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Edward A. Lebit

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Tax Exempt Organizations

Edward A. Lebit*

SINCE WORLD WAR II, tax exempt organizations have grown significantly in numbers. Many tax avoidance devices and schemes have been used in attempts to shift the tax burden, and members of Congress have inquired into this. In 1949 there was Senator Tobey; in 1954, Congressman Cox; in 1956, Congressman Reece; and in 1962, Congressman Patman. In the 1962 inquiry, a study of use of foundations for tax avoidance purposes was carried on by Patman's committee at Cleveland-Marshall Law School in consultation with Dean Howard L. Oleck of this law school. Although a tax exempt organization is a creature of the state, it is under the federal law—the Internal Revenue Code—that tax exemption litigation arises.

In 1950 legislation was passed to close some of the existing loopholes. A tax on unrelated business income was aimed at the problem of unfair competition. "Feeder organizations" were also taxed on the same principle.

At present new emphasis has been placed on the matter of exactly which Code section applies to an organization attempting to gain tax exempt status. Although each case is a question of fact, the main issue usually is whether or not the organization was organized and operated within the principles of the particular provisions of law (*i.e.*, which section of the Code) upon which it relies to exempt it from income tax.

Section 501(c)(1) exempts from income tax corporations organized under an Act of Congress. To qualify for exemption under this section it is necessary that the organization be an instrumentality of the United States and that it be exempt from federal income tax not only under the original act creating it, but also under its supplements and amendments. Examples of associations exempt from tax under Section 501(c)(1) are the Commodity Credit Corporation, Federal Reserve Banks, Federal Credit Unions, and the Home Owners Loan Corporation. Federal credit unions organized and operated in accordance with the Federal Credit Union Act have been held to be instrumentalities

* Attended Oberlin College; B.A., Western Reserve University; Graduate of the School of Business, Ohio State University; Certified Public Accountant; Third-year student at Cleveland-Marshall Law School.

of the United States.¹ No significant litigation has occurred in this area.

Section 501(c) (2) of the Internal Revenue Code provides for exemption of

corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under this section.

It is clear that this section applies only to those organizations which confine their activities to the ownership and management of property. However, by necessary implication this section authorizes a title-holding corporation to engage in some income producing activities.

Oftentimes the corporate charter may contain broad powers and business purposes far beyond the scope necessary to a holding company exempt under Section 501(c) (2) of the Code. The courts thus far have favored corporations whose charters contain broad but unused powers. Yet, in certain cases amendment of the charter has been required before exempt status has been granted.²

“Stock ownership” in these corporations need not be fatal in an exempt organization as long as such ownership confers no rights to dividends or profits realized.³ The term “stock” in such an organization really means “evidence of membership.”

Because of a lack of regular audits by the I.R.S. in the last few years, much abuse has occurred, often in the form of unrelated business activities carried on under the cloak of Section 501(c) (2) of the Internal Revenue Code.

Section 501(c) (3) undoubtedly is the best known of the tax exemption statutes. This subsection grants exemption to

corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literacy, or educational purpose, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, and which does not participate in or intervene in (including the publishing

¹ Rev. Rul. 55-133, 1955-1 C. B. 1938.

² N. P. E. F. Corp. v. Comm., 5 CCH Tax Ct. Mem. 313 (1946).

³ I. T. 3860, 1947-2 C. B. 70.

or distributing of statements) any political campaign on behalf of any candidate for public office.

Many organizations claiming exemption from taxation seek to qualify under this section, as it confers a double benefit—(1) contributors may deduct their contributions under Section 170, and (2) the organization is itself tax-exempt.

Study of this section reveals that there are four main requirements that an organization must meet in order to be tax exempt. Requirement number one is that it must be organized and operated for one or more specific nonprofit purposes. The second requirement is that its net income must not inure in whole or in part to the benefit of private shareholders or individuals. The third requirement is that it must not, in any substantial part of its activities, attempt to influence legislation by propaganda or other means. The fourth requirement is that it must not participate, or intervene, in any political campaign on behalf of any candidate for public office.

