Ohio Furnace Company, Inc., Petitioner, v. Commissioner of Internal Revenue, Respondent. Shattuck-Ohio Foundation, Petitioner, v. Commissioner of Internal Revenue, Respondent, 25 T.C. 179 (1955)</p>

A corporation whose sole purpose is to generate income for an educational organization, where all earnings are dedicated to that purpose, may qualify for tax exemption, even if the income is not directly distributed to the educational organization in the tax year it is earned.

Summary</p>

The Shattuck-Ohio Foundation was established as a non-profit corporation to support educational institutions. The Foundation purchased the stock of Ohio Furnace Company, Inc. (the Furnace Company), a for-profit business, using a series of notes. The Foundation's charter stated that all of the Furnace Company's net earnings would be used to pay off these notes and, subsequently, to support educational causes. The Tax Court addressed whether the Foundation and the Furnace Company qualified for tax exemptions under relevant sections of the Internal Revenue Code. The court held that the Foundation was exempt because it was organized and operated exclusively for educational purposes and that the Furnace Company was also exempt as a "feeder corporation" under the Revenue Act of 1950 because its earnings benefited an educational organization as defined by the Act.

The Shattuck-Ohio Foundation was formed in 1948 as a Minnesota nonprofit corporation. Its stated purpose was to financially assist educational organizations, particularly schools for boys. In the same year, the Foundation purchased all the stock of the Ohio Furnace Company, Inc. The purchase was financed by Foundation notes. The Foundation's agreement with the sellers stipulated that substantially all of the Furnace Company's earnings would be used to pay off the notes. After the notes were paid, the earnings would support educational institutions. The Furnace Company was a for-profit business that distributed dividends to the Foundation. The Foundation used these dividends to service the notes. The Commissioner of Internal Revenue determined deficiencies in income tax against both the Foundation and the Furnace Company, arguing they did not qualify for tax exemptions. The parties agreed that the Furnace Company and the Foundation's activities did not consist of carrying on propaganda or attempting to influence legislation.

The Commissioner of Internal Revenue assessed income tax deficiencies against both the Shattuck-Ohio Foundation and Ohio Furnace Company, Inc. The petitioners contested the deficiencies. The case was heard by the United States Tax Court. The Tax Court considered whether the Foundation and Furnace Company qualified for tax exemptions under Section 101 of the Internal Revenue Code of 1939. After considering the relevant facts and arguments, the Tax Court ruled in favor of the

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petitioners, holding that both organizations qualified for exemptions.

1. Whether the Shattuck-Ohio Foundation was organized and operated exclusively for educational purposes and thus exempt from income tax under Section 101(6) of the Internal Revenue Code of 1939.

2. Whether the Ohio Furnace Company, Inc. was exempt from income tax under Section 101(6) and/or Section 302(d) of the Revenue Act of 1950.

1. Yes, because the Foundation's purpose was to support educational institutions, and all of its income was dedicated to that purpose.

2. Yes, because the Furnace Company's net earnings inured to the benefit of an educational organization, and thus qualified for exemption under Section 302(d) of the Revenue Act of 1950.

The court found the Foundation's operations exclusively educational because its purpose was to give financial assistance to educational institutions. It rejected the Commissioner's argument that the Foundation was not operated exclusively for educational purposes because it used its income to pay off the notes for the Furnace Company stock rather than directly funding educational activities. The court reasoned that the Foundation's investment in the Furnace Company was a sound investment for the benefit of educational institutions. "Inasmuch as the investment in the Furnace Company stock was a sound investment and the price was fair, the payments from the Foundation's income to the sellers of the Furnace Company stock did not constitute an inurement of the Foundation's income to them but was the consideration in a purchase of stock for value received."

Regarding the Furnace Company, the court applied the principle that, even if a for-profit business exists, it may be tax-exempt if it is a "feeder corporation" whose earnings benefit an exempt organization. The court considered whether the Furnace Company's earnings inured to an educational organization as defined by section 302(d) of the Revenue Act of 1950. The court held that the Foundation was created to fund educational activities and met the definition, so the Furnace Company qualified for the exemption. "While it is true that the Foundation does not qualify as an educational organization within the meaning of section 302 (d), that section does not provide that all the net earnings must be paid directly to the type of educational organization set forth in that section, but that they 'inure' to the benefit of such an educational organization."

This case clarifies the criteria for tax exemption for "feeder corporations" that support educational or charitable organizations. It demonstrates that tax exemption may be granted even if the income is not directly distributed to the exempt

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organization in the year it is earned, as long as all earnings benefit the exempt organization. It also provides an example of how an entity structured with the aim of generating income to support educational or charitable institutions can be structured to achieve tax exempt status. Businesses that intend to support a non-profit can consider structuring themselves so that their earnings are directed towards such organizations as a means of achieving tax exemption, provided the organization meets the requirements of the relevant tax codes. Later courts have followed this case in finding that the focus is whether the ultimate use of the income is for an exempt purpose.

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