Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:
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RE:

Organization =

Activity A =

Year 1 =

y =

z =

State X =

Dear :

This letter responds to your December 5, 2002 request for rulings on certain federal income tax consequences of a proposed transaction. The following reflects information contained in that letter.

Summary of Facts

Organization is a State X not-for-profit corporation organized in Year 1 to engaged in Activity A pursuant to its articles of incorporation. At the time of Organization's formation, the Internal Revenue Code ("Code") had not been enacted into law. Historical documentation reflects that Organization was organized for pleasure, recreation and other

non-profitable purposes similar to those described in § 501(c)(7) of the Code. Non-member income from the rental of Organization's facilities has been minimal and all non-member use of these facilities requires member sponsorship.

Organization's articles and by-laws: (i) limit benefits of Organization and the use of its facilities to its stockholding members, (ii) provide for governance by an uncompensated, voluntary board of directors drawn from its membership, (iii) authorized a second class of stock subject to assignment to charity upon sale or liquidation of the primary assets of the corporation, and (iv) require the return of stock certificates to Organization upon resignation, failure to pay dues, forfeiture, or termination of membership.

Organization has represented that it has always filed returns as a taxable corporation; no member of the Organization has ever received a dividend, liquidating distribution, a distribution in redemption of stock or any other financial benefit by virtue of stock ownership in Organization; and all share certificates have been cancelled and shares of stock exist only as accounting entries. It has also been represented that the only benefits of stock ownership in Organization are the benefits of membership, so long as dues are paid and membership is maintained in good standing. Additionally, non-member income accounts for less than y% of Organization's total gross receipts factoring in membership dues and assessments and gross receipts from restaurant and catering operations and related income from the use of Organization's facilities is consistently less than z% from non-member sources.

Law

Section 501(c)(7) of the Code provides for the exemption of taxpayers organized and operated for pleasure, recreation, and other nonprofitable purposes, substantially all the activities of which are for such purposes, and no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1(a) of the Income Tax Regulations ("Treas. Reg.") states that the exemption provided to organizations described in § 501(c)(7) of the Code applies only to taxpayers which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any taxpayer if its net earnings inure to the benefit of any private shareholder. The regulation also states that, in general, this exemption extends to social and recreational taxpayer's which are supported solely by membership fees, dues, and assessments. However, a taxpayer otherwise entitled to exemption will not be disqualified because it raises revenues from members through the use of taxpayer facilities or in connection with taxpayer activities.

Treas. Reg. § 1.501(c)(7)-1(b) provides that a taxpayer 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 tax exempt. Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the taxpayer is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes.

Rev. Rul. 58-589, 1958-2 C.B. 266, discusses the various criteria for recognition of exemption under § 501(c)(7) of the Code. In order to establish that a taxpayer is organized

and operated for pleasure, recreation, and other nonprofitable purposes, “there must be an established membership of individuals, personal contacts and fellowship. A commingling of the members must play a material part in the life of the organization.”

Rev. Rul. 58-589 also states that a taxpayer which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, etc., may not be considered organized and operated exclusively for pleasure, recreation, or social purposes. Further, a social taxpayer which advertises to attract public patronage of its facilities is engaged in an activity which impacts adversely on its exempt status. However, a taxpayer will not be denied exemption merely because it receives income from the general public, that is, persons other than members and their bona fide guests, or because the general public on occasion is permitted to participate in its affairs, provided such participation is incidental to and in furtherance of its general taxpayer purposes. This is generally true where the receipts from nonmembers are no more than enough to pay their share of the expenses.

Rev. Rul. 60-324, 1960-2 C.B. 173, describes a social taxpayer, exempt under § 501(c)(7), whose facilities include a regular dining room and bar; a private dining room suitable for cocktail parties, small wedding receptions, or similar private parties; and a ballroom which, when not used for the taxpayer’s dances, is available for private use by members for larger parties, such as wedding receptions, banquets and parties, and similar non-taxpayer activities. Over a seven year period, banquet sales for outside organizations and groups accounted for 12 to 17 percent of total income from all sources, including dues. In one year, gross profits from outside activities accounted for 25 percent of total gross income for the year. Rul. 60-324 concludes that the organization does not qualify for exemption because its transactions with outside organizations and groups “are of such magnitude and recurrence as to constitute engaging in business.”

Rev. Rul. 68-639, 1968-2 C.B. 220, holds that the exempt status of a social taxpayer 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. The revenue ruling cites Rev. Rul. 58-501 C.B. 262 and Rev. Rul. 65-64, 1965-1 C.B. 241, to the effect that under certain circumstances, a § 501(c)(7) social taxpayer may make cash distributions to its members without losing its tax exemption. The stockholders have a right, both legal and equitable, to the assets of the taxpayer. When the taxpayer 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 taxpayer ’s assets.

Section 337(d)(1) authorizes regulations to prevent avoidance of corporate level gain by the use of a tax-exempt entity. Treas. Reg. § 1.337(d)-4(a)(1) provides that if a taxable corporation transfers all or substantially all of its assets to a tax-exempt entity, the taxable corporation must recognize gain or loss immediately before the transfer as if the assets transferred were sold at their fair market value. Under Treas. Reg. § 1.337(d)-4(a)(2), a taxable corporation's change in status to a tax exempt entity will be treated as if it transferred all of its assets to a tax-exempt entity immediately before the change in status becomes effective in a transaction in which § 337(d)-4(a)(1) applies.

Treas. Reg. § 1.337(d)-4(c)(1) defines “taxable corporation” as any “corporation that is not a tax-exempt entity as defined in paragraph (c)(2) of this section.” In turn, Treas. Reg.

§ 1.337(d)-4(c)(2) defines "tax-exempt entity" as any "entity that is exempt under section 501(a) or section 529."

Ruling

Based on the above and the information submitted, Organization should be able to qualify for tax exemption under § 501(c)(7) of the Code on a retroactive basis upon its submission of an exemption application on IRS Form 1024. If Organization qualifies for recognition of tax-exempt status as of a date that is prior to January 28, 1999, Organization will recognize no gain under Treas. Reg. § 1.337(d)-4.

Caveats

We express no opinion on the federal income tax treatment of the proposed transaction under other provisions of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction that are not specifically covered by the above ruling.

Procedural Statements

The rulings in this letter are based on the facts and representations submitted under penalties of perjury in support of the request. Verification of the information, representations, and other information may be required as part of the audit process.

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated. This ruling is directed only to the taxpayer(s) requesting it.

Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely yours,

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Lisa A. Fuller
Assistant to Chief, Branch 1
Office of Associate Chief Counsel (Corporate)