H. Fort Flowers Foundation, Inc. v. Commissioner, 72 T. C. 399 (1979)

A private foundation cannot treat income used to restore its corpus as a qualifying distribution for purposes of avoiding the excise tax on undistributed income.

Summary

The H. Fort Flowers Foundation, a private charitable foundation, used income from 1970 to 1974 to restore its corpus depleted by a 1965 donation to Vanderbilt University. The IRS imposed a 15% initial excise tax under IRC section 4942(a) for failure to distribute this income for charitable purposes. The Tax Court held that the Foundation's use of income to restore corpus did not constitute a qualifying distribution, making it liable for the initial tax. However, the court found the Foundation had reasonable cause for not filing required tax forms due to prior IRS approval of its accounting method, thus avoiding additional penalties.

Facts

In 1965, the H. Fort Flowers Foundation donated $200,000 to Vanderbilt University for a library, exceeding its current and accumulated income. The Foundation treated this as an advance from its corpus, planning to repay it with future income. From 1970 to 1973, the Foundation's income was used to restore its corpus. In 1975, the Foundation made a qualifying distribution and elected to apply it retroactively to correct any underdistributions from 1970 to 1973, conditional on the IRS prevailing in its position.

Procedural History

The IRS audited the Foundation's returns and imposed deficiencies for initial and additional excise taxes under IRC section 4942 for 1972-1974, plus penalties for failure to file Form 4720. The Foundation petitioned the U. S. Tax Court, which upheld the initial tax liability but found no liability for the additional tax or penalties.

Issue(s)

1. Whether the Foundation's allocation of income to restore its corpus constitutes a qualifying distribution under IRC section 4942.
2. Whether the Foundation is liable for the 100% additional excise tax under IRC section 4942(b).
3. Whether the Foundation is liable for additions to tax under section 6651(a)(1) for failure to file Forms 4720.

Holding

1. No, because the Foundation's use of income to restore corpus did not qualify as a distribution for charitable purposes under the statute and regulations.
2. No, because the correction period for the additional tax had not expired at the

time of the decision.
3. No, because the Foundation had reasonable cause for not filing Forms 4720 due to prior IRS approval of its accounting method.

Court’s Reasoning

The court determined that the Foundation could not borrow from itself, and thus its use of income to restore corpus did not constitute a qualifying distribution under IRC section 4942 and the applicable regulations. The court rejected the Foundation’s constitutional arguments, finding no equal protection or due process violations. The court also upheld the validity of the Foundation’s conditional election to apply the 1975 distribution to correct prior underdistributions. Finally, the court found the Foundation had reasonable cause for not filing Forms 4720 due to prior IRS approval of its accounting method.

Practical Implications

This decision clarifies that private foundations cannot avoid the excise tax on undistributed income by using income to restore their corpus. Foundations must distribute income for charitable purposes in a timely manner to avoid tax liability. The decision also emphasizes the importance of proper tax filings, even when relying on prior IRS guidance. Subsequent cases have applied this ruling in determining the validity of distributions and the applicability of excise taxes on private foundations.

