

Square Dance Club Non-Profit Status¹

Square dance clubs can become tax-exempt as either a 501(c)(4) or a 501(c)(7). This status avoids having to file a yearly income accounting to the IRS.

1. SQUARE DANCER ASSOCIATION EXPERIENCE

The table below from SDSDA² makes it clear that most square dance clubs are social 501(c)(7) organizations and not general public service 501(c)(4) organizations because the primary purpose of a square dance club is to entertain its club-members and not to perform community service such as teaching square dancing or demonstrating square dancing as an American folk art.

Comparison of 501(c)(4) & 501(c)(7) Characteristics

Category	501(c)(4)	501(c)(7)
Membership	No requirement, General Public.	Exclusive membership (members of the organization and their invited guests). (Members have to square dance)
Assets	No requirement to dedicate assets.	Assets primarily dedicated to Members (Party Nights, Social Functions)
Activities	Social activity may be anything less than "primary".	Social activity must be primary; other activities must be less than primary. (Square dancing is primary)
Organization Goal	Organization must operate primarily to further the common good and general welfare of the people of the community.	Organization must operate primarily to further the common good and general welfare of the members. (Entertains members)
Operations	Can serve community purposes, can be somewhat narrower than (cX3).	Can Serves the social and recreation purposes of members. (Primary function)
Donations	Donations not deductible as charitable contributions.	Donations not deductible as charitable contributions. (No tax letters allowed)
Private/Public	Not an issue under (c)(4)	Not an issue under (c)(7)
Taxable items	Exempt from Federal income tax unless the organization has unrelated business income.	Exempt from Federal income tax on income derived from members. Other income may be taxed depending on the type and relative amount.

¹ Please see the disclaimer in Section 7.

² See the San Diego Square Dancers Association (SDSDA) analysis by Jim Kidwell (619-294-9893) in the APPENDIX. It includes a summary of the SDSDA IRS ruling, which shows that the IRS is enforcing the non-member income limits for 501(c)(7) organizations. This fact caused SDSDA to become a 501(c)(4).

2. SOCIAL CLUBS ARE 501(c)(7) ORGANIZATIONS

The quote below from the Internal Revenue Code (IRC)³ clearly states that a 501(c)(7) square dance club may take in no more than 15% of its gross income from non-club-members and still remain tax-exempt. Also an IRS ruling in conjunction with an audit of the SDSDA finances⁴ states that non-club-members do include members of other square dance clubs.

Non-club-member income includes guest fees on dance nights and non-club-member admission fees at club sponsored hoedowns. Hence each 501(c)(7) club needs to analyze its club and hoedown gross incomes to see if the 15% limit is exceeded and to see if they need to give an accounting to the IRS.

Note: It is assumed in this document that donations fall into other income, the 35% category, and are not considered as an admission fee by either club-members or non-club-members.⁵

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The tax treatment of social clubs underwent a substantial change due to the passage of P.L. 94-568 on October 20, 1976. Prior to passage of this law, IRC 501(c)(7) provided exemption for social clubs organized exclusively for pleasure, recreation and other non-profit purposes. That law substituted the word "substantially" for "exclusively."

The Committee reports show that this wording change was intended to make it clear that social clubs may receive outside income, without losing their exempt status. However, the Committee reports also specified clearly defined limits on this outside income, which if exceeded then invoke the application of a facts and circumstances test. The audit standard of Rev. Proc. 71-17 has been effectively raised, as of October 21, 1976, to allow social clubs to receive up to 35% of their gross receipts, including investment income, from sources outside their membership without losing their exempt status. Within this 35%, no more than 15% of gross receipts may be derived from nonmember use of club facilities and/or services. Gross receipts are defined for this purpose as those receipts from normal and usual activities that have been traditionally conducted by the club or by other social and recreational clubs of the same general type.

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³ See eotopicc82.pdf at <http://www.irs.gov/pub/irs-tege/eotopicc82.pdf> .

⁴ See the APPENDIX.

⁵ See Section 5 for a discussion of donations.

3. LARGE CLUB EXAMPLE

CLUB NIGHT

Assume that the Club has 100 club-members who pay dues of \$13 per month or \$156 per year. They also pay association dues and dancer insurance of \$12 per year. Assume that there are 400 non-club-member guest nights (average) at \$5 per guest. The total non-club-member guest fees would be \$2000. The total dance-night income is $\$15600 + 1200 + 2000 = \18800 .

HOEDOWNS

Assume that a hoedown attracts 128 dancers (16 squares), and assume that half the dancers are club-members and half non-club-members. Assume that each dancer pays \$10 admission. The \$1280 income divides into \$640 for both the club-member and non-club-member group. Further assume that donated items are raffled off for a total of \$500 for all hoedowns in one year.

