TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Dear :

This letter is in reference to the letter dated December 16, 2005, as augmented by the letter dated May 22, 2008, from the authorized representative of M. M is requesting a ruling that the use of its golf course and clubhouse facilities by unaccompanied guests and full privilege guests constitutes member use for purposes of determining M's exempt status under section 501(c)(7) of the Internal Revenue Code, and that M's income from members for the use of its facilities by guests (including unaccompanied guests) constitutes "exempt function income" for purposes of section 512(a)(3) of the Code.

M is an organization recognized by the Internal Revenue Service as exempt from federal income tax as a club organized for pleasure, recreation, and other nonprofitable purposes under section 501(c)(7) of the Code.

M's Articles of Incorporation state that M was organized for athletic, recreation, and social purposes. M's membership application requires that each member acknowledge that M exists solely for golfing and related social purposes and that business activities are inappropriate.

M states that its only activity is the maintenance and operation of its golf course and clubhouse and the conduct of social activities directly connected therewith. In addition to the golf course, M's clubhouse offers dining facilities and four guest rooms for out-of-town members. In general, M states these rooms are available only to members visiting the area, but may, in limited circumstances, be used by guests of members.

M's By-laws provide that there shall be only one class of membership, and that the total

number of members shall not exceed m. The By-laws also provide that each member shall have the right to use and enjoy the golf course, the facilities of the clubhouse, and the services provided by M's staff, subject to certain restrictions set out in the By-laws, M's rules, and any other regulations that may be adopted by the Board of Directors. No membership shall be transferable.

M states that its written Customs and Privileges, which are provided to members with the Articles of Incorporation and By-laws, serve as its operational guidelines. According to these guidelines, a member is allowed to invite a guest "personally known to a host Member" provided the guest remains in the company of a member, and a member and his spouse may invite up to six guests to accompany them in play. However, member guests are not allowed to play M's golf course more than twelve times per year, regardless of the potential number of sponsoring members. Members' spouses, unwed children of members, and unwed children of members' spouses are granted full membership privileges and are not considered "guests." The golf course is not available to outside groups and organizations or to the general public. However, an exception may be made for charitable and non-profit events of major significance to the community and development of public support for golf.

A full privilege guest is a person eighteen years or older who has had a guest card issued by the Board of M, at the request of a member, in accordance with the By-laws. He or she is extended the privileges of the use of the clubhouse as well as the golf course for a maximum period of two weeks. He or she may not extend privileges to others or entertain non-members on M's premises. Issuance of a full privilege guest card is limited to no more than two persons per member at any one time. No guest may have more than two, non-consecutive full privilege guest cards during a calendar year. An unaccompanied guest is a person eighteen years of age or older, who is personally known to a host member, and who is invited to play the course (with no clubhouse privileges) by a member at a date and time, approved by the Board of Directors, and arranged and scheduled in the golf shop. In any given year, each member may not sponsor more than 40 unaccompanied guests or full privileged guests, in the aggregate. M's By-laws state that each member shall be individually liable for all charges of any member of his family to whom the privileges of M may at his request be extended and for all charges of any guest to whom, at his request, a guest card may be issued.

M has provided the following information concerning the use of its golf course by full privileged guests and unaccompanied guests:

Year	Number of full privilege guests	Number of unaccompanied guests	Total number of rounds played
20	r	u	x
20	s	v	y
20	t	w	z

M states that its procedures for unaccompanied guest use of its golf course and club facilities are very formal and restrictive. For example, the procedures for requesting Board approval of guest use requires a written, signed request by a current member to the Board of Directors and then issuance by the Board of either a guest card or a letter of acceptance

indicating date and time for use of the course, and liability on the part of the member for any charges incurred by the guest. Further, unaccompanied guests, other than full privilege guests, are restricted from using clubhouse facilities other than locker rooms.

M emphasizes that it is strictly a private organization that exists solely for golfing. No recreational facilities, other than the golf course, are provided (e.g., there are no tennis courts or a swimming pool); and while the clubhouse does serve food, use of the clubhouse by unaccompanied guests is restricted to a very limited number of full privilege guests annually. Even then, any charges attributable to guest use remain the sole responsibility of the member who requested Board permission for the guest's use of the clubhouse. While guests may purchase merchandise for cash in the pro shop, the pro shop is owned and operated by an independent third party who is unrelated to M, and who cannot accept payment for a guest for greens fees.

Section 501(c)(7) of the Code provides for the exemption from federal income tax of clubs organized and operated for pleasure, recreation, and other nonprofitable purposes, substantially all 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 512(a)(1) of the Code provides, in general, that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in 512(b).

Section 512(a)(3) of the Code provides special rules applicable to organizations described in section 501(c)(7).

Section 512(a)(3)(A) of the Code provides, in general, that in the case of an organization described in section 501(c)(7), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), both computed with the modifications provided in section 512(b).

Section 512(a)(3)(B) of the Code provides, in part, that for purposes of section 512(a)(3)(A), the term "exempt function income" means the 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.

Section 1.501(c)(7)-1(a) of the Income Tax Regulations provides, in part, that in general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

Section 1.501(c)(7)-1(b) of the 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) of the Code. Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes.

Rev. Rul. 58-589, 1958-2 C.B. 266, discusses the various criteria for recognition of exemption under section 501(c)(7) of the Code. In order to establish that a club is organized and operated for pleasure, recreation, and other nonprofitable purposes, there must be an established membership of individuals, personal contacts, and fellowship. A commingling of the members must play a material part in the life of the organization. The revenue ruling states that it is clear that a club which engages in business, such as making its social and recreational facilities available to the general public may not be considered as being organized and operated exclusively for pleasure, recreation or social purposes. A club will not be denied exemption merely because it receives income from the general public, that is, persons other than members and the 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 nonmembers are no more than enough to pay their share of the expense.

