
IRS LTR: Support of Organization's Program Won't Affect Club's Exemption.

The IRS ruled that a social club's support of a social welfare organization established to conduct events for the club's members and the general public will not affect the club's exempt status, finding that the organization's gross receipts will not be attributed to the club and other payments will not be deemed gross receipts to the club.

Citations: LTR 201428009

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Employer Identification Number: * * *

LEGEND:

M = * * *
P = * * *
r = * * *
S = * * *

Dear * * *:

This responds to your letter dated June 24, 2011, in which you request rulings with respect to certain transactions between M and P, and their effect on M's status as an organization described in I.R.C. § 501(c)(7).

FACTS

M is organized as a not-for-profit corporation under state law. It is recognized as a social club described in § 501(c)(7). M has actively fostered interest in amateur r by organizing and conducting regional, national, and international r that were open or by invitation to both its members and nonmembers. These events were in addition to those organized solely for M's members.

P is organized as a not-for-profit corporation under state law. It is recognized as a social welfare organization described in § 501(c)(4). It was established to conduct the amateur open and by invitation r events previously conducted by M for members and nonmembers.

P has no members. Its activities are managed by a six-member board of directors. All of its directors

and officers are presently members of M, though there is no requirement that they be so. Two directors are appointed by M, while the rest are presently neither trustees nor directors of M. P's bylaws provide that a majority of P's directors must at all times consist of persons who are not concurrently either a trustee or an officer of M, and that P's president must be a director who is not concurrently a trustee or officer of M.

P will conduct those open and by invitation r agreed with M. P will utilize volunteers and contractors to conduct its events; it does not expect to have employees of its own. In carrying out its responsibilities, P will utilize certain facilities, equipment, intellectual property and website facilities made available by M without cost. M will provide office space and record storage facilities to P without cost, and P will reimburse M for services provided by M's S Office and certain administrative employees (based on an allocable share of their compensation and benefits and their time devoted to P activities). P may either pay M for catering services and accommodations (based on member pricing rates) or obtain them from third parties.

More specifically, M and P have entered into an Administration Agreement, among the provision of which are the following —

S Office Personnel. During the Term [of the Agreement] M agrees to make available to P the services of its S Office personnel . . . for use in planning and conducting [r] Events & Programs, provided that P shall reimburse M for its allocable share of the compensation and benefits provided to such personnel based on the time that such employees devote to P activities.

Administrative Services. During the Term, M agrees to provide to P such administrative services (including bookkeeping, clerical, secretarial, annual filings) relating to conducting Events & Programs and maintaining P's annual reporting requirements as P may request, and P agrees to reimburse M for its allocable share of the compensation and benefits provided to such personnel based on the time that such employees devote to P activities.

Insurance. During the Term, M agrees to include P as a named insured under its current personal injury and property damage insurance coverage so as to cover P's activities in conducting its Events & Programs. P agrees to reimburse M for P's allocable share of the premiums for such coverage as determined by the insurer(s), provided that M may in its discretion waive all or part of such reimbursement. P shall obtain, at its own cost, directors and officers liability insurance for P's directors and officers at the same level as that provided currently by M to its trustees and officers.

M and P maintain separate books and records on which their respective revenues and disbursements are recorded. They also maintain separate bank accounts into which their respective revenues are deposited and from which their respective expenses are paid. For accounting purposes, they will have separate audited financial statements, and they will file separate annual information returns on Form 990.
For accounting and Form 990 reporting purposes, M does not include P's allocable share of the compensation and benefits provided to S Office and administrative personnel or P's allocable share of insurance premiums in expenses when paid by M. Rather, such amounts are recorded as advances to P. Conversely, M does not include reimbursements by P in revenue, but, instead, records them as the payment of an advance.

RULINGS REQUESTED

M has requested the following rulings:

1. The gross receipts of P will not be attributed to M for purposes of determining M's compliance

with the 15 percent limit on nonmember gross receipts under § 501(c)(7).

