Internal Revenue Service Department of the Treasury

District
Director

31 Hopkins Plaza, Baltimore, MD 21201

Person to Contact:
[redacted]
Telephone Number:
[redacted]
Refer Reply to:
[redacted]
Date:
MAR 21 1986

[redacted]

CERTIFIED MAIL

Dear Sir or Madam:

We have considered your application for recognition of exemption as a social club described in Section 501(c)(7) of the Internal Revenue Code of 1954.

Information submitted shows that you were incorporated under the Non-profit Corporation Law of the State of [redacted] on [redacted].

Your purposes are to promote good fellowship among members; encourage participation in society activities; disseminate and share knowledge and experiences in the hobby; to promote friendly competition through monthly bowl shows for the members and periodic fish shows open to the public; to participate in the work of selected national and international organizations devoted to the hobby.

Membership consists of four (4) classes: Individual, Family, Junior and Corresponding. Membership in your organization is open to anyone interested and requires only the payment of dues.

Your activities include monthly meetings with a speaker and/or slide show program, tropical fish competition with trophies and ribbons, an Annual Show and an Annual Banquet with guest speaker. You stated that your main fund raisers were your Annual Show and your Annual Banquet. Further, you stated, "at both functions, the club has a large auction of fish and hobby related items to generate funds used to offset yearly expenses."

Your income is from membership dues, banquets, raffles, auctions, show registration, T-shirts sales, book sales and contributions.

An analysis of the financial data you submitted shows that during the period from [redacted] thru [redacted] your total income was $[redacted]. During this period you received $[redacted] ([redacted]%) in membership dues, $[redacted] ([redacted]%) in contributions and $[redacted] ([redacted]%) from activities conducted by your organization. From this total $[redacted] ([redacted]%)was from non-members or the general public.

[redacted]

Section 501(c)(7) of the Internal Revenue Code exempts from Federal income tax clubs organized for pleasure, recreation, and other non-profitable 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 that, in general this exemption extends to social and recreation clubs which are supported solely by membership fees, dues and assessments. However, a club which engages in business, such as making its social and recreational facilities available to the general public is not organized and operated exclusively for please, recreation and other non-profitable purposes.

Revenue Ruling 69-220, 1969-1 C.B. 154 held that a club which entered into business leases for rental of real property, and used the income to defray expenses and to improve and expand the facilities, was not exempt under Section 501(c)(7) because it regularly engaged in a business ordinarily carried on for profit and its earnings inured to the benefit of its members in the form of improved and expanded facilities.

In United States v. Fort Worth Club of Fort Worth, Texas, 345 F 2d 52 (1965), modified and reaffirmed 348 F 2d 891 (1965), the court cited a series of cases establishing that, in order to be exempt under 501(c)(7), a club's outside profit must be strictly incidental to club activities, not as a result of outside business, and either negligible or non-recurring.

Revenue Ruling 58-589, 1959-2, 267, holds that 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 non-members are no more than enough to pay their share of the expenses.

Revenue Ruling 68-119, 1968-1, 268 hold that an equestrian club that holds one steeplechase per year will not necessarily lose its exemption if it derives income from transactions with other than bona fide members or if 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 income therefrom does not inure to members.

[redacted]

[redacted]

Revenue Ruling 69-220, published in Internal Revenue Cumulative Bulletin 1969-1, page 154 describes why exemption was denied to a social club that received a substantial portion of its income from the rental of property and used such income to defray operating expenses and to improve and expand its facilities. In this Revenue Ruling it was concluded that the club was engaged in a business ordinarily carried on for profit and that the net income from the activity was inuring to the members of the club in the form of improved and expanded facilities.

Revenue Ruling 71-17, published in Internal Revenue Cumulative Bulletin 1971-1, page 683, indicated that, as an audit standard, a social club's annual income from outside sources should not be more than 5% of the total gross receipts of the organization.

Public Law 94-568 liberalized this standard. The intent of this law, as explained in Senate Report No. 94-1318, published in Cumulative Bulletin 1976-2, page 597, is that a club exempt from taxation and described in Section 501(c)(7), is to be permitted to receive up to 35% of its gross receipts from a combination of investment income and receipts from non-members (from the use of its facilities or services) so long as the latter do not represent more than 15 per cent of the total receipts. It is further stated that if an organization exceeds these limits, all of the facts and circumstances must be considered in determining whether the organization qualifies for exempt status. However, the amendment was not intended to allow social clubs to receive, even within the allowable guidelines, income from the active conduct of business not traditionally carried on by social clubs. (Senate Report No. 94-1318 2nd Session, 1976-2 C.B. 596.)

Based on financial data submitted by the organization, it shows your total income from [redacted] thru [redacted] was $[redacted]. Further, from the evidence presented it is concluded that $[redacted] ([redacted]%) of your income was from non-members or the general public. It is clear the club's outside profit is not incidental to the club's activities. The club's activities are resulting in substantial income which is neither negligible nor non-recurring.

Further, since the income is being used to pay for improvements and expenses that would otherwise have to paid for by the members, this activity results in prohibited inurement of benefit.

Based on the foregoing, the requirements for exemption of a social and recreational club defined in the Code and Regulations. We hold tghat you are not operated exclusively for pleasure, recreation and other non-profitable purposes; and that a portion of your net earnings inures to the benefit of your members. Therefore, we conclude that you do not qualify for exemption under Section 501(c)(7) or any other Section of the Internal Revenue Code.

[redacted]

Since you have not been granted tax exempt status, you are reuired to file Federal income tax returns on Form 1120.

If you do not accept our findings, we recommend that you request a conference with a member of our Regional Office of Appeals. Your request for a conference should include a written appeal giving the facts, law, and any other information to support your position as explained in the enclosed Publication 892. You will then be contacted to arrange a date for a conference. The conference may be held at the Regional office or, if you request, at any mutually convenient District office. If we do not hear from you within 30 days of the date of this letter, this determination will become final.

Sincerely yours,

[redacted]
District Director

Enclosure: Publication 892