There have been conflicting decisions as to whether the word "organized" can be separated from the word "operated," so that the actual activities rather than the stated purposes determine the exemption status.⁴ However, the policy of the Internal Revenue Service appears to be that an organization seeking exemption must be judged by its articles of incorporation.⁵ Express authority to exercise an "all powers" clause in articles of incorporation, under state law, with no restriction that such powers shall be exercised only in furtherance of exempt purposes, is inconsistent with the tax exemption, even under the organizational test.⁶

It is in the area of inurement of income that tax exempt organizations may be challenged most. It is here that most tax abuse has taken place. Income may inure to an individual member in many forms. For example, exemption has been lost because of distribution of profits in the form of salaries.⁷ An illustration of this was the case of a privately operated outpatient

⁴ Samuel Freidland Foundation v. U. S., 144 F. Supp. 74 (D. C. N. J. 1956). See, Oleck, Foundations Used as Business Devices, 9 Clev-Mar. L. R. 339 (1960).

⁵ O. C. 190, C. B. 1, 194 (1919). But see Oleck, *supra*, n. 4.

⁶ Announcement 62-19, I. R. B. No. 1962-8, 20. See, generally, Oleck, Non-Profit Corporations & Associations (1956).

⁷ Birmingham Business College, Inc. v. Comm., 276 F. 2d 476 (5th Cir. 1960).

clinic where the salary of each doctor was based upon the number of patients he brought into the clinic.⁸

Security transactions often are the technique of tax abuse. Exempt organizations have been challenged and defeated when they have purchased stock at a price substantially in excess of its fair market value.⁹

Various plans and abuses have been used by foundations, which probably will be under even closer scrutiny in years to come. In one specific case a foundation acquired all the stock of a business corporation, dissolved the corporation, and sold, leased, and licensed the assets to an operating company, receiving in return a substantial portion of the operating company's profits, which it used to liquidate the indebtedness incurred in acquiring the business. Because of this inurement of income, the exempt status of this foundation was disallowed.¹⁰

Another widely used scheme which may cause a foundation to lose its exemption is the practice of contributing Section 306 stock, commonly known as "hot stock," to one's own foundation. This stock is then redeemed by the corporation with no tax effect on the contributor. The donor has actually taken a tax free dividend from his corporation, as he was allowed a tax deduction for his contribution of such stock to the foundation.

In general, it may be said that a denial of exemption will occur in cases where the organization serves the private interests of its founders, rather than the public interest contemplated by the statutes.

The propaganda prohibition has not caused much of a problem as organizations which openly attempt to influence legislation seldom have tried to qualify for exemption. Although tax exempt groups once in a while may make legislative recommendations, it is doubtful they will be disqualified for so doing unless such activities constitute a substantial part of their functions.

The provision that an exempt organization must not participate or intervene in any political campaign may cause some organizations to lose their tax exempt status. Because of a recent increase in the number of audits of foundations, more cases of such political activities may come to light. Exemption probably

⁸ Lorain Avenue Clinic, 31 T. C. 141 (1958).

⁹ Emanuel N. Kolkney v. Comm., 254 F. 2d 51 (7th Cir. 1958).

¹⁰ Rev. Rul. 55-420, 1954-2 C. B. 128.

will be denied not only to organizations engaged in such activity, but to those whose charters even permit them to do so.¹¹

Various religious organizations have tried to qualify for tax exemption, and for one reason or another have failed, under Section 501(c)(3) of the Code. The mere fact that an organization is denominated a "church" does not necessarily mean that it is entitled to exemption. In *Puritan Church—The Church of America*¹² an exemption was denied on the ground that it was formed in part to accomplish its organizer's personal objectives. Printing companies have attempted to print religious literature on what really amounted to a profit basis, but have been stopped from claiming exemption as religious organizations.¹³

Charitable foundations have become the chief devices employed by the business world today due to the fact that a number of administrative, as well as tax, advantages are available in them, which would not be so if the parent business corporation made direct contributions to charity.

Thus, charitable trusts and foundations have been created by employers for the primary purpose of paying pensions to retired employees. However, as the payments of such pensions are not charitable undertakings, such trusts have failed to qualify under Section 501(c)(3).¹⁴ In certain cases such trusts have qualified when it was shown that they relieved the community of burdens of public welfare expenses as would ordinarily fall upon it.

Oftentimes hospitals are operated for profit. Therefore, specific rules have been set up for a hospital to qualify as a tax exempt organization.¹⁵ It must be a non-profit organization for the care of the sick. It must be operated, to the extent of its financial ability, for those not able to pay for the services rendered. It must not restrict the use of its facilities to a particular group of doctors. Its net earnings must not inure directly or indirectly to the benefit of any private shareholder or individual.

