Understanding Advertising: A Complex Situation for Private Clubs

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Inevitably, any downturn in the economy is met with an avalanche of new marketing ideas, each aimed at solving such puzzles as slumping new car sales, decreases in new home construction and declining retail sales activity. The club industry is no exception. As your membership director struggles to locate and “land” prospective members, your banquet coordinator laments the lack of private functions on the books for the upcoming holiday season and your board reviews the quarterly financial statements, all sorts of pressure will come to bear upon you to advertise aggressively and market, market, market! If your decisions were as simple as how much money to allocate for marketing, which glossy photo of the club to use for the color ad and which advertising agency to hire to write the copy, your decision-making process might be pretty simple. Unfortunately, for most private clubs, it’s not that easy and understanding the complexity of decisions surrounding the marketing process is critical to the well-being of your club.

Certainly, the type of entity your club is and the laws under which it was organized play a huge role in determining how marketing decisions should be viewed. If your club is federally tax-exempt — organized under Section 501(c)(7) of the Internal Revenue Code — your considerations are markedly different than that of a facility organized and operated as a for-profit entity.

Once a club has been granted tax-exempt status, in order to continue to enjoy such status, the law requires that the purpose of the club continue at all times, that is, it must be operated as a private social club for the social and recreational benefit of its members. Substantially all of the activities of the club, therefore, must be for the social benefit of its members. Just as important, the club itself must be extremely selective in choosing its members.

The process by which members are chosen is very important. Selectivity is the most important criterion in evaluating whether a club is truly private and, therefore, must be carefully monitored if the club desires to preserve its tax-exempt, private status. Indicia of selectivity include (i) a permanent mechanism in place to evaluate prospective members, (ii) consistent adherence to admission policies and (iii) enunciated standards and qualifications for membership other than immutable characteristics protected by various anti-discrimination laws. There is a strong possibility that, if members seem to be selected at random, the club will be perceived as public, not private, and could be in danger of forfeiting its tax-exempt status. Accordingly, “blind” advertisements whether in print, on television or in electronic form, which seem, either directly or discreetly, to indicate that anyone may join the club, are not usually utilized by tax-exempt private clubs.

Based upon the above analysis, many tax-exempt private clubs decide not to advertise memberships for sale, but actively advertise their facilities for use by non-members. Such a decision is made, for most clubs, not because they relish the thought of non-members using their clubhouses and dining facilities, but because the harsh economic reality is that non-member income is critical to the financial survival of most clubs. Economic reality or not, the decision to affirmatively market to non-members is a decision that can
have profoundly different consequences for tax-exempt, private clubs as compared to those for-profit entities.

In accordance with standards established by the Internal Revenue Service (IRS), such a club's revenue must come primarily from member sources. Specifically, in a tax-exempt club, no more than 35 percent of the club's revenue can come from non-member sources. The general rule is that non-member revenue cannot exceed 35 percent of the club's gross receipts, including receipts from investment income. This can be a fairly difficult maximum to avoid because within this 35 percent, not more than 15 percent of the gross receipts may be derived from the use of the club's facilities or services by the general public. If the club earns more than the amount permitted under these guidelines, a decision as to whether substantially all of its activities are for the social benefit of its members, based on all of the facts and circumstances, may be made by the IRS. The theory is that an exclusive club primarily organized for social purposes should have limited commercial activity. It can be difficult to argue that there is limited access to the activities of the club and its facilities if advertisements seeking to increase commercial activity are commonplace.

Even if your club is not a tax-exempt private club, advertisements seeking to increase non-member usage should be undertaken only after you, your board and your counsel have carefully reviewed the documentation in use at the club, along with any documentation previously published for members. Do you have policies in place to permit unaccompanied guests to use the facilities or do all events require a member sponsor? Do you have bylaw provisions that limit the use of the club to "members only" or "members and their guests"? Do your bylaws state that your club is private and for use exclusively by the members? Are there rules and regulations in place that effectively deal with the booking and management of non-member events? Does your liquor license permit the service of alcoholic beverages to non-members or limit the sale or service of such drinks to "members only"? Finally (and I know this seems obvious), is there any language prohibiting the advertisement by the club of its membership and facilities to the public?

Beyond tax considerations, there may be other reasons to be concerned about the effect outside advertising may have on your club in the event you ever have reason to argue that your facility is a private club and is not a place of public accommodation. In recent years, many state legislatures have, with strong constituent support, passed regulations forbidding discrimination based upon gender or other factors in places of "public accommodation." Many clubs, seeking to continue to utilize "Men Only" tee times and "Ladies Day" golf events because their members prefer them, do not want their facilities to qualify as public accommodations. In recent years, court challenges to the right of private clubs to control the selection process for membership, coordinate the use of their facilities and control their daily operations have increased. The consistent use of anti-discrimination laws and public accommodation statutes to reclassify a private club as a public facility often involves discussions of club activities, including advertising for member and non-member business. Accordingly, clubs should be aware that engaging in this type of advertising is a factor that may be used against them if a member or member of the public issues a challenge to their private status.

To make matters even more complicated, advertising is not strictly a one-way street. Many clubs publish newsletters and other flyers and have traditionally sold advertising space inside such publications to outside vendors. This activity not only increases the coffers of clubs, but it also provides outside businesses with exposure to a group of people (members) with a specific type of demographic profile that many businesses find extremely attractive. For tax-exempt facilities, however, accepting advertising dollars from outside sources can have important tax implications.

