



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE
1100 Commerce, MC 4920 DAL
Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: January 30, 2015

Number: **201518018**
Release Date: 5/1/2015

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ ID Number

Contact Numbers:

Phone:

Fax:

UIL: 501.04-00

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

In a determination letter dated March, 20XX, you were held to be exempt from Federal income tax under section 501(c)(4) 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)(4) of the Code. Accordingly, your exemption from Federal income tax is revoked effective May 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 August 26, 20XX you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(4) 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 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 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,

Margaret Von Lienen
Director, EO Examinations

Department of the Treasury
Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations
Mail Stop 4900 PHX:CC
4041 North Central Avenue, Suite 112
Phoenix, AZ 85012

Date: August 16, 2013

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.

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

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

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.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Director, EO Examinations

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

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer	Tax Identification Number		Year/Period ended April 30, 20XX and April 30, 20XX

Issue:

1. Should _____ continue to be exempt from tax under Internal Revenue Code (IRC) section 501(c)(4) as a social welfare organization?

Facts:

_____ was incorporated in the State of _____ on February 6, 20XX. The organization is listed with a business type of Homeowners Association on the Corporation Commission website. _____ Articles of Incorporation (AOI), Article VI, states the following purpose for which the corporation was formed:

The purpose for which the corporation is organized is the conducting of any or all lawful affairs for which corporations may be incorporated under Title 10, Chapter 22 Revised Statutes. Initially, the character of affairs, which the corporation intends actually to conduct in this State, is as follows:

1. To cooperate with the Forest Service in its efforts to maximize the recreational benefits of the residences of the members/permittees.
2. To provide such services and make such improvements for the benefit of the recreational residences of the members as may be authorized by the Forest Service.
3. To represent and serve the members in matters of mutual concern, including without limitation, fee and rental determination, appraisals, environmental studies, permit termination proceedings, fire protection, utilities, Forest Service planning in relation to recreational residences of the members, and in all similar or other endeavors relating to continuance and maintenance of such recreational residences and their related permits held by the members.
4. To do all things necessary or appropriate to protect the interests of the members, collectively and individually, in the maintenance, continuance and enjoyment of the recreational residences of the members and the use permits authorizing such residences.

According to Internal Revenue Service (IRS) records, the organization was granted tax-exempt status under IRC section 501(c)(4) effective February 6, 20XX. The organization has filed all Forms 990 timely since being granted exempt status.

The following facts contained in this report were collected during an initial interview with the organization conducted on April 5, 20XX. Present at the initial interview were the President of the organization and the bookkeeper, who was also the former President. Following the initial interview the examiner took a tour of the area in which _____ is located. The examiner also reviewed the records of the organization on April 8, 20XX (for fiscal year April 30, 20XX) and later reviewed the records for fiscal year April 30, 20XX.

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Physical description:

property consists of recreational residences that the members own individually. The geographic location of property is in an area of National Forest, of . The area occupied by members is divided into three subsections called Upper, Middle, and Lower . The members must apply for a permit to use the land that their respective residences occupy. Effectively, the members do not own the land upon which the residences sit, but they own their individual improvements. All land in the area is National Forest land and not owned by or its members. comprises a total of residences. Access to the three subsections is provided by driveways that branch off from unimproved public roads in the National Forest. Although does not own the roads or forest land, approved permits designate the permit holder to be responsible for maintaining and preserving the environment and natural resources. The President has also stated that permit holders are responsible for maintaining the roadways that provide access to residences.

In addition to the improvements on the individual lots, also put into service a water chlorination system in fiscal year 4/30/20XX. Previously water was distributed to the residences via plumbing, the source of which was a spring adjacent to the area. Testing conducted by the U.S. Forest Service indicated the water quality to be insufficient for health standards. As a result, the Forest Service mandated that install a water chlorination system to achieve acceptable water qualities for health and safety of all persons accessing the water. is responsible for maintaining the chlorination system and quality of the water.

Access to the property:

During a tour of the area, the examiner noted that the driveways leading to the recreational residences were restricted by gate access. The member providing the tour stated that the gates were installed to prevent the public from driving down into the occupied area and becoming stuck due to the narrow access, as well as to reduce the possibility of burglary of the residences as much of the year the homes are left vacant. Permit holders have keys to unlock the secured gates.

