

Internal Revenue Service
Director, Exempt Organizations

Department of the Treasury
P.O. Box 2508 - EP/EO
Cincinnati, OH 45201

Date: JUL 24 2001

Employer Identification Number:
[REDACTED]

Person to Contact - I.D. Number:
[REDACTED]

Contact Telephone Numbers:
[REDACTED]

Phone

FAX

Dear Sir:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(7) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office.

We have sent a copy of this letter to your representative as indicated in your power of attorney.

[REDACTED]

If we do not hear from you within the time specified, this will become our final determination.

Sincerely,

Steve Miller

Director, Exempt Organizations

Enclosures: 3

Enclosure I

FACTS:

The information submitted indicates that the organization, incorporated on [REDACTED]. Article 4 of your Articles of Incorporation states that the purposes of the organization are: to lease property or secure hunting rights on real estate for the sport of hunting and fishing; and to lease, own and operate a private hunting club for entertainment and recreational purposes.

Article II, Section 1 of your bylaws states, in part, that one membership unit shall be issued to [REDACTED] to compensate him for his organizational activities. Each member of the corporation, other than [REDACTED], shall purchase one membership unit for the consideration of \$[REDACTED].

Article II, Section 3 of your bylaws states that [REDACTED] (or his heirs, successors or assigns) shall have a perpetual right of first refusal with respect to the membership unit until [REDACTED], [REDACTED]. This right gives [REDACTED] the right to purchase the membership unit for an amount equal to the price offered by a third party or \$[REDACTED], whichever is less. The perpetual right continues to apply to the purchaser. Section 3 also states that [REDACTED] shall have the right to purchase the interest in [REDACTED] acres of property for an amount equal to the price offered by a third party, or \$[REDACTED], whichever is less. Section 3 shall not be amended, revoked or otherwise terminated without the written consent of [REDACTED].

The Form 1024 application states that the purpose of the club is to acquire and maintain rural properties to be used primarily for the purpose of hunting ducks, dove, deer and other game. The club will own an interest in real estate and will also lease local farm properties for the purpose of hunting. It is anticipated that -- there will be [REDACTED] members who will share maintenance expenses, real estate taxes, insurance and other expenses. The use of the property will be restricted to the members and their guests.

In addition to the \$[REDACTED] membership fee, members will be required to pay annual assessments in the amount of \$[REDACTED].

An amount of \$[REDACTED] is paid per year to [REDACTED], his heirs, successors or assigns, for maintaining the premises through bush hogging and minor maintenance work. This maintenance expense will be adjusted periodically to reflect inflationary costs.

Included with the application is a copy of a lease agreement between the club and [REDACTED]. The lease is for the three-- year period [REDACTED] to [REDACTED] and is for property in [REDACTED]. The lease amount is \$ [REDACTED] a year. The owner [REDACTED] is responsible for the real estate taxes on the property. The lease is signed by [REDACTED] as the owner, and as the tenant.

[REDACTED] is the president and director of the club. He is also the registered agent, and incorporator.

Correspondence from the club dated [REDACTED] states that:

- The club currently has [REDACTED] members, and is soliciting a [REDACTED] member;
- There is no intention to admit more than [REDACTED] members;
- The annual \$ [REDACTED] dues is to pay real estate taxes on the property, to maintain liability insurance and to pay other expenses;
- [REDACTED] determined the \$ [REDACTED] membership based on his knowledge of what good duck hunting property should be worth;
- The lease is for [REDACTED] acres;
- The club chose to lease the land because it is near the property which the club owns;
- The \$ [REDACTED] lease amount is the same as the lease amount from prior years;
- The club has purchased [REDACTED] acres of wetlands near [REDACTED] from [REDACTED];
- The purchase price of \$ [REDACTED] for the land was determined by [REDACTED];
- The property was purchased in [REDACTED];
- The clubs [REDACTED] expenses included real estate taxes (\$ [REDACTED]), insurance, legal fees, and guide fees and duck blind maintenance of \$ [REDACTED] was paid to [REDACTED];
- The property maintenance expenses for [REDACTED] were \$ [REDACTED], and for [REDACTED] they were \$ [REDACTED] and are greater than the \$ [REDACTED] paid annually to [REDACTED]; and
- It will not take more than \$ [REDACTED] annually for the property maintenance in the future.

Your correspondence dated [REDACTED] states that:

- [REDACTED] sold the property to the club and also contributed part of the real estate to the club in return for his membership;

- This contribution was in addition to organizational matters that he handled for the club;
- [REDACTED] is owned by one of [REDACTED] children and another person;
- The organizational duties handled by [REDACTED], for which he received membership, includes reviewing tracts of property to purchase, establishing the corporation, establishing the clubs rules and regulations, and soliciting members;
- The club has purchased a [REDACTED]-year fee interest in the [REDACTED] acres.

