



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

Date: April 12, 2021

Taxpayer ID number:

Form:

Tax periods ended:

Person to contact:

Name:

ID number:

Telephone:

Fax:

Number: 202216022

Release Date: 4/22/2022

UIL: 501.07-00

CERTIFIED MAIL RETURN RECEIPT REQUESTED

Dear _____ :

Why we are sending you this letter

This is a final determination explaining why your organization doesn't qualify as an organization described in Internal Revenue Code (IRC) Section 501(c)(7) for the tax periods 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: During the tax year in question, you did not qualify for exemption as a social club described in IRC Section 501(c)(7) because your gross receipts have consistently exceeded the limitation of 35%, including investment income, from sources outside of your membership.

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.

What you must do if you disagree with this determination

If you want to contest our final determination, you have 90 days from the date this determination letter was mailed to you to file a petition or complaint in one of the three federal courts listed below.

How to file your action for declaratory judgment

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.

Please contact the clerk of the appropriate court for rules and the appropriate forms for filing an action for declaratory judgment by referring to the enclosed Publication 892, How to Appeal an IRS Determination on Tax-Exempt Status. 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.

Information about the IRS Taxpayer Advocate Service

The IRS office whose phone number appears at the top of the notice can best address and access your tax information and help get you answers. However, you may be eligible for free help from the Taxpayer Advocate Service (TAS) if you can't resolve your tax problem with the IRS, or you believe an IRS procedure just isn't working as it should. TAS is an independent organization within the IRS that helps taxpayers and protects taxpayer rights. Contact your local Taxpayer Advocate Office at:

Or call TAS at 877 777 4778 For more information about TAS and your rights under the Taxpayer Bill of Rights, go to taxpayeradvocate.irs.gov. Do not send your federal court pleading to the TAS address listed above. Use the applicable federal court address provided earlier in the letter. Contacting TAS does not extend the time to file an action for declaratory judgment.

Where you can find more information

Enclosed are Publication 1, Your Rights as a Taxpayer, and Publication 594, The IRS Collection Process, for more comprehensive information.

Find tax forms or publications by visiting www.irs.gov/forms or calling 800-TAX-FORM (800-829-3676).

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

If you prefer to write, use the address shown at the top of this letter. Include your telephone number, the best time to call, and a copy of this letter.

Keep the original letter for your records.

Sincerely,



Sean E. O'Reilly

Director, Exempt Organizations Examinations

Enclosures:

Publication 1

Publication 594

Publication 892



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

Date: 2/21/2020

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 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 800-829-4178.

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,

For Maria Hooke
Director, Exempt Organizations Examinations

Enclosures:
Form 886-A
Form 6018

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

ISSUE: Does the Social Club fail the Gross Receipts Test and Non-member income?

FACTS:

is a social club that currently has an assigned status as a 501(c)(7) Social Club. They received their tax-exempt designation in 19xx. Since that time has entered into a agreement with an exploration company in 20xx. As part of this agreement to lease the of their property, they receive royalty revenue on a monthly basis. While the royalty revenue has been declining, it is still a substantial part of the income received by the social club. Its royalty revenue accounted for almost % of the total revenues in the tax period ended , 20xx. Prior and subsequent years, with slight deviation, also received substantial non-member income from these royalties. has been filing returns and paying taxes on these Royalties. There is currently no termination date for when these royalties will cease or be reduced to a much lower level.

Non-Member Income Calculation from		Return
Tax Period Ended / /20xx		Amount
Name		
Royalties		\$.
15/35% Income Issue		
Exempt Org Income		
Member Dues	\$.	Non-Member Royalties
Interest	\$.	Revenue Percentage
Royalties	\$.	. %
Adjusted income	\$.	

LAW

IRC 501(c)(7) lists a type of organization exempt from federal income tax under section 501(a) described as clubs organized for pleasure, recreation, and other non-profitable purposes.

Treas. Reg. 1.501(c)(7)-1 provides that section 501(c)(7) organizations are those 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 recreation clubs which are supported solely by membership fees, dues, and assessments.

Rev. Rul. 66-149, 1966-1 C.B. 146, held a social club is not exempt from Federal income tax under IRC 501(c)(7) of the Code where it regularly derives a substantial part of its income from nonmember sources, such as dividends and interest on investments that it owns.

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
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Rev. Rul. 69-220, 1969-1 C.B. 154, held 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 section 501(c)(7) of the Code. Public Law 94-568, indicates that social clubs may receive some outside income, including investment income, without losing their exempt status and permit them to derive a higher percentage of gross receipts from the use of their facilities and services by nonmembers than would have been permitted under published Service guidelines. The law allows organizations to receive up to 35 percent of their gross receipts, including investment income, from sources outside their membership without losing their exempt status. Within this 35 percent, not more than 15 percent of gross receipts should be non member income. Gross receipts are defined as: "...those receipts from normal and usual activities of the club (that is, those activities they had traditionally conducted) including charges, admissions, membership fees, dues, assessments, investment income (such as dividends, rents and similar receipts) contributions."

If the club earns more than is permitted under this law, a facts and circumstances test will be applied.

