yellow

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: SEP 20 2001

Contact Person:
[redacted]
Identification Number:
[redacted]
Contact Number:
[redacted]

NO PROTEST RECEIVED
Release to Manager, EO Determinations - Cincinnati
DATE: [redacted]
SURNAME [redacted]

[redacted]

Employer Identification Number: [redacted]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(7). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were incorporated on [redacted] in [redacted]. You were formed as a country club for social, recreational, athletic and other non-profitable purposes. You also state that your purpose is to promote personal contact, co-mingling and fellowship among your members. You are a membership organization. You have twenty-one members who pay two dollars/year in dues.

You have three members on your Board of Directors; [redacted], [redacted], and [redacted]. You have a Building Fund committee and a Scholarship committee. None of your Directors, officers, or committee members receive a salary from you.

Your major activity is weekly beano games. Beano is a game identical to bingo. You have these games three nights/week with twenty games played per night. You indicate that your gross receipts from beano were $[redacted] for one month in [redacted], and $[redacted] in [redacted]. All (100%) of your beano receipts in [redacted] were derived from non-members. Out of $[redacted] (100%) of your total revenues earned in [redacted], $[redacted] (93%), were derived from beano, and $[redacted] (7%), were derived from investment income.

You place advertisements in your local newspapers advertising your beano games, and you also produce handouts advertising these games. You rent a bingo hall from a third party to run your weekly beano games, paying your lessor $[redacted]/night. You have a d/b/a/ name; [redacted] which you use occasionally to advertise your beano games.

Most of your expenses are for supplies for the beano games. You hire a professional Beano Manager to run your games, who is paid approximately 2.5% of your gross receipts from

[redacted]

beano as his compensation. Your members also volunteer in helping run the beano games. You have a picnic for your beano volunteers and tee-shirts and sweatshirts for beano volunteers, too. You pay approximately 3% of your annual gross revenues to local charities. You are also saving funds to buy a clubhouse to house your beano games so you won't have to continue to pay rent to a for-profit operator.

Your other activities include card parties, annual "bean" suppers, a Christmas party, a New Years' Eve Party, a summer picnic, guest speakers on government topics, and horseshoe tournaments.

Section 501(c)(7) of the Code provides for the exemption from federal income tax of 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.

Section 1.501(c)(7)-1 of the Income Tax Regulations provides as follows:

(a) The exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other 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.

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

The Committee Reports for Public Law 94-568 (Senate Report No.94 –1318, 2d Session, 1976-2 C.B. 597) state that it is intended that social clubs should be permitted to receive up to 35 percent of their gross receipts, including investment income, from sources outside of their memberships without losing their exempt status. 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. This means that an exempt social club may receive up to 35 percent of its gross receipts from a combination of investment income and receipts from non-members, so long as the latter do not represent more than 15 percent of total receipts. Thus, a social club may receive investment income up to the full 35 percent amount of its gross receipts, where a social club receives no income from non-members' use of club facilities. In addition, the Committee Reports state that where a club receives unusual amounts of income, such as from the sale of its clubhouse or similar facilities, that income is not to be included in the

[redacted]

35 percent formula. If an organization's income exceeds one or both of these limitations, then the club may still be able to show through facts and circumstances that "substantially all" of its activities are for pleasure, recreation, and other nonprofitable purposes.

Rev. Rul. 58-589, 1958-2 C.B. 266, states that when an organization solicits by advertisement for public patronage of its facilities, it is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes.

Rev. Rul. 65-219, 1965-2, C.B. 168, describes an organization that was formed as a swim club providing a pool for its members. It entered into an agreement which provided that the manager would bear the cost of building and running the pool. All monies collected as initiation fees and 90 percent of the annual dues and transfer fees were to be paid over to the manager. It was concluded that the arrangement went beyond the normal management contract whereby a club is saved the burden of administrative details by paying a reasonable rental to an outside operator in the form of a share of the receipts. The club was held to be operating as a commercial venture for the financial benefit of the manager. Thus, it was held not to qualify as an organization described in section 501(c)(7) of the Code.

Rev. Rul. 69-527, 1969-2 CB 125, describes an organization that was formed to assist its members in their business endeavors through study and discussion of problems, and other activities at weekly luncheon meetings. Any social activities at the luncheon were merely incidental to the business purposes of the organization. Accordingly, the ruling holds that this organization is not exempt under section 501(c)(7) of the Code.

