No Third Party Contact
512.09-03

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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date:
APR 26 1999

Contact Person:

ID Number:

Telephone Number:

OP:E:EO:T:4

EIN:
Key District: Ohio (Cincinnati)

Dear Sir or Madam:

We are responding to your letter dated , as modified and supplemented by subsequent correspondence, in which you requested a ruling regarding the income tax consequences attendant to the sale of certain real property. You have specifically inquired as to whether, under section 512(a)(3)(D) of the Internal Revenue Code, gain shall be recognized as a result of the sale of such property, where the proceeds from the sale will be used to improve your golf course.

You are exempt from federal income tax under section 501(a) of the Code as a social club described in section 501(c)(7). You consist of 274.85 acres, which was purchased more than 40 years ago. Located on this property is a clubhouse, an 18 hole golf course, a swimming pool, tennis courts, a driving range, a water basin, grass growings for lawn replacement, tree and shrubbery plantings, and equipment storage and maintenance buildings.

During the current year you intend to sell a parcel of real property, approximately 6.75 acres, to an unrelated third party. You state that this parcel of land has been used for many years in the following ways:

1. As a water basin to supply your water irrigation system, which is necessary for the proper maintenance of the golf course;

2. For the sheltering of foxes, which keep the geese population at a minimum;

3. For the storing of new trees and shrubbery for landscaping purposes; and,

4. As a "buffer zone" in order to buffer the noise of the adjoining interstate highway.

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You have also stated that the area adjacent to and easterly of a proposed subdivision line is the 6th hole of your golf course. Because the 6th hole is a dog leg left, the natural flight of a tee shot is a draw, which results in many golf balls landing on a portion of the parcel in question. Because of the topography of the property, club members constantly walk upon that portion of the parcel in order to retrieve their errant tee shots. This portion of the parcel used by the members during the playing of golf is not considered "out of bounds" and constitutes 2.5 acres out of the parcel's total 6.75 acres.

Within the period of time referred to in section 512(a)(3)(D) of the Code, you intend to reinvest all of the proceeds from the sale of the parcel for improvements to the golf course. You have no future plans to sell any more of your real property.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of, among others, organizations described in section 501(c)(7) of the Code.

Section 512(a)(3)(A) of the Code provides, in part, that in the case of organizations described in section 501(c)(7), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less allowable deductions, both computed in accordance with certain modifications contained in section 512(b).

Section 512(a)(3)(D) of the Code provides that if a section 501(c)(7) organization sells property used directly in the performance of its exempt function, and within a period beginning one year before the date of such sale and ending three years after such date, other property is purchased and used by such organization directly in the performance of its exempt function, gain (if any) from such sale shall be recognized only to the extent that such organization's sales price of the old property exceeds the organization's cost of purchasing the other property.

The Senate Finance Committee Report provides an example of a sale and purchase where application of section 512(a)(3)(D) of the Code would be considered appropriate. S. Rept. 91-552, 1969-3 C.B. 423, 471:

> "...where a social club sells its clubhouse and uses the entire proceeds to build or purchase a larger clubhouse, the gain on the sale will not be taxed if the proceeds are reinvested in the new clubhouse within three years."

In Framingham Country Club v. United States, 659 F. Supp. 650 (D.C. Mass. 1987), the court held that section 512(a)(3)(D) of the Code was inapplicable, and that a $50,000 option premium constituted unrelated business taxable income. The court also stated the following:

> [a]lthough the plaintiff may have purchased the original 120 acres of land with the intention of providing expanded golf facilities, the plaintiff never actually used the 60 acres in question for that purpose. The deposition of Thomas D. Burke, former Treasurer of the Club, indicates that up until January of 1986 the land "was not in use for anything" and that the Club's greens keeper lived in a house on the property. Burke Deposition, p. 43. Burke also stated that "large equipment" was stored on the land. Burke deposition, p. 43. This Court would hesitate to find, on the basis of this rather inconclusive deposition testimony, that the use of a home by the greens keeper and the storage of some "large equipment" directly facilitated the performance of the exempt function of the Club.

