German Soc. of Maryland, Inc. v. Commissioner, 80 T. C. 741 (1983)

A private foundation's correction of an improper expenditure does not relieve it from liability for the initial excise tax imposed under section 4945(a)(1) of the Internal Revenue Code.

Summary

The German Society of Maryland, a private foundation, made scholarship grants without obtaining the required advance approval from the IRS, resulting in taxable expenditures. Despite later receiving retroactive approval, the foundation was held liable for the initial 10% excise tax under IRC section 4945(a)(1) for the grants made before approval. The Tax Court ruled that the statutory scheme does not allow correction to negate the initial tax, emphasizing the two-tier structure of the excise taxes where only the second-tier tax can be avoided through correction.

Facts

The German Society of Maryland, Inc. , a private foundation established to provide scholarships, made grants in 1974, 1975, and 1976 without obtaining advance approval of its grant-making procedures as required by IRC section 4945(g). Approval was sought and received on November 15, 1976, retroactively from that date. The IRS determined the foundation liable for the initial excise tax under section 4945(a)(1) for grants made prior to receiving approval.

Procedural History

The IRS issued a notice of deficiency on January 10, 1980, asserting that the German Society of Maryland was liable for the initial excise tax for the taxable expenditures made in 1974, 1975, and prior to November 15, 1976. The foundation petitioned the U. S. Tax Court, which upheld the IRS's determination, ruling that correction does not relieve liability for the initial tax.

Issue(s)

1. Whether a private foundation that has corrected its improper expenditure under IRC section 4945 is relieved of liability for the initial tax imposed by section 4945(a)(1).

Holding

1. No, because the statutory language, legislative history, and case law indicate that correction of an improper expenditure does not relieve a foundation of liability for the initial tax under section 4945(a)(1).

Court's Reasoning

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The Tax Court interpreted the statutory language of section 4945, noting that the initial tax under section 4945(a)(1) is imposed unconditionally on taxable expenditures, while the additional tax under section 4945(b) is conditional upon correction. The court relied on legislative history indicating the initial tax was intended as an immediate sanction, not subject to avoidance by subsequent correction. Case law, such as Larchmont Foundation, Inc. v. Commissioner and Adams v. Commissioner, reinforced the two-tier nature of the excise taxes, where only the second-tier tax could be avoided through correction. The court acknowledged the foundation's argument that its procedures were consistent and the error was inadvertent but emphasized that the statutory scheme does not permit disregarding the initial tax based on correction.

Practical Implications

This decision clarifies that private foundations must ensure compliance with IRC section 4945(g) before making expenditures to avoid the initial excise tax. It underscores the importance of obtaining advance approval for grant-making procedures, as failure to do so results in immediate tax liability regardless of later correction. Foundations should implement robust internal controls to prevent such errors. The ruling may affect how foundations plan their grant-making activities and manage their tax obligations, emphasizing the need for timely compliance with IRS requirements. Subsequent cases have similarly distinguished between the first and second-tier taxes under section 4945, reinforcing the practical need for foundations to adhere strictly to statutory procedures.

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