

NON-PROFIT STATUS:

DOES IT MEAN MORE THAN MONEY?

This second article on the problems a club might face if it relinquishes its non-profit status answers the questions of how this change would affect the club's liquor license and its position under state and local tax laws

by JACK JANETATOS

P rivate clubs have been exempted from the Federal income tax since it began early in this century. Until recently that tax exemption had a large economic value to clubs because it enabled them to earn profits from non-member business without the necessity of dividing those profits with the Government. In 1969 the now famous Tax Reform Act imposed a tax on the unrelated business of clubs, and this economic benefit was effectively eliminated.

There still is an economic benefit in tax exempt status, particularly in the exemption from tax on the gains from the sale of club property. The principal benefit, nevertheless, disappeared with the Tax Reform Act, and many clubs began considering whether or not they should give up their tax exempt status.

It is hard to imagine any set of laws and regulations that have had as much effect on clubs as have the tax exemption provisions. These rules govern the contents of articles of incorporation, by-laws, house rules and even the forms and procedures used in day-to-day business. Even beyond these organizational controls, the rules govern the manner of operating the club. The tax law governs the amount of outside business a club can have and how it sells its property.

Nearly all member-owned clubs were organized along the lines required by the tax rules. Even today the majority of clubs maintain their operations in

complete conformity with the strictures imposed by the complicated regulations of the Internal Revenue Service. A number of clubs, however, do not maintain tax exempt status either because the IRS took it away or the clubs' managements decided they didn't want to keep it.

Today, one rarely sees a new member-owned club formed. The current trend is toward investor-owned clubs connected with real estate developments; these rarely seek tax exempt status. The growing number of these profit-making clubs and the successful operation of most of them raises the question of whether tax exempt status is essential to a club. There is no recorded case in which a club has terminated operations solely because it lost its tax exemption, and anyone looking at such a club would feel that it continues to operate the same after losing its exemption as it did before.

All of these factors come regularly into the view of members of club boards. Their natural reaction is to question whether they couldn't operate without a tax exemption and rid their clubs of all of the restrictions and obligations of the Internal Revenue rules. Unfortunately, there have been some instances where the propounding of the question has produced a visceral response, and clubs have given up tax exemptions without fully considering all facets of the question.

A preliminary, but most important consideration

in this question, is to ascertain why exempt status should be given up. What is to be gained?

It well may be that the greatest gain in relinquishing exemption is to be able to accept larger amounts of non-member business. It seems beyond debate that the 5 per cent limitation on outside business is unduly restrictive. Both the Treasury Department and the House Ways and Means Committee have agreed to expand the 5 per cent rule to 15 per cent, but Congress has not enacted such a bill and any action on it in the very near future seems doubtful. Some clubs, however, would find even the 15 per cent to be restrictive.

There are clubs that receive substantial amounts of investment income. One club receives more than a half million dollars a year in dividends on stock left to it under the will of a deceased member. Many clubs receive substantial rental income from commercial tenants. The Internal Revenue Service has a vague rule that permits small amounts of investment income and denies exempt status to clubs that receive too much. No one knows how much is too much because the Service says that every case must be decided on its own facts. There certainly are more than a few clubs that would like to increase investment income, but cannot do so because of the restrictive rules. It is worth noting here that the same bill that would increase the limit on non-member income to 15 per cent would impose a limit of 10 per cent on investment income.

These then are the two most significant reasons for clubs to give up their exemptions, and the first of these, the outside business restriction, is by far the most important. Briefly stated, most clubs that give up or lose their tax exempt status do so because they wish to have more than 5 per cent in non-member business.

Once the goal has been established, the hard questions must follow. The first and most obvious, of course, is what will be the tax impact. This question is extremely complex and will be the subject of a separate article in a forthcoming issue of this publication. The secondary questions may, however, be so important that they will solve the problem without having to make the complex judgements necessary to determine the tax effects of the loss of exemption. The question then is, what else happens to a club besides a change in tax status when it gives up its tax exemption?

In an earlier issue of this magazine, the Civil Rights Act of 1964 (see May issue, p. 49) was discussed. There it was clearly stated that the loss of tax exemption will automatically cause the loss of exemption from the Equal Employment Opportunity provisions of the Civil Rights Act. Thus, a club that gives up its tax exempt status, automatically and at the same time gives up its exemption under the Equal Employment Opportunity Law.

Questions under the Public Accommodations Title are more difficult. Unlike the equal employment law where the exemption is phrased in terms of the tax exemption, the public accommodations law provides exemption for clubs "not in fact open to the public." Thus, losing or giving up tax exempt status will not cause an immediate and automatic loss of exemption from the Public Accommodations law.

