

Unrelated income; health club facilities. The operation of health club facilities in a commercial manner by an organization exempt from tax under section 501(c)(3) of the Code, whose purpose is to provide for the welfare of young people, constitutes unrelated trade or business under section 513.

#### ISSUE

Is the operation of health club facilities by an organization exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code, under the circumstances described below, unrelated trade or business within the meaning of section 513?

#### FACTS

The purpose of the organization and basis for its exemption under section 501(c)(3) of the Code as a charitable organization is to provide for the welfare of young people by the conduct of charitable activities and maintenance of services and facilities that will contribute to their physical, social, mental, and spiritual health, at a minimum cost to them or, where appropriate, at no cost to them. Membership in, and the services and facilities of, the organization are available upon payment of nominal annual dues.

The organization has recreational facilities that are used in its general physical fitness program. These facilities include a track, gymnasium, swimming pool, and courts for racquet ball, handball, and squash. Members use these facilities as often as they wish.

The organization has also organized a health club program that its members may join for an advance annual fee that is sufficiently high to restrict participation in the program to a limited number of the members of the community. The annual fee is comparable to fees charged by similar local commercial health clubs. The advance annual fee is in addition to the nominal annual dues for membership in the organization. Health club facilities include an exercise room, whirlpool, steam room, sauna, massage facilities, and sun room. Those who are not health club members pay admission fees comparable to fees charged by similar local commercial establishments for each time they use any of the health club facilities.

#### LAW AND ANALYSIS

Section 513(a) of the Code provides that the term 'unrelated trade or business' means any trade or business the conduct of which is not substantially related (aside from the organization's need for income or funds or the use it makes of the profits derived) to the exercise or performance of an organization's purpose or function constituting the basis for its exemption under

section 501.

Section 513(c) of the Code provides that an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization.

Section 1.513-1(d)(2) of the Income Tax Regulations provides that a trade or business is 'related' to exempt purposes, in the relevant sense, only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income); and that it is 'substantially related', for purposes of section 513 of the Code, only if the causal relationship is a substantial one. Thus, for the conduct of a trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

The operation of the health club program is in addition to the organization's general physical fitness program. The commercially comparable annual dues or daily fees charged are sufficiently high to restrict the health club's use to a limited number of the members of the community. Thus, the operation of the health club program does not contribute importantly, in the causal sense, to the accomplishment of the organization's exempt purposes.

Compare Rev. Rul. 76-33, 1976-1 C.B. 169, which holds that the rental of residential accommodations to certain classes of people by a similar organization is related to its exempt purposes and is not unrelated trade or business.

#### HOLDING

The operation of the health club facilities by an organization exempt under section 501(c)(3) of the Code, under the circumstances described above, is unrelated trade or business within the meaning of section 513 of the Code.