

# **§ 7995—Unreasonable Accumulations**

34 Am Jur 2d

1. Code Sec. 504(a)(2).
2. *Shiffman*, 32 T.C. 1073 (A).
3. *Tell Foundation v. Wood*, D.C. Ariz., 11/26/57.

§ 7995. Investment of income jeopardizing exempt purpose. Part of the rule against improper accumulation, use, or investment of income bars investment of accumulated income in such a manner as to jeopardize the carrying out of the purpose or function constituting the basis for exemption of the organization.<sup>1</sup>

The test under this rule has been held to be whether whatever loss is likely to occur would imperil the capability of the organization to carry out its charitable purposes. It was held that:

... Investments which would have no substantial adverse effect on the organization's continued operation even if totally lost could be disregarded.

... A very substantial stock investment made with borrowed funds wasn't objectionable, even though a 15% decline in the price of the stock would have wiped out the foundation, where the investment was made on the recommendation of the grantor and principal stockholder of the corporation who had inside knowledge of its affairs and unquestioned investment acumen.

... Investment in amply secured second and third mortgages subject only to limited amounts of prior mortgages in relation to the value of the property.<sup>2</sup>

1. Code Sec. 504(a)(3).
2. *Samuel Friedland Foundation v. U.S.*, 144 F. Supp. 74.

§ 7996. Penalty for improper accumulation, use or investment of income. An exempt organization that improperly accumulates, uses, or invests its income in violation of the rule against unreasonable accumulations is denied exemption for the taxable year in which the improper accumulation, use, or investment occurs.<sup>1</sup> An organization that has lost its exemption under this provision may file a new application for exemption showing that the cause for the loss of the exemption no longer exists.<sup>2</sup>

But a contributor to an otherwise exempt organization isn't denied a charitable contribution's deduction for a donation made in the year in which the organization lost its exemption solely for violation of the unreasonable income accumulation rule.<sup>3</sup>

1. Code Sec. 504(a).
2. Regs. § 1.504-1(e).
3. Regs. § 1.504-1(f).

# **§ 8000. Unrelated Business Income.**

Virtually all exempt organizations, other than churches and certain other religious organizations, are taxable on their unrelated business income over \$1000. In general, the tax applies to a trade or business that isn't substantially related to the organization's exempt purpose. Special rules apply to trusts that qualify as exempt organizations. Unrelated business income includes so-called "business lease" income.

§ 8001. Organizations taxed on unrelated business income. The Code imposes income tax on the "unrelated business taxable income" of exempt organizations<sup>1</sup> without otherwise affecting their tax exempt status.<sup>2</sup> The tax applies only to unrelated business taxable income over \$1,000.<sup>3</sup>

The exempt organizations that are nevertheless taxable on their unrelated business taxable income are listed at § 7905.

1. Code Sec. 511.
2. Code Sec. 501(b).
3. Code Sec. 512(b)(12).

§ 8002. Unrelated trade or business of a trust. In the case of trusts, unrelated trade or business means any trade or business regularly carried on by the trust or by a partnership of which it is a member. This rule applies to:

... Exempt employees' supplemental unemployment compensation benefits trusts.

... Exempt qualified employee pension, profit-sharing, and stock bonus plan trusts.

... Non-exempt trusts.<sup>1</sup>

Under the foregoing rule, the following have been held to be taxable unrelated trades or businesses of trusts:

... Leasing of railroad tank cars for a term of years with renewal option, by an exempt employee trust.<sup>2</sup>

... Leasing of tire manufacturing machinery by an exempt employee trust to the employer tire manufacturer.<sup>3</sup>

✓ *observation:* Nonexempt trusts are taxable under the general rules for taxation of estates and trusts. Those rules allow a deduction for charitable contributions made by the trust. A limitation on that deduction bars