Rev. Proc. 71-17, 1971-1 C.B. 683, sets forth guidelines for determining the effect gross receipts derived from use of a social club's facilities by the general public have on the club's exemption from federal income tax under section 501(c)(7) of the Code. The procedure defines the term "general public," as used in the procedure, as persons other than members of a club or their dependents or guests. The procedure states that where a club makes its facilities available to the general public to a substantial degree, the club is not operated exclusively for pleasure, recreation, or other nonprofitable purposes.

Public Law 94-568 (1976) amended section 501(c)(7) of the Code to allow social clubs to receive some outside income, including investment income, without jeopardizing their exempt status. Specifically, the Senate Finance Committee Report (1976-2 C.B. 597, 599) states:

> "It is intended that these organizations be permitted to receive up to 35 percent of their gross receipts, including investment income, from sources outside of their membership without losing their tax-exempt status. It is also intended that within this 35 percent amount not more than 15 percent of the gross receipts should be derived from the use of a social club's facilities or services by the general public. In effect, this latter modification increases from 5 percent (current audit standard: Rev. Proc. 71-17) to 15 percent the proportion of gross receipts a club may receive from making its club facilities available to the general public without losing its exempt status. This also means that a club exempt from taxation described in section 501(c)(7) is to be permitted to receive up to 35 percent of its gross receipts from a combination of investment income and receipts from non-members so long as the latter do not represent more than 15 percent of total

receipts.

> "Gross receipts are defined for this purpose as those receipts from normal and usual activities of the club (that is, those activities they have traditionally conducted)...."

The Report also states that the decision in each case as to whether substantially all of the organization's activities are related to its exempt purposes is to continue to be based on all the facts and circumstances. However, the facts and circumstances approach is to apply only if the club earns more than is permitted under the new guidelines. If the outside income is less than the guidelines permit, then the club's exempt status will not be lost on account of nonmember income.

Congress anticipated that the Service would continue to address the problem of unrelated activities as it had in the past. Thus, a passage from the House Report states:

> Your committee does not intend that these organizations should be permitted to receive, within the 15- or 35- percent allowances, income from the active conduct of business not traditionally carried on by these organizations.

In order for an organization to be exempt under section 501(c)(7) of the Code, two tests must be met: an activities test and a member income test.

The activities test means that substantially all of the activities of an organization exempt under section 501(c)(7) of the Code must be "normal and usual activities" for a social club, that is, "activities they have traditionally conducted." Conversely, no more than an insubstantial amount of a social club's income can be derived from "nontraditional" activities, even if it conducts those activities exclusively with its members. Examples of "nontraditional" activities include an athletic club's liquor store (selling package liquor for off-premises consumption), a flower shop, long-term rental, and a gas station. These kinds of activities, if substantial, preclude exemption under section 501(c)(7), even if the sales are limited to members.

The Congressional intent in amending section 501(c)(7) of the Code with Public Law 94-568 is clear: the percentage of outside income a social club is to receive is to be liberalized according to a fixed percentage (now 15 percent); in all other aspects, social clubs will continue to be treated as they were in the past, that is, traditional business activities should continue to be distinguished from nontraditional business activities. A nontraditional business is any business (other than investments) which, if conducted on a membership basis, would not further the club's exempt purposes. Nontraditional business activities continue to be prohibited (subject to an insubstantial, trivial, and non-recurrent test) for business conducted with both members and nonmembers.

To distinguish a nontraditional business and any other unrelated business for purposes of income subject to the 15 percent and 35 percent limitation, the Committee Report defined such gross receipts in virtually the same manner as in Rev. Proc. 71-17, supra, for purposes of the earlier 5 percent limitation. Also discussed in Rev. Proc. 71-17, "normal and usual activities" of a social club encompasses those social and recreational activities upon which the club's exemption is based. Extension of such traditional social club activities to the general public

gives rise to unrelated business income. In this case, it is clear that M does not engage in nontraditional business or social club activities with the general public.

M has also shown that it has an established membership of individuals and that it does not make its social and recreational facilities available to the general public. M's facilities are available only to its members and their invited guests with the possible exception for charitable and non-profit events of major significance to the community and development of public support for golf. Each member is individually liable for all charges incurred by his or her guests. In this case, M does not have gross receipts from nonmember use of its facilities.

From the information that has been presented, it is clear that M's primary activity is the maintenance and operation of its golf course and clubhouse and the conduct of social activities directly connected therewith.

Accordingly, based on the facts and circumstances discussed above, we rule as follows:

(1) The use of M's golf courses and clubhouse facilities by unaccompanied guests and full privilege guests constitutes member use for purposes of determining M's exempt status under section 501(c)(7) of the Code.

(2) M's income from members for the use of its facilities by guests (including unaccompanied guests) constitutes "exempt function income" for purposes of section 512(a)(3) of the Code.

These rulings are based on the facts as they were presented and on the understanding that there will be no material changes in these facts. Any changes that may have a bearing upon M's tax status should be reported to the Service. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in M's permanent records. Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to M's authorized representative.

Except as we have specifically ruled herein, we express no opinion as to the consequences of this transaction under the cited provisions or under any other provision of the Code.

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 as precedent.

If there are any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Enclosure
Notice 437

Sincerely yours,

Ronald J. Shoemaker
Manager, Exempt Organizations
Technical Group 2