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Consolidated Sportsmen of Lycoming County,

Petitioner

v.

Commissioner of Internal Revenue

Respondent

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Docket No. 18549-23X
Document No. 32

Memorandum in Support of Motion for Summary Judgment

UNITED STATES TAX COURT

CONSOLIDATED SPORTSMEN OF LYCOMING COUNTY,	)	
Petitioner,	)	
v.	)	Docket No. 18549-23X
	)	Filed Electronically
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

MEMORANDUM IN SUPPORT OF THE RESPONDENT'S MOTION FOR SUMMARY JUDGMENT

This memorandum is filed in support of the Internal Revenue Service's ("respondent's") Motion for Summary Judgment.

Pursuant to I.R.C. § 7428(a)(1)(E)[1], Consolidated Sportsmen of Lycoming County ("petitioner") seeks a declaratory judgment that respondent improperly revoked its tax exempt status under I.R.C. § 501(a) as a social club organization described in I.R.C. § 501(c)(7). Respondent asserts that its revocation is appropriate because petitioner had not satisfied the requirements for section 501(c)(7) tax exempt status based on the petitioner's receipt of non-member

[1] All references to "section" refer to the Internal Revenue Code of 1986 unless otherwise indicated.

income in excess of established, allowable amounts during the years in issue, 2017-2023.[2]

The factual basis of the respondent's Motion for Summary Judgment is the pleadings, and the jointly-filed administrative record filed on June 27, 2024, and the Joint Stipulation of Facts ("stipulation") also filed on June 27, 2024.

Based on the documents in the administrative record and stipulation there is no genuine dispute regarding the material facts in this case. There will be no need for a Tax Court Rule 155 calculation. This case may be properly submitted as permitted by Tax Court Rules 217(a) and 122(a).

QUESTION PRESENTED

Whether petitioner is no longer entitled to exemption from tax under I.R.C. § 501(a) as an organization described in I.R.C. § 501(c)(7) regarding tax years 2017-2023.

FACTS

[2] In respondent's Answer filed on January 25, 2024, respondent affirmatively alleged that the years in issue should be changed from 2017 only, to 2017-2023 because the same issue was recurrent for 2018-2023 (i.e., excessive non-member income and investment income). Consolidation of these years will help deter re-litigation of the same issue in the later years. See petitioner's reply, p. 6, ¶18, "… [p]etitioner and Appeals agreed that years 2020, 2021 and 2022 are relevant to consider for purpose of possibly not having to revisit the same issues in a later examination cycle by Examination."

The evidence contained in the administrative record and stipulation is the factual basis for this motion. The pertinent items are described in detail below. The administrative record consists of 105 exhibits, the stipulation contains 6 exhibits. All citations are to the appropriate document exhibit-page, and the corresponding Bates-stamped page(s).

A. The creation and operation of petitioner

1. Petitioner is the Consolidated Sportsmen of Lycoming County, a non-profit corporation, which operated as a social club during the years in issue, 2017-2023. (Ex. 1-J, p. 0018, entire record)

2. Petitioner was incorporated on July 24, 1936 in Pennsylvania. (Ex. 1-J, p. 0017)

3. Petitioner received IRS recognition of its tax exempt status as a social club under section 501(c)(7) on November 19, 1981. (Ex. 3-J)

4. The favorable determination letter included the statements that the favorable determination was "[b]ased on information supplied, and assuming your operations will be as stated in your application for recognition of exemption," and "[i]f your purposes, character or method of operation change, please let us know so we can consider the effect of the change on your exempt status." (Ex. 3-J, p. 0052)

5. Its articles of organization state that it was formed to promote the conservation of forests, fields and streams of the state of Pennsylvania, to promote better fishing and hunting, in particular in Lycoming County and adjoining counties, to promote the purification of streams and rivers of Pennsylvania, to promote the care and reforestation of Pennsylvania forests and woodlands, and to promote the enjoyment of outdoor life by its members and the community in general. (Ex. 1-J, p. 0017)

6. Its articles also state that the petitioner "…is a corporation which does not contemplate pecuniary gain or profit, incidental or otherwise, to its members." (Ex. 1-J, p. 0017)

7. Petitioner maintains a 230-acre property in Williamsport, in Lycoming County, Pennsylvania. (Ex. 1-J, p. 0041; Ex. 25-J, p. 0382)

8. Petitioner's members meet and conduct the club's activities on this property. (Ex. 25-J, p. 0382)

9. Member activities included: rifle ranges, shotgun areas for trap and skeet shooting, picnic areas, playground areas for children, camp sites, fishing, hunting, ball fields, canoeing, kayaking, swimming, and raising game. (Ex. 1-J, p. 0005; Ex. 38-J, p. 0504)

10. Petitioner had 940 annual members and 270 life members in 2017, 952 annual members and 270 life members in 2018, and 1,015 annual members and 270 life members in 2019. (Ex. 38-J, p. 0504) Petitioner had 940 annual members and 200+ life members in 2020, 932 annual members and 200+ life members in 2021, 871 annual members and 200+ life members in 2022, and 830 annual members and 200+ life members in 2023. (Ex. 109-J, p. 2390)

11. Petitioner assisted other nonprofit organizations by hosting them on petitioner's property at no charge and permitting them to fundraise. (Ex. 38-J, pp. 0504-05)

12. Petitioner filed Form 990 returns for the tax years 2007-2023.[3] (Ex. 25-J, p. 0382; Ex. 77-J; Ex. 78-J; Ex. 85-J, pp. 1240-1251; Ex. 110-J)

13. Petitioner filed Form 990-T returns for the tax years 2007-2023. (Ex. 25-J, p. 0382; Ex. 26-J, pp. 0405-0419; Ex. 79-J; Ex. 85-J, pp. 1222-1239; Ex. 111-J)

14. In March 2011 petitioner entered into an Oil and Gas Lease with Rice Drilling B. LLC ("Rice"), to exclusively lease all the oil, gas, coalbed methane and

[3] For its Forms 990 and 990-T, petitioner used the calendar year accounting period.

other minerals and their constituents on and under its land to Rice for a primary term of five years. (Ex. 62-J, pp. 0815, 0822-0825, 0831)

15. Pursuant to an Addendum to this agreement dated March 2011, petitioner received a signing bonus in 2011 of about $921,800. (Ex. 62-J, pp. 0816, 0826-0829; Ex. 86-J, p. 1276)

16. In March 2011 petitioner's board of directors, by unanimous vote, approved entering into the Gas and Oil Lease and Addendum with Rice. (Ex. 62-J, pp. 0816, 0822, 0830)

17. Pursuant to the Oil and Gas Lease, royalties were not to be paid until the lessee (or its assignee) commenced extracting gas - which did not occur until December 2016. (Ex. 62-J, p. 0816)

18. In October 2013, the Oil and Gas Lease was amended so that petitioner agreed to permit an assignee gas driller (Inflection Energy, LLC) to drill and to pool or utilize any part of the premises with any other leases, lands, etc., and to include petitioner's land located in two additional land areas known as Rider Park West and Allegheny Ridge East. (Ex. 62-J, pp. 0816, 0833, 0836)

19. In 2013 petitioner's board of directors, by corporate resolution, voted to approve the 2013 Amendment to the Oil and Gas Lease in favor of Inflection

Energy, LLC., to include the enlargement of production units beyond 640 acres, and to include Rider Park West and Allegheny Ridge East areas. (Ex. 62-J, pp. 0816, 0836)

20. In October 2015 a Declaration of Pooling and Unitization Agreement executed by Inflection Energy, LLC was filed in Lycoming County by the Recorder of Deeds. (Ex. 62-J, pp. 0815, 0837-0839)

21. The calculation for determining the amount of gas royalty payments to petitioner beginning in January 2017 was 15-percent of the price of gas extracted from 42 acres of petitioner's land covered by the Pooling Agreement - which covered 836 acres in total. (Ex. 62-J, p. 0816)

22. The price of the gas varied based on market conditions. (Ex. 62-J, p. 0816)

23. During 2017-2023 respectively, the revenue from gas leasing became a significant source of revenue for petitioner: $232,866, $186,099, $172,637, $78,027, $34,085, $1,180,656, $303,610.[4] (Ex. 74-J, pp. 1031, 1039; Ex. 75-J, p.

