TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Contact Person:

Number: **201414029**
Release Date: 4/4/2014

Identification Number:

Telephone Number:

Date: January 10, 2014

Employer Identification Number:

UIL 501.07-00
501.07-05

LEGEND:

Municipality =

Dear :

We have considered your ruling request dated August 12, 2013, regarding the federal income tax consequences of the proposed transaction described below.

Facts

You are a nonprofit corporation exempt from federal income taxation under § 501(c)(7) of the Internal Revenue Code. You are organized and operated for the social benefit of your members ("Members"), who pay monthly membership dues to you. Your purpose is to provide opportunities for Members to socialize and engage in recreational and athletic activities. You own a facility that includes a swimming pool, tennis courts, a golf course, pro shop, and a club house that serves food. You do not currently open your facilities to the general public except occasionally and where such participation by the general public is incidental to and in furtherance of your exempt purposes of providing social and recreational opportunities for your Members.

Members are not required to pay green fees for using your golf course. Nonmembers who use your golf course, including guests of Members, are charged a green fee. You maintain records to separate Member and nonmember receipts from pro shop sales, food sales, and golf cart rentals.

You are considering entering into an agreement with Municipality (the "Agreement"). Municipality owns and operates a public golf course that it intends to temporarily close for renovations. Municipality anticipates that such renovations will take approximately one year to complete. Municipality wishes to provide its residents the opportunity to play golf locally during the time its course is closed, and your course is the only local alternative.

Under the Agreement, you will grant Municipality non-exclusive use of your golf course, pro shop, and certain areas of the club house (restrooms and locker rooms). The result of entering into the Agreement would be using your golf course during the term of the Agreement by nonmembers (i.e., residents of Municipality) and additional receipts due to nonmembers using your facilities. Municipality would pay a fixed amount to you during the term of the Agreement. In addition, nonmembers who wish to use your golf course pursuant to the Agreement will pay green fees at a rate established under the Agreement. You represent that the payments from Municipality to you, as well as the green fees from nonmembers, are intended to cover the cost of additional wear and tear and the increased cost of servicing the needs of additional guests. You will retain the receipts generated by the green fees, cart rental, and pro shop sales. You will maintain and operate your golf course according to the terms of the Agreement. Nonmembers will not be permitted in certain areas of the club house and will not be permitted to use other club facilities, such as the dining room and bar, meeting rooms, pool, or tennis courts.

Based on the projected revenues you submitted, you represent that, during the term of the Agreement, less than 15 percent of your annual gross revenues will be derived from green fees paid by members of the general public. You further represent that, when the payments from Municipality to you are combined with those green fees, they will account for approximately 35 percent of your annual gross receipts.

Rulings Requested

You have requested the following rulings in connection with the circumstances described above:

1. You will not be deemed to have opened your facilities to the general public in a manner that will result in you losing your tax-exempt status under § 501(c)(7) if you enter into the Agreement with Municipality and allow nonmembers to play on your golf course pursuant to the terms of the Agreement;

2. Your exempt status under § 501(c)(7) will not be revoked if the income you receive from Municipality, green fees, and cart rental fees under the Agreement causes either your gross receipts derived from the use of your facilities or services by the general public to exceed 15 percent of your total gross receipts, or your gross receipts from nonmember sources to exceed 35 percent of your total gross receipts.

Law

I.R.C. § 501(a) states that an organization described in subsection (c) or (d) shall be exempt from taxation under this subtitle unless such exemption is denied under § 502 concerning feeder organizations or § 503 concerning organizations engaged in prohibited transactions.

I.R.C. § 501(c)(7) describes 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.

Treas. Reg. § 1.501(c)(7)-1(a) provides that the exemption provided by § 501(a) for

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

Treas. Reg. § 1.501(c)(7)-1(b) provides that a club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber or other products, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under § 501(a). Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption.

Rev. Rul. 58-589, 1958-2 C.B. 266, sets forth criteria for exemption under § 501(c)(7), and provides that a club must have an established membership of individuals, personal contacts, and fellowship. It also provides that, while the regulations indicate that a club may lose its exemption if it makes its facilities available to the general public, this does not mean that any dealings with nonmembers will automatically cause a club to lose its exemption. A club may receive some income from the general public, that is, persons other than members and their bona fide guests, or permit the general public to participate in its affairs, provided that such participation is incidental to and in furtherance of the club's exempt purposes and it may not be said that income therefrom is inuring to members. This is particularly true where the receipts from nonmembers are no more than enough to pay their share of the expense. Where, however, a club makes its facilities open to the general public and the purpose is to increase its funds for enlarging its club facilities or for otherwise benefiting its members, it is evident that it is not operating as an exempt social club within the meaning of § 501(c)(3).

