

OPERATING UNDER THE TAX REFORM LAW

By JACK P. JANETATOS and KENNETH EMERSON



This complex law has even the experts baffled. Until new regulations are issued, private clubs will have to file returns without official guidance. The authors give authoritative advice

NEARLY all country clubs in the United States are member-owned non-profit corporations; therefore, they have always been exempt from the Federal income tax. Now, the much publicized Tax Reform Act of 1969 has gone into effect, imposing on these clubs for the first time an income tax. Hereafter, the management of private clubs will have to provide for the payment of an income tax bill.

Complying with this new law, however, will not be easy. The Tax Reform Act is so complex that many tax counselors have called it a monster, because portions of it puzzle even the experts.

In its most pertinent parts, the act amends the Internal Revenue Code to provide for a tax at regular corporate rates on the "unrelated business taxable income" of clubs. The new law defines unrelated business taxable income as "gross income." It then goes on to permit certain deductions.

The first and most important deduction is "exempt function income," defined as: "Gross income from dues, fees, charges or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests, goods, facilities or services in furtherance of the purpose constituting the basis for the exemption of the organization to which such income is paid."

Next, clubs are permitted to take a deduction for all the ordinary and necessary business expenses directly connected with earning the gross income but not the exempt function income. Since all exempt function income is deductible it is not possible to deduct expenses connected with it, because that would amount to taking the same deduction twice.

Clubs may also deduct amounts of income set aside for charitable purposes without limitation.

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Finally, clubs need not include certain capital gains in income. Where property used directly in the performance of a club's exempt purposes is sold at a profit and if the proceeds of the sale are reinvested in property to be used for exempt purposes during a period beginning one year before the sale and ending three years after the sale, then gain on the sale is not recognized and will not be included in gross income.

QUITE clearly, the Tax Reform Act works a revolution. *Clubs which never paid income tax will now have some tax obligation.* It is difficult to imagine a club not having at least some small amount of unrelated business income. At the very least the tax will be applied to non-member income and investment income and nearly all clubs have some of both.

The new law went into effect on January 1, 1970, but the tax is applicable to clubs only for fiscal years commencing after December 31, 1969. A club on a calendar year accounting system became subject to tax on January 1, 1970. A club on a June 30 fiscal year will be taxed on income earned after July 1, 1970.

THE most obvious problems under the new law revolve around the definition of exempt function income. This is a lengthy and complex definition—perhaps too lengthy; certainly too complex. There are four parts to the definition; each raises other questions.

The income, to be excludable, must be paid by a mem-

ber. *If a member's bill is paid by the member's employer, will the amount be taxable? No such ruling has been made, but the possibility exists.* Certainly, if the charge is paid by a guest the tax would apply, and if in the case of a group party, the group should pay or reimburse the member, the same adverse result could occur. *

The seriousness of this suggestion should not be discounted. One club currently under audit has been required to provide the Internal Revenue Service with a list of the employers of its members. These companies, in turn, are being asked by the IRS to state whether, in fact, they are paying the member's dues and charges.

The amounts paid must be for dues, fees, charges or similar purposes. Congress, it may be assumed, intended to be all-inclusive with this wording, and it is difficult to imagine any amounts paid to clubs which would not be included by this language.

To be excluded from the tax, the charges must be incurred by members, their dependents or their bona fide guests. This part of the definition incorporates the long standing question of who is a bona fide guest. (A rule of thumb definition is someone whom the host pays for.) Since the advent of Revenue Procedure 64-36 promul-

*The NCA in its newsletter has been urging clubs to accept only personal checks in payment of members' accounts. One Eastern club, reportedly, issued a notice to its members which said: "Membership in the club is held only by individuals. Payment of a member's account . . . other than by the member's personal check creates improper inferences as to the status of the membership and also might raise tax problems for the club."

gating the Five Per Cent Rule, the IRS, however, has never formulated a definition which would serve to identify a guest from a non-member paying customer. Perhaps now this new law will impel the service to formulate some rules so that clubs will be able to compute their taxes properly.