2. Payments made by P to M to reimburse M for shared services of S Office and certain administrative personnel, and for personal injury and property damage insurance coverage, will be regarded as reimbursements for advances made for the benefit of P and will not be deemed to be nonmember gross receipts to M.

3. M's exemption under § 501(c)(7) will not be adversely affected by its support of P's r program.

LAW

I.R.C. § 501(a) exempts from federal income taxation organizations described in § 501(c).

I.R.C. § 501(c)(7) describes clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Treas. Reg. § 1.501(c)(7)-1(a) provides that the exemption provided by § 501(a) for organizations described in § 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

Treas. Reg. § 1.501(c)(7)-1(b) provides that a club which engages in business, such as making its social and recreational facilities available to the general public, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under § 501(a).

In Moline Properties v. Comm'r, 319 U.S. 436 (1943), the Supreme Court said that "[t]he doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of a business activity or is followed by the carrying on of business by the corporation, the corporate remains a separate taxable entity. . . . In general, in matters relating to the revenue, the corporate form may be disregarded where it is a sham or unreal. Id. at 438-39. In response to the argument that the corporation was a mere agent of its sole stockholder, the Court said that "the mere fact of the existence of a corporation with one or several stockholders, regardless of the corporation's business activities, does not make the corporation the agent of its stockholders.

In National Carbide Corp. v. Comm'r, 336 U.S. 422, 437 (1949), the Supreme Court said that a finding of a "true agency" relationship turns on several factors. "Whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money received to the principal, and whether receipt of income is attributable to the services of employees of the principal and to assets belong to the principal are some of the relevant considerations in determining whether a true agency exists. If the corporation is a true agent, its relations with the principal must not be dependent upon the fact that it is owned by the principal, if such is the case. Its business purposes must be the carrying on of the normal duties of an agent."

In Krivo Indus. Supply Co. v. Nat'l Distillers & Chem. Corp., 483 F.2d 1098 (5th Cir. 1973) the court examined the "instrumentality doctrine," which allows the separate legal existence of a corporation

to be disregarded when that corporation is a mere instrumentality of a dominant entity. Specifically, the court was called upon to determine whether a creditor corporation should be held liable for debts of its borrower, where the financial circumstances of the borrower put the creditor in a position to exert substantial influence over the operations of the borrower. Id. at 1101. The corporate form is not lightly disregarded; however, a subservient corporation's separate existence may be disregarded if the subservient corporation exists to further the purposes of the parent/dominant corporation and the subservient corporation has no separate, independent existence of its own. Id. at 1102. Direct and actual operative control of the subservient corporation is required to apply the instrumentality doctrine. The court will look past stock ownership to the specific facts to determine whether the dominant entity, in fact, possessed full control over the subservient corporation and whether, through its manipulation of the subservient corporation, a third party was harmed. Id. at 1104. The court held that the "absence of an independent corporate purpose is most apparent in those cases in which the dominant corporation, to further its own corporate purposes, either organized or acquired the subservient corporation." Id. at 1105. The court found that the creditor lacked the level of control over the borrower for the instrumentality doctrine to apply. Id. at 1114.

In United States v. Fort Worth Club of Fort Worth, Texas, 345 F.2d 52, (5th Cir. 1965), a § 501(c)(7) social club, through its wholly owned subsidiary, owned a 13 story building. The building was used in part by the club, and the remainder of the building was rented to commercial tenants. Each month, the subsidiary corporation turned over its income less expenses to the club. The club deposited these funds in its general bank account and drew on this account to pay expenses. The court held that the club was not organized and operated exclusively for social purposes, because, through a wholly owned subsidiary, the club was in the business of leasing office space to the public. The court said that the social club was attempting to accomplish indirectly what it could not accomplish directly — to derive income from dealings with the general public.