[4] For 2018 and 2019, amounts are from petitioner's Forms 990, line 11. For 2017 and 2020, amounts are based on petitioner's Forms 990, and are a combination of "royalties" and "rental income" (Part VIII, p. 9, lines 5 and 6c) to reflect an understanding the petitioner and Appeals Officer had that "rental income" was related to the gas leasing. The above statement is confirmed by petitioner's

1054; Ex. 76-J, p. 1077; Ex. 77-J, pp. 1100, 1108; Ex. 79-J, p. 1149; Ex. 85-J, p. 1226; Ex. 111-J, p. 2412)

24. In petitioner's Form 1024, Application for Exemption, although petitioner does include information about its income (such as membership dues, investment income, and rent) and its expenses, on part VIII and part IX (Ex. 1-J, pp. 0064-0065), there is no mention or indication that petitioner was receiving or anticipated receiving gas leasing revenue in any amount. (Ex. 1-J)

25. During all years in issue, 2017-2023, petitioner's "non-member income" consisted of petitioner's: 1) investment income; and 2) gas royalty payments during the year. (Ex. 86-J, p. 1276; Ex. 108-J, Ex. 109-J, p. 2392)

Administrative Proceedings

26. An IRS examiner sent petitioner a letter dated October 27, 2021 proposing to revoke petitioner's tax exempt status as a social club on the basis of petitioner having received revenue from non-member sources in excess of 35-percent of petitioner's total income for years 2017-2019, inclusive. (Ex. 29-J, pp. 0429, 0431-0432)

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statement in its letter to the Appeals Officer that, "[f]or 2017 and 2020 this rent revenue arose from [petitioner's] ground leasing situation with gas producer(s)." Ex. 85-J, p. 1195; Ex. 91-J, p. 1401. For 2021-2023, amounts are from the petitioner's Forms 990-T, Schedule A, page 3.

27. The IRS letter stated, "[t]he organization has reported the following amounts for Investment Income and Royalties (Non-Member sourced Income) on their books and records and on their Forms 990 and Forms 990-T returns for the Tax Year Ending:

December 31, 2017, Non-member income of $274,891 which is 69.33-percent of the total income of $396,472.
December 31, 2018, Non-member income of $193,499 which is 60.68-percent of the total income of $318,861.
December 31, 2019, Non-member income of $180,340 which is 59.94-percent of the total income of $300,867."

(Ex. 29-J, p. 0432)

28. In the IRS letter the effective date of revocation was stated as January 1, 2017. (Ex. 29-J, pp. 0436-0437)

29. In a letter to the IRS examiner dated November 10, 2021, petitioner stated that it would be appealing the examiner's determination to the Independent Office of Appeals. (Ex. 32-J)

30. In a letter dated December 6, 2021 petitioner submitted a 5-part protest in response to the IRS examiner's letter recommending revocation. (Exs. 38-J - 42-J)

31. In its main argument petitioner asserted that the IRS misapplied the 35-percent rule primarily because very little of its members' time was spent

maintaining the gas lease operations and/or acquiring the revenue arising from petitioner's gas lease. (Ex. 38-J, pp. 505-509)

32. Petitioner believes that the statute in issue, and the legislative history in issue, measure time spent - in terms of hours - engaged in social club activities by its members, rather than a social club's revenue from member and non-member sources, in the determination of whether or not substantially all of a club's activities are for pleasure, recreation and other nonprofitable purposes. (Ex. 38-J, pp. 505-509; Ex. 106-J, pp. 2356-2366)

33. Petitioner argued that a significant portion of petitioner's resources and its members' activities were devoted to its exempt purposes of conservation and social activities, and provided the number of hours its members and officials engaged in these activities. (Ex. 54-J, pp. 0749, 0753-0761; Ex. 106-J, pp. 2356-2366)

34. In a letter dated September 27, 2023 the Appeals Officer issued a final adverse determination letter stating that petitioner's tax exempt status as a social club was revoked. (Ex. 98-J, p. 1458)

35. The Appeals letter stated petitioner's tax exempt status as a social club was revoked because "… a substantial amount of your activities (gas leasing)

is not in furtherance of exempt purpose under IRC section 501(c)(7), regulations and applicable revenue rulings …" (Ex. 98-J, p. 1458)

36. The Appeals letter states that revocation shall be effective as of January 1, 2023. (Ex. 98-J, p. 1458)

37. An Appeals letter to petitioner dated October 12, 2023 included the previously-issued Form 886-A from the examiner. (Ex. 101-J)

38. The Appeals Officer prepared a chart of petitioner's revenue from all sources (member and non-member income) from 2008 to the first quarter of 2023 as follows:

sources of income per Form 990 with POA adjustments *													
	member income		non-member income										
tax year	member-ship dues	program service revenue**	other contri-butions	invest-ment income	tax-exempt bond proceeds	rent	sales of securities	fund-raising events	natural gas lease	total income	total member income	total non-member income	non-member % of total income
2008	$ 34,521	$ -	$ -	$ 3,512	$ -	$ 4,675	$ -	$ 10,975	$ -	$ 53,683	$ 34,521	$ 19,162	36%
2009	$ 37,487	$ -	$ -	$ -	$ -	$ -	$ -	$ (2,320)	$ -	$ 35,167	$ 37,487	$ (2,320)	-7%
2010	$ 40,245	$ -	$ -	$ 1,472	$ -	$ -	$ -	$ (2,251)	$ -	$ 39,466	$ 40,245	$ (779)	-2%
2011	$ 39,110	$ 19,140	$ 2,297	$ 3,277	$ -	$ -	$ -	$ -	$ 921,800	$ 985,624	$ 58,250	$ 927,374	94%
2012	$ 59,242	$ 9,524	$ 1,121	$ 15,064	$ 1,397	$ -	$ -	$ -	$ -	$ 86,348	$ 68,766	$ 17,582	20%
2013	$ 54,255	$ 69,736	$ 419	$ 18,075	$ 1,764	$ 5,945	$ 691	$ -	$ -	$ 150,885	$ 123,991	$ 26,894	18%
2014	$ 60,055	$ 72,704	$ 2,947	$ 18,757	$ 1,764	$ 6,332	$ 5,742	$ -	$ -	$ 168,301	$ 132,759	$ 35,542	21%
2015	$ 18,197	$ 29,952	$ -	$ 21,859	$ 1,369	$ 8,265	$ -	$ -	$ -	$ 79,642	$ 48,149	$ 31,493	40%
2016	$ 11,940	$ 55,581	$ -	$ 23,783	$ -	$ -	$ -	$ -	$ -	$ 91,304	$ 67,521	$ 23,783	26%
2017	$ 36,520	$ 85,061	$ -	$ 21,803	$ -	$ -	$ 20,222	$ -	$ 232,866	$ 396,472	$ 121,581	$ 274,891	69%
2018	$ 66,835	$ 58,527	$ -	$ 7,400	$ -	$ -	$ -	$ -	$ 186,099	$ 318,861	$ 125,362	$ 193,499	61%
2019	$ 69,387	$ 51,149	$ -	$ 7,703	$ -	$ -	$ -	$ -	$ 172,637	$ 300,876	$ 120,536	$ 180,340	60%
2020	$ 61,576	$ 46,323	$ -	$ 35,427	$ -	$ -	$ -	$ -	$ 78,027	$ 221,353	$ 107,899	$ 113,454	51%
2021***	$ 50,675	$ 21,987	$ -	$ 66,788	$ -	$ -	$ -	$ -	$ 34,085	$ 173,535	$ 72,662	$ 100,873	58%
2022	$ 48,512	$ 44,990	$ -	$ 31,060	$ -	$ -	$ -	$ -	$ 1,180,656	$ 1,305,218	$ 93,502	$ 1,211,716	93%
2023****	?	?	?	?	?	?	?	?	$ 48,256	?	?	?	?

(Ex. 86-J, p. 1276, Ex. 87-J, p. 1324)

39. Based on data later provided by the petitioner and separately included in the stipulation, the following information applies to complete the above chart so

as to include relevant data for all of 2023.[5] (Ex 110-J, p. 2395; Ex. 111-J, p. 2412)

tax year	Memb-ership dues	program service revenue	other contri butio ns	Invest-ment income	tax-exempt bond proceeds	rent	sales of securities	fund-raising events	natural gas lease	total income	total member income	total non-member income	non-member % of total income
2023	$67,341	$248,516	-	$61,490	-	-	-	-	$303,610	$ 680,957	$ 315,857	$365,100	54%

40. Respondent's chart below, is a summary of the information contained in the above two charts.

Year	Member Income	Gas Lease Revenue	Total Income	Total Non-member Income	Non-member Percent of Total Income
2017	$121,581	$232,866	$396,472	$274,891	69%
2018	$125,362	$186,099	$318,861	$193,499	61%
2019	$120,536	$172,637	$300,876	$180,340	60%
2020	$107,899	$78,027	$221,353	$113,454	51%
2021	$72,662	$34,085	$173,535	$100,873	58%
2022	$93,502	$1,180,656	$1,305,218	$1,211,716	93%
2023	$315,857	$303,610	$680,957	$365,100	54%

[5] Respondent is unaware how petitioner's program service revenue (treated as member income) rose 500% compared to all prior years' program service revenue on average, from 2008-2022. (entire record)

41. On November 13, 2023 petitioner filed a Petition ("petition") in this case contending that it is entitled to a declaratory judgment pursuant to I.R.C. § 7428(a)(1)(E) that it qualifies as a social club under I.R.C. § 501(c)(7) as a matter of law.

