West Virginia State Medical Association v. Commissioner, 91 T. C. 659 (1988)

Losses from an activity of an exempt organization cannot be used to offset unrelated business taxable income unless that activity is engaged in with a profit motive.

Summary

The West Virginia State Medical Association, a tax-exempt medical association, attempted to offset its unrelated business income from endorsing a collection service with losses from advertising in its journal. The Tax Court held that the advertising activity did not constitute a trade or business because it lacked a profit motive, as evidenced by 21 years of consistent losses. Therefore, the losses could not be used to offset the unrelated business income. This case clarifies that for an activity of an exempt organization to be considered a trade or business for tax purposes, it must be engaged in primarily for profit.

Facts

The West Virginia State Medical Association, a 501(c)(6) exempt organization, published the West Virginia Medical Journal to its members. The journal included scientific articles, news, and paid advertisements. The association incurred consistent losses from the advertising activities in the journal, totaling $21,810 in 1983. In the same year, it earned $9,908 from endorsing I. C. Collection Systems, which it attempted to offset with the advertising losses. The IRS determined that such an offset was not permissible.

Procedural History

The IRS determined a deficiency in the association’s 1983 federal income tax and denied the offset of advertising losses against the income from the collection service endorsement. The case was assigned to a Special Trial Judge, whose opinion was adopted by the Tax Court.

Issue(s)

1. Whether an exempt organization may offset income from one unrelated activity with losses from another unrelated activity.
2. Whether the advertising activities conducted in the association’s journal constitute a trade or business.

Holding

1. No, because losses from an activity cannot offset unrelated business income unless the activity is a trade or business.
2. No, because the advertising activity lacked a profit motive and thus did not constitute a trade or business.

Court’s Reasoning

The court applied the legal standard that to be considered a trade or business, an activity must be engaged in with continuity and regularity and primarily for income or profit. The court found that the association’s advertising activity did not meet this standard due to consistent losses over 21 years, indicating a lack of profit motive. The court cited Commissioner v. Groetzinger and section 513(c) to support this requirement. It also referenced conflicting circuit court decisions on social clubs but noted these were not directly applicable to the case at hand, which involved a business league under section 501(c)(6). The court emphasized that allowing the offset would grant the association an unfair tax advantage, which Congress sought to prevent with the unrelated business income tax.

Practical Implications

This decision impacts how exempt organizations handle losses from activities not related to their exempt purpose. It requires that such activities be conducted with a profit motive to qualify as a trade or business, allowing losses to offset unrelated business income. Practitioners advising exempt organizations must ensure that any unrelated activities are genuinely profit-driven if they are to be used to offset other income. This ruling may influence how organizations structure their revenue-generating activities and how they report losses for tax purposes. Subsequent cases, such as North Ridge Country Club v. Commissioner, have further explored the application of this principle in different contexts.

