



Department of the Treasury
Internal Revenue Service
Independent Office of Appeals

Date: **OCT 14 2021**

Person to contact:

Name:

Employee ID Number:

Phone:

Fax:

Employer ID number:

Number: **202201014**

Release Date: **1/7/2022**

Uniform issue list (UIL):

0501.07-03

Certified Mail

Dear :

This is a final adverse determination that you do not qualify for exemption from federal income tax under Internal Revenue Code (the "Code") Section 501(a) as an organization described in Section 501(c)(7) of the Code.

We made the adverse determination for the following reasons:

Organizations described in section 501(c)(7) of the Internal Revenue Code and exempt from tax under section 501(a) must be both organized for pleasure, recreation, and other non-profitable purposes, substantially all of which activities are for such purposes. Your organization leases your land and building facilities to the general public, which results in excessive nonmember and investment income exceeding 35 percent of your total income. Reg. 1.501(c)(7)-1(b) provides 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, timber, or other products, is not organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, and is not exempt under section 501(a). Accordingly, your organization is not organized and operated exclusively for exempt purposes within the meaning of section 501(c)(7).

You're required to file federal income tax returns on Forms 1120, U.S. Corporation Income Tax Return. Mail your form to the appropriate Internal Revenue Service Center per the form's instructions. You can get forms and instructions by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676).

You've agreed to waive your right to contest this determination under the declaratory judgment provisions of Section 7428 of the Code.

We'll make this letter and the proposed adverse determination letter available for public inspection under Section 6110 of the Code after deleting certain identifying information. We provided to you, in a separate mailing, Notice 437, Notice of Intention to Disclose. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

If you have questions, contact the person at the top of this letter.

Sincerely,

Enclosure
Closing Agreement.

cc:

Form 886A	Department of the Treasury Internal Revenue Service Explanation of Items	Exhibits
Name of Taxpayer		Year/Period Ended 12/31/

ISSUES

Whether the _____ at _____ (the Organization or Association) qualifies for exemption under Internal Revenue Code (IRC) Section (Sec.) 501(c)(7).

FACTS

Formation and Purpose

The _____ at _____ (the Organization or Association) was formed in the _____. The association incorporated on _____ in _____. It did not apply for exemption with an IRS form 1024 with TEGE. Article II of the Articles of Incorporation state the following:

ARTICLE II

The purpose of the corporation shall be for _____ and other interested persons to associate in a fraternal and social organization, and to promote the general and community welfare of its membership and their families.

The Corporation shall be authorized to hold meetings of the membership, hold Board of Directors meetings, meetings of the officers and committees, conduct charitable activities, hold parties, dances or other fraternal gatherings, to lease real or personal property, to own and transfer real property for the purpose of constructing and operating a fraternal meeting hall or club house, build recreational facilities, and to do all acts not prohibited to a non-profit organization under the laws of the State of _____ or the United States of America. In addition, the Corporation shall have all powers to do all acts conferred by the laws of the State of _____, and to

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Exhibits
Name of Taxpayer		Year/Period Ended 12/31/

engage in all acts and lawful activities incidental to the foregoing purposes.

There are no amendments to the organizing documents.

Application and Recognition of Exempt Status

The Organization did not submit Form 1024, *Application for Recognition of Exemption under Section 501(a)*. The Organization is considered a self-declared exempt organization. Internal documents do not show an application received or a date of determination.

Examination

On , an initial Information Document Request (IDR#1) was issued with a letter to inform the Organization of selection of audit. An appointment was scheduled for . However, it was rescheduled and was converted to a correspondence examination. The interview took place on as a teleconference.

Initial Meeting

On , Representatives and a manager of the Organization provided the following information during the initial meeting:

Memberships

The Organization is an association of members. There was a roll of reported members, but incoming fees did not match amounts reported. The reported amounts equal enough for members.

Activities

The primary activities of the Organization are to maintain a rental hall structure and provide rental space to cellular towers. During the interview with the Organization stated they had potlucks and poker nights, but this is not recorded in the documentation given to the IRS. There were no attendance sheets or a calendar of events. No publications with announcements.

Lease

There are two lease groupings. Most of the income for comes for the daily rental of the hall to individuals for family celebrations or other organizational meeting space. There were also a few instances of donated or discounted rentals to other groups such as school or bible clubs.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Exhibits
Name of Taxpayer		Year/Period Ended 12/31/

Minutes

On _____, the organization's representative, attorney _____ provided minutes that the organization took in board meetings held on: _____ and _____.

. There were three Board of Directors meetings in the span of two years

Publications

There was a PowerPoint showing the Ribbon Cutting dated _____ event showcasing the remodeled building and historical pictures of members. The Organization possesses a website to advertise their hall rental to the public and its members.

Contracts/agreements

On _____ Representatives provided written agreements that the Organization entered into during the year _____ for the rental of the hall. This is labeled as Response to IDR #2.

