



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

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x =

y =

z =

Dear \_\_\_\_\_ :

We have considered your ruling request dated March 27, 2006, as modified and supplemented by subsequent correspondence, in which you requested a ruling regarding the income tax consequences attendant to the sale of certain real property.

You are exempt from federal income tax under section 501(a) of the Code as a social club described in section 501(c)(7). You owned w when the property was originally purchased. In the early years, you offered a wide variety of activities to your members, including equestrian events, shooting sports, golfing, swimming, tennis, and a club house. The northwest portion of the original property provided large flat surfaces for equestrian events and housed large stables, two polo fields, show grounds, and riding rings. Through the exercise of the government's right of eminent domain, your property has been reduced in size to x acres. Located on this property is a club house, swimming pool, tennis courts, and golf course.

You state that there will be two sale transactions, A and B.

**Sale A**

This transaction involves a y acre parcel plus a small buffer zone bordered by a road, power lines and another parcel of land that you own. This land was originally used for equestrian events including bridle paths and drag hunts, shooting sports, cross country skiing, overflow parking and employee housing until the government, exercising its right of eminent domain, purchased a large portion of this property to construct an interstate highway. After the highway

was built, the property was no longer used for equestrian events. The property was affected by eminent domain a second time when the utility company purchased land for power generating lines. During this time, the property was used for shooting sports, cross country skiing, overflow parking, and employee housing. The city further restricted your activities by revoking your permit for shooting sports. Because of new, stricter noise restraints imposed by the county, you closed your facilities for shooting sports. Currently, the property is used for cross country skiing, overflow parking and employee housing. There are two homes on this parcel. No other structures exist. The homes are occupied by your executive chef and building maintenance supervisor. For your convenience, these employees are required to live on the site and occupy these homes. They do not pay rent. At no point in your history have these homes been rented to either members or nonmembers. You have received an offer to purchase the land from a housing developer. You would retain approval of design and landscaping plan upfront prior to closing.

### **Sale B**

This transaction involves a z acre parcel bordered by a state road, interstate highway and two other parcels that you own. You state that your members use this area for cross country skiing. This parcel contains the sod farm, greenhouse, equipment storage area, and the home occupied by the golf course superintendent. The sod is used to repair the golf course and the greenhouse produces flowers and greenery for the clubhouse. Neither facility provides items for sale. You state that the golf course superintendent's home is adjacent to the equipment storage area. The home has never been rented to either members or nonmembers.

You intend to use the proceeds from Sale A and Sale B to improve your golf course and clubhouse. You also plan to build an activity center that would contain an area for paddle tennis, indoor driving ranges, exercise areas and children's activity center, as well as for electric cart storage.

You have requested the following rulings:

1. The planned sale of the x and y acres will not adversely affect your exempt status under section 501(c)(7) of the Code.
2. Under section 512(a)(3)(D) of the Internal Revenue Code, the gain shall not be recognized as a result of the sale of such property.

Section 501(a) of the Code generally provides an exemption from federal income tax for any organization described in section 501(c).

Section 501(b) provides that an organization exempt from taxation under section 501(a) shall be subject to the unrelated business income tax under section 511.

Section 501(c)(7) provides that organizations 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 are exempt from federal income tax.

Section 1.501(c)(7)-1 of the Income Tax Regulations 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 section 501(a)...However, an incidental sale of property will not deprive each club of its exemption.

Rev. Rul. 69-232, 1969-1 C.B. 154 provides that even though a profit is realized, the sale of property will not cause a social club to lose its exemption provided the sale is incidental in that it does not represent a departure from the club's exempt purposes. All of the facts and circumstances of a sale will be considered in determining the club's primary purpose in making the sale, including: (1) the purpose of the club in purchasing the property; (2) the use the club makes of the property; (3) the reasons for the sale; and (4) the method used in making the sale. Situation 2 of Rev. Rul. 69-232 provides that where a social club subdivides land into building lots, makes improvements to the lots, and sells the lots for a substantial profit over a period of years when it could have sold the property in a single unit, the sale of the property is not an incidental sale. Situation 3 of Rev. Rul. 69-232 provides that where a social club sells all of its recreational use property to developers at a profit and uses the proceeds to purchase more modern facilities in a location that is more desirable to its members, the sale is incidental within the meaning of the Income Tax Regulations.

Your club's proposed property sale is similar to the sale of a social club's clubhouse or similar facility. The acreage that you intend to sell is part of property acquired in order to provide recreational facilities for your club's members, and your purpose in selling it is to pay for renovations and improvements to your recreational facilities. You do not intend to subdivide the property, make improvements to it, or otherwise prepare it for sale. Therefore, your proposed sale of y and z acres will be an incidental sale of property that will not be a departure from your club's exempt purposes and will not jeopardize your exempt status under sections 501(a) and 501(c)(7) of the Code.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of, among others, organizations described in section 501(c)(7) of the Code.

Section 512(a)(3)(A) of the Code provides, in part, that in the case of organizations described in section 501(c)(7), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less allowable deductions, both computed in accordance with certain modifications contained in section 512(b).

Section 512(a)(3)(D) of the Code provides that if a section 501(c)(7) organization sells property used directly in the performance of its exempt function and within a period beginning one year before the date of such sale and ending three years after such date, other property is purchased and used by such organization directly in the performance of its exempt function, gain (if any) from such sale shall be recognized only to the extent that such organization's sales price of the old property exceeds the organization's cost of purchasing the other property.

The Senate Finance Committee Report provides an example of a sale and purchase where application of section 512(a)(3)(D) of the Code would be considered appropriate. S. Rept. 91-552, 1969-3 C.B. 423, 471:

“...where a social club sells its clubhouse and uses the entire proceeds to build or purchase a larger clubhouse, the gain on the sale will not be taxed if the proceeds are reinvested in the new clubhouse within three years.”

In *Tamarisk Country Club v. Commissioner*, 84 T.C. 756 (1985), the Tax Court held that section 512(a)(3)(D) of the Code does not require the purchase of property that is of like kind or use to the property sold and that expenditures for golf carts, land improvements and other items were qualifying purchases of other property for purposes of that section.

In *Atlanta Athletic Club v. Commissioner*, 980 F.2d 1409 (11<sup>th</sup> Cir. 1993), expenditures made for the construction of a tennis center and the renovation of a clubhouse were deemed to be purchases of other property for purposes of section 512(a)(3)(D) of the Code.

The x and y acres that you propose to sell have been used directly in your exempt function since their acquisition. You intend to use the proceeds from the sale of x and y acres to pay for renovations and improvements to your recreational facilities. Therefore, the proceeds from the sale of the properties will be deemed to be used for the purchase of other property used directly in the performance of your 501(c)(7) exempt function for purposes of section 512(a)(3)(D) of the Code.

Accordingly, we rule as follows:

1. The planned sale of the x and y acres will not adversely affect your exempt status under section 501(c)(7) of the Code.
2. Under section 512(a)(3)(D) of the Internal Revenue Code, the gain shall not be recognized as a result of the sale of such property.

This ruling is based on the understanding there will be no material changes in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Service. 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.

Please keep a copy of this ruling in your organization's permanent records.

This ruling will be made available for public inspection under section 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.

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.

Sincerely,

Robert C. Harper, Jr.  
Manager, Exempt Organizations  
Technical Group 3

Enclosure  
Notice 437