DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

UIL 501.07-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: September 12, 2014

Number: **201450023**
Release Date: 12/12/2014

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ ID Number

Contact Numbers:
Phone:
Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

In a determination letter dated October 8, 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 June 12, 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 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

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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

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

Date: April 30, 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:

Certified Mail – Return Receipt Requested

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

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

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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.

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Thank you for your cooperation.

Sincerely,

Acting Director, EO Examinations

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

Letter 3610-R (10-2012)
Catalog Number 59432G

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Form **886-A** (Rev. January 1994)	**EXPLANATIONS OF ITEMS**	Schedule number or exhibit
Name of taxpayer	Tax Identification Number	Year/Period ended 12/31/20XX

ISSUE

Whether should be exempt from federal income tax under Internal Revenue Code (IRC) section 501(c)(7) as a social club.

FACTS

was incorporated in the state of in December of 19XX. applied for exempt status and a Letter 948 was issued on October 8, 19XX granting exempt status as a 501(c)(7) organization. An addendum was added to that letter stating:

> "If your organization owns and maintains private residential streets, roadways, culverts, bridges and drainage areas which are not a part of your social facility you may jeopardize your exempt status under section 501(c)(7). This is not a 501(c)(7) activity."

The original started as a development that would sell lots, and have numerous amenities. Among these amenities were to be horse stables, bridle trails, a golf course, a horse racing track and other attractions. The original development had financial trouble and had to sell off land. The original 0 lot owners did not want to see the development fail and started . Their intent was to resume sales in the 19XX's and continue to sell lots until the could take over operations. That goal was reached in the late 19XX's when The dissolved and the new took over operations as a members-only facility.

The current consists of 0 one-quarter acre lots. Of the 0 total lots, there are 0 lots that can be developed and 0 are set aside as an open space conservation easement. The developed lots and the open space lots are not contiguous.

The only sells enough lots to maintain the 40 year old common facilities, so that the dues on the membership are not raised. Dues are the largest percentage of the income brought into the organization. Lots are primarily used for dry camping, as the organization does not provide water. There are only a few full time residents of the organization. Guests pay their own way. They do not rent the common facilities to the public. The organization has two winter storage areas for members to store their RV's for a fee. The organization provides this amenity to members as additional security due to vandalism and thefts in the complex. Members have to transport water to their own properties. The clubhouse is open all year round.

County health laws place restrictions on the number of days members can stay on the property due to the lack of water and sanitation facilities.

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Articles of Incorporation .

The articles of incorporation for list seven Purposes for the . They are:

1) To foster and maintain acquaintanceship and friendship among the members of through the maintenance generally of a western atmosphere and way of life through recreational activities fostered through the acquisition and ownership of community parkway, bridle trails, stables, playgrounds, open spaces and recreational areas, clubhouses, swimming pools and other places of amusement throughout the general real estate development known as in .

2) Own all of the roads designated as private roads on the various plat of subdivisions within the general development of ; to maintain all of these roads and bridle trails, also to own and operate a water system or systems within certain designated areas of the development, and to levy monthly charges for dues among the members of the and additional charges from among the users of the water system or systems.

3) To enforce liens, charges, restrictions, conditions and covenants existing upon and/or created benefit of parcels of real property within the overall development over which this corporation will have jurisdiction and to which said Parcels may be subject to the extent that the corporation has the legal right to enforce the same and to pay all expenses incidental thereto.

4) To pay the taxes and assessments which may be levied by any public authority upon any of the property now or hereafter acquired as common areas, parks, playgrounds clubhouses, club buildings, places of amusement and /or recreation areas, wherever situate as may be maintained for the general benefit and use of the members of the .

5) To expend the monies collected by the from assessments and charges and other sums received for the payment and discharge of costs, expenses and obligations incurred by the in carrying out any and all of the purposes for which this corporation has been formed particularly to pay out from dues all sums necessary for the maintenance of the private roads throughout .

6) Generally, to do any and all lawful things which may be advisable, proper, authorized and/or permitted to be done by nonprofit corporations under and by virtue of the laws of the state of incidental to the general welfare of the members of the association, all of whom will be owners of lots within the various subdivisions of , a real estate development.

7) To improve and maintain all of the roadways, culverts, bridges, and drainage areas set forth in the various plats of subdivisions of and to provide for generally and in cooperation with public agencies, police and fire protection throughout the general development of , .

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The organization reported the following gross receipts on its 20XX Form 990.

