

Reviewing Reciprocal Agreements

--James J. Reilly

Certain social clubs permit members from other clubs to use their facilities pursuant to reciprocal agreements. For example, a New York club and a Massachusetts club enter into a reciprocal agreement that permits members of the Massachusetts club to use the facilities of the New York club when members of the Massachusetts club are in New York, and the agreement permits members of the New York club to utilize the facilities of the Massachusetts club when members of the New York club are in Massachusetts. The New York club and the Massachusetts club are clubs of a like nature.

The Massachusetts club member who utilizes the New York club will generally make a payment to the Massachusetts club to be remitted to the New York club. Is the payment by the person treated as member income to the New York club?

No. In a revenue ruling issued in 1979, the Internal Revenue Service advised that income derived by a tax-exempt social club pursuant to a reciprocal agreement with a club of like nature is income from nonmembers.

Regarding reciprocal agreements or working arrangements between clubs and the production of unrelated business income to the host club, it is the position of the IRS that under the Internal Revenue Code, amounts paid to a social club by visiting members of another social club are amounts paid by nonmembers, even though both clubs are similar in nature, and the amounts paid are for goods, facilities or services provided by one social club under a reciprocal agreement with another social club. The use of a section 501(c)(7) social club's facilities by members of another club under a reciprocal agreement or working arrangement subjects the host club of unrelated business income tax.

A private letter ruling issued in 1979 containing advice regarding treatment of reciprocal income seems to be counter-intuitive because the fact pattern deals exclusively with bona fide members of tax-exempt social clubs of like nature who have entered into an agreement to provide social and recreational activities or services to their members while in different jurisdictions. Isn't such an agreement consistent with the rationale for tax-exempt status?

It is interesting to note that in 1964 the IRS took a different view. The IRS formerly took the view that persons making payments under a reciprocal arrangement would be treated as "bona fide guests" by the host club, but as exhibited by the 1979 rulings, the IRS revised its position. The IRS view has remained unchanged since 1979. Reciprocal income is treated as nonmember income that is subject to the unrelated business income tax. Be careful; it is not necessarily common sense that rules. A club takes a position contrary to the IRS at its own risk!

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