Country Club v. Commissioner, 92 T. C. 21 (1989)

A tax-exempt social club may offset losses from one unrelated business taxable income activity against gains from another such activity if both activities are profit-motivated.

Summary

In Country Club v. Commissioner, a tax-exempt social club sought to offset net losses from its nonmember food and beverage sales against the profits from its nonmember golf tournaments and interest income. The court ruled that the club could aggregate its unrelated business taxable income (UBTI) from multiple activities, allowing losses from one to offset gains from another, provided all activities were entered into with the objective of profit. This decision clarified the application of Section 512(a)(3) of the Internal Revenue Code, emphasizing that Congress intended to tax income not derived from member activities but did not preclude the offsetting of losses between profit-motivated activities.

Facts

The petitioner, a tax-exempt social club under Section 501(c)(7), operated facilities including a golf club, restaurant, bar, swimming pool, and tennis courts for its members and occasionally nonmembers. In 1979, the club derived revenue from nonmember golf tournaments, food and beverage sales to nonmembers, and interest income. The club reported a deficiency in its 1979 Federal income tax due to its attempt to offset net losses from nonmember food and beverage sales against other nonmember income sources.

Procedural History

The case was assigned to a Special Trial Judge, whose opinion was adopted by the Tax Court. The Commissioner of Internal Revenue determined a deficiency in the club’s 1979 tax return, leading the club to file a petition for redetermination. The Tax Court reviewed the case and ultimately decided in favor of the petitioner.

Issue(s)

1. Whether a tax-exempt social club may offset net losses from one unrelated business taxable income activity against net gains from another such activity under Section 512(a)(3) of the Internal Revenue Code?

Holding

1. Yes, because the statute and legislative history indicate that Congress intended to allow such offsets as long as all activities were entered into with a profit motive.

Court’s Reasoning

The court analyzed the language of Section 512(a)(3) and its legislative history, concluding that the purpose was to tax income from nonmember activities but not to disallow the offsetting of losses between profit-motivated activities. The court distinguished this case from others where losses from exempt activities were improperly used to offset unrelated business income. The club’s activities were classified into three profit-motivated sources: golf tournaments, nonmember banquets, and interest income. The court rejected the Commissioner’s argument that taxable profit was necessary to establish profit motivation, holding that any incremental increase in available funds to the club constituted profit motivation. The court’s decision was supported by a majority of judges and was consistent with the policy of not allowing nonmember income to subsidize member activities, yet allowing losses from one profit-seeking activity to offset gains from another.

Practical Implications

This decision impacts how tax-exempt social clubs and similar organizations handle their unrelated business income. It allows them to offset losses from one profit-motivated activity against gains from another, potentially reducing their tax liability. Practitioners should consider the profit motive of each activity when advising clients on tax planning. This ruling also affects how the IRS might audit such organizations, focusing on the profit motivation of their activities. Subsequent cases, such as Cleveland Athletic Club v. United States, have reinforced this principle, while The Brook, Inc. v. Commissioner has provided contrasting views based on different statutory interpretations.

