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Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:CORP:02-PLR-102483-99
Date:
September 30, 1999

LEGEND:

Taxpayer =

Subsidiary =

State Z =

a =

b =

c =

d =

e =

f% =

g% =

h% =

$p =

528

$q =

$r =

$s =

$t =

Date 1 =

Date 2 =

Date 3 =

Year 1 =

Dear

This letter responds to your letter dated January 15, 1999, requesting rulings on behalf of the above referenced taxpayer. Specifically, rulings were requested regarding the federal income tax treatment of the following: (1) whether initiation fees to be received by Taxpayer from incoming Regular members will qualify as amounts received in exchange for stock under § 1032(a) of the Internal Revenue Code; (2) whether annual course improvement assessments ("ACIAs") to be received by Taxpayer from members will qualify as contributions to capital under § 118(a); and (3) whether amounts to be paid by incoming members to Taxpayer in exchange for preferred equity certificates ("PECs") will be includible in gross income under § 61. Additional information was submitted in letters dated March 17, July 8, and September 21, 1999. The material information submitted for consideration is summarized below.

Taxpayer was incorporated on Date 1 as a State Z nonprofit corporation. Taxpayer is a non-exempt organization for federal income tax purposes and is subject to § 277. Taxpayer is an accrual method taxpayer using a fiscal year ending on Date 2. Taxpayer is a membership corporation currently comprised of approximately a members. Taxpayer was organized to create and maintain a golf course and related facilities exclusively for the pleasure and recreation of its members.

Taxpayer has a wholly-owned subsidiary, Subsidiary, a State Z corporation, with which Taxpayer files a consolidated federal income tax return. Subsidiary is a for-profit corporation that hosts an annual golf tournament ("Tournament").

Incoming members presently pay an initiation fee of $p and receive a membership certificate. Incoming members are also required to purchase a PEC for $q. In addition, all members in good standing presently pay the ACIAs of $r and annual dues of $s, as well as any special assessments that Taxpayer's board of directors may levy from time to time.

Taxpayer's articles of incorporation and by-laws set forth the rights and obligations of members. Taxpayer's by-laws provide for three classes of voting memberships: (i) Founder members, limited to b persons; (ii) Charter members, limited to c persons; and (iii) Regular members, limited to d persons. The first two classes of membership are not open to new members. The general management of Taxpayer's affairs is exercised by a board of directors, which is elected by the voting members. In addition, voting members are entitled to vote on certain extraordinary matters, including whether to liquidate Taxpayer, to sell or convey real property, or to merge Taxpayer with another corporation. In an election of the board of directors or in any other matter requiring a vote by voting members, a majority vote of the members of each class, computed separately, is required.

Members in Taxpayer do not have the right to receive dividends because State Z law prohibits the payment of dividends by a nonprofit corporation. Taxpayer's articles of incorporation provide that upon the dissolution or liquidation of Taxpayer, members are entitled to receive the remaining assets in proportion to their capital contributions.

Taxpayer's by-laws provide that the interests of Regular and Charter members are generally non-transferable. The by-laws further provide that upon a Regular member's termination of membership, whether by death, resignation or expulsion, such member has the right to have his or her membership certificate redeemed by Taxpayer, provided there are d Regular members. The amount paid in redemption is calculated pursuant to a formula providing that the member is entitled to receive f% of the current initiation fee at the time of termination for each year of membership, up to a total of g%. This right is subject to a candidate for Regular membership being elected and paying the required capital contribution. A terminating Charter member is entitled to receive an amount equal to the current Regular membership initiation fee, provided there are d Regular members, and provided that a candidate for Regular membership is elected and pays the required capital contribution. The by-laws further provide that Charter members as a class have a redemption preference over terminating Regular members. A Founder membership is transferable by gift, sale, or will to a natural or adopted child, after which such membership becomes a Regular membership. If a Founder member dies or withdraws without transferring his or her membership, that member or that member's estate is entitled to receive the current Charter membership initiation fee (i.e., equal to the Regular membership initiation fee).

In Year 1, Taxpayer began to redeem the interests of former members pursuant to the above described provisions in its by-laws. Taxpayer represents that because initiation fees have risen from $t to the current $p in the years since it first opened, many former members have received a full return of their initiation fees as well as a profit pursuant to the redemption formula.

