TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE EO Examinations

Date: July 23, 2014

Number: **201442058**
Release Date: 10/17/2014

Person to Contact:
Identification Number:
Contact Telephone Number:

In Reply Refer to:
EIN:
Tax Period(s) Ended:

UIL: 501.07-00

CERTIFIED MAIL – Return Receipt Requested #

Dear :

In a determination letter dated July 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 letter with regard to your exempt status.

We previously provided you a report of examination explaining why we believe revocation of your exempt status was necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On May 2, 2014, 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 periods shown above. If you have not yet filed these returns, please file them 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 of 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

© 2006-2020, CPC Holdings, LLC. All rights reserved.

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:

Internal Revenue Service
Office of the Taxpayer Advocate

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

Thank you for your cooperation.

Sincerely,

Barbara L. Harris
Acting Director, EO Examinations

© 2006-2020, CPC Holdings, LLC. All rights reserved.

UIL: 501.07-00

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

Date: April 29, 2014

Taxpayer identification number:

Form:

Tax year(s) ended:

Person to contact/ID number:

Contact numbers:
Telephone:
Fax:
Manager's name/ID number:

Manager's contact number:

Response due date:

Dear :

Why you are receiving this letter
Enclosed is a copy of our report of examination explaining why revocation of your organization's tax-exempt status is necessary.

What you need to do if you agree
If you agree with our findings, please sign the enclosed Form 6018-A, *Consent to Proposed Action,* and return it to the contact at the address listed above. We'll send you a final letter revoking your exempt status.

If we don't hear from you
If we don't hear from you within 30 calendar days from the date of this letter, we'll process your case based on the recommendations shown in the report of examination and this letter will become final.

Effects of revocation

© 2006-2020, CPC Holdings, LLC. All rights reserved.

In the event of revocation, you'll be required to file federal income tax returns for the tax year(s) shown above. File these returns with the contact at the address listed above within 30 calendar 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.

What you need to do if you disagree with our findings
If you disagree with our position, you may request a meeting or telephone conference with the supervisor of the contact identified in the heading of this letter. You also may file a protest with the IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information, including a statement of the facts, the applicable law and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*, and page six of the enclosed Publication 3498, *The Examination Process.* Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

If you and Appeals don't agree on some or all of the issues after your Appeals conference, or if you don't 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.

You may also request that we refer this matter for technical advice as explained in Publication 892. Please contact the person identified in the heading of this letter if you're considering requesting technical advice. If we send a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, then no further IRS administrative appeal will be available to you.

Contacting the Taxpayer Advocate Office is a taxpayer right
You have the right to contact the office of the Taxpayer Advocate Service (TAS). **TAS is your voice at the IRS. This service helps taxpayers whose problems with the IRS are causing financial difficulties; who have tried but haven't been able to resolve their problems with the IRS; and those who believe an IRS system or procedure is not working as it should. If you believe you are eligible for TAS assistance, you can call the toll-free number 1-877-777-4778 or TTY/TDD 1-800-829-4059. For more information, go to www.irs.gov/advocate.**
If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service
Office of the Taxpayer Advocate

For additional information
If you have any questions, please call the contact 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.

© 2006-2020, CPC Holdings, LLC. All rights reserved.

Thank you for your cooperation.

Sincerely,



Mary Epps
Acting Director, EO Examinations

Enclosures:
Report of Examination
Form 6018-A
Publication 892
Publication 3498

© 2006-2020, CPC Holdings, LLC. All rights reserved.

Form **886-A** (Rev. January 1994)	**EXPLANATIONS OF ITEMS**	Schedule number or exhibit
	Tax Identification Number	Year/Period ended December 31, 20XX December 31, 20XX

ISSUES

1. Should continue to be exempt from federal income tax under Internal Revenue Code ("Code") 501(c)(7) as a social club?
2. Should be exempt from federal income tax under Code 501(c)(4) as a homeowners association?
3. Is exempt from federal income tax under Code 501(a)?

FACTS

(also referred to as exempt organization) is organization and classified as a 501(c)(7) social and recreational club. The exemption extends to social and recreation clubs which are supported by membership fees, dues, and assessments.

, the exempt organization's articles were not available for inspection. Information obtained from the Secretary of State Website the showed that the exempt organization's filing type as a nonprofit corporation and a date filed as October 26, 19XX.

is a membership organization that was formed by a housing developer.

The exempt organization's primary exempt purpose was listed on their 20XX, Form 990 return and it was to provide member families with recreational activities including swimming, tennis, playground, marina, and social events to promote community spirit.