Since the organization sits on National Forest, the land is open to the public. Aside from the gate to deter vehicles from entering via the driveways, anybody can access the area by foot (i.e. hikers, bird-watchers, etc.). District Ranger's for the Forest Service also have access to the area for inspection of the individual improvements.

Details of Permit:

The permits for recreation residences in the National Forest are granted to authorize the individual applicant's to occupy a recreation residence for personal, noncommercial recreation use. Each permit describes what improvements are authorized in addition to the residence (i.e. septic system, sidewalks, patios, storage buildings, etc.). Generally, the permits expire 20 years from the date of issuance. The permits only authorize occupancy of a recreation residence. Any activities planned, to include development, construction, or alteration, must be approved by the Forest Service. Some improvements requiring specific approval include signs, fences, mailboxes, pipelines, antennas. All permit holders are also required to prepare an operating plan that will

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outline steps the holder will take to protect public health and safety, and the environment. The operating plan must address requirements for the following:

1. Maintenance of vegetation, tree planting, and removal of dangerous trees and other unsafe conditions.
2. Maintenance of the authorized improvements.
3. Size, placement and description of authorized signs.
4. Removal of garbage.
5. Fire protection.
6. Identification of the person responsible for implementing the operating plan, if other than the holder, and a list of the name, address, and telephone numbers of persons to contact in the event of an emergency.

Permits stipulate that the residence must be occupied at least 15 days of the year, but shall not be used as a full-time residence.

Annual permit fees that each individual owner of a recreational residence must pay to the Forest Service are determined by appraisals done by the Forest Service. Every 10 years the Forest Service will appraise two residences in and use the valuation to calculate what the annual permit fees will be for each permit holder. If disagrees with the valuation from the appraisal, can secure an independent appraisal and propose that it be used in lieu of the Forest Service's appraisal. In the fiscal year ending 20XX, secured its own appraisal to propose for use by the Forest Service.

Financial Analysis:

provided their financial records for fiscal years ending April 30, 20XX and April 30, 20XX. During the examination, the examiner determined that the statements tie closely to the Forms 990 filed for each year, excluding a mistyped amount on the April 30, 20XX Form 990 that was acknowledged by the President and bookkeeper. The organization recordkeeping procedures are effective and account for tracking all revenues and expenses of the organization. The examining agent used the following table to show the percentage of each revenue and expense item, as compared to the totals:

Revenues	30-Apr-XX	Percentage of Total	30-Apr-XX	Percentage of Total
Membership Dues & Assessments	\$	%	\$	%
Interest on Savings	\$	%	\$	%
Total	\$	100.00%	\$	100.00%

Expenses	30-Apr-XX	Percentage of Total	30-Apr-XX	Percentage of Total
Accounting Fees	\$	%	\$	%
Appraisal Fees	\$	%	\$	%
Permit Fees	\$	%	\$	%
Meetings	\$	%	\$	%
Water Testing	\$	%	\$	%

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Parts & Supplies	\$	%	\$	%	
Electric	\$	%	\$	%	
Other Fees	\$	%	\$	%	
Postage & Filing	\$	%	\$	%	
Chlorination System Installation	\$	%	\$	%	
Bank Fees	\$	%	\$	%	
Total	\$	100.00%	\$	100.00%	

This organization has no previous audit history.

Law:

Internal Revenue Code

Section 501(c)(4)(A)

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

Section 501(c)(4)(B)

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.

Treasury Regulations

Section 1.501(c)(4)-1 Civic organizations and local associations of employees

(a) Civic organizations

(1) In general. —A civic league or organization may be exempt as an organization described in section 501(c)(4) if:

- (i) It is not organized or operated for profit; and
- (ii) It is operated exclusively for the promotion of social welfare.

(2) Promotion of social welfare

(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 section 1.501(c)(3)-1 and is not an "action" organization as set forth in paragraph (c)(3) of section 1.501(c)(3)-1.