Income & Expenses Reported on Form 990-EZ for 20

The Organization provided the following information in Part I, *Revenue, Expenses and Changes in Net Assets or Fund Balances*, on Form 990-EZ, *Return of Organization Exempt from Income Tax*.

Income	
2. Program Service Revenue	\$
3. Membership Dues & Assessment	
4. Investment Income	
Total Revenue	\$

Expenses	
13. Professional Fees and other	
16. Other Expenses (Sched. O below)	
17. Total expenses	
18. Excess or (deficit) for the year	
From Schedule O	
Program Service Expenses	
Depreciation	
Interest Exp	
Utilities	
Insurance - Property	
Repairs & Maintenance	
Property Taxes	
Total Other Expenses	\$

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Exhibits
Name of Taxpayer		Year/Period Ended 12/31/

The "Program Service Revenue" is actually the rent income from hall rentals. And the "Investment Income" on the Form 990-T should also be classified as rental income from the rental of the cellular towers. Both rents are considered non-member income.

Rental Income & Expenses Reported on Form 990-T for

The Organization reported the following gross rents, rental expenses, and gross receipts on Form 990-T. This is reported as "Investment income" of the Form 990-EZ for . On the Form 990-T It is reported as "Rent income" and not "Investment income".

Rents from the Space Used by Cell Towers

Year	Gross rents	Rental expenses	Net rental income or (loss) after Spec Deduct of \$	Gross receipts	Percentage of Gross rents / Gross receipts
20					%
20					%
20					%

Rents from the cell towers were labeled as investments in the accounting system and subsequently in the tax filing. Rents from use of the hall are as follows:

Rents from the Use of the Hall Space

Year	Gross rents ¹	Rental expenses ²	Net rental income or (loss) after Spec Deduct of \$	Gross receipts	Percentage of Gross rents / Gross receipts
20					%
20					%
20					%

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Exhibits
Name of Taxpayer		Year/Period Ended 12/31/20

Total Non-Member Income as a Percentage of Gross Receipts

Year	HALL Gross Rents	HALL Percentage of Gross rents / Gross receipts	CELL TOWERS Gross Rents	CELL TOWERS Percentage of Gross rents / Gross receipts	Gross receipts	TOTAL NON- MEMBER Percentage of Gross rents / Gross receipts
20		%		%		%
20		%		%		%
20		%		%		%

Membership Dues as a Percentage of Gross Receipts

Year	Membership Dues	Gross receipts	Percentage of Membership Dues / Gross receipts
20			%
20			%
20			%

There were some discrepancies as to how program revenue was computed for __, nevertheless the totals still agree at the end that membership dues are very low in comparison to non-member income. The organization tried recruiting members within their hall rental contracts. A portion of the rental was used as if the leasee was paying a portion to the association as membership dues to incentivize those leasees to join.

Year	Membership Dues	Income for the organization	Percentage of Membership Dues / Income
--			%
			()%
			%

Whether looking at gross receipts or income, most revenue or income is not coming from members.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Exhibits
Name of Taxpayer		Year/Period Ended 12/31/20

Responses to Follow-up Information Documents Request (IDR#2 & 3)

On _____, IDR#2 was issued to the Organization requesting:

A. Documents to verify if the Organization meets the requirements under the IRC Section 501(c)(7) which included asking for a copy of the 990/990-EZ and 990-T filings for _____ the articles of Incorporation (amendments to those if appropriate) and a copy of current bylaws.

B. Documents to verify if the Organization meets the operational requirements for an IRC Sec. 501(c)(7) social club by asking for the minutes for board meetings, media publications to show activity during the exam year, schedules or calendars of activities or rental of facilities, sign-in sheets for members and detail financial data reported in 990-EZ form.

C. Documents to verify if the Organization's financial records match the filed Form 990-EZ. The electronic version of financial records that were still missing including the general ledger, and workpapers to reach the reported figures on filing income tax forms. Records that showed transactions and bank statements for the Organization.

On _____, Representatives of the Organization provided a fax of 239 pages including:

A.(1) Form 990-EZ & Form 990-T filed for tax year ending December 31, 20____ Form 8879-EO. Includes Depreciation Report. Form 990-W. Form 2220. Form 8868.

A.(2) Articles of Incorporation

A.(3) Amendments to Articles of Incorporation - None

A.(4) Current Bylaws

B.(1) Minutes for Board _____ to present

B.(2) EO Publications

B.(3) Activities conducted

B.(4) Member sign-in sheets - BBQ, Members roster

B.(5) Listing of rental contracts

C.(2) Underlying accounting records

C.(3)(a) Canceled checks and check register

C.(3)(D) F2848 for _____, CPA

Or _____, the Organization was given a transcript of the initial interview administered over a teleconference meeting between the Attorney, the CPA and _____. The Organization was asked to make comments or corrections. The Organization's POA, Representative attorney _____ was called to see if they had received the letter and was reminded the deadline was on _____ which was on a Saturday, but gave the Organization a chance to make corrections to the transcript of _____. No response was received.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Exhibits
Name of Taxpayer		Year/Period Ended 12/31/20

LAW

IRC Sec. 501(c)(7) provides exemption from federal income tax for clubs that are organized for pleasure, recreation, and other non-profitable 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.

