Accent on management

by Ken Emerson

Should your club Be tax exempt?

Nearly every golf club, at one time or another, has seriously questioned the advisability of retaining its non-profit, tax exempt status.

The review usually comes about as the result of one of several lines of reasoning. Either the club would like to be able to adopt a more liberal "outside business" policy; wants to sell or lease a portion of its property, or reasons that since it is not making a profit anyway, why worry about retaining its exemption.

While it may be true that some clubs might logically choose to relinquish their non-profit exemptions, such rationalizing *can* be the result of too hasty an examination of the problem.

Before a club decides to relinquish its tax exemptions it should carefully analyze its purpose for being a private club in the first place.

Most private clubs are granted their exemption as non-profit, social and recreational organizations under section 501 (c) 7 of the Internal Revenue Service Code.

This section of the code grants private golf clubs their exemptions when they are organized purely for pleasure, recreation, and other non-profit purposes; when no part of their net earnings inure to *individual* members; and when the facility is maintained for the use of the membership and supported by membership dues, fees, and assessments.

Admittedly the section is broad and some of the wording vague, but since most problems relating to non-profit status are governed by its restrictions we should take a close look at some IRS interpretations.

The most troublesome area, in this respect, is the amount of outside, non-member business a club can accept before it jeapordizes its tax exempt status. Certainly, if a club's primary function is to serve its members, any non-member use is incidental. But how "incidental" can this use be?

In an effort to clarify this point, IRS has issued a number of statements. None has received more attention than Revenue Procedure 64-36—often refered to as the "5% Rule".

Rev. Proc. 64-36 was issued to provide, not a "rule," but a *guideline* for determining the effect of non-member use of a club's facilities.

Should a club's non-member income exceed the guidelines, it does not mean that there will be an automatic loss of exemption. It *does* mean that the agent should continue with his audit to determine the purpose and frequency of non-member use.

The club could also *lose* its exemption with *less* than 5 per cent of its income from non-member sources if the club, for instance, has actively solicited non-member use in competition with tax paying business, or has realized a profit as a result of this revenue.

Such a profit need not necessarily be in the form of a money dividend. It could also take the form of a dues reduction.

A profit might also be assumed if it could be determined that the non-member business made it unnecessary to *raise* dues.

In addition to revenues from non-member use of a club's facilities, there is also the problem of selling or leasing club property.

Generally speaking a single sale of club securities or real estate will not endanger a club's exemption. IRS has issued several rulings on this aspect of non-member income and they generally hold that a one-time transaction, incidental to the general purpose of the club, will not jeapordize a club's non-profit status.

There is an important exception to this rule.

When the sale of club property is made in disregard of the purpose for which the club was formed—made with the obvious intent of making a profit, exemption will likely be denied.

Whether or not a club retains a non-profit status depends therefore, on its understanding of its purpose as a club and on the manner in which it tries to fulfill that purpose.

A well-run private club should not lose money. Its members can expect their profits in one of two forms. Either in services in which they all share, or in dollars. If it is the latter, and there is a member choice, then they must expect to pay taxes on those dollars.

In the same way, a club can either cater exclusively to members and guests or it can expand its services to include a greater or lesser portion of the public. If a club serves the public on more than an incidental basis, then it must assume the responsibilities of those businesses that cater to the public.

There is nothing morally wrong with either philosophy. It is simply a matter of member policy as to which course a particular club will follow. □