Revenues	Amount
Membership Dues	$ 0
Investment Income	$ 0
Rents	$ 0
Gross Sales (land)	$ 0
Sales of Inventory	$ 0
Total Gross Receipts	$$ 0.00

President, , advised that the organization sells lots and holds the contracts on the mortgages to those sales, which allows the organization to foreclose on the lots for nonpayment. The organization has to purchase properties at a sheriff's auction when contracts held by outside lenders are foreclosed upon. This costs the organization more money.

has limited nonmember use of its facilities as part of the . This program gives members access to camping areas nationwide.

Nontraditional Income Sources

Nontraditional income is received by an organization exempt under IRC section 501(c) (7) when money-making activities do not serve the organization's exempt purpose. The nontraditional sources for are:

Lot Sales	$ 0
Investment income	$ 0
Propane sales	$ 0
Range lease	$ 0
RV Storage	$ 0
Total	$ 0

Bylaws

In Article 1 of the Bylaws the organization's purpose is stated as:

> The shall be conducted as a nonprofit social and maintenance organization for the purposes generally set forth in the Articles of Incorporation concerning the development and sale of property at in . The purpose of the shall be in part to maintain shared facilities and infrastructure for the enjoyment, pleasure and benefit of the Membership as set forth below. The may authorize the Board of Directors of to draw, enact, and enforce regulations governing access to and use of shared facilities and infrastructure for the purpose of maintaining and preserving said facilities and

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infrastructure, maintaining peace and tranquility, minimizing harmful, excessive or costly impact on said facilities and infrastructure, and for the purpose of ensuring access and to provide for the enjoyment, welfare and security of the Membership. The shall authorize such regulations and shall take or authorize such actions as it may determine to be in the general interests of the lot owners and . The shall take no action that unduly favors either those owners who have purchased lots primarily for recreation, or those owners who have purchased lots with the intent to establish permanent residence now or in the future. The shall therefore be conducted so as to preserve for both recreational and residential lot owners."

Article 2 of the Bylaws states:

> **2.1 Authorization to sell lots.** The is authorized to sell real property consisting of the platted lots in the area known as in . The may appoint agents to show lots for sale to prospective purchasers, and may enter into legal agreements and derive income from the sale of lots or transfer ownership of said lots from the to purchasers. Notwithstanding the conditions set forth in below, the may, with approval of the Board of Directors, sell, lease, grant rights to enter upon, or may withhold from sale or withhold the right to enter upon, portions of within Divisions or other legal description when the sale, lease, rights to entry, or the withholding of sale or rights to entry benefits the . Said benefits may generally include but are not strictly limited to preservation of sections of in a natural or undeveloped state, the preservation and protection of various species of plants or animals, the creation of fire breaks, the control of access, the preservation and control of hunting or fishing, other sporting used including use by off-road vehicles, and activities relating to conservation.

LAW

Internal Revenue Code
Section 501(c)(7) provides exemption from income tax for clubs 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.

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Treasury Regulations
Section 1.501(c)(7)-1 provides that:

(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 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.

(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 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. However, an incidental sale of property will not deprive a club of its exemption.

In Revenue Ruling 68-168, 1968-1 C.B. 269, a nonprofit organization was formed to develop a lake and adjacent areas to provide facilities for the pleasure and recreation of its members. They acquired substantial acreage, subdivided the lots, and leased them to members for 99 year terms. Receipts from the organization were primarily derived from initial payments and annual rentals and not from the members' use of recreational facilities or activities. The subdividing and leasing of lots in the manner described constitutes engaging in business. Although the revenues from this activity are derived from the organization's members only, the revenues are not raised from the members' use of recreational facilities, or in connection with the organization's recreational activities. The conduct of such real estate activity, whether with members only or with the general public, is not incidental to or in furtherance of any purpose covered by section 501 (c)(7) of the Code. Accordingly, the organization does not qualify for exemption from Federal income tax under that section.

In Revenue Ruling 66-149,1966-1 C. B. 146, a club was held to be not exempt as an Organization described in Code section 501(c)(7) because it regularly derived a substantial part of its income from nonmember sources such as, for example, dividends and interest from investments it owned. The ruling clearly states that "to the extent that income is derived from nonmember sources, it inures to the benefit of the members."

Revenue Ruling 58-589 provides that there must be an established membership of individuals, personal contacts and fellowship. A commingling of the members must play a material part in the life of the organization. In addition, net earnings may inure to members in such forms as an increase in services offered by the club without a corresponding increase in dues or other fees paid for club support or as an increase in the club's assets, which would be distributable to members upon the dissolution of the club. The revenue ruling provides practical guidance stating that a business activity (a non-traditional activity) will defeat exemption, unless it is incidental, trivial or nonrecurring in nature. *West Side Tennis Club* v. *Commissioner,* 111 Fed.