Taxpayer represents that its operating expenses are funded by the following: (1) the annual dues paid by members; (2) taxable income derived from the operation of Tournament by Subsidiary; and (3) member expenditures for food, beverages and other items purchased from Taxpayer's golf shop, and cart fees. By resolution of the board of directors dated Date 3, it is Taxpayer's policy that neither the initiation fees paid by incoming members nor the ACIAs is to be used to pay Taxpayer's operating expenses. Funds received pursuant to the ACIAs are deposited and maintained in a separate bank account, payments out of which may only be used for golf course improvements designated by Taxpayer's President. Amounts received as initiation fees are also kept in a separate bank account and are presently used only for capital improvements, to repay any indebtedness of Taxpayer, or to redeem the equity interests of retiring or deceased members.

Issue One: Initiation Fees

Section 1032(a) provides in part that no gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation.

Section 1.1032-1(a) of the Income Tax Regulations provides in part that the disposition by a corporation of shares of its own stock (including treasury stock) for money or other property does not give rise to taxable gain or deductible loss to the corporation regardless of the nature of the transaction or the facts and circumstances involved.

Courts and the Service have developed a two prong test to assess whether a corporation has received money or other property "in exchange for stock" for purposes of § 1032(a): (1) whether the transferor received a significant proprietary or equity interest in the corporation; and (2) the transferor's motive or intent for transfer of the money or other property. See Affiliated Gov't Employees' Distributing Co. v. Commissioner, 322 F.2d 872, 877 (9th Cir. 1963), cert. denied 376 U.S. 950 (1964); Rev. Rul. 81-83, 1981-1 C.B. 434.

In assessing whether membership fees received by a non-stock membership corporation qualified under § 1032(a), the court in Affiliated Gov't Employees' Distributing Co. noted initially that the determination of the federal income tax

consequences of the transaction was a matter of substance and not mere form. Id. at 877. Although the membership interests at issue bore some of the indicia of stock--such as the right to vote for management and the right to share in assets of the corporation upon dissolution–the court weighed these against a number of other factors: (1) the merchant-customer relationship that existed between the taxpayer and its members; (2) the small amount of the membership fee paid for the right to shop at the taxpayer's stores; (3) the inability of members to share in profits or potential growth of the corporation during its life; (4) refunds of the fee upon death or resignation were solely within the discretion of the Board of Directors; and (5) the non-transferability of the membership interests. Id. The court held that the fees constituted taxable income, reasoning that because members received no substantive equity rights in the taxpayer, their motivation in paying the fees was to secure the privilege of purchasing discounted goods at the taxpayer's stores. Id. at 877-78.

I. Equity Interest

Whether a transferor obtains an equity interest in a corporation is determined by examining the rights accompanying the stock received. Rev. Rul.81-83, 1981-1 C.B. 434. Where traditional stock is not present, courts and the Service apply the same substantive analysis to the membership interest received. In general, an equity interest implicates three basic rights: (1) the right to vote, and thereby to exercise control; (2) the right to participate in current earnings and accumulated surplus; and (3) the right to share in net assets on liquidation. Paulsen v. Commissioner, 469 U.S. 131, 138 (1985); Himmel v. Commissioner, 338 F.2d 815, 817 (2d Cir. 1964).

With respect to voting rights, Taxpayer's by-laws provide for three classes of voting memberships: Founders, limited to b memberships; Charter, limited to c memberships; and Regular, limited to d memberships. Upon payment of the initiation fees, incoming Regular members become entitled to vote for members of the board of directors and to vote in certain extraordinary matters (e.g., whether to liquidate the corporation, to sell or convey real property, or to merge Taxpayer with another corporation). In an election of the board or in any other matter requiring a vote by voting members, the articles of incorporation require a majority vote of the members of each class, computed separately for each class. Thus, Regular members as a class have voting power equal to that of the other two classes. The instant case is therefore distinguishable from those cases holding § 1032(a) inapplicable due to the inferior (or nonexistent) voting rights accorded a particular class. See Community T.V. Ass'n v. United States, 203 F.Supp. 270, 274-75 (D. Mont. 1962) (holding a corporation taxable on receipt of subscriptions for Class B stock where all voting rights were vested in another class of stock); University Country Club, Inc. v. Commissioner, 64 T.C. 460, 472-73 (1975) (holding that a country club's Class B stock did not represent a proprietary interest where, inter alia, holders of such stock were not provided notice of

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annual meetings, had the power to elect only 20% of the board of directors, and a 51% vote of the outstanding voting stock constituted a quorum).