The inquiry will not end with the simple answer; it is necessary to take one more step. If the club should increase outside business once it was no longer subject to the restrictions of the tax law, it would be hard to say that it was "not in fact open to the public." One can conclude, then, that giving up tax exempt status and increasing outside business would

continued



probably bring the club within the provisions of the Public Accommodations law.

It has been said that a club could not exist without a liquor license. That is, of course, a very broad statement, but a glance at a typical club's profit and loss statement would quickly reveal the tremendous profit made by beverage operations. Even if a liquor license is not absolutely essential, it certainly is very important.

We are not aware of any state that issues club liquor licenses contingent upon Federal tax exempt status, but many states issue special licenses to clubs that do not do business with the general public. An analysis of the effect of the loss of exempt status here would be similar to that used under the Public Accommodations law and the conclusion would be the same. Loss of exempt status would not produce loss of the liquor license, but an increase in non-member business would. To tie the tax exemption even closer to the liquor license, one state liquor authority has proposed non-member business regulations adapted from the Federal tax regulations.

Another significant ancillary area is state and local taxation. One must look carefully at what effect loss of exemption would have on a club's position under state law. Some states would deny benefits under greenbelt laws, and there may be changes in treatment under state income tax laws and even other taxes, such as sales taxes.

It should be clear that no shoot-from-the-hip decision can be used by a club's management in determining whether to preserve or surrender its tax exempt status. Careful study of all of the items discussed here should be made.

Beyond this, a careful economic analysis will have to be made, and this will be the subject of a forthcoming article in this publication. □

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GRAU *from page 15*

last write your congressman to protest the cut in agricultural appropriations, which will severely hurt our turfgrass programs? Write it in your own way, but write it. Letters can be understood even by our legislators.

A VOTE FOR SOD

Q—*During the summer, a member of our club had a new home built. Unexpected delays in delivery of supplies and materials brought lawn establishment time well into November, which most authorities consider too late for a successful seeding. A question was put to a local authority as to what to do. It brought the response, "Wait until spring." The member was not too pleased about the idea of living with mud all winter, so he asked another authority. The reply this time was, "Lay a good quality sod." We would like your expert opinion. Who was right?* (Pennsylvania)

A—From my experience, I would cast my vote for sod; I wouldn't live with mud, either. Spring seedings are notorious for becoming patches and for withering in summer's heat. The one who advocated waiting until spring should clean the man's rug all winter. The quality sod that the recognized sod producers deliver these days can be depended on. They follow the most advanced practices and use the best seed mixtures that have been proved by research. Sod, as we all know, is instant lawn.

STAY WITH OLD OR CHANGE TO NEW?

Q—*At our club, the fairways have received tri-calcium arsenate for a number of years. The turf, a mixture of Penncross, Astoria and Highland, has thinned and is showing stress. We plan to reseed a number of areas where we need some grass. A high-phosphorus fertilizer will be used to try to get better root development. The question is: In a spring seeding (western Pennsylvania) should we stay with the old mixture or is there something that would be compatible and would yield quicker results?* (Pennsylvania)

A—A blend of the fine-leaf perennial ryegrasses seems to me to be your best approach. One such blend

is Palo Mora, which contains Pennfine, Manhattan, Pelo and Epic. Another blend with which I am less familiar is Medalist II, used in the South. These fine ryegrasses will be compatible and will yield cover and playing turf sooner than anything else I now know of.

RESTORE NEEDED FUNDS

Q—*Recent budget cuts, both state and Federal, have seriously threatened research and extension operations upon which all agriculture depends heavily for advancement and progress. Turf is a major part of agriculture, so that it, too, stands to lose funds and personnel. What, if anything, is being done to reverse this trend and to restore the needed funds?* (Maryland)

A—Now is the time for all good turf men to rally to their state turfgrass council and learn how each one can be heard. Now, as never before, turf needs a unified voice—one that can speak with authority.

I cannot speak for all turfgrass councils, but two with which I'm familiar are doing something. An appeal has gone out to every member organization, club, firm and individual to send a letter of protest to their senators and representatives. In Pennsylvania, this guidance flows from the Agricultural Advisory Council through all member organizations, which includes the Pennsylvania Turfgrass Council. In Maryland the appeal came through the office of the head of the agronomy department. The message is the same, "Write letters."

Another thing that is being done is an appeal to every facet of turf to join the council to build a fund that can keep them from putting the plow to the plots. This fund will be used to tide the turfgrass program over this crisis until, hopefully, reason prevails once more. When the once-plentiful funds for grants and contributions begin to fall off, we must look for support to those who will benefit and who have benefited most from state programs over the years. I'm afraid that the day of the "free ride" is gone, along with the dodo and the passenger pigeon. □

Editor's note: A discussion of this subject appears on page 45.