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501.07-05

Internal Revenue Service
District Director

Department of the Treasury

Date:

COPY

Form Number:
990-EZ
Tax Period:

In Reply Refer to:

Person to Contact:

Contact Telephone Number:

Dear Sir or Madam:

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

If you do not accept our findings, you may appeal the proposed adverse determination through our office to the Office of the Regional Director of Appeals. To request Appeals consideration, you should follow the instructions in the enclosed Publication 892. We will then forward your request to the Office of Regional Director of Appeals. If you request a hearing, they will contact you to arrange a mutually convenient time and place. When you write, please provide your daytime telephone number and most convenient time for us to call in case we need to contact you.

You may also request that we refer this matter to the National Office for technical advice, as explained in Publication 892. If a determination letter is issued to you based on technical advice from the National Office, no further administrative appeal is available to you within the Service on the issue that was the subject of technical advice.

If you accept our findings, you do not need to take further action. 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 examination report 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 your key District Director for exempt organization matters 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.

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

Thank you for your cooperation.

Sincerely,

Glenn E. Henderson
District Director

Letter 1433(DO)(5-85)

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Form 886-A	EXPLANATION OF ITEMS	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended

FACTS: (cont'd)

The Club received more than)% of their total income from the following activities, which were open to the public and no records were kept to distinguish between revenue received from members and non-members:

1. Catalogs sold during the dog show;
2. Booth space rented to vendors to exhibit and sell their wares;
3. Trophies sold to sponsors and used at the dog show;
4. Obedience classes held 2 to 3 times each year;
5. Sale of raffle tickets;
6. Annual barbecue; and
7. RV hookups.

The Club also sold advertising contained in their show catalog.

A comparison was made between the Club's membership roster and 14 deposit slips. This comparison disclosed that more than '% of the money deposited came from non-members.

Based on the information submitted, the Club received more than % of their total gross receipts from non-member participation in the Club's activities.

In addition, more than % of the Club's total income came from interest on savings and temporary cash investments.

During most of , the Club's meetings were held at a local restaurant. In September, the Club voted to bid on the purchase of the fire station. During the November meeting, it was stated that the Club "put in a bid of $. No one else placed a bid on the building. A request for a permit will be submitted to the planning Commission which will be decided on in by the planning Commission. They will send out letters to people living within 200 feet of the building to see if there are any objections to us using the building as a meeting place. If all goes well we will be put on the agenda for the City Council meeting. Then we will know if we got the building."

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."

LAW: (cont'd)

Section 1.501(c)(7)-1 of the Income Tax Regulations relates to the exemption of social clubs, 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 nonprofitable 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. 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 organization which engages in business such as making its social and recreational facilities available to the general public ... is not organized an operated for pleasure, recreation, and other nonprofitable 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 organization in engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes..."

Revenue Procedure 71-17, published in Cumulative Bulletin 1971-1 C.B. 683 sets forth guidelines for determining the effect of gross receipts derived from nonmember use of a social organization's facilities on the organization's exemption under section 501(c)(7), and states, in part, as follows:

" Where a organization makes its facilities available to the general public to a substantial degree, the organization is not operated exclusively for pleasure, recreation, or other nonprofitable purposes. See Rev. Rul. 60-324, C.B. 1960-2,173; and Rev. Rul. 69-219, C.B. 1969-1, 153."

Section 3.01 of Revenue Procedure 71-17, describes the minimum gross receipts standard, and states, in part, as follows:

"A significant factor reflecting the existence of a nonexempt purpose is the amount of gross receipts derived from use of a organization's facilities by the general public. As an audit standard, this factor alone will not be relied upon by the Service if annual gross receipts from the general public for such use is $2,500 or less or, if more than $2,500, where gross receipts from the general public for such use is five percent or less of total gross receipts of the organization..."

LAW: (cont'd)

Prior to the enactment of Public Law 94-568, an organization was required to be organized and operated *exclusively* for pleasure, recreation and other nonprofitable purposes.

The Committee Reports show that the wording change was intended to make it clear that social clubs may 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 limitation, no more than 15 percent of gross receipts may be derived from non-member use of the organization's facilities and/or services.

In addition, the statute prohibits exemption under section 501(c)(7) if any part of the organization's net earnings inures to the benefit of any private shareholder.

Traditionally, inurement has been found to be present where a organization derives income from non-member sources and uses it to reduce the cost of providing services to members. Revenue Ruling 58-589, 1958-2 C.B. 266, states, in part, as follows:

> " Net earnings may inure to members in such forms as an increase in services offered by the organization without a corresponding increase in dues or other fees paid for organization support or as an increase in the organization's assets which would be distributable to members upon the dissolution of the organization."

Revenue Ruling 79-145, published in Cumulative Bulletin 1979-1 on page 360, states that "amounts paid to a social club by visiting members of another social club are amounts paid by nonmembers, even though both clubs are of like nature and the amounts paid are for goods, facilities, or services provided by such social club under a <reciprocal> arrangement with such other social club."

LAW: (cont'd)

Revenue Ruling 71-421, published in Cumulative Bulletin 1971-2 on page 229, states, in part, as follows:

"A dog club, exempt under section 501(c)(7) of the Code, formed to promote the ownership and training of purebred dogs and conducting obedience training classes, may not be reclassified as an educational Club exempt under section 501(c)(3)."

