



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

Release Number: 202323012
Release Date: 6/9/2023
UIL Code: 501.07-00

Date:
02/24/2023
Taxpayer ID number (last 4 digits):

Form:

Tax periods ended:

Person to contact:
Name:
ID number:
Telephone: () -
Fax: () -
Last day to file petition with United States
Tax Court:
5/25/2023

CERTIFIED MAIL - Return Receipt Requested

Dear :

Why we are sending you this letter

This is a final determination that you don't qualify for exemption from federal income tax under Internal Revenue Code (IRC) Section 501(a) as an organization described in IRC Section 501(c)(7), for the tax periods above. Your determination letter dated , , is revoked.

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

You have not established that you are organized and operated exclusively for an exempt purpose within the meaning of IRC Section 501(c)(7). You have made your social and recreational facilities available to the general public, and your nonmember income has exceeded the 15% and 35% threshold as outlined in Public Law 94-568 for tax years ending , , and . As a result, you are not operating substantially for pleasure, recreation, or other non-profitable purposes.

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 **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 can file an action for declaratory judgment under the provisions of Section 7428 of the Code in either:

- The United States Tax Court,
- The United States Court of Federal Claims, or
- The United States District Court for the District of Columbia

You must file a petition or complaint in one of these three courts within 90 days from the date we mailed this determination letter to you. You can download a fillable petition or complaint form and get information about filing at each respective court's website listed below or by contacting the Office of the Clerk of the Court at one of the addresses below. Be sure to include a copy of this letter and any attachments and the applicable filing fee with the petition or complaint.

You can eFile your completed U.S. Tax Court petition by following the instructions and user guides available on the Tax Court website at ustaxcourt.gov/dawson.html. You will need to register for a DAWSON account to do so. You may also file your petition at the address below:

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

The websites of the U.S. Court of Federal Claims and the U.S. District Court for the District of Columbia contain instructions about how to file your completed complaint electronically. You may also file your complaint at one of the addresses below:

US Court of Federal Claims
717 Madison Place, NW
Washington, DC 20439
uscfc.uscourts.gov

US District Court for the District of Columbia
333 Constitution Avenue, NW
Washington, DC 20001
dcd.uscourts.gov

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.

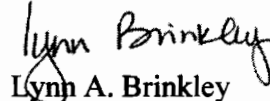
Find tax forms or publications by visiting irs.gov/forms or calling 800-TAX-FORM (800-829-3676). If you have questions, you can call the person shown at the top of this letter.

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.

You may fax your documents to the fax number shown above, using either a fax machine or online fax service. Protect yourself when sending digital data by understanding the fax service's privacy and security policies.

Keep the original letter for your records.

Sincerely,



Lynn A. Brinkley

Director, Exempt Organizations Examinations

Enclosures:

Publication 1

Publication 594

Publication 892



Address:

12/09/2021

:

Letter 3618 (Rev. 8-2019)
Catalog Number 34809F

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.

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,

Oscar E. Salcido

Sean O' Reilly

Director, Exempt Organizations Examinations

Enclosures:

Publication 892 and 3498

Form 886-A

Form 6018

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended

ISSUE

Whether the
(IRC) section 501(c)(7).

qualifies for exemption under Internal Revenue Code

FACTS

The () was incorporated in the State of with an exemption date of . The organization's purpose is to . The organization is managed by a group of board officers including a , , and retains a body of

An interview was conducted with the , on , stated the following activities of the organization, "The was established in the mid . It is a nonprofit in . There are about who , and . Agent observed two different sources of revenue on the organization's calendar year end income statement: and sales. When asked about the two different sources of revenue stated, "The for is only for use and what the pay on day to . The for is revenue that comes from who want to the . I asked if such as people outside the , the public, that want to can pay to replied, ' . I asked if the organization retains any type of record keeping or separation of receipts to indicate income from income for use of the replied, "No, and pretty much all that revenue for the comes from who come to the to pay and . I asked if that was the case in subsequent years , and reported a response on a follow up information document request, "We do not have any official log of vs. . Like in , all the entries can be considered and all the entries are only. This is the only distinction we have available at this time".

The organization's annual income statement and bank statements during tax years' end through , show the following revenue and dual use expenses:

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended

Tax year end , :

Revenue:

per income statement	\$.
Total gross revenue per income statement	\$
per monthly bank statements	Cannot be determined based on combined monthly bank deposit slips
Total gross revenue per monthly bank statements	\$

Dual Use Expenses per bank statements:
(portable toilets)

Utilities	\$
Accounting	\$
Property Taxes	\$
Advertising (banner and advanced graphics)	\$
General Repairs	\$
Supplies (internet and plumbing)	\$
Fees ()	\$

Tax year end , :

Revenue:

Sales per income statement	\$.
Total gross revenue per income statement	\$
per monthly bank statements	Cannot be determined based on combined monthly bank deposit slips
Total gross revenue per monthly bank statements	\$

Dual Use Expenses per bank statements:
Taxes

General Track Repairs	\$
Internet Expense	\$
Supplies	\$
Accounting	\$
Supplies	\$
Insurance Expense	\$

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Name of Taxpayer		Year/Period Ended

Tax year end , :

Revenue:

	Sales per income statement	\$, .
Total gross revenue per income statement		\$, .
	Sales	Cannot be determined based on
per monthly bank statements		combined monthly bank deposit slips
Total gross revenue per monthly bank statements		\$, .