Homes for the aged qualify under Section 501(c)(3). Many of these organizations in fact are run with a profit motive. These homes lose tax exemption if they do not accept charity cases or

¹¹ Regs. Sec. 1.501(c)(3)-1(b)(3)(ii).

¹² ¶51,150 P-H Tax Ct. Mem. (1951).

¹³ *Scripture Press Foundation v. U. S.*, 285 F.2d 800 (Ct. Cls. 1961).

¹⁴ Rev. Rul. 56-138, 1956-1 C. B. 202. But see the discussion of the Scholler case in *Oleck*, *supra* n. 4.

¹⁵ Rev. Rul. 56-185, 1956-1 C. B. 202.

if they require the discharge of guests who fail to make certain required monthly payments.¹⁶

Educational organizations are numerous. The term "educational" has been interpreted to mean dedication to the development or improvement of the capabilities of the individual through instruction or training, or the instruction of the public on subjects useful to the individual and beneficial to the community.¹⁷ Examples of education groups, other than schools or colleges, are organizations whose principal activity consists of informing the public through panels or lectures on radio and television, or by literature and correspondence and symphony orchestras. Colleges and other institutions of learning, the purposes and activities of which are the instruction or training of the individual, are exempt as educational organizations, provided that they do not disqualify themselves through failure to meet the four requirements of tax exemption discussed above.

Until recently, on-campus organizations furnishing supplies, services, or facilities to students and faculty members were not exempt, on the ground that they were not operated exclusively for educational purposes.¹⁸ However, now such organizations can be exempt provided that they effectively restrict the use of earnings and profits to the benefit of students and faculty.¹⁹

Alumni associations organized primarily for the purpose of promoting the welfare of the college or university with which they are affiliated, and which are subject to the control of the school as to their policies and destination of funds, have been held exempt where they were operated as integral parts of the school.²⁰

Organizations such as the Salvation Army have been granted exemption under Section 501(c)(3) of the Internal Revenue Code.²¹ The American Red Cross also comes under this exemption statute.²² Many other organizations have attempted to obtain exemption under this section of the Code, and many tax abuses have occurred. The four requirements for exemption appear inclusive enough to close any loopholes.

¹⁶ Rev. Rul. 57-467, 1957-2 C.B. 313.

¹⁷ I. T. 3182, 1938-1 C. B. 168.

¹⁸ I. T. 2636, 1932 C. B. XI-2, 1.

¹⁹ Rev. Rul. 58-194, 1958-1 C. B. 240.

²⁰ Rev. Rul. 56-486, 1956-2 C. B. 309.

²¹ I. T. 2747, 1933 C. B. XII-2, 70.

²² I. T. 3258, 1939-1 C. B. 123.

Section 501 (c) (4) of the Code grants exemption to:

civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

This section embraces two general classifications: organizations promoting the social welfare of mankind; and local associations of employees devoted to charitable, educational, or recreational purposes.

The American Legion, Veterans of Foreign Wars, and similar veterans' organizations have claimed their exemption from tax under this section of the Code.

Medical service plans such as Blue Cross also are exempt under this section.

"Social welfare" has been interpreted to mean the benefiting of a whole community of people rather than a specific group. Thus, a television community antenna organization, whose only function was to provide television reception for its members exclusively, was held to operate for the benefit of its members rather than for the social welfare of mankind.²³ Yet, organizations may benefit a limited few and still qualify for exemption. The deciding factor will not be the number of beneficiaries directly affected, but rather the broader consideration of community welfare.

Local employee associations can qualify for exemption as long as they are of a local character, have membership limited to employees of a designated person or persons in a particular municipality, and devote their net earnings to charitable, educational, or recreational purposes.

Organizations which fail to qualify under other exempting subsections of Section 501 have qualified under Section 501 (c) (4).²⁴ It is likely that litigation will occur in this area, as the position of the Internal Revenue Service is that the provisions of Section 501 are mutually exclusive rather than cumulative. The Service feels that, when Congress placed restrictions upon a given class of organizations, it did not intend that such

²³ Rev. Rul. 54-394, 1954-2 C. B. 131.