The second right that is indicative of an equity interest is the right to participate in current earnings and accumulated surplus. Under State Z law, a nonprofit corporation is not permitted to pay dividends to members. Although this prohibition prevents the members from sharing in the club's assets on an annual basis, to the extent members share in Taxpayer's assets on liquidation (see infra) their ultimate equity ownership in the club's assets is unaffected. See Lake Petersburg Ass'n v. Commissioner, T.C. Memo. 1974-55. Consequently, this represents a neutral factor.

The third characteristic of an equity interest is the right to share in net assets on liquidation. Taxpayer's articles of incorporation provide that upon dissolution or liquidation, members are entitled to receive Taxpayer's remaining assets in proportion to their capital contributions. Because Regular members possess rights in liquidation that are proportionate to their capital contributions and such rights are not inferior to the rights of other classes, this represents a positive factor. Cf. University Country Club v. Commissioner, 64 T.C. at 473 (holding that amounts received by a country club for its Class B stock were paid in order to use club facilities where, inter alia, liquidation rights of Class B holders were inferior to those of Class A).

In addition to the three traditional equity characteristics discussed above, other factors are relevant to the analysis. To qualify under § 1032(a), a payment must be made as an investment in the capital of the corporation, rather than in consideration of goods or services. Affiliated Gov't Employees' Distributing Co., 322 F.2d at 877. An indication of whether a payment is for goods or services is whether the amount of the payment is directly related to the amount and number of services provided, or merely incidental thereto. Board of Trade v. Commissioner, 106 T.C. 369, 380 (1996). Taxpayer represents that approximately e Regular members, or h% (i.e., more than half), live outside of State Z and, therefore, use its facilities infrequently. Thus, there is no correlation between the amount of the initiation fees and a member's use of Taxpayer's facilities because Regular members pay the same initiation fee regardless of their proximity to Taxpayer or their actual use of the club. Cf. James Hotel Co. v. Commissioner, 325 F.2d 280, 283 (10th Cir. 1963) (holding that initiation fees represented taxable payments for services based, in part, on varying rates charged to local versus non-local members).

As an additional positive factor, we note that members presently pay significant annual dues of $s to fund Taxpayer's operating expenses. Taxpayer represents that operating expenses are also funded by Subsidiary's operation of the Tournament, member expenditures for various items from Taxpayer's golf shop, and cart fees. In addition, the sizeable amount of the initiation fees, currently $p, itself weighs against

finding a taxable payment for services: this distinguishes Taxpayer's situation from those cases in which courts have held amounts received by corporations to be taxable payments for services based, in part, on the relatively insignificant fees paid in exchange for a purported equity interest. See Affiliated Gov't Employees' Distributing Co., 322 F.2d at 877; James Hotel Co. v. Commissioner, 39 T.C. 135, 142 (1962), aff'd 325 F.2d 280 (10th Cir. 1963); see also Washington Athletic Club v. U.S., 614 F.2d 670, 675 (9th Cir. 1980) (§ 118(a) context).

Based upon the above factors and the information submitted, we conclude that a Regular member will receive a significant equity interest in Taxpayer in exchange for the payment of the initiation fee to Taxpayer.

II. Investment Motive

The second prong of the inquiry for assessing whether a payment is made "in exchange for stock" is the payor's motive or intent in transferring the money or other property. Affiliated Gov't Employees' Distributing Co., 322 F.2d at 877; Rev. Rul. 81-83, 1981-1 C.B. 434. Although no court has yet set forth a test for determining investment motive under § 1032(a), the test for investment motive developed in the context of shareholder contributions to the capital of a corporation under § 118(a) is relevant.[1] The most recent, comprehensive restatement of this test is Board of Trade v. Commissioner, 106 T.C. 369 (1996). In Board of Trade, the Tax Court identified three objective factors as relevant in determining the existence of an investment motive: (1) whether the fee is earmarked for application to a capital expenditure; (2) whether the payors are the equity owners of the corporation and the payment increases the corporation's equity capital; and (3) whether the members have the opportunity to profit from their investment. Id. at 386.