The exempt organization maintains swimming pool, tennis court, duck pond, and marina for benefit of their members. The organization also maintains common areas throughout the subdivision in which general public has access.

During the examination of provided a copy their Declaration of Covenants and Restrictions pertaining to the enforcement covenants and/or restrictions on members of the organization.

The , Covenants and Restrictions and Architectural committee is a 17 page document that was updated and notarized on October 2, 20XX.

In the document the following information is available in Article III, people who own property are automatically members of the association and Article VII, list the covenants for maintaining the property.

During the examination of the exempt organization the determination letter was available to review at the initial audit and it showed that they were granted exemption in July 19XX, IRC 501(c)(7).

, started in 19XX, membership is not an option, they must own a home within the subdivision, belong to the association, and pay yearly home owners association fees. During the interview with , Treasurer/Secretary, explained that there were 0 homes within the association and that most of the homeowners were current with their assessment fees but others were in default.

© 2006-2020, CPC Holdings, LLC. All rights reserved.

During the initial interview and in a telephone conversation with officer, , verified what the organization's definition were to be a member and the qualifications. said, " that a member is a person who owns property at subdivision and they have to own property in to be a member of the organization."

allows access to organization's facility from outside the community to a second adjoining subdivision. The organization has a verbal agreement with 31 homes. The adjoining subdivision, called " " if they pay monies may attend the exempt organizations activities.

homeowners pay the same assessment fees as the members of . receives the same amenities as the exempt organization member's access to social activities, swimming pools, tennis court, and marina. homeowners are not under the same covenants and restrictions as the organization homeowner/members.

homeowners are not required to pay the assessment fees on a year to year basis.

During the interview it was verified that the organization activities were to maintain a pavilion for social events, maintain and up keep of three swimming pools, maintain and up keep of tennis court, maintain and up keep of marina, maintain and up keep of duck pond, and maintain and up keep of common property through the organization.

The organization conducts four to five regularly scheduled yearly events Opening Pool Day, St. Patrick's Day, Fourth of July, Closing Pool Day, and other unscheduled events for the members only. The exempt organization does allow members to bring guest for a nominal fee.

The assessment fees for each home in for the current year $0 for each member.

Information was requested for the examination from the organization for the initial audit appointment of for the minute books for the period ending December 31, 20XX. During the interview officer said that they did not have any minutes for the year under audit for 20XX that the prior Secretary did not maintain any minutes of the board meetings or general meetings. Then it was requested to review the board meeting minutes and general meeting minutes for the subsequent year 20XX to gain knowledge of the organization's operations. The review provided minimal information that the organization allowed nonmembers from the adjoining community to become members and allowed nonmembers to rent the marina slips.

	20XX	20XX
Membership Dues	$0	$0
Expenses related management, maintenance, and care of the		

© 2006-2020, CPC Holdings, LLC. All rights reserved.

association's property		
General Administrative	$0	$0
Grounds Maintenance	$0	$0
Marina	$0	$0
Tennis court	$0	$0
Swimming Pool	$0	$0
Total	$0	$0

income in 20XX and 20XX consisted of assessment fees charged to nonmembers of the subdivision five in the amount $0 and four in the amount $0, respectively.

During the tour of the facility the EO had a marina in which members and nonmembers rent the slips I determined that it was not an issue with the members but the nonmembers was an unrelated business activity.

also owns and maintains marina slips. The exempt organization rents out the marina slips to its members first and any remainder slips not rented are then rented to non-members.

Marina Rent	**20XX**	**20XX**
Member slips rented	0 - $0	0 - $0
Non Member slips rented	0 - $0	0 - $0

The tax law changed in 19XX for certain homeowners association.

ISSUE #1: LAW

§ 501(c)(7) of the Code provides for the exemption from federal income tax of clubs organized and operated 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.

§ 512(a)(3)(A) of the Code provides that in the case of all exempt organizations, including social clubs described in Code *§ 501(c)(7)*, the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income).

§ 512(a)(3)(B) of the Code provides that, for purposes of Code *§ 512(a)(3)(A)*, the term "exempt function income" means 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 purpose of the purposes constituting the basis for the exemption of the organization to which such income is paid.

§1.501(c)(7)-1(a) of the federal Tax Regulations 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

© 2006-2020, CPC Holdings, LLC. All rights reserved.

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. 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.

§1.501(c)(7)-1(b) of the federal Tax Regulations states that the 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). 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.

