21 T.C. 807 (1954)

To qualify for tax-exempt status under section 101(9) of the Internal Revenue Code, a club must be organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, with no part of its net earnings inuring to the benefit of any private shareholder.

Summary

The Aviation Country Club, Inc. sought tax-exempt status under section 101(9) of the Internal Revenue Code for the fiscal years ending April 30, 1950, and April 30, 1951. The IRS denied the exemption, arguing the club did not meet the requirements for tax-exempt status. The court examined whether the club was organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and whether any of its net earnings benefited private shareholders. The court found in favor of the Aviation Country Club, Inc., concluding it met the statutory requirements and was thus entitled to the tax exemption.

Facts

Aviation Country Club, Inc. (petitioner) was incorporated in Colorado in 1944. The club leased the Broadmoor Country Club premises from a partnership, which included a lease and a management contract. The Broadmoor premises were owned by Nellie and Eddie Ott, who formed a partnership with George Ott. The Otts, seeking to profit from the property, leased the premises to petitioner. The lease stipulated that 40% of the annual net profits went as rent, 30% for improvements, and 30% to the club, with a guaranteed minimum. The club's activities included family nights, parties, and contributions to charities. Slot machines were operated at the club, with 75% of the revenue from these machines going to the club. The Otts' primary purpose was to make money and they were interested in slot machine operation to do so. The IRS disallowed the club's claim for tax exemption.

Procedural History

The U.S. Tax Court considered the Commissioner of Internal Revenue's determination of deficiencies in the income tax of the Aviation Country Club, Inc. The Tax Court's decision is the subject of this case brief.

Issue(s)

1. Whether the Aviation Country Club, Inc., was organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes.

2. Whether any part of the club's net earnings inured to the benefit of any private shareholder.

Holding

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1. Yes, because the club was organized and operated for pleasure, recreation, and other nonprofitable purposes.

2. No, because the court found that the net earnings did not inure to the benefit of any private shareholder.

Court’s Reasoning

The court relied on the statutory definition of exempt clubs in section 101 (9) of the Internal Revenue Code. The court examined the facts and evidence presented, including the club’s articles of incorporation, bylaws, lease agreements, and the nature of its activities. The court found the Aviation Country Club was organized and operated exclusively for pleasure and recreation, and that no private shareholder benefited from net earnings. The court distinguished this case from Aviation Club of Utah, <span normalizedcite="7 T.C. 377“>7 T.C. 377, where the club’s activities were altered to benefit non-member officers. The court found that the Otts were interested in making a profit, but the club was still primarily for the benefit of its members, and the slot machine revenue did not disqualify the club.

Practical Implications

This case provides guidance on determining whether a club meets the requirements for tax-exempt status under section 101(9). The court’s focus was on the club’s purpose, activities, and the absence of private inurement. This case illustrates the importance of the club’s governance structure, the nature of its activities, and the absence of private financial benefit. Lawyers representing similar clubs should carefully examine these factors when advising clients on compliance with tax laws and preparing for potential IRS scrutiny. The presence of slot machines did not prevent tax-exempt status, so long as the operation was not for the benefit of the owners of the building.

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