Rev. Rul. 70-32, 1970-1 CB 132, describes an organization that was formed as a flying club providing flying facilities for its members. It had no organized social and recreation programs. The Service held that this organization did not qualify for exemption under section 501(c)(7) of the Code because the sole activity of the club was rendering services to its individual members, and there was no significant commingling of its members.

Rev. Proc. 71-17, 1971-1 C.B. 683, states that personal business use of club facilities by club members furthers a club's social or recreational purposes, even if the employer pays the cost of the use of club facilities. However, the use must be a member's use and not a device to permit the public, in the form of an employer or fellow employees, to use club facilities.

The Senate Committee reports listed above mandate the application of a facts and circumstances test to allow exceptions to the general percentage tests, but do not specify any of the relevant facts and circumstances that should be considered. However, a Court of Appeals has indicated some factors to consider. (Pittsburgh Press Club v. USA, 536 F.2d 572, (1976)). Factors to consider are:

- the actual percentage of nonmember receipts or investment income. (As the percentages increase above the permitted levels, the facts and/or circumstances in the organization's favor must increase proportionately to avoid revocation.)

[redacted]

- frequency of use of club facilities or services by nonmembers. (An unusual or single event that generates all of the nonmember income should be viewed more favorably than nonmember income arising from frequent use by nonmembers.)
- the record over a period of years.
- the purpose for which a club's facilities are made available to nonmembers.
- whether or not the nonmember income generates net profits for the organization.

Where 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 intendment of section 501(c)(7) of the Code. See Aviation Club of Utah v. Commissioner, 162 F.2nd 984, (10th Cir. 1947).

An analysis of the information you have submitted shows that operating beano games is your primary activity. The primary purpose of your activity is to raise money for your building, and to pay a small percentage to charity. Out of $[redacted] (100%) of your total revenues earned in [redacted], $[redacted] (93%), were derived from beano, and $[redacted] (7%), were derived from investment income. All (100%) of your beano receipts in [redacted] are derived from non-members. Your activities are carried on in the same way as for-profit businesses that operate similar beano franchises throughout the United States. Raising money to build your new building is a commercial activity. You are operated in a manner similar to the organizations described in Rev. Ruls. 65-219 and 69-527, Rev. Proc. 71-17, and Aviation Club of Utah v. Commissioner, supra, because you are primarily engaged in carrying on a business with the general public in a manner similar to organizations which are operated for profit.

You advertise your beano games in your local newspaper, and also produce handouts advertising these games. The games are open to the general public. This is prima facie evidence that you are engaging in business and that you are not a club operated exclusively for pleasure, recreation, or social purposes. See Rev. Rul. 58-589, supra.

Your purposes also appear to be to raise funds for charity and build a clubhouse for your beano games. These are not social and recreational activities. Your activities are not exclusively social and recreational, which are required for an organization to operate under section 501(c)(7) of the Code. The social activities which you do have are merely incidental to your business of operating a bingo hall, and thus similar to the organization described in Rev. Rul. 69-527, which was held not exempt under section 501(c)(7) of the Code. Your beano games are open to the general public. Your revenue is generated entirely from non-member sources. These are all indicia of operating a business. A business is not an exclusively social and recreational activity allowed under section 501(c)(7) of the Code. Your goal of building a clubhouse will primarily benefit your members, which is a financial benefit to them not allowed under Sec. 501(c)(7). See Aviation Club of Utah v. Commissioner, supra, and Rev. Proc. 71-17, supra.

You have failed to meet the 35% test of gross receipts listed in the Senate committee

[redacted]

reports, supra, since 100% of your gross receipts derive from non-members, via beano and investment income. Within 100% of your gross receipts, 93% derive from non-members (via beano). This shows that you are operating in a commercial manner, and fails to show that your activities are nonprofit in nature, as is required under Section 1.501(c)(7)-1 of the Income Tax Regulations.

Also, you have failed to meet the "facts and circumstances" exception discussed in the Pittsburgh Press Club v. USA, supra, because 100% of the beano proceeds were derived from non-members. Also, most, if not all, of your beano proceeds from the three prior years were derived from non-members. This nonmember income generated net profits for your organization. Due to these facts, the income fails to meet the Pittsburgh Press Club exception for allowing certain commercial activities by a social club and still maintain its tax-exempt status.

Based upon the above, you do not qualify for exemption as an organization described in section 501(c)(7) of the Code and you must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201.

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
[redacted] T:EO:RA:T:4
1111 Constitution Ave, N.W.
Washington, D.C. 20224

[redacted]

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

Sincerely,

(signed) Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

[redacted]