42. On January 25, 2024 respondent filed an Answer ("answer") wherein respondent maintained that as a matter of law, petitioner does not meet the critical factors necessary to qualify as a social club and therefore respondent did not erroneously revoke its status.

43. Petitioner filed a Reply to Answer ("reply") on March 5, 2024.

44. On June 27, 2024, the parties filed a joint administrative record and joint stipulation of facts.

45. On July 1, 2024, petitioner filed a First Amended Petition.

46. On July 12, 2024, respondent filed an Answer to First Amended Petition.

47. On July 25, 2024, petitioner filed a Reply to Answer to First Amended Petition.

LAW AND ARGUMENT

I. Jurisdiction

A. The Statutory Scheme

This case is a declaratory judgment case involving the continuing qualification of petitioner as an organization described in section 501(c)(7) which is exempt from tax under section 501(a). Section 7428(a)(1)(E) confers subject matter jurisdiction on the Tax Court to "make a declaration" with respect to the "initial qualification" or "continuing qualification" of an organization as an organization described in section 501(c)(7) which is exempt from tax under section 501(a). Respondent may revoke a favorable determination letter for good cause. Treas. Reg. § 1.501(a)-1(a)(2).

B. Application of Statutory Scheme

i. Actual Controversy

In order properly to invoke this Court's declaratory judgment jurisdiction under section 7428(a), there must exist an "actual controversy." Id.; T.C. Rule 210(c)(2). An actual controversy exists when the taxpayer has received an adverse ruling from the IRS. CREATE v. Commissioner, 634 F.2d 803, 812-13 (5th Cir. 1981).

Here, the Appeals Officer's final adverse determination letter (Ex. 98-J) was a determination made by the Secretary "with respect to the ... continuing

classification of an organization as an organization described in section 501(c) … and exempt from tax under section 501(a)…" Section 7428(a)(1)(E). Therefore, an actual controversy exists in this case.

ii. Exhaustion of Administrative Remedies

Section 7428(b) requires that the taxpayer exhaust all administrative remedies available to it within the IRS before this Court's authority can properly be exercised. Section 7428(b)(2); T.C. Rule 210(c)(4). The statute contains no language further defining the exhaustion requirement but it has been taken to mean that an organization has satisfied all procedural requirements of the IRS before advancing to a court. Educ. Assistance Found. for the Descendants of Hungarian Immigrants in the Perf. Arts, Inc., v. United States, 904 F.Supp.2d 95, 102 (D.D.C. 2012); See Treas. Reg. §§ 601.201(n)(7)(iv), 601.201(n)(6)(ii)(b),(c); H.R.Rep. No. 94-658, at 287-88, 3183-84; S.Rep. No. 94-938, at 590, 4014.

Petitioner exhausted its administrative remedies in accordance with section 7428(b)(2) as it filed a protest (Exs. 38-J - 43-J) after its receipt of the examiner's proposed revocation letter (Ex. 29-J), and took its case to the Independent Office of Appeals where it was offered the opportunity to produce evidence sufficient to

prove its case. (Ex. 45-J) Petitioner's exhaustion of administrative remedies within the IRS is not contested by the parties.[6]

Respondent affirmatively alleged in the Answer that the tax years in issue covered by the revocation should include the tax years 2017-2023, and not only the tax year 2017, as stated in the Office of Appeals' final adverse determination letter (Ex. 98-J), and asks this Court to rule as such. In addition, respondent affirmatively alleged that the effective date of revocation shall be January 1, 2017, instead of January 1, 2023, as stated in the Appeals' final adverse determination letter. (Ex. 98-J) Both of these items were previously discussed and examined at the IRS's examination and Appeals stages, thus this Court need not concern itself as to whether or not petitioner has exhausted its administrative remedies as to them.

Proof that these two issues respondent raised as affirmative allegations were previously addressed is that by the time the Office of Appeals issued the final adverse determination letter, the record already contained all of this data and information. At respondent's counsel's time of receipt, the administrative record contained: (1) the petitioner's revenue for tax years 2017-2022 (2017-2022 Forms

[6] petition, p. 4, ¶23

990 and 990-T),[7] and separately, gas leasing revenue for 2017-2022, and seven months of 2023;[8,9] (2) a chart prepared by the Appeals Officer and shared with petitioner detailing income from all sources for years 2008-2023;[10,11] and (3) the IRS examiner's letter proposing revocation with the effective date of January 1, 2017.[12]

Moreover the main issue in this case - whether petitioner exceeded permissible limits for non-member income - is the same for each of the years 2017 to 2023. Petitioner provided the needed data for these years all the while maintaining its core position that the number of member hours devoted to its club activities is most critical for tax exemption. (Ex. 85-J, pp. 1197-1198) Neither

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[7] Exhibits 13-J, 14-J, 17-J, 22-J, 78-J, 79-J, 85-J, 88-J

[8] Ex. 54-J, p. 0763-0767 (2017-2021); Ex. 62-J, p. 0845 (2022); Ex. 91-J, pp. 1404-1407 (2023 gas revenue to July 2023)

[9] Subsequently, petitioner provided the remaining 2023 gas leasing revenue to respondent's counsel directly for inclusion in the stipulation. (Ex. 108-J)

[10] Ex. 86-J, p. 1276, Ex. 87-J, p. 1323 (copy of same chart)

[11] Subsequently in April 2024, petitioner provided the remaining 2023 data to respondent's counsel directly for inclusion in the stipulation. (Exs. 108-J - 111-J)

[12] Ex. 29-J, pp. 0436-0437; Ex. 51-J, p. 0723

party has been prejudiced here.

As such, there are no new issues being presented currently for which exhaustion is in question. See Airlie Foundation, Inc. v. United States, 826 F.Supp. 537, 547-548 (D.D.C. 1993), aff'd per curiam, 55 F.3d 684 (D.C. Cir. 1995) (while not discussing exhaustion per se, the district court, in a revocation case, allowed the government to rely of facts underlying an issue alleged by the foundation to have been raised for the first time in the government's summary judgment motion - financial misuse occurring years earlier than previously stated by the IRS - even though the IRS did not rely on these facts and issue as a basis for its revocation previously. Id. at 547-548. The court stated that the government did not assert any affirmative defenses or raise any grounds for revocation that were not already part of the administrative record; even if grounds were not previously relied on, it was sufficient that the grounds were discussed and included in the administrative record. The foundation's argument that the government failed to plead a new ground in a timely manner, and thus waived its right to assert a new ground in its motion for summary judgment was rejected. Id. at 547-548); see also EFCO Tool Co. v. Commissioner, 81 T.C. 976 (1983) (a revocation case involving a retirement plan in which a distinction was drawn between cases

involving revocation and those involving initial qualification, this Court held that "…the purposes of the exhaustion requirement have been satisfied once the Internal Revenue Service has issued a final revocation letter and the petitioner shall be deemed to have exhausted its administrative remedies."[13]) Id. at 981.