Please see the discussion in Section 5 below about treating admission fees as donations as a way to reclassify non-club-member income.

INCOME SUMMARY

The overall club income calculation in the table below is LESS THAN the 15% non-club-member and UNDER the \$25000 maximum 501(c)(7) income limits. In this example the club WOULD NOT have to file a tax accounting with the IRS.

ACTIVITY	MEMBER INCOME	NON-MEMBER INCOME	OTHER INCOME	ITEM TOTAL
Club Dance Night	\$16800	\$2000		\$18800
Hoedown #1	\$ 640	\$ 640		\$ 1280
Hoedown #2	\$ 640	\$ 640		\$ 1280
Donations (Raffle)			\$ 500	\$ 500
Interest Income			\$ 240	\$ 240
GRAND TOTALS	\$18080 (81.8%)	\$3280 (14.8%)	\$740 (3.4%)	22000⁶ (100%)

⁶ The IRC allows a \$25000 gross, tax-exempt income for 501(c)(7) organizations.

4. SMALL CLUB EXAMPLE

CLUB NIGHT

Assume that the Club has 40 club-members who pay dues of \$15 per month or \$180 per year. They also pay association dues and dancer insurance of \$12 per year. Assume that there are 100 guest nights (average) at \$5 per guest. The total non-club-member guest fees would be \$500. The total dance-night income is $\$7200+480+500=\8180 .

HOEDOWNS

Assume that a hoedown attracts 128 dancers (16 squares), and assume that 0.25 of the dancers are club-members and 0.75 non-club-members. Assume that each dancer pays \$10 admission. The \$1280 income divides into \$320 for club-members and \$960 for non-club-members.

Please see the discussion in Section 5 below about treating admission fees as donations as a way to reclassify non-club-member income.

INCOME SUMMARY

The overall club income calculation in the table below is ABOVE the 15% non-club-member and WELL BELOW the \$25000 maximum 501(c)(7) income limits. In this example the club WOULD PROBABLY have to file a tax accounting with the IRS. If this club had 2 hoedowns it WOULD DEFINITELY have to file.

ACTIVITY	MEMBER INCOME	NON-MEMBER INCOME	OTHER INCOME	ITEM TOTAL
Club Dance Night	\$ 7680	\$ 500		\$ 8180
Hoedown #1	\$ 320	\$ 960		\$ 1280
Donations (Raffle)			\$ 0	\$ 0
Interest Income			\$ 0	\$ 0
GRAND TOTALS	\$ 8000 (84.5%)	\$1460 (15,5%)	\$ 0 (0%)	9460 ⁷ (100%)

⁷ The IRC allows a \$25000 gross, tax-exempt income for 501(c)(7) organizations.

5. DONATIONS AT HOEDOWNS

Some 501(c)(7) square dance clubs argue that their hoedowns are community service events, and they place a sign at the door stating that the entrance fees are suggested donations.

Certainly the food donations by club-members are truly donations, but if the club members do not pay admission fees because of these donations then the non-club-member admission fees may be the only source of income for the hoedown, which might worsen the non-club-member income percentage for the club.

The IRS might use any or all of the following arguments to disqualify hoedown admissions as donations.

- 1) If the club (in the written minutes of a board meeting) does not clearly refer to the hoedown as a 'free community service activity at which donations will be accepted from anyone, including callers, cuers and club-members', then the claim that the admission payment is a donation might be in question. Further the club should prominently post a sign stating that the hoedown is a free community service and that donations per person in a certain amount are requested to cover costs.
- 2) If the word 'charge' is used as in 'we do not charge admission to callers, cuers or club-members', then the IRS might assume that the admission fee is obligatory for everyone else.
- 3) If the caller or cuer contract states that he or she will receive a fixed dollar amount for every person signing in at the hoedown, then it becomes more difficult to argue that the admission fee is a donation.
- 4) If there is a profit and loss accounting for a hoedown, such an accounting might imply that the hoedown is a profit-making activity for the club. The interpretation might depend on the wording used in the accounting. For example, income might be referred to as 'donations at the door' instead of 'entrance fees' in order to make the clubs intentions clear.

The safest method for dealing with the IRS is to make sure that the limit on non-club-member income does not exceed 15% of gross revenue. In this case the club treasurer should keep records of club-member and non-club-member admission fees at both dance nights and hoedowns.

