Quarrie Charitable Fund v. Commissioner, 70 T. C. 182 (1978)

A charitable organization with a trustee's discretionary power to substitute beneficiaries fails the organizational test for exclusion from private foundation status under Section 509(a)(3).

Summary

The Quarrie Charitable Fund, created by Mable E. Quarrie's exercise of a power of appointment, was challenged by the Commissioner of Internal Revenue regarding its private foundation status. The fund's trust allowed the trustee to substitute beneficiaries if the original charitable uses became unnecessary, undesirable, impracticable, impossible, or no longer adapted to public needs. The key issue was whether this discretionary power violated the organizational test under Section 509(a)(3) of the Internal Revenue Code, which requires supporting organizations to be organized exclusively to support specified public charities. The Tax Court held that the broad discretionary power of the trustee made the substitution of beneficiaries not contingent on events beyond its control, thus failing the organizational test and affirming the fund's status as a private foundation.

Facts

William F. Quarrie created a trust in 1942, granting his wife, Mable E. Quarrie, the power to appoint charitable beneficiaries. Mable exercised this power in 1960, establishing the Quarrie Charitable Fund with The Northern Trust Company as trustee. The trust designated the Chicago Community Trust, Columbia-Presbyterian Medical Center Fund, Inc. , and the Art Institute of Chicago as beneficiaries. The trust also allowed the trustee to substitute other charitable beneficiaries if the original uses became unnecessary, undesirable, impracticable, impossible, or no longer adapted to public needs.

Procedural History

The Quarrie Charitable Fund sought a declaratory judgment under Section 7428 to establish it was not a private foundation, claiming it met the requirements of a supporting organization under Section 509(a)(3). The Commissioner determined the fund was a private foundation, and the case was submitted to the U. S. Tax Court based on the pleadings and administrative record. The Tax Court ruled in favor of the Commissioner, holding that the fund failed the organizational test of Section 509(a)(3).

Issue(s)

1. Whether the Quarrie Charitable Fund's organizational structure, allowing the trustee to substitute beneficiaries based on subjective judgment, satisfies the organizational test under Section 509(a)(3)(A) and Section 1. 509(a)-4(d)(4)(i)(a) of the Income Tax Regulations.

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Holding

1. No, because the trustee's power to substitute beneficiaries based on subjective criteria like "undesirable" or "no longer adapted to the needs of the public" is not conditioned upon events beyond its control, failing the organizational test under Section 509(a)(3)(A) and Section 1. 509(a)-4(d)(4)(i)(a) of the Income Tax Regulations.

Court's Reasoning

The Tax Court focused on the organizational test under Section 509(a)(3), which requires that supporting organizations be organized exclusively to support specified public charities. The court applied the regulation's requirement that any substitution of beneficiaries must be conditioned upon an event beyond the control of the supporting organization. The court found that the trustee's power to determine if a charitable use had become "undesirable" or "no longer adapted to the needs of the public" was a subjective judgment, thus within the trustee's control. This broad discretion did not meet the narrow, objective criteria required by the regulation. The court distinguished the trustee's power from the cy pres doctrine, which requires a potential failure of the charitable trust to trigger its application. The court also noted the legislative intent behind Section 509(a)(3) to ensure public scrutiny over supporting organizations, which is weakened by broad trustee discretion.

Practical Implications

This decision impacts how charitable trusts are structured to avoid private foundation status. Organizations must ensure that any power to substitute beneficiaries is tightly constrained and contingent on objective events beyond the trustee's control. This case informs legal practice by highlighting the need for precise drafting of trust instruments to meet the organizational test under Section 509(a)(3). The ruling affects the planning and operation of charitable trusts, as broad discretionary powers can lead to private foundation status and the associated regulatory burdens. Subsequent cases, such as those involving similar discretionary powers, would need to be analyzed in light of this precedent, potentially leading to more scrutiny of trust terms by the IRS.

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