1952 Tax Ct. Memo LEXIS 67

An organization is not exempt from federal income tax as a scientific or educational organization if a substantial portion of its net earnings inures to the benefit of a private individual.

Summary

The Foundation for the Study of Cycles sought exemption from federal income tax under Section 101(6) of the Internal Revenue Code, arguing it was organized and operated exclusively for scientific and educational purposes. The Tax Court denied the exemption because a significant portion of the Foundation's net earnings inured to the benefit of its director, Mr. Shipley. The court found that Shipley, the dominant figure in the organization, received compensation directly tied to the Foundation's net earnings, thus violating the requirement that no part of the net earnings benefit any private shareholder or individual.

Facts

The Foundation for the Study of Cycles was established to study cyclical phenomena. Shipley was the driving force behind the organization. A substantial portion of the Foundation's net earnings was paid to Shipley as compensation above his base salary. His additional compensation was directly tied to and determined by the Foundation's net earnings. In 1944, Shipley's compensation over salary was $7,651.37, mirroring the Foundation's net earnings after deducting this amount. Similar arrangements existed in 1945 and 1946, with Shipley receiving significant compensation based on the Foundation's net income.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Foundation's income tax. The Foundation petitioned the Tax Court for a redetermination, claiming exemption from tax. The Tax Court reviewed the Commissioner's determination and the Foundation's claim for tax-exempt status.

Issue(s)

Whether the Foundation qualifies for tax exemption under Section 101(6) of the Internal Revenue Code, given that a substantial portion of its net earnings inured to the benefit of a private individual, Mr. Shipley?

Holding

No, because a significant portion of the Foundation's net earnings inured to the benefit of Mr. Shipley, a private individual, which violates the requirements for tax exemption under Section 101(6) of the Internal Revenue Code.

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Court’s Reasoning

The court emphasized that to qualify for tax exemption under Section 101(6), an organization must meet three tests: (1) it must be organized and operated exclusively for exempt purposes; (2) its net income must not benefit private shareholders or individuals; and (3) it must not substantially attempt to influence legislation. The court found that the Foundation failed the second test. The court determined Shipley was a

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