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(ii) Political or social activities. —The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office. Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit. See, however, section 501(c)(6) and section 1.501(c)(6)-1 relating to business leagues and similar organizations. A social welfare organization that is not, at any time after October 4, 1976, exempt from taxation as an organization described in section 501(c)(3) may qualify under section 501(c)(4) even though it is an “action” organization described in section 1.501(c)(3)-1(c)(3)(ii) or (iv), if it otherwise qualifies under this section. For rules relating to an organization that is, after October 4, 1976, exempt from taxation as an organization described in section 501(c)(3), see section 504 and section 1.504-1

(b) Local associations of employees. —Local associations of employees described in section 501(c)(4) are expressly entitled to exemption under section 501(a). As conditions to exemption, it is required (1) that the membership of such an association be limited to the employees of a designated person or persons in a particular municipality, and (2) that the net earnings of the association be devoted exclusively to charitable, educational, or recreational purposes. The word “local” is defined in paragraph (b) of section 1.501(c)(12)-1. See paragraph (d)(2) and (3) of section 1.501(c)(3)-1 with reference to the meaning of “charitable” and “educational” as used in this section.

Court Cases

Commissioner v. Lake Forest Inc., 305 F. 2d 814 (1962) The case involved a nonprofit membership housing cooperative that provided low cost housing to its members. In denying exemption, the court stated that the organization was not organized exclusively for the promotion of social welfare. The court found that although its activities were available to all citizens eligible for membership, “its contribution is neither to the public at large nor of a public character.” The court looked to the benefits provided and not to the number of persons who received benefits through membership.

Flat Top Lake Association. Inc. v. U.S.A., 868 F.2d 108, 63 A.F.T.R.2d 89-721, 89-1 USTC P 9180 (1989) Association consisting of owners of property surrounding an artificial lake that sought to restrict development to members only brought civil action seeking judicial determination that it currently was and had been exempt from federal taxation as a social welfare organization. The Court of Appeals, K.K. Hall, Circuit Judge, held that: (1) organization that operated for exclusive benefit of members did not serve as “community,” as that term related to broader concept of social welfare, for purposes of tax exemption, and (2) association that had done everything within its power to create wholly private environment for its members was not “community,” within meaning of federal tax exemption, and could not claim tax exemption for benefiting itself.

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Revenue Rulings

Revenue Ruling 74-99, 1974-1 CB. 131, modified Rev. Rul. 72-102 to make clear that a homeowners' association of the kind described in Rev. Rul. 72-102 must, in addition to otherwise qualifying for exemption under section 501(c)(4) of the Code, satisfy the following requirements: (1) It must engage in activities that confer benefit on a community comprising a geographical unit which bears a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof; (2) It must not conduct activities directed to the exterior maintenance of private residences; and (3) It owns and maintains only common areas or facilities such as roadways and parklands, sidewalks and street lights, access to, or the use and enjoyment of which is extended to members of the general public and is not restricted to members of the homeowners' association.

Revenue Ruling 80-63, 1980-1 CB 116

To clarify Revenue Ruling 74-99, specific questions that have been raised and their answers are as follows:

Question 1.

Does Rev. Rul. 74-99 contemplate that the term "community" for purposes of section 501(c)(4) of the Code embraces a minimum area or a certain number of homeowners?

Answer:

No. Rev. Rul. 74-99 states that it was not possible to formulate a precise definition of the term "community". The ruling merely indicates what the term is generally understood to mean. Whether 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 Rev. Rul. 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.

Question 2.

May a homeowners' association, which represents an area that is not a community, qualify for exemption under section 501(c)(4) of the Code if it restricts the use of its recreational facilities, such as swimming pools, tennis courts, and picnic areas, to members of the association?

Answer:

No. Rev. Rul. 74-99 points out that the use and enjoyment of the 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. For purposes of Rev. Rul. 74-99, recreational facilities are included in the definition of "common areas".

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Question 3.

Can a homeowners' association establish a separate organization to own and maintain recreational facilities and restrict their use to members of the association?

Answer:

Yes. An affiliated recreational organization that is operated totally separate from the homeowners' association may be exempt. See Rev. Rul. 69-281, 19691 C.B. 155, which holds that a social club providing exclusive and automatic membership to homeowners in a housing development, with no part of its earnings inuring to the benefit of any member, may qualify for exemption under section 501(c)(7) of the Code.

