

An organization created exclusively for the promotion of social welfare which conducts weekly drawings among members of the general public as its principal activity and uses the profits therefrom primarily for the payment of its general expenses is not entitled to exemption from Federal income tax as an organization described in section 501(c)(4) of the Internal Revenue Code of 1954.

Advice has been requested whether a nonprofit organization, created exclusively for the promotion of social welfare, which conducts a weekly drawing among members of the general public as its principal activity and uses the profits therefrom primarily for the payment of its general expenses, is entitled to exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code of 1954.

The instant organization was formed as a nonprofit corporation under state law exclusively for the promotion of social welfare. Its bylaws provide that all of its net above reasonable operating expenses shall be devoted exclusively to social welfare purposes and that no part of its net earnings shall inure to the benefit of any member or other private individual.

The organization owns its quarters consisting of a meeting-hall, dining room and bar. The dining room and bar facilities are open from three to five evenings each week for members only. Members meet at regular intervals and pay only nominal monthly dues.

The organization also conducts weekly drawings which are managed by two full-time paid employees. The tickets for the drawings are sold to the general public primarily by non-members who otherwise have regular employment. Each salesman receives a commission of 25 percent of the selling price of each ticket he sells. The drawings are held at the organization's meeting-hall each Saturday evening. Cash prizes are paid to the holders of the three winning tickets.

Income attributable to the operation of the weekly drawings constitutes the primary source of overall gross receipts. An analysis of the gross receipts and disbursements discloses that the major portion of the gross profits from all sources was used to pay expenses of the organization, leaving only a small portion for furtherance of the organization's stated purposes.

Section 501(c) of the Code describes certain organizations which are exempt from Federal income tax under section 501(a) of the Code and reads, in part, as follows:

(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social

welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

Section 1.501(c)(4)-1 of the Income Tax Regulations provides in general that a civic league or organization may be exempt if both of the following conditions are met. The first condition is that it must not be organized or operated for profit. The second condition is that it must be operated exclusively for the promotion of social welfare. An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.

To be embraced within the scope of section 501(c)(4) of the Code an organization must be one which is operated primarily for the purpose of bringing about civic betterments and social improvements. An organization is not operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

Under the foregoing regulations, an organization which carries on a business with the general public as a primary activity for profit is not entitled to exemption from Federal income tax under section 501(c)(4) of the Code, even though it may formally be organized exclusively for social welfare purposes.

The instant organization conducts weekly drawings among the general public with the participation of nonmember soliciting agents. Its gross profits from drawings are the primary source of its income. Only a small portion of the gross profits is used in the furtherance of the organization's stated purposes, the balance of such profits being used for the payment of general expenses. Thus, members are relieved from paying a larger share of the expenses than otherwise would have been the case.

The instant organization, by conducting a lottery on a weekly basis with the general public and using almost the entire proceeds therefrom to pay general expenses of the organization in the circumstances described above, is not operating exclusively for the promotion of social welfare, but is considered to be engaged in a business for profit. Accordingly, it is held that the organization is not entitled to exemption from Federal income tax under section 501(c)(4) of the Code.