Even if the issues were treated as new, this Court is not prevented from deciding this case. Unitary Mission Church of Long Island v. Commissioner of Internal Revenue, 74 T.C. 507, 512 (1980), aff'd per curiam, 647 F.2d 163 (2nd Cir. 1981) (in a revocation case involving a Church (where no initial application was filed), this Court, based on a finding of "sufficient facts in the administrative record," determined that exhaustion occurred (Id. at 507, fn. 2), while also holding that respondent may raise the issue of private benefit for the first time in its answer. Id. at 512-513; see also Dumaine Farms v. Commissioner, 73 T.C. 650 (1980) acq., 1980-2 C.B. 1 (issue whether operated exclusively for exempt

[13] This Court noted in EFCO that a revocation generally follows an audit by the IRS, whereas an initial qualification ruling is based upon facts which are provided by the applicant. Thus this Court reasoned that there is no prejudice to the Service in revocation cases: "In cases in which sufficient evidence has been adduced from which the Commissioner is able to make a determination … the ends of exhaustion have been satisfied and jurisdiction is proper. Where, however, the Commissioner lacks enough evidence on which a determination can be made no final revocation letter will usually be issued." Id. at 979-983.

purposes), nonacq., 1980-2 C.B. 2 (issue whether organized exclusively for exempt purposes) (in an initial application case, this Court decided that the issue whether the petitioner was properly organized - raised for the first time in the respondent's answer - was not too late. Id. at 659-660. The Court reasoned that the underlying evidence (the trust instrument) was already included in the administrative record, and the respondent, who bore the burden of proof under T.C. Rule 217(c)(2)(ii) (since superseded) assumed the risk that the facts in the record were insufficient to prove respondent's point. Id. at 660. It stated that T.C. Rule 213(a)(2)[14] expressly permits such issues to be raised in respondent's answer, and T.C. Rule 217(c)(2)(ii)[15] (superseded) implicitly permits respondent to raise issues not relied on in the determination letter.)

As such, exhaustion of plaintiff's administrative remedies has occurred.

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[14] T.C. Rule 213(a) provides in part:
"(2) Form and Content: * * * In addition, the answer shall contain a clear and concise statement of every ground, together with the facts in support thereof, on which the Commissioner relies and has the burden of proof."

[15] T.C. Rule 217(c) provided in part:
"Burden of Proof: The burden of proof in declaratory judgment actions shall be as follows:
"(2)(ii) Respondent: The burden of proof shall be upon the respondent as to any ground upon which he relies and which is not stated in the notice of determination." * * *

Because both jurisdictional prerequisites are met, this case is properly before this Court pursuant to section 7428.

II. Scope and Standard of Review

A. Judgment on the Administrative Record and Stipulation

In revocation cases such as the instant one, the scope of review includes the administrative record, however, the parties may also offer additional evidence. See Educational Assistance Foundation for the Descendants of Hungarian Immigrants in the Performing Arts, Inc., v. United States, 904 F.Supp.2d 95, 101 (D.D.C. 2012). And "the Court may, upon the basis of the evidence presented, make findings of fact which differ from the administrative record." T.C. Rule 217(b)(1).

Here, the scope of review is the contents of the joint administrative record[16] and the stipulation; the parties agree that such contain all the relevant facts and the facts are not in dispute. T.C. Rule 217(a); T.C. Rule 121(a)(2), (c) and (j).

Respondent requested to enlarge the years in issue with the affirmative allegations. As indicated above, there is sufficient data and information contained in the administrative record and stipulation that cover the tax years 2017-2023

[16] The administrative record refers to "all documents and materials received, developed, considered, or exchanged in connection with the administrative determination." T.C. Rule 210(b)(12).

upon which the respondent relies. Thus the scope of review of the evidence in this case is also appropriately extended to the evidence contained in the administrative record and stipulation.

The instant case is dissimilar to Foundation of Human Understanding v. United States, 88 Fed. Cl. 203, 214-215 (2009), aff'd., 614 F.3d 1383, 1391 (Fed. Cir. 2010), cert. denied, 131 S.Ct. 1676 (2011) where the foundation asked the court to consider evidence outside the years already deemed to be in issue (1998-2000); there was no prior request to expand the years stated in the IRS's revocation letter. Id. Thus the court ruled that in deciding whether the foundation qualified as a church, its review of the facts was limited to the foundation's activities during 1998 to 2000 because the outside years were "subsequent to those which formed the subject of defendant's audit …" Id. at 215.

The instant case is also dissimilar to Synanon Church v. United States, 557 F. Supp. 1329, 1332–33 (D.D.C. 1983). In Synanon the IRS revoked the organization's tax-exempt status following an audit of the organization's activities during the fiscal years 1977 and 1978. Id. at 1331. The organization brought suit for the fiscal years 1977 and 1978, and for years after the audited years. Id. at 1332. The district court ruled that it lacked subject matter jurisdiction

over any years beyond the years which were the subject of the IRS's audit (1977 and 1978) because an IRS determination was not made as to them, and the organization did not exhaust its administrative remedies as to them. Id. at 1332-33.[17] Here in contrast, the IRS examined and collected the relevant data for the years 2017 to 2023. (Exs. 60-J, 61-J, 77-J, 78-J, 84-J, 87-J)[18] Thus, as previously stated, the scope of review in this case should appropriately cover the contents of the administrative record and stipulation relating to the 2017-2023 tax years.

B. Declaratory Judgment Actions Pursuant to Section 7428(a)(1)(E)

i. De Novo review

[17] In fn. 5, the court stated that "… once a determination is made, a record has been created and the Service has arrived at a conclusion that it can defend. If the Court allows plaintiff to challenge its status for years in which no such determination has been made, the Service would be required to perform all of the background work that usually precedes arriving at a determination now. It would have to determine if it held a position adverse to plaintiff's - i.e., if it believed plaintiff should be non-exempt for the years in question. In the process, the Service would develop a record to defend that determination. Requiring the Service to do that work now would be unduly burdensome and would cause undue delay in this action." This is not a concern in the instant case.

[18] In an e-mail with an attachment sent to petitioner's attorney dated July 12, 2023, the Appeals Officer states, "… I updated the spreadsheet analyzing % of non-member income using some of the information from your most recent letter. See the footnotes for details of changes." (Ex. 87-J, p. 1323) The attachment to the e-mail is the spreadsheet covering petitioner's income sources for years 2008-2023 (to the extent known at the time for year 2023). (Ex. 87-J, p. 1324)

De novo review[19] is the applicable standard of review in an action under section 7428 challenging the revocation of an organization's tax exempt status. Foundation of Human Understanding v. United States, 88 Fed. Cl. 203, 212 (2009), aff'd., 614 F.3d 1383, 1391 (Fed. Cir. 2010), cert. denied, 131 S.Ct. 1676 (2011); Educ. Assistance Found. for the Descendants of Hungarian Immigrants in the Perf. Arts, Inc., v. United States, 904 F.Supp.2d 95, 96-97 (D.D.C. 2012); see Partners in Charity, Inc. v. Commissioner, 141 T.C. 151, 161-162 (2013) (the Court noted that the parties implicitly tried the case under a de novo standard of review and proceeded accordingly).

ii. Burden of Proof

Exemptions are matters of legislative grace and the burden of establishing entitlement to an exemption is on the taxpayer. Foundation of Human Understanding v. United States, 88 Fed. Cl. 203, 212-213 (Fed. Cl. 2009), aff'd, 614 F.3d 1383 (Fed. Cir. 2010), cert. denied, 131 S. Ct. 1676 (2011); St. Matthew Publishing Inc. v. United States, 41 Fed. Cl. 142, 145 (Fed. Cl. 1998); Church of

[19] See discussion infra for the standard of review on the issue of the retroactivity of the IRS's adverse determination to January 1, 2017 under I.R.C. § 7805(b)(8) where the appropriate standard of review is abuse of discretion. Partners in Charity, Inc. v. Commissioner, 141 T.C. 151, 162 (2013).

the Visible Intelligence that Governs the Universe v. United States, 4 Cl.Ct. 55, 65 (Cl. Ct. 1983); Schoger Foundation v. Commissioner, 76 T.C. 380, 387-89 (1981); Virginia Educational Fund v. Commissioner, 85 T.C. 743, 750 (1988), aff'd per curiam, 799 F.2d 903 (4th Cir. 1986); Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 849, 854 (10th Cir. 1972) (citing Dickinson v. United States, 346 U.S. 389 (1953)).

Petitioner bears the burden of proving that it satisfied all of the requirements necessary to continue to qualify for income tax exemption as an organization described in section 501(c)(7). T.C. Rule 142(a)(1).

The burden of proof standard applicable in section 7428 cases is proof by a preponderance of the evidence. Partners in Charity, Inc. v. Commissioner, 141 T.C. 151, 162; Federation Pharmacy Serv. Inc. v. Commissioner, 72 T.C. 687, 691 (1979), aff'd, 625 F.2d 804 (8th Cir. 1980); Bowen Family Foundation v. Commissioner, T.C. Memo. 1999-149.

