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The activities of a taxable subsidiary of a social club (which club is otherwise exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954) are considered activities of the parent club for the purpose of determining whether the parent is engaging in business with the general public for profit.

Advice has been requested whether the activities of a taxable subsidiary of a social club (which club is otherwise exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954) are considered activities of the parent club for the purpose of determining whether the parent is engaging in business with the general public for profit.

The club is operated as a nonprofit corporation to promote yachting and other activities for the pleasure and recreation of its members. In addition to a clubhouse, which is used for social activities, the club owns yachting facilities, including a marina for the mooring and servicing of boats.

The club formed a wholly owned stock corporation to which it leases its marina facilities for a rental that is based on the value of the facilities so leased. The subsidiary corporation operates the marina as a business for profit, and pays Federal income taxes on its earnings like any other taxable corporation. Members of the club have preference in renting the marina facilities. However, facilities in excess of membership usage are offered to the general public at the same rental as that paid by club members. The general public is not allowed to use the clubhouse or participate in club activities.

Section 501(c)(7) of the Code provides that clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes are exempt from Federal income tax provided no part of the net earnings 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 recreation clubs which are supported solely by membership fees, dues, and assessments. 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.

The club, as sole owner of the subsidiary and the leased facilities, is entitled to receive all profits of the subsidiary and all rental payments for the facilities. To the extent that the subsidiary's profits and rental payments result from business done with the general public, (1) nonmember income inures to the

members of the club within the meaning of section 501(c)(7) of the Code, and (2) the club is not supported solely by membership fees, dues, and assessments within the meaning of section 1.501(c)(7)-1 of the regulations. See United States v. Fort Worth Club of Fort Worth, Texas, 345 F.2d 52 (1965).

The effect of the decision in the Fort Worth case is that social clubs claiming exemption under section 501(c)(7) of the Code may not do indirectly what they cannot do directly. A club may not insulate itself from the effects of business activities carried on with the general public for profit by forming a subsidiary corporation to carry out those activities.

Accordingly, the activities and operations of the wholly owned subsidiary are considered to be those of the club for the purpose of determining whether the club is engaging in business with the general public for profit.