



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
TE/GE EO Examinations  
1100 Commerce Street, MC4920DAL  
Dallas, Texas 75242

501.07-00

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

December 21, 2010

Release number: 201111015

Release Date: 3/18/11

LEGEND

ORG = Organization name

XX = Date

Address = address

**Taxpayer Identification Number:**

**Form:**

**Tax Year(s) Ended:**

**Person to Contact/ID Number:**

**Contact Numbers:**

Telephone:

Fax:

Dear

In a determination letter dated September 30, 19XX, you were held to be exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(7) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(7) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On January 7, 20XX, you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(7) of the Code.

You are required to file Federal income tax returns for the tax period(s) shown above. If you have not yet filed these returns, please file them with the Ogden Service Center

**Agreed Revocation Letter**

within 60 days from the date of this letter, unless a request for an extension of time is granted, or unless an examiner's report for income tax liability was issued to you with other instructions. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States 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 may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

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

Sincerely,

Nanette M. Downing  
Director, EO Examinations



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service  
1100 Commerce Street  
Dallas, Tx 75242

December 1, 2009

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States 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 may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Sunita Lough  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Form 6018  
Report of Examination  
Envelope

FORM 886-A	EXPLANATION OF ITEMS	SCHEDULE NO. OR EXHIBIT
NAME OF TAXPAYER ORG		YEARS/PERIODS ENDED 20XX12 and 20XX12

LEGEND

ORG = Organization name  
COMPANIES

XX = Date

RA-1 = 1<sup>st</sup> RA

CO-1 & Co-2 = 1<sup>st</sup> & 2<sup>nd</sup>

**ISSUE(S):**

Whether the ORG (ORG) qualifies for exemption under Internal Revenue Code (IRC) section 501(c) (7)?

**FACTS:**

The ORG (ORG) was formed and incorporated in 19XX. ORG offers its members full golf facilities including golf, dining and social activities and generates revenue primarily through membership dues, bar/restaurant sales, golf shop and golf fees.

ORG operates 18-hole golf course open to members and the public. The income received by ORG includes membership dues, greens fees, cart rentals, restaurant & bar sales, pro shop sales, and miscellaneous income including interest and rebates received on credit cards. Cart rental fees of varying amounts (based on member vs. nonmember and 18 holes vs. 9 holes) are charged to both members and the public.

ORG operates a pro shop, bar and a restaurant, all of which are open to both members and the general public. ORG was granted a liquor license from the State of Minnesota to sell alcoholic beverages at its facility. The license type is OP – On Premises Liquor. An On Premises Liquor license is a full liquor license with no restrictions as to the sale of alcoholic beverages for on premises consumption. This differs from a club license where alcoholic beverages can only be sold to members of ORG. ORG has no such restriction.

ORG advertises on the website that they are a semi-private club, open to the public and available for corporate tournaments, group and family outings and league play. There was additional advertisement on the website for fast food restaurants. ORG was listed as one of the fast food establishments, along with other for-profit entities, such as CO-1 and CO-2.

In addition, there was advertisement on the website as such:

*"The ORG is the perfect location for weddings, receptions, grooms dinners, reunions, banquets, and meetings. Our club house features a beautiful panoramic view over looking the golf course. We also feature a more quaint setting in our fireplace room perfect for smaller gatherings, parties, and private wine dinners.*

*Executive Chef RA-1 can customize a special menu to fit your dining needs and make your events memorable. ORG features a full dining menu and bar".*

ORG offers private lessons, playing lessons and junior clinics. These lessons are available to members and the public.

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<b>NAME OF TAXPAYER</b> ORG		<b>YEARS/PERIODS ENDED</b> 20XX12 and 20XX12

The income attributable to non-members is unknown because ORG did not comply with the record keeping requirements of Revenue Procedure 71-17. As per Revenue Procedure 71-17, without records of non-member sales, all income from cart rentals, restaurant & bar, and pro-shop sales can be assumed to be from non-members. However, taxpayer and agent agreed on a method involving utilizing the rounds of golf played by member and non-member to determine a reasonable nonmember percentage. The taxpayer did acknowledge that method of record keeping was not done as accurately due to staff turnover.

As a result, the analysis of nonmember percentage based on a three year period was noted below:

<b>Year/Period Ended</b>	<b>% of gross receipts from nonmember use</b>	<b>% of gross receipts from investment income</b>	<b>Total % investment income/nonmember income</b>
December 31, 20XX	20%	0%	20%
December 31, 20XX	23%	0%	23%
December 31, 20XX	25%	0%	25%

A closing conference was held following the conclusion of the examination on November 20, 20XX with the Treasurer of ORG to discuss the facts and disposition of the case.