Rev. Rul. 68-74, 1968-1 C.B. 267, concerns a social club that operates as a nonprofit corporation to promote yachting and other activities for the pleasure and recreation of its members. In addition to a clubhouse, the club owns yachting facilities, including a marina for the mooring and servicing of boats. The club formed a wholly owned stock corporation to which it leases its marina facilities for a rental that is based on the value of the facilities so leased. The subsidiary corporation operates the marina as a business for profit, and pays Federal income taxes on its earnings. Facilities in excess of membership usage are offered to the general public at the same rental as that paid by club members. The ruling states that the club, as sole owner of the subsidiary and the leased facilities, is entitled to receive all profits of the subsidiary and all rental payments for the facilities. To the extent that the subsidiary's profits and rental payments result from the business done with the general public, (1) nonmember income inures to the members of the club within the meaning of § 501(c)(7), and (2) the club is not supported solely by membership fees, dues, and assessments within the meaning of § 1.501(c)(7)-1. Accordingly, the ruling holds that the activities and operations of the wholly owned subsidiary are considered to be those of the club for purposes of determining whether the club is engaging in business with the general public for profit. The ruling cites United States v. Fort Worth Club for the proposition that social clubs claiming exemption under § 501(c)(7) may not do indirectly what they cannot do directly. A club may not insulate itself from the effects of business activities carried on with the general public for profit by forming a subsidiary corporation to carry out those activities.

In Rev. Rul. 84-138, 1984-2 C.B. 123, the taxpayer, a management investment company that elected to be taxed as a regulated investment company under subchapter M (§§ 851-855), established S, a wholly-owned subsidiary, to operate as a small business investment company under the Small Business Act of 1958. S also elected to be taxed as a regulated investment company under

subchapter M. Because the taxpayer and S use the same facilities and some of the same personnel, it was agreed that taxpayer would pay all the expenses for general and administrative overhead, including personnel costs. S agreed to reimburse the taxpayer for its pro rata share of these expenses on an arms-length basis. The taxpayer was not engaged in the business of receiving compensation for services of the type that were reimbursed. The reimbursements were not included in gross income and no deduction was taken by the taxpayer for S's share of the expenses. The Service found that the amounts taxpayer received as reimbursement for paying S's general and administrative overhead expenses, including personnel costs, represented advancements made on behalf of S. Citing Rev. Rul. 80-348 (holding that amounts paid by a labor union to reimburse delegates from local chapters for expenses of traveling from home to attend a convention are not includible in gross income if the delegates have a right or expectation of reimbursement), the Service ruled that the amounts received in reimbursement for advances are not includible in gross income under § 61(a).

ANALYSIS

Issue 1: Whether the gross receipts of P would be attributed to M for purposes of determining M's tax-exempt status under § 501(c)(7).

Under the "separate-identity principle" annunciated in Moline Properties, Inc. v. Comm'r, the activities of a subsidiary will not be attributed to its parent unless (1) the subsidiary lacks a business purpose, or (2) the subsidiary is merely an arm or an agent of the parent. Aside from the fact that P is not a subsidiary of M, P was organized and is operated for the valid business purpose of conducting r events for M's members and for the general public, thus satisfying the first prong.

P also satisfies the second prong. Under the holding in National Carbide Corp. v. Comm'r, the finding of a true agency relationship turns on factors such as whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money received to the principal, and whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal. P is a separately incorporated entity. P operates under its own name and for its own account, not under the name or for the account of M. P's board of directors is not controlled by M, and M is not involved in the day-to-day management of P. P cannot bind M by its actions. P does not transmit the money it receives to M, except to reimburse M for certain administrative, insurance, and catering expenses. Although P will utilize some employees and assets of M under the Administrative Agreement, P will utilize volunteers and contractors to conduct the r events. And unlike the situation described in Krivo Indus. Supply Co., M does not have the direct and actual operative control of P that is required to apply the instrumentality doctrine. Therefore, under the separate-identity principle of Moline Properties v. Comm'r, the activities of P should not be attributed to M.

