Revenue Service  
P.O. Box 2508  
Cincinnati, OH 45201

Number: 202017037  
Release Date: 4/24/2020

Date:  
January 27, 2020  
Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

**UIL: 501.07-00, 501.07-05**

Dear \_\_\_\_\_ :

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(7) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

Sincerely,

Stephen A. Martin  
Director, Exempt Organizations  
Rulings and Agreements

Enclosures:

Notice 437

Redacted Letter 4034, *Proposed Adverse Determination under IRC Section 501(a) Other Than 501(c)(3)*

Redacted Letter 4040, *Final Adverse Determination under IRC Section 501(a) Other Than 501(c)(3) - No Protest*



Department of the Treasury  
Internal Revenue Service  
P.O. Box 2508  
Cincinnati, OH 45201

Date:  
December 4, 2019  
Employer ID number:

Contact person/ID number:

Contact telephone number:

Contact fax number:

**Legend:**

B = State  
C = Date  
D = Law  
E = Restaurant  
F = Company  
g percent = Amount  
H = County  
J = Individual  
k percent = Amount  
M = Number  
N = Number  
o dollars = Amount  
p dollars = Amount

**UIL:**

501.07-00  
501.07-05

Dear :

We considered your application for recognition of exemption from federal income tax under Internal Revenue Code (IRC) Section 501(a). We determined that you don't qualify for exemption under IRC Section 501(c)(7). This letter explains the reasons for our conclusion. Please keep it for your records.

**Issues**

Do you qualify for exemption under IRC Section 501(c)(7)? No, for the reasons stated below.

**Facts**

You were incorporated in the state of B on C. You are incorporated as a nonprofit corporation formed for "any lawful purpose." Your Bylaws state that you are organized for social, civic, and benevolent purposes including for the purpose of forming a private club under the D law. D is the law in B concerning requirements for private club alcohol licenses. Furthermore, you will provide social interaction, service of food and alcoholic beverages and may provide other forms of entertainment for club members.

You provide recreational opportunities for your members where they can meet and discuss their social and family issues. In addition, you provide a forum where members will discuss participation in community services. Your facility is located within the already established local restaurant, E, that is open to the public. E is owned by F. You have entered into a management agreement with F to provide food to your members.

The only qualification necessary to become a member is to be 21 years old or older and be a resident of H County. You have two membership options in accordance with the D law. A preliminary membership in which a member has all of the privileges of a member for at least \_\_\_\_\_ days. The membership committee must vote on whether or not to approve the member within \_\_\_\_\_ days. You also have non-preliminary members which must be voted on and accepted by the membership committee prior to being served alcohol. There are M preliminary memberships available. You stated that this number remains below the amount set by D because the new members become inactive after \_\_\_\_\_ months of no activities. The original N members stay active, but the preliminary members fluctuate. The membership fee assessed to preliminary members is p dollars, which includes a drink. You charge a service fee by the glass, which covers the upkeep of the club and related expenses.

Your preliminary membership application solicits basic biographical information including name, address, date of birth, phone number, and occupation. The application also includes the statement under the signature line that the applicant wishes to consume alcoholic beverages upon completing the application.

Your Bylaws state that the initial liquor purchase shall be made from the promissory note agreed upon by your initial charter members. You have obtained a zero percent interest loan from F to purchase the initial inventory of liquor. The loan agreement with F is signed by J as both President of F and as your President.

Future purchases will be made up of equal contributions from the members derived from charges for alcoholic beverages. Alcoholic beverages are required under B state law to be owned by the members. This is accomplished by members pooling their money and purchasing the alcoholic beverages served in the club. Money is pooled by the members through the assessment of the service fee. A pool system of storage will be used whereby a set percent of charges will be deposited into the liquor pool account. The initial percentage you have selected, k percent, may be adjusted if needed.

Your facility is located within E, a restaurant that does not have a permit to sell alcohol. The D law states that because you and E are located in one premise only one permit can be issued. You do not meet in a designated or reserved area of E. Any individual that is aged 21 or older resides in H County, and is ordering food at E can immediately become a preliminary member. You open at \_\_\_\_\_ a.m. each day and close at \_\_\_\_\_ p.m., except on weekends when you close at \_\_\_\_\_ p.m.