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(2d) 6, certiorari denied, 311 U. S. 674; *Mah Jongg League, Inc.* v. *United States,* 75 Fed.Supp.769.

Revenue Ruling 75-494, 1975-2 C.B. 214, 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 section 501(c)(7). The ruling was given in question/answer format. The question/answers that are relevant to this report are shown below:

Question 1.
Will a club fail to qualify for exemption under section 501(c)(7) of the Code if it owns and maintains residential streets, which are not a part of its social facilities?

Answer:
Yes. A street providing immediate access to a club's golf course could be considered part of the course, and thus part of a social facility. However, streets primarily serving residential areas are not a part of a club's social facilities, even though members must travel on them to reach the social facilities. Thus, a club which owns and maintains residential streets is not operated exclusively for pleasure, recreation, and other non-profitable purposes as required by section 501(c)(7) of the Code.

Question 2
Will a club fail to qualify for exemption under Code section 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 section 501(c)(7).

TAXPAYER'S POSITION

The taxpayer's position has not been determined at this time.

GOVERNMENT'S POSITION

The no longer qualifies for exemption from federal income tax under Internal Revenue Code section 501(c)(7). isn't operated for pleasure, recreation, and other non-profitable purposes. A substantial number of the activities are not for such purposes and a portion of the net earnings inure to the benefit of members. The disqualification is for the following reasons:

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1. is selling lots on a continuing basis. In addition, holds the mortgage contracts on a number of the lots. A 501(c)(7) organization cannot be in the business of holding mortgages.
2. has issued restrictions and covenants governing the property. This is not an allowed 501(c)(7) activity.
3. owns and maintains the roads of the property, which is not a 501(c)(7) activity.

Treasury Regulation 501(c)(7)-1 (b) states 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). 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. However, an incidental sale of property will not deprive a club of its exemption.

continues to sell real estate lots. activity was never intended to be allowed by a 501(c)(7). This activity invalidates the exempt status under section 501(c)(7) of the Internal Revenue Code. Further evidence that this activity is in violation of section 501(c)(7) is that holds the sales contracts on a number of the lots. This activity, according to the president of the organization, is to make it easier to maintain control of the property in the case of a foreclosure.

maintains covenants and restrictions on the property. Revenue 75-494 states that 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 section 501(c)(7).

The articles of incorporation for states one of its purposes is: "to enforce liens, charges, restrictions, conditions and covenants existing upon and/or created benefit of parcels of real property within the overall development over which this will have jurisdiction and to which said Parcels may be subject to the extent that the has the legal right to enforce the same and to pay all expenses incidental thereto."

The fact that enforcing covenants and restrictions on the property is in the articles of incorporation is evidence of an activity in violation of 501(c)(7) status.

Revenue Ruling 75-494, states a road providing access to a club's golf course could be considered a part of the course and part a social facility. However, streets primarily serving residential areas are not a part of a club's social facilities, even though members must travel on them to reach the social facilities. Thus, a club which owns and maintains residential streets is not operated exclusively for pleasure, recreation, and other non-profitable purposes as required by section 501(c)(7) of the Code

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Multiple portions of the articles of incorporation for pertain to the ownership and maintenance of the residential roads of the complex. The ownership of the roads is not allowed for a 501(c)(7) organizations. The owning of roads was addressed in an addendum to the determination letter for .

The sale of inventory (Propane) by the organization contributes $0 to the organization. This is a continuing activity by the organization. Despite being members-only, the sale of propane is a nontraditional activity. The sale of the propane is a personal service to the members and is not in keeping with the normal activities of a 501(c)(7) exempt organization.
Another personal service activity is the providing of RV storage facilities to the members. A social club's purpose is to be engaged in the activity of promoting social interaction.

The mention of the social requirements of a 501(c)(7) organization does not appear the prime purpose of the organization. See Attachment A for a calculation of nontraditional income.

The amount of nontraditional income of 81% significantly exceeds the 5% limit allowed to a 501(c)(7) organizations. The gross receipts from the sale of land are almost a quarter of the total gross receipts of the organization. This shows that the activity is not trivial or insignificant for the organization. This is an activity more in line with a mortgage lender or bank, not an organization with exemption under section 501(c)(7).

CONCLUSION

The no longer qualifies as an exempt organization under the provisions of section 501(a) as an organization described in section 501(c)(7). A number of the activities are in violation of the 501(c)(7) status. The $0 of income from these activities is significant as it results in an 81% nontraditional income percentage (see Exhibit A at the end of this report for the calculation). Therefore, exempt status should be revoked effective January 1, 20XX.

Should this revocation be upheld the organization is required to file Form 1120 or Form 1120-H for all periods, starting with the effective date, whether or not it has taxable income.

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ALTERNATIVE POSITION

If the organization is in compliance with the requirements of law and continues to qualify as an exempt organization described in IRC 501(c)(7), forms 990-T should be filed to report the net income from nontraditional activities.

FACTS

In the year ended December 31, 20XX, included its receipts from investment income and nontraditional income in total gross receipts. has not filed a Form 990-T under the assumption that all income is member only income, which is not taxable.

Activity	Income	Expense	Gain/ loss.
Sales (land)	$ 0	$ 0	0
RV Storage	0	0	0
Propane sales	$ 0	$0	0
Rangeland Lease	$ 0	$ 0.00	0
Investment income	0	$ 0.00	0
Net income subject to Form 990-T			$ 0

LAW

Reg. 1.501(c)(7)-1(b) provides in part, that a club which engages in business, such as by 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 ("exclusively" is the standard exercised prior to the 1976 enactment of P.L. 58-568) for pleasure, recreation, and other non-profitable purposes, and is not exempt under IRC Section 501(a). Following the enactment of P.L. 58-568 in 1976, the term "exclusively" should be replaced with the terms "substantially all".

IRC Section 512(a)(3)(A) stipulates that all income derived by an organization exempt under the provisions of 501(c)(7) is taxable income except for the income derived from members for dues, assessments, or participation by members and their bona fide guests for activities traditionally considered to be exempt purpose activities of a social or recreational club.

Revenue Procedure 71-17 provides the record keeping requirements for social clubs to substantiate the member and nonmember character of the income derived by the organization for products or services provided.

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Public Law 94-568 amends Revenue Procedure 71-17 to allow organizations exempt from income tax to have up to 15% of their gross income from nonmember sources and an additional 20% from investment income without jeopardizing the organization's exempt status. It also amends the language of IRC Section 501(c)(7) from "operated exclusively for pleasure, recreation, and other non-profitable purposes" to "substantially all of the activities" are for such purposes.

Portland Golf Club v. Commissioner, the Supreme Court affirmed the original position of the Service held in Revenue Ruling 81-69 and decided that nonmember income must be determined by using the same method to allocate fixed costs to nonmember sales as that used to compute the club's actual profit or loss.

Revenue Ruling 58-589 states in part, "An organization must establish (1) that it is a club both organized and operated exclusively for pleasure, recreation and other non-profitable purposes and (2) that no part of its net earnings inures to the benefit of any private shareholder or individual. To meet the first requirement, there must be an established membership of individual's personal contacts and fellowship. A commingling of the membership must play a material part in the life of the organization."

GOVERNMENT'S POSITION

has received income from nontraditional sources and investment income. The total nontraditional income including investment income is $0. The expenses allocable to nontraditional activities are $0, leaving a net amount of $0. The organization would be entitled to the specific deduction of $0 leaving taxable income of $0. The $0 would be taxed at a rate of 39% on the amount over $0 resulting in a tax amount of $0.

TAXPAYER'S POSITION

The taxpayer's position is not known at this time.

CONCLUSION

has incurred at least $0 in unrelated business taxable income in the tax year ended December 31, 20XX. Accordingly, the organization should file Form 990-T and be assessed $ 0 in tax.

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Form **886-A** (Rev. January 1994)	**EXPLANATIONS OF ITEMS**	Schedule number or exhibit
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EXHIBIT A

Nontraditional Income Percentage calculation.

	12/31/20XX
Gross Receipts	$ 0
(Minus)	
Membership Dues	(0)
Investment Income	(0)
0	(0)
Rangeland Lease	(0)
RV Storage	(0)
Gross sales (land)	(0)
Modified Gross Receipts per Rev Proc 71-17	$ 0
Non-Traditional Activity -	
Gross Sales (land)	$ 0
Investment income	0
Propane Sales	0
Rangeland Lease	0
RV Storage	0
Total Nontraditional Income	$ 0

Divided by(Modified Gross Receipts +Nontraditional income) ($0+0)=

Percentage of Non-Traditional Income **81%**

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