

Starting Off Right: What New Non-501(c)(3) Organizations Need to Know

“Determination” Letter

IRS recognizes your tax-exempt status

Includes:

*Compliance Guide for Tax-Exempt
Organizations* (Publication 4221-NC)



5 Areas to Watch

Private Benefit/Inurement

Lobbying/Legislation

Political Campaigns

Unrelated Business Income

Reporting Obligations



Basic Requirements

Organized and operated exclusively for exempt purposes.



7.25.7 Social and Recreational Clubs

7.25.7.1 (02-23-1999) Overview

1. IRC 501(c)(7) exempts from federal income tax, clubs "organized for pleasure, recreation, and other nonprofitable purposes, substantially all of 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."
2. Social clubs are membership organizations.
 - a. The exemption of social clubs is based on the logic of allowing members to pool their funds for recreational purposes, rather than for a compelling public benefit.
 - b. IRC 501(c)(7) was amended by P.L. 94–568, 1976–2 C.B. 596. The effect of IRC 501(c)(7) being changed to provide that "substantially all" of a club's activities must be for recreational purposes is to allow social clubs to receive some investment income and income from nonmember use of its club facilities without jeopardizing its tax exempt status.
 - d. Support received by members is not taxed, but any other income such as nonmember payments and passive income is taxed under IRC 512(a)(3). See discussion on section 512(a)(3) in IRM 7.27.7. Some familiarity with IRC 512(a)(3) is helpful in understanding the tax status of social clubs because exemption operates properly only if passive sources of income are taxed to the organization as unrelated business taxable income.

7.25.7.2.1.1.1 (02-23-1999) Classes of Membership

1. Clubs may have more than one class of membership, such as: regular, associate, corporation-sponsored, and corporate.
2. If a club has more than one class of membership, each membership class should have eligibility requirements and a formal admittance procedure, even for a nonvoting class. With such bona fide members, the memberships are not a sham and the club is not a subterfuge for a regular business operation. However, see IRM 7.25.7.2.3.
3. If a second class of member has the right to use a club facility on the payment of nominal yearly dues plus charges for services utilized, then the club may not be exempt because the club will be engaged in the business of selling services for profit to an unlimited number of individuals. (See Rev. Rul. 58–588, 1958–2 C.B. 265).

7.25.7.2.1.1.2 (02-23-1999) Rights and Privileges

1. Member's rights and privileges are as follows:
 - a. A regular member has the right to vote and determine the management, operation and control of the club. He/she will generally share in the assets of the club in the event of dissolution.
 - b. An associate member has no right to vote and will not generally share in the assets in the event of dissolution. In some cases, both regular and associate members may be entitled to the use and enjoyment of all club facilities, or may be limited to the use of a part of the facilities (i.e., golf only, tennis only, clubhouse only, etc.).

7.25.7.2.1.3 (02-23-1999) Fellowship/personal contacts

1. Face to face interaction is important for members of a social club. Organizations that do not afford opportunities for personal contact among members, (or there is such contact, but it is incidental to the primary purpose) are not entitled to exemption even though organized not for profit with no part of their earnings inuring to the benefit of shareholders. See Rev. Rul. 55-716, 1955-2 C.B. 263.

7.25.7.2.4 (02-23-1999) Distribution to Members

1. Liquidating distributions to club members after sale of club assets are consistent with exemption under IRC 501(c)(7) and does not constitute inurement. Rev. Rul. 58-501, 1958-2 C.B. 262.

Distributions to club members in the form of prizes for winning club recreational events are consistent with exemption under IRC 501(c)(7). Rev. Rul. 74-148, 1974-1 C.B. 138.

A club is not exempt under IRC 501(c)(7) if the money for the prizes is raised from the public. See Rev. Rul. 56-475, 1956-2 C.B. 308.

3. The tax consequences of a distribution by an exempt social club of cash or property to its members is unrelated to the tax consequences upon the members. Consequently, such a distribution may not affect a club's IRC 501(c)(7) exempt status and yet create taxable income to its members under IRC 301.