Respondent contends that it did not assert any new matters in its affirmative allegations in its answer so that the burden otherwise shifts to the respondent under T.C. Rule 142(a)(1)[20] as to them. This is because the respondent did not introduce

[20] "The burden of proof shall be upon the petitioner … except that, in respect of

new and different evidence not already in the administrative record. See Martin Ice Cream Co. v. Commissioner, 110 T.C. 189, 210 (1998), fn. 16 ("[g]enerally, when the Commissioner makes allegations in an amended answer requiring the presentation of different evidence, then the Commissioner "has introduced a new matter" or a new issue that requires the shifting of the burden of proof to the Commissioner as to the new matter or issue …" (citing Achiro v. Commissioner, 77 T.C. 881, 890 (1981)).[21]

Arguably however, the final adverse determination letter (Ex. 98-J), did not include the affirmative allegations made in respondent's answer, and those allegations may be treatable as "new matters" under T.C. Rule 142(a)(1) for which respondent would bear the burden of proof. As with petitioner, the burden of proof

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any new matter … plead in the answer, it shall be upon the respondent."

[21] In Achiro, this Court stated "[t]he assertion of a new theory which merely clarifies or develops the original determination without being inconsistent or increasing the amount of the deficiency is not a new matter requiring the shifting of the burden of proof. Id. at 890 (citations omitted). However, if the assertion in the amended answer either alters the original deficiency or requires the presentation of different evidence, then respondent has introduced a new matter. Id. (citations omitted). In the instant case, the answer does not invoke additional evidence not already contained in the administrative record other than additional data for 2023 (not available at the time) which the petitioner readily provided for inclusion in the stipulation.

standard as to respondent would be proof by a preponderance of the evidence. See Martin Ice Cream Co. v. Commissioner, 110 T.C. 189, 210 (1998), fn. 16 ("… we issued an order shifting the burden of proof to respondent … However, we decide the issue on a preponderance of the evidence; therefore, the allocation of the burden of proof does not determine the outcome."); see also Seagate Tech. Inc. & Consol. Subs. v. Commissioner, 102 T.C. 149, 169 (1994), acq. in result, 1995-2 C.B. 1.

If such a burden shift were to occur, it appears it would not change the calculus in a meaningful way. See Partners in Charity, Inc. v. Commissioner, 141 T.C. 151, 162 ("[b]ecause we determine by the preponderance of the evidence the facts in this case that relate to the revocation of the petitioner's exemption ruling, we need not determine whether the burden of proof on the issue of tax-exempt status has shifted.") Accordingly, even with a burden shift so that respondent must establish petitioner's non-entitlement to exemption for tax years 2018-2023,[22] and that the effective date of revocation shall be January 1, 2017,[23] respondent satisfies

[22] Both the examiner's IRS letter and the Appeals Officer's IRS letter state that the tax year in issue shall be 2017. (Ex. 29-J, p. 0429; Ex. 98-J, p. 1462)

[23] While the IRS examiner's letter states the effective date of revocation shall be January 1, 2017, (Ex. 29-J, p. 0437), the Appeals letter states that the effective date

this burden with the evidence contained in the administrative record and the stipulation, see infra, pp. 30-47.

III. Summary Judgment Standard

Summary judgment may be rendered where the pleadings, answers to interrogatories, depositions, admissions, and any other acceptable materials, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that a decision may be rendered as a matter of law. T.C. Rule 121(b); O'Neal v. Commissioner, 102 T.C. 666, 674 (1994).

Summary judgment may not be used, however, to resolve disagreements over factual issues. Northern Indiana Public Service Company & Subsidiaries v. Commissioner, 101 T.C. 294, 295 (1993).

The moving party bears the burden of establishing that there is no genuine issue of material fact and that the moving party is entitled to judgment on the substantive legal issues. O'Neal, 102 T.C. at 674. In addition, factual inferences must be read in the light most favorable to the party opposing the motion. Blanton v. Commissioner, 94 T.C. 491, 494 (1990); Dahlstrom v. Commissioner, 85 T.C.

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of revocation shall be January 1, 2023. (Ex. 98-J, p. 1463) As further discussed in section 6. below, respondent contends the effective date of revocation should be 2017 for purposes of consistency and tax efficiency, and based on IRS procedures.

812, 821 (1985); Jacklin v. Commissioner, 79 T.C. 340, 343 (1982); Espinoza v. Commissioner, 78 T.C. 412, 416 (1982). The party opposing summary judgment must set forth specific facts showing that a genuine question of material fact exists and may not rely merely on allegations or denials in the pleadings. T.C. Rule 121(d); Celotex Corp v. Catrett, 477 U.S. 317, 324 (1986); King v. Commissioner, 87 T.C. 1213, 1217 (1986).

A summary judgment motion is an appropriate method for resolving a declaratory judgment action under Rule 217(b). T.C. Rule 217(b)(2); Est. of Hawaii v. Commissioner, 71 T.C. 1067, 1078 (1979); Pulpit Resource v. Commissioner, 70 T.C. 594, 601 (1978) (acknowledging T.C. Rule 217(b)(2) but treating cross motions for summary judgment as submission on the record where parties had stipulated to the administrative record); Solutions Plus, Inc. v. Commissioner, T.C. Memo. 2008-21; Cono A. Pecora, M.D., P.A. v. Commissioner, T.C. Memo. 1988-104.

In the instant case, a trial is unnecessary, and this case is ripe for a decision on a motion for summary judgment. The administrative record and stipulation which the parties jointly filed with the Court on June 27, 2024, contain all the relevant evidence this Court needs to decide whether petitioner was operating

according to section 501(c)(7) standards during the years in issue (2017-2023). Disposition by summary judgment is appropriate in this case because there are no disputes as to any material facts in this case. T.C. Rule 121.

IV. Petitioner Failed to Satisfy the Section 501(c)(7) Requirements for Tax Exemption

Petitioner's exempt status as a social club under section 501(c)(7) should be revoked for several reasons. First, during the years in issue, petitioner failed the 35-percent gross receipts test set forth in the legislative history written in 1976 when section 501(c)(7) was amended. Second, petitioner's gas leasing revenue does not meet an exception in the legislative history for unusual or unique income received. Lastly, under a facts and circumstances analysis - a default provision in the legislative history that applies when a social club fails the 35-percent test - petitioner's facts and circumstances do not establish it qualifies for exemption.

1. I.R.C. § 501(c)(7)

Section 501(a) exempts from federal taxation organizations described in section 501(c)(7). Section 501(c)(7), which was most recently amended in 1976, provides exemption from federal income tax for clubs organized for pleasure, recreation, and other nonprofitable purposes, *substantially all* of the activities of which are for such purposes and no part of the net earnings of which inures to the

benefit of any private shareholder or individual. (emphasis added) Id. In general this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. Treas. Reg. section 1.501(c)(7)-1(a). 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. Id.

2. 1976 Amendment and Legislative History

Before its amendment in 1976 by Public Law 94-568, 1976-2 C.B. 596, section 501(c)(7) required clubs to be organized and operated *exclusively* for pleasure, recreation, and other nonprofitable purposes. After the amendment, "substantially all" of a club's activities was required to be for those purposes, allowing section 501(c)(7) clubs to receive some non-exempt income without losing their exempt status. However, a Senate Report (Finance Committee) recommended limits: a section 501(c)(7) organization could receive up to 35-percent of its gross receipts, including investment income, from sources outside of its membership without losing its tax-exempt status.[24] The Senate Report further

[24] Ex. 106-J, pp. 2368-2378, extract from The Committee Reports for Public Law 94-568 (Senate Report No. 94-1318 2d Session, 1976-2 C.B. 597-601; H. Rept. No. 94-1353, 1-5 (1976) to accompany H.R. 1144 (Pub. L. 94-568), 4-5 (1976).

states: 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.[25] This means that an exempt social club may receive up to 35-percent of its total gross receipts from a combination of receipts from outside, non-member sources, which includes investment income, so long as not more than 15-percent of the club's total gross receipts arose from the use of the club's services or facilities by the public.[26]

According to the legislative history, gross receipts include receipts from

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Specifically, at p. 2371 wherein, the legislative history states that "… organizations be permitted to receive up to 35 percent of their gross receipts, including investment income, *from sources outside of their membership* without losing their tax-exempt status." (emphasis added)

[25] Ex. 106-J, p. 2371, specifically "[i]t is also intended that within this 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."

