¶ 7992. Barred accumulations, uses, and investments of income. The rule against improper accumulation, use or investment of income is violated if the amounts accumulated out of income in or prior to the taxable year and not *actually* paid out by the end of year are either:

. . . Unreasonable in amount or duration in order to carry out the exempt purpose of the organization. This provision doesn't apply (a) to income attributable to property of a decedent dying before '51 transferred under his will to a trust created by it and (b) to income accumulated after the end of 21 years following the death of the last life in being designated in a trust created by the will of a decedent dying after '50 if income *must* be accumulated by the terms of the will creating the trust.

. . . Used to a substantial degree for nonexempt purposes.

. . . Invested in a manner that jeopardizes the tax exempt purposes of the organization.[1]

The following aren't *income* for purposes of the improper accumulations rule:

. . . Contributions received by the exempt organization.[2]

. . . Gain on sale or exchange of donated assets to the extent of the excess of the fair market value of the assets *when donated* over their substituted basis to the organization. This gain doesn't have to be paid out.[3]

1. Code Sec. 504(a); Regs. § 1.504-1(b)(1).
2. Rev. Rul. 58-535, CB 1958-2, 270.
3. Regs. § 1.504-1(c)(1).

¶ 7993. Unreasonable accumulation of income. The principal prohibition of the rule against improper accumulation, use, or investment of income bars accumulations of income that are unreasonable in amount or duration in order to carry out the purposes or functions constituting the basis for the organization's exemption.[1] The mere fact that an exempt organization may accumulate income won't bar its exemption. There must be an *unreasonable* accumulation.[2]

Accumulations of income were held to be unreasonable where they were excessive in relation to current expenditures and weren't otherwise justified by any specific program.[3]

But the following have been held not to be unreasonable income accumulations:

. . . Temporary accumulation of any gain on sale or exchange of income producing investment property, *but only if* such gains are reinvested within a reasonable time in other income producing investment property.[4]

. . . Accumulations to restore capital distributed in prior years.[5]

. . . Accumulations held as a reserve for a *specific and unconditional* charitable grant to be paid over a fixed period, or over the period necessary to accomplish the specific purpose of the grant, extending beyond the year of the commitment to make the grant. Apparently any undistributed balance of the reserve would be treated as distributable income for the year in which the commitment was otherwise satisfied or released.[6]

. . . Accumulations to build a reserve fund for an employee pension plan.[7]

. . . Accumulations to pay off debt on corpus of an otherwise bona fide exempt organization.[8]

. . . Accumulations over a period of six or seven years to build up (through income plus additional contributions) a fund to be donated to Brandeis University for construction of a medical research center.[9]

✓ *recommendation:* To protect deduction for charitable contributions to private foundations don't contribute more property than the foundation needs to meet the income requirements of its existing charitable program. The foundation, of course, can always prevent accumulations of excess income by contributing it to other exempt organizations.

1. Code Sec. 504(a)(1).
2. John Danz Charitable Trust, 32 T.C. 469, aff'd on other issues 284 F. (2d) 726.
3. Stevens Bros. Foundation, Inc., 39 T.C. 93, aff'd 324 F. (2d) 633, cert. den. 376 U.S. 969, reh. den. 377 U.S. 920; Erie Endowment v. U.S., 316 F. (2d) 151; Danforth Foundation v. U.S., 222 F. Supp. 761, aff'd 347 F. (2d) 673.
4. Regs. § 1.504-1(c)(2).
5. Rev. Rul. 54-137, CB 1954-1, 289; Rev. Rul. 54-227, CB 1954-1, 291.
6. Rev. Rul. 55-674, CB 1955-2, 264.
7. Truscott v. U.S., D.C. Pa., 4/1/58.
8. Tell Foundation v. Wood, D.C. Ariz., 11/26/57; Randall Foundation v. Riddell, 244 F. (2d) 803.
9. Samuel Friedland Foundation v. U.S., 144 F. Supp. 74.

¶ 7994. Substantial nonexempt use of income. One of the prohibitions of the rule against improper accumulation, use, or investment of income bars use of income to a substantial degree for purposes or functions other than those constituting the basis for the organization's exemption.[1]

It has been held that use of income to pay indebtedness wasn't an improper use, where:

. . . The indebtedness paid was incurred in acquiring income producing property, the income from which was used to make the debt payments.[2]

. . . The indebtedness paid was secured by mortgages on income producing property that the organization received as a gift subject to such mortgage debt.[3]