²⁴ U. S. v. Pickwick Electric Membership Corp., 158 F. 2d 272 (6th Cir. 1946).

organizations should be exempt under some other section which did not contain such limitations or restrictions.

Labor, agricultural and horticultural organizations, described in Section 501(c) (5) of the Code, are those which

(1) have no net earnings inuring to the benefit of any member, and (2) have as their objectives the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.²⁵

In order to gain and maintain an exempt status, a labor organization must be organized to carry out the true purposes of a labor union. Sometimes these organizations go beyond this scope. In one instance an organization was owned and operated by a local labor union for the purpose of entering into competition for business and furnishing employment to members of the local union. Employed members were paid wages, and net profits were turned into the union treasury. The organization was denied exemption on the ground that it was not part of the union as such, and that its activities were such as to make it a business enterprise.²⁶

Labor unions have been the source of considerable abuse in respect to unreasonable compensation of officers and payment of personal living expenses. However, as long as the union's principal purpose is to engage in qualified labor activities, its exempt status will not be challenged, and little if any litigation probably will arise in this field.

Agricultural and horticultural organizations described in Section 501(c) (5) must be engaged in activities in furtherance of agricultural or horticultural pursuits. No part of the net earnings should inure to the benefit of any member.

Whenever an organization exempt as described in Section 501(c) (5) abandons activities directed at fulfilling the principal purpose for which the exemption was granted, its exemption will be revoked. In one case a corporation was incorporated for the purpose of holding fairs, stock shows, and horse races. The organization discontinued the holding of agricultural fairs and stock shows in order to devote itself solely to horse racing, in connection with which it shared in the betting profits. Upon audit it lost its exemption status.²⁷

²⁵ Regs. Sec. 1.501(c) (5)-1(a).

²⁶ O. D. 523, 1920 C. B. 2, 211.

²⁷ *Forest City Line Stock & Fair Company v. U. S.*, 1 P-H BTA Memo ¶32,215 (1932).

Section 501(c) (6) grants exemption to non-profit business leagues, real estate boards, and boards of trade. In general, to be protected by the exemption provisions of the Code, the business league must meet the public purpose or quasi-purpose test. The Code requires that these organizations must not be organized for profit and that no part of the net earnings inure to the benefit of any private shareholder. Organizations qualifying under this statute must have a common business interest. An automobile association was denied exemption because its members were held not to have a common business interest, as membership was available to individual motorists without regard to business interests or activities.²⁸ Activities should be directed to the improvement of business conditions as a whole and not for the benefit of a special group. Thus, where a group of automobile dealers selling a certain make of car sponsored an organization to make the public more aware of the car they were selling, exemption was denied. The members and not the auto industry as a whole benefited from the organization's activities.²⁹ It appears that the key issue will be the inurement test. The question will be not whether members benefit from the activity of the league, but whether they benefit because they are members of the league or benefit because they are members of the business line which the league is trying to improve.

Section 501(c) (7) exempts from tax:

clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

College fraternities and country clubs are examples of organizations which qualify for exemption under this section of the Code. As the word "club" does not contemplate unrestricted membership, operations such as health clubs and golf courses open to the public in general, would never qualify under this section. The inurement of benefit will cause a social club to lose its exempt status. Opening the facilities to the general public without restriction, the purpose of which is to enlarge the facilities for its own members, will cause a social club to lose its exemption.³⁰

²⁸ American Automobile Association, 19 T. C. 1146 (1953).

²⁹ Automotive Electric Assn. v. Comm., 168 F. 2d 366 (6th Cir. 1948).

³⁰ Aviation Club of Utah v. Comm., 162 F. 2d 984 (10th Cir. 1947).

Organizations qualifying for exemption under Section 501 (c) (7) of the Internal Revenue Code have been the source of numerous complaints because of the unfair competition they have been giving to profit-making bars and restaurants. If these clubs allow the public to participate on a regular basis, their exemptions will be disallowed.³¹

Sport and hobby clubs can lose their exemptions because of business dealings with the public. In one case a tennis club held championship matches, from which source it derived more than half its gross income. The court held that the club was not entitled to exemption because it carried on a profitable business which had only an indirect relation to the recreational objectives of the club.³²

Earnings may inure to the benefit of the members in many ways. They can be in the form of unreasonable compensation, or even on a sliding scale reflected by a decrease in membership dues.³³ Clubs claiming exemption under this section of the Code may expect future litigation because of the many abuses that have occurred.