In Atlanta Athletic Club v. Commissioner, 980 F.2d 1409 (11th Cir. 1993), the court of appeals reversed a Tax Court ruling and held that the nonrecognition of gain provision under section 512(a)(3)(D) of the Code was available where property was used directly for recreation. The court of appeals based its decision on the uncontradicted testimony of the Club's members and employees, who recounted events such as Turkey Trot races, kite flying contests, pasture parties, fishing contests, and jogging by members, all of which took place on the property in question.

Amounts derived by a section 501(c)(7) organization from the sale of land generally constitute unrelated business taxable income within the meaning of section 512(a)(3) of the Code. However, under certain circumstances, section 512(a)(3)(D) provides for the nonrecognition of gain derived from the sale of property. If the property sold was used directly in the performance of the exempt function of the organization, the gain will not be recognized, so long as it is used to purchase other property used directly in the performance of the organization's exempt function. The legislative history of section 512(a)(3)(D) is helpful in interpreting the phase "used directly." The example cited in the Committee Report indicates that the sale of an organization's clubhouse will qualify for nonrecognition of gain, when the proceeds are used to build or purchase another clubhouse. The Committee Report states that this result is desired because the proceeds are not being withdrawn for gain by the organization.

With regard to the parcel of land you intend to sell, you have failed to show that the entire parcel was used directly in the performance of your exempt function, as required by section 512(a)(3)(D) of the Code. The use of the property as a water basin, fox shelter, landscape storage and "buffer zone" does not sufficiently establish direct exempt function use. See Framingham Country Club v. United States, supra, which reinforces the interpretation of the phrase "used directly" suggested by the legislative history of section 512(a)(3)(D). Atlanta Athletic Club v. Commissioner, supra, is distinguishable, as the kind of evidence provided in that case is not present here.

However, to the extent the parcel, or a portion thereof, was used as a part of your golf course, the direct use standard might be met. Here, although you have not shown that the entire 6.75 acres have been used as a part of your golf course, you have shown that 2.5 acres of the parcel have been used by golfers who hit errant shots and retrieve their golf balls. As the entire 6.75 acres were not used to accommodate such shots to any significant degree, an allocation between the exempt part of the property and the nonexempt part is appropriate. Club members constantly use 2.5 acres of the parcel as part of the golf course when playing from the 6th tee. The use of the 2.5 acres reflects direct use in furtherance of your exempt function as required by section 512(a)(3)(D) of the Code. As noted previously, the other 4.25 acres have not been used directly in the performance of your exempt function. You have represented that you will reinvest the proceeds from the sale of the parcel for improvements to the golf course.

Accordingly, based upon the information presented, and assuming the transaction will be conducted as proposed, we rule as follows:

1. Any gain from the sale of the 2.5 acres, as described above, will meet the requirements of the nonrecognition provision under section 512(a)(3)(D) of the Code, and thus will not be subject to the unrelated business income tax.

2. Any gain from the sale of the remaining 4.25 acres, as described above, will not meet the requirements of the nonrecognition provision under section 512(a)(3)(D) of the Code, and thus will be subject to the unrelated business income tax.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. A copy of this ruling is being forwarded to the Ohio EP/EO key district office. Any such change should be reported to the Ohio EP/EO key district office. 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 immediate questions about this letter, please feel free to contact the person whose name and telephone number are listed in the heading of this letter. All other questions should be directed to the Ohio EP/EO Customer Service office at 877-829-5500 (a toll free number) or send correspondence to Internal Revenue Service, EP/EO Customer Service, P.O. Box 2508, Cincinnati, OH 45201.

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

Sincerely yours,

Gerald V. Sack

Gerald V. Sack
Chief, Exempt Organizations
Technical Branch 4

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