G. SOCIAL CLUBS - IRC 501(c)(7)

by
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1. Introduction

Social clubs are organized for pleasure, recreation and other nonprofitable purposes for the benefit of their members. These organizations were granted exemption in 1916 by Congress under a predecessor of IRC 501(c)(7) mainly because securing returns from social clubs was a source of expense and annoyance that resulted in collection of little or no tax, rather than because of any presumed beneficial purposes.

The tax treatment of social clubs is designed to allow individuals to join together to provide themselves with recreational or social facilities on a mutual basis without tax consequences. It operates properly only when the club's sources of income are limited to its membership, so the member is in substantially the same position as if he or she had spent his or her after-tax income on pleasure or recreation without the intervening organization.

A social club's exemption does not operate properly when it receives income from sources outside its membership, because the members will receive a benefit not contemplated by the statute in that untaxed dollars are used by the organization to provide pleasure or recreation to its membership. To prevent club members from receiving benefits not contemplated by IRC 501(c)(7), the receipt of nonmember income and investment income is permitted up to certain limits without jeopardizing exemption, but the net income from these sources is made taxable to the clubs by IRC 512(a)(3).

Examples of taxable income include investment income or income generated from nonmembers through traditional activities- i.e., those activities that if conducted with members further a social purpose.

Income from activities that do not further a club's exempt purpose - i.e., income from nontraditional activities - will also be taxable to the social club, and may affect exemption, unless the activity is insubstantial in comparison to all of the club's activities.

This article will analyze the current Service position as to the exemption of

social clubs. Areas that will be discussed within this article include the amount of nontraditional income that a social club may receive without jeopardizing its exempt status, record keeping requirements, and taxable activities of social clubs.

G.C.M.'s, PLR's and TAM's are cited herein for instructional purposes and may not be used or cited as precedent.

2. Nontraditional Business Activities

A. Background

Social club activities conducted with members and/or nonmembers can be categorized into two types: traditional and non-traditional. Traditional activities may be conducted with members or nonmembers, but are those types of activities that if engaged in with members further the exempt purposes of the social club. Income from traditional activities is not subject to tax if it is derived from members. Any income from traditional activities conducted with nonmembers will be considered unrelated business income and subject to tax. Examples of traditional social club activities would be the operation of a golf course or the operation of a bar or restaurant that is used by the club members, their guests, or non-members.

G.C.M. 39115 (January 12, 1984) as modified by G.C.M. 39412 (September 19, 1985) defines a nontraditional activity as a business which, if conducted on a membership basis, would not further the club's exempt purposes. An example of what the Service now considers a nontraditional business activity is discussed in Rev. Rul. 68-535, 1968-2 C.B. 219, in which liquor is sold to members for consumption off the club's premises. This activity was "neither related to nor in furtherance of the social club's exempt purposes." For a further discussion on traditional and nontraditional activities see the 1992 CPE text at page 113.

Prior to 1976, when the language of IRC 501(c)(7) was amended, social clubs were required to be organized and operated "exclusively" for pleasure, recreation, and other nonprofitable purposes, with no part of the net earnings inuring to the benefit of any private shareholder. A strict interpretation could conclude that a social club could not receive any nonmember income. The Service's position prior to 1976 was that clubs could have some nonmember income without jeopardizing their exemption if the nonmember income was within the audit standard of Rev. Proc. 71-17, 1971-1 C.B. 683, as discussed, infra. Business activities are strictly prohibited. Reg. 1.501(c)(7)-1(b) states that a club

engaging in a business is not organized and operated exclusively for nonprofitable purposes and is not exempt. However, Congress did not intend to classify traditional activities as businesses within Reg. 1.501(c)(7)-1(b). See discussion below.

IRC 501(c)(7) was amended in 1976 by Pub. L. 94-568 to allow these organizations to receive a greater amount of nonmember income without jeopardizing their exempt status. The committee reports provide that an organization described in section 501(c)(7) is permitted to receive up to 35 percent of its gross receipts from nonmember sources, including investment income, as long as the nonmember gross income does not represent more than 15 percent of total gross receipts. See S. Rep. No. 94-1318, 94th Cong., 2d Sess. 4 (1976); 1976-2 C.B. 597, 599. See also H.R. Rep. No. 94-1353, 94th Cong. 2d. Sess. 4 (1976). Where the permitted levels of nonmember source income are exceeded, all facts and circumstances will be taken into account in determining whether the social club continues to qualify for exempt status. Thus the 15% and 35% rules are essentially safe-harbors. See the 1982 CPE text at page 41 for a discussion of the facts and circumstances test.

The Committee Reports make it clear that clubs are permitted to derive income from nonmember sources. In determining the source of the nonmember income, the Committee Report's definition of "gross receipts" provides some guidance. Gross receipts are defined as "...those receipts from normal and usual activities of the club (that is, those activities they have traditionally conducted), including charges, admissions, membership fees, dues, assessments, investment income (dividends, rents and similar receipts), and normal recurring capital gains on investments, but excluding initiation fees and capital contributions." The Committee Reports further state that social clubs should not be able to receive within the 15 or 35 percent allowances income from the active conduct of businesses not traditionally carried on by social clubs, which is inconsistent with Reg. 1.501(c)(7)-1(b). Thus, it could be argued that social clubs could lose their exemption if any nonmember income is derived from nontraditional activities as the 15 to 35 percent limitations apply solely to traditional activities and investment income.

B. Nontraditional Activities - What Amount Is Permissible?

From the changes in section 501(c)(7) mandated by Public Law 94-568 in 1976, it could be interpreted that social clubs are strictly prohibited from conducting nontraditional business activities. Rev. Rul. 58-589, 1958-2 C.B. 266,

states that a business activity will defeat exemption, unless it is incidental, trivial or nonrecurrent. In a recent letter ruling discussed below, the Service has interpreted incidental, trivial or nonrecurrent to mean insubstantial for this purpose.

Court cases and service rulings have not set out a test to determine whether a club has conducted an insubstantial amount of nontraditional business activities. The initial point of analysis is to determine the percentage of gross receipts (sales, gross admissions) from the nontraditional business activities and compare the amount with the gross receipts of all of the organization's activities.

In 1976, Congress, in amending IRC 501(c)(7), presumably took into account the opinion in Santa Barbara Club v. Commissioner, 68 T.C. 200 (1974). In that case, the Tax Court had to determine whether a social club's status as a tax-exempt organization under IRC 501(c)(7) could be revoked because the club sold liquor to its members for consumption away from the club's premises. The liquor sales were conducted for over 40 years. In determining whether the activity was substantial, the Tax Court based its decision on the amount of gross receipts generated from the liquor sales, which was in excess of 25% of gross receipts from all sources, and the profit generated from the liquor sales, which amounted to 7% of all gross profit. Thus, the Tax Court held that the organization was not exempt because the activity did not further any social club purposes, was recurrent, and the gross receipts were in excess of 25% of total gross receipts.

In G.C.M. 39115 (July 21, 1983) as modified by G.C.M. 39412 (September 19, 1985), a club conducted various nontraditional activities that amounted to 13.7% of the club's total gross receipts. The G.C.M. concludes that any gross receipts from a nontraditional business would require revocation, but as a practical matter it may be administratively appropriate in some cases to allow insubstantial amounts of such income; Counsel suggested, however, that no fixed standard as to the measure of insubstantial be adopted in order to preserve administrative flexibility to consider all the surrounding facts and circumstances on a case by case basis.

Chief Counsel recommended in this situation that the organization's exemption should be revoked based upon conducting nontraditional activities to more than an insubstantial extent. Chief Counsel based its decision upon the volume of gross receipts generated from the nontraditional activities conducted by the organization.

In TAM 92-12-002 (Dec. 4. 1991), the social club under examination was selling various food products to its members. The sales were for off-premises consumption. Over a five year period, the percentage of off-premises sales increased from 4.28 percent of gross revenue to 6.07 percent of gross revenue.

The Service ruled that the off-premises food sales were a nontraditional activity because this was a service to members that is neither related to nor in furtherance of the club's exempt purpose. Furthermore, the activity was not insubstantial, trivial or nonrecurrent because it was a regularly carried on activity with increasing gross receipts. Thus the organization's exemption was revoked due to the conduct of substantial nontraditional business activities.

In a recent case, the Service had to decide whether a social club's operation of a take-out food and catering service for off-premises use for its members was considered a non-traditional activity that would warrant revocation of exemption under section 501(c)(7). The catered events and take-out sales amounted to 4.69% of the Club's gross receipts for the first year in question and 3.9% for the second year in question.

The Service's position was that these activities were recurring nontraditional business activities since they were neither related to nor in furtherance of the club's exempt purposes. Income from these activities was not derived from the use of the club's facilities or in connection with club activities within the meaning of Reg. 1.501(c)(7)-1.

In determining whether revocation of exempt status was warranted, the Service looked at the total amount of gross receipts generated from these nontraditional business activities in comparison to total gross receipts and ruled that the gross receipts generated from these nontraditional business activities were insubstantial and did not warrant revocation.

In conclusion, an organization may conduct an insubstantial amount of nontraditional activities. In determining whether the nontraditional activities are insubstantial, the organization should look at its gross receipts for the years in question, and determine the percentage of gross receipts generated in comparison to its total activities. If the percentage of gross receipts is less than 5%, the organization's nontraditional activities would normally be insubstantial and not affect exemption. If the gross receipts for the years in question are increasing and are more than 5%, then the organization's exemption may be affected based upon the activity becoming a substantial activity not in furtherance of the organization's

exempt purpose.

3. Recordkeeping Requirements/Rev. Proc. 71-17

Social clubs receive income from their members for various social and recreational services. Fees received by the club from its members for these purposes will be considered "exempt function income" pursuant to IRC 512(a)(3)(B) and not taxed under IRC 512(a)(1), because the fees are derived from members in payment for activities that further a social club's exempt purposes.

Prior to IRC 501(c)(7) being amended in 1976, Rev. Proc. 71-17, 1971-1 C.B. 683, provided guidelines to determine the permissible limits of nonmember income. The standard relied upon was whether gross receipts from nonmembers exceeded $2,500 or were more than 5% of total gross receipts. Due to IRC 501(c)(7) being amended in 1976 by Pub. L. 94-568, the 5% standard as to nonmember income from active traditional sources has been effectively increased to 15%. The assumptions listed in Rev. Proc. 71-17 as to whether an activity generates member or nonmember income are still applicable.

A. Definition of General Public

Rev. Proc 71-17 provides guidelines for determining the effect gross receipts derived from the use of a club's facilities by the general public will have on an organization's exemption under IRC 501(c)(7). Rev. Proc. 71-17 defines "general public" for this purpose as persons other than members of a club or their dependents or guests. A member's spouse is treated as a member.

The issue in G.C.M. 39343 (March 1, 1985) concerned whether the treatment of income derived by a social club from members of a like club pursuant to a reciprocal agreement should be treated as nonmember income. Prior to the issuance of Rev. Proc. 71-17, Rev. Proc. 64-36, 1964-2 C.B. 962, provided guidelines concerning the effect on a social club's exempt status of providing use of its facilities by the general public. Excluded from the definition of general public in Rev. Proc. 64-36 were visiting members of exempt clubs of like nature, such as country clubs or yacht clubs, who use club facilities under reciprocal arrangements. Rev. Proc 71-17 did not address the treatment of income received by reciprocal arrangements.

In making its decision, Chief Counsel referred to Rev. Rul. 79-145, 1979-1 C.B. 380, which concerned reciprocal arrangements. Rev. Rul. 79-145 interprets

the application of IRC 4421 to a wagering pool conducted by a social club described in IRC 501(c)(7). Rev. Rul. 79-145 distinguishes a guest from a nonmember as follows:

> A guest of a nonprofit social club is an individual who is a guest of a member of the club and who ordinarily does not reimburse the member for the guest's expenses. On the other hand, amounts paid to a social club by visiting members of another social club are amounts paid by nonmembers, even though both clubs are of like nature and the amounts are paid for goods, facilities or services provided by such social club under a reciprocal arrangement with such other social club.

Thus Chief Counsel's position is to treat income derived by a social club pursuant to a reciprocal arrangement with another social club, even one of like nature, as income from nonmembers as provided by Rev. Rul. 79-145, rather than income from guests.

B. Assumptions Concerning Nonmember Use of Club Facilities

Section 3 of Rev. Proc. 71-17 provides a set of assumptions as to the status of nonmembers using club facilities. If nonmember use can be classified into one of the assumptions listed in Rev. Proc. 71-17, then the income derived from these individuals will be income from "guests" and treated as if from members and classified as exempt function income under IRC 512(a)(3)(B). Clubs are required to provide detailed records of nonmember use to substantiate the assumptions.

The first two assumptions presume nonmembers are guests of members: (1) where a group of eight or fewer individuals, at least one of whom is a member, use club facilities, provided payment is received by the club directly from the member or the member's employer, and (2) where 75% or more of a group using club facilities are members, provided payment for the club use is to be received directly from one or more members or member's employer.

The third assumption provides that payment made by a member's employer will be presumed to be for a use that serves a direct business objective of the employee-member. This assumption would apply when an employer pays for an employee's membership in a club as provided in Rev. Rul. 74-168, 1974-1 C.B. 136. G.C.M. 39773 (January 23, 1989) concerned whether payments by an employer to clubs on behalf of former employees were considered exempt function

income. Chief Counsel stated that the employer-employee relationship should include former employees because the payments made by the employer serve a direct personal and social benefit of the retiree-members. The payments by the employer are not made for purposes unrelated to the activities of the retiree-members. Thus payments made by an employer to a social club on behalf of former employees would be considered exempt function income.

The fourth assumption provides that in all other situations a host-guest relationship is not assumed, but must be substantiated. As to these situations, the club must provide records about each use and the income derived from each use.

Section 4 of Revenue Procedure 71-17 concerns the records that a social club must maintain with respect to the assumptions listed in section 3. With respect to the assumption of how to treat a group of eight or fewer individuals, the club must maintain records that substantiate that the group had eight or fewer individuals, and one individual within the group was a club member. The club must keep records showing payments received were directly from its members or the member's employer. The club is under no obligation to inquire about reimbursement where the member pays the club directly.

With respect to the assumption in which seventy-five percent of the group are club members, the club must maintain adequate records to substantiate that 75 percent or more of the persons in the group were, in fact, members of the club at the time of such use. The club needs to show that payment received was directly from its members or their employers. The club is under no obligation to inquire about reimbursement where the member pays the club directly.

With respect to all other situations, the club must maintain books and records of each use, even if the member pays for such use. The club's records must include:

1. the date of the use;

2. the total number in the party;

3. the number of nonmembers in the party;

4. total charges;

5. charges attributable to nonmembers;

6. charges paid by nonmembers;

7. where a member pays charges attributable to a nonmember, a statement signed by the member indicating whether reimbursement will occur for nonmember use, and the amount of the reimbursement;

8. where a member's employer reimburses the member or makes direct payment to the club for the member's use, then the member must sign a statement indicating the employer's name; amount of the payment attributable to nonmember use; nonmember's name and business or other relationship to the member; and the business, personal or social purpose of the member served by the nonmember use. If a large group of nonmembers are involved and readily identifiable as a particular class of individuals, the member may record such class, rather than all of the names;

9. where a nonmember, other than the member's employer, makes payment to the club or reimburses a member and a claim is made that the amount was paid gratuitously for the benefit of a member, a member must sign a statement indicating the donor's name and relationship to the member, and contain information to substantiate the gratuitous nature of the payment or reimbursement.

What happens to a social club if it does not maintain adequate records? Will all income received be considered gross receipts from nonmembers, which may have the result of putting the club over the 15% or 35% test, thus jeopardizing its exempt status?

Section 4.04 of Rev. Proc. 71-17 states that the club will be precluded from using the minimum gross receipts standard and audit assumptions if adequate records are not kept. Reg. 1.6001-1(c) of the Regulations provides that every exempt organization must keep such permanent books of account or records as are sufficient to show specifically the items of gross income, receipts and disbursements. The burden is on the club to maintain adequate records, and the failure to maintain records of nonmember use could result in the club losing its exemption, because it could not distinguish between receipt of member and

nonmember income.

4. Unrelated Income of Social Clubs - How To Treat It

A. Introduction

The unrelated business taxable income of social clubs is not calculated in the same manner as that of most other exempt organizations. The difference in calculating unrelated business taxable income for social clubs is that passive income (dividends, rents and interest) is taxable, and a social club is not entitled to calculate its unrelated business taxable income with all modifications listed in IRC 512(b).

IRC 512(a)(3)(A) defines unrelated business taxable income for social clubs as all gross income that is not exempt function income as defined in IRC 512(a)(3)(B). This section will discuss whether advertising expenses can be allocated to advertising income under Reg. 1.512(a)-1(f), the tax consequences of a club holding a non-recurring event on its premises, and whether the gain from the sale of land held for exempt purposes can be excluded under IRC 512(a)(3)(D) due to the 11th Circuit's decision in Atlanta Athletic Club v. Commissioner, 980 F.2d 1409 (11th Cir. 1993).

B. Allocation of Advertising Expense

Many social clubs distribute publications to their members. Within these publications, clubs sell advertising space to help defray publishing costs. Nonmember advertising income is unrelated business income under IRC 512(a)(3)(A) because it is not exempt function income. The issue whether a social club may offset its advertising income with excess readership costs as provided in Reg. 1.512(a)-(1)(f) was recently considered by the National Office, but has not yet been numbered as a private letter ruling as of this writing.

The advertising regulations under Reg. 1.512(a)-1(f) apply to organizations calculating their unrelated business taxable income from the sale of advertising under IRC 512(a)(1). However, these regulations do not apply to social clubs when they receive advertising income from nonmembers. Social clubs calculate their taxable income in such a way that deductions are limited to those that are directly connected with the production of gross income, including advertising income. It is not possible for social clubs to reduce advertising income by deducting excess readership costs. Thus advertising income would be considered

unrelated business taxable income, less the expenses directly connected to the production of that income.

In its ruling request, the club argued that not permitting it to use excess readership costs artificially creates positive taxable income, when in fact the organization creates no income. However, if the publication taken as a whole loses money, but a profit is being made on the advertising sales, then clearly activities for members (the editorial content of the publication) are being subsidized by untaxed payments from nonmembers, which is contrary to the legislative intent as previously discussed.

A social club's tax exemption has the practical effect of allowing the individuals comprising their membership to join together to provide themselves with recreational or social facilities without further tax consequences, when the club's income is limited to membership receipts. The exemption of social clubs is based on the logic of allowing members to pool their funds for recreational purposes rather than by any public benefit conferred by social clubs.

When the 1969 Tax Reform Act extended the unrelated business income tax to social clubs, Congress decided, by the enactment of IRC 512(a)(3), that social clubs, unlike other exempt organizations, should be taxed on their passive income. Untaxed income from any nonmember source operates to subsidize the recreational facilities or activities of the members. Therefore there is no basis for the advertising regulations under Reg. 1.512(a)-1(f) to be applied to calculations under IRC 512(a)(3), as doing so would be contrary to Congressional intent.

C. Sale of Assets/Atlanta Athletic

A social club selling property is not entitled to exclude any gain from its sale under IRC 512(b)(5), because UBI calculated under IRC 512(a)(3)(A) for social clubs is not computed with the IRC 512(b)(5) modification.

However, social clubs selling property at a gain may be entitled to nonrecognition of some or all gain under IRC 512(a)(3)(D), which provides for a social club not to recognize gain on property it sells, if the property sold was used directly in the performance of its exempt function, and it purchases and directly uses other property in performance of its exempt function. A club will be able to utilize the nonrecognition of gain provision if it purchases new property within a four year period, which begins one year before the date of the sale of the old property, and ends three years after the date of sale of the old property. No gain is

recognized by the social club if the sales price of the old property is equal to or less than the sales price of the new property. Gain, if any, is recognized by the social club to the extent the sales price of the old property exceeds the cost of purchasing the new property.

The Committee Reports indicate that IRC 512(a)(3)(D) was intended to be similar to the IRC 1034 treatment of a taxpayer who sells or exchanges his residence. Congress's reason for adopting IRC 512(a)(3)(D) was that the organization is not withdrawing the gains for the members' benefit, but is reinvesting funds formerly used for the benefit of its members in other types of assets that will be used for the same purposes. S. Rep. No. 91-552, 91st Cong. 1st Sess. 72-73 (1969). The Committee Report's example of property subject to the nonrecognition of gain provisions of IRC 512(a)(3)(D) was a social club selling its clubhouse and using the proceeds to build or purchase a larger clubhouse.

The primary issue that has arisen when social clubs sell property has been whether the property sold was used directly in performance of their exempt function. In Atlanta Athletic Club v. Commissioner, T.C. Memo 1991-83 (1991), the club owned a parcel of land across the street from its main facilities. The club sold this land and reinvested the proceeds in exempt function property. The property sold had a slag road for member and guest parking. A pine-bark jogging track was also built on the property but later abandoned because of drainage problems. Other than mowing the grass, the club made no efforts to improve this property for recreational uses. The club did not report unrelated business income tax from the sale of this land, asserting the applicability of the nonrecognition of gain rule of IRC 512(a)(3)(D).

Club members testified that the property was the site of a number of activities over the years including such intermittent activities as pasture parties, Easter egg hunts, fishing tournaments, kite flying contests, hot air balloon rides and organized foot races. Members jogged on the property, used it for archery practice and flew model airplanes. Some of these activities were mentioned in newsletters.

The Service argued that gain will be excluded under IRC 512(a)(3)(D) on property that is in actual, direct, recreational use. The Service noted that intentions to use property for social or recreational purposes are irrelevant for purposes of IRC 512(a)(3)(D). The Service applied the direct use standard to Atlanta Athletic Club and declared that the club did not clearly establish that the property was in actual, direct, continuous and regular use in furtherance of its exempt purposes.

The Tax Court discounted the member testimony and agreed with the Service determination that the Club had not adequately proved that the property was used directly in furtherance of exempt purposes.

Atlanta Athletic Club appealed the Tax Court ruling to the Court of Appeals for the 11th Circuit. The club argued that the gain qualifies for nonrecognition under IRC 512(a)(3)(D), because the club used the property for its members' recreation.

The Service argued that the Tax Court was correct to conclude that the Club failed to establish that the property was used directly in the performance of its exempt function. The Service argued that "used directly" should be equated with the use of certain social club assets, such as a clubhouse, tennis court, swimming pool or golf course. These specific club assets form an integral part of a club's exempt function. Looking over a twenty year period that the Club owned the property, the Service asserted that incidental use over short periods of time was insufficient under the terms of the statute to permit nonrecognition of gain. The Service contended that the Tax Court's finding that the direct use requirement of the statute was not met in this case must be sustained as not clearly erroneous.

The Eleventh Circuit saw things differently than the Tax Court. The Eleventh Circuit saw nothing in the record to contradict the Club's evidence that the property was used for recreational purposes. The Court held that by discounting the club's testimony, the Tax Court mistakenly determined that no club activities occurred on the land.

The Eleventh Circuit disagreed with equating direct use with dominant use or requiring that direct use have either continuity or regularity. The Court stated IRC 512(a)(3)(D) does not qualify the concept of direct use to require that the use be dominant. Thus direct use is determined by looking at the activities or lack of activities that took place on the property and determining whether these activities constitute recreational uses by the Club.

The effect of the Eleventh Circuit's opinion is to expand the meaning of "used directly" in IRC 512(a)(3)(D). To benefit from this nonrecognition provision, organizations must keep records that provide details concerning the use of the property to prove that the property sold furthered their exempt purposes. As of this writing, the Service has not issued an action on decision in Atlanta Athletic.

D. One-time Events

Many social clubs hold events on their premises, such as golf tournaments. Golf tournaments will attract a large number of spectators and country clubs will derive a large amount of gross receipts from nonmembers that includes parking, admission fees, and sales of food and beverages. What is the effect of a social club holding these events?

A club holding a yearly golf tournament could put its exemption into jeopardy, because the gross receipts received could exceed the 15 percent limitation as stated above. What if a social club holds a tournament on its premises that is a non-recurring event (held every 10 years)? Service position is to not include the income generated from nonmembers into the 15% calculation, as the Committee Reports behind Public Law 94-568 indicate that Congress did not intend to include unusual amounts of income within the non-member gross receipts calculation. The club will still have to pay unrelated business income tax on this nonmember income.

5. Conclusion

If a social club is conducting nontraditional activities, it may be putting its exemption into jeopardy if it is deriving more than an insubstantial amount of gross receipts from these activities. Comparison of the gross receipts from the nontraditional activity with total gross receipts for each year should be made. If the percentage of gross receipts from nontraditional activities is less than 5% of total gross receipts, then the nontraditional activities will be considered insubstantial and exemption will not be affected. All gross receipts from nontraditional activities will be subject to tax and included within the 15% limitation, if they are derived from nonmembers. If the organization's receipts from nontraditional activities are below 5%, but are increasing, the organization's exemption may be put into jeopardy.

If a club does not maintain adequate records of nonmember use, then income may be considered nonmember income and the organization's exemption may be jeopardized, if that income pushes the club's non-member income level above the 15% or 35% tests.

In determining whether the nonrecognition provision of IRC 512(a)(3)(D) is applicable to a social club, the organization needs to substantiate that the property was used for social or recreational purposes. The use has to be more than an intention to use the property for social purposes, but need not be a dominant,

continuous use. The Service will closely scrutinize sales of property held for recreational purposes by analyzing the facts of each situation to determine direct use. The anticipated action on decision in the Atlanta Athletic case may clarify the Service's litigating position on this issue.

The advertising regulations do not apply to organizations that calculate their UBI under IRC 512(a)(3). Thus advertising income derived from non-members will be subject to the 15% limitation.

Unusual amounts of non-member income will not be included for purposes of the 15% to 35% tests, but organizations will still have to pay tax on unusual amounts of non-member income.