Unrelated Business Income (UBI)

Generates taxable income



Unrelated Business Income (UBI)

Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*



Unrelated Business Income (UBI)

Income from:

- Trade or business
- Regularly carried on
- Not substantially related to exempt purpose



Unrelated Business Income (UBI)

Common UBI activities:

- Advertising
- Sale of merchandise
- Services



Unrelated Business Income (UBI)

Common Exceptions:

- Volunteer activities
- Activities for organization members, students, employees, officers
- Selling donated articles
- Traditional bingo

Membership Organizations

501(c)(7) Social and Recreational

- Donations not deductible
- Investment income taxable
- 35% limit on gross receipts from outside



Membership Organizations

Basic Requirements

- Exclusively exempt purpose
- Private benefit/Inurement prohibited

The Unrelated Business Income Tax is now calculated differently

The unrelated business income tax (“UBIT”) is imposed on the unrelated business taxable income (“UBTI”) of most tax-exempt organizations. Before the Act, nonprofits were able to aggregate all activities generating UBTI in calculating UBIT. Now, the Act requires that UBIT be calculated on each trade or business in isolation. This inability to aggregate UBTI generating activities may result in increased UBIT for some nonprofits. Additionally, the Act includes the fringe benefits of paying for on-site gym membership and commuting/parking expenses for employees as UBTI.

In light of these changes to the UBIT under the Act, nonprofits should begin carefully tracking all sources of UBTI. Nonprofits should also evaluate each trade or business that generates UBTI and consider whether consolidating them would result in lower taxes. More guidance is needed from the IRS on what exactly are separate UBIT activities and how such activities will be reported for purposes of calculating the UBIT. Also, if a fringe benefit offered to employees will be subject to UBIT, nonprofits might consider whether paying increased compensation of equal value in lieu of the taxable benefit would be more tax efficient.

- Nonprofits with multiple unrelated business activities are no longer allowed to offset income from profitable business activities with losses from unprofitable activities. Each activity is viewed separately. Unused losses can be carried forward to future years. This is effective to tax years beginning after December 31, 2017. Three months into the new year, the highly anticipated GOP Tax Bill (H.R.1) is in full effect. Below, we look at how the new tax regime may impact individual and corporate giving, and steps nonprofits can take in response to new opportunities.

7.25.7.5 (02-23-1999) Dealing with Public

1. Social clubs are permitted to receive a certain amount of income from the general public and investments because P.L. 94-568 substituted "substantially all" for "exclusively " in IRC 501(c)(7).

The following table explains the consequences of receiving income from outside of the club membership.	
IF THE ORGANIZATION	THEN
Receives 35% of its gross receipts from investments	The organization may maintain its exemption under IRC 501(c)(7).
Receives no more than 15% of its gross receipts from nonmember use of club facilities and/or services.	the organization may maintain its exemption under section 501(c)(7).
Receives 35% of its gross receipts from outside its membership and no more than 15% of its gross receipts are derived from nonmember use of club facilities.	the organization may maintain its exemption under IRC 501(c)(7).

Exceeds the 35% and/or 15% limitations	the organization may maintain its exempt status if it can show through facts and circumstances that "substantially all" of its activities are for "pleasure, recreation, and other nonprofitable purposes."
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Records need to be maintained to substantiate these scenarios. If records are not maintained in accordance with Rev. Proc. 71-17, then assumptions and minimum income standard may not be used.

These assumptions will also be applied for computing a club's exempt-function income under IRC 512(a)(3). See IRM 7.27.7 for discussion of unrelated business income. See section 4.03 of Revenue Procedure 71-17 for a complete listing of the required information.

Guests are not considered visiting members of another social club, where the visiting members are in a similar club, and are permitted to use the facility under a reciprocal arrangement. See Rev. Rul. 79-145, 1979-1 C.B. 360 and Rev. Rul. 60-324, 1960-2 C.B. 173.

7.25.7.6 (02-23-1999) Traditional v. Nontraditional

1. Activities conducted by a social club need to further its exempt purposes. Traditional business activities are traditional those that further a social club's exempt purposes. Nontraditional business activities do not further the exempt purposes of a social club even if conducted solely on a membership basis.

7.25.7.6.1 (02-23-1999) Traditional Business Activities

Social clubs are permitted to receive no more than 15% of its gross receipts from the use of its facilities by the general public, i.e, from traditional business activities.

Traditional business activities include income from investments since investing is a normal and usual activity for a social club.

Other examples of permitted traditional business activities include:

Legal or illegal gambling engaged in by members and guests of a social club. Rev. Rul. 69–68, 1969–1 C.B. 153.

Sale of food and beverages at a club’s facility for on premises consumption.

Provision of athletic facilities for members’ use.

Sale of timber by a hunting club to protect and preserve fish, birds, game and natural resources.

7.25.7.6.2 (02-23-1999) Nontraditional Business Activities

Social clubs are not permitted to receive income from nontraditional business within the 15 or 35 percent allowances.

Social clubs may lose their tax exempt status if the nontraditional business activities are not incidental, trivial or nonrecurrent.

Examples of nontraditional business activities include:

The sale of package liquor to members for off premises consumption. See Rev. Rul. 68–535, 1968–2 C.B. 219.

Sale of takeout food to members.

Provision of personal services to club members, such as the operation of a gas station, flower shop, barber shop, and long term room rental.

7.25.7.7 (02-23-1999) Digests of Published Rulings and Procedures

Fees paid to members—An exempt social club may pay a reasonable fixed fee to members who bring in new members to the club without disqualifying the club from exemption. Rev. Rul. 80–130, 1980–1 C.B. 117.

Food and beverage sales to non-members—An exempt social club, in determining its unrelated business income, may not deduct from its net investment income losses incurred on sales of food and beverages to nonmembers where these sales have consistently over a number of years resulted only in losses, and there is every indication that such sales will continue to result in losses for the club. Rev. Rul. 81–69, 1981–1 C.B. 361.

Dues and fees; active and associate members—A social club whose active members pay substantially lower dues and initiation fees than associate members, although both classes enjoy the same rights and privileges in the club facilities, does not qualify for exemption under IRC 501(c)(7). Rev. Rul. 70–48, 1970–1 C.B. 133.

Filing Requirements



Filing Requirements

Depends on revenue and assets

- Form 990
- Form 990-EZ
- Form 990-N (the “e-postcard”)



Filing Requirements

Returns Due...

15th day ...

of the 5th month...

after the close of the tax year



Filing Requirements

Failure to file for 3 consecutive years leads to **AUTOMATIC** revocation of tax-exempt status.



EO Education & Outreach Resources

Internet Resources

IRS Exempt Organizations Web page

www.irs.gov/eo

Life Cycles of Exempt Organizations



EO Education & Outreach Resources

Internet Resources

- IRS Exempt Organizations Web page
www.irs.gov/eo
- Frequently Asked Questions
- Calendar of Events



EO Education & Outreach Resources

“CPE” articles



The screenshot shows the IRS.gov website interface. At the top right, there are navigation links: Home, Change Text Size, Contact IRS, About IRS, and Site Map. Below these is a search bar with a magnifying glass icon and the text 'Advanced Search'. A horizontal menu below the search bar contains categories: Individuals, Businesses, Charities & Non-Profits (which is highlighted), Government Entities, Tax Professionals, Retirement Plans Community, and Tax Exempt. Below this menu is a sub-menu for Charities & Non-Profits with links: Charitable Orgs, Churches and Religious Orgs, Contributors, Other Non-Profits, Political Orgs, and Private Foundations.

The main content area is titled 'Exempt Organizations Continuing Professional Education Technical Instruction Program'. Below the title is a paragraph: 'Most articles published in the [IRS continuing education program for exempt organizations specialists](#) between 1979 and 2004 on-line, through the links below, using the freely available [Adobe Acrobat Reader](#) software. Please be advised that the online versions of articles for fiscal years 1979 through 1996 may have formatting that differs from the originally published text; that charts and diagrams in the articles may not be shown; and that attachments or appendices referenced by the articles may not be included.'

Below the paragraph is a table with three columns of links representing fiscal years from 1979 to 2004.

FY 1979	FY 1987	FY 1996
FY 1980	FY 1988	FY 1997
FY 1981	FY 1989	FY 1999
FY 1982	FY 1990	FY 2000
FY 1983	FY 1992	FY 2001
FY 1984	FY 1993	FY 2002
FY 1985	FY 1994	FY 2003
FY 1986	FY 1995	FY 2004

At the bottom of the page, there is a note: 'Refer to the [Exempt Organizations CPE Topical Index](#) for a cumulative listing of available articles.'

On the left side of the page, there are two sections: 'Charities & Non-Profits Topics' with links like Life Cycle, Search for Charities, A-Z Site Index, StayExempt.irs.gov, EO Newsletter, EO Tax Law Training, Calendar of Events, Exempt Organizations FAQs, and More Topics ...; and 'IRS Resources' with links like Compliance & Enforcement, Contact My Local Office, and e-file.



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