NATIONAL CLUB ASSOCIATION
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January 30, 2017

Internal Revenue Service
Tax Exempt and Government Entities (TE/GE)
1111 Constitution Ave., NW
Washington, DC
Via email: IIR@IRS.gov

Re: Industry Issue Resolution (IIR) Program-Section 501(c)(7) Social Clubs with Section 501(c)(3) Affiliates

Dear Sir or Madam:

The National Club Association ("NCA"), a Section 501(c)(6) trade association,[1] is the largest trade association representing the private social club industry. NCA has been in existence for more than 55 years and acts as the voice of the private social club industry in Washington DC. It assists member clubs with issues that affect them the most: taxation and public accommodation legislation, balancing the need for privacy with the realities of outside business, and assisting its member clubs with other issues that can affect the private club industry's future.

ISSUE

This NCA submission is tendered to the IRS Tax Exempt and Government Entities (TE/GE) Division for consideration of pre-filing guidance under the IRS Industry Issue Resolution ("IIR") Program. The issue for which the NCA seeks IRS pre-filing guidance, pursuant to Rev. Proc. 2016-19, is whether, and under what facts and circumstances, a Section 501(c)(3) affiliated foundation of a Section 501(c)(7) social club may provide funding for the Section 501(c)(7) club's physical fitness facilities and health and wellness programs without running afoul of the prohibition on impermissible private benefit applicable to a Section 501(c)(3) exempt organization under Treas. Reg. Sec. 1.501(c)(3)-1(c), (d)(1).

Rev. Proc. 2016-19 Compliance

As set forth in Rev. Proc. 2016-19, the IRS has announced that issues most appropriate for IIR pre-filing guidance will have two (2) or more of the following characteristics:

(1) The proper tax treatment of a common factual situation is uncertain;
(2) The uncertainty results in frequent, and often repetitive, examinations of the same issue;

[1] All section references, unless otherwise noted, are to the Internal Revenue Code of 1986, as amended.

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(3) Frequent, and often repetitive, examinations require significant resources from both the IRS and impacted entities;
(4) The issue is significant and impacts a large number of entities;
(5) The issue requires extensive factual development; and
(6) Collaboration would facilitate proper resolution of the tax issues by promoting an understanding of entities' views and business practices.

For reasons discussed below, the NCA submits that the above private benefit issue currently or potentially possesses all of the above characteristics, and is therefore eminently suitable for IIR Program consideration by TE/GE.

BACKGROUND

NCA represents more than 600 private clubs in the United States, and also has a number of associate members that service the private club industry. Of its 600 member clubs more than four hundred (400) are Section 501(c)(7) social clubs, with the balance being for-profit, taxable entities. Many Section 501(c)(7) social clubs have established, or are considering establishing, Section 501(c)(3) tax exempt affiliated foundations to pursue charitable and educational activities to complement the social purposes of their respective clubs. These existing Section 501(c)(3) affiliated foundations are Section 509(a)(1) public charities, and help to fund community service and educational programs undertaken by their affiliated club, such as supporting the development of library and art collections, historic preservation of club buildings, and providing club employees and underprivileged members of the local community scholarship programs. The support for these Section 501(c)(3) affiliated club foundations is provided by the general public, with club members generally being the largest contributors by number and dollar contributions.

One recent trend in both Section 501(c)(7) social clubs and their Section 501(c)(3) affiliated foundations reflects the national concern about obesity and the emphasis on physical fitness, health and well-being. The clubs' desire is to provide health and wellness training to individuals, both for club members and for some of the community groups that they support. Various IRS revenue rulings have consistently held that promotion of community health is deemed a charitable activity for Section 501(c)(3) purposes, and expenditures to promote such health and well-being will not violate the private benefit prohibition, even if not all members of the community are benefitted, provided that the class of persons benefitted is not unduly small.

ILLUSTRATIVE FACTS AND CIRCUMSTANCES

The following scenarios illustrate some, but not all, of the various facts and circumstances in which a Section 501(c)(7) social club and its Section 501(c)(3) affiliated foundation either have supported physical fitness, health and wellness programs

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and facilities, or wish to do so. In each of these scenarios assume the club is a Section 501(c)(7) social club, and its affiliated nonprofit foundation is a Section 501(c)(3)/509(a)(1) public charity ("Foundation").

