

The exempt status of a social club will not be adversely affected where it redeems certain members' stock at the book value of the shares at the time of redemption, even though the stockholder may realize gain therefrom.

A club exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954 has asked whether its exempt status will be adversely affected if it redeems some of its outstanding stock in the manner described below.

The articles of incorporation of the club provide that each member of the club is required to purchase a minimum of five shares of stock. The articles further provide that, when the club's financial condition permits, the club will purchase at book value the stock of shareholders who die, resign, or wish to reduce their holdings to the minimum number of shares required of each member.

In accordance with its articles, the club redeemed stock of certain of its members at a price in excess of the amount they originally paid. The price was based on the book value of the stock at the time of redemption. Such value reflected increases in the club's net worth resulting entirely from expanded club facilities, which were financed by amounts collected from members, and realized gain from the sale of club assets which no longer served a useful purpose to the club. The club does not engage in business with the general public.

Section 501(c)(7) of the Code provides for exemption from Federal income tax for 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.

Under certain circumstances, a club exempt under section 501(c)(7) of the Code may make cash distributions to its members without loss of its exemption. See Rev. Rul 58-501, C.B. 1958-2, 262, and Rev. Rul. 65-64, C.B. 1965-1, 241.

The stockholders have a right, both legal and equitable, to the assets of the club as set out in Revenue Ruling 58-501. When the club dissolves, the assets may be distributed to members without loss of exemption. Similarly, when a stockholder terminates his membership or reduces his stock ownership, he is entitled to an aliquot share of the club's assets. Thus, in circumstances set forth above, the repurchase of stock based upon book value of the club's assets will not preclude exemption even though the stockholder may realize a gain therefrom.

Accordingly, the redemption of members' stock under the foregoing circumstances will not adversely affect the club's exemption from Federal income tax under section 501(c)(7) of the

Code.