Rev. Rul. 69-281; 1969-1 C.B. 155, It is recognized that the existence of the club's facilities assisted the developer in selling homes. However, the club is not controlled by him and is not operated as a commercial venture for his financial benefit. Instead, the club is operated exclusively for the pleasure and recreation of its established membership of individuals by providing recreational facilities that afford opportunities for fellowship and social commingling. Accordingly, it is held that the club is exempt from Federal income tax under *section 501 (c) (7) of the Code*. The fact that membership in the club is automatic on becoming a home owner does not affect its qualification for exemption.

Rev. Rul. 75-494; 1975-2 C.B. 214 A club providing social and recreational facilities, whose membership is limited to homeowners of a housing development, will be precluded from qualifying for exemption under *section 501(c)(7) of the Code* by owning and maintaining residential streets, enforcing restrictive covenants, or providing residential fire and police protection and trash collection service.

And provides answers to inquires asking whether certain activities engaged in by clubs similar to the club described in *Revenue Ruling 69-281, 1969-1 C.B. 155*, will preclude their exemption under Code *§ 501(c)(7)*. The ruling was given in question/answer format. The question/answers that are relevant to this report are shown below:

Question Will a club fail to qualify for exemption under Code *§ 501(c)(7)* if it administers and enforces covenants for preserving the architecture and appearance of the housing development?

Answer Yes, A club which administers and enforces covenants for the preservation of the architecture and appearance of the housing development is not operated exclusively for pleasure, recreation, and other non-profitable purposes as required by Code *§ 501(c)(7)*.

ISSUE #2: LAW

Code *§ 501(c)(4)(A)* provides for exemption from federal income tax Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a

© 2006-2020, CPC Holdings, LLC. All rights reserved.

particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

Code *§ 501(c)(4)(B)* states that subparagraph (A) shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

Federal Tax Regulations *§ 1.501(c)(4)-1(a)(1)* of the federal Tax Regulations states that civic leagues or organizations may be exempt as an organization described in Code *§ 501(c)(4)* if: (i) it is not operated for profit; and (ii) it is operated exclusively for the promoting of social welfare.

§ 1.501(c)(4)-1(a)(2) of the regulations states that: (i) In general. -- An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements. A "social welfare" organization will qualify for exemption as a charitable organization if it falls within the definition of "charitable" set forth in *paragraph (d)(2) of § 1.501(c)(3)-1* and is not an "action" organization as set forth in *paragraph (c)(3) of § 1.501(c)(3)-1*.

Revenue Ruling 74-99, 1974-1 C.B. 131, describes the circumstances in which a homeowner's association may qualify for exemption under Code *§ 501(c)(4)*. The Ruling states that three elements must be satisfied:

1) It must serve a "community" that bears a reasonably recognizable relationship to an area ordinarily identified as governmental;
2) It must not conduct activities directed to the exterior maintenance of private residences, and
3) 3) The common areas or facilities it owns and maintains must be for the use and enjoyment of the general public. The Ruling also states that a "community", in within the meaning of Code *§ 501(c)(4)* is not merely "an aggregation of homeowners bound together in a structured unit formed as an integral part of a plan for the development of real estate subdivision and the sale of purchase of homes therein."

Revenue Ruling 72-102, 1972-1 C.B. 149, states in order to be exempt under Code *§ 501(c)(4)*, an organization must maintain common streets and sidewalks, which will be available for use by the community as a whole.

Revenue Ruling 74-99, 1974-1 C.B. 131, further emphasizes that such organizations must serve a community which bears a reasonable and recognizable relation to an area ordinarily identified as governmental, and that the common area it owns or maintains, must be for the use and enjoyment of the general public.

Revenue Ruling 80-63, 1980-1 C.B. 116, was issued to discuss, in question and answer format, certain issues raised by *Revenue Ruling 74-99*.

Question: Does *Revenue Ruling 74-99* contemplate that the term "community" for purposes of Code *§ 501(c)(4)* embraces a minimum area or a certain number of homeowners? Answer: No. *Revenue Ruling 74-99* states that it was not possible to formulate a precise definition of the term "community." The ruling merely

© 2006-2020, CPC Holdings, LLC. All rights reserved.

indicates what the term is generally understood to mean. Whether [*46] a particular homeowners' association meets the requirements of conferring benefit on a community must be determined according to the facts and circumstances of the individual case. Thus, although the area represented by an association may not be a community within the meaning of that term as contemplated by Revenue Ruling 74-99, if the association's activities benefit a community, it may still qualify for exemption. For instance, if the association owns and maintains common areas and facilities for the use and enjoyment of the general public as distinguished from areas and facilities whose use and enjoyment is controlled and restricted to members of the association then it may satisfy the requirement of serving a community.

ISSUE #3: LAW

Code § 528, as added by Code § 2101 of the Tax Reform Act of 1976, P.L. 94-455, 90 Stat. 1525, provides an elective exemption for certain homeowners associations that are described in Code § *528(c)*.