Scenario 1

A Foundation is established by a yacht club to support and develop amateur sailors for national and international competition. The Foundation also supports sailing instruction for disadvantaged youth who are not club members, but reside in the club's local community. The Foundation proposes to purchase additional sailboats to use in its program. The boats will also be available on a regular basis for the disadvantaged youth program at the club.

Scenario 2

A Foundation established by a city club to provide funding for the club's library and for other charitable and educational purposes would like to use some of its funds to support the athletic facilities and health, wellness and physical fitness programs at the club. The club does not restrict membership on the basis of race, religion, color, creed, sex, or national origin. The Foundation has recently received a grant from another unrelated Section 501(c)(3) exempt organization to establish an athletic fund to be used exclusively for athletic facilities, health and wellness, and physical fitness programs. The dollar amount to be contributed annually by the Foundation to the club for use on club physical fitness facilities and health and wellness, and physical fitness programs would be a de minimis amount (about 1 %) of the annual gross revenues of the club. In addition, the club's squash courts are made available on a regular basis to a local Section 501(c)(3) exempt organization so that underprivileged youths in the inner city may learn the game under club supervision. The club pool is also made available on a regular basis to disadvantaged youth in the inner city for swimming and lifesaving instruction.

Scenario 3

A Foundation established by a country club plans to contribute funding to a golf practice facility being constructed by the club for use by members. The facility will also be made available to local high school golf teams for practice on a regular basis.

Scenario 4

A country club is located in a gated community. The community is composed of members and nonmembers of the club. The Foundation formed by the club wants to establish a health and wellness program that will be made available to all members of the community, regardless of whether they belong to the club.

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DISCUSSION

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax of corporations organized and operated exclusively for charitable, scientific, or educational purposes, provided no part of the corporation's net earnings inures to the benefit of any private shareholder or individual. To be exempt as an organization described in Section 501(c)(3), an organization must be both organized and operated exclusively for exempt purposes. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

An organization will be regarded as operating exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in Section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

An organization does not exist exclusively for any of the purposes specified in Section 501(c)(3) unless it serves public rather than private interests. Treas. Reg. Sec. 1.501(c)(3)-1(c), (d)(1). To meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as, among others, the creator of the organization. If an organization serves a public interest and also serves a private interest, other than "incidentally," it is not entitled to exemption under Section 501(c)(3).

The word "incidental" has both qualitative and quantitative connotations. In the qualitative sense, to be incidental an organization must show that the benefit to the public cannot be achieved without necessarily benefiting the individual or group of individuals. In the quantitative sense, to be incidental the benefit to the private interests must not be substantial. *See* G.C.M. 39862 (12/2/91); *American Campaign Academy*, 92 T.C. 1053 (1989).

The IRS has issued guidance in a variety of contexts as to whether a Section 501(c)(3) exempt organization has conferred an impermissible private benefit on an individual or entity. As stated above, the IRS looks at the totality of the facts and circumstances in conducting a qualitative and quantitative analysis to determine whether an impermissible private benefit has been provided.

Promotion of community health is deemed a charitable activity for Section 501(c)(3) purposes, and will not violate the private benefit prohibition even if not all members of the community are benefitted, provided that the class of persons benefitted is not unduly small. See Rev. Rul. 69-545. See also Rev. Rul. 77-68; Rev. Rul. 79-360.

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For example, in Rev. Rul. 75-196, a nonprofit organization operating a law library in a building owned by the Section 501(c)(6) local bar association was held to qualify as a Section 501(c)(3) exempt organization. Rev. Rul. 75-196 held that the limitation of the use of the library to members of the bar, judges and local law professors does not confer an impermissible private benefit where the class of persons benefitted is sufficiently broad to warrant the conclusion that the library is serving a public interest.

There appears, however, no precedent directly on point with respect to the IRS position on private benefit involving a Section 501(c)(3) foundation providing funding (for any purpose) to an affiliated Section 501(c)(7) social club. However, there is a series of IRS pronouncements indicating a long and vacillating IRS struggle with the issue of funding for libraries and study rooms provided by Section 501(c)(3) foundations to affiliated Section 501(c)(7) fraternities.

