INTERNAL REVENUE SERVICE
DISTRICT DIRECTOR
31 HOPKINS PLAZA
BALTIMORE, MD 21201

DEPARTMENT OF THE TREASURY

Person to Contact: [redacted]
Contact Telephone Number: [redacted]
Reply to: [redacted]
Date: FEB 0 1 1996

[redacted]

CERTIFIED MAIL:

Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code and have determined that you do not qualify for exemption under that section. Our reasons for this conclusion and the facts on which it is based are explained below.

The evidence submitted indicates that you were incorporated [redacted], under the laws of the State of [redacted]. Article Third of your Articles of Incorporation state that "The purposes for which the corporation is organized are to promote and sponsor activities for the charitable, benevolent, civic, patriotic, social and fraternal benefit of its members and the [redacted]ng of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code of 1954 (or the corresponding provisions of any future United States Internal Revenue Law)." Provision has been made to distribute your assets to qualified 501(c)(3) organizations in the event your organization dissolves.

The activities of your organization, as described in your application, include sponsoring dinner-dances, weekly pasta nights and an annual golf tournament.

Your sources of income include membership dues, club functions, food and beverage sales, advertising, hall rental and 50/50 drawings. Expenses are shown for charitable donations, insurance, utilities, postage and printing, maintenance, and licenses. You also indicate that you provide a $[redacted] Benevolent Distribution upon the death of a member.

Information submitted with your application shows that during [redacted], your total income was $[redacted] from a combination of membership dues, gross amounts from your related activities and investment income. You indicate that of this amount, $[redacted] was received from related activities. You also furnished us with a breakdown of member/non-member income for [redacted]. You indicate that during this period you received $[redacted] or [redacted]% of your related income from non-member sources. You further state that your total income from related activities was $[redacted]. Our analysis of this income indicates that [redacted]% was from non-member sources, $[redacted], or approximately [redacted]% from your members.

Section 501(c)(7) of the Internal Revenue Code provides for the exemption from federal income tax for clubs organized for pleasure, recreation and other non-profitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(c)(7) of the Income Tax Regulations provides as follows:

(a) The exemption provides by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, but does not apply to any club if any part of the net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenues from members through the use of club facilities or in connection with club activities.

(b) A club which engages in business, such as making its social and recreation facilities available to the general public is not organized and operated exclusively for pleasure, recreation and other non-profitable purposes, and is not exempt under section 501(a). Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes.

Section 512 of the Internal Revenue Code defines the term "unrelated business income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less deductions allowed by this section.

Section 512 (a)(3)(A) of the Code defines the term "exempt function income" as the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing these members or their dependents or guests goods, facilities or services in furtherance of the exempt purposes of the organization. The sale of advertising by an organization exempt under this section is considered unrelated business income. The sale of advertising does not promote the pleasure and recreation needs of a social club's members or facilitate the use of the club for recreational or social activity.

Revenue Ruling 58-589, published in Cumulative Bulletin 1959-2, page 267, held that a club will not be denied exemption merely because it receives income from the general public; that is, persons other than members or their bona fide guests, or because the general public on occasion is permitted to participate in its affairs, provided such participation is incidental to and in furtherance of its general club purposes and it may not be said that income therefrom is inuring to members. This is generally true where the receipts from non-members are no more than enough to pay their share of expenses.

Revenue Ruling 63-190, published in Cumulative Bulletin 1963-2, page 212, states in part that "a non-profit organization that maintains a social club for members and also provides sick and death benefits for its members and their beneficiaries does not qualify for exemption under section 501(c)(7) since the net earnings inure to the benefit of a private shareholder.

Revenue Ruling 65-63, published in Cumulative Bulletin 1965-1, page 240, holds that a non-profit organization which, in conducting sports car events for the pleasure and recreation of its members, permits the general public to attend such events for a fee on a recurring basis and solicits patronage by advertising, does not qualify for exemption as a club organized and operated exclusively for pleasure, recreation and other non-profitable purposes under section 501(c)(7) of the Internal Revenue Code.