Earmarking is defined as setting aside funds for application to a capital acquisition or expenditure. Board of Trade, 106 T.C. at 386. Taxpayer represents that pursuant to a resolution of the board of directors, amounts received as initiation fees are kept in a separate bank account and are to be used only for capital improvements,

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[1] In many of the cases decided under § 1032(a), taxpayers presented alternative arguments for nonrecognition under § 118(a). See, e.g., Oakland Hills Country Club v. Commissioner, 74 T.C. 35 (1980); James Hotel Co. v. Comissioner, 39 T.C. 135 (1962), aff'd, 325 F.2d 280 (2d Cir. 1963); Affiliated Gov't Employees' Distributing Co. v. Commissioner, 37 T.C. 909 (1962), aff'd 322 F.2d 872 (9th Cir. 1963).

to repay any indebtedness of Taxpayer, or to redeem the equity interests of retiring or deceased members. This factor is therefore satisfied.

The second factor is whether the payors are the equity owners of the corporation and the equity interest of the members increased because of the contribution to the corporation. We concluded supra that the Regular memberships constitute a significant equity interest in Taxpayer. Accordingly, it follows that payment of the initiation fees by incoming Regular members increases members' equity as a whole.

The third factor is whether the payors have the opportunity to profit from their investment. As a general proposition, the ability to sell an interest in a corporation permits an equity holder to profit from any appreciation in the investment. Thus, limitations or restrictions on the power to sell or transfer an interest in a corporation weigh against finding an investment motive by the payor. See Affiliated Gov't Employees' Distributing Co. v. Commissioner, 37 T.C. 909, 918 (1962), aff'd, 322 F.2d 872 (9th Cir. 1963); see also Oakland Hills Country Club v. Commissioner, 74 T.C. 35, 43 (1980) (denying taxpayer's motion for summary judgment on § 118(a) issue where transferability of stock was restricted). Cf. Board of Trade, 106 T.C. at 390 (unrestricted transferability of membership interests was viewed as evidence that payors of transfer fees had the opportunity to profit from appreciation in their investment). In the instant case, Taxpayer's by-laws provide that the interests of Regular members are generally non-transferable. However, the redemption mechanism enables members to profit from their investment in the Club. Specifically, upon the death, resignation or expulsion of a Regular member, the member is to receive f% of the current initiation fee for each year of membership, up to g%, provided that another candidate for Regular membership is elected and has paid the required capital contribution. Because membership fees have historically risen (from $t in the early 1980s to the current $p), the value of membership has increased, thereby providing members the opportunity to profit from such increases. Provided that initiation fees continue to rise, a retiring member will receive a redemption payment greater than the initial investment. The taxpayer's situation is, therefore, distinguishable from those cases, cited supra, in which courts have found no investment motive due to the non-transferability of the equity interests involved.

Weighing the above factors and the information submitted, we conclude that (i) a Regular member will receive a significant equity interest in Taxpayer in exchange for the payment of the initiation fee to Taxpayer, and (ii) such payment will be made with an investment motive.

Issue Two: Annual Course Improvement Assessments

Section 118(a) provides that in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.

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Section 1.118-1 provides in pertinent part:

> [I]f a corporation requires additional funds for conducting its business and obtains such funds through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special account, such amounts do not constitute income, although there is no increase in the outstanding shares of stock of the corporation. In such a case the payments are in the nature of assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company. ... However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid for the purpose of inducing the taxpayer to limit production.

In United Grocers, Ltd. v. U.S., 308 F.2d 634 (9th Cir. 1962), the court held that monthly payments by members of a nonprofit retail cooperative, which provided merchandise and services to both members and nonmembers, were made as payment for reduced prices through patronage dividends paid to members. The court stated that the motive or purpose and intent in making the payment is a "dominant factor" in determining whether it was a capital contribution or a taxable payment for goods and services. Id. at 639.

In Washington Athletic Club v. U.S., 614 F.2d 670 (9th Cir. 1980), the Ninth Circuit, relying on its earlier decision in United Grocers, stated that it was unnecessary to decide whether there was a meaningful distinction between a shareholder and a member of a non-stock corporation in determining whether a payment qualifies under § 118(a). The membership fees and dues at issue in Washington Athletic Club were segregated from other funds and deposited into a capital improvement fund, all expenditures from which were used solely for capital improvements rather than operating expenses. In holding that club members could have had no investment motive for payment of the fees and dues, the court emphasized the following factors: (1) a long-term member who had paid a greater amount of dues had no greater rights on liquidation than a new member; (2) upon termination of membership, a member simply forfeited all amounts previously paid, losing any right to share in the club's assets on liquidation; and (3) membership conferred no significant rights other than the use of the club's facilities and the right to vote for the board of directors. Id. at 675. The court also noted that the earmarking of the payments for capital improvements, although relevant, was not determinative of whether the payments were capital contributions.

