Zeta Beta Tau Fraternity, Inc. v. Commissioner, 87 T. C. 421, 1986 U. S. Tax Ct. LEXIS 64, 87 T. C. No. 23 (1986)

National college fraternities are classified as tax-exempt social clubs under section 501(c)(7) and cannot also be classified as domestic fraternal societies under section 501(c)(10) of the Internal Revenue Code.

Summary

Zeta Beta Tau Fraternity, a national college fraternity, sought to be classified as a tax-exempt domestic fraternal society under section 501(c)(10) to exclude its investment income from unrelated business taxable income. The U. S. Tax Court held that national college fraternities are intended by Congress to be treated solely as social clubs under section 501(c)(7), and thus, their investment income is subject to tax. This decision was based on the legislative history of the Tax Reform Act of 1969 and subsequent amendments, which clearly distinguished national college fraternities from other fraternal organizations like the Masons.

Facts

Zeta Beta Tau Fraternity, Inc. was organized as a New York corporation in 1907 and served as the central organization for a national college fraternity. It had been granted tax-exempt status under section 501(c)(7) as a social club since 1940. Zeta Beta Tau sought to be classified under section 501(c)(10) as a domestic fraternal society to exclude its investment income from unrelated business taxable income. The IRS denied this application, leading to a deficiency notice for the taxable year ending June 30, 1971.

Procedural History

Zeta Beta Tau filed a timely petition with the U. S. Tax Court challenging the IRS's determination of a deficiency in its unrelated business income tax. The case was submitted fully stipulated under Rule 122 of the Tax Court Rules of Practice and Procedure. The court heard the case and issued its opinion on August 13, 1986.

Issue(s)

1. Whether Zeta Beta Tau Fraternity, Inc. , a tax-exempt social club under section 501(c)(7), also qualifies as a tax-exempt domestic fraternal society under section 501(c)(10).

2. Whether Treasury Regulation section 1. 501(c)(10)-1, which excludes national college fraternities from section 501(c)(10) classification, is valid.

Holding

1. No, because Congress intended national college fraternities to be treated solely

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under section 501(c)(7) and not under section 501(c)(10), as evidenced by the legislative history of the Tax Reform Act of 1969 and subsequent amendments.

2. Yes, because the regulation is a valid and reasonable interpretation of the statutory provisions and is consistent with the legislative intent.

Court's Reasoning

The court analyzed the legislative history of the Tax Reform Act of 1969, which added section 501(c)(10) to the Internal Revenue Code. The court found that Congress intended to tax the investment income of national college fraternities under section 501(c)(7), as they were seen primarily as social clubs providing housing, board, and social activities to undergraduate members. The court distinguished national college fraternities from organizations like the Masons, which are typically classified under section 501(c)(10). The court also upheld the validity of Treasury Regulation section 1. 501(c)(10)-1, which explicitly excludes national college fraternities from section 501(c)(10) classification, as a reasonable interpretation of the statutory provisions. The court concluded that Zeta Beta Tau's investment income was properly included in its unrelated business taxable income.

Practical Implications

This decision clarifies that national college fraternities cannot seek dual tax-exempt status under both sections 501(c)(7) and 501(c)(10) of the Internal Revenue Code. Legal practitioners advising such organizations must recognize that their clients' investment income will be subject to unrelated business income tax. The decision also reinforces the importance of legislative history in interpreting tax statutes, particularly when statutory language may be ambiguous. Subsequent cases involving similar organizations have followed this ruling, ensuring consistent treatment of national college fraternities under the tax code. This ruling impacts how such organizations manage their finances and plan for tax liabilities related to investment income.

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