[26] The 15-percent limit is not respondent's focus in the instant case. Thus petitioner's contention in its petition, p. 15, ¶99, that, "[t]he correct interpretation of the term 'gross receipts from use by the general public of social club facilities or services' in the Senate Report is that the term refers to a social club having gross receipts from non-member, human, paying customers invited by a club or its respective members to use social club facilities or services ('invitees'),…" is not applicable to the instant case. The same applies to petitioner's statement in its reply, p. 16, ¶98, "…[p]etitioner and [r]espondent [have a] legal disagreement regarding the significance of the Senate Report language, 'gross receipts from use by the general public of social club facilities or services' …"

normal and usual activities of the club such as charges, admissions, membership fees, dues, assessments, investment income and normal recurring capital gains. (Ex. 106-J, p. 2371) Excluded from gross receipts are initiation fees, capital contributions, and unusual amounts of income, such as amounts from the sale of a clubhouse or similar facility. (Ex. 106-J, p. 2371) If a club's income sources are within these limits, the club will be considered to be operated substantially for pleasure, recreation, and other nonprofitable purposes. (Ex. 106-J, pp. 2371-2372)

In addition, the Senate Report indicates that if a club's income sources are in excess of the 35-percent limit (or 15-percent limit in the case of gross receipts from non-member use of services or club facilities), then a club may be able to retain its exemption if it can show through facts and circumstances, that substantially all of its activities are for pleasure, recreation, and other nonprofitable purposes. (Ex. 106-J, p. 2372) Further, it did not intend that social clubs and similar organizations be permitted to receive, within the 15- or 35-percent allowances, income from the "active conduct of businesses not traditionally carried on by these organizations." (Ex. 106-J, p. 2371)

The legislative history to the Senate Report, while not binding, is useful for interpreting the changes to the statute and at least two Courts have considered it in

determining whether or not a substantial non-exempt purpose exists.

In Skillman Family Reunion Fund, Inc. v. United States, 196 F. Supp. 2d 543, 547 (N.D. Ohio 2002) the organization, whose mission was similar to a family reunion committee, lost its tax exempt status because 100-percent of its income came from non-member sources, i.e., investment income. The court did not make a determination as to the precise percentage of investment income that exceeds a permissible limit of non-member income. Id. at 548. It noted that, "the legislative history [in the Senate Report] gives no indication of what precisely constitutes a fact or circumstance allowing an organization generating outside income in excess of thirty-five percent to retain its tax-exempt status" but it held a family reunion fund that derived all of its income from investments could not be exempt under section 501(c)(7). Id.[27] The court, while referencing a particular passage of the legislative history stated, "… the drafting of the passage seems to presume that if the outside income exceeds thirty-five percent, the organization is not entitled to an exemption unless the facts and circumstances indicate that an organization is

[27] See also, Rev. Rul. 66-149, 1966-1 C.B. 146 (a social club is not exempt from federal income tax as an organization described in section 501(c)(7) if it regularly derives a substantial part of its income from non-member sources such as, for example, dividends and interest on investments).

otherwise so entitled." Id.

In Santa Barbara Club v. Commissioner, 68 T.C. 200, 211 (1977) a social club was denied exemption because in each of the years involved (1969-1971) the dollar volume from the sale of its bottled liquor for off-premises consumption (sold in packages to club members or a guest with a member present) was in excess of 25-percent of the club's gross receipts from all sources, and the gross profit derived from this service to members was in excess of 7-percent of petitioner's gross income from all sources and not insignificant. Id. at 207. On this basis, this Court determined that "[i]n the light of petitioner's both ongoing and recurring sales of bottled liquor and the sizable percentages of gross receipts and gross income which such sales represent, we conclude that petitioner is not entitled to an exemption under section 501(c)(7) in any of the years in issue." Id. at 207.

In Santa Barbara Club the years involved were 1969-1971. In the Court's main opinion, the 35-percent and 15-percent guidelines set forth in the legislative history were not applied as the guidelines were effective for tax years beginning after October 20, 1976. Id. at fn. 9. However, in the dissent opinion, Judge Simpson looked to the legislative history and applied it on the theory that "… [i]n a number of cases, the Supreme Court has recognized the wisdom of considering any

relevant legislative history in interpreting a statute, even congressional declarations which occurred subsequent to the enactment of the legislation." Id. at 212. On this basis it was determined in the dissent opinion that the club met the conditions of the 35-percent test, and the 15-percent test was not applicable because of a lack of non-member activities. Id.

Regulations to accompany the 1976 Amendment have not been issued.

3. Application of the 35-Percent Test

Under the administrative record and stipulation, the evidence shows that petitioner's gross receipts, including investment income, from sources outside of its membership for tax years 2017-2023, were greater than the 35-percent limitation set forth in the legislative history to Public Law 94-568. During the years is issue (2017-2023) petitioner's gross receipts from these non-member, outside sources as a percentage of its total income were 69, 61, 60, 51, 58, 93, and 54 percent, respectively. (Exs. 86-J, p. 1276; 108-J - 111-J)

In response, petitioner asserts that since section 501(c)(7) does not use the words "revenues" or "gross receipts" in its definition of a social club it follows that the real measurement of a club's activities is the number of hours spent by its

members in the pursuit of club-related activities.[28] And since the majority (i.e., "substantially all") of its members' time was spent on exempt club activities, the petitioner passes the 35-percent test for all years.[29]

Respondent contends that the legislative history is clear; in applying the 15- and 35-percent tests it is the gross receipts of the social club that is to be measured in order to determine whether or not a club is entitled to exemption. In Part I, - the

[28] petition, p. 6, ¶34, "[r]espondent's conclusion is erroneous because it reflects Respondent's position that the amount of Petitioner's relatively large revenues … is a proxy for the quantity of Petitioner's members' activities that are not pleasure, recreational and other nonprofitable activities." See also, petition, p. 6, ¶35, "[s]ection 501(c)(7) itself does not employ the term 'revenues' or a similar term (such as 'gross receipts' or 'gross income')…" See also petition, p. 9, ¶59, "The Senate Report does not define or describe member pleasure, recreation and other nonprofitable activities or disallowed activities by reference to social club 'revenues' arising from allowed and disallowed activities (or a similar term such as 'gross receipts' or 'gross income.')" See also reply, p. 8, ¶35 "[t]he absence of the term 'revenues' or a similar term (such as 'gross receipts' or 'gross income') is manifest in Section 501(c)(7)."

[29] petition, p. 7, ¶¶ 45, 44, "The overwhelming hours per year of members' activities are their hours spent in the pleasure, recreation and other nonprofitable activities for which Petitioner was organized." "Member activities by hours of member activity type for each of the years 2017-2022 are annexed as Exhibit C hereto. See also reply, p. 14, ¶86, "Petitioner's Exhibit C is manifest as to Petitioner's members, board of directors and officers spending very little time on activities related to natural gas revenues." See also reply, p. 14, ¶81, "…[p]etitioner's members' time involved in the foregoing [gas leasing] activities was *de minimis* relative to Petitioner's members' activities." (emphasis in original)

"Summary" section of the Senate Report - it states in part:

> The House-passed bill, H.R. 1144, amends the requirements for tax exemption for social clubs and similar organizations … in two respects. First, it provides that "substantially all" of such an organization's activities must be for pleasure, recreation, and other nonprofitable purposes. This change (present law requires such an organization to be organized and operated 'exclusively' for these purposes) allows the organization *to earn income from nonmember sources* to a limited extent and to have a limited amount of investment income (both types of income being subject to tax) without losing its general exemption from income tax.

(emphasis added) (Ex. 106-J, p. 2368) In addition, the "General Explanation" heading in part II. to the Senate Report bears the subtitles "A. Social Clubs" and "1. Income From Nonmembers and Investment Sources." (Ex. 106-J, p. 2369) Also, in the paragraph below, the Report references Treas. Reg. § 1.501(c)(7)-1(b) which states in part that a club that 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).[30,31] (Ex. 106-J, p. 2369) The Report's reference to the regulation supports

[30] The regulation pre-dates the 1976 amendment to code section 501(c)(7), above.

the conclusion that the proper measuring stick is the degree to which a club engages in business and the revenue it raises from these outside sources (which include resources on or under the club's land such as gas, timber, etc.).

Moreover, in the paragraph that follows, the Report references Rev. Proc. 71-17, 1971-1 C.B. 683 and an auditing standard the IRS had been using up until the passage of the 1976 Amendment.[32] (Ex. 106-J, p. 2369) This indicates

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[31] In Santee Club v. White, 87 F. 2d 5 (1st Cir. 1936), the U.S. Court of Appeals for the First Circuit held that, where a hunting and fishing club engages in income producing transactions which are not a part of the club purposes, exemption will not be denied because of incidental, trivial, or nonrecurrent activities such as sales of property no longer adapted to the club's purpose. Id. at 7. The IRS, shortly after the Santee Club opinion was handed down, amended Treas. Reg. section 1.501(c)(7)-1(b) to provide that "… an incidental sale of property will not deprive the club of its exemption." See The Coastal Club, Inc. v. Commissioner, 43 T.C. 783, 821 (1965), aff'd. per curiam 368 F.2d 231 (5th Cir. 1966), cert. denied 386 U.S. 1032 (1967).