The goods, facilities and services for which the charges are made must be within the exempt purposes of the club. *Several months ago a ban on package liquor sales was imposed by the IRS.* The reason for the ban was that off-premises consumption of liquor was not social and did not further a club's exempt purposes. *Any income from this type of activity would be taxable even when paid by a member.*

SIGNIFICANT problems exist also under the deduction for the ordinary and necessary business expenses directly connected with investment and outside income. Determining the amount of allowable deductions will be very difficult. Consider, for example, a typical outside party of 100 non-members at a luncheon. It seems clear that a club would be able to deduct its cost for the food and beverages sold at the lunch and the salaries of the personnel working at that party. But it cannot now be determined whether the club will be permitted to charge off any portion of depreciation on the clubhouse or the capital equipment necessary to conduct

such luncheons. There is also a question whether any of the salaries of the supervisory and administrative personnel would be deductible.

The Treasury Department will, perhaps in 1971, issue regulations under the law which may clarify some of the problems. Numerous articles will be appearing in various trade and professional journals in the coming months which will alleviate some confusion, and inquiries can be mailed to the National Club Assn. in Washington, D.C. *Nevertheless, a large number of clubs will be forced to file tax returns and pay taxes before any official guidance is issued.*

Few observers fault Congress for its noble intention of reforming the tax law. Even fewer would grant that Congress did an adequate job of it. The new law, if it has closed some loopholes, has nevertheless created additional complexity which may result in a protracted course of litigation harmful to clubs and costly to the Government. □

Jack Janetatos is a partner in the law firm of Baker & McKenzie, resident at Washington, D.C. He is the general counsel of both the National Club Assn. and the Club Managers Assn. of America.

Ken Emerson is the executive director of the National Club Assn. and a columnist for GOLFDOM.

A Brief Tax History

When the income tax came into existence in the early part of this century, private clubs were generally considered not subject to this law because they were non-profit organizations, which the Internal Revenue Service recognized publicly when it issued a ruling advising clubs that no tax returns would be required from them.

But by 1916, it became necessary for the IRS to back up its earlier ruling with statutory authority. So in that year at the Treasury Department's request, Congress added private clubs to the list of tax exempt organizations described in the law. The provision, section 501(c)(7), exempting clubs has changed little over the years.

Subsection (7) exempting clubs is but one of 17 such subsections which provide exemptions for a multitude of different types of organizations. The same law which exempts from the tax hospitals and schools, also exempts country clubs, the operations of which are certainly of a different kind. To many the inclusion of private clubs in this group appears to be an unjustified tax preference.

As the years passed and tax rates climbed, tax exempt organizations began to expand their operations into

areas outside the scope of their tax exempt purposes. By the end of the 1940s these business activities began to take on the appearance of tax avoidance. Becoming aware of these profits, Congress enacted in 1950 a tax on the unrelated business income of some types of exempt organizations. These groups were required to set up separate accounts for their unrelated business and pay a tax on the profits. It should be noted that clubs were not included in the list of organizations covered by this tax.

In the early 1960s, the IRS initiated a course of increased audit activity. From these audits came numerous cases in which the agents proposed that the exemptions of clubs be revoked. The contention was invariably based upon the amount of non-member business the clubs were doing. Each case had to be decided finally at the IRS headquarters in Washington.

Clearly the time had come for the IRS to formulate a standard to determine how much outside business was permissible. In 1964 the IRS issued the now famous Revenue Procedure 64-36 setting forth the Five Percent Rule. The rule took the form of an audit guideline instructing revenue agents in the field that they were not to propose

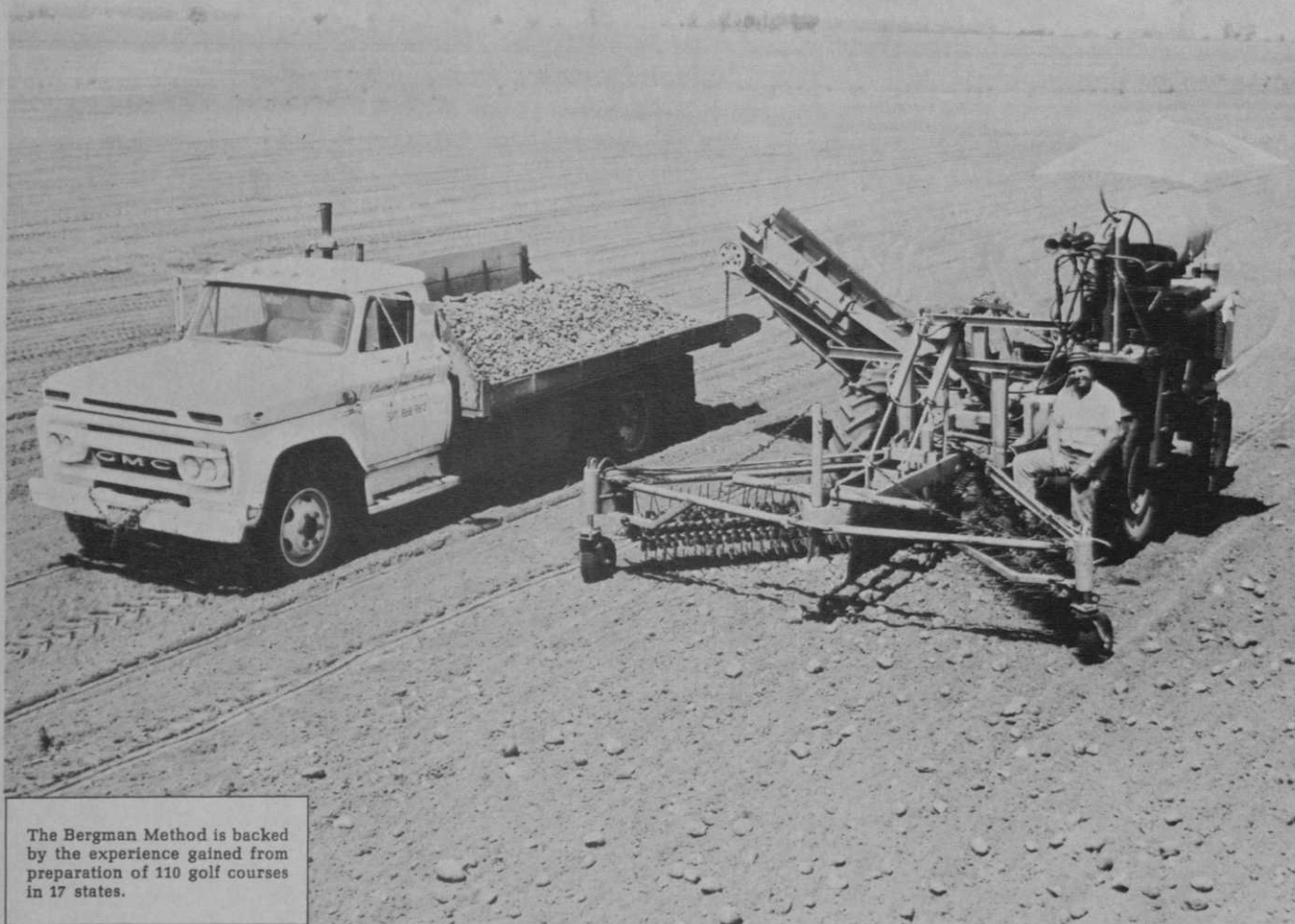
revocation where total gross receipts of a club from non-member sources did not exceed 5 per cent of total gross receipts from all sources.

Despite cries of anguish from many club representatives, this restrictive rule seemed to work well in practice. Certainly the rule caused a drastic reduction in the number of proposed revocation cases. First, it prevented the agents from proposing revocation where the amount of outside business was very small. Second, it gave club management a firm guideline to aim for in cutting down on non-member business.

A few years ago strong taxpayer sentiment began to develop for drastic reform of the tax laws. The 10 per cent surtax pushed tax rates to unbelievable heights and the increasing publicity surrounding tax "loopholes" added impetus to the movement. In response, the Johnson Administration, late in 1968, developed a package of tax reform proposals.

Early in 1969 the House Ways and Means Committee held hearings on the proposals; and the first draft of the Tax Reform Act of 1969 resulted. The bill worked its way through the Congress; last December, the President signed it into law.

