Rev. Rul. 74-489, 1974-2 C.B. 169

Social clubs; corporate members. A country club that issues corporate membership is dealing with the general public in the form of the corporations' employees. Gross receipts from such members will be a factor in determining whether the club qualifies as a social club under section 501(c)(7) of the Code.

Advice has been requested whether a social club exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954 will jeopardize its exemption by admitting corporations as members under the circumstances described below.

The club is a nonprofit membership corporation that was formed for pleasure and recreational purposes. Its function is to operate a country club for its members, who pay initiation fees, annual membership dues, and established charges for the use of the facilities. Memberships are issued to both individuals and corporations. The corporations designate which of their officers and employees may use the club's facilities.

Section 501(c)(7) of the Code provides for exemption from Federal income tax for clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, 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, the exemption extends to social and recreational clubs that are supported by membership fees, dues, and assessments. However, the regulation further states that a club that engages in business, such as making its social and recreational facilities available to the general public, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under section 501(d) of the Code.

Rev. Rul. 58-589, 1958-2 C.B. 266, sets forth the criteria for exemption under section 501(c)(7) of the Code, and provides that a club must have an established membership of individuals, personal contacts, and fellowship. It also provides that, while the regulations indicate that a club may lose its exemption if it makes its facilities available to the general public, this does not mean that any dealings with nonmembers will automatically cause a club to lose its exemption. A club may receive some income from the general public, that is, persons other than members and their bona fide guests, or permit the general public to participate in its affairs, provided that such participation is incidental to and in furtherance of the club's exempt purposes, such dealings with the general public and the receipt of income therefrom does not indicate the existence of a club purpose to make a profit, and the income does not inure to club members.

Rev. Proc. 71-17, 1971-1 C.B. 683, provides guidelines for determining the effect of gross receipts derived from nonmember use of a social club's facilities on the club's exemption under section 501(c)(7) of the Code. Rev. Proc. 71-17 sets as an audit standard that if the annual gross receipts from the general public for use of a club's are five percent or less of the club's total gross receipts, the Service will consider that the existence of gross receipts from the general public does not indicate a nonexempt purpose. If the annual gross receipts from the general public exceed this audit standard, this will be considered as one factor among all the facts and circumstances examined to determine whether there is a nonexempt purpose.

Rev. Rul. 67-428, 1967-2 C.B. 204, holds that an organization whose membership consists entirely of artificial entities not qualify for exemption from Federal income tax under section 501(c)(7) of the Code. Rev. Rul. 67-428 emphasizes that artificial entities are incapable of producing the personal contacts and fellowship contemplated by section 501(c)(7). Such Revenue Ruling clearly indicates that artificial entities, such as corporations, are not a type of 'member' that is considered as falling within the term member for purposes of section 501(c)(7).

However, Rev. Rul. 67-428 does not expressly deal with the situation when a club's membership consists only partially of artificial entities. Thus, the question remains whether some corporate members may be permitted without jeopardizing a club's exemption under section 501(c)(7) of the Code.

Since corporate members of a club are not the kind of members contemplated by the statute, a club in permitting such a type of membership is, in fact, dealing with the general public, in the form of the corporation's employees. Thus, having and dealing with such members is the same as dealing with corporations and individuals that have no connection with the club. However, bona fide individual memberships paid for by a corporation would be a different matter, since there would then be no dealing with the general public. See Rev. Rul. 74-168, 1974-1 C.B. 139.

Accordingly, whether having corporate members jeopardizes a social club's exemption from Federal income tax under section 501(c)(7) of the Code depends on the amount of gross receipts from the corporate members, together with the amount of gross receipts from all other nonmember sources, in the context of all the facts and circumstances concerning the club