Nevertheless, United States v. Fort Worth Club of Fort Worth, Texas and Rev. Rul. 68-74 appear to hold that the activities and operations of a wholly-owned subsidiary could be considered those of its § 501(c)(7) parent for purposes of determining whether the parent is engaging in a business with the general public for profit for purposes of § 1.501(c)(7)-1(b), regardless of whether the subsidiary has a valid business purpose and is not a merely an arm, agent, or instrumentality of its parent. P, however, is not a wholly-owned subsidiary of M. Its bylaws provide that a majority of its directors must at all times consist of persons who are not concurrently either a trustee or an officer of M, and that P's President must be a director who is not concurrently a trustee or officer of M.

Consequently, we hold that the gross receipts of P would not be attributed to M for purposes of determining the percentage of M's gross receipts that M receives from sources outside its membership or that are derived from the use of M's facilities or services by the general public.

Issue 2: Whether the payments made by P to M under the Administration Agreement to reimburse M for shared services of M's S Office and certain administrative personnel, and for P's allocable share of the premiums for personal injury and property damage insurance coverage, would be deemed to be nonmember gross receipts to M.

"Gross receipts" for purposes of determining tax-exempt status of § 501(c)(7) organizations are the income from a club's usual activities, and include admissions, membership fees, dues, assessments, investment income, and normal recurring capital gains on investments. While M will receive amounts from P in reimbursement for the expense of providing P with the services of its S Office and certain administrative personnel, and for the cost of personal injury and property damage insurance coverage allocable to P's r Events & Programs, such amounts cannot be considered income from M's usual activities. M is not engaged in the business of rendering the services of its S Office and administrative personnel, or of providing personal injury and property damage insurance coverage, to others for profit. Under the reasoning of Rev. Rul. 84-138, amounts paid by M for these expenses represent advancements made on behalf of P, and amounts received in reimbursement for such advancements are not gross income. Reflecting this reasoning, M does not include these amounts in revenue for accounting or Form 990 reporting purposes. Consequently, since the amounts are not "income" and are not derived from M's usual activities, they do not constitute gross receipts for purposes of determining M's tax-exempt status under § 501(c)(7).

Issue 3: Whether M's exemption under § 501(c)(7) would be adversely affected by its support of P's r program.

M will support P's r program by allowing P to use a portion of its facilities, equipment, and intellectual property without charge. As explained in Issue 2, above, M will also make available to P its S Office and administrative personnel in return for reimbursement.

When Congress amended § 501(c)(7) in 1976, it made clear that a social club should not lose its tax-exempt status if it receives no more than 35 percent of its gross receipts from sources outside its membership and, within that 35-percent amount, if no more than 15 percent of its gross receipts is derived from the use of its facilities or services by the general public. See S. Rep. No. 94-1318, at 4 (1976), reprinted in 1976 U.S.C.C.A.N. 6051, 6054.

You have asked us to assume that, for purposes of this ruling, such payments as M will receive from P (except those amounts received as reimbursement under the Administration Agreement), together with other nonmember payments, will make up no more than 15 percent of your total gross receipts. In Issue 1, above, we determined that the activities of P will not be attributed to M. Furthermore, in Issue 2, above, we determined that payments received from P under the Administration Agreement will not be considered gross receipts of M for purposes of determining M's exempt status under § 501(c)(7). Therefore, under these circumstances, we conclude that M's exemption under § 501(c)(7) will not be adversely affected by its support of P's r program.

CONCLUSION

In light of the foregoing, we rule as follows:

1. The gross receipts of P will not be attributed to M for purposes of determining M's tax-exempt status under § 501(c)(7).

2. The payments made by P to M under the Administration Agreement to reimburse M for shared services of M's S Office and certain administrative personnel, and for P's allocable share of the premiums for personal injury and property damage insurance coverage, will not be deemed to be

gross receipts to M for purposes of determining M's tax-exempt status under § 501(c)(7).

3. M's exemption under § 501(c)(7) will not be adversely affected by its support of P's r program.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Steven B. Grodnitzky
Manager, Exempt Organizations
Technical Group 1
Enclosure
Notice 437