Treasury Regulations Sec. 1.501(c)(7) provides that, in general, the exemption extends to social and recreation clubs supported solely by membership fees, dues and assessments. However, a club that engages in a business, such as making its social and recreational facilities open to the general public, is not organized and operated exclusively for pleasure, recreation and other non-profitable purposes, and is not exempt under section 501(a).

Prior to its amendment in 1976, IRC Sec. 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 an IRC Sec. 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 (Senate Report No. 94-1318 2d Session, 1976-2 C.B. 597) 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 rental income 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.

(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 60-324 illustrates a club, which has a regular club dining room and a bar. The private dining room is suitable for cocktail parties, small or medium sized parties or luncheons, small wedding receptions, similar private parties and the like. 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.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Exhibits
Name of Taxpayer		Year/Period Ended 12/31/20

Revenue Ruling 66-149 holds a social club as not exempt as an organization described in IRC Sec. 501(c)(7) to the extent that income is derived from nonmember sources, it inures to the benefit of the members. If such activities are other than incidental, trivial, or nonrecurrent, it is considered that they are intended to produce income and are reflective of a purpose inconsistent with exemption under IRC Sec. 501(c)(7).

Revenue Ruling 69-635 illustrates an automobile club whose principal activity is rendering automobile services to its members but has no significant social activities does not qualify for exemption under IRC Sec. 501(c)(7).

Revenue Procedure 71-17 sets forth the guidelines for determining the effect of gross receipts derived from the general public's use of a social club's facilities on exemption under IRC Sec. 501(c)(7). Where nonmember income from the usage exceeds the standard as outlined in this Revenue procedure, the conclusion reached is that there is a non-exempt purpose and operating in this manner jeopardizes the organization's exempt status.

TAXPAYER'S POSITION

Taxpayer's position has not been provided.

GOVERNMENT'S POSITION

It's the Government's position that the Organization does not qualify for 501(c)(7) status.

Under IRC Sec. 501(c)(7), there must be at least some sort of commingling of members to constitute an exempted "club".

Here, the Organization is operated as an _____ and is member-supported. However, most of the income comes from the rental of the hall and rent income from cell towers on the property. The income from the hall rental is designated as income coming from "program services" and the income from the cell towers rental is designated as "Investment income" on the Form 990-EZ and as rent income on the Form 990-T. Only \$ _____ is coming from member dues from actual members.

Therefore, the Organization is not organized and operated for pleasure, recreation, and other non-profitable purposes of its members.

It's the Government's position that the Organization's rental income, received from the rental the Organization's hall, is considered income from the general public's use of the Organization's facilities and jeopardizes its tax-exempt status

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Exhibits
Name of Taxpayer		Year/Period Ended 12/31/20

Under Public Law 94-568, amendment of IRC Sec. 501(c)(7) allows an IRC Sec. 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. Further, 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.

Here, the Organization was in the hall rental business to make profits. The hall was rented for special events and for weekend parties. The gross rents the Organization received from the renting of the hall accounted for a lot more than 15 percent of gross receipts for — in the range of gross income from non-members consistently above %.

The gross rents are considered income generated from the use of the Organization's facilities by the general public.

Therefore, the Organization's rental income is considered income from the general public's use of the Organization's facilities and jeopardizes its tax-exempt status.

It's the Government's position that the Organization no longer qualifies for exemption under IRC Sec. 501(c)(7).

In Revenue Ruling 60-324, a social club had a regular club dining room and a bar. By making its social facilities available to the general public, the club was not operating exclusively for pleasure, recreation or other non-profitable purposes.

Under Revenue Ruling 66-149, a social club was not exempt as an organization described in IRC Sec. 501(c)(7) to the extent that income is derived from nonmember sources from activities that are other than incidental, trivial, or nonrecurrent.

Under Revenue Ruling 69-635, an automobile club whose principal activity is rendering automobile services to its members but has no significant social activities does not qualify for exemption under IRC Sec. 501(c)(7).

Here, the Organization manages a dining place, through the rental agreement, and regularly makes it available to the general public. The service the Organization provides to its members is, through a managing agent, to maintain facilities located on a real property.

Therefore, the Organization no longer qualifies for exemption under IRC Sec. 501(c)(7).

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Exhibits
Name of Taxpayer		Year/Period Ended 12/31/20

CONCLUSION

The Organization does not qualify for exemption under IRC Sec. 501(c)(7) for the year , as illustrated in the Government's position. Accordingly, the Organization's tax-exempt status should be disqualified effective

Should this revocation be upheld, Form 1120, *U.S. Corporation Income Tax Return*, must be filed starting with the tax period ending and years after.