Rev. Rul. 60-324, 1960-2 C.B. 173, concerns an organization formed to operate a social club for the pleasure and recreation of its members and their guests. Among other facilities, the club has a regular club dining room and bar, a private dining room, and a ballroom. A considerable number of functions are held at the club that involve the use of the private dining room and the ballroom. Such functions include civic and business club meetings, employee parties by business firms, school and alumni banquets, and similar non-club activities. The club submitted a financial analysis showing its banquet sales over a seven-year period indicating that the income from sales on behalf of outside organizations and groups ranged from 12 to more than 17 percent of total income from all sources, including dues, in each of the years involved. In one of the years, gross profits from these outside activities amounted to 25 percent of the total gross profits for the year. The number of such outside functions totaled over 200 during the year. The number of major functions for outside organizations and groups conducted on club facilities during each year of the seven-year period is very substantial, exceeding 40 percent of the total number of major functions conducted on club facilities in one of those years. Moreover the availability of club facilities to outside organizations and groups under the ready sponsorship of club members serves to indicate that the club is catering to the general public and places it in

competition with other business enterprises in the community for such business or activities. An analysis of the club's transactions with outside organizations and groups demonstrates that such outside activities are of such magnitude and recurrence as to constitute engaging in a business. Thus, the general public's use of club facilities is not considered to be merely incidental or in furtherance of the general club purposes. Accordingly, on the basis of the facts and circumstances described above, it is concluded that the club, by making its social facilities available to the general public, cannot be treated as operated for pleasure, recreation, or other non-profitable purposes, and no longer qualifies for exemption under § 501(c)(7).

Rev. Rul. 69-219, 1969-1 C.B. 153, concerns a club organized for social and recreational purposes. Its principal function is to operate a golf course for its members, who pay annual dues. However, the club regularly holds the golf course open to the general public to use upon the payment of an established green fee. Green fees from the general public have constituted a significant portion of the club's total receipts from all sources for each of the past five years. The income from this source is used to help defray the expense of maintaining and improving the golf course. Based on the facts presented, this golf club does not qualify for exemption under § 501(c)(7) because it is engaged in business with the general public by regularly holding its golf course open to the public for use upon payment of established green fees, and the income from this source is inuring to the benefit of the members because it is used for maintenance and the improvement of club facilities.

Rev. Rul. 69-636, 1969-2 C.B. 126, concerns a club organized to operate and maintain a country club for the pleasure and recreation of its members. The club has been asked to permit an organization exempt from Federal income tax under § 501(a) to use its facilities to raise funds for charity. The sponsoring organization will sell admission tickets to the general public. Any profits will be donated by the sponsoring organization to an organization exempt under § 501(c)(3). The club's charges to the sponsoring organization will be set at or below cost. "Cost" for this purpose will be direct cost only and will not include any pro rata share of overhead expenses or depreciation. These charges will not reimburse the club for any portion of the expenses normally incurred in running the club for its members. Making its social and recreational facilities available to the sponsoring exempt organization to raise funds for charity does not evidence a business activity within the meaning of the regulations because no possibility of profit exists because the charges will be set at a rate equal to or less than direct cost. Moreover, this activity will not result in inurement to the club or its members. Accordingly, it is held that the use of the club facilities under these circumstances will not result in inurement to the club or its members, and will not adversely affect the club's exemption under § 501(c)(7).

In *Pittsburgh Press Club v. U.S.,* 536 F.2d 572 (3d Cir. 1976), the court found that the Government's evidence that the club received between 11 and 17 percent of its gross receipts from nonmembers was not so high as to preclude, as a matter of law, the club from establishing exemption, nor so low as to entitle the club, as a matter of law, to exemption. Other factors noted by the court to consider in addition to the level of nonmember income include the purposes for which the club's facilities were made available to nonmember groups, the frequency of use of the club facilities by nonmembers, and the amount of net profits derived from the nonmember income. *Id.* at 575-76.