Code § *528* exempts from federal income tax any dues and assessments received by qualified homeowners' associations that are paid by property owners who are members of the association, where the assessments are used for maintenance and improvements of the association property.

Code § 528 defines a "homeowners' association" as an organization which is a condominium management association or a residential real estate management association if:

- It is organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property,
- It elects to have the section apply for the taxable year,
- No part of the earnings of the association inures to any private shareholder or individual,
- 60 percent or more of the association's gross income consists solely of amounts received as membership dues, fees, assessments from owners of residential units or residences or residential lots (exempt function income), and
- 90 percent or more of the association's expenditures for the taxable year are expenditures for the acquisition, construction, management, maintenance, and care of association property.

Code § 277(a) provides that in the case of a social club or other membership organization which is operated primarily to furnish services or goods to members and which is not exempt from taxation, deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members shall be allowed only to the extent of income derived during such year from members or transactions with members (including income derived during such year from institutes and trade shows which are primarily for the education of members). If for any taxable year such deductions exceed such income, the excess shall be treated as a deduction attributable to furnishing services, insurance, goods, or other items of value to members paid or incurred in the succeeding taxable year. The deductions provided by Code §§ 243, 244 & 245 (relating to dividends received by corporations) shall not be allowed to any organization to which this section applies for the taxable year.

TAXPAYER'S POSITION

© 2006-2020, CPC Holdings, LLC. All rights reserved.

The taxpayer is being presented with this report at this time and their position is unknown at this time on Issues 1, 2, and 3.

GOVERNMENT'S POSITION

Issue # 1
Should continue to be exempt from federal income tax under the Internal Revenue Code ("Code") § 501(c)(7) as a social club?

no longer qualifies for exemption from federal income tax under Code *§ 501(c)(7)*. Organization is not operated for pleasure, recreation, and other non-profitable purposes, where substantially all of the activities of which are for such purposes for the following reasons:

The has in its books and records a 17 page document entitled Declaration of Covenants and Restrictions that outlines the covenants and restrictions that the organization enforces.

operates in direct violation of *Revenue Ruling 75-494* by administering and enforcing covenants to preserve architecture and appearance of a housing development.

Issue # 2
Should be exempt from federal income tax under Code *501(c)(4)* as a homeowners association?

The exempt organization does not qualify for exemption from federal tax under Code *§ 501(c)(4)* as a home owners association for the following reasons:

The activity of exempt organization is for the benefit, pleasure, or recreation of its members. This is evident when the activities and facilities of the organization are considered.

It owns and maintains a swimming pool, tennis courts, lake with a marina and hiking trails that are limited to member access that are restricted to member's use and a majority of the organization's expenditures and expenses are in furtherance of social club type activities.

The has in its books and records a 17 page document entitled Declaration of Covenants and Restrictions that outlines the covenants and restrictions that enforces covenants to preserve architecture and appearance of a housing development.

Revenue Ruling 80-63 plainly states that the use and enjoyment of common areas owned and maintained by a homeowners' association must be extended to members of the general public, as distinguished from controlled use or access restricted to the members of the association. Therefore, by limiting access to common areas and recreational facilities per organization's By Laws and Declaration of Covenants and Restrictions they are not entitled to exemption from federal income tax under Code *§ 501(c)(4)*.

ISSUE # 3

© 2006-2020, CPC Holdings, LLC. All rights reserved.

is no longer qualified for exemption from federal income tax under Code § *501(c)(7)* social organization. Neither is qualified for exemption under Code § *501(c)(4)* social welfare organization. There is no other code section that the organization could qualify for tax exemption.

CONCLUSION

was granted exemption in 19XX as a 501(c)(7). Then the law changed in 19XX. The homeowners no longer qualified under Code § 501(c)(7).

does not qualify Code § 501(c)(4) because they do not meet social welfare. Because they do not maintain the property for the community in general they maintain the property for benefit of their membership.

it is possible that they meet homeowner's association criteria. The organization should investigate if they meet that criteria and if they meet that is an election and they can file Form 1120-H.

The correction the organization needs to make they need to file Form 1120, U.S. Corporation Income Tax Return, should be filed for the tax periods ending December 31, 20XX, and December 31, 20XX.

The organization can take advantage of Code § 277 in determining the correct amount of tax liability for those years where the membership income and expenses are not taxable.

The government contends in its position that the exemption from federal Income Tax should be revoked back to the tax period ending January 1, 20XX.

© 2006-2020, CPC Holdings, LLC. All rights reserved.