Arthur Jordan Foundation v. Commissioner, 17 T.C. 313 (1951)

A corporation organized and operated exclusively for religious, charitable, or educational purposes can maintain its tax-exempt status under Section 101(6) of the Internal Revenue Code, even if its funds are invested in entities controlled by its founders, provided the investments are secure, bear reasonable interest, and do not result in private benefit.

Summary

The Arthur Jordan Foundation sought tax-exempt status under Section 101(6) of the Internal Revenue Code. The IRS argued against the exemption, claiming the Foundation was part of a plan to exploit tax benefits and maintained a fund benefiting the creators. The Tax Court found that while the Foundation's corpus was invested in mortgages of enterprises connected to its directors, these investments were secure and bore reasonable interest. Further, distributions were for charitable or specifically earmarked purposes. The court held that the Foundation qualified for tax-exempt status because its investments were sound, and its income did not inure to the benefit of private individuals.

Facts

The Arthur Jordan Foundation was incorporated in Kentucky as a non-stock, non-profit organization for religious, educational, and charitable purposes. The Foundation received contributions, the amounts of which were determined based on permissible deductions under Section 101 of the Code. The Foundation invested its corpus in mortgage notes of enterprises either owned or controlled by its directors. These mortgage notes were amply secured, bearing 6% interest, with property values exceeding twice the notes' face value. The Foundation made a $300 distribution to the Manual-Male Memorial Fund in 1946 and a $399.50 distribution to Stratford S. Goin in 1947, the latter specifically earmarked by donors.

Procedural History

The Commissioner of Internal Revenue determined that the Arthur Jordan Foundation did not qualify for tax exemption under Section 101(6) or (14) of the Internal Revenue Code. The Arthur Jordan Foundation petitioned the Tax Court for a redetermination of this finding.

Issue(s)

1. Whether the investment of the Foundation's corpus in amply secured mortgage notes of enterprises controlled by its directors disqualifies it from tax-exempt status under Section 101(6) of the Internal Revenue Code.
2. Whether the distribution to the Manual-Male Memorial Fund and Stratford S. Goin disqualifies the Foundation from tax-exempt status.

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Holding

1. No, because the investments were reasonable, amply secured, bore a reasonable interest rate, and did not result in any private benefit.
2. No, because the distribution to the Manual-Male Memorial Fund was for educational and charitable purposes, and the distribution to Goin was specifically funded and earmarked by outside donors, effectively making the foundation an agent.

Court's Reasoning

The court reasoned that while a corporation must be both organized and operated exclusively for exempt purposes, the destination of income is more significant than its source, citing *Trinidad v. Sagrada Orden de Predicadores, 263 U.S. 578*. The court noted that the Foundation's investments, though in entities controlled by its directors, were adequately secured and offered reasonable interest rates, confirmed by external financial assessments. Furthermore, the Revenue Act of 1950 defined "prohibited transactions" that would disqualify an organization from exemption, and the Foundation's investments did not fall within those prohibitions. The court considered that the distribution to the Manual-Male Memorial Fund was for a public charitable purpose, and the distribution to Goin was merely an agency action for the donors.

The court emphasized, "One of the tests prescribed in subdivision (6) of section 101 of the Code is that no part of the net income of a corporation claiming exemption from tax shall inure 'to the benefit of any private shareholder or individual.' This limitation may indicate that Congress was concerned primarily with the use of the net income rather than with the manner and character of its investments. The destination of the income is more significant than its source."

Practical Implications

This case demonstrates that tax-exempt organizations can invest in entities related to their founders or directors without automatically losing their tax-exempt status. However, such investments must be carefully structured to ensure they are sound, yield reasonable returns, and do not provide disproportionate private benefits. Later cases have cited *Arthur Jordan Foundation* to support the principle that the ultimate use of funds is more important than their source, emphasizing that investments should primarily serve the organization's exempt purpose. It also highlights the importance of complying with regulations regarding prohibited transactions under Section 503 of the Internal Revenue Code (formerly Section 3813) to maintain tax-exempt status.

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