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TAXATION—CHARITABLE CONTRIBUTION V. DIVIDEND—PAYMENT BY A CORPORATION TO AN EXEMPT ORGANIZATION OWNING 75% OF THE CORPORATION'S STOCK WAS A DIVIDEND RATHER THAN A CHARITABLE CONTRIBUTION. *Sid Richardson Carbon & Gasoline Co. v. United States*, 416 F.2d 867 (5th Cir. 1969).

Sid Richardson Carbon & Gasoline Co. ("taxpayer"), a Texas corporation, deducted as a charitable contribution \$100,000 paid in 1962 to the Sid Richardson Foundation ("Foundation"), a Texas nonprofit corporation. The payment to the Foundation was made pursuant to a resolution passed by unanimous vote of taxpayer's board of directors.

Prior to 1959 taxpayer was owned by Sid W. Richardson (75 per cent) and Perry R. Bass, Richardson's nephew (25 per cent). Richardson's 75 per cent, after his death in 1959, was transferred to the Foundation by reason of Richardson's will, which bequeathed the residue of his estate, including the stock, to the Foundation.

The Foundation was created in 1947 by Richardson and at all times was classified by the Internal Revenue Service as an organization exempt from income tax under what is now section 501(c)(3),¹ contributions to which are deductible under what is now section 170(c)(2).

From its inception, the Foundation received contributions from Richardson, Bass, and their related enterprises totaling \$1,020,500, exclusive of the \$100,000 involved in the case. All contributions were deducted as such by the respective donors in their income tax returns, and all were allowed as such, except the \$100,000 in issue. The Foundation did not conduct any charitable activity itself, but used its funds to support charitable activities operated by others. Since its inception, the Foundation contributed \$819,247 to various qualified donees. It was the practice of Richardson, Bass, and the businesses owned by them to make contributions to the Foundation rather than to active charitable organizations directly. The Foundation's directors were Bass, various members of the Richardson and Bass families, and an employee of Bass's business enterprises.

The Commissioner disallowed the taxpayer's claimed deduction and assessed a deficiency, which was paid. The taxpayer filed a claim for refund, which was denied, and suit followed.

The district court² held for the taxpayer, finding as a fact that the payment was intended to be a charitable contribution. Held—*Reversed*. A transfer, without consideration, from a taxable corporation to an exempt organization owning 75 per cent of the corporation's stock

¹ All "sections" cited herein are with reference to the Internal Revenue Code of 1954.

² *Sid Richardson Carbon & Gasoline Co. v. United States*, 291 F. Supp. 674 (N.D. Texas 1968).

is a dividend to the extent provided in section 316(a) and cannot be deducted under section 170.

A taxable corporation wholly owned by a charitable foundation is not entitled to a charitable contribution deduction for the value of property transferred to its parent.³ Nor will a deduction be allowed where the charitable foundation, although not a stockholder, is on the facts the beneficial owner of the taxable corporation.⁴

The problem was pinpointed by the court in *Crosby* when it said:

[T]here is no specific statutory provision which compels but one result. The transfers in this case fall equally within the literal meanings of "charitable contributions" under section 170(c) of the Internal Revenue Code, and of "dividend" under section 316(a). Neither provision provides a clue to resolving the problem, for the transfers in this case were admittedly made to a qualifying charity and were also a distribution of property by a corporation to its shareholders.⁵

The clue to resolving the problem was found in the statutory treatment and legislative background of what are now sections 502 and 511-515, dealing with feeder organizations and unrelated business income of charitable organizations. One of the problems faced by Congress was the growing involvement of charitable organizations in competitive business operations. Congressional concern was stated by the House:

The tax-free status of these . . . organizations enables them to use their profits tax-free to expand operations, while their competitors can expand only with the profits remaining after taxes. . . .⁶

The court in *Crosby* concluded that Congress intended to place businesses owned by charitable organizations on par with their non-charitable competitors and that the taxpayer must be prevented from enjoying an advantage over its competitors:

[W]ere petitioner's deductions to be allowed it would be able to make a partially tax-free distribution of its earnings to its sole stockholder—something denied to its competitors and clearly

³ *Crosby Valve & Gage Co. v. Commissioner*, 380 F.2d 146 (1st Cir. 1967), *cert. denied*, 389 U.S. 976, 88 S. Ct. 477, 19 L. Ed. 2d 468 (1967).

⁴ *United States v. Knapp Brothers Shoe Manufacturing Corp.*, 384 F.2d 692 (1st Cir. 1967), *cert. denied*, 390 U.S. 989, 88 S. Ct. 1182, 19 L. Ed. 2d 1293 (1968).

⁵ *Crosby Valve & Gage Co. v. Commissioner*, 380 F.2d 146, 147 (1st Cir. 1967), *cert. denied*, 389 U.S. 976, 88 S. Ct. 477, 19 L. Ed. 2d 468 (1967).

⁶ H.R. Rep. No. 2319, 81st Cong., 2d Sess. 37 (1950). For a full discussion of the evil sought to be avoided, see Note, *The Macaroni Monopoly: The Developing Concept of Unrelated Business Income of Exempt Organizations*, 81 HARV. L. REV. 1280 (1968).

contrary to the approach to the tax treatment of "feeder" organizations taken by section 502 of the Internal Revenue Code.⁷

The district court distinguished *Crosby* and *Knapp Bros.*:

[I]n each of these cases, the charitable donee either actually or beneficially owned all of the donor corporations, and in each case, the donor organization was acquired as a "feeder" to the charitable organization; whereas, in the present case, Foundation acquired the 75 per cent of the stock of plaintiff, held by it at the pertinent times, involuntarily and as a part of the bequest of the residue of the Estate of Sid W. Richardson.⁸

On the issue of ownership, the Fifth Circuit did not consider the difference of controlling importance. As in *Crosby* and *Knapp Bros.*, there was effective control:

[T]he taxpayer was owned $\frac{1}{4}$ by Mr. Bass outright and $\frac{3}{4}$ by an organization which was under the sole control of taxpayer's directors and persons closely related to one of those directors. Though taxpayer was not owned 100% by the Foundation the conclusion is inescapable that any action taxpayer took was also an action taken by the persons who had the sole control of Foundation.⁹

On the issue of method of acquisition of the corporation's stock by the Foundation, the court ruled:

Neither the language nor the policy of the statute appears to support the contention that distributions from "feeders" are taxable when the "feeder" is bought or established for the purpose of feeding the charity but may be exempt when the ownership of the "feeder" is obtained involuntarily by the charity. The language of the Internal Revenue Code indicates that the mode of acquisition is irrelevant . . . Furthermore, to accept the "involuntarily acquired" defense would be to create a simple loophole for a taxpayer wishing to make a tax-exempt profit-making business of a favorite charity. The taxpayer would only need to give the charity a business (or the stock thereof) and the charity would be entitled to the profits of the business tax-free.¹⁰

The decision raises some serious questions about the use of exempt foundations for effective tax planning. If the nature of control is a key element, for example, would the result be the same if the charitable organization owns 51 per cent of the taxable corporation, and the remaining 49 per cent ownership control the foundation? Or if the

⁷ *Crosby Valve & Gage Co. v. Commissioner*, 380 F.2d 146, 149 (1st Cir. 1967), *cert. denied*, 389 U.S. 976, 88 S. Ct. 477, 19 L. Ed. 2d 468 (1967).

⁸ *Sid Richardson Carbon & Gasoline Co. v. United States*, 291 F. Supp. 674, 678 (N.D. Texas 1968).

⁹ *Sid Richardson Carbon & Gasoline Co. v. United States*, 416 F.2d 867 (5th Cir. 1969).

¹⁰ *Id.*