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Marriner W. Merrill Family Foundation, Inc v. The State Tax Commission of Utah : Defendant's Brief

Utah Supreme Court

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**IN THE SUPREME COURT OF
THE STATE OF UTAH**

MARRINER W. MERRILL FAMILY
FOUNDATION, INC.,

Plaintiff,

—vs.—

THE STATE TAX COMMISSION
OF UTAH,

Defendant.

Civil No.
8192

DEFENDANT'S BRIEF

ON WRIT OF CERTIORARI
from
THE STATE TAX COMMISSION OF THE
STATE OF UTAH

FILED

SEP 30 1977

C. PRESTON ALLEN,
Attorney for Defendant.

Clerk, Supreme Court

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THE STATE OF UTAH IN THE SUPREME COURT OF

MARRINER W. MERRILL FAMILY
FOUNDATION, INC.,

Plaintiff,

—vs.—

THE STATE TAX COMMISSION
OF UTAH,

Defendant.

Civil No.
8192

STATEMENT OF FACTS

The Tax Commission believes that the Statement of Facts as set forth in plaintiff's brief is generally accurate and conforms to our understanding and interpretation of the Affidavit of Incorporation, the By-laws and the method of doing business of this taxpayer. By way of clarification, however, and in the hope of not being burdensomely repetitive, we would like to set forth in a cursory manner the facts which substantiate and support the decision of the Commission heretofore entered. They are as follows:

A. From the Affidavit of Incorporation the following purposes are set forth:

1. The investments and assets of the corporation

are to be used "for loaning or otherwise advancing money and property." (Tr. 24).

2. "For loaning or otherwise advancing money and property . . . to any and all descendents . . . of Marriner W. Merrill." (TR-24)

3. "To aid and assist financially in the training of any member of the family." (TR-24)

B. The following methods and restrictions on conducting the business of the corporation are taken from the By-laws of the corporation:

1. "The Board of Directors is given the power to loan or otherwise advance . . . funds for the accomplishment of the purposes of the foundation." (Tr. 18).

2. "Any member of the Marriner W. Merrill family is entitled to borrow and receive from the foundation money as the Board of Directors may from time to time prescribe." (Tr. 18).

C. Transcript testimony showed, and Mr. Merrill so testified, that the Affidavit of Incorporation was broad enough to permit the loaning of money to any descendent of Marriner W. Merrill by blood or by marriage. (Tr. 10).

Mr. Merrill also testified that a donor or a member of the corporation might have a loan made to such donor and it would seem a fair inference to say that members of the corporation could therefore receive any or all benefits afforded by the corporation. (Tr. 10-11).

We would like to draw the Court's attention, first, to the fact that there is not one bit of evidence in the Affidavit of Incorporation, in the By-laws or in the testimony which would indicate that the corporation has given away any-

thing of value in the past, that it presently intends to give anything away or that the board or any officer of the corporation has the power to give away any of the assets of the corporation and, second, that there is no limitation or definition upon the word "education" in any of the formative documents of the corporation and it would therefore appear that the board of directors has the exclusive and sole power to determine the application of the word "education" in the operation of the business of the corporation.

It is, therefore, the position of the Commission that this corporation is organized exclusively for the purpose of making loans and receiving the increments therefrom in the form of interest for the purpose of perpetuating the economic level of a narrow, selfish and restricted group and as such, it is a taxable entity in the state of Utah for franchise tax purposes.

POINT I

IF THE MARRINER W. MERRILL FAMILY FOUNDATION, INC. IS ORGANIZED AND OPERATED FOR CHARITABLE PURPOSES, IT IS TAXABLE UNDER THE PROVISIONS OF THE CORPORATION FRANCHISE TAX ACT.

The plaintiff herein has argued extensively and persuasively that a charitable institution is exempt from taxation under the provisions of our act. We concur in their reasoning and in the authorities which they have cited, but we believe, and the evidence indicates, that the Marriner W. Merrill Family Foundation, Inc. is not organized for, nor intended to pursue, charitable activities as the term is understood in Anglo-Saxon Jurisprudence. The plaintiff has attempted without reference to the facts

of its operation but with extensive free use of authority to show what is a charity. The oft-quoted case of *Bok vs. McCaughn*, 42 F 2d, 616, states in part that charity is “whatever is given for the love of God or the love of your neighbor in the catholic or universal sense, given from these motives and to these ends free from the strain or taint of every consideration that is personal, private or selfish.” This is the accepted definition of the term “charity” as we understand the term and which has been followed quite universally in construing acts similar to the one here under consideration.

Conceding *arguendo* that the Marriner W. Merrill Family Foundation, Inc. is a “charity” we believe that the very testimony of one of the original incorporators who conceived this organization removes it from exemption under our act. You will recall that Section 59-13-4 (4) provides in part that “. . . no part of the net earnings of which [the corporation] inure to the benefit of any *private shareholder or individual*.” Mr. Merrill, however, has already testified that a donor of the corporation could receive any of the benefits of such corporation. He, of course, could not testify otherwise because the Affidavit of Incorporation and the By-laws of the corporation clearly make the assets of the corporation and any increments thereto available to *any* of the descendants of Marriner W. Merrill. Obviously, and the affidavit so indicates, the incorporators and the donors of this corporation are such descendants and, consequently, any charitable function engaged in or pursued by this corporation *could* inure to the benefit of any or all of the private shareholders of the corporation or other individuals or of the donors of the fund created in the corporation. We are, of course,

not concerned here as to what the corporation will or won't do, but only what the corporation *can do* by the provisions of its Affidavit—by the business purpose or pursuit it is licensed or permitted by its franchise to do. See *American Investment Corporation v. State Tax Commission et al.*, 101 Utah 189, and 1938-1 CB 168.

This situation, of course, that is, where the private shareholders, individuals or donors of the alleged charitable organization could receive the increments and benefits of the funds, takes such organization out of the exempt category it might otherwise be in. See *Scholarship Endowment Foundation v. Nicholes*, 106 Fed 2d 552. The obvious purpose in forming this type of an institution is to enable the donors to obtain a tax benefit and a deduction on their personal tax returns from the contributions made to the corporation which contributions if made direct to the donors would not otherwise be deductible for tax purposes. In other words, if the donors of the corporation made loans directly to their sons, daughters, grandsons, etc., such loans or gifts would not be deductible for tax purposes for the very reason that they are of a private and selfish nature. The founders of this corporation are merely attempting to accomplish indirectly and by means of the corporate veil and structure what they cannot do directly—they are certainly not concerned with the \$10.00 yearly tax paid to Utah—the state creating the entity.

We would like to repeat and emphasize that if the plaintiff is a charitable organization, any of the participants in the corporation by way of shareholders, individuals or donors may receive any and all benefits from the corporation and, consequently one of the primary requirements set forth in the statute entitling the corporation to the

privilege of exempt status for corporation franchise tax purposes is not fulfilled or complied with.

POINT II

THE MARRINER W. MERRILL FAMILY FOUNDATION, INC., IS A CORPORATION ORGANIZED TO MAKE LOANS AND, THEREFORE, IS NOT EXEMPT FROM THE PAYMENT OF THE CORPORATION FRANCHISE TAX.

For a corporation to be exempt from the corporation franchise tax of the state of Utah, such corporation must be organized so as to fall under one of the subