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CC:TEGE:EOEG:E02
PLR-122243-04
Date: March 31, 2005
March 31, 2005

DO TY:

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Dear :

This is in reference to your letter dated March 21, 2004 requesting the following ruling:

Whether real estate commissions received by B, a wholly-owned subsidiary of A, from A's members for services provided in the sale and/or rental of A member properties constitute amounts received by A for the furnishing of goods and services to members within the meaning of section 277 of the Internal Revenue Code.

FACTS AND REPRRESENTATIONS

A is a property owners association offering tennis, a beach and a social club organized exclusively to provide services to its members for their pleasure and recreation. A does not qualify as a tax-exempt social club under section 501(c)(7) nor can it elect as a homeowners association under section 528 to file Form 1120H.

A's members own residential real property in a gated community. A currently has c members. A's main facilities are located within the gated community for the exclusive use of its members and guests.

A was created pursuant to a Declaration of Protective Covenants and Restrictions for the purpose of managing, maintaining and caring for the common areas of the planned unit development. It was created in part to own, operate, govern, administer and manage the common areas; to provide, purchase, acquire, replace, improve, maintain, and repair such buildings, structures, landscaping, paving and equipment both real and personal, related to health, safety and social welfare of the members; and to operate, without profit, for the sole and exclusive benefit of its members.

A is organized as a not-for-profit corporation and has no issued stock nor stockholders. Membership in A is derived solely from the purchase of property in the development.

A purchased B from the community developer. B is a wholly-owned subsidiary of A. B is qualified to act as a real estate broker in the state and county of A. B provides brokerage services including assisting in the leasing, sale or resale of member residences. Fees for B's services are paid for by the listing party, always a member of A. Members are not required to use B's services. All of B's transactions are with A's members. For book and tax purposes its income is consolidated with that of A.

LAW

Section 277(a) provides that in the case of a social club or other membership organization which is operated primarily to furnish services or goods to members and which is not exempt from taxation, deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members shall be allowed only to the extent of income derived during such year from members or transactions with members (including income derived during such year from institutes and trade shows which are primarily for the education of members). If for any taxable year such deductions exceed such income, the excess shall be treated as a deduction attributable to furnishing services, insurance, goods, or other items of value to members paid or incurred in the succeeding taxable year. The deductions provided by sections 243, 244, and 245 (relating to dividends received by corporations) shall not be allowed to any organization to which this section applies for the taxable year.

Section 277 narrowly defines membership income to mean only gross income derived from members or transactions with members. This interpretation is supported by the legislative history of section 277, which states that, A[b]oth the House bill and the committee=s amendments provide that in the case of a taxable membership organization the deduction for expenses incurred in supplying services, facilities or goods to the members is to be allowed only to the extent of the income received from these members.@ S. Rep. No. 552, 91st Cong., 1st Sess. 74 (1969), 1969-3 C.B. 423 at 471. The Claims Court has recognized that section 277 was designed to "thwart the possibility of shifting the costs of member services to nonmember income, that is, reducing member costs at the expense of taxable income." Landmark, Inc. v. United States, 25 Cl. Ct. 100, 108 (1992).

In Armour-Dial Men=s Club, Inc. v. Commissioner 77 T.C. 1, aff=d, 708 F.2d 1287 (7th Cir. 1983), the Tax Court recognized a three part test to determine whether section 277 applies: AIn order for ' 277 to be operative, three conditions must be satisfied. The entity must be (1) a social club, or other membership organization; (2) operated primarily to furnish services or goods to its members; and (3) nonexempt from taxation." Id. at 7.

A corporation is a separate taxable entity for federal income tax purposes if the corporation is formed for valid business purposes, and is not a sham, an agency or instrumentality. Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943); Commissioner v. Bollinger, 485 U.S. 340 (1988).

In Rev. Rul. 2002-55, 2002-2 C.B. 529, an electric cooperative wholly-owned a subsidiary that did not operate on a cooperative basis and which distributed an amount to the cooperative as a dividend. Noting the corporation was formed with a valid business purpose, Rev. Rul. 2002-55 held that under Moline Properties the subsidiary is recognized as a separate entity and the subsidiary's income is not included for purposes of determining whether the cooperative satisfies the 85 percent member income test of section 501(c)(12)(A). Because the subsidiary is not a member of the cooperative, amounts paid to the cooperative by the subsidiary are nonmember income for purposes of meeting the 85 percent member income test.

ANALYSIS

A represents that it is a membership organization that provides various services to its members. A believes that its activities in managing, maintaining and caring for the common areas of the gated community prevent A from qualifying for exemption under section 501(c)(7), based on Rev. Rul. 75-494, 1975-2 C.B. 214. A also states that it fails to meet the income requirements of section 528 and, therefore, cannot to file a Form 1120-H. A therefore states that it is a taxable membership organization subject to section 277.

Applying the reasoning of Rev. Rul. 2002-55, which relies on Moline Properties, we conclude that the amounts A receives from B are not derived from transactions with members. B is not a member of A, and the amounts it receives are not derived from A's transactions with A's members. Thus, the gross receipts of B are not receipts of A, and any payments B makes to A would be non-member income of A.

For the reasons stated above, the amounts received by A from B do not constitute income derived from members or transactions with members within the meaning of section 277.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Robin J. Ehrenberg
Senior Counsel, Exempt Organizations Branch 2,
Office of Division Counsel/Associate Chief
Counsel (Tax Exempt & Government Entities)

cc: