Mill Lane Club, Inc. v. Commissioner of Internal Revenue, 23 T.C. 433 (1954)

A social club’s tax-exempt status is not automatically revoked when it sells its property at a profit and distributes the proceeds to its members during dissolution, provided the sale is incidental to the dissolution and not a business activity, and the distribution is a final division of assets, not net earnings.

Summary

The Mill Lane Club, a social club, sold its clubhouse at a profit to facilitate its dissolution due to declining membership. The Commissioner of Internal Revenue argued that this sale and the subsequent distribution of the sale proceeds to the members revoked the club’s tax-exempt status for its final year. The U.S. Tax Court disagreed, holding that the sale was incidental to the club’s dissolution, not a profit-making business activity, and the distribution of assets was not the distribution of net earnings. The court emphasized that the sale was a singular event in the club’s history and was necessary to its closure, thus not negating its tax-exempt status.

Facts

Mill Lane Club, Inc., a New York social club, was founded in 1888 and was exempt from federal income tax. By 1928, the club faced declining membership and financial difficulties. The club’s board of directors voted to sell the clubhouse, pay off debts, and distribute the remaining assets to the members. A special meeting of the members approved the sale of the clubhouse for $200,000. The sale was completed on August 1, 1928, resulting in a profit of $31,190.48 for the club. The club distributed $200 to each member in September 1928. The club never formally dissolved.

Procedural History

The IRS ruled that the club was tax-exempt until July 31, 1928, but no longer exempt thereafter due to the sale of the clubhouse and distribution of proceeds. Mill Lane Club, Inc., filed a tax return for 1928, and a deficiency notice was issued by the Commissioner. The Tax Court reviewed the case to determine whether the club retained its tax-exempt status for its final year of operation.

Issue(s)

1. Whether the sale of the clubhouse at a profit destroyed the club’s exemption from income tax for the last year of its operation.

2. Whether the distribution of the sale proceeds among the members caused the club to lose its tax-exempt status.

Holding

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1. No, because the sale was incidental to the club’s dissolution, not a business activity.

2. No, because the distribution was a final division of assets, not a distribution of net earnings.

Court's Reasoning

The court analyzed whether the club met the requirements for exemption under the Revenue Act of 1928, which required the club to be organized and operated exclusively for pleasure, recreation, or nonprofitable purposes, and that no net earnings should benefit any private shareholder. The Commissioner argued the club’s activities in 1928 did not meet these criteria. The court distinguished the case from Juniper Hunting Club, Inc. where the club continued to operate after the sale. The court found that the sale was incidental to the club’s dissolution and the distribution of the sale proceeds was not a distribution of net earnings. The court relied on Santee Club v. White and emphasized that the sale was not part of a business activity to avoid holding the property. The court stated, “Presumably, it is impossible to dissolve the group more than once and the single, final, and most important transaction to facilitate the dissolution does not convert a social club into a real estate business.”

Practical Implications

This case provides guidance for social clubs considering the sale of assets and subsequent dissolution. It establishes that a sale of property at a profit does not automatically revoke a club’s tax exemption if the sale is part of a dissolution plan and is not a primary income-generating activity. The distribution of assets to members in proportion to their holdings, as opposed to a distribution of ‘net earnings,’ will not destroy the club’s tax-exempt status. This ruling helps clubs avoid unintended tax liabilities when concluding their operations, providing them with a framework on how to structure the sale and distribution process. Later cases frequently cite Mill Lane Club to determine whether a club’s activities and asset distribution were related to its core purpose, or whether a profit-making business venture had been entered into.

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