#### **LAW:**

IRC Section 501(a) states that an organization described in subsection (c) or (d) shall be exempt from taxation under this subtitle unless such exemption is denied under Section 502 concerning feeder organization or Section 503 concerning organizations engaged in prohibited transactions.

Organizations exempt from federal taxes as described in IRC Section 501(c)(7) include clubs organized for pleasure, recreation, and other nonproftable 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.

Section 1.501(c)(7)-1 of the Income Tax Regulations, relating to the requirements of exemption of such clubs under section 501(a), reads in part as follows:

- (a) The exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonproftable purposes, but does not apply to any club if its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.
- (b) A club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber or other products, is not organized and operated exclusively for pleasure, recreation, and other nonproftable 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 ORG is engaging in business and is not being operated exclusively for

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pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption.

Prior to its amendment in 1976, IRC Section 501(c)(7) required that social clubs be operated exclusively for pleasure, recreation, and other non-profitable purposes. Public Law 94-568 amended the "exclusive" provision to read "substantially" in order to allow a section 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 further state:

- (a) Within this 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. These percentages supersede those provided in Revenue Ruling 71-17, 1971-1 C.B. 683.
- (b) Thus, a social club may receive investment income up to the full 35 percent of its gross receipts if no income is received from non-members' use of club facilities.
- (c) In addition, the Committee Reports state 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.
- (d) The Senate report also indicates that even though gross receipts from the general public exceed this standard, it does not necessarily establish that there is a nonexempt purpose. A conclusion that there is a nonexempt purpose will be based on all the facts and circumstances including, but not limited to, the gross receipts factor.

Revenue Ruling 58-589 sets forth the criteria for exemption under section 501(c)(7) of the Code, and provides that a club must have an established membership of individuals, personal contacts, and fellowship. It also provides that, while the regulations indicate that a club may lose its exemption if it makes its facilities available to the general public, this does not mean that any dealings with nonmembers will automatically cause a club to lose its exemption. A club may receive some income from the general public, that is, persons other than members and their bona fide guests, or permit the general public to participate in its affairs, provided that such participation is incidental to and in furtherance of ORG's exempt purposes, such dealings with the general public and the receipt of income therefrom does not indicate the existence of a club purpose to make a profit, and the income does not inure to club members.

Revenue Ruling 66-149 provides that a social club is not exempt from federal income tax as an organization described in section 501(c)(7) of the code if it regularly derives a substantial part of its income from non-member sources such as, for example, dividends and interest on investments.

Revenue Ruling 68-119 provides that a club will not necessarily lose its exemption if it derives income from transactions with other than bona fide members and their guests, or if the general public on occasion is



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permitted to participate in its affairs, provided such participation is incidental to and in furtherance of its general club purposes and the income therefrom does not inure to members.

Revenue Ruling 60-324 provides that a social club that made its social facilities available to the general public through its member-sponsorship arrangement can not be treated as being operated exclusively for pleasure, recreation, or other nonprofitable purposes and ORG no longer qualified for exemption under 501(c)(7) of the Code.

Revenue Procedure 71-17 sets forth guidelines for determining the effect of gross receipts derived from nonmember use of a social club's facilities on exemption under Internal Revenue Code Section 501(c)(7) and recordkeeping requirements. Failure to maintain such records or make them available to the Service for examination will preclude use of the minimum gross receipts standard and audit assumptions set forth in this Revenue Procedure.

#### **TAXPAYER'S POSITION:**

Unknown at this time

#### **GOVERNMENT POSITION:**

Based on the examination, the organization does not qualify for exemption as a social club described in IRC §501(c)(7). An organization exempt from federal income taxes as described in IRC section 501(c)(7) must meet the gross receipts test in order to maintain its exemption. In order to meet the gross receipts test, an organization can receive up to thirty-five percent (35%) of its gross receipts, including investments income, from sources outside its membership without losing its tax exempt status. Within this 35% amount, not more than fifteen percent (15%) of the gross receipts should be derived from the use of social club's facilities or services by non-members.

ORG has exceeded the 15% gross receipts standard for nonmember income on a continuous basis for at least three years. The nonmember receipts are earned throughout the year. There was no one single or unusual event that caused ORG to exceed the 15% threshold.

Based on the large percentages of gross nonmember income to total gross receipts of ORG, (i.e., 20%, 23%, and 25% as noted in the above table), which exceeds the limitation of 15% as set forth by IRC 501(c)(7) for each of these years and the fact that it advertises the use of its facilities to the public. ORG also receives nonmember income from the cart rentals, restaurant & bar sales, and pro shop sales, but the exact amount of income from these activities is indeterminable because they did not comply with the record keeping requirements of Rev Proc. 71-17. The facts of the case show that it is operating in a manner consistent with a for-profit business.