In Coastal Club, Inc., 43 T.C. 783 (1965), the Tax Court held a corporation organized as a duck-hunting club which repeatedly leased its property for the exploration for and the production of oil and gas was not exempt from income tax under section 501(c)(7). The Court noted that the oil and gas lease income exceeded the amounts received from its members in the form of dues and service and guest charges and also supplied more than half of the amounts required and expended for operations, repairs, maintenance, and improvements, the Court felt that if the petitioner were held exempt under the statute, such holding would attribute an intent to Congress that in enacting section 501(c)(7), Congress had not intended. Its opinion held that the facts show not only were the leasing activities not incidental or related to those purposes but in disregard thereof they were entered 'for the purpose of profit' and that the profits therefrom have been both regularly recurring and substantial.

In Pittsburgh Press Club v. U.S., 536 F.2d 572 (1976); 579 F.2d 751 (1978); and 615 F.2d 600 (1980), the court found that a substantial portion of the club's total gross receipts was from nonmember use of club facilities (determined to be between 11–17% of gross income). This indicated to the court that the club was engaged in business with the general public. Other factors noted by the court to consider in addition to the level of nonmember income include the purposes for which the club's facilities were made available to nonmember groups, the frequency of use of the club facilities by nonmembers, and the amount of net profits derived from the nonmember income.

Rev. Rul. 58-589, 1958-2 C.B. 266, To meet the first requirement, 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.

Form 886-A (May 2017)	Department of the Treasury – Internal Revenue Service Explanations of Items	Schedule number or exhibit
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Rev. Rul. 55-716, 1955-2 C.B. 263, states face to face interaction is important for members of a social club. Organizations that do not afford opportunities for personal contact among members, (or there is such contact, but it is incidental to the primary purpose) are not entitled to exemption even though organized not for profit with no part of their earnings inuring to the benefit of shareholders.

The cited Code and Regulations above, provide criteria for recognition of a tax-exempt organization under IRC 501(c)(7). Generally, an organization is to be organized and operated exclusively for pleasure, recreation, and other nonprofit purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder.

In the case of the organization under examination, it was granted exemption, in _____, as a social club, under IRC 501(c)(7) to acquire _____. At the time of recognition, it appears to have met the requirements of Tres. Reg. 1.501(c)(7)-1 at time of application.

The cited revenue rulings and case law provide precedent as to how an organization can, based on its activities and sources of income, be denied recognition of exemption or have their tax-exempt status revoked.

As outlined in Rev. Rul. 66-149 and Rev. Rul. 69-220, a social club is not exempt from federal income tax where the organization derives a substantial part of its income from nonmember sources.

P.L. 94-568, states an organization is allowed to receive up to 35% of its gross receipts, including investment income, from nontraditional business activities without losing its exempt status. Within the 35%, not more than 15% of gross receipts should be nonmember income. If an organization earns more than permitted, a facts and circumstance test is applied.

Nontraditional business activities are activities that don't further the pleasure or recreation or other nonprofitable exempt purposes of a social club, even if conducted solely on a membership basis. Social clubs may lose or be denied their tax-exempt status if the nontraditional business activities are not incidental, trivial, or nonrecurrent.

It is not intended that Section 501(c)(7) 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. See S. REP. 94-1318, 4, 1976 U.S.C.C.A.N. 6051, 6054.

In the case of Coastal Club, Inc., a duck hunting club, which leased its property for the exploration of and the production of oil and gas, the Court held that "for the years before us petitioner was not operated exclusively for pleasure, recreation, and other nonprofitable purposes within the meaning of the statute...the petitioner on brief concedes that its oil and gas income has

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made it possible for Coastal Club to operate and maintain its hunting facilities for the use of its members and their guests, and to make improvements, without the necessity of raising its dues or increasing its charges to members. And the facts show, as noted, that this has been so even though the club expenditures have ranged from approximately two to five times the total of dues and other charges to members.” In the Court’s opinion it stated, “the club members were to a most substantial extent enjoying a free ride from the nonrecreational use of their properties.”

GOVERNMENT’S POSITION

The facts provided about the organization under examination are that the entity receives over % of its income from royalties from This has gone on for almost years

Based on the general facts provided, the subject case under examination closely mirrors the Coastal Club case. Receipt of over % of the organization’s gross receipts from nonmember investment income appears to exceed the 35/15 percent threshold outlined in P.L. 94-568.

Based on the case law provided, royalties should be included in the calculation of the non-member income test. A 501(c)(7) does not receive an exception as passive income for this as do other entities. This is evident in the case law or revenue rulings pertinent to the 35/15% test based on royalties (particularly or royalties). Since exceeds the 35/15 percent test and the facts and circumstances test is failed, then that is grounds for revocation. Failure of this non-member income test indicates that no longer meets the legal requirements of a tax-exempt organization under IRC 501(c)(7) and may be revoked.

CONCLUSION

It appears that the income of this organization exceeds the allowable limits on non-member income for an organization to be exempt from taxation under IRC 501(c)(7). As a result, the organization fails to meet the requisite legal requirements for exemption under IRC 501(c)(7).