6. CONCLUSION

- Typical square dance clubs are SOCIAL CLUBS. Such clubs may become 501(c)(7) tax-exempt organizations, but their non-club-member income is limited.
- Clubs that primarily teach square dancing or demonstrate square dancing as an American folk art are GENERAL PUBLIC SERVICE CLUBS. Such clubs may be classified as a 501(c)(4) tax-exempt organization, and non-club-members income is not limited.
- Both 501(c)(4) and 501(c)(7) organizations have to file an accounting with the IRS if their gross income exceeds \$25,000.
- A 501(c)(7) organization has to file an accounting with the IRS if more than 15% of its gross income derives from non-club-members.
- Sample analyses above show that hoedown income may account for a large part of the non-club-member income. If small clubs have several hoedowns, they will probably have to file an accounting with the IRS even if the hoedowns are not profitable.
- The San Diego ruling in the APPENDIX states that students participating in a square dance class have to join the club after 3 sessions, which is not the practice of local clubs. However, these students might be considered PROVISIONAL club-members because they are covered under the club's United Square Dancer Association (USDA) dancer insurance. A club might then argue that the income from the class should be included as an item in club-member income. However, student income is a gray area.
- Treating hoedown admission fees as donations as a way to minimize non-club-member income is problematical. The IRS might view it as a veiled way of tax avoidance.
- Clubs can work with their 501(c)(4) square dancers associations or with a 501(c)(3) square dance promotion charity to sponsor their hoedowns and/or run their classes as a legitimate way to minimize non-club-member income.

7. LEGAL DISCLAIMER

This document is intended to raise the consciousness of square dance clubs as to the requirements for 501(c)(7) organizations.

The author is not an attorney and his statements in this document may not be correct interpretation of the Internal Revenue Code or other public law.

Each club is solely responsible for any decisions it makes about becoming a 501(c)(4) or 501(c)(7) non-profit organization and for filing or not filing a tax accounting with the IRS. Each club should get proper legal advice from an attorney that specializes in Tax Law.

APPENDIX – SDSDA ANALYSIS by Jim Kidwell

Internal Revenue Code on Non-Profit Organizations

501(c)(4)

Internal Revenue Code (IRC) section 501(c)(4)

To be tax-exempt, an organization must not be organized for profit and must be operated exclusively to promote social welfare.

“Social welfare” means “the community good and general welfare” or “civic betterments and social improvements.”

1. Focus of organization’s purpose must be a benefit to the community or society as a whole not just the organizations members and their families or other select individuals.
2. Neither can the organization be operated primarily as a ‘social club for the benefits, pleasure, or recreation of its members.’ However, social functions for the benefit of members may be carried out if they are incidental to the organizations primary purposes.
3. An organization that restricts the use of its facilities to employees of selected corporations and their guests is primarily benefiting a private group rather than the community and, therefore, does not qualify under this section.
4. The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.

501(c)(4) social welfare organizations may further its exempt purposes through lobbying as its primary activity without jeopardizing its exempt status. In addition, an organization that engages in lobbying may be required to either provide notice to its members regarding the percentage of dues paid that are applicable to lobbying activities or pay a proxy tax.

501(c)(7)

IRC section 501(c)(7)

A social club must be organized for pleasure, recreation, and other similar non-profitable purposes and substantially all of its activities must be for the purpose of its members. The membership in a 501(c)(7) social club must be limited. The organizations by laws, or other governing instrument, or any written policy statement provides for discrimination against any person based on race, color, or religion. A club that in good faith limits its membership to members of a particular religion, to further the teachings or principles of that religion and not to exclude individuals of a particular race or color, does not discriminate based on religion.

Evidence that a club's facilities will be open to the general public (persons other than members or their dependents or guests) may cause denial of exemption. This does not mean, however, that any dealing with outsiders will automatically deprive a club of exemption. In general, a club should be supported solely by membership fees, dues, and assessments. An organization may receive up to 35 percent of its gross receipts, including investment income, from sources outside of its membership without losing its tax-exempt status. Of the 35 percent, **not more than 15 percent of the gross receipts may be derived from the use of the club's facilities or services by the general public or from other activities not furthering social or recreational purposes for members. If an organization has non-member income that exceeds these limits, all the facts and circumstances will be taken into account in determining whether the organization qualifies for exempt status.**

Test:

- Public use of club facilities :Under tax regulations, a club which engages in the business of making its facilities available to the general public is not organized and operated for exclusive pleasure, recreation and other nonprofit purposes and is not exempt under 501(c)(7).
- Solicitation of the general public to utilize club facilities will disqualify the organization from exempt status.