[32] Rev. Proc. 71-17, 1971-1 C.B. 683, sets forth guidelines for determining the effect gross receipts derived from the use of a social club's facilities by the general public have on the club's exemption from income tax under section 501(c)(7). It states that non-member income shall not exceed 5-percent of gross receipts otherwise a taxpayer is at risk of losing its exemption (and a facts and circumstances test must be considered). The club must maintain books and records of each such use and the amount derived therefrom. Rev. Rul. 71-17 provides:

> .01 Minimum gross receipts standard.--A significant factor reflecting the existence of a nonexempt purpose is the amount of gross receipts derived from use of a club's facilities by the general public. As an audit standard, this factor alone will not be relied upon by the Service if annual gross receipts from the

Congress's endorsement of the standard - which was based on a percentage calculation using non-member income in relation to gross receipts.

The exact issue arose in Skillman Family Reunion Fund, Inc. v. United States, 196 F. Supp. 2d 543 (N.D. Ohio 2002) and the court rejected the club's argument. As previously stated above, in Skillman the IRS revoked the tax exempt status of a family social club that derived all of its receipts from investment income. The organization contended that less than one-percent of its activities was concerned to investment matters, and so long as its members spent substantially all of their time pursuing the club's stated purposes, it should maintain its exemption. In response, the court stated, "… even if the ratio of time spent on investments is small in comparison to the time spent pursuing family activities, [p]laintiff cannot

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> general public for such use is $2,500 or less or, if more than $2,500, where gross receipts from the general public for such use is five percent or less of total gross receipts of the organization. This minimum gross receipts standard reflects the audit experience of the Service that gross receipts at or below this level do not, standing alone, usually demonstrate a nonexempt purpose. Even though gross receipts from the general public exceed this standard, it does not necessarily establish that there is a nonexempt purpose. A conclusion that there is a nonexempt purpose will be based on all the facts and circumstances, including but not limited to the gross receipts factor.

escape the fact that courts, based upon guidance from the legislative history of section 501(c)(7), regard the *percentage* of investment income, in relation to an organization's *total gross receipts* as an indicator of whether the organization is conducting 'substantially all' of its activities for statutorily permissible non-profit purposes," citing, United States v. Fort Worth Club of Fort Worth, Texas, 345 F. 2d 52 (5th Cir. 1965) (emphasis in original). Id. at 547. It also stated "… the characterization of the Fund's operations is not to be hinged on the amount of time spent by the trustees in coordinating investments." Id. at 548. It added that "… if the primary evaluatory criterion were to lie in an examination of the activities of an organization's members, then an organization would be free to conduct whatever side ventures it desired, at whatever income levels of profit, so long as the individual members were pursuing the stated purposes of the club." Id.

Thus it is clear that the organization's gross receipts were the intended measuring stick, petitioner's claim cannot stand, and petitioner failed the 35-percent test for all tax years 2017-2023.

4. Petitioner's Income was Not an Unusual Event

The legislative history also states, "[h]owever, where a club receives unusual amounts of income, such as from the sale of its clubhouse or similar facility, that

income is not to be included in the formula; that is, such unusual income is not to be included in either the gross receipts of the club or in the permitted 35- or 15-percent allowances."[33] Since the petitioner's gas leasing activity was a regular, recurring event which initially occurred in 2011 in the form of a bonus payment (Ex. 62-J, p. 0816), with continuous payments starting in 2017 and lasting to present day (Exs. 86-J, p. 1276, 108-J), this activity should not be regarded as unusual. Nor was the gas leasing activity similar to "an incidental sale of property" permissible under Treas. Reg. 1.501(c)(7)-1(b), or other type of one-time transaction analogous to an incidental sale.[34]

In response, petitioner contends that it was unusual for petitioner's property to be situated "… over the top of said Marcellus Shale strata" which yielded the extracted gas and revenue in issue.[35] But petitioner's argument misses the mark. If

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[33] Ex. 106-J, p. 2371

[34] Treas. Reg. 1.501(c)(7)-1(b) provides in part, "A club which engages in business … is not exempt under section 501(a)… However, an incidental sale of property will not deprive a club of its exemption." See supra, p. 39, fn. 30.

[35] petition, p. 13, ¶90, more specifically, "[b]ecause Petitioner's forest and meadow acreage just happened to be over the top of said Marcellus Shale strata, the resulting lease bonus payments and royalties received by Petitioner are 'unusual' in nature for a social club within the meaning of the Senate Report's discussion …" See also, reply, p. 12, ¶72 "…[p]etitioner's members never sought or solicited

a land owner of this type of property agreed to lease the property to a gas extractor, it is not unusual for the land owner to receive continuous payments in exchange for the permission to extract. Even if the gas beneath the property was unexpected and a result of good fortune, it is not unusual for the oil and gas industry to make gas royalty payments in the form, method and frequency used.

5. Petitioner Fails a Facts and Circumstances Test

As previously stated, according to the legislative history if an organization fails the 15- and 35- percent tests, it still may be entitled to exemption based on the facts and circumstances.[36] Petitioner contends it passes a facts and circumstances test because it is appropriate to compare the amount of hours spent in member activities with the hours engaged in gas leasing under this test.[37]

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revenues from natural gas industry."

[36] Ex. 106-J, p. 2371, specifically, "… the facts and circumstances approach is to apply only if the club earns more than is permitted under the new guidelines."

[37] petition, p. 10, ¶63, if a "social club fails the 15%/35% revenues formula test, Respondent must then look into all of the facts and circumstances relating to a social club's *members' activities* (emphasis in original) that are productive of the revenues of a character resulting in test failure and compare those revenues to the members' exempt purposes activities." See also, reply, p. 9, ¶63, "… [r]espondent should look to member exempt purposes activities and non-exempt purpose activities in the event that the revenue formula test would not be met (presuming that said formula is federal law)."

However, the Senate Report is not so worded. (Ex. 106-J, p. 2371) Respondent admits it is likely that more of petitioner's members' time was spent on social club member-related activities than on its gas leasing activity and on managing its assets. However, as previously discussed, time is not the appropriate measuring stick. See, Skillman Family Reunion Fund, Inc. v. United States, 196 F. Supp. 2d 543 (N.D. Ohio 2002) (social club made the same argument and the court rejected it).

In applying a facts and circumstances analysis, the facts and circumstances of surrounding conditions are explored objectively to determine if the evidence explains or supports that which is being asserted. See, e.g. Treas. Reg. 1.512(a)-1(f)(7)(ii)(b) and (iii).[38] For instance in Treas. Reg. 1.512(a)-1(f)(7)(ii), an exempt

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[38] According to this regulation, the determination whether the publication of a periodical is an activity engaged in for profit is "to be made by reference to objective standards taking into account all the facts and circumstances involved in each case. The facts and circumstances must indicate that the organization carries on the activity with the objective that the publication of the periodical will result in economic profit (without regard to tax consequences), although not necessarily in a particular year. Thus, an exempt organization periodical may be treated as having been published with such an objective even though in a particular year its total periodical costs exceed its total income. Similarly, if an exempt organization begins publishing a new periodical, the fact that the total periodical costs exceed the total income for the startup years because of a lack of advertising sales does not mean that the periodical was published without an objective of economic profit.

organization's periodical is published for the production of income if all the facts and circumstances indicate that the publication of the periodical will result in economic profit. A publication with high startup costs which fails to earn profit in its initial years may still be regarded as having a profit-motive if the facts and circumstances so indicate. Id.

By comparison, in the instant case the facts and circumstances must demonstrate that the gas leasing activity contributed to the petitioner achieving its tax exempt mission of operating a social club in accordance with section 501(c)(7). They do not. The petitioner's gas leasing activity during the years in issue was unrelated to the club's purposes, as stated in its 1936 Certificate of Incorporation -

> … formed for the purposes of promoting the conservation of forests, fields and streams of the State of Pennsylvania; promoting better fishing and hunting in this State, and particularly Lycoming County and adjoining counties; promoting the purification of streams and rivers of Pennsylvania; promoting the care and reforestation of Pennsylvania forests and woodlands; and promoting the enjoyment of outdoor life…

(Ex. 1-J, p. 0017)

The organization may establish that the activity was carried on with such an objective. This might be established by showing, for example, that there is a reasonable expectation that the total income, by reason of an increase in advertising sales, will exceed costs within a reasonable time."