Dual Use Expenses per bank statements:

Taxes	\$, .
Web Hosting	\$, .
Accounting	\$, .
Supplies	\$, .
Insurance Expense	\$, .

LAW

IRC section 501(c)(7) provides exemption from income taxes for clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of 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.

The enactment of P.L. 94-568 in 1976 changed the term "exclusively" to "substantially all". This change, as incorporated in the IRC allows for an insubstantial amount of income from activities that do not further the club's exempt purposes. These activities which constitute an unrelated trade or business include the use of the club facilities by the general public.

Senate Report No. 94-1318 (1976), 2d Session, 1976-2 C.B. 597, at page 599 defines "substantially all" and explains that a social club is permitted to receive up to 35% 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% not more than 15% of the gross receipts should be derived from the use of a social club's facilities or services by the general public (nonmembers). The Committee Reports for Public Law 94-568 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 non-members, 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 non-members' use of club facilities.

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Name of Taxpayer		Year/Period Ended

(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.

Revenue Ruling 66-149 holds a social club as not exempt as an organization described in IRC § 501(c)(7) where it derives a substantial part of its income from non-member sources.

Revenue Ruling 60-324 states by making its social facilities available to the general public the club cannot be treated as being operated exclusively for pleasure, recreation or other non-profitable purposes.

Treas. Reg. §1.501(c)(7)-1(a) further provides that 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.

A social club that opens its facilities to the public is deemed to be 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. [Reg. §1.501(c)(7)-1(b)]

[*Treas. Reg. §1.501(c)(7)-1 has not been updated to reflect P.L. 94-568 which changed "exclusively" to "substantially all".]

Rev. Rul. 58-589, 1958-2CB 266 examines the criteria for determining whether an organization qualifies for exemption under IRC section 501(a) as an organization described in section 501(c)(7) of the Code. This ruling states 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 the solicitation by advertisements or otherwise of public patronage of its facilities may be adverse to the establishment of an exempt status.

Rev. Proc. 71-17, 1971 WL 26186, 1971-1 C.B. 683 sets forth guidelines for determining the effect gross receipts derived from use of a social club's facilities by the general public have on the club's exemption from federal income tax under section 501(c)(7) of the Code.

The club must maintain books and records of each such use and the amount derived therefrom. This requirement applies even though the member pays initially for such use. In each instance the record must contain the following information:

1. The date;
2. The total number in the party;

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3. The number of nonmembers in the party;
4. The total charges;
5. The charges attributable to nonmembers;
6. The charges paid by nonmembers;
7. Where a member pays all or part of the charges attributable to nonmembers, a statement signed by the member indicating whether he has been or will be reimbursed for such nonmember use and, if so, the amount of the reimbursement;
8. Where the member's employer reimburses the member or makes direct payment to the club for the charges attributable to nonmembers, a statement signed by the member indicating the name of his employer; the amount of the payment attributable to the nonmember use; the nonmember's name and business or other relationship to the member; and the business, personal, or social purpose of the member served by the nonmember use.
9. Where a nonmember, other than the employer of the member, makes payment to the club or reimburses a member and a claim is made that the amount was paid gratuitously for the benefit of a member, a statement signed by the member indicating the donor's name and relationship to the member, and containing information to substantiate the gratuitous nature of the payments or reimbursement.

Exceptions to these record keeping requirements are:

1. Where a group of eight or fewer individuals, at least one of whom is a member, uses club facilities, it will be assumed for audit purposes that the nonmembers are the guests of the member, provided payment for such use is received by the club directly from the member or the member's employer.
2. Where 75 percent or more of a group using club facilities are members, it will likewise be assumed for audit purposes that the nonmembers in the group are guests of members, provided payment for such use is received by the club directly from one or more of the members or the member's employer.
3. Solely for purposes of 1 and 2, above, payment by a member's employer will be assumed to be for a use that serves a direct business objective of the employee-member.

Where a club makes its facilities available to the general public to a substantial degree, the club is not operated exclusively for pleasure, recreation, or other non-profitable purposes.

