

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:6-PLR147957-01

Date:

January 11, 2002

Legend

Corporation =

Date1 =

LocationA =

StateA =

#AA =

#BB =

YearA =

Dear

This is in response to your request for a ruling that exclusive “discounts” provided to shareholders of Corporation for (i) food and beverage purchases, (ii) annual golf membership dues, (iii) cart rental fees, and (iv) range fees do not constitute constructive dividends.

The ruling contained in this letter is predicated upon the facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for a ruling. Verification of the factual information, representations, and other data may be required as part of the audit process.

FACTS

You state that Corporation is an accrual basis corporation having an annual accounting period ending Date1. Corporation owns, manages and operates a country club in LocationA, StateA, including a golf course, tennis courts, a swimming pool, a restaurant, a lounge, and a golf shop.

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Use of the Corporation club facilities is available to approximately #AA homeowners in the LocationA area who are paid members, and to the #BB shareholders of Corporation, most of whom are also homeowners. Each year the Corporation Board of Directors sets fees for membership as well as various usage fees for club services and facilities.

Corporation has only one class of common stock. As of the date of the Ruling Request, Corporation has indicated that it would not pay any cash dividends for the YearA year. The Board of Directors established different fixed annual fees for shareholders and for non-shareholders regarding membership dues, cart rentals and range fees. In addition, shareholders were charged a fixed percentage amount less for food and beverage purchases in the restaurant than were charged to non-shareholders. The foregoing price differentials were offered to shareholders who purchased these club offerings as a benefit of being a shareholder in Corporation.

LAW AND ANALYSIS

Section 61(a)(7) of the Internal Revenue Code (the "Code") provides that except as otherwise provided, gross income means all income from whatever source derived, including dividends. Dividends may be formally declared or constructive.

Section 1.61-9(a) of the Income Tax Regulations states, in part, that except as otherwise specifically provided, dividends are included in gross income under sections 61 and 301 of the Code. For the principal rules with respect to dividends includible in gross income, see section 316 and the regulations thereunder.

Section 316(a) of the Code provides, in part, that the term "dividend" means any distribution of property made by a corporation to its shareholders out of its earnings and profits for the taxable year, without regard to the amount of earnings and profits at the time the distribution was made. Except as otherwise provided, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision in this subchapter treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of section 316(a).

Section 301(a) of the Code provides that except as otherwise provided, a distribution of property made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in section 301(c).

Section 301(c)(1) of the Code provides that in the case of a distribution to which section 301(a) applies, that portion of a distribution which is a dividend (as defined in section 316) shall be included in gross income.

Section 1.301-1(j) of the Income Tax Regulations states, in part, that if property is transferred by a corporation to a shareholder which is not a corporation for an

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amount that is less than its fair market value in a sale or exchange, such shareholder shall be treated as having received a distribution to which section 301 of the Code applies. In such a case, the amount of the distribution shall be the difference between the amount paid for the property and its fair market value.

Section 317(a) of the Code defines the term “property” for purposes of sections 301 and 316 as money, securities, and any other property; except that such term does not include stock in the corporation making the distribution (or rights to acquire such stock). See also §1.317-1, Income Tax Regs. The provision of services and the use of corporate-owned property have been held to be “property” for purposes of section 301. See, e.g., Ireland v. United States, 621 F.2d 731, 735 (5th Cir. 1980), and cases cited therein; Magnon v. Commissioner, 73 T.C. 980, 993 (1980), acq. in part, acq. in result in part, 1981-2 C.B. 2 (1981); Rev. Rul. 58-1, 1958-1 C.B. 173.

The disbursement of corporate earnings serving the ends of stockholders may constitute a dividend to such stockholders notwithstanding that the formalities of a dividend declaration are not observed; that the distribution is not recorded on the corporate books as such; that it is not in proportion to stockholdings; or even that some of the stockholders do not participate in its benefits. Paramount-Richards Theatres v. Commissioner, 153 F.2d 602, 604 (5th Cir. 1946). Where a stockholder has received an economic benefit as a result of a bargain sale of services by the corporation to him, or a bargain rental of corporate property for use by him, it has been held that the stockholder received constructive dividends. See, e.g., Ireland v. United States, supra; Magnon v. Commissioner, supra.

Based on the information submitted, the corporation conferred an economic benefit upon the participating stockholders with respect to their stock to the extent that it charged them less than fair market value for food and beverage purchases, annual memberships and for usage of club services and facilities.

RULING

Any excess of fair market value over the amount paid by each participating stockholder for (i) food and beverage purchases, (ii) annual golf membership dues, (iii) cart rental fees, and (iv) range fees should be treated, for Federal income tax purposes, as a constructive distribution of property to which section 301 of the Code applies. The amount of such excess is includible in the gross income of each participating stockholder to the extent that it constitutes a dividend. The amount of the excess which constitutes a dividend is that part of such excess which is considered to have been derived from the corporation's earnings and profits to the extent provided under section 316 of the Code.

No opinion is expressed as to the tax treatment of the transactions under other provisions of the Code or 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 ruling.

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In accordance with a written request of the taxpayer on file with this office, a copy of this letter is being sent by facsimile and mail to the taxpayer.

A copy of this letter must be attached to any income tax return to which it is relevant.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,
Steven J. Hankin
Senior Technical Reviewer, Branch 6
Office of Associate Chief Counsel
(Corporate)