

Criteria or tests for determining whether an organization qualifies for exemption from Federal income tax under section 501(a) of the Internal Revenue Code of 1954 as an organization described in section 501(c)(7) of the Code.

Advice has been requested concerning the criteria or tests to be met in determining whether a social club can qualify for exemption from Federal income tax under the provisions of section 501(a) of the Internal Revenue Code of 1954.

Section 501(c) of the Code describes certain organizations exempt from income tax under section 501(a) and reads, in part, as follows:

(7) Clubs organized and operated exclusively for pleasure, recreation, and other nonproitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

In making a determination whether an organization comes within the provisions of section 501(c)(7) of the Code, all facts pertaining to its form of organization, method of operation and activities should be considered. An organization must establish (1) that it is a club both organized and operated exclusively for pleasure, recreation and other nonproitable purposes and (2) that no part of its net earnings inures to the benefit of any private shareholder or individual. To meet the first requirement, there must be an established membership of individuals, personal contracts and fellowship. A commingling of the members must play a material part in the life of the organization. See G.C.M. 23688, C.B. 1943, 283.

Section 1.501(c)(7)-1 of the Income Tax Regulations relating to the exemption of social clubs under section 501(a) of the Internal Revenue Code of 1954 reads 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 nonproitable 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 recreational 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 (*Italics supplied.*)

It is clear under the foregoing regulations 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, etc., may not be considered as being organized and operated exclusively for pleasure, recreation or social purposes. It is equally clear that activities by a social club such as the solicitation by advertisements or otherwise of public patronage of its facilities may be adverse to the establishment of an exempt status.

Therefore, to qualify for income tax exemption, a social club should not advertise its facilities for nonmember patronage since this would be *prima facie* evidence it was engaging in business. Likewise a social club should not engage in any type of business activity for profit which is designed to increase or which could result in an increase in net earnings inuring to the benefit of any shareholder or individual. Net earnings may inure to members in such forms as an increase in services offered by the club without a corresponding increase in dues or other fees paid for club support or as an increase in the club's assets which would be distributable to members upon the dissolution of the club.

However, this is not to say that a club will necessarily lose its exemption if it derives income from transactions with other than its bona fide members and their guests. A club will not be denied exemption merely because it receives income from the general public, that is, persons other than members and 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 nonmembers are no more than enough to pay their share of the expense. *Barstow Rodeo and Riding Club, Inc. v. Commissioner*, Tax Court Memorandum Opinion entered November 30, 1953. 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 intendment of section 501(c)(7) of the Code. *Jockey Club v. Helvering*, 76 Fed. (2d) 597; *Aviation Club of Utah v. Commissioner*, 162 Fed. (2d) 984. Compare *West Side Tennis Club v. Commissioner*, 111 Fed. (2d) 6, certiorari denied, 311 U.S.

Similarly, where a 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 club purposes. *Santee Club v. White*, 87 Fed. (2d) 5. But in order to retain exemption a club must not enter into outside activities with the purpose of deriving profit. Section 1.501(c)(7)-1 of the Income Tax Regulations and *Santee Club v. White*, *supra*. If such income producing activities are other than incidental, trivial or nonrecurrent, it will be considered that they are designed to produce income and will defeat exemption. *West Side Tennis Club v. Commissioner*, *supra*; *Mah Jongg League, Inc. v. United States*, 75 Fed.Supp. 769.

The fact that an organization believes that it falls within the scope of this Revenue Ruling does not relieve it from the requirement that it file, with the District Director of Internal Revenue for the internal revenue district in which is located the principal place of business or principal office of the organization, an application on Form 1025, Exemption Application. See section 1.501(a)-1 of the Income Tax Regulations.

See Revenue Ruling 56-334, C.B. 1956-2, 831, as to the status of an exempt social club for purpose of the excise tax on club dues imposed by section 4241 of the Code.