Pittsburgh Press Club v. USA, 536 F.2d 572, (1976)

While the reports mandate the application of a "facts and circumstances test" in the event that gross receipts from nonmember and/or investment income reach the prohibited levels, they do not specify any of the relevant facts and circumstances that should be considered. However, the Court of Appeals in this case has indicated some factors to consider in determining exempt status.

Factors to consider in applying this test include:

- The actual percentage of nonmember receipts and/or investment income.
- The frequency of nonmember use of club facilities. (An unusual or single event (that is, non-recurrent on a year to year basis) that generates all the nonmember income should be viewed more favorably than nonmember income arising from frequent use by nonmembers).

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- The number of years the percentage has been exceeded. (The record over a period of years is also relevant. The high percentage in one year, with the other years being within the permitted levels, should be viewed more favorably to the organization than a consistent pattern of exceeding the limits, even by relatively small amounts).
- The purposes for which the club's facilities were made available to nonmembers.
- Whether the nonmember income generates net profits for the organization. Profits derived from nonmembers, unless set aside, subsidize the club's activities for members and result in inurement within the meaning of IRC 501(c)(7).

IRC Section 511 imposes a tax on unrelated business income of charitable, etc., organizations
(a) Charitable, etc., organizations taxable at corporation rates

IRC Section 512 describes the term "unrelated business taxable income" to mean the gross income derived by any organization from any unrelated trade or business (as defined in section 513) 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).

IRC 512(a)(3)(A), provides that for certain organizations, including those described in IRC §501(c)(7), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the allowable deductions directly connected with the production of gross income (excluding exempt function income).

IRC Section 513(a) describes The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 except that such term does not include any trade or business :

513(a)(1)

in which substantially all the work in carrying on such trade or business is performed for the organization without compensation; or

513(a)(2)

which is carried on by the organization primarily for the convenience of its members, students, patients, officers, or employees, or, in the case of a local association of employees described in section 501(c)(4) organized before May 27, 1969, which is the selling by the organization of items of work-related clothes and equipment and items normally sold through vending machines, through food dispensing facilities, or by snack bars, for the convenience of its members at their usual places of employment; or

513(a)(3)

which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

"Regularly carried on" is described in Treas. Reg. 1.513-1(c) as "the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued."

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Treasury Reg. 1.513-1(d)(1) provides that gross income derives from "unrelated trade or business", within the meaning of IRC 513(a), if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities that generate the particular income in question - the activities, that is, of producing or distributing the goods or performing the services involved - and the accomplishment of the organization's exempt purposes.

GOVERNMENT'S POSITION

Issue 1

IRC §512(a)(3)(A), provides that for certain organizations, including those described in IRC §501(c)(7), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the allowable deductions directly connected with the production of gross income (excluding exempt function income).

IRC Regulations §1.512(a)-1(a) defines "unrelated business taxable income," except as otherwise provided in §1.512(a)-2, §1.512(a)-4, or paragraph (f) of this section, as the gross income derived from any unrelated trade or business regularly carried on, less those deductions allowed by chapter 1 of the Code.

Deductions are calculated in the same manner under IRC Section 512(a)(3) as they are calculated under IRC Section 512(a)(1). The deduction must be allowable under Chapter One of the Code and must be directly connected with the carrying on of unrelated trade or business. When there is dual (exempt and non-exempt) use of facilities or staff, only the expenses attributable to the non-exempt use can qualify as deductions. When expenses are incurred from an activity that receives both exempt function and non-exempt function income, the expenses attributable to the non-exempt income must be determined by a reasonable allocation method.

The definition of "unrelated business taxable income" for organizations exempt from federal income tax under Code §501(c)(3), can be restated as follows:

Gross Income	\$XX,XXX
(less) Exempt Function Income	(\$X,XXX)
(less) Allowable Deductions	<u>(\$X,XXX)</u>
 = Unrelated Business Taxable Income	 \$X,XXX

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended

Tax Year End

After the bank reconciliation analysis was conducted it was determined that generated \$ in total gross revenue during the organization's tax year end. The Sales revenue cannot be determined based on the monthly bank statements because the monthly revenue deposit slips are combined and determining Sales revenue from any other source of revenue on every deposit slip cannot be determined.

However, reports on their tax year end income statement Sales in the amount of \$, and total gross revenue in the amount of \$. Although there is an understated variance of \$, between what is reported on the income statement and what reflects economic reality in the bank statements the Agent will accept what reports on the income statement to determine a reasonable allocation percentage to arrive at the dual use expense deductions.

