St. Joseph Farms of Indiana Bros. of Congregation of Holy Cross, Southwest Province, Inc. v. Commissioner, 85 T. C. 9 (1985)

The farming operations of an exempt organization under a vow of poverty are not subject to unrelated business income tax if substantially all work is performed without compensation.

Summary

St. Joseph Farms, operated by the Congregation of Holy Cross, was deemed a trade or business not substantially related to its exempt purposes. However, the Tax Court ruled that because 94% of the farm work was performed by the Brothers under a vow of poverty without receiving compensation, the farming activities fell within the exception provided by section 513(a)(1) of the Internal Revenue Code. This decision was grounded in the fact that the support provided to the Brothers did not constitute compensation since it was given irrespective of their specific duties.

Facts

St. Joseph Farms of Indiana, an exempt organization under section 501(c)(3), operates a 1600-acre farm in Indiana. The farm was given to the Southwest Province of the Congregation of Holy Cross to provide a source of income. The farm is run primarily by the Brothers, who are under a vow of poverty and receive food, clothing, shelter, and medical care from the order, regardless of their specific assignments. Approximately 91% of the farm labor force and 94% of the total hours worked were provided by the Brothers. The farm's operations were commercially oriented, including participation in government farm programs, and the profits were used to support the Province's apostolic works.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in St. Joseph Farms' income tax for the years 1977, 1978, and 1979, asserting that the farming operations constituted an unrelated trade or business under section 513. St. Joseph Farms contested this determination. The case was submitted for decision under Rule 122 of the Tax Court Rules of Practice and Procedure. The Tax Court found in favor of St. Joseph Farms, applying the exception under section 513(a)(1).

Issue(s)

1. Whether the farming operations conducted by St. Joseph Farms constitute an unrelated trade or business within the meaning of section 513.
2. If the farming operations are deemed an unrelated trade or business, whether substantially all of the work in carrying on the trade or business was performed without compensation.

Holding

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1. Yes, because the farming operations were conducted for profit and were not substantially related to the organization's exempt purposes.
2. Yes, because substantially all of the farm work was performed without compensation, as the support provided to the Brothers did not constitute compensation for the purposes of section 513(a)(1).

Court's Reasoning

The court first determined that St. Joseph Farms' operations constituted a trade or business under section 162 due to their commercial nature and profit motive, as evidenced by participation in government subsidy programs and the scale of operations. The court rejected the argument that the farm was operated primarily as an apostolate, finding no substantial relationship between farming and the propagation of moral values. However, the court found that the farming activity fell within the exception of section 513(a)(1), as the Brothers performed the vast majority of the work without compensation. The court reasoned that the support provided to the Brothers was not contingent on their farming duties but was a standard provision to all members under a vow of poverty. The court emphasized that for an activity to be considered compensation, there must be a "but-for" connection between the payment and the services rendered, which was not present in this case.

Practical Implications

This decision clarifies that exempt organizations can engage in commercial activities without incurring unrelated business income tax if the work is performed by members under a vow of poverty without compensation. Legal practitioners advising such organizations should ensure that the support provided to members is not contingent on their specific duties. This ruling may encourage similar religious orders to engage in commercial ventures as a means of funding their exempt activities, provided they meet the criteria of section 513(a)(1). The decision also highlights the importance of distinguishing between support and compensation in the context of tax-exempt organizations.

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