Rev. Rul. 60-324, 1960-2 C.B. 173

A social club which has been granted exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954 may lose its exemption if it makes its club facilities available to the general public on a regular, recurring, basis since it may then no longer be considered to be organized and operated exclusively for its exempt purpose.

Advice has been requested as to the extent to which a social club, which has been granted exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954, may make its club facilities available to outside organizations and groups and still retain its exemption.

In the instant case, an organization was formed for the purpose of operating a social club on a nonprofit basis for the pleasure and recreation of its members and their guests. The club's bylaws provide for the admission of guests only when accompanied by members. Members are responsible for the conduct of their guests on club premises.

The club had been granted exemption from Federal income tax as a social and recreational club under section 101(9) of the Internal Revenue Code of 1939 (now section 501(c)(7) of the 1954 Code).

Among other facilities provided for the pleasure and convenience of its members and their guests, the club has a regular club dining room and bar; a private dining room suitable for cocktail parties, small or medium sized parties or luncheons, small wedding receptions or similar private parties; and a ballroom which, when not used for the club's dances, is available for private use by members for larger parties, such as wedding receptions, banquets, debutante dances, and the like.

A considerable number of functions are held at the club which involve the use of the private dining room and the ballroom. Such functions include civic and business club meetings, employee parties by business firms, school and alumni banquets and parties, and similar non-club activities. In such cases, negotiations for the use of club facilities by an organization or group are made with the particular club member sponsoring the organization or group. The member's name is entered on the club records as the party responsible for the behavior of his guests and the protection of club property. He is billed for the expenses of the function and it is apparent that he, in turn, is reimbursed therefor by the particular organization or group which he sponsored. If a particular member is entertaining a business, professional, or civic group, the name of the organization or group is listed on the club's daily function sheet. That sheet serves as a guide to the day's activities and assists in directing persons to the proper rooms when arriving for private parties and functions.

A financial analysis submitted by the club showing its banquet sales over a seven-year period indicates that the income from sales on behalf of outside organizations and groups ranged from 12 to more than 17 percent of total income from all sources, including dues, in each of the years involved. In one of the years, gross profits from these outside activities amounted to 41x dollars compared to 166x dollars of gross profit from all club operations, or 25 percent of the total gross profit for the year. In that same year, the amount of net profit from these outside activities was 25x dollars. The number of such outside functions totalled over 200 during the year.

The number of major functions for outside organizations and groups conducted on club facilities during each year of the seven-year period covered in the financial analysis is very substantial, in fact, exceeding 40 percent of the total number of major functions conducted on club facilities in one of those years. Moreover, the availability of club facilities to outside organizations and groups under the ready sponsorship of club members serves to indicate that the club is catering to the general public and places it in competition with other business enterprises in the community for such business or activities.

The report of an independent survey conducted in recent years by the club's accounting firm concluded that, in the opinion of that firm, if these functions for outside organizations and groups were to be discontinued, a substantial increase in the amount of annual dues from club members would be necessary. Consequently, the outside functions have not been discontinued, although the amount of dues was recently increased because of rising costs.

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

> (7) 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, relating to the requirements for exemption of such clubs under section 501(a), reads in part as follows:

> (a) The exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder. 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.
>
> (b) 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). * * *. (Italics supplied.)

While these regulations indicate that a club may lose its exempt status if it makes its facilities available to the general public, this does not mean that any dealings with outsiders will automatically cause a club to lose its exemption. A club will not lose its exemption merely because it receives some income from the general public, that is, persons other than members and their bona fide guests, or because the general public may occasionally be permitted to participate in its affairs, provided such participation is incidental to and in furtherance of its general club purposes and the income therefrom does not inure to members. See the discussion in Revenue Ruling 58-589, C.B. 1958-2, 266, and the court decisions cited therein.

In the instant case, the club is making its facilities available for the use of outside organizations and groups through the member-sponsorship arrangement. Any member may invite other organizations and groups to use the club's facilities for their activities.

The club is permitting, if not actually inviting, the general public to use its facilities through its member-sponsoring arrangement for outside groups to a degree that will not permit the club to retain its exempt status.

An analysis of the club's transactions with outside organizations and groups demonstrates that such outside activities are of such magnitude and recurrence as to constitute engaging in business. Thus, the participation in the use of club facilities by the general public is not considered to be merely incidental or in furtherance of the general club purposes.

Accordingly, on the basis of the facts and circumstances herein described, it is concluded that the instant club by making its social facilities available to the general public through its member-sponsorship arrangement can not be treated as being operated exclusively for pleasure, recreation or other nonprofitable purposes. Accordingly, it is held that the club no longer qualifies for exemption from Federal income tax under section 501(c)(7) of the Code.