Question 4.

Can an exempt homeowners' association own and maintain parking facilities only for its members if it represents an area that is not a community?

Answer:

No. By providing these facilities only for the use of its members the association is operating for the private benefit of its members, and not for the promotion of social welfare within the meaning of section 501(c)(4) of the Code.

Government's Position:

Should _____ continue to be exempt from tax under Internal Revenue Code (IRC) section 501(c)(4) as a social welfare organization?

The government contends that _____ does not operate as an organization exempt under IRC section 501(c)(4) for the following reasons:

1. The organization does not promote social welfare. Although the organization is located on National Forest Service land, the facts show that their operations mainly consist of activities that affect permit holders who maintain recreational residences in the area.
2. The general public does not benefit significantly from this organization's activities.

An organization exempt under IRC section 501(c)(4) must operate "exclusively for the promotion of social welfare" which is further explained by the Regulations thus: being primarily engaged in promoting in some way the common good and general welfare of the people of the community. Revenue Ruling 74-99 confirms that the benefit must be conferred to "the community". Revenue Ruling 80-63 clarifies Revenue Ruling 74-99 stating that while a "community" cannot be strictly defined, that 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.

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Effectively all of _____ activities are subject to the approval of the United States Forest Service (USFS) according to the terms of the special use permits that are held by _____ members. Due to the restrictions in place by the USFS, it would be difficult for the organization to meet the criteria set forth for an organization exempt under IRC section 501(c)(4). The organization's main activities during the years under examination consisted of the installation of a water chlorination system (as mandated by the USFS), and contracting for appraisals of selected member recreational residences. The installation of the chlorination system and related costs to maintain the system accounted for approximately 68% in fiscal year ending 20XX, and 81% in fiscal year ending 20XX. Additionally, in the fiscal year ending in 20XX, the appraisal fees accounted for 27% of the organization's expenses.

The chlorination system was mandated by the Forest Service as a result of water testing that produced unacceptable water quality levels. The water that filters through the chlorination system is routed to each individual residence through a primitive plumbing system. The only benefit that anybody outside of _____ membership could possibly receive is by using one of a very select few water spouts that are disbursed throughout the area. This benefit to the general public is minimal and indirect.

_____ also secured real estate appraisals for two of the residences during the fiscal year ending 20XX. The real estate appraisals were done as a response to appraisals that were conducted on the same two residences by the Forest Service. Since individual annual permit fees are based on valuation of the appraisals, the expense of conducting this appraisal solely benefits the permit holders that have recreational residences in the _____ area.

In addition, meeting minutes of the years under examination indicate no intent of the organization to benefit anybody outside of the organization. Although the land where _____ is located is a National Forest and open to the general public, the organization's benefits to the general public are minimal at best. Gates installed at access points to the recreational residences further serve to reduce access to the general public.

Taxpayer's Position:

At this time, officers of _____ have stated that they agree with the findings of the examining agent and do not dispute that they are not operating within the context of an IRC section 501(c)(4) exempt organization.

Conclusion:

_____ activities do not coincide with the Internal Revenue Code or Treasury Regulations that define an organization exempt under IRC section 501(c)(4). The examination has shown that the promotion of social welfare has not been fulfilled by the organization during the years under examination. As indicated by the regulations, "civic betterments and social improvements" are keystones to an IRC section 501(c)(4) organization. _____ activities reflect that of a traditional homeowners' association, in which, the benefits provided by the organization are almost exclusively for its members. Its benefits are primarily material in nature, and do not aim to improve social welfare.

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The organization functions to benefit its members by maintaining a water chlorination system and appeal annual permit fees proposed by the US Forest Service. In doing so, the organization neglects to benefit the public in general. In the case *Commissioner v. Lake Forest Inc.*, *supra*, it was held that the contribution of the organization should be public in nature. fails to meet that standard and should not be permitted to maintain its exempt status as an IRC section 501(c)(4) organization.

should no longer qualify for exemption from federal income tax under IRC section 501(c)(4). The organization's exempt status should be revoked back to the tax period beginning the first day of the organization's fiscal year, May 1, 20XX.