In Board of Trade v. Commissioner, 106 T.C. 369 (1996), the Tax Court held that transfer fees received by a futures exchange from the transferees of exchange

memberships constituted nontaxable contributions to capital within the meaning of § 118(a). The court noted that a member-owner's receipt of goods or services from the corporation does not in itself negate a contribution to capital. Id. at 379. Rather, the test is whether the payor has an investment motive in making the payment. Id. at 381. The Court then set forth a three factor test for determining the existence of an investment motive: (1) whether the fee is earmarked for application to a capital expenditure; (2) whether the payors are the equity owners of the corporation and the payment increases the corporation's equity capital; and (3) whether the members have the opportunity to profit from their investment in the corporation. Id. at 386.

Service pronouncements have also focused on the motive or purpose and intent behind a payment in assessing whether the payment constitutes a contribution to capital under § 118(a). Rev. Rul. 75-351, 1975-2 C.B. 52, involved a special assessment agreed to by the unit owner-stockholders of a condominium management corporation. The assessment was deposited into a special account and used only to replace outdoor furniture surrounding the condominium's swimming pool. In holding that the special assessment was a contribution to the capital of the condominium management corporation, the ruling stated:

> Since ownership of the taxpayer is inextricably and compulsorily tied to the acquisition and enjoyment of a unit owner's property, this enhanced value is sufficient to show the motive or purpose and intent for paying the special assessment is something other than a payment for services rendered by the taxpayer to its owner-stockholders.

Id. at 53. The ruling emphasized three factors: (1) the assessment was earmarked and segregated from other funds; (2) the assessment was pro rata on each unit owner-stockholder; and (3) replacement of the outdoor furniture added to the attractiveness or usefulness of condominium project as a whole, thereby enhancing the value of each unit owner-stockholder's property. See also Rev. Rul. 74-563, 1974-2 C.B. 38 (special assessment levied by an incorporated homeowners' association to be used only for paving a community parking area constituted a contribution to capital under § 118(a)).

In this case, the ACIAs satisfy each of the three criteria identified by the Tax Court in Board of Trade as indicating an investment motive by the payors. First, the ACIAs are earmarked for capital improvements to the golf course. Amounts received pursuant to the assessment are segregated from other funds received from members and used solely to make capital improvements. Further, Taxpayer's operating expenses and non-capital expenditure items will continue to be covered by the significant annual dues (currently $s), the operation of Tournament by Subsidiary, member purchases from the golf shop, and cart fees.

Second, payment of the ACIAs enhances the members' collective interest in Taxpayer through capital improvements to Taxpayer's primary asset, the golf course. See Board of Trade, 106 T.C. at 390 & n.22; Rev. Rul. 75-371, 1975-2 C.B. 52; Rev. Rul. 74-563, 1974-2 C.B. 38. Although each member's individual interest in Taxpayer does not directly reflect the amount of the ACIA paid by such member, member equity as a whole is increased by payment of each assessment. See Board of Trade, 106 T.C. at 390; Rev. Rul. 75-371, 1975-2 C.B. 52.

Third, members have an opportunity to profit from their investment in Taxpayer. As previously discussed, a terminating Regular member is entitled to a redemption based upon the formula set forth in the by-laws. A terminating Charter member is entitled to receive an amount equal to the current Regular membership capital contribution, and has a redemption preference over a terminating Regular member. A Founder membership is transferable by gift, sale, or will to a natural or adopted child; upon death or withdrawal of a Founder without transfer, that member or that member's estate is entitled to receive the current Charter membership surrender value (which, in turn, is equal to the current Regular membership capital contribution). Because Taxpayer's membership fees have steadily increased since its inception, many former members have received a full return of their initiation fees in addition to a profit. So long as the initiation fees continue to increase, incoming members can anticipate to profit from their investment in Taxpayer. Thus, payment of the ACIAs is an investment motivated by the expected increase in the value of membership.

Issue Three: Preferred Equity Certificates

Section 61(a) of the Code provides that gross income means all income from whatever source derived. Section 451(a) provides that the amount of any item of gross income shall be included in the gross income for the taxable year in which received, unless under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period. The Supreme Court in Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955), defined gross income as any item that increases a taxpayer's net worth. In James v. United States, 366 U.S. 213 (1961), the Supreme Court explained that, to be includible in gross income, there must be the absence of a definite, unconditional obligation to repay or return the money. Thus, the Court stated that loans are not within the realm of gross income. Normally a loan is reflected as both an asset (cash) and a liability (e.g., a note payable) on the borrower's statement of financial position. Accordingly, a loan does not increase the borrower's net worth and does not constitute gross income.

The terms of the PECs provide that amounts paid for a PEC are fully refundable upon a member's death, resignation or expulsion. Taxpayer has never offset a refund of a PEC by any outstanding obligation of a former member, nor do the terms of the

PEC provide for such an offset. Taxpayer represents, however, that if any member resigned and refused to pay an indebtedness owed to Taxpayer, it is likely that Taxpayer would withhold a portion of the amount paid for the PEC until such time as the member had satisfied its indebtedness.

It is represented that the PECs issued by Taxpayer have no indicia of capital stock such as voting rights, management participation rights, rights to share in profits, or rights to share in assets upon liquidation. Thus, the amounts received for the PECs constitute neither (1) a contribution to capital excluded from gross income by § 118(a) of the Code, nor (2) money received in exchange for stock excluded from gross income by § 1032(a). Based on the facts presented, the primary issue is whether the amounts received from members for PECs are in the nature of loans to Taxpayer or are payments for goods or services.

The Supreme Court in Commissioner v. Indianapolis Power & Light Co., 493 U.S. 203 (1990), considered whether deposits required of certain utility customers to assure payment of future bills were taxable upon receipt as advance payments to the utility. The Court stated that "in determining whether a taxpayer enjoys 'complete dominion' over a given sum, the crucial point is not whether the use of the funds is unconstrained during some interim period. The key is whether the taxpayer has some guarantee that he will be allowed to keep the money." The Court distinguished the characteristics of loans from advance payments by noting that "[f]rom the moment an advance payment is made, the seller is assured that, so long as it fulfills its contractual obligation, the money is its to keep." In Indianapolis Power, after sufficient creditworthiness was established by customers, they had the option of having the deposit refunded in full or having the funds applied to outstanding charges for electricity. However, upon payment of a deposit, a customer made no commitment to purchase electricity; thus, it could not be said that, from the moment the payment was made, the money was an advance payment for the utility to keep. Consequently, the Supreme Court held that the deposits were not taxable as advance payments for electricity.

Similarly, the amounts received by Taxpayer for PECs are not taxable upon receipt as advance payments for goods or services. The members who purchase PECs are not obligated to purchase goods or services and may demand a full refund of the amount paid for a PEC upon termination of membership. Even if Taxpayer sought to offset a departing member's obligations with the money paid for the PEC, the amounts are received with an obligation to repay. Therefore, the amounts received for PECs are not includible in Taxpayer's gross income when received.

Rev. Rul. 58-17, 1958-1 C.B. 11, supports the premise that amounts received by Taxpayer for PECs are not includible in gross income, even though the possibility for

future offset against outstanding liabilities exists. In the ruling, the owner and operator of a swimming school, in order to construct a new pool and ancillary facilities, organized a club. A precondition for joining the club was the payment of a membership fee that was refundable after five years of membership. In addition, members were required to pay annual dues. If a member became over 30 days in arrears in paying the annual dues, the club could offset the amount in arrears against the otherwise refundable membership fee. The Service held in Rev. Rul. 58-17 that only the amounts used to offset a delinquency were taxable to the club. Cf. Rev. Rul. 66-347, 1966-2 C.B. 196 (no unconditional repayment obligation upon receipt, where membership fee only refundable if member moves away from club within five years after joining).

Based on the foregoing analysis, the information submitted, and the representations made by Taxpayer, we rule as follows:

(1) The initiation fees to be received by Taxpayer from incoming Regular members will qualify as amounts received in exchange for stock of Taxpayer under § 1032(a).

(2) The ACIAs to be received by Taxpayer from members will qualify as contributions to capital under § 118(a).

(3) Amounts to be paid by incoming members to Taxpayer in exchange for PECs will not be includible in gross income in the year received.

No opinion is expressed about the tax treatment of the above transactions under other provisions of the Code and regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above rulings. In particular, no opinion is expressed under § 277, or on amounts received by Taxpayer from its members for services which Taxpayer renders to its members.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this ruling letter should be attached to the Taxpayer's federal income tax return for all years affected.

In accordance with a power of attorney currently on file with this office, a copy of this ruling is being sent to the taxpayer.

Sincerely,

Assistant Chief Counsel (Corporate)

by _____
Lewis K Brickates
Assistant to the Chief, Branch 2

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