DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
1100 Commerce Street, MC 4920DAL
Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: **202052035**
Release Date: 12/24/2020

UIL: 501.07-00

Date: August 6, 2020
Taxpayer ID Number:

Form:

For Tax Period(s) Ending:

Person to Contact:

Identification Number:

Telephone Number:

Fax Number:

CERTIFIED MAIL – Return Receipt Requested
LAST DAY FOR FILING A PETITION WITH THE TAX COURT:

Dear :

This is a final determination explaining why your organization does not qualify as an organization described in Internal Revenue Code (IRC) section 501(c)(7) for the tax period(s) listed above.

In the future, if you believe your organization qualifies for tax-exempt status and would like a determination letter from the Internal Revenue Service, you can request a determination by filing Form 1024, Application for Recognition of Exemption Under Section 501(a), or Form 1024-A, Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code (as applicable) and paying the required user fee.

Our adverse determination as to your exempt status was made for the following reasons:

> You do not meet the requirements for exemption under IRC section 501(c)(7). You meet neither the gross income test nor the facts and circumstances test. You receive the majority of your income from sources outside of your membership by engaging in substantial, nontraditional, recurring trade or business activity outside of your membership. Therefore, you do not operate substantially for pleasure, recreation, or other nonprofitable purposes.
>
> We propose to disqualify your self-declared tax-exempt status under IRC section 501(c)(7) for the years ending December 31, 20XX and December 31, 20XX.

Organizations that are not exempt under IRC Section 501 generally are required to file federal income tax returns and pay tax, where applicable. For further instructions, forms, and information please visit www.irs.gov.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of IRC Section 7428 in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules and the appropriate forms for filing petitions for declaratory judgment by referring to the enclosed Publication 892. You may write to the courts at the following addresses:

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

U.S. Court of Federal Claims
717 Madison Place, NW
Washington, DC 20439

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

Processing of income tax returns and assessments of any taxes due will not be delayed if you file a petition for declaratory judgment under IRC Section 7428.

You may 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. 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.

Taxpayer Advocate assistance can't be used as substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determination, nor extend the time fixed by law that you have to file a petition in 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 can get any of the forms or publications mentioned in this letter by calling 800-TAX-FORM (800-829-3676) or visiting our website at www.irs.gov/forms-pubs.

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

Sincerely,

Sean E. O'Reilly

Sean E. O'Reilly
Director, EO Examinations

Enclosures:
Publication 892

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

Date:
December 10, 2019
Taxpayer ID number:

Form:

Tax periods ended:

Person to contact:
Name:
ID number:
Telephone:
Fax:
Address:

Manager's contact information:
Name:
ID number:
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 your organization doesn't qualify as an organization described in Internal Revenue Code (IRC) Section 501(c)(7).

This letter is not a determination of your tax-exempt status under IRC Section 501 for any period other than the tax periods above.

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.

In the future, if you believe your organization qualifies for tax-exempt status and would like a status determination letter from the IRS, you can request a determination by filing Form 1024, Application for Recognition of Exemption Under Section 501(a), and paying the required user fee.

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,

Denise Gonzalez for

Maria Hooke
Director, Exempt Organizations
Examinations

Enclosures:
Form 886-A
Form 6018
Publication 892
Publication 3498

ISSUE

Whether the qualifies for self-declared tax-exempt status under Internal Revenue Code (IRC) section 501(c)(7) when it derives significant income from a substantial, nontraditional, ongoing business activity outside of its membership.

FACTS

The , hereinafter referred to as the Club, was formed as an association in the . The Club has never been issued a determination letter by the Internal Revenue Service (IRS) and has been filing its exempt organization returns as a self-declared organization since . The Club's calendar year ends on December 31.

The Club provides pleasure and recreation to hunters and marksmen in the practical shooting of firearms. Additionally, its activities include education in the use of firearms as well as the promotion of natural resource conservation. Its educational activities include presentations by its members and state/local officials about firearm use and safety. Its conservation activities include being a good steward of its land as well as participating in an ongoing program directed by the Department of Natural Resources where the efficacy of a treatment for an invasive tree species is being tested.

The Club is a membership organization that has active members and retired members possessing the same voting rights. The use of the Club is for members and bona fide guests.