Using the gross to gross method to arrive at a reasonable allocation percentage, Agent took ratio of Sales per the income statement in the amount of \$, and total gross revenue per the income statement in the amount of \$ and arrived at the following:

= or %

The % was applied to the total gross revenue in the amount of \$ reported on the bank statements to arrive at an approximate total of \$ in Sales Revenue. The % was also applied to the dual use expenses reported in the bank statements to arrive at expense deductions allocated to the activity of Sales Revenue as follows:

<u>Dual Use Expenses per</u>	<u>bank statements</u>	<u>Actual Expense</u>	<u>% Allocation</u>
<u>Applied</u>			
	(portable toilets)	\$	()
Utilities		\$	()
	Accounting	\$	()
	Property Taxes	\$	()
Advertising (banner and advanced graphics)		\$	()
General Repairs		\$	()
Supplies (internet and plumbing)		\$	()
		\$	()
	Fees ()	\$	()
Special Deduction		\$	()

tax year end unrelated business income tax plus interest totals an amount due of \$

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended

Tax Year End

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Using the gross to gross method to arrive at a reasonable allocation percentage, Agent took ratio of Sales per the income statement in the amount of \$ and total gross revenue per the income statement in the amount of \$ and arrived at the following:

$\frac{\text{Sales}}{\text{Total Gross Revenue}} = \text{or } \%$

The % was applied to the total gross revenue in the amount of \$ reported on the bank statements to arrive at an approximate total of \$ in Sales Revenue. The % was also applied to the dual use expenses reported in the bank statements to arrive at deductions allocated to the activity of Sales Revenue as follows:

<u>Dual Use Expenses per</u>	<u>bank statements</u>	<u>Actual Expense</u>	<u>% Allocation</u>
<u>Applied</u>			<u>Percentage</u>
Taxes		\$	()
General Track Repairs		\$	()
Internet Expense		\$	()
Supplies		\$	()
Accounting		\$	()
Supplies		\$	()
Insurance Expense	at 100%	\$	()
Special Deduction		\$	()

tax year end unrelated business income tax plus interest totals an amount due of \$

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended

Tax Year End

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However, reports on their tax year end income statement Sales in the amount of \$, and total gross revenue in the amount of \$. Although there is an overstated immaterial variance of \$ between what is reported on the income statement and what reflects economic reality in the bank statements the Agent will accept what reports on the income statement to determine a reasonable allocation percentage to arrive at the dual use expense deductions.

Using the gross to gross method to arrive at a reasonable allocation percentage, Agent took ratio of Sales per the income statement in the amount of \$, and total gross revenue per the income statement in the amount of \$ and arrived at the following:

= or %

The % was applied to the total gross revenue in the amount of \$ reported on the bank statements to arrive at an approximate total of \$ in Sales Revenue. The % was also applied to the dual use expenses reported in the bank statements to arrive at deductions allocated to the activity of Sales Revenue as follows:

<u>Dual Use Expenses per</u>	<u>bank statements</u>	<u>Actual Expense</u>	<u>% Allocation</u>
<u>Applied</u>			<u>Percentage</u>
Taxes		\$	()
Web Hosting		\$	()
Accounting		\$	()
Supplies		\$	()
Insurance Expense	at 100%	\$	()
Special Deduction		\$	()

tax year end unrelated business income tax plus interest totals an amount due of \$,

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In summary, calendar year gross to gross receipt percentages that are derived from the general public () use of the are as follows:

Tax year end = . %
Tax year end = . %
Tax year end = . %

Based on the examination, the organization does not qualify for exemption as a social club described in IRC §501(c)(7) and Treas. Reg §1.501(c)(7) which provides that in general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments.

Senate Report No. 94-1318 (1976), 2d Session, 1976-2 C.B. 597, at page 599 defines "substantially all" and explains that a social club is permitted to receive up to 35% 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% not more than 15% of the gross receipts should be derived from the use of a social club's facilities or services by the general public (nonmembers). The Committee Reports for Public Law 94-568 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 non-members, so long as the latter do not represent more than 15 percent of total receipts.

Rev. Ruls. 66-149 and 60-324 support this position stating that a social club that opens to the public and derives a substantial part of its income from non-member sources is not exempt as an organization described in 501(c)(7).

Year over year, receives more than the insubstantial part of its gross receipts allowed by the Code from outside its membership.

permits unrestricted use of its facilities by the general public. The organization has exceeded the 15% non-member threshold as outlined in Public Law 94-568, on a recurring basis during tax years ending December 31, December 31, and December 31,

The non member income percentages listed above are considerably higher than the 15% allowed under P.L. 94-568 and shows a pattern of frequency and reoccurring use by the public. The facts of the case show that it is operating in a manner consistent with a for-profit business.

Accordingly, it is proposed that tax exempt status be revoked effective , .

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TAXPAYER'S POSITION

To Be Determined

CONCLUSION

no longer qualifies for exemption under § 501(c)(7) of the Code as their income has exceeded the 15% nonmember threshold on a continuing basis. Therefore, it is proposed that their exempt status under § 501(c)(7) of the Code be revoked effective , .

Should this revocation be upheld, must be filed starting with tax periods ending , and each subsequent calendar tax year end.