Your correspondence dated [REDACTED] states that:

- [REDACTED] located the property, transferred it to the club, and performed administrative work, and received a membership in return;
- The [REDACTED] paying members pay additional assessments of \$[REDACTED] annually in order to pay the \$[REDACTED] annual rent for the leased land;
- Included with the [REDACTED] correspondence is a copy of the Warranty Deed transferring the land. The Warranty Deed includes two grantees. Grantee 1 is your organization, [REDACTED]. Grantee 2 is [REDACTED], trustee of the [REDACTED] trust. Grantee 1 is assigned the land for a term equal to the lesser of (a) [REDACTED] years, or (b) for as long as the land shall be used solely and exclusively for the permitted uses (i.e., hunting). Upon expiration of the term or defeasance by Grantee 1, the land reverts to Grantee 2 in fee simple. The Warranty Deed also states the Grantors [REDACTED] and [REDACTED].

The Minutes of the first meeting of your Board of Directors, dated [REDACTED] states the [REDACTED] Trust was created for the benefit of one of [REDACTED] grandchildren.

LAW:

Section 501(c)(7) of the Internal Revenue Code provides exemption to 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.

Section 1.501(a)-1(c) of the Income Tax Regulations states that the words "private shareholder or individual" in section 501 refer

to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(7)-1(a) states that 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 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.

Revenue Ruling 65-219, 1965-2 C.B. 168, describes a swimming club established for the social, athletic and recreational benefit of its members. The club entered into a license agreement with its resident agent who agreed to pay for the construction of an olympic size pool for the exclusive use of the club, on a tract of land which he leased. The club agreed to pay the licensor all monies collected as initiation fees from members, 90 percent of all annual dues, and 90 percent of all transfer fees. Under the terms of the agreement the licensor controls the size of the club membership, the amount of initiation fees, and the amounts of annual club dues and transfer fees. The club is held to be operated as a commercial venture for the financial benefit of the licensor and is not exempt under section 501(c)(7) of the Code.

Revenue Ruling 66-259, 1966-2 C.B. 214, holds that a trust which provides for the reversion of principal on termination to the creator does not qualify for exemption under section 501(c)(3) of the Internal Revenue Code. Upon the termination of the trust the principal shall be paid to the creator or his estate. Where an individual has a reversionary interest, any gains derived from investing and reinvesting the principal would flow to him.

Revenue Ruling 70-48, 1970-1 C.B. 133, describes a social club whose active members pay substantially lower dues and initiation fees than associate members, although both classes enjoy the same rights and privileges in the club facilities. The active members received the same club benefits as associate members, although they pay a lesser share of operating expenses. In effect, the active members are being subsidized at the expense of the associate members, which constitutes inurement of income. The club was held not to be exempt under section 501(c)(7) of the Code.

██████████
██████████
APPLICATION OF LAW:

██████████ received membership in your club in return for -- reviewing property to purchase, establishing the corporation, establishing the club rules and regulations, and soliciting members. The membership allows ██████████ the right to hunt on the land the club owns and leases. All other members must pay a one time membership fee of \$██████████, annual dues of \$██████████, and annual assessments of \$██████████. The paying members also have the right to hunt on the land.

You have assigned a value of \$██████████, plus \$██████████ per year on the services ██████████ provided to establish the club. The services included reviewing property to purchase for the club. This appears not to have taken much effort or time since the club purchased land from ██████████. And the effort wasn't entirely on behalf of the club. The effort benefited ██████████ since the sale of his land was arranged.

You have stated that ██████████ also contributed part of the real estate in return for his membership. A ██████████-year fee interest was sold to the club for \$██████████. \$██████████ of the amount has been received, or is receivable, from the ██████████ current paying members. A ██████████ paying member is being sought. When the ██████████ paying member has been located, the full \$██████████ will have been paid and/or payable to ██████████.

██████████ is considered a private shareholder or individual since he has a personal and private interest in the activities of the club. Because ██████████ did not pay the \$██████████ membership fee, does not pay the annual membership dues and assessments, and he receives all the benefits of membership, he privately benefits from the club. The value you placed on the services provided by ██████████ is not substantiated, and the value is not accepted. Your claim that ██████████ contributed real estate in return for his membership also has not been substantiated.

Your organization is similar to the organization described in Revenue Ruling 65-219 since your registered agent, ██████████ determined the number of members, and the membership fees, dues and assessments. He also chose the land the club purchased and leased, which is his own property, and receives virtually all of the income of the club. Even though members control the club, ██████████ has made all of the decisions regarding the hunting property.

Revenue Ruling 66-259 contemplates an organization applying for exemption under section 501(c)(3) that is involved in inurement and private benefit. Your club is similar to the organization described in this revenue ruling because the Warranty Deed allows for the reversion of the land to the [REDACTED] Trust at the end of [REDACTED] years or upon your ceasing to use the land solely and exclusively for permitted uses, whichever occurs first. These permitted uses are private, noncommercial hunting and farming. The increase in the value of the land over [REDACTED] years shall pass to the [REDACTED] Trust and its successors for the benefit of one of [REDACTED] grandchildren.

The club is similar to the organization described in Revenue Ruling 70-48 since a non-paying member receives the same benefits of membership that the paying members receive.

The perpetual right assigned to [REDACTED] (and his heirs, successors or assigns) in the membership unit and the [REDACTED]-acre tract of land as stated in the bylaws results in the inurement of private earnings to [REDACTED].

CONCLUSION:

Accordingly, it is held that you are not entitled to exemption from Federal income tax as an organization described in section 501(c)(7) of the Internal Revenue Code. You are, therefore, required to file Federal income tax returns on Form 1120.