In addition to the overall limitation of income from the general public discussed above, tax-exempt facilities are subject to payment of unrelated business income tax (UBIT) on income derived from non-traditional business activity. Avoiding UBIT is important for two reasons. First, minimizing tax liability is always a good thing. Second, it is often difficult to justify that non-traditional business activity furthers the tax-exempt purpose of the club. Interpretation of both the limitation on non-member income and ramifications of non-traditional business activity is complicated, but the following scenario may help clarify the issue.

Non-traditional business activity does not further the tax-exempt purpose of a club even if it is conducted solely to benefit the club's membership. A good example is a yacht club that derives a substantial portion of its revenue from the sale of gasoline at its marina where members' boats are serviced. This activity was found to generate non-traditional business activity income subject to UBIT. The same is true for the sale of advertising to outside sources for the club's newsletter. Even if the newsletter is mailed only to members and purportedly produced for the members' benefit, such advertising generates non-traditional business activity income subject to UBIT. Is there a way to collect advertising dollars and exempt such dollars from taxation? Yes, but the guidelines aren't very clear. The IRS requires that such activity, to avoid tax, must be incidental, trivial and non-
Image Advertising

An excerpt from The Guide to Membership Marketing

Also available online at www.premierclubservices.org

Developers and club owners eager to get their multi-million dollar membership revenue stream flowing often turn to the most familiar method of marketing that they know — advertising. Getting the word out quickly to the largest audience they can, with the fastest return possible, seems to be the most logical approach to take. That is why, as we set out to structure membership marketing plans for private clubs, we are often asked, “When and where should we advertise?” Our answer typically is, “You should not advertise.”

More precisely, you should not advertise in the usual sense; in other words, with a direct solicitation. Although there may be certain cases when direct advertising for new members of a private club can be effective, there is probably nothing more contradictory than openly soliciting a club’s exclusivity. This principle is similar to the old Groucho Marx adage, “I wouldn’t want to be a member of a club that would have me as a member.” Most members of a private club would say, “I wouldn’t want to be a member of a club that advertises for members.”

Marketing memberships is more of an art form than a science, requiring a departure from the more mainstream marketing techniques. As such, directly advertising for members is tricky and can be damaging to the image of the club. There is one form of advertising, however, that can be used effectively in membership marketing — “image advertising.” Essentially, image advertising is indirect advertising designed to develop or reinforce an image, build awareness or create an impression without using a hard-sell message or appearing like a solicitation. Another explanation is that image advertising creates an association using a thought, feeling, picture or another product or service to create a positive image of the club in a prospective member’s mind. The objective of image advertising is to trigger a feeling and invite curiosity without raising the person’s natural defenses against being “sold.” After all, the area of membership sales is really not about selling; it is about helping prospects join through the process of referral, application and acceptance. A membership is not a commodity, a product or even a service, but rather, a long-term relationship.

There are many forms of image advertising, of which one form is literally using a simple image. An example would be a picture of rolling hills shrouded in a misty fog with a...
silhouette of a lone golfer walking with a golf bag over his shoulder. Only the name, address and phone number of the golf club are printed below the picture. This type of ad might conjure an image of a traditional old golf club in Scotland. The images will resonate with the reader, and perhaps when a golfing partner mentions that there is a new club about to open, the image is already in place and ready to do its job.

Another example of image advertising would be “state of existence” advertising, better known as “the announcement.” The ad uses no sales pitch, no slogan, no overt message and no instruction — it simply conveys that the club exists. Examples include “The Creek Club Plans to Tee-Off in May” or “The Standard City Club Celebrates Its 50th Year.” This type of ad is especially helpful when the club has had little or no media attention during its development or over an extended period of time. It also is an effective technique if the project has been stalled for a long duration (common in golf club developments with financing, construction, permitting and weather delays) and has been overlooked in the community. It should be strategically used, however, because it cannot be used repeatedly. State-of-existence advertising works because it simply states a fact.

A club’s image can also be conveyed through the use of “alliance advertising,” which builds positive associations with allied organizations like the Chamber of Commerce, a local homeowners association or even with the media (e.g., a local or regional golf magazine, business journal or radio or television station). Using a forum of community interest, the club joins forces with its partner to send a message of credibility and goodwill. An example of alliance advertising might be a charity golf tournament — a combined effort between the club and a charitable organization to attract the attention of the golfing and business communities using the club’s golf course as the back drop. The club could co-sponsor the event along with the local Chamber of Commerce or local TV station. Such an alliance could have many advantages, such as free media exposure for the club, access to an important mailing list, extended media coverage portraying the club as a steward of the community and, most importantly, inviting interest and inspection of the club by targeted prospects.

If applied with care, “image advertising” can be an effective form of marketing for your club. For more information on image advertising, contact Bob Bodman at (800) 267-6758 or via e-mail at clubreport@aol.com.

The January/February 2002 issue of the Legal Newsletter will focus on the Americans with Disabilities Act (ADA) as it applies to your club. Clubs should submit their questions on this or any other topic to Darcie Saleh via e-mail at saleh@cmaa.org or via FAX at (703) 739-0124.