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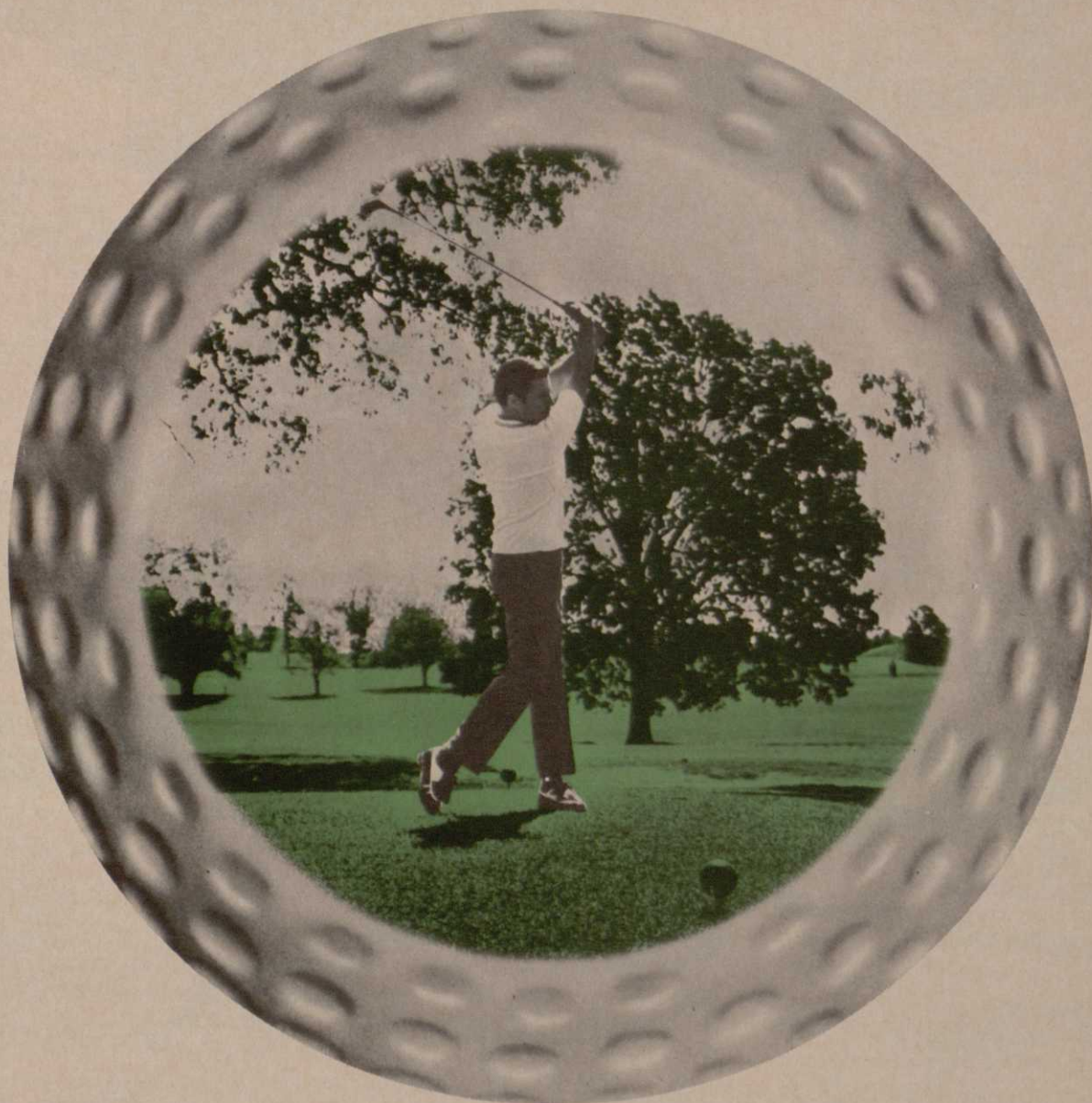
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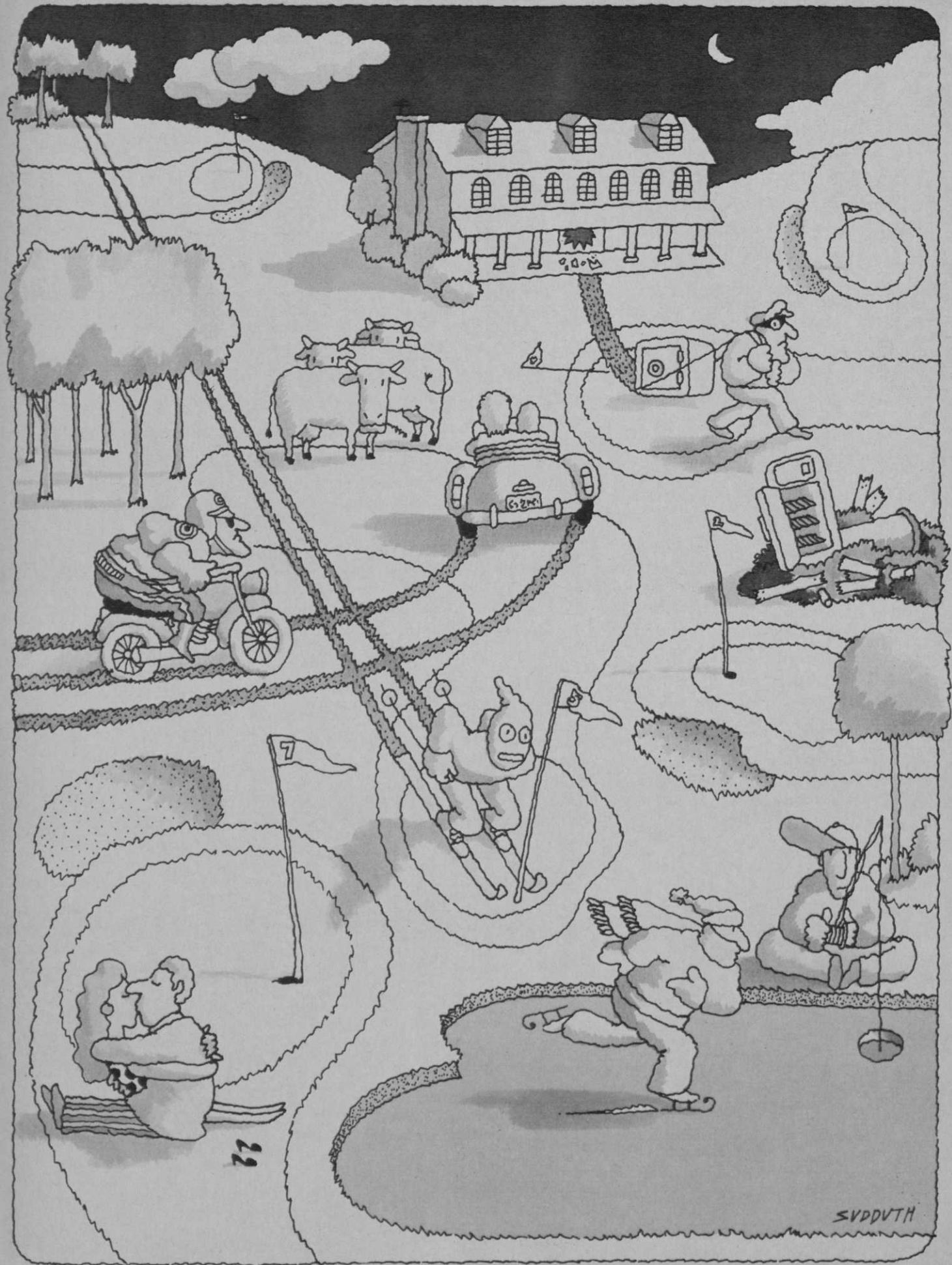
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Fencing with the Problem

By JOE DOAN

Vandalism and burglaries are forcing more and more clubs to fence in their courses. The cost can be enormous, but clubs feel the money is well spent

IN the early morning a truck is backed up to a pro shop and a safe winched through a window that's been forced. Youngsters in a stolen car turn onto a club's access road, and with three police cars in pursuit, hurtle across fairways and greens, rutting and tearing up turf over several acres. Livestock from an adjoining farm gets loose and spends the night grazing a course and damaging soft greens with backhoe hoofs. Old stoves, refrigerators and hot water tanks, which householders have trouble getting hauled away, are disposed of behind a 14th green or a 16th tee—and with them maybe the week's garbage.

These are only a few ways in which golf clubs are harassed and set upon. Almost every superintendent has a few favorite stories, if not of depredation, then of how he had night visitors, interlopers, people who stray onto the acres in his custody as if they were in the public domain.

Golf courses long have been favorite trysting spots. Nocturnal fishermen covertly troll their lakes and ponds and in the winter ice skaters will take over if they aren't chased out. Knolls and hillocks offer tempting ski runs at some courses. In the last few years the country club's rolling terrain has beckoned snowmobilers.

These are the more innocuous types of interlopers. Clubs and superintendents might be inclined to suffer them if they were sure their numbers could be controlled. But they rarely are. If a few skaters or skiers are permitted to use a course, ultimately they are followed by many more. Severe damage to snow covered turf may result if there is too much skiing. A club may become exposed to a lawsuit if a mishap occurs as the result of people ice skating.

As for love-ins, the biggest drawback to them is that so many take place in the spring. "If," as one superintendent says, "the trysters would stick to the blacktop and macadam and not drive out on the course, we might tolerate them. Probably we wouldn't know that they paid us a visit. But too many of them, looking for a secluded spot, stray from the clubhouse grounds and damage the soft turf on the course."

Non-malicious trespassers easily outnumber those in-

tent on larceny or destruction. At first thought this is good, but petty thievery by non-malicious types can cost a club quite a bit of money. Mostly they are after flagsticks, tee markers or signs, but sometimes they make off with hoses, sprinkler heads and benches. It isn't unheard of for a club to have some of its shrubbery dug up and carried off. Generally, these people come under the souvenir hunter category or, at least, they aren't felonious. But whatever their classification it can't be overlooked that a flagpole costs \$7 or \$8, a sprinkler head is worth around \$20 and a bench from \$25 to \$50.

What causes golf clubs the most distress, of course, are vandals and people intent on robbing pro shops, clubhouses and maintenance buildings. Whether they are more of a menace now than ever before is open to question. There has been a lot of vandalism and burglarizing of country clubs going on for the last 15 to 20 years. Speakers at two or three national Golf Course Superintendents Assn. of America conventions have discussed vandalism in recent years. For the most part it has been in connection with the senseless damage done to greens. As for burglaries, pro shops have been prime targets. Consignment stealing, dictated by hoodlums who fence stolen goods, seems to break out somewhere every spring. Clubhouses and maintenance buildings haven't escaped looting on a rather large scale.

There is no denying that golf clubs are at the mercy of all kinds of predators, malicious or otherwise. Out in the open, away from everything, as many of them are, they are rather easy targets. Most have taken steps to protect their properties, but because of their sprawling nature, it isn't easy. Various types of alarm systems, night watchmen, the employment of private or public police services have proved to be only partly adequate. Clubs are still looking for better protection measures.

One of these is the fencing of properties. It wouldn't be accurate to say that this is a new idea, nor by any means the full solution to the security problem. But in the last

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three or four years more and more clubs have been turning to fencing. It provides not only greater interior security, but protection for those who live or travel outside the fence. People who live in homes immediately adjoining courses are usually glad to see a club put up a fence, since it gives their persons and properties added protection against the hazard of flying golf balls. And, of course, the same kind of protection is given where streets and highways run parallel to courses.

One club manager recently said that he was greatly relieved when his club finally realized that it should erect a fence adjoining a busy highway. In his five years at the club he had paid at least a dozen windshield claims. He was living in fear of the day when a golf ball struck a car and caused a really serious accident. It would have made the club liable to a lawsuit that might have put it out of business. He was able to convince the members of this serious problem and an 18-foot fence was erected.

Installation of a fence, however, will not reduce the club's premium. But it could have an indirect affect. A fence may reduce the club's loss experience, which has a substantial influence on the premium, according to a spokesman for a major insurance firm.

A club has one other highly important responsibility in protecting outsiders. Courts have ruled in several cases that a country club grounds is an "attractive nuisance" and, therefore, children even though they may stray onto a course, have to be protected from its hazards. Several years ago, GOLFDOM reviewed a case in which a child was injured while playing around machinery and the club had to pay his medical and hospital bills. In another case, a child was drowned in a lake on a course and the club was held liable. In both instances the courts ruled that the clubs were negligent because they did not provide a fence or similar barricade around these hazards.

As already mentioned, a fence doesn't answer a club's security problem. Far from it. Joe Cuthbertson of the All-

state Fence Company, Oak Lawn, Ill., whose company has erected six-foot chain link fences, topped out with barb wire, for several golf clubs in the Chicago area, quotes an old fence proverb in speaking of his product: "Fences keep out honest people." He goes on to say that a vandal, petty thief or burglar can get through any fence if he has a little resolve. All he has to do is climb it, in spite of barbs, go under it or use a pair of three-eighths-inch bolt cutters to go through it.

So what good is a fence?

It serves as a deterrent. A man with vandalism or larceny in his heart more often than not is too lazy, doesn't have enough resolve, to climb or tunnel a fence. If he finds one he probably won't bother to probe it, but will go to the next course and look for a walk-in.

A substantial six-foot fence, the kind surrounding golf courses, parks or industrial properties is an expensive proposition. A chain link, such as a Cyclone fence, may cost \$3.50 a foot or more for the deluxe installation, which includes either concrete or tri-set bases and a two-inch top bar around the complete circuit. Multiply this by 10,000 or 15,000 feet, the area you may wish to enclose, and the cost is substantial. So substantial, in fact, that many clubs have their fences installed in sections over a period of several years.

Many clubs only fence off areas that face streets, highways and adjoining properties, omitting fencing where the property isn't open to access roads or where there is only light trespassing. Butterfield CC, Hinsdale, Ill., for example, fenced in 9,000 of 12,000 feet when it had its installation made in 1968. Its neighbor across the highway, Midwest CC, closed in about 10,500 feet, two-thirds of its course, when it erected its fence about a decade ago. Midwest, incidentally, made the installation over four years.

Fencing is a job for specialists and is almost always done on contract. If a superintendent and his crew were to attempt it, installation time probably would cost more than if a contracting company were to do it, and the latter would probably have to come in and shore up the job. A three-man, experienced fence crew can install about 100 yards a day. Poles are set 10 feet apart, top bars are connected to them and the fence is hung from the top bars with the aid of a three-fourths to 1 1/2-ton hoist. The chain link is then stretched at the bottom with a cable pull and the entire fence is secured to the poles. Where the ground is firm, concrete is used as a base in the post holes. When it is swampy, tri-set anchors are set in the holes and the upright poles bolted to them.

Usually, the course maintenance crew prepares the right-of-way along the fence line. Ideally, this calls for the removal of trees, bushes and brush and a 10-foot swath cleared so that there is maneuvering room for the concrete truck and other equipment used on the job. Some superintendents, however, prefer to have bushes abreast the fence, making it necessary for the fencing crew to work around them. Usually it can be arranged, but at an additional cost

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Fencing hints

- A six-foot, chain link fence may cost \$3.50 a foot or more for an installation which includes either concrete or tri-set bases and a two-inch top bar around the complete circuit.
- Because of the expense only fencing in areas that face streets, highways or adjoining properties has become common practice.
- Fencing should be done by a reliable and experienced company. A three-man fence crew can install about 100 yards a day.
- Check carefully all available descriptive land pattern materials, which can be obtained from local, county engineering or assessment offices. If the fence has to be moved because it violates property lines, the club is responsible for the expense.
- Frequently, allowance is not made for the barb wire overhang, which can angle over an adjoining property and can result in a lawsuit. Regulations regarding overhangs are stipulated in building codes. These codes should be checked thoroughly before building begins.

IDEAS

Signs of golf

If compliments could be converted to dollars the city of Walnut Creek, Calif., would be rich already from the directional signs it put up when its municipal course opened for play in April, 1969.

The silhouette of a golfer, a directional arrow and the words "Walnut Creek golf" are in white on a greenish blue background. The entire sign is made with reflectorized paint by the silk screen process in the city's own sign shop at a cost of \$5.40 each, according to city manager Ralph Snyder. About three dozen have been installed at all access roads leading to the city.

Snyder explained that the signs comply with state highway department restrictions by being directional in nature, without advertising the course by name or calling attention to other facilities offered.

Design of the signs was the work of an architectural student named Darrell Quasnick, employed temporarily by the city as a draftsman. Several designs were submitted by Quasnick, and a golf advisory committee selected this one.

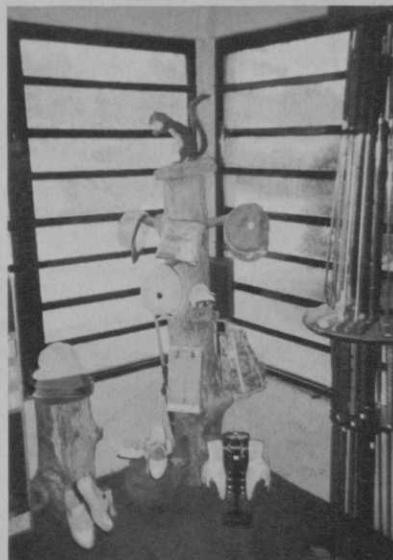
"Response has been excellent," Snyder says. Best of all, the signs are not copyrighted, and Snyder said anybody who wants to copy the design is welcome to do so.



Just like new

This spring when Bud Welch, the head professional at Pine Valley CC, Wilmington, N.C., greeted his members in the golf shop, they saw something new.

During the winter, Bud and his assistants, Harold Dozier and Tom Plankers, decided that a "new look," centering around an antique theme would be nice, so they proceeded to do just that.



They used wagon wheels as a slacks rack. A buggy wheel on top is made to revolve. It's powered by a small electric motor which can be installed to turn this wheel to display items featured that week in the shop. Wagon wheels also display clubs. From an old black cooking pot members can now get their tees. Wooden stumps and trees help to display small items.

These are only a few ideas that a golf professional and his staff can come up with during the cold days. This change was very inexpensive (less than \$100), but it has stimulated interest and conversation among Pine Valley's members.