"The nature of obedience training requires that the owner of the dog appear at the classes so that the dog is trained to respond to his owner's commands. While the owner receives some instruction in how to give commands to his dog, it is the dog that is the primary object of the training. The dog is also the primary object of the subsequent training in sporting and show events. Therefore, the Club's training program for dogs is not within the meaning of educational as defined in the regulations."

Revenue Ruling 73-520, published in Cumulative Bulletin 1973-2 on page 180, provides that a club that promotes and protects a particular breed of dog not raised or used by members as farm animals is not exempt as an agricultural Club under section 501(c)(5) of the Code, but may qualify for exemption as a social club under section 501(c)(7). The ruling states, in part, as follows:

"Agriculture", which is the art or science of cultivating the ground, includes preparing the soil, planting seeds, raising crops, and rearing, feeding, and managing livestock. See Rev. Rul. 67-252, 1967-2 C.B. 195."

"Since the dogs are not used as farm animals, they cannot be considered livestock. Therefore, by promoting and protecting a particular breed of dog under the circumstances described above, the does not have as its object the betterment of conditions of persons engaged in agriculture."

Revenue Ruling 71-421, published in Cumulative Bulletin 1971-2 on page 229, held that a dog club, exempt under section 501(c)(7) of the Code may not be reclassified as an educational organization under section 501(c)(3). The ruling, states, in part, as follows:

"The nature of obedience training requires that the owner of the dog appear at the classes so that the dog is trained to respond to his owner's commands. While the owner receives some instruction in how to give commands to his dog, it is the dog that is the primary object of the training. The dog is also the primary object of the subsequent training in sporting and show events. Therefore, the Club's training program for dogs is not within the meaning of educational as defined in the regulations."

LAW: (cont'd)

In *Ann Arbor Dog Training Club, Inc., v. Commissioner*, 74 T.C. 207. the court held that the club was not operated exclusively for one or more exempt purposes as specified in section 501(c)(3). The case states, in part, as follows:

> " The nature of obedience training requires that the owner of the dog appear at the classes so that the dog is trained to respond to his owner's commands. While the owner receives some instruction in how to give commands to his dog, it is the dog that is the primary object of the training. The dog is also the primary object of the subsequent training in sporting and show events. Therefore, the organization's training program for dogs is not within the meaning of educational as defined in the regulations. [Rev. Rul. 71-421, 1971-2 C.B. at 230.] Although we need not follow respondent's position as urged in his 1971 revenue ruling (see Browne v. Commissioner, 73 T.C. 723 (1980) (concurring opinion); Estate of Lang v. Commissioner, 64 T.C. 404 (1975)), we find that its conclusions are sound, and that petitioner's situation is not significantly different from the one presented in the ruling."

Revenue Ruling 68-119, Cumulative Bulletin 1968-1, page 268, held that a social club does not jeopardize its exemption under section 501(c)(7) of the Code by charging the public admission to its annual steeplechase. The annual one-day meet was in addition to its other club activities, which were supported by membership dues. The ruling state, in part, as follows:

> "In this case, the holding of a steeplechase in which nonmembers participate is incidental to and in furtherance of the club's general purpose of promoting the enjoyment of equestrian sports. Although the club on occasion derives a small amount of income from nonmembers in excess of expenses attributable to their participation and attendance, the meet is not operated to make a profit, but for the pleasure and recreation of members of the club. If any profit results, it is turned over to charity. Therefore, the income from nonmembers does not inure to the club's members."

TAXPAYER'S POSITION:

The contends that the facts in their case are identical to those in Revenue Ruling 68-119. They claim that the dog shows and obedience classes are incidental to and in furtherance of their general purpose. They claim that although they occasionally derive a small amount of income from non-members in excess of expenses, the shows are not operated to make a profit. They also claim that no income inures to any member of the in any form.

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GOVERNMENT'S POSITION:

Since the dues paid by members constitutes a small portion of the total revenue, the does not qualify under section 501(c)(7). See section 1.501(c)(7)-1(a) of the Income Tax Regulations.

Unlike the organization described in Revenue Ruling 68-119, the non-member participation in the dog shows and obedience classes is not *incidental*, but rather, *intentional*.

In addition, the non-member activities conducted during the year examined *did* result in a profit and unlike the situation described in the revenue ruling, the net profits were not turned over to charity.

The costs of conducting the monthly meetings, annual awards banquet and publishing the monthly newsletters are paid for only by the membership dues of $. In addition, the Club would not have been able to purchase a building without the revenue received from non-members.

Since the club uses the excess funds generated from non-member participation to their events for the pleasure and recreation of their members, their net earning *do* inure to members. See Revenue Ruling 58-589.

It is the position of the Internal Revenue Service that reciprocal income is amounts paid by non-members. See Revenue Ruling 79-145.

CONCLUSIONS:

Based upon the information submitted, the receives a substantial part of their income from the use of their facilities and services by the general public.

Therefore, we have determined that the exempt status under section 501(c)(7) of the Internal Revenue Code should be revoked.