In GCM 35897 (7/15/74), the IRS National Office considered whether to grant the IRS field office request to revoke a 1940 IRS National Office decision approving a Section 501(c)(3) foundation to build, equip, and maintain libraries and reading rooms in an affiliated Section 501(c)(7) fraternity. Citing Rev. Rul. 56-304 approving the grant of academic scholarships by a Section 501(c)(3) exempt organization to members of the affiliated Section 501(c)(7) fraternity, the IRS National Office concluded that the Section 501(c)(3) foundation, by equipping fraternity library/reading rooms, was similarly providing educational assistance to a charitable class of individuals. Such assistance therefore served a public interest of advancing education, and only incidentally advanced the nonexempt purposes of the fraternity. Accordingly, the IRS declined to grant the IRS field office request, and the fraternity foundation was therefore entitled to retain its Section 501(c)(3) exempt status.

In GCM 39612 (3/23/87), the IRS considered four national fraternity Section 501(c)(3) foundations which wished to make grants to their respective local Section 501(c)(7) fraternities for libraries and study rooms. The issue was whether funding such libraries and study rooms would further the Section 501(c)(3) foundations' exempt purposes, or result primarily in a private (and impermissible) benefit to fraternity members. Acknowledging that on virtually identical facts in GCM 39288 (9/20/84) the IRS National Office had found that such funding resulted primarily in an impermissible private benefit, the IRS National Office herein considered "additional evidence" that the funding would help alleviate overcrowding in university libraries and study areas. Based on supporting letters from the universities in question, the IRS National Office concluded that the class of persons benefitted was sufficiently broad (*i.e.*, the whole university community) as to warrant the conclusion that the Section 501(c)(3) foundations did not violate the private benefit test in funding the Section 501(c)(7) fraternities. GCM 39288 was therefore deemed overly broad and modified to avoid the interpretation that it enunciated a *per se* rule of private benefit in those circumstances.

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In Zeta Beta Tau Fraternity v. Comm 87 T.C. 421 (1986), the issue was whether the Zeta Beta Tau fraternity, a Section 501(c)(7) exempt social club subject to UBIT, was also a Section 501(c)(10) fraternal society exempt from UBIT. In its findings of fact the Tax Court noted that the ZBT Foundation and another related Section 501(c)(3) exempt organization (NPEF Foundation) provided fellowship grants, research and publication programs and fraternity house libraries to Zeta Beta Tau chapters, and observed that such affiliated foundations were recognized by the IRS as entitled to Section 501(c)(3) exempt status.

In determining whether the private benefit test is violated, the NCA submits there is no material difference between a section 501(c)(3) exempt organization funding Section 501(c)(7) fraternity libraries and study rooms to further the accepted charitable purpose of education than funding a Section 501(c)(7) club's fitness facility, health and wellness, or physical fitness programs to further the accepted charitable purpose of community physical fitness and health. In the above four scenarios, the Foundations have been in existence and have performed many other accepted charitable and educational activities. The current national emphasis on curbing obesity by expanding health and wellness, and physical fitness, programs have prompted NCA member clubs to expand their scope of charitable activities. In all cases, the amounts planned to be spent by the Foundations on physical facilities, and health, wellness and physical fitness of their affiliated clubs is de minimis in relation to the budgets of the clubs as a whole. The facilities and programs are also generally made available to guests of the members who would not necessarily have access to similar programs.

CONCLUSION

Since the above private benefit issue has not been addressed in the context of Section 501(c)(7) social clubs with affiliated Section 501(c)(3) exempt organizations funding club health and wellness programs, and physical fitness facilities, we believe that the issue is appropriate for pre-filing guidance under the IIR program and is consistent with Rev. Proc. 2016-19.

We would be happy to discuss the issues in more detail with you at your earliest convenience. Please contact Kevin Reilly at (703) 385-8809 or kreilly@pbmares.com with any questions or comments.

Sincerely,

Henry Wallmeyer
President and CEO
National Club Association

Kevin Reilly JD, CPA, CGMA
Treasurer
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