GOLFDOM will pay \$25 for each idea, accepted for publication, that will help make superintendents', managers' or professionals' jobs easier. If your idea saves time or money, write it down on your club stationery and send it to Idea Editor, **GOLFDOM**, 235 East 45th St., New York, N.Y. 10017.

COMING EVENTS

Club Managers Assn. of America Workshop in Outdoor Recreation Administration, University of Houston, Houston, Tex., July 19-22.

CMAA Workshop in Advanced Management Techniques, University of Houston, Houston, Tex., July 23-26.

CMAA Workshop in Executive Development, Executive Park Motel, Atlanta, Ga., July 27-30.

CMAA Workshop in Marketing Management, Executive Park Motel, Atlanta, Ga., July 28-31.

CMAA Workshop in Outdoor Recreation Administration, Cornell University, Ithaca, N.Y., August 10-13.

Golf Course Superintendents Field Day, University of Rhode Island, Kingston, R.I., August 26.

Law and Utility Turf Field Day, University of Rhode Island, Kingston, R.I., August 27.

Michigan State University Turfgrass Field Day, Traverse City CC, Traverse City, Mich., September 9.

Third Annual Professional Golfers' Assn. West Coast Merchandise Show, Oakland-Alameda County Coliseum, Oakland, Calif., September 27-29.

Annual Hardware Show, Coliseum, New York City, October 12-15.

Central Plains Turfgrass Foundation Conference, Ramada Inn and Kansas State University, Manhattan, Kan., October 21-23.

44th Annual Club Managers Assn. of America Conference, Grosvenor House Hotel, London, Eng., January 17-24, 1971. (Registration starts two days before the conference.)

BANK BACKUP

GOLFDOM interviews two officers of Chemical Bank about banking aids to the professional and the introduction of bank credit cards in the pro shop

Wrestling with financial matters in the operation of a shop has by now become a traditional burden for the professional. Keeping a good credit rating, paying bills within the stipulated time for a discount, keeping track of accounts receivable—these are just a few of the headaches that many pros feel they must live with as long as they are in business. But for many pros there may be some relief. Banks in recent years have broadened the scope of their services, and it is worth the professional's time to consult with his bank on aids which may be suited to his needs.

Realizing the possibilities of banking aids for the pro, GOLFDOM interviewed Thomas McCullough, vice president, Chemical Bank, and A.V. Canino, assistant vice president, Chemical Bank. Both were well received at a recent educational forum of the Professional Golfers' Assn. Metropolitan Section.

GOLFDOM: *In general, what are some of the banking services available to the professional to aid him in keeping his finances in order?*

McCullough: One thing that comes most immediately to mind, outside of normal checking accounts, is the overdraft banking plan offered by a number of banks. Ours is called Privilege Checking. Basically, it is an arrangement whereby the checking account becomes a loan account if you write a check that overdraws your account. The bank sets a limit on the account, which might be \$5,000, \$10,000 or perhaps \$15,000. I think this would be useful to the professional if he wanted to buy some merchandise and didn't have enough money in his account to cover it. He would write the check to pay for the merchandise, and the check would be good. Also the professional would not lose out on the supplier's discount for payment

within a stipulated time period.

The professional then would have the merchandise in his shop, and with part of the proceeds from his sales, repay the loan.

GOLFDOM: *What would this service cost the professional?*

McCullough: I believe the cost is usually 1 per cent a month on the balance outstanding. This isn't much more than any other type of financing—it would have the same rate on it. However, with a regular loan, he has the inconvenience of going to the bank and arranging for the loan. For instance, the traditional loan is a 90-day note whereby the pro goes to his bank and explains that he needs a certain amount of money for a period of time. The bank approves and they agree on what collateral he leaves with the bank—either stock exchange collateral or perhaps a savings passbook. The loan could

be unsecured too, of course. The pro executes the note, leaves it with the bank and they pay the money into his checking account. After the lapse of 90 days, the bank expects him to repay the full loan. Now if the merchant had occasion to repay the loan before the 90 days, he would pay the money to his bank and go in and explain that he was repaying the loan before the 90 days had expired, and they would probably re-compute the interest and charge him, let's say, for 40 days instead of 90.

The Privilege Checking type of loan is all automatic. He's arranged it beforehand and he has the freedom to purchase merchandise on the spot.

Canino: With a bank credit card relationship, such as Master Charge, I think the probability of the professional's having to borrow would be cut down considerably. When he makes a credit card sale,

