18 T.C. 454 (1952)

A trust that operates a regular, substantial business as its primary activity, even if its ultimate purpose is to benefit charitable organizations, is not exempt from federal income tax under Section 101(6) of the Internal Revenue Code.

Summary

The John Danz Charitable Trust, established to fund organizations promoting a specific philosophy, operated several businesses, including a hotel and retail candy shops. The Tax Court addressed whether the trust qualified for tax exemption under Section 101(6) of the Internal Revenue Code, whether its income was taxable to the grantors, whether it was an association taxable as a corporation, and various deduction issues. The court held that the trust was not exempt because it was primarily engaged in business activities, its income was not taxable to the grantors, it was not an association taxable as a corporation, and clarified the deductibility of certain expenses and contributions.

Facts

John and Jessie Danz created an irrevocable trust, naming themselves and their sons as trustees, to fund organizations promoting a specific philosophy. The trust received contributions of cash and stock. It operated a hotel and several retail candy shops adjacent to theaters owned by Sterling Theatres, Inc. The trust's income was derived primarily from these business operations and secondarily from dividends and rents. Distributions were made to various charitable organizations.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the trust's income tax, declared value excess-profits tax, and excess profits tax for multiple years. The Commissioner also determined deficiencies against John and Jessie Danz individually, asserting the trust's income was taxable to them. The Tax Court consolidated the cases to resolve the various tax issues.

Issue(s)

1. Whether the trust is exempt from tax under Section 101(6) of the Internal Revenue Code.
2. Whether the trust income is taxable to the community of John and Jessie Danz.
3. Whether the trust is an association taxable as a corporation.
4. Whether the trust is entitled to deduct its entire net income under Section 162(a).
5. Whether the Commissioner erred in disallowing Christmas bonuses to employees.
6. Whether the individual petitioners are entitled to deductions under Section 23(o)(2) for contributions to the trust.
7. Whether the statute of limitations for assessment and collection of tax had expired before the deficiency notice.

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8. Whether the trust had reasonable grounds for believing no return was due for 1947, precluding a penalty for failure to file.

Holding

1. No, because the trust was not operated exclusively for charitable purposes due to its substantial business activities.
2. No, because the trust was irrevocable, the grantors retained limited powers, and it primarily benefited charitable organizations.
3. No, because the trust was not created to enable participants to carry on a business and divide the gains.
4. No, because the trust deed did not require any specific part of the gross income to be paid or permanently set aside for charitable purposes during the tax year.
5. Yes, because the Christmas bonuses were ordinary and necessary business expenses.
6. Yes, because the contributions were made to a valid trust for the use of charities described in Section 23(o).
7. No, because the Forms 990 filed were insufficient to start the statute of limitations.
8. No, because the trust was notified it was not exempt and failed to demonstrate reasonable cause for the late filing.

Court's Reasoning

The court reasoned that Section 101(6) requires an entity to be "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes." The trust's operation of retail businesses was a substantial activity, not merely incidental to charitable purposes. The court distinguished the case from those where the business activity was directly related to the charitable purpose. Regarding the taxation of the grantors, the court found the *Clifford* doctrine inapplicable because the trust was irrevocable, the grantors retained minimal control, and the trust's primary beneficiary was charitable organizations. The court dismissed the association taxable as a corporation argument, noting the trust lacked the characteristics of a business enterprise where participants share in gains. The court further explained that Section 162(a) required the trust instrument to mandate that income be "paid or permanently set aside" for charitable purposes during the tax year, which was not the case. Contributions were deemed deductible by the individuals because they were "for the use of" qualified charities, even if the trust itself did not qualify.

Practical Implications

Danz v. Commissioner clarifies the strict requirements for tax exemption under Section 101(6), emphasizing that substantial business activities can disqualify a trust, even if its ultimate goal is charitable. This case highlights the importance of structuring charitable trusts to ensure they are primarily engaged in charitable

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activities, not for-profit ventures. It also illustrates that contributions “for the use of” a charity can be deductible even if the immediate recipient (the trust) is not a qualified charity. The ruling also demonstrates the importance of adherence to filing deadlines and properly documenting expenses like employee bonuses, to ensure deductibility. Later cases have cited *Danz* for its interpretation of Section 101(6) and the “exclusively” operated requirement.

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