The Club receives modest amounts of income from membership dues, interest earned on deposits in a savings account. and land rented for crop production. Its primary income source is royalties from the leasing of its land

LAW

Prior to its amendment in 1976, IRC section 501(c)(7) provided exemption from federal income tax for social clubs organized exclusively for pleasure, recreation, and other nonprofitable purposes where no part of the club's net earnings inures to the benefit of any private shareholder. Subsequently, Public Law 94-568 amended the "exclusive" provision to read "substantially' in order to allow an IRC § 501(c)(7) organization to receive up to 35 percent of its gross receipts, including investment income, from sources outside its membership without losing its tax-exempt status. The Committee Reports for Public Law 94-568 (Senate Report No. 94-1318 2d Session, 1976-2 C.B. 597) further states;

(a) Within the 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. This means that an exempt social club may receive up to 35 percent of its gross receipts from a combination of investment income and receipts from nonmembers, so long as the latter do not represent more than 15 percent of total receipts.

(b) Thus, a social club may receive investment income up to the full 35 percent of its gross receipts if no income is derived from nonmembers' use of club facilities.

(c) In addition, the Committee Report states that where a club receives unusual amounts of income, such as from the sale of its clubhouse or similar facilities, that income is not to be included in the 35 percent formula.

The Committee Reports for Public Law 94-568 state that it is not "intended that these organizations should be permitted to receive, within the 15 or 35 percent allowances, income from the active conduct of businesses not traditionally carried on by these organizations." This language means that Congress intended that exempt social clubs should not be permitted to receive income from activities not conducted in furtherance of their exempt purposes. Therefore, a club that engages in nontraditional business activity can jeopardize its exempt status even when its gross receipts are within the permissible limits.

Revenue Ruling 58-589, 1958-2 C.B. 266 states that a social club's business activity will defeat exemption unless such activity is incidental, trivial or nonrecurrent; which the IRS has interpreted to mean "insubstantial" for this purpose.

Treasury Regulation 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 nonprofitable purposes, and is not exempt under section 501(a). However, an incidental sale of property will not deprive a club of its exemption.

Revenue Ruling 66-149, 1966-1 C.B. 146 provided that a social club is not exempt from federal income tax as an organization described in IRC section 501(c)(7) if it regularly derives a substantial part of its income from nonmember sources such as, for example, dividends and interest on investments. In this instance, the club's funds were invested primarily for the purpose of producing income through dividends, interest, or capital appreciation. It was evident that 1) such income was regularly derived from nonmember sources, 2) that the income was received in fulfillment of and pursuant to a profit motive, and 3) that the income from investments was substantial in relation to total income.

Revenue Ruling 69-220, 1969-1 C.B. 154 held that a social club that receives a substantial portion of its income from the rental of property and uses such income to defray operating expenses and to improve and expand its facilities is not exempt under IRC section 501(c)(7).

Santee Club v. White, 87 F. 2d 5 (1936) held that, where a club engages in income producing transactions which are not a part of the club purposes, exemption will not be denied because of incidental, trivial, or nonrecurrent activities such as sales of property no longer adapted to the club's purpose.

National Mah Jongg League v. U.S., 75 F. Supp. 769 (1947) stated that a corporation that was organized for the purpose of promoting the game of Mah Jongg; where its income from memberships was insufficient to meet expenses and where the corporation engaged in the commercial enterprise of selling to the public lists and tiles where the income therefrom enabled the corporation to meet its deficit, carry on without an increase of dues or curtailment of operations, and accumulate a surplus which was donated to charity, was not operated exclusively for social purposes or charitable purposes. Therefore, the corporation was not exempt from federal income tax under IRC section 501(c)(7) or IRC section 501(c)(3).

United States of America v. Fort Worth Club of Fort Worth, Texas, 345 F. 2d 52, 57 (5th Cir. 1965) held that a social club which derived over half of its receipts, in amounts of hundreds of thousands of dollars, from profitable outside business was not exempt from federal income taxes on grounds it was organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes. The court declared that for a social club to qualify for exemption under IRC section 501(c)(7), its outside profits must be 1) strictly incidental to club activities, not a result of an outside business, and 2) either negligible or nonrecurring

GOVERNMENT'S POSITION

Utilizing the guidance provided in Public Law 94-568, as well as previous revenue rulings and court cases, the Service prescribes two tests that a club can use to demonstrate it is organized substantially for pleasure, recreation, and other nonprofitable purposes; a "gross receipts" test and a "facts and circumstances" test.

