Clubs million-dollar losers in Supreme Court decision

GOVERNMENT UPDATE

BY MARK LESLIE

The U.S. Supreme Court has clarified a gray area of the Tax Code in a decision that will cost private tax-exempt clubs millions of dollars a year.

"We are naturally disappointed with the decision," said Harold B. Berman, chairman of the National Club Association's legal/legislative committee. "The High Court, at least, has clarified a murky part of the law."

The Supreme Court voted 6-3 in favor of the Internal Revenue Service's interpretation of Revenue Ruling 81-69 in the case of Portland Golf Club v. Commissioner of Internal Revenue.

The decision settles a nine-year court battle with the National Club Association and various clubs during which the clubs won two decisions in the Tax Court and one of four in circuit courts.

The contested tax has averaged $2,000 to $5,000 a year for tax-exempt clubs that have been in the Revenue Ruling 81-69 audit. A few clubs have substantially more at stake, according to the NCA.

James Singerling, executive vice president of the Club Managers Association of America, said of the Supreme Court decision: "Without a doubt, we're talking about millions of dollars a year."

NCA Director of Government Relations Tom Walsh said, "There are probably 100 to 200 clubs that will feel an appreciable impact."

At issue is a complex rule concerning the circumstances under which a social club may offset losses from selling food and beverages to nonmembers against the income from investments.

The High Court unanimously held that tax-exempt clubs must have a profit motive in "unrelated business activities" if losses from those activities were to be used to offset income from other sources.

Six of the nine justices agreed that profit motive must be determined by the same accounting method employed for tax-reporting purposes.

Writing the majority opinion, Justice Harry Blackmun said: "Congress intended that the investment income of social clubs (unlike the investment income of most other exempt organizations) should be subject to the same tax consequences as the investment income of any other taxpayer. To allow such an offset for social clubs would run counter to the principle of tax neutrality which underlies the statutory scheme."

Therefore, Blackmun wrote, losses incurred in sales to nonmembers can only offset investment income if those sales "are motivated by an intent to profit."

Portland Golf Club — and many others nationwide — use two accounting methods in figuring fixed expenses. The "gross-to-gross" method sets the percentage of fixed costs equal to the percentage of income earned from nonmember activities.

The IRS has demanded that the clubs use the alternate "square-foot-and-hours-of-actual-use" method, which greatly reduces the fixed expenses.

Justices Anthony Kennedy, Sandra Day O'Connor and Antonin Scalia disagreed with the majority, arguing that clubs should have greater flexibility in demonstrating profit motive than the single choice.

Kennedy said the Internal Revenue Code allows clubs the option of demonstrating profit motive by methods different from reporting taxes.

"A taxpayer's profit motive, in my view, cannot turn upon the particular accounting method by which it reports its ordinary and necessary expenses ... The Court cites no authority for its novel rule and we cannot adopt it simply because we confront a hard case," Kennedy wrote.

"A taxpayer does not alter the nature of an enterprise by selecting one reasonable allocation method over another... The Court's decision also departs from the traditional practice of the courts and the IRS. Rather than relying on strict consistency in accounting, the courts long have evaluated profit motivation according to a variety of factors that indicate whether the taxpayer acted in a manner characteristic of one engaged in a trade or business."

Jack Kelly, acting executive assistant of the IRS' Exempt Organizations Technical Division, agreed with the NCA and CMAA that the added taxes to clubs nationally "could be millions."

The Portland Golf Club had only $5,000 at stake. The NCA rose to its aid to use it as a test case for everyone, Walsh said.

Now, Walsh said: "The only way to get around this would be to get the IRS to change its interpretation ... or go to Congress. And this is basically too small a matter to get Congress involved. It amounts to asking them to open a loophole. The prospects of that are just not good."

Kelly agreed the Supreme Court decision should mark the end of the

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Referenda to reduce field-burning fail

BY MARK LESLIE

A pair of statewide initiatives that would have drastically or totally reduced field-burning in Oregon have failed.

The petitions were filed with the Oregon Secretary of State's Office on July 6, but fell short of the 63,578 signatures needed to put the matter before voters in November.

"We have a reprieve for a year maybe," said Dennis Hays, executive vice president of the Oregon Seed Trade Association in Portland. "We're sure a bill will be proposed in the state Legislature in January. If they (field-burning opponents) don't get that through, they'll bring up this initiative again.

"These people are not going to stop."

The case is important to the golf industry in the United States. Oregon's 70 seed companies provide all U.S.-produced ryegrass, bentgrass, Chewings and creeping red fescues seed, half the U.S.-grown tall fescue seed, and about one-fourth its bluegrass seed.

For the growers, field-burning is the proven method to ensure a healthy crop.

"When you burn, the root stays alive and it comes back next year. The burning gives it a new life so that it comes back pure and clean," Hays said.

"If there's no burning, you get disease-filled crops. The burning purifies. It kills disease and insects."

One of the initiatives called for a total ban on burning in five years. That failed to get the needed signatures but was still turned in to the secretary of state.

The second initiative would cut the number of acres that could be burned every year for four years until it lowered the maximum from the current 250,000 to 50,000 acres. That one got just more than 65,000 signatures, but some 1,500 allegedly were forged by petitioners who were being paid per vote.

Research continues

Hays said "tons of research" is being done to find new ways to purge the fields of disease and pests.

"The state is financing some of the research, a lot of private companies are researching it, and Oregon State University is studying it.

"They're looking for some way to deal with all the straw. Some straw goes to Japan now for animal feed, but there's not much nutrient in it. And there's not nearly enough demand."

Asked about the possibility of more propane burning, Hays said the process can create more

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Tax case

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debate.

"A Supreme Court decision is the law of the land. This decides the issue," he said.

Singerling feels Congress might be persuaded to rewrite the Code, but it is not the CMAA's role to lobby. "We encourage our members to assist congressmen to write positive legislation," he said.

The IRS is undefeated in the Supreme Court on tax-exempt tax code matters over a number of years, according to Walsh and Kelly. Walsh placed the number of cases at 18.

Added Kelly: "Yes, we've gone 12 or 13 (cases) over the last 15 to 20 years without losing. Most every case was a close issue that could have gone either way. And this one as well because we lost in several circuits."

In fact, the IRS lost this issue in three of six court decisions.

The IRS won in the 2nd Circuit (vs The Brook, Inc. in 1986), but lost in the 6th Circuit (vs Cleveland Athletic Club, Inc. in 1985) and twice in the Tax Court (vs North Ridge Country Club in 1989 and vs Portland GC). The IRS successfully appealed both Tax Court decisions to the 9th Circuit Court.

"It (Supreme Court decision) is disappointing," Walsh said. "Especially because when we left the oral arguments we at least had our fingers crossed that we might win. As it turns out we got three of the nine. We weren't that far off, especially given the IRS success rate-kill ratio on taking anyone to court on tax-exempt matters."

CMAA's Singerling doesn't think anyone "won" this case.

He said the IRS and courts are judging clubs by circumstances 20 years ago, when, in some cases, there was competition with local businesses. But, he added, clubs have vastly changed since then.

"Clubs today aren't in competition with local business but provide a place for special functions... As club business has expanded, we have further defined what a private club is. In a given community it may be the only place to hold a special dinner, or charity event," he said.

Singerling said: "Private clubs don't generate profits. No member of a private club has ever received a dividend from that club. Any revenue goes directly back into the community — to hourly employees and businesses who supply goods to that club. So by inhibiting these dollars, the community loses.

"Those who look at this as a victory, I'd like to know who they think will benefit..."

Singerling said CMAA is financing a study to determine the impact of the court decision. That study should be complete by September.