17 T.C. 899 (1951)

A company actively engaged in a for-profit business, even if its profits are ultimately directed to charitable organizations, is not exempt from federal income tax under Section 101(6) of the Internal Revenue Code.

Summary

Donor Realty Corporation, formed to donate profits to charity, engaged in real estate transactions. It claimed tax-exempt status under Section 101(6) of the Internal Revenue Code, arguing it was a charitable organization. The Tax Court denied the exemption, holding that the corporation's primary activity was conducting a for-profit business, despite its charitable intentions. The court emphasized that the source of income, a for-profit business, took precedence over the destination of the income, namely charitable contributions.

Facts

Donor Realty Corporation was incorporated in 1946 with broad powers to engage in real estate transactions. Its stated purpose included distributing income to charitable organizations. Frederick Brown, a real estate professional, controlled the corporation and intended to use it to channel profits to charities. During 1946, the corporation engaged in real estate deals, including purchasing and selling a contract for a profit. It donated sums to qualified charitable organizations and claimed tax-exempt status.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency against Donor Realty Corporation for the 1946 tax year. Donor Realty Corporation petitioned the Tax Court for a redetermination, arguing it was exempt from taxation under Section 101(6) of the Internal Revenue Code.

Issue(s)

Whether a corporation engaged in the active conduct of a real estate business, with the purpose of donating its profits to charitable organizations, is exempt from federal income tax under Section 101(6) of the Internal Revenue Code.

Holding

No, because the corporation was primarily engaged in a for-profit business, and this activity precluded it from being considered an organization "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes" under the meaning of Section 101(6) of the Internal Revenue Code.

Court's Reasoning

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The Tax Court relied on its prior decision in *C.F. Mueller Co.*, which held that a company actively engaged in business for profit is not exempt from taxation, even if its profits are ultimately directed to charity. The court acknowledged that the Third Circuit Court of Appeals reversed the *Mueller* case, but the Tax Court respectfully disagreed and maintained its position. The court found that Donor Realty Corporation's primary activity was engaging in real estate transactions for profit, thus disqualifying it from tax-exempt status under Section 101(6). The court reasoned that the source of the income (a for-profit business) took precedence over the destination of the income (charitable contributions). As the court stated, the prime consideration is, "whether the destination of the income is more important than source."

Practical Implications

This case underscores that merely intending to donate profits to charity does not automatically qualify a for-profit business for tax-exempt status. The organization's activities must be primarily and exclusively dedicated to charitable purposes. This case instructs legal practitioners to analyze the actual operations of an organization seeking tax exemption, focusing on whether the organization is actively engaged in a trade or business for profit. Subsequent cases have cited *Donor Realty* to emphasize that an entity cannot claim tax exemption if its primary purpose is to conduct a commercial enterprise, even if the profits benefit charitable causes. This affects how tax attorneys advise clients on structuring business activities to achieve charitable goals without losing tax benefits. It also highlights the IRS's scrutiny of organizations claiming charitable exemptions while engaging in substantial for-profit activities.

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