The Changing Outlook for Private and Tax Exempt Status

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PRIVATE AND TAX EXEMPT STATUS

- A private club is like a train
  - That train must run on a track
  - The track must have two rails
  - Our two rails are:
    - Private Status, and
    - Tax Exempt Status
- If either rail fails, then the club fails
- Thus, we must protect both to keep the train going...
PRIVATE STATUS

- The 1st Amendment protects our right of freedom of association
  - We also have the right *not* to associate as we so choose
  - Federal laws were passed to make sure that right was not abused in a public setting or “place of public accommodation”
    - Civil Rights Act of 1964 – Titles II and VII prohibit different treatment of people in public places and by employers of employees
    - The Americans with Disabilities Act – Titles I and III prohibit different treatment of those with disabilities in employment situations and in public places
  - State anti-discrimination laws were passed, too, and they are based on the Civil Rights Act language
- However, private clubs are specifically excluded from them because we are not “public places”
  - Thus, private clubs may treat people differently because we function in a private and not public setting
THE SUPREME COURT & PRIVATE CLUBS

- Naturally, federal and state courts are very protective of civil rights – for good reason
  - Indeed, no one should be treated differently in a public setting simply because he is part of a protected class of individuals or has an immutable characteristic – race, color, gender, religion, or national origin and sexual orientation is making its way into that grouping, too

- As such, courts scrutinize whether a club has done what it needs to do to be seen as truly private
  - The Supreme Court had to balance the need to protect our First Amendment right with the need to ensure equal treatment of all individuals
  - Thus, the question of whether the club is a public or private entity becomes extremely important
Two seminal case by the U.S. Supreme Court helped define what is not a truly private club

- Board of Directors of Rotary International v. Rotary Club of Duarte (1987)

The Court made clear that these two entities were not truly private

- They have no genuine selectivity in membership
- They did not limit the size of club membership
- They did not limit participation by nonmembers
- They allowed advertising of membership openings and club events
- They used the clubs for business purposes by members
THE SUPREME COURT & PRIVATE CLUBS

Knowing what a club cannot do has allowed us to know what we must do to protect our private status

A club must ensure that it:
- Has a plan or purpose of exclusiveness
- Has an extremely selective membership practice
- Limits access to the facilities to members only
- Is organized around the social interests of its members and not around business interests
- Does not advertise
- Is controlled by its members
- Is a non-profit organization (may be tax exempt or taxable)
Cautionary Case Law

- Arizona Platinum club
  - Discrimination suit filed by female member because of the men’s only grill
  - The findings of fact showed:
    - Club failed to follow a selective and exclusive membership process
    - Club hosted and catered numerous social events for nonmembers
    - Nonmember events were advertised to the public on the internet, etc.

- Long Island country club
  - Discrimination suit filed by member who didn’t like the membership policy
  - The findings of fact showed:
    - Nonmembers regularly used the golf and tennis facilities as well as the pro shop and paid for those services
    - Club hosted and catered numerous social events for nonmembers and some events furthered trade and business activities, not social ones
CAUTIONARY CASE LAW

- Washington State country club
  - Discrimination suit filed by four female members who didn’t like the club’s tee time policy and men’s only grill
  - The findings of fact showed:
    - The club conducted membership open houses, distributed membership flyers in targeted neighborhoods, mailed membership applications to those who inquired and handed applications to those who stopped by the club or the pro shop
    - Nonmembers regularly used the facilities with no member present or acting as sponsor – local university golf teams on corp. membership
    - The pro shop was open to nonmembers use
    - Club hosted and catered numerous social events for nonmembers, including events for high schools, weddings, businesses and other private organizations
The claim in each case was filed under the state’s civil rights act

- On its face, the clubs did discriminate – a “men’s only” grill, a religious-based membership policy and “men’s only” tee times
- However, those state laws specifically exempt truly private clubs
  - Thus, we can’t be sued under these laws and the case must be dismissed
  - But, such a lawsuit can be successful if the club is NOT truly private

Remember, a discrimination claim can only succeed if it’s filed against a public entity – not a private one

- Some people, even some of your members, may confuse selectivity by the club as discrimination – that is where the lawsuit starts
- Our exemption from these laws protects us from those discrimination lawsuits
What it **should not** include:

- “The club provides a pristine setting for your wedding ceremony or reception. Our stunning ballroom and breathtaking view of the golf course offers the perfect location for your special day. Located just minutes from the interstate, our venue is perfectly centralized to accommodate you and your guests. *Plus, membership is not required to host an event at our beautiful club!*

- “If you would like more information on membership or would like to set up a tour of the club, please fill out an inquiry form or you may contact us. We can also mail you a packet of all membership information prior to your tour, so we can answer any questions that you may have!”

What it **should** include:

- [www.thelacc.org](http://www.thelacc.org)
- [www.stlouiscountryclub.org](http://www.stlouiscountryclub.org)
- [www.wfgc.org](http://www.wfgc.org)
Are you a private club?
- A public golf course must admit everyone
- Do you admit every candidate?
  - Do you want to admit the son of Bernie Madoff?
  - Do you want to admit Henry Gates, Jr.?
- Are you a women’s or men’s only club or do you have gender specific areas in your club?
  - What if someone alleges you turned him/her down because of race, color, religion, gender or sexual orientation?
- Clubs treat people differently and we have been given the right to do so - protect that right

If you don’t follow the factors outlined, you jeopardize your rights and the exemptions you are provided
- New ADA regulations do not apply to truly private clubs
**Why Private Status Matters**

- Without your private status, you may not pick and choose whom you allow in the door – men’s or women’s clubs are gone
  - Civil rights violation otherwise

- Without your private status, you lose the right to determine your own internal policies
  - Federal and state laws dictate

- Without your private status, you lose what makes a private club unique
  - Members pay an initiation fee to belong because they are part of something different by choice – it is their second home
  - The club becomes a second home your members no longer control if you lose your private status
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Tax–Exempt Status

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TAX INFORMATION

Social Club--Tax-Exempt

Section 501(c)(7) of the Internal Revenue Code provides an exemption from income taxation for social clubs provided:

- The club is organized for pleasure, recreation, and other non-profitable purposes;

- Substantially all of its activities are for the aforementioned purposes; and

- No part of the club’s earnings may inure to benefit of a private shareholder.
In the *Portland Golf Club v. Commissioner* case (110 S. Ct. 2780 (1990)), the Court stated that “the tax-exempt status [of a social club] provides that members of social clubs are in substantially the same position as if individual members had spent his or her after-tax income on pleasure or recreation. Social clubs are exempted from tax not as a mean of conferring tax advantages but as a means of ensuring that members are not subject to tax disadvantages as a consequence of their decision to pool their resources for the purchase of a social or recreational services.”
Are Social Club’s Really Tax-Exempt?

- Social clubs are not as tax-exempt as other exempt organizations, such as soup kitchens, museums, hospitals & homeless shelters.

- With respect to social clubs, the term “tax-exempt” should be approached with some caution.

- Certain activities of social clubs are subject to federal income tax.
What Is Member Income?

- Social clubs are not taxed on member income. Clubs can generate as much member income as desired without paying income tax.

- Member income includes dues, fees, charges or similar amounts paid by members of the social club as consideration for providing members and their dependents and guests with goods, facilities or services in furtherance of the exempt purpose of the social club.

- Member income does not include payments to the club by non-members. Non-member revenues are subject to unrelated business tax, with two exceptions.
TAX INFORMATION

Limitations on Non-Member & Investment Income

- Not only are “tax-exempt” social clubs subject to income tax on non-member & investment income, but social clubs are limited with respect to the amount of non-member & investment income that they may receive.

- Social clubs are allowed to receive up to 35% of their gross receipts from non-members & investment income provided that not more than 15% of the gross receipts of the club may be derived from use of club facilities or services by non-members of the club.
Limits on Non-Member and Investment Income

- Gross receipts are defined as those receipts from normal & usual activities of the club, including dues, membership fees, admissions, assessments, investment income & normal recurring capital gains from investments.

- Do revenues for the 15%/35% safe harbor purpose include initiation fees & capital assessments?

- Are unusual receipts included in the formula in determining if the social club meets the 35% test?
Reciprocal Agreements

- Certain social clubs permit members from other clubs to use their facilities pursuant to reciprocal agreements. For example, the New York Club & the Texas Club enter into a reciprocal agreement that permits members of the Texas Club to use the facilities of the New York Club, and the agreement permits members of the New York Club to utilize the facilities of the Texas Club.

- The Texas Club member who utilized the New York Club will generally make a payment to the Texas Club to be remitted to the New York Club. Is payment by such person member income to the New York Club?
MYTH & LEGEND

Employer pays = Non-member Income?

If a member’s employer pays for a function that the member hosts at his/her club, the payment by the employer is non-member income to the social club?
RESPONSE TO MYTH & LEGEND

The answer is that the employer payment may likely be member income.

- Employer payments or reimbursements are considered member income if guests were present at the club because of a direct business objective of the employee-members.

- For example, if the vice president of sales of a corporation hosts a meeting of her sales staff at her club and her employer pays the cost of the meeting, the sales staff are guests of the member because their presence is related to a direct business purpose of the employee-member. Therefore, such payment by the employer, on the member’s behalf, would be considered to be member income.

- Alternatively, what if the vice president of sales sponsored a meeting of his corporation’s board of directors at the club?
Club sets up a for-profit subsidiary in order to remove non-member revenues from the exempt organization to satisfy the 15% UBI test.

Does it work?
No, setting up a for-profit subsidiary in order to satisfy the 15% UBI test doesn’t work.

A club may not do indirectly what it cannot do directly.

The activities of the subsidiary are considered to be those of the club for the purpose of computing the 15% UBI test.
Tax-exempt social clubs are not taxed on investment income.
RESPONSE TO MYTH & LEGEND

Although investment income is generally not taxable to most other tax-exempt organizations, investment income earned by a social club is generally subject to federal income taxation.
MYTH & LEGEND

- Tax-exempt social clubs are always taxed on their investment income.
No, tax-exempt social clubs are not always taxed on their investment income.

Investment income, which is set aside to be used exclusively for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children & animals, is excluded from the definition of unrelated business income and, therefore, is not subject to taxation.
The gain on the sale of club property is always subject to federal income tax.
**RESPONSE TO MYTH & LEGEND**

- **No**—not if the club has the right fact pattern.

- If property used directly in the performance of the exempt function of a social club is sold by the club and, within a period beginning one year before the date of such sale and ending three years after the date of such sale, other property is purchased and used by the social club directly in the performance of the club’s exempt function, gain from such sale shall be recognized only to the extent that the club’s sale price of the old property exceeds the club’s cost of purchasing the other property.
Social clubs may engage in non-traditional activities.
A social club is not absolutely prohibited from participating in non-traditional activities.

As a general matter, a tax-exempt social club may receive an insubstantial amount of income from non-traditional activities.
TAX INFORMATION

- Non Traditional Activities
  - Baked goods
  - Holiday sales
  - Food to go

- The tax-exempt social club that participated in these activities lost its tax-exempt status.
TAX INFORMATION

Non Traditional Activities

- Revenue for non-traditional activities is treated as unrelated business income and is subject to taxation.

- Club can received an insubstantial amount of revenues from non-traditional activities.
  
  - Less than 5% of gross receipts—generally fine.
  
  - More than 5% of gross receipts—tax exempt status is at risk.
MYTH & LEGEND

- Accepting corporate checks for payments of member charges creates UBI.

- True or False
False

Accepting corporate checks could result in a challenge to the clubs “private status,”-a non-tax issue.
Advertising

A tax-exempt 501(c)(7) private club can advertise all it wants.
Advertising for members is not addressed under the federal tax law.

Advertising for the use of facilities for events such as golf outings, weddings, etc.—Proceed with Caution.
**Advertising Regulation**

- Treasury Regulation 26 CFR 1.501(c)(7)-1(b)

- A club which engages in business, such as making its social and recreational facilities available to the general public...is not organized and operated...for pleasure, recreation, and other non-profitable purposes, and is not exempt under section 501(a).

- Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated...for pleasure, recreation, or social purposes....
NOT-FOR-PROFIT TAXABLE STATUS

- IRC Section 337
- IRC Section 277
In a July 24, 2009 letter, IRS advised club that it could not “merely stop being exempt”

“exemption based upon a voluntary application”

“1) dissolve and dispose of {its} assets as required by law or 2) activities change and exempt functions are no longer conducted and a revocation process is completed through an examination”
THANK YOU FOR JOINING US!

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