Respondent admits the administrative record lacks clear evidence of damage caused to the locations where gas extraction occurred or to the surrounding waterways, air, wildlife, etc., causing petitioner to depart from its long-standing exempt purpose of preservation and conservation.

However, the administrative record also lacks evidence that during the years in issue petitioner's gas leasing furthered petitioner's mission to conserve and protect the club's forests and woodlands and to promote the enjoyment of outdoor life by hunting, swimming, camping, and other types of recreation. (Entire record)

Rather, petitioner engaged in a substantial, recurring, business-like activity wholly apart from its mission. (Ex. 86-J, p. 1276). Since the petitioner's gas leasing did not further its exempt purposes, petitioner fails a facts and circumstances test.

In sum, during the years in issue, petitioner failed the 35-percent allowable limit for non-member income, and cannot avail itself of two exceptions within the legislative history. Furthermore, as Skillman, supra, points out, petitioner's argument[39] that it is the amount of its members' time spent in exempt activities that

[39] e.g., petition, p. 6, ¶34

controls under the "substantially all" test, fails. Accordingly, petitioner's tax exempt status should be revoked.

6. Retroactivity

Respondent proposes that petitioner's tax exempt status under section 501(c)(7) for the years ending 2017 through 2023 be revoked effectively as of January 1, 2017.[40] I.R.C. § 7805(b)(8) provides that "[t]he Secretary [of the Treasury] may prescribe the extent, if any, to which any ruling (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws shall be applied without retroactive effect."

Both Treas. Reg. § 601.201(n)(6)(i), Statement of Procedural Rules[41] and

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[40] In respondent's Answer, respondent affirmatively alleged that the effective date should be January 1, 2017 instead of January 1, 2023.

[41] Section 601.201(n)(6)(i), Statement of Procedural Rules, provides: "Revocation Or Modification Of Rulings Or Determination Letters On Exemption And Foundation Status. (i) An exemption ruling or determination letter may be revoked or modified by a ruling or determination letter addressed to the organization, or by a revenue ruling or other statement published in the Internal Revenue Bulletin. The revocation or modification may be retroactive if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented … In any event, revocation or modification will ordinarily take effect no later than the time at which the organization received written notice that its exemption ruling or determination letter might be revoked or modified."

section 12.03 of Rev. Proc. 2024-5, 2024-1 I.R.B. 262, provide in pertinent part that the revocation of a determination letter may be retroactive if: the organization omitted or misstated a material fact, or the organization operated in a manner materially different from that originally represented in an application for recognition of exemption. Id.

Section 12.05 of Rev. Proc. 2024-5, provides in part that where the organization operated in a manner materially different from that originally represented in its application for recognition of exemption, the effective date of revocation shall be the date of the material change. Id.

"The [United States] Supreme Court has held that the IRS Commissioner has broad discretion ... to decide whether to revoke a ruling retroactively and that such a determination is reviewable by the courts only for abuse of that discretion." Democratic Leadership Council, Inc. v. United States, 542 F. Supp.2d 63, 70 (D.D.C. 2008) (citing Automobile Club of Michigan v. Commissioner, 353 U.S. 180, 184 (1957); see also Partners in Charity, Inc. v. Commissioner, 141 T.C. 151, 163 (2013). ("A retroactive revocation of a tax-exemption ruling will not be

disturbed in the absence of an abuse of discretion, and we therefore review that retroactive determination for abuse of discretion." (citation omitted)).

In the instant case, petitioner's exemption application stated that the sources of its income for 1980 were membership dues, purpose-related activities, timber sales, interest income, and miscellaneous activities of $3,042.18. (Ex. 1-J, pp. 0008, 0040) Petitioner also stated similar income sources on its application for years 1979 and 1981-1983. (Ex. 1-J, pp. 0032, 0039, 0043, 0044) Petitioner's application did not indicate any gas leasing revenue. (Ex. 1-J)

Since substantial revenue was derived from a source not stated in petitioner's application, petitioner was operating in a "manner materially different from that originally represented in its application" during the years in issue. Treas. Reg. § 601.201(n)(6)(i); Rev. Proc. 2024-5, section 12.03. The start of the gas leasing activity was in 2011 wherein petitioner received a signing bonus of $921,800 pursuant to an oil and gas lease contract with Rice. (Ex. 62-J, pp. 0816, 0826-0829; Ex. 86-J, p. 1276) Thereafter, beginning in 2017, petitioner received gas leasing revenue far in excess of permissible limits for a social club's non-member income. (Ex. 86-J, p. 1276) The change was so great that it was no

longer reasonable for the petitioner to rely on the determination letter without seeking the assurance of the IRS.

In 1981 when the IRS issued petitioner its favorable determination letter, the IRS specifically cautioned that the favorable determination was "[b]ased on information supplied, and assuming your operations will be as stated in your application for recognition of exemption …" (Ex. 3-J, p. 0052) In addition it stated, "[i]f your purposes, character or method of operation change, please let us know so we can consider the effect of the change on your exempt status." (Ex. 3-J, p. 0052)

In sum, there is sufficient evidence in the administrative record to support respondent's position that petitioner operated in a manner materially different from what it originally represented in its application. Thus, the respondent's position comports with the requirements for retroactive revocation set forth in Treas. Reg. § 601.201(n)(6)(i) and Rev. Proc. 2024-5, and the Court may conclude that the IRS did not abuse its discretion when it retroactively revoked the petitioner's tax-exempt status to January 1, 2017. See Christian Echoes Nat. Ministry, Inc. v. United States, 470 F.2d 849, 858 (10th Cir. 1972), cert. denied 414 U.S. 864 (1973) (retroactive revocation of a church's tax-exempt status proper where the

facts revealed during an IRS audit were materially different from those disclosed in the organization's original exemption application, which did not refer specifically to the organization's involvement in activities aimed at influencing legislation); Western Catholic Church v. Commissioner, 73 T.C. 196, 198-199, 215 (1979), aff'd. per curiam, 631 F.2d 736 (7th Cir. 1980); cert. denied 450 U.S. 981 (1981) (IRS's retroactive revocation upheld where organization was not operating exclusively for charitable purposes, petitioner did not operate as it stated in its application, and it was not shown that no part of its net earnings inured to the benefit of private individuals); United Missionary Aviation, Inc. v. Commissioner, T.C. Memo. 1990-566, (the Court found material differences in organization's stated purpose in its application verses organization's later commercial-like activities, and concluded retroactive revocation was proper). But see Leasavoy Foundation v. Commissioner, 238 F.2d 589 (3rd Cir. 1956) (United States Court of Appeals for the Third Circuit determined the IRS abused its discretion by retroactively revoking organization's exempt status, causing a tax bill large enough to "wipe it out of existence." The IRS retroactively revoked to the date organization acquired a mill that manufactured textiles for business purposes of the

donor. The organization disclosed the acquisition on its return for the year.[42] The United States Court of Appeals for the Third Circuit held the organization committed no fraud and made no misstatement, and retroactive revocation was improper due to a lack of bad faith.)

CONCLUSION

Under the administrative record and stipulation, and based on the guidelines set forth in the legislative history to the 1976 amendment to section 501(c)(7), during the years in issue, 2017-2023, the petitioner failed to meet: (1) the 35-percent gross receipts test for income from non-member, outside, public sources; and (2) a facts and circumstances test. Petitioner may not avail itself of the exception for unusual items of income also contained in the legislative history. Petitioner did not operate substantially for pleasure, recreation, or other nonprofitable purposes and its exempt status should be revoked.

Based on the application of section 12.05 of Rev. Proc. 2024-5, the effective date of revocation should be January 1, 2017 - the year when consecutive, annual

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[42] The organization stated, "yes" in response to the question on its 1946 information return, "[h]ave you any sources of income or engaged in any activities which have not previously been reported to the Bureau? If so, attach detailed statement." Id. at 592-593. In addition it stated that it had purchased a spinning mill company, and attached a balance sheet listing assets, inventory, liabilities, and gross receipts which reflected substantial sales of yarn and cloth. Id.

gas leasing payments began. This is because the petitioner's operations changed significantly from that originally represented in its application for recognition of exemption, and there is no abuse of discretion in revoking the initial determination letter to that date.

WHEREFORE, respondent requests that the respondent's Motion for Summary Judgment be granted.

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