Ye Mystic Krewe of Gasparilla v. Commissioner, 83 T. C. 676 (1984)

Income from nonmembers of a social club is subject to tax under section 512(a)(3) of the Internal Revenue Code, regardless of whether the income is from a regularly carried on trade or business.

Summary

Ye Mystic Krewe of Gasparilla, a social club, challenged the IRS's determination that income from concessions and a special ship fund was unrelated business taxable income. The Tax Court held that such income was taxable under section 512(a)(3), emphasizing that nonmember income of social clubs is taxable irrespective of whether it stems from a regularly carried on trade or business. The court also ruled that expenses for the club's annual parade and invasion could not be deducted against the concession income, and interest from the special ship fund did not qualify as exempt function income.

Facts

Ye Mystic Krewe of Gasparilla, a social club, staged an annual mock invasion and parade in Tampa, Florida. The Krewe received income from concessions along the parade route and from the sale of souvenirs, as well as interest on a special ship fund used to maintain a replica pirate ship used in the event. The Krewe was recognized as exempt under section 501(c)(7) of the Internal Revenue Code but did not file Form 990-T for unrelated business income tax. The IRS determined deficiencies in the Krewe's federal income taxes for the fiscal years ending 1975, 1976, and 1977.

Procedural History

The IRS determined deficiencies in the Krewe's federal income taxes for the fiscal years ending 1975, 1976, and 1977. The Krewe filed a petition with the Tax Court, challenging the IRS's determination. The Tax Court upheld the IRS's position, ruling that the income in question was unrelated business taxable income and that the Krewe could not deduct expenses related to the invasion and parade.

Issue(s)

1. Whether the income received by the Krewe from concessions and souvenir sales constitutes unrelated business taxable income under section 512(a)(3)(A)?
2. Whether the Krewe can deduct the expenses of staging the invasion and parade in computing its unrelated business taxable income?
3. Whether the income from the special ship fund constituted exempt function income under section 512(a)(3)(B)?

Holding

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1. Yes, because section 512(a)(3) taxes nonmember income of social clubs regardless of whether it is derived from a regularly carried on trade or business.
2. No, because the expenses of staging the invasion and parade were not directly connected with the production of the concession income.
3. No, because the Krewe failed to prove that the income from the special ship fund was set aside for an educational purpose under section 170(c)(4).

Court's Reasoning

The court interpreted section 512(a)(3) to mean that all nonmember income of social clubs is taxable, not just income from a regularly carried on trade or business. The legislative history supported this interpretation, emphasizing the intent to prevent nonmember income from subsidizing member activities. The court rejected the Krewe's argument that the annual parade and invasion were not a regularly carried on trade or business, stating that the taxability of the concession income did not depend on this classification. The court also determined that the expenses for the invasion and parade could not be deducted because they were not directly connected with the production of the concession income. Lastly, the court found that the Krewe did not meet its burden of proving that the interest from the special ship fund was set aside for an educational purpose, as required for exempt function income.

Practical Implications

This decision clarifies that social clubs must report and pay taxes on all income derived from nonmembers, regardless of the source. It impacts how social clubs structure their activities and finances, particularly those involving nonmember participation or income. The ruling reinforces the IRS's ability to tax such income and may lead to increased scrutiny of social clubs' financial practices. It also serves as a precedent for future cases involving the taxation of social clubs, emphasizing the importance of distinguishing between member and nonmember income and the limited deductibility of expenses against nonmember income. Later cases, such as Council of British Societies in Southern California v. United States, have followed this interpretation of section 512(a)(3).

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