Section 501 (c) (8) exempts from tax:

Fraternal beneficiary societies, orders, or associations

(a) Operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and

(b) Providing for the payment of life, sick, accident or other benefits to the members of such society, order, or association or their dependents.

Organizations are considered to operate under the lodge system only when they have a parent and local organization which is active. Mere provisions in the constitution and by-laws for such parent bodies are not enough.³⁴ The Code also demands that these organizations have an established system for the payment of life, sickness, and accident benefits to members or their dependents. If the members have any latitude in conferring beneficial interest on others than themselves or their dependents, an

³¹ Regs. Sec. 1.501(c)(7)-1(b).

³² *West Side Tennis Club v. Comm.*, 111 F. 2d 6 (2nd Cir. 1940), cert. denied, 311 U. S. 674 (1941).

³³ Rev. Rul. 58-589, 1958-2 C. B. 266.

³⁴ I. T. 1516, 1922 C. B. I-2 180.

organization will fail to qualify. As one court pointed out, Section 501 (c) (8) (B)

would mean little if satisfied by a lodge which provides for the payment of death benefits to the beneficiaries named by one class of members regardless of whether those named are dependents, and which provides for the payment of no benefits to another class of members.³⁵

Organizations of this type will also fail to qualify if they engage in business. In one case a corporation controlled by an exempt fraternal society was denied exemption because it owned rental property, operated bowling alleys, and ran a bar which was open to the general public.³⁶

There are four conditions which must be met in order for an organization to qualify for exemption under Section 501 (c) (9) as a Voluntary Employees' Beneficiary Association. It must be a voluntary association of employees. It must provide for the payment of specific benefits to members or their dependents. No part of its earnings may inure to the benefit of any private individual except in the form of scheduled benefit payments. At least eighty-five percent of the income must be collected from members and the employer of members for the sole purpose of making benefit payments and meeting expenses.

Plans which provide the members with a vested right in the fund do not qualify for exemption because they go beyond the emergency or special need concept. However, supplemental unemployment benefit plans are governed by Section 501 (c) (9) because, under the above standards, the hazards of unemployment are similar to those occasioned by illness, death or injury.³⁷ Future litigation under this section will probably occur in the area of unreasonable salaries and excessive investment income.

Section 501 (c) (10) organizations are the same as those described in Section 501 (c) (9), except that their membership is limited to officers or employers of the United States Government.

Section 501 (c) (11) of the Code provides for the exemption of:

teachers' retirement fund associations of a purely local character if (A) no part of their net earnings inures (other than through payment of retirement benefits) to the benefit of

³⁵ Fraternal Order of Civitans of America, 19 T. C. 240 (1952).

³⁶ Banner Building Co., Inc., 46 BTA 857 (1942).

³⁷ Rev. Rul. 58-422, 1958-2 C. B. 194.

any private shareholder or individual, and (B) the income consists solely of amounts received from public taxation, amounts received from assessments on the teaching salaries of members, and income in respect of investments.

As most teacher retirement systems are statewide, this section is very narrow in its application. Except for the ever-present problem of inurement, not much litigation should be expected in this area.

Exemption is provided under Section 501(c) (12) of the Code for the following organizations:

Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or the organizations; but only if eighty-five percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

Two groups are covered—local life insurance associations and mutual or cooperative associations. Any organization of this type which accumulates a larger reserve than is necessary for the fulfillment of its immediate needs will probably be the subject of litigation.

Mutual insurance companies are owned by and for the benefit of the policy holders, and should not be confused with stock companies operated for a profit. These companies are entitled to exemption although rates may be on established schedules, provided that the policy holders are liable for additional assessments if losses occur.³⁸

Organizations which fail to qualify under this section of the Code, because of the eighty-five percent rule, may try to attempt to qualify under another section. However, as stated before, it appears that the Internal Revenue Service will challenge any such attempt.

Section 501(c) (13) exempts qualified cemetery companies. Under the regulations, an exempt cemetery company must be owned and operated exclusively for the benefit of lot owners, and no part of the net earnings may inure to the benefit of any private shareholder or individual.