It is the Government's position that ORG is no longer operating exclusively for the pleasure and recreation of its members and is not exempt under section 501 (c) (7).

#### **CONCLUSION:**

<b>FORM 886-A</b>	<b>EXPLANATION OF ITEMS</b>	<b>SCHEDULE NO. OR EXHIBIT</b>
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The IRC Section 501 (c) (7) tax exempt status of the ORG should be revoked since the nonmember income received by ORG exceeded 15% of ORG's total gross receipts for the years under examination. Further, it advertises the use of their facilities to the general public reflecting evidence that ORG is engaged in a business and is not being "operated exclusively for pleasure, recreation, or social purpose." In addition, the organization failed to meet the reporting requirements under sections 6001 and 6033 to be recognized as exempt from federal income tax under 501(c)(7) of the Internal Revenue Code.

ORG no longer meets the requirements to qualify as exempt from federal income tax under IRC section 501(a) as described in section 501(c)(7). Therefore, your exempt status under 501(c) (7) of the Internal Revenue Code will be revoked effective January 1, 20XX.

As a taxable entity, the organization is required to file Form 1120, U.S. Corporation Income Tax Return for the periods open under statute. Under 6501(g) these periods include the years ending December 31, 20XX and subsequent tax years.

Additionally, the organization is reminded of the provisions of IRC 277 concerning membership organization which are not exempt organizations.

#### **ALTERNATIVE ISSUE(S);**

In the alternative, if the organization qualifies for exemption under IRC 501(c)(7), should they be subject to the unrelated business income tax under IRC 512(a)(3)?

#### **FACTS:**

ORG generates non member income primarily through membership dues, bar/restaurant sales, golf shop and golf fees. Records were not kept per Revenue Procedure 71-17, concerning member and non member income. All of the expenses are related to either the golfing, bar/restaurant or rental income.

#### **LAW:**

Section 511(a) of the Code provides for the taxation of unrelated business taxable income of organizations described in section 501(c).

IRC section 512(a)(3) provides for the taxation of all income other than exempt function income. Exempt Function Income is defined in IRC section 512(a)(3)(B) as "gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid."

Non-exempt function income is all income that is not exempt function income. Non-exempt function income includes traditional income, such as income from investments and food and beverage sales to non

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members, as well as income from non-traditional activities, such as the sale of liquor to members for off premises consumption.

**TAXPAYER'S POSITION:**

Unknown at this time

**GOVERNMENT'S POSITION:**

ORG generates non member income primarily through membership dues, bar/restaurant sales, golf shop and golf fees. Records were not kept per Revenue Procedure 71-17, concerning member and non member income. As such, the organization is subject to Unrelated Business Income Tax as described in section 512 of the Internal Revenue Code.

**CONCLUSION:**

As an alternative position, the income classified as non exempt function income should be unrelated business taxable income, reported on Form 990-T.

Attached as Schedule I is a recap of the ORG's "Statement of Operating Revenue and Expense" for tax years 20XX12 and 20XX12. ORG generated the following amounts of Unrelated Business Taxable Income :

20XX12	\$
20XX12	\$
	-----
TOTAL	\$
	=====

**SCHEDULE 1. AUDIT ADJUSTMENTS FOR TAX YEARS 20XX12 – 20XX12**

**Year 20XX12**

**Income per 990**

Program Service Revenue	\$ \$	23%	\$ \$
Membership dues	\$ \$	23%	\$ \$
Interest	\$ \$	23%	\$ \$
Cart/Locker Room	\$ \$	23%	\$ \$
Net Gain or (Loss) from sale of assets	\$ \$	23%	\$ \$
Gross Sales of Inventory	\$ \$	23%	\$ \$
Other Revenue	\$ \$	23%	\$ \$
Total Revenue	<u>\$ \$</u>		<u>\$ \$</u>

**Expense per 990**

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Cost of Good Sold	\$ \$	23%	\$ \$
Other Expenses	\$ \$	23%	\$ \$
Total Expenses	<u>\$ \$</u>		<u></u>
Total Adjustments			
Specific Deduction			
Unrelated Business Taxable Income			<u></u>

**Year 20XX12**  
**Income per 990**

Program Service Revenue		25%	
Membership dues		25%	
Interest		25%	
Cart/Locker Room		25%	
Net Gain or (Loss) from sale of assets		25%	
Gross Sales of Inventory		25%	
Other Revenue		25%	

**Expense per 990**

Cost of Good Sold		25%	
Other Expenses		25%	
Total Adjustments			
Specific Adjustments			
Unrelated Business Taxable Income			<u></u>

**NOTE: THIS IS A PROPOSED ADJUSTMENT. THE YEAR 20XX WILL NEED TO BE ADDED ONCE THE RETURN IS FILED.**