2 T.C. 1238 (1943)

A social club does not lose its tax-exempt status under Section 101(9) of the Internal Revenue Code if it sells off unused portions of land acquired to support its recreational purposes, provided the sales are incidental to the club's primary purpose and the profits are used to reduce club indebtedness.

Summary

Anderson Country Club sought a tax exemption as a non-profit social club. The IRS denied the exemption, arguing the club's profits from selling real estate and operating a "Winter Club" disqualified it. The Tax Court ruled in favor of the Country Club, holding that the real estate sales were incidental to the club's primary recreational purpose because the land was originally purchased to support the golf course, and the profits were used to reduce the club's mortgage. The temporary "Winter Club" was also deemed incidental, serving the social needs of members during the off-season.

Facts

An unincorporated association operated a golf course on leased land. Upon lease expiration and a demanded rent increase, the association incorporated as Anderson Country Club to purchase the land. The purchase required buying 97 acres, though only 67 were used for the course. Efforts to sell the unused portion as a whole failed. Over several years, the club sold small tracts of the land at a profit. Proceeds were used to reduce the club's mortgage. To maintain social activities during winter, the club ran a "Winter Club" with a small profit that went into club funds.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Anderson Country Club's income and excess profits taxes for 1936-1938, denying the exemption under Section 101(9) of the Internal Revenue Code. The Country Club petitioned the Tax Court, claiming entitlement to the exemption and seeking a refund for overpayment in 1938.

Issue(s)

Whether Anderson Country Club is exempt from federal income tax under Section 101(9) of the Internal Revenue Code as a club organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, where it sold portions of its real estate at a profit and operated a "Winter Club" that generated income.

Holding

Yes, because the sales of real estate were incidental to the club's primary recreational purpose, and the profits were used to reduce club indebtedness, not to

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benefit private shareholders. The “Winter Club” activities were also incidental and for social purposes.

Court’s Reasoning

The court reasoned that the club’s purpose was primarily recreational. The purchase of the entire tract of land was necessary to secure the land used for the golf course. The sales of the unused land were “incidental” to the club’s primary purpose, which was operating a social and recreational club. The court emphasized that the profits from the land sales were used to reduce the club’s mortgage, benefiting the club as a whole, not individual shareholders. The court distinguished this case from those where the income was recurrent and derived from activities directly related to generating profit, stating, “Not only were the sales of real estate by petitioner incidental to its purpose of existence, but also the income derived therefrom was necessarily of a nonrecurrent type…” The “Winter Club” was also deemed incidental, primarily serving the social and recreational needs of the members. The court cited *Koon Kreek Klub v. Thomas, 108 F.2d 616* and *Santee Club v. White, 87 F.2d 5*, noting that substantial revenues from incidental activities did not necessarily negate tax-exempt status.

Practical Implications

This case clarifies that social clubs can engage in some profit-making activities without losing their tax-exempt status, provided those activities are incidental to their primary purpose. When analyzing similar cases, attorneys should focus on: (1) the original intent behind acquiring the asset that generated the profit; (2) whether the profits are used for the club’s overall benefit or distributed to members; (3) whether the profit-making activity is recurrent or a one-time event. This ruling helps social clubs manage their assets strategically without automatically jeopardizing their tax exemptions. It emphasizes that enhancing club facilities or retiring debt through such sales does not constitute a benefit to private shareholders, as long as no dividends are paid, and dues are not reduced as a direct result.

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