

ance of its exempt purposes. So, if its charter gives the charitable organization the power to engage in a manufacturing business or to operate a social club, the organization would generally not qualify for exemption. This would be so, even though the charter stated that its purposes were exempt.<sup>2</sup> However, an organization may be exempt even though a trade or business is a substantial part of its operation, provided it is not organized and operated primarily to carry on an *unrelated* trade or business and the trade or business furthers its exempt purposes. There are no hard and fast rules for determining whether the trade or business is related to the exempt purposes. Among the factors to be considered are the size and extent of the trade or business and the extent to which its activities further the exempt purposes.<sup>3</sup> The Treasury has said that renting a commercial building which the organization maintains to finance its charitable activities is sufficiently related to the exempt purposes.<sup>4</sup> For further discussion of when a trade or business is unrelated, see § 8002 *et seq.*

Another aspect of the organizational test is the disposition of the exempt organization's assets on its dissolution. To qualify for exemption, the charter cannot provide for a transfer to anyone except another exempt organization, or the federal, state, or local government for a public purpose. It is not, however, necessary to provide for a disposition of the assets on dissolution if local law would require their permanent dedication to an exempt organization.<sup>5</sup>

The Treasury set up its organizational requirements in '59. Organizations which were granted exemption before July 27, '59, will not have their exemptions revoked solely on the basis that their charters do not meet the organizational requirements. However, organizations applying for exemptions after that date must meet these tests.<sup>6</sup>

1. Regs. § 1.501(c)(3)-1(b).
2. Regs. § 1.501(c)(3)-1(b).
3. Regs. § 1.501(c)(3)-1(c).
4. Rev. Rul. 64-182, CB 1964-1, 186.
5. Regs. § 1.501(c)(3)-1(b)(4).
6. Regs. § 1.501(c)(3)-1(b)(5).

§ 7913. Operated exclusively for the exempt purposes. In addition to being organized for an exempt purpose, a religious, charitable, educational, etc., organization must operate as an exempt organization. The regs say this means:

- ... it engages primarily in activities which accomplish one or more exempt purposes.
- ... it does not function as an action organization.
- ... no part of its net earnings inure to the benefit of private shareholders or individuals.

An organization that makes grants to individuals (writers, composers, painters, sculptors, scholars, etc.) for the purpose of assisting them to carry on their creative efforts qualifies for the exemption, where the results of the research and the rights to the artistic and scholarly work belong to the recipient of the grant.<sup>1</sup> But an organization which makes funds available to authors and editors for preparing teaching materials and writing textbooks does *not* qualify for the exemption where it receives a portion of the royalties earned by the authors and editors.<sup>2</sup>

Organizations were not considered operated exclusively for exempt charitable purposes where long-term credit was extended to the organization's founders after refusal by a bank even though the charity was repaid with an ample return.<sup>3</sup> Publishers of educational and economic materials who operated on a competitive basis with other companies were held not to be operated exclusively for exempt purposes.<sup>4</sup>

An essential of qualifying for exemption is that no part of the organization's net earnings inure to the benefit of any private shareholders or private individuals.<sup>5</sup> The by-laws may not permit the directors to declare dividends from profits,<sup>6</sup> fix shareholders' salaries in proportion to their holdings<sup>7</sup> or give them discretion to make or not make distributions to charities, so that the dedication is less than irrevocable.<sup>8</sup>

Many private schools will be taxable since they are operated for the owners' profit.<sup>9</sup> This will also be true of many private hospitals.<sup>10</sup>

The benefit to the individual may be indirect such as excessive maintenance or similar allowances,<sup>11</sup> excessive rent to the organization's managers,<sup>12</sup> reimbursement of expenses incurred by the founder before setting up the organization.<sup>13</sup> The private benefit has taken the form of promoting the works of an author who was one of the organization's founders.<sup>14</sup> On the other hand a foundation devoted to the spread of scientific knowledge did not lose its exemption because an unrelated publisher made a profit from the distribution of its books.<sup>15</sup>

The payment of reasonable compensation to the trustee, even though he is related to the founder will not disqualify the trust.<sup>16</sup> Nor will the organization be disqualified for reasonable payments to or on behalf of staff members who are needed to achieve the organization's exempt purposes.<sup>17</sup>

The charity should keep records of its disbursements, showing the names and addresses of the payees and their relationship to the organization or its founder, the amounts and the purposes of the payments.<sup>18</sup>

A charitable organization may have an obligation to make annuity or other payments to