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# FEDERAL TAX REGULATIONS 1961

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tion M, which files the calendar year return purportedly for the year 1955, from its gross income of \$100,000. The amount of the gift tax credit available to M for such year is \$100,000. M contributes to the foundation \$100,000 and takes the deduction for such year. In 1956, M purports to divert the assets of Corporation M, and the corporation is so dissolved for the year 1956. For the year 1956, the exemption as an organization is denied by section 501(a). Both M and the foundation would be denied the contributions deduction. Moreover, M is denied the deduction for the contribution to the foundation in the year 1956. M also is denied the right to the charitable deduction for the purpose of the foundation. M shall also be denied the deduction for the contribution to the foundation in the year 1956 by reason of the fact that M was not a party to the contribution.

Internal Revenue Code section 501(c)(3), U.S.C.A. (I.R.C.)

Internal Revenue Code section 501(c)(3), U.S.C.A. (I.R.C.)

#### reference

Internal Revenue Code section 401(a), see

Internal Revenue Code section 501(c)(3), U.S.C.A. (I.R.C.)

#### Exemption

Internal Revenue Code section 501(c)(3), U.S.C.A. (I.R.C.)

Internal Revenue Code section 501(c)(3), U.S.C.A. (I.R.C.)

in section 501(c)(3). Even though an organization has not violated any of the terms of section 504, it still may not qualify for tax exemption in view of the general provisions of section 501(c)(3). Thus, if a trustee or other fiduciary of the organization (whether or not he is also a creator of such organization) enters into a transaction with the organization, such transaction will be closely scrutinized in the light of the fiduciary principle requiring undivided loyalty to ascertain whether the organization is in fact being operated for the stated exempt purposes.

(b) (1) Any organization described in section 501(c)(3) other than an organization described in section 503(b)(1) through (5), inclusive, shall not be exempt under section 501(a) if the amounts accumulated out of income during the taxable year, or any prior taxable year, and not actually paid out for exempt purposes by the end of the taxable year, are unreasonable. Amounts accumulated out of income become unreasonable when more income is accumulated than is needed, or when the duration of the accumulation is longer than is needed in order to carry out the purpose constituting the basis for the organization's exemption. Furthermore, such an organization shall not be exempt under section 501(a) if amounts accumulated out of income are used to a substantial degree for purposes or functions other than those constituting the basis for the organization's exemption, or if such amounts are invested in such a manner as to jeopardize the carrying out of the purpose or function constituting the basis for the organization's exemption.

(2) The provisions for the denial of exemption for unreasonable accumulations of income will not apply to income attributable to property of a decedent dying before January 1, 1951, which is transferred under his will to a trust created by such will. In the case of a trust created by the will of a decedent dying on or after January 1, 1951, where income is required to be accumulated by the trust, the denial of exemption for unreasonable accumulations of

income under paragraph (b)(1) of this section will apply only to income accumulated during a taxable year of the trust beginning more than 21 years after the date of death of the last life in being designated in the trust instrument.

(c) For the purpose of section 504, the term "income" means gains, profits, and income determined under the principles applicable in determining the earnings or profits of a corporation. The amount accumulated out of income during the taxable year or any prior taxable year shall be determined under the principles applicable in determining the accumulated earnings or profits of a corporation. In determining the reasonableness of an accumulation out of income, there will be disregarded the following:

(1) The accumulation of gain upon the sale or exchange of a donated asset to the extent that such gain represents the excess of the fair market value of such asset when acquired by the organization over its substituted basis in the hands of the organization;

(2) The accumulation of gain upon the sale or exchange of property held for the production of investment income, such as dividends, interest, and rents, where the proceeds of such sale or exchange are within a reasonable time reinvested in property acquired and held in good faith for the production of investment income.

(d) Whether the conditions specified in paragraphs (1), (2), and (3) of section 504(a) are present in any case must be determined from all the facts. The conditions specified in section 504(a)(1), (2), and (3) may result from the use of only one organization or of a chain of two or more organizations.

(e) An organization that has lost its exempt status by reason of the provisions of section 504 may, in order to reestablish its exemption, file a claim for exemption with the district director for the internal revenue district in which is located the principal place of business or principal office of the organization. Form 1023, the exemption

Internal Revenue Code references are identical with 26 U.S.C.A. (I.R.C.1954) sections