Exempt cemetery companies have been the subject of numerous tax avoidance schemes. Owners of profit organizations have sought tax exemption for the cemetery income while at the same

³⁸ I. T. 2288, 1926, C. B. V-1, 87.

time receiving the income from the business at capital gain rates. This has been done by the device of organizing new non-profit cemeteries with no appreciable assets of their own. Stock of the profit cemeteries is then sold to the new non-profit cemeteries for long-term notes payable out of the income from cemetery operations. The parties involved then claim that the income from the cemetery is exempt from taxation, and that the receipt by the transferors of profits from the business is subject to capital gains treatment. Such transactions may be looked upon as tax avoidance, and may well be attacked under the "step-transaction" doctrine.

Organizations which are exempt from tax under Section 501 (c) (14) are credit unions, which must be associated or incorporated in accordance with a state credit union law substantially similar to that of Massachusetts. They must operate in accordance with such state laws and must be subject to state supervision and control. As the states supervise these organizations rather closely, little litigation is likely in this area.

To be exempt under Section 501 (c) (15) an organization must be a mutual insurance company or association, other than life or marine, whose gross receipts during the taxable year from interest, dividends, rents, premiums (including deposits and assessments) and non-insurance business income does not exceed \$75,000.00. The courts have recognized that democratic ownership and control is a fundamental of mutual insurance companies, and have found that there was a substantial departure from this principle of control where non-policy holders had the right to vote.³⁹ The other key issue which might cause litigation in this section is the area of unreasonable reserve accumulation. If, in fact, a company builds up a large reserve (by paying no dividends or rebates) with which to expand the scope of its operations and compete with other companies, it clearly is not qualified as a tax exempt organization.⁴⁰

Section 501 (c) (16) exempts corporations organized and operated in conjunction with exempt farmers cooperatives for the purpose of financing such operations. Although this provision is part of the law, it has produced little activity. About the only cause for litigation would be if such an organization were in fact not organized by an association exempt from tax.

³⁹ *Keystone Automobile Club Casualty Co. v. Comm.*, 122 F. 2d 886 (3rd Cir. 1941), cert. denied, 315 U. S. 814 (1942).

⁴⁰ *Ibid.*

Section 501(c) (17) grants exemption to trusts set up under a plan which provides supplementary unemployment benefits to employees. Such plans may be disqualified and litigation may occur if it is found that the corpus or income is being diverted to purposes other than providing for supplemental unemployment benefits, or if the plan is discriminatory in nature. Litigation may also occur if it is found that excessive salaries and expense allowances are being paid to the officers.

Section 501(d) taxes religious or apostolic associations with a common or community treasury, similarly to the way in which small business corporations are taxed. The purpose of this section was to protect these organizations from the undistributed profits tax, as the rules of such organizations prevent their members from being holders of property in individual capacities. Very little tax litigation should occur under this section of the Code.

Section 502 denies exemption to so called "feeder organizations." These organizations are those whose profits are payable to organizations exempt from tax under Section 501. The purpose of this section is to prevent unfair business competition. The law is very clear on this point. Therefore, little litigation should occur under this section.

Farmers' cooperatives, unlike many other tax exempt organizations, are not exempt because they perform a function which would otherwise fall upon the government. Their exemption is based upon an economic situation peculiar to farmers. A farmer sells his products in a producers' market, and makes his purchases in a retail market. The farmers attempted to correct this condition by forming associations to market their products at a price nearer the retail price, and to make their purchases at wholesale rather than retail. For this reason, the savings in the form of patronage dividends are received as adjustments to the income and expense of each patron and not as income of the cooperative.

The exemption under Section 521 of the Internal Revenue Code is limited to farmers, fruit growers, or like associations. Exemption will be denied to cooperative associations or consumer cooperatives formed by producers of non-agricultural products. The admission of a substantial number of non-producers to membership in an otherwise exempt agricultural producers' cooperative also destroys exemption, as the organization loses its identity

as a farmers' association. The law is clear and little litigation should occur in this area.

Although tax exempt organizations are creatures of the state, it is under the federal law that they seek exemption from tax. Many unqualified organizations have sought and received this exemption. Many abuses and schemes have arisen, in which even qualified organizations have been made parties. The big question is whether the exemption laws are not clear enough or whether they have been lackadaisically enforced. It is this writer's opinion that the law is adequate, and that strict enforcement of the law is all that is necessary to clear up the tax abuses by non-profit organizations which have taken place since the end of World War II.