- The gross receipts test is an income test where its limitations reflect those of Public Law 94-568:
    - Clubs may receive up to 35 percent of their gross receipts, including investment income, from sources outside of their membership
    - Within the 35 percent limitation, no more than 15 percent of gross receipts may be derived from nonmember use of club facilities and/or services

  If a club's income sources are within these limits, the club will be considered to be operated substantially for pleasure, recreation, and other nonprofitable purposes.

- If a club's income sources are outside of the limits of the gross receipts test, then the club may still be able to show through facts and circumstances that substantially all of its activities are for pleasure, recreation, and other nonprofitable purposes.

The Club's testing results are as follows:

20XX

- Gross Receipts Test – fail
    - 0 = gross receipts from sources outside of the club's membership
    - 0 = total gross receipts
    - 0 / 0 = 0%
- Facts and Circumstances Test – fail
    - For a social club, the leasing of land for
        - is a nontraditional business activity
        - is an ongoing/recurring business activity
        - is not an insubstantial business activity
        - does not further an exempt purpose

20XX

- Gross Receipts Test – fail
    - 0 = gross receipts from sources outside of the club's membership
    - 0 = total gross receipts
    - 0 / 0 = 0.00%
- Facts and Circumstances Test – fail
    - For a social club, the leasing of land for

Form **886-A** (May 2017)	Department of the Treasury – Internal Revenue Service **Explanations of Items**		Schedule number or exhibit
Name of taxpayer		Tax Identification Number *(last 4 digits)*	Year/Period ended December 31, 20XX December 31, 20XX

- is a nontraditional business activity
- is an ongoing/recurring business activity
- is not an insubstantial business activity
- does not further an exempt purpose

The Club is like the organization in Revenue Ruling 66-149 that did not qualify for exemption under IRC section 501(c)(7) because it regularly derives income from nonmember sources that is substantial in relation to its total income.

The Club is like the organization in Revenue Ruling 69-220 that did not qualify for exemption under IRC section 501(c)(7) because it receives a substantial portion of its income from sources other than members.

The Club is not similar to the organization in Santee Club v. White because its royalties from its oil and gas lease are not incidental, not trivial and are recurring.

The Club is similar to the organization in National Mah Jongg League v. U.S because the majority of the Club's revenue is from oil and gas lease royalties where its royalty income exceeds the income from its members many times over. The revenue from royalties is recurring and more than incidental. While the Club may have been organized for pleasure, recreation, and other nonprofitable purposes, its revenues show that it is not operating for these purposes.

Per United States of America v. Fort Worth Club of Fort Worth, Texas, the Club's royalty income must be incidental to the Club's activities and either negligible or nonrecurring. Instead, the Club's royalty income is both recurring and substantial.

As prescribed in Treasury Regulation section 1.501 (c)(7)-1 (b), the Club is engaging in business activities and is therefore not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes.

TAXPAYER'S POSITION

In , the Club recognized it no longer qualified as exempt under IRC section 501(c)(7). As a result, it filed a 20XX Form 1120, U.S. Corporation Income Tax Return, with the IRS; and intended to do the same in future years. However, the IRS returned this 20XX Form 1120 to the Club with correspondence indicating that the Club must continue filing Form 990-series returns because it was a tax-exempt organization. Therefore, the Club continued filing Form 990-series returns along with their related Forms 990-T, Exempt Organization Business Income Tax Return.

The Club has not yet been presented with this report. However, it has communicated that it agrees with the disqualification of its tax-exempt status under IRC section 501(c)(7).

CONCLUSION

The Club does not meet the requirements for exemption under IRC section 501(c)(7). It meets neither the gross income test nor the facts and circumstances test. The Club receives the majority of its income from sources outside of its membership by engaging in a substantial, nontraditional, recurring trade or business. Therefore, the Club does not operate substantially for pleasure, recreation, or other nonprofitable purposes.

We propose to disqualify the Club's self-declared tax-exempt status under IRC section 501(c)(7) for the years ending December 31, 20XX and December 31, 20XX.