Lobbying: may devote substantial part of activities for lobbying purposes

Data Searches:

- Of 303 organizations researched nationwide: 23 percent are 501(c)(3), 17 percent are 501(c)(4), and 5 percent are 501(c)(7)
- Of the 40 Associations researched nationwide: 18 percent are 501(c)(3), 20 percent are 501(c)(4), and 1 percent are 501(c)(7)
- Of the 40 organizations researched just for California: 20 percent are 501(c)(3), 25 percent are 501(c)(4), and 55 percent are 501(c)(7)

Comparison of 501(c)(4), and (7) Status

Category	501(c)(4)	501(c)(7)
Membership	No requirement, General Public invited	Exclusive membership (members of organization and their invited guests)
Assets	No requirement to dedicate assets	Assets primarily dedicated to Members
Activities	Social activity may be anything less than "primary"	Social activity must be primary; other activities must be less than primary
Organization Goal	Organization must operate primarily to further the common good and general welfare of the people of the community	Organization must operate primarily to further the common good and general welfare of the members
Operations	Can serve community purposes, can be somewhat narrower than (c)(3)	Serves the social and recreation purposes of members
Donations	Donations not deductible as charitable contributions	Donations not deductible as charitable contributions
Private or Public	Not an issue under (c)(4)	Not an issue under (c)(7)
Taxable items	Exempt from Federal income tax unless the organization has unrelated business income	Exempt from Federal income tax on income derived from members; other income taxed

IRS draft letter received in January 2006. The interpretation by the IRS of a 'member' is a person or organization that belongs directly to the Association. A Square Dancer visiting from outside the area is a 'non-member'. Purchasing of a membership as part of the admittance is not allowed, full dues are required to become a 'member'.

- 1) During the audit, it was recognized that the Association's printed material does not completely agree with the Association's operations. The Association must abide by those written rules, which it establishes in its governing instruments.
- 2) A club should have "established membership criteria" in its governing instruments (i.e. interest in a particular hobby or recreational activity), which *effectively prohibits the general public at large from becoming a member of the organization.*
- 3) *One time or transient participation by the general public should not be encouraged. Public support should not be solicited.*
- 4) *Event promotion to the general public is not allowed.*
- 5) *Classes shall be permitted as long as the interested student is required to become a member after the first free class.*
- 6) The Association must abide by the recordkeeping requirements as provided in Rev. Proc. 71-17.
 - *Clubs relying on either of the host-guest assumptions described in Rev Proc. 71 -17 are required to maintain adequate records to substantiate the appropriate facts. For all other occasions involving use by nonmembers, the club must maintain books and records of each use and the amount of income earned. This requirement applies even if the member pays initially for the use.*
 - *The Association must maintain measures to ensure control of non-member activity by restricting activities to members & guests only.*
 - *The Association must ensure that the club does not exceed the income limitations, i.e., no more than 35 percent of gross receipts including investment income from sources outside the membership, and within the 35 percent, no more than 15 percent of gross receipts derived from nonmember participation in club activities.*
- 7) It is the Association's duty to inform all persons related to the Association (including officers, board members, club members, etc) of the necessary changes in order to ensure a successful move towards compliance.
- 8) *Restriction of non-member income must extend to the club level. The Association must ensure that all of their members are complying with the changes in procedures since members of the clubs are members of the Association.*
- 9) It is the Association's duty to establish measures to ensure the smooth transition of governing officials. Because the Association is made up of volunteers, it endures frequent changes in officers and board members. The Association must ensure that its new officers are aware of its legal requirements as a non-profit organization.
- 10) The Association is required to report all sources of nonmember income on the Form 990T and pay the related taxes accordingly, set retroactive to period under exam.

The Association will be given two weeks from the date of this letter to prove its intent to comply. Otherwise, a 30 day letter proposing revocation of the Association's exempt status will be issued. This 30 day letter will come with full explanation of the issues and the Association's

Audit issues revolve around the definition of Members

- IPS is taking a strict definition of Members as the people that belong to the local organization. People visiting from other Clubs/Associations are non-members.
 - Squares Dancers definition of Members - anybody that is a Member of the Square Dance Family (world wide).
1. Publications are for Members only (Association and Member Clubs)
 2. Bylaws need to change to redefine Members as the Association and Member Clubs to the exclusion of all other Dancers
 3. No promotion dances or dances for the public to see Square Dancing
 4. Class Members are required to join after 3 classes or leave the class
 5. Records must be kept to prove attendance at dances are Association and Member Clubs only, compliance with 15% rule
 6. Establish an education program for the Association and Member Clubs on the rules for 501(c)(7) compliance
 7. Clubs within the Association must comply with the above

Clubs that hold a 501(c)(7) status should start work on changing their status or complying with the above. It is only a matter of time.

Where are we

- Majority of work completed by lawyer is being used for new organization
- SDSDA incorporated as non-profit in State of CA
- Applied for and received EIN for SDSDA
- Authorization from Square Dancers of San Diego County to use San Diego Square Dancer Assoc
- Application for 501(c)(4) nearing completion
Bylaws used from Square Dancers of San Diego County
Standing Rules from Square Dancers of San Diego County

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