

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

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to: Jason C. Kall,  
Manager, Compliance Strategy & Critical Initiatives  
(EO Examinations)

from: Assistant Branch Chief, Exempt Organizations Branch 2 *Jud. Hunt*  
(Tax Exempt & Government Entities)

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subject: Continued Applicability of GCM 39343

This is in response to your request for us to consider the continuing applicability of the holding in GCM 39343 regarding the treatment of income derived by a social club under a reciprocal agreement with a social club of like nature. GCM 39343 holds that income received by a section 501(c)(7) social club from members of another club, under a reciprocal agreement, is income from members of the general public. The amounts are not member income for purposes of the member income tests for exemption under section 501(c)(7).

LAW AND ANALYSIS

Section 501(c)(7) provides for exemption from federal income taxation "[c]lubs 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 or individual." This exemption extends to social and recreation clubs which are substantially supported by membership dues, fees and assessments.

Prior to the Tax Reform Act of 1976, section 501(c)(7) provided for exemption from Federal income tax of clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes provided no part of the net earnings inures to the benefit of any private shareholder. In implementing the "operated exclusively" language, the Service had set forth guidelines in which the Service stated that where a club had 5% of gross receipts from the general public this did not indicate a deliberate attempt to engage in business and still qualified for exemption. Rev. Proc. 64-36, 1964-2 C.B. 962, superseded by Rev. Proc. 71-17, 1971-1 C.B. 683. Accordingly, the ceiling

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on nonmember income was low and a social club lost its exemption if it had even small amounts of receipts from the general public and other nonmember income.

In Pub. L. No. 94-568, 90 Stat 1697, reprinted in 1976 U.S. Cong & Admin News 2697, Congress amended section 501(c)(7) by changing "exclusively" to "substantially." The Senate Finance Committee stated that it intended that social clubs be able to receive 35% of their gross receipts from nonmember sources without losing exemption and within this 35%, up to 15% of the gross receipts from the use of the club's facilities by members of the general public. See S. Rep. 94-1318, 2-5, reprinted in 1976 U.S. Cong & Admin News, 6051, 6052-6055.

Generally, a social club may make its social and recreational facilities or goods and services available to bona fide guests of members without jeopardizing its exemption. In Rev. Proc. 64-36, 1964-2 C.B. 962, the Service defines, as bona fide guests, visiting members of social clubs using the facilities of another social club of similar nature under reciprocal agreements. The income from such individuals was treated as member income for determining whether the organization qualifies under section 501(c)(7).

The Tax Reform Act of 1969 (TRA 1969) extended the unrelated business tax to a number of exempt organizations including social clubs. Section 512(a)(3), added by section 121(b)(1) of TRA 1969, provides that social clubs are taxed on their income other than their exempt function income. Exempt function income is defined as: "[T]he gross income from dues, fees, charges or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid."

Under this definition, social clubs are taxed on income received from nonmembers for goods, facilities or services that would constitute exempt function income if received from members or their guests. After TRA 1969, determining whether a club's income is received from members or their guests is relevant for both determining whether the organization qualifies for exemption as an organization described in section 501(c)(7) and whether its income is unrelated business income for purposes of section 512(a)(3). Too much income from nonmembers arising from their use of the club's facilities will lead to the revocation of the club's exemption under section 501(c)(7).

Proposed regulations (36 FR 8080, May 13, 1971) did not directly address income received from nonmembers through reciprocal agreements. Proposed Treas. Reg. §1.512(a)-3(c)(2)(ii), contained the broad statement that gross income from members does not include any amount paid to an organization by any person who is not a member, even though paid as consideration for providing goods, facilities, or services. The proposed regulations were never finalized and were withdrawn (52 Fed. Reg. 2724, Jan. 26, 1987).

Rev. Proc. 71-17, 1971-1 C.B. 683, published at the same time as the proposed regulations, effectively revoked Rev. Proc. 64-36 as to income from members of other

clubs under reciprocal agreements between the clubs. Rev. Rul 71-17 defined "general public" as "persons other than members of a club or their guests." This is less expansive language than used in the earlier revenue procedure.

In GCM 39343, the Service considered both Rev. Proc 64-36 and Rev. Proc. 71-17 and interpreted the more restrictive language in Rev. Proc. 71-17 and its silence as to reciprocal agreements as demonstrating the Service's intent to withdraw the exception for reciprocal agreements. According to the GCM, Rev. Proc. 71-17 narrowed the definition of "guest."

The GCM also noted that Rev. Rul. 79-145, 1979-1 C.B. 380, made the narrowing of "guest of member" quite clear. Rev. Rul. 79-145 considered the application of section 4421 to a wagering pool conducted by a section 501(c)(7) social club. Rev. Rul. 79-145 applied the principles of Rev. Proc 71-17 and stated:

A guest of a nonprofit social club is an individual who is a guest of a member of the club and who ordinarily does not reimburse the member or the guest's expenses. On the other hand, amounts paid to a social club by visiting members of another social club are amounts paid by nonmembers, even though both clubs are of like nature and the amounts paid are for goods, facilities, or services provided by such social club under a reciprocal arrangement with such other social club.

Because these persons are not guests of members but members of the general public, Rev. Rul. 79-145 held that the wagering pool was conducted for profit for purposes of section 4421(a).

GCM 39343 concluded that "[i]t seems clear that the Service's current position is to treat income derived by a social club pursuant to a reciprocal agreement with a social club of like nature as income from non-members. Absent any formal modification, the Service must, of course, continue to follow the rule of Rev. Rul. 79-145."

The Service has not addressed the issue of reciprocal agreements since GCM 39343. However, Rev. Rul. 79-145 and the position expressed in GCM 39343 continue to be cited for purposes of what constitutes non-member income. See PLR 200511023 (enclosing report of examination recommending revocation of social club's exempt status as the result of substantial pull tab income from the general public); PLR 8722003 (signing of guest registry by nonmembers does not change status as a member of general public so that pull tab activity is subject to section 4401 and 4411 taxes on wagering); PLR 8542003 (nonmembers use social club with member sponsorship, but pay for their use of the club, such nonmembers are not guests but members of the general public citing Rev. Rul. 79-145).

The Service's position, on income pursuant to reciprocal agreements, has not been rejected in any court proceeding. Also, because the position is expressed in a

published revenue ruling, the Service would have to revoke or distinguish the ruling to take the position that reciprocal use income is member income.

**CONCLUSIONS**

Accordingly, the holding in GCM 39343 continues to apply. Please call Ronald Weinstock or me on (202) 622-1124 if you have any further questions.