

TAX IMPLICATIONS OF YOUR ASSOCIATION'S DUES

**Executives Association SW Regional Conference
San Francisco, California, March 25, 1995**

1. Deductions for Entertainment Expenses.

a. Expenses with respect to entertainment facilities are deductible if the expense was —

(i) Directly related to the active conduct of the taxpayer's trade or business; and

(ii) The facility is used primarily in furtherance of the taxpayer's trade or business.

Internal Revenue Code Section 274(a)(1)(A) and (C)

Note: Sub-paragraph (i) above may be satisfied if the expense incurred was directly preceding or following a substantial and bona fide business discussion, including meetings at conventions or otherwise.

b. Example: A real estate broker meets with a client in his office to discuss the listing of the client's house, and then takes the client to his private club for lunch. The monthly dues of the club would be deductible (prior to 1993) if the club was primarily used for business rather than personal entertainment, amusement or recreation.

2. Deductions for Entertainment Facilities after 1993.

a. As part of the Revenue Reconciliation Act of 1993, Congress enacted IRC Section 274(a)(3) which denies a deduction for amounts paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose.

b. Specific business expenses such as meals incurred at a club are deductible only to the extent they otherwise satisfy the standards for deductibility. After 1993, the maximum deduction for meals is 50%.

c. As written, this statute would eliminate club dues paid to any organization, whether the club was organized for business or personal reasons.

3. IRS Proposed Regulation 1.274-2(a)(2)(iii) [59 Federal Register 41414, 8/12/94].

a. In response to the outcry of civil organizations, especially the Lion's and Kiwanas International, both of which organized extensive letter-writing campaigns, the IRS issued proposed regulations that would exempt professional, civic and public service organizations. Proposed regulations do not have the force of law until they are finalized, but reflect the IRS's thinking on a matter.

b. The proposed regulations state —

Absent a showing that a principal purpose of the organization is to conduct entertainment activities for members or their guests or to provide members or their guests with access to entertainment facilities, business leagues, trade associations, chambers of commerce, boards of trade, real estate boards, professional organizations (such as bar associations and medical associations), and civic or public service organizations will not be treated as clubs organized for business, pleasure, recreation, or other social purpose.

c. This proposed exception permits the continued deduction for dues paid to these types of organizations; however, do Executives Associations fit within any of the groups described in the proposed regulations?

4. Characterizing an Executives Association.

a. In Revenue Ruling 59-391, 59 CB2 151, the IRS dealt with an association which restricted its membership to individuals, firms, associations and corporations, each of which represented a different trade, business, occupation, or profession and no one of which competed with another. The IRS found that association was organized —

- (i) for the mutual exchange of business information among its members;
- (ii) to facilitate the making of business contacts for its members;
- (iii) to encourage all types of trade expansion for the benefit of its members; and
- (iv) to encourage better business relations among its members.

b. The IRS ruled that such an association was not a business league entitled to tax-exempt status under IRC Sec. 501(c)(6), since the association's activities were not directed to the improvement of business conditions of one or more lines of business. In short, there was no charitable or tax-exempt purpose being served by the association; therefore, it was not a business league for purposes of IRC Sec. 501(c)(6).

c. Can an Executives Association be a business league for purposes of Proposed Regulation 1.274-2(a)(2)(iii), but not qualify as a tax-exempt business league under IRC Sec. 501(c)(6)? Is an Executives Association similar to any other organization described in the Proposed Regulation?

d. Groups that promote business among their members, without a civil or public service focus, are not specifically mentioned in the proposed regulations.

e. The Supreme Court in National Muffler Dealers Association, Inc. vs. United States, 440 U.S. 472 (1979), held that:

The statute's term "business league" has no well-defined meaning or common usage outside the perimeters of IRC Sec. 501(c)(6).

The Court analyzed at length the origin of the term, business league, and concluded that it meant a tax-exempt organization under IRC Sec. 501(c)(6). Since the IRS has ruled that an association strikingly similar to an Executives Association is not a business league, we would be hard-pressed to argue that Executives Associations fall within the business league exception of Prop Reg. 1.274-2(a)(2)(iii).

f. Nevertheless, an Executives Association's principal purpose is neither to conduct entertainment activities for members or their guests nor to provide members or their guests with access to entertainment facilities. Also, while it may not neatly fit within any of the specific groups enumerated, it appears that its dues should be deductible given its absence of the prohibited purpose expressed by the statute and the proposed regulation.

5. Conclusion.

There is nothing in the proposed regulation indicating that an Executives Association would be exempt from the general disallowance of the payment of dues as a business deduction, but there is plenty of room to argue that it is similar to the types of organizations that have been exempted. Therefore, the tax implications of your association's dues is unclear, and your members could take conflicting positions on this issue, depending on their risk tolerance.