

A nonprofit organization that leases building lots to its members on a long-term basis is not exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954.

Advice has been requested whether a nonprofit organization that leases lots to its members under the circumstances described below qualifies for exemption from Federal income tax as a social club under section 501(c)(7) of the Internal Revenue Code of 1954.

The organization was formed on a nonprofit basis to develop a lake and adjacent areas to provide facilities for the pleasure and recreation of its members. Membership is open to any person in the community who is approved by the club's board of directors.

Upon formation, the organization acquired substantial acreage and, after developing recreational facilities on a portion thereof, subdivided the remaining land into building lots which it leases to members for ninety-nine years. Application for membership in the organization and choice of lot are embodied in a single form and each member must lease at least one lot. The leased lots may be used for summer cabins or permanent residences, or left vacant. When a lease is executed, the member pays the organization an amount based on the lot value and thereafter pays a nominal annual rental. Receipts of the organization are primarily derived from initial payments and annual rentals. Its expenditures are for acquiring, improving, and maintaining its properties.

A lessee-member of the organization may transfer his leasehold interest only after obtaining written consent from the organization and the lessees of all lots adjacent to his tract.

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(a) of the Income Tax regulations provides that 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 selling real estate, 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 subdividing and leasing of lots in the manner described

constitutes engaging in business. Although the revenues from this activity are derived from the organization's members only, the revenues are not raised from the members' use of recreational facilities, or in connection with the organization's recreational activities. The conduct of such real estate activity, whether with members only or with the general public, is not incidental to or in furtherance of any purpose covered by section 501(c)(7) of the Code. Accordingly, the organization does not qualify for exemption from Federal income tax under that section.