Revenue Ruling 68-638, published in Cumulative Bulletin 1968-2, page 220, holds that a club that hosts an annual golf tournament and receives substantial income from the public and uses the income for club operating expenses and improvements is not exempt under section 501(c)(7).

[redacted]

Revenue Ruling 71-17, published in Cumulative Bulletin 1971-1, page 683, indicates that, as an audit standard, a social club's annual income from outside sources should not be more than 5% of the total gross receipts of the organization. Public Law 94-568 liberalized this standard. The intent of this law, as explained in Senate Report No. 94-1318, published in Cumulative Bulletin 1976-2, page 597, is that a club exempt from taxation and described in section 501(c)(7), is permitted to receive up to 35% of its gross receipts from a combination of investment income and receipts from non-members (from the use of its facilities and services) so long as the non-member income does not exceed 15% of total receipts.

It is further stated that if an organization exceeds these limits, all of the facts and circumstances must be considered in determining whether the organization qualifies for exempt status. However, the amendment was not intended to allow social clubs to receive, even within the allowance guidelines, income from the active conduct of business not traditionally carried on by social clubs (Senate Report No. 94-1318, 2nd session, 1976-2, C.B. 596).

Organizations recognized as exempt under section 501(c)(7) must be organized and operated exclusively for pleasure, recreation and other non-profitable purposes. Your Articles of Incorporation filed with the State of [redacted] indicate that "The purposes for which the corporation is organized are to promote and sponsor activities for the charitable, benevolent, civic, patriotic, social and fraternal benefit of its members and the making of distributions to organizations that qualify for exemption under section 501(c)(3)." Our review of these purposes indicates that your organization is not organized exclusively for pleasure and recreation as required to be exempt under section 501(c)(7).

Income from the general public (non-members) and solicitation from the general public by advertising is price facie evidence that you club is engaging in a business. This is borne out by the fact that [redacted]% of your income during [redacted] was from non-members. You have also indicated that you received $[redacted] from advertising solicited from local businesses. This activity is considered to be unrelated to your exempt purposes since solicitation of advertising does not further pleasure and recreation for your members.

Since a substantial portion of your income comes from these sources, it is clear that your club's outside profit is not incidental to the club's activities. The club's activities are producing substantial income which cannot be classified as negligible or non-recurring. The organization and operation of a social club in this manner constitutes a subterfuge for doing business with the public and is inconsistent with the term "club" as used in section 501(c)(7) of the Internal Revenue Code.

In addition, the profits received by your organization from your annual golf tournament are set aside for future use in your building fund. This non-member income is subsidizing the operation of your club and is being used to defray expenses that would otherwise have to be paid for by the members. The record also shows that during [redacted], $[redacted] has been paid in death benefits for members.

[redacted]

Revenue Ruling 63-190 holds that when a non-profit organization maintains a social club and provides benefits for member's beneficiaries, the net earnings of the organization inures to the benefit of private individuals. The use of non-member income from the golf tournament to accumulate a building fund also causes the net earnings of your organization to inure to private individuals and destroys exemption under section 501(c)(7).

Based on the information submitted, we have concluded that you are not entitled to exemption under section 501(c)(7). In accordance with this determination, you are required to file Federal income tax returns on Form 1120.

If you don't agree with our determination, you may request consideration of this matter by the Office of the Regional Director or Appeals. To do this, you should file a written appeal as explained in the enclosed Publication 892.

Your appeal should give the facts, law, and any other information to support your position. If you want a hearing, please request it when you file your appeal and you will be contacted to arrange a date. The hearing may be held at the regional office, or, if you request, at any mutually convenient district office.

If you will be represented by someone who is not one of your principal officers, that person will need to file a Power of Attorney or tax information authorization with us.

If you don't appeal this determination within 30 days from the date of this letter, as explained in Publication 892, this letter will become our final determination in this matter. Further, if you do not appeal this determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies.

Appeals submitted which do not contain all the documentation required by Publication 892 will be returned for completion.

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

Sincerely yours,

[redacted]

District Director

Enclosure:
Publication 892