

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

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Refer Reply To:

T:EO:RA:T4/229369

Date:

April 23, 2002

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Dear

We received your recent letters requesting information as to whether certain income received by a yacht club exempt under section 501(c)(7) of the Internal Revenue Code will be considered exempt function income and not included in the calculation of the club's unrelated business taxable income.

You indicate that the club maintains a club house for social meetings of its members and as headquarters for the conduct of regattas and other aquatic and athletic sports. The club also maintains certain wharves and docks for the benefit of its members. The club has two types of members; full members and associate members. Full members are individuals who are the age of majority. Associate members are individuals who are under the age of majority and whose parents are full members.

Each summer season the associate members plan, organize, and sponsor a 10 week series of dances for children ages 9 to 16. You indicate that the members and associate members on the dance committee are volunteers and are not compensated for the work involved. The dances are advertised in the community and are open to the public as well as to associate members and their guests. Fees are charged. Because the dances are popular in the community, the club will make a profit this year (i.e. net receipts from admissions will exceed net expenses).

Section 501(c)(7) of the Code provides a tax exemption for social 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. Such clubs must also not have a policy of discrimination on the basis of race, color, or religion.

Social clubs are primarily supported by their members' payments. Their tax exemption has the practical effect of allowing the individuals comprising the membership to join together to provide themselves with recreational or social facilities without further tax consequences, so long as the club's income is limited to membership receipts. Congress decided, by the

enactment of section 512(a)(3) of the Code, that social clubs, unlike other exempt organizations, should be taxed on their passive income and income received from nonmembers. Only "exempt function income" is tax exempt.

Section 512(a)(3) of the Code requires a social club to include all gross income as unrelated business taxable income unless it is "exempt function income" which includes income set aside for charitable purposes. Exempt function income is defined as gross receipts from dues, fees, charges, or similar items paid by members for goods, facilities, or services to the members or their dependents or guests, to further the club's exempt purposes. For this purpose, "guests" are those whom a member invites and pays for.

Social clubs may receive up to 35% of their gross receipts, including investment income, from sources outside their membership without losing their exempt status. Within the 35 percent limitation, no more than 15 percent of gross receipts may be from nonmembers use of the club facilities or services. (Senate Report 94-1318, 2<sup>nd</sup> Session, 1976-2 C.B. 597, 599).

You have not requested a private letter ruling and have not paid the applicable fee for such a ruling letter. The following is provided for your general information only.

Youth dances and similar social activities for club members and associate members are the type of activities traditionally carried on by social clubs and would further the club's exempt purposes by promoting fellowship among its members. Opening the function to nonmembers by selling tickets to the general public, however, does not further the club's exempt purposes. Income from tickets sold to nonmembers must be included in the club's calculation of unrelated business taxable income. Unless the amounts from this nonmember source, when added to the club's other nonmember income exceeds the 15% limitation, it will not affect its exemption under section 501(c)(7).

Social clubs are required to maintain adequate records that will substantiate the appropriate facts. See Rev. Proc. 71-17, 1971-1 C.B. 683, for a complete listing of the required information. Accordingly, the club should maintain books and records with respect to nonmember attendance at the youth dances and all other occasions involving club use by nonmembers.

This letter is advisory only and has no binding effect on the Internal Revenue Service. The information provided here cannot be relied upon as a ruling on the matters discussed. If you have any questions regarding this discussion or we can be of further assistance, please feel free to call me at 202-283-8926 or Ms. Debra Cowen at 202-283-8943.

Sincerely,  
David Daume  
Manager, Exempt Organizations  
Technical Group X