P.L. 94-568 amended § 501(c)(7), effective for tax years beginning after October 20, 1976. S. Rep. No. 94-1318, at 4 (1976), *reprinted in* 1976 U.S.C.C.A.N. 6051, 6054, explains the effect of the amendment as follows—

> The effect of this is twofold. First, it is intended to make it clear that these organizations may receive some outside income ... without losing their exempt status. Second, it was intended that a social club be permitted to derive a substantially higher level of income than was previously allowed from the use of its facilities and services by nonmembers without the club losing its exempt status. The decision in each case as to whether substantially all of the organization's activities are related to its exempt purpose is to continue to be based on all the facts and circumstances. However, the facts and circumstances approach is to apply only if the club earns more than is permitted under the new guidelines. If the outside income is less than the guidelines permit, then the club's exempt status will not be lost on account of nonmember income.
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> It is intended that these 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. It 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....

Analysis

You represent that you will meet the 15 and 35 percent requirements within the meaning of § 501(c)(7). However, if your receipts exceed such requirements, then you would still be tax-exempt under § 501(c)(7) because you've shown through facts and circumstances that substantially all of your activities are for pleasure, recreation, and other non-profitable purposes.

Non-members playing golf at your course under the Agreement will pay you green fees and cart rental fees as mutually agreed between you and Municipality. You anticipate that such fees will not exceed 15 percent of your total gross receipts in each of the two years encompassing the term of the Agreement. Further, when such fees are added to the payment you will receive from Municipality under the Agreement, you anticipate that the resulting amount of income will not exceed 35 percent of your total gross receipts in each of the two years encompassing the term of the Agreement. But even if those amounts were to exceed such percentages of total gross receipts, you would not automatically lose your exempt status. Rather, the decision as to whether substantially all of your activities were related to your exempt purpose would be based on all the facts and circumstances.

As noted in *Pittsburgh Press Club v. U.S.,* 536 F.2d 572, 575-76 (3d Cir. 1976), relevant facts and circumstances to consider in determining whether revenues generated from nonmembers are so high as to preclude exemption under § 501(c)(7) include the frequency of use by nonmembers, the record of nonmember use over a period of years, the purpose for such use, and the existence of net profits earned from such use. Here, the facts and circumstances with respect to your Agreement with Municipality show that substantially all of your activities will be related to your exempt purpose. While the Agreement will allow the general public to use your

golf course, they will not be allowed to use any of your other social and recreational facilities.

Furthermore, non-member use of your golf course will be limited to the 12 to 18 month period during which the municipal course is closed for renovation. Aside from the Agreement, you do not normally hold your golf course open to the general public. You are not like the organization described in Rev. Rul. 60-324 or Rev. Rul. 69-219 (which described organizations that were deemed to have held their facilities open to the public) because your arrangement with Municipality is merely temporary, and you are not relying on the arrangement to supplement your revenue stream. In addition, you did not enter into the agreement to solicit business from the general public, but to accommodate Municipality in providing a place for residents to play golf while the municipal course is undergoing renovation. Finally, you do not anticipate that the nonmember income will generate net profits for you – instead, you represent that the payments made to you are intended to reflect the wear and tear on the golf course and the increased cost of servicing the needs of the additional users of the golf course and other facilities. Rev. Rul. 58-589 explains that "exemption will not be denied because of incidental, trivial or nonrecurrent [income-producing] activities such as sales of property no longer adapted to club purposes." It goes on to stipulate that "in order to retain exemption a club must not enter into outside activities with the purpose of deriving profit." Rev. Rul. 69-636 states that "no possibility of profit exists" where "the charges will be set at a rate equal to or less than direct cost." Your arrangement with Municipality is incidental to your normal operations and will not recur or continue beyond a period of about 18 months. Likewise, you are not entering into the Agreement for the purpose of deriving a profit, and the payments from Municipality and the public to you are meant to merely offset the cost of providing such facilities.

Conclusions

Based on the information provided, we rule as follows:

1. You will not be deemed to have opened your facilities to the general public in a manner that will result in you losing your tax-exempt status under § 501(c)(7) if you enter into the Agreement with Municipality and allow nonmembers to play on your golf course pursuant to the terms of the Agreement;

2. Your exempt status under § 501(c)(7) will not be revoked if the income you receive from Municipality, green fees, and cart rental fees under the Agreement causes either your gross receipts derived from the use of your facilities or services by the general public to exceed 15 percent of your total gross receipts, or your gross receipts from nonmember sources to exceed 35 percent of your total gross receipts.

This ruling will be made available for public inspection under § 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose.* A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent. This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Steven B. Grodnitzky
Manager, Exempt Organizations
Technical Group 1

Enclosure
Notice 437