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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: JAN 6 2003

Uniform Issue List
501.07-02
512.09-03

Contact Person:

Identification Number:

Contact Number:

T:EO:B4

Employer Identification Number:

Legend:

M =
x =

Dear Sir or Madam:

We have considered the ruling request dated June 25, 2002, submitted on behalf of M, a nonprofit organization which is exempt from federal income tax under section 501(c)(7) of the Internal Revenue Code. M requests a ruling that any gain realized by it on the sale of certain property, as described below, will not cause it to lose its tax exempt status and will not be considered unrelated business taxable income under section 512 of the Code.

FACTS:

M was incorporated in 1948. In 1973, it received a determination letter from the Service recognizing it as tax exempt under section 501(c)(7) of the Code. The activities of M include raising and training beagles to compete in field trials. Several years ago M purchased x acres of land that it has held and used directly in furtherance of its exempt activities.

Because of the age of M's members, they have decided to dissolve the club. They would like to sell the land as part of the dissolution and distribute the sales proceeds to themselves in liquidation. M does not intend to make any improvements to the land for purposes of the sale.

LAW:

Section 501(c)(7) of the Code provides for the exemption of clubs organized and operated exclusively 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 states that the exemption provided to organizations described in section 501(c)(7) of the Code 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 its net earnings inures to the benefit of any private shareholder. The regulation also states that, 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.

Section 1.501(c)(7)-1(b) of the regulations provides that 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 tax exempt. Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption.

Section 511 of the Code imposes a tax on the unrelated business taxable income (defined in section 512) of organizations exempt from tax under section 501(c) of the Code, including those described in section 501(c)(7).

Section 512(a)(3)(A) of the Code provides, in part, that with respect to an organization described in section 501(c)(7), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), both computed with certain modifications provided in section 512(b).

Section 512(a)(3)((B) of the Code defines "exempt function income" to mean the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which income is paid.

Section 512(a)(3)(D) of the Code provides, in part, that if property used directly in the performance of an exempt function of an organization described in section 501(c)(7) is sold by such organization, and within a period beginning one year before the date of such sale and ending three years after such date, other property is purchased and used by such organization directly in the performance of its exempt function, gain (if any) from such sale shall be recognized only to the extent that such organization's sales price of the old property exceeds the organization's cost of purchasing the other property.

Rev. Rul. 58-501, 1958-2 C.B. 262, holds that where a social club described in section 501(c)(7) of the Code finds it impracticable to continue to conduct its exempt activities and, as such, sells its property and liquidates, such sale is incidental to its exempt purposes. The Rev. Rul. states that the club is still to be considered as operated exclusively for pleasure, recreation, and similar purposes up through the date of the sale and distribution of the liquidated assets to its active members. The Rev. Rul. concludes that profit from the sale by the club of all its property in conjunction with the termination of its activities and liquidation does not deprive the club of the exemption provided by section 501(c)(7) of the Code.

The facts surrounding the proposed sale of x acres of land show that such land has been used to carry out M's exempt activities, but circumstances have changed, particularly with respect to the aging of the club membership. Thus, M now wishes to sell the land in conjunction with the dissolution of the club. As in the case of the sale of club property by the organization described in Rev. Rul. 58-501, supra, the purpose of the sale of M's land is to facilitate the club's dissolution rather than to make a profit. As noted in section 1.501(c)(7)-1(b) of the regulations, an incidental sale of property will not adversely affect a social club's tax exempt status. Furthermore, the distribution of liquidated assets to M's members will not result in the revocation of the club's tax exempt status. See Rev. Rul. 58-501, which states that the sale of a club's property and the distribution of its assets are important transactions in the dissolution of a club. Therefore, the fact that M's assets will, upon dissolution, be paid to its members does not cause the club to incur a federal income tax liability.

Concerning the unrelated business tax issue, as indicated above, the x acres were used directly in the performance of M's exempt function, and the distribution of liquidated assets is directly in the performance of its exempt function, i.e., the dissolution of the club. See Rev. Rul. 58-501, supra. Under these circumstances, although no "other property" will be purchased by M, gain from the sale of the x acres need not be recognized in accordance with section 512(a)(3)(D) of the Code. Income from the sale of the x acres is not considered unrelated business taxable income pursuant to section 512(a)(3)(A).

RULINGS:

Based on the foregoing, we rule as follows:

1. Any gain which M realizes on the sale of the 80 acres of land in question will not cause it to lose its tax exempt status under section 501(c)(7) of the Code.

2. Any gain which M realizes on the sale of the above 80 acres will not be treated as unrelated business taxable income under section 512 of the Code.

Except as specifically ruled upon, no opinion is expressed concerning the federal income tax consequences of the transactions described above under any other provision of the Code. Specifically, we express no opinion as to whether amounts received by M's members upon dissolution of M are taxable to such members.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon M's exempt status should be reported to the Ohio Tax Exempt and Government Entities (TE/GE) Customer Service Office. The mailing address is: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The telephone number there is 877-829-5500 (a toll free number).

Pursuant to a Power of Attorney on file in this office, we are sending a copy of this letter to your authorized representative.

We are also sending a copy of this ruling to the TE/GE Customer Service Office. Because this letter could help resolve any questions about M's exempt status, it should be kept with M's permanent records.

If there are any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Thank you for your cooperation.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4