

EXPERTS' CORNER

Q I heard that the club's tax-exemption is at risk because it permits nonmember events (such as a wedding or golf outing) to be held at the club. Why didn't your firm tell us?

A The club's tax-exemption is not at risk provided that the club acted within the applicable federal tax law. For this answer, we refer to S. Rept. No. 94-1318 (1976), 1976-2 C.B. 597, which provides that "[s]ocial clubs are permitted to receive up to 35 percent of their gross receipts from nonmembers and investment income provided that not more than 15 percent of the gross receipts may be derived from the use of club facilities or services by nonmembers of the club."

Simply stated, we disagree that a club, which makes its social and recreational facilities available to nonmembers, is necessarily jeopardizing its tax-exempt status. Our view, which is consistent with the federal tax law, is that, if the club's revenues exceed the 15/35 percent safe harbor amounts with respect to its nonmember revenue (as defined), the club's tax-exempt status may be at risk. If the club exceeds the 15/35 percent safe harbor amounts, then a facts and circumstance analysis is applied to determine if substantially all of the club's activities are related to its exempt purpose.

Q Will advertising for nonmember use of the club's facilities result in the club losing its tax-exempt status? Our website has a banquet section!

A The rules with respect to club advertising are often misunderstood, in large part, because the oft-cited treasury regulation has not been revised to incorporate changes that have occurred to the federal tax law, including among others, PL 94-568 (see generally, S. Rept. No. 94-1318 (1976)). Treas. Reg. 1.501(c)(7)-1(b) provides, in part, that 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 exclusively for pleasure, recreation or social purposes. In considering the regulatory language with respect to advertising, it should be noted that, because of PL 94-568, the present statutory language for exemption only requires that a club be operated substantially, and not exclusively, for pleasure, recreation or social purposes, and such change

should be considered with respect to the application of Treas. Reg. 1.501(c)(7)-1(b)). Furthermore, advertising is not per se prohibited by Treas. Reg. 1.501(c)(7)-1(b)).

The club may want to consider the following:

- Remove the banquet page;
- Move the banquet page to the members only section of the website, if available; or
- If removal or movement of the banquet page is not practical, it may be prudent to note "The Privileges of Membership" on the banquet page; therefore, the website reader is on notice that the banquet facilities are for members only.

... we are not proponents of advertising for other reasons and would be concerned if the club's unrelated business income was in the upper third of the safe-harbor amount. As we have repeatedly advised our clients ... "Proceed with Caution."

If the club's unrelated business income is more than 15 percent, advertising is problematic; but, if the club's unrelated business income is less than the aforementioned 15 percent safe-harbor, advertising does not, on its face, seem problematic under the federal tax law. That being said, we are not proponents of advertising for other reasons and would be concerned if the club's unrelated business income was in the upper third of the safe-harbor amount. As we have repeatedly advised our clients with respect to advertising, "Proceed with Caution."

Editor's Note: While advertising and its impact on tax-exempt status are discussed in the article, clubs should also look at the requirements to maintain private status, too.



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