Relinquishing the Non-profit exemption

Last month we discussed some of the activities which can affect a club’s status as a non-profit, tax exempt organization as defined by Section 501 (c) 7 of the Internal Revenue Service Code.

Most club boards question, at one time or another, the value of retaining this non-profit status. This month we will discuss some of the possible long range consequences of relinquishing a club’s non-profit exemption.

When a board of directors reviews its club’s financial statement, it often reasons that since the club shows little or no profit, no tax would be due in any case, therefore retaining the exemption is hardly worth the effort.

Often, completely overlooked is the fact that if the exemption is lost ALL revenues become taxable. This means that initiation fees, stock transfer charges, and special and capital improvement assessments, not normally included in profit and loss statements, will be added to the club’s revenues; an addition that could be costly in terms of taxes due.

Many clubs choose to charge off capital expenditures in the year of purchase, particularly when the financial statement shows that a net gain for the year will be forthcoming.

Loss of tax exemption will bring much more stringent depreciation scheduling requirements. An IRS agent would probably not approve writing off a new mower, or the purchase of ten golf carts, in a single year. Enforcement of strict depreciation schedules could easily add considerably to the club’s profit... and taxes.

Upon the loss of exemption, income from a sale of club property would automatically become subject to income tax.

Normally, such transactions are isolated, one-time, sales. IRS considers them incidental to the general purpose of the exempt club, and therefore not subject to taxation.

When the same land is sold by a non-exempt club, it is immediately subject to capital gains tax. Conceivably, a $1 million sale could mean a tax bill of a quarter of that amount. Obviously, any change in non-profit status should be considered only after full consideration of the club’s long range plans and prospects.

At many quarters it is a considered opinion that the final decision on exactly which departments will be considered exempt and which not exempt will not rest entirely with the club after it loses its non-profit status.

It is entirely possible that the Internal Revenue Service will rule that only a part of the club’s operations will be subject to income tax when only part of it is open to the public.

Such a situation could easily arise if a club made its dining room available to the public and opened its banquet facilities to special functions, but limited the use of the golf course and swimming pool to members and their guests.

In this case the IRS could rule that food and beverage income was taxable, but that golf course and pool expenses could be deducted as operational expenses. A major portion of a club’s income would then be subject to taxation without the advantage of any off-setting golf course or pool expenses.

Not the least of the considerations to be reviewed when thinking about relinquishing a non-profit status is the additional burden which will be placed on the accounting department. Most clubs with a non-profit exemption have little conception of the number of reports that tax paying organizations must file or the questionnaires that must be answered. Add to this the annual audit by the IRS and you have a big additional load to what is usually an already hard working department.

All of these factors will have some influence on any decision between profit and non-profit status. In the final analysis, however, it should be the club’s basic philosophy that controls its policy.

It is what is best for the members, and how it can best be obtained, that should decide in the end.

Certainly, if a club is better off financially when it retains its non-profit exemptions, it should make every effort to do so. But it should also be prepared to accept the responsibilities that accompany the privileges of its non-profit status.

If the club can serve its members better by relinquishing its non-profit exemptions, then it should follow that course. There is a growing body in the club industry that feels that the tax paying club may well be the private club of the future.

Prestige is important in such a decision only insofar as it is important to the membership. For the club, in a very real sense, is the membership. An unwise decision that places unnecessary financial burdens, whether present or future, on the membership, or one which limits their use or enjoyment of the facilities is likely

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to have serious repercussions and could easily change the whole purpose of the club.

If a club loses its non-profit exemption either through deliberate choice or by some miscalculation, is the action irreversible? The answer is no! Loss of non-profit exemption is not irreversible.

When a club is found not to be entitled to exemption it becomes subject to the regular rate of income tax and must file Form 1120 or 1065 for each taxable year of operation. This can be made retroactive to the date from which the club failed to act according to an established purpose.

In order to recover its exemption it must re-apply with a new application or Form 1025 and the necessary supporting documents required by the government. Accordingly, a club should thoroughly investigate and carefully weigh the pros and cons of its particular position before relinquishing its non-profit status. Its decision may change its future.

Turf students are wiser

Twenty five turf management students, each from a different university in the U.S. and Canada, recently graduated from a one-week course on equipment maintenance and handling.

The course was sponsored by Jacobsen Manufacturing Company, a major producer of turf care equipment, lawn and garden tractors and lawn mowers and snow throwers.