The management agreement between you and F states that it is entered into pending authorization of the liquor commission. The duties of the manager under the agreement include furnishing adequate facilities to serve alcoholic beverages and provide food service, insuring liquor stock is replenished, prompt bill payment, and proper record keeping of cash and membership. The manager's compensation is set at a rate of g percent of gross revenue. The agreement is signed by J as both President of F and as your President.

You have also entered into a commercial sub-lease agreement with F for the use of E. Rent is g percent of gross revenue not to exceed o dollars per month, plus a portion of the property taxes. The agreement states that the

property will be used for carrying on food business or trade/activity of any kind. The agreement is signed by J as both President of F and as your President.

Your revenue is derived solely from the sale of alcoholic beverages to members. Your expenses consist of management fees, rent, liquor license fees, and the cost of alcoholic beverages.

### **Law**

IRC Section 501(c)(7) provides for the exemption from federal income tax of clubs organized and operated 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.

Treasury Regulation Section 1.501(a)-1(c) provides that the term "private shareholders or individuals" refers to persons having a personal and private interest in the activities of the organization.

Treas. Reg. Section 1.501(c)(7)-1(b) 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).

Revenue Ruling 58-588, 1958-2 C.B. 265, found that a social club that sells an unlimited number of memberships to so-called "members," who have no voice in the management of the club and whose only rights are to use the club's facilities upon payment of specified fees, is not a tax-exempt social club within the meaning of IRC Section 501(c)(7). Income from the members was, in reality, income from the general public.

Rev. Rul. 58-589, 1958-2 C.B. 266, discusses the various criteria for recognition of exemption under IRC Section 501(c)(7) of the Code. In order to establish that a club is organized and operated for pleasure, recreation, and other non-profitable purposes, "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."

Rev. Rul. 66-225, 1966-2 C.B. 227, determined that a nonprofit organization which provides entertainment to its members does not qualify for exemption under IRC Section 501(c)(7) where it is controlled by a taxable corporation and operated as an integral part of such corporation's business.

Rev. Rul. 69-635, 1969-2 C.B. 126, found 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 IRC Section 501(c)(7). The basis for this conclusion is the fact the club had no significant commingling of its members.

In Chattanooga Automobile Club v. Commissioner, Warren Automobile Club, Inc. 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 IRC Section 101(9) of 1939 as social clubs because the members of these clubs did not commingle.

In Keystone Automobile Club v. Commissioner, 181 F.2d 402 (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 IRC Section 101(9) for a number of reasons one of which was because they saw no evidence of the commingling of members.

### **Application of law**

You do not qualify for exemption under IRC Section 501(c)(7) because you are not organized and operated for pleasure, recreation, or other nonprofitable purposes. You do not meet the requirements in Treas. Reg. Section 1.501(c)(7)-1(b) which states, in part, that if a club engages in business, such as making its social and recreational facilities available to the general public, it is not exempt under Section 501(a).

You also do not meet the requirements of IRC Section 501(c)(7) because your earnings are inuring to J through F. As provided in Treas. Reg. Section 1.501(a)-1(c) the term "private shareholders or individuals" refers to persons having a personal and private interest in the activities of the organization. Your tax-exempt status will enable you to apply for and obtain an alcohol license as a private club. F is owned by J as evidenced by your loan, management, and sub lease agreements. F is willing to loan you start up funds because the restaurant, E, will benefit. In addition, your management agreement with F is contingent upon you getting a private club alcohol license in accordance with B state law. The lease agreement provision that F gets g percent of gross alcohol sales as well as the comprehensive management agreement showing F gets another g percent of gross alcohol sales. Finally, the agreements with F were not negotiated at arm's length as substantiated by the fact that J signed the agreements on your behalf as well as on F's behalf. Inurement is evident through the arrangements which benefit J's restaurant.

You are similar to the organizations described in Rev. Rul. 58-588 and Rev. Rul. 58-589. Like the organizations in these rulings, social activities are not one of your primary purposes, but are merely incidental to the purpose of engaging in the sale of alcohol to the general public. Anyone can become a member by meeting the minimum age and residency requirements. Therefore, income from your members is, in reality, income from the general public, as most of your "members" are not bone fide members.

You are also like the organization in Rev. Rul. 66-225. You were organized by J as an integral part of E's business so that E can benefit from your alcohol license to increase sales. Your sole activity is the sale of alcoholic beverages to your members under a contract with F, who owns E, a restaurant that is open to the general public. Your activities are conducted at E, where you do not have a designated or reserved space. F also provides food to your members at E. Any individual who is of legal drinking age, resides in H County, and is eating at E may immediately become a member and purchase alcohol by paying a fee of p dollars. The fact that you have very limited requirements for membership and will issue preliminary memberships that only last for seven days demonstrates you are not operating exclusively for pleasure, recreation, and other non-profitable purposes.

Like the organization described in Rev. Rul. 69-635, you are primarily providing services with insignificant or no commingling. You do not have a designated or reserved space in E for your members to commingle. By operating in such a way, you do not qualify for exemption under IRC Section 501(c)(7).

You are like the organizations described in Chattanooga Automobile Club, Warren Automobile Club, Inc., and Keystone Automobile Club. You have not demonstrated that members have any interaction other than being at the same location to purchase alcohol. There is no common interest among your members and your social activities are only incidental. Because you have demonstrated very little, if any, personal contact among members and there is no expectation of personal contact among members, commingling is not a substantial part of your activities. Therefore, you are not primarily operating in accordance with IRC Section 501(c)(7).

### **Your position**

You say that you are established not only to serve alcohol to members, but also a place for them to gather and interact with each other on matters of mutual concern. While F sells food for a profit, your members own the alcohol inventory. You believe you qualify for exempt status as a social club because you have limited membership, are organized for pleasure, recreation and other non-profit purposes, and you provide a place for members to commingle. In addition, you don't operate like a business because you serve your members at replacement cost which also covers your expenses. Finally, you do not have a written policy that discriminates against individuals seeking membership.

### **Our response to your position**

While you do charge your members fees based on replacement cost, rather than a profit margin, you do not qualify for exemption under IRC Section 501(c)(7). You do not have bone fide members engaging in the requisite commingling activities. In addition, your net earnings inure to the benefit of J through your agreement with F.

### **Conclusion**

Based on the information provided, we conclude that you are not operated for pleasure, recreation, or other nonprofitable purposes described in IRC Section 501(c)(7). Any such activities that you engage in are merely incidental to the purpose of serving alcoholic beverages to individuals dining at E. You do not meet the membership and commingling requirements for organizations qualifying for exemption under Section 501(c)(7). Furthermore, your net earnings inure to insiders through your contracts. Accordingly, you do not qualify for recognition of exemption under Section 501(c)(7).

### **If you agree**

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

### **If you don't agree**

You have a right to protest if you don't agree with our proposed adverse determination. To do so, send us a protest within 30 days of the date of this letter. You must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A statement of the facts, law, and arguments supporting your position
- A statement indicating whether you are requesting an Appeals Office conference
- The signature of an officer, director, trustee, or other official who is authorized to sign for the

organization or your authorized representative

- The following declaration:

**For an officer, director, trustee, or other official who is authorized to sign for the organization:**

Under penalties of perjury, I declare that I have examined this request, or this modification to the request, including accompanying documents, and to the best of my knowledge and belief, the request or the modification contains all relevant facts relating to the request, and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, Power of Attorney and Declaration of Representative, with us if they haven't already done so. You can find more information about representation in Publication 947, Practice Before the IRS and Power of Attorney.

We'll review your protest statement and decide if you gave us a basis to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't given us a basis for reconsideration, we'll send your case to the Appeals Office and notify you. You can find more information in Publication 892, How to Appeal an IRS Decision on Tax-Exempt Status.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court later because the law requires that you use the IRC administrative process first (IRC Section 7428(b)(2)).

**Where to send your protest**

Send your protest, Form 2848, if applicable, and any supporting documents to the applicable address:

U.S. mail:

Internal Revenue Service  
EO Determinations Quality Assurance  
Mail Stop 6403  
P.O. Box 2508  
Cincinnati, OH 45201

Street address for delivery service:

Internal Revenue Service  
EO Determinations Quality Assurance  
550 Main Street, Mail Stop 6403  
Cincinnati, OH 45202

You can also fax your protest and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that they received it.

You can get the forms and publications mentioned in this letter by visiting our website at [www.irs.gov/forms-pubs](http://www.irs.gov/forms-pubs) or by calling 800-TAX-FORM (800-829-3676). If you have questions, you can contact the person listed at the top of this letter.

**Contacting the Taxpayer Advocate Service**

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 if 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](http://www.taxpayeradvocate.irs.gov) or call 877-777-4778.

Sincerely,

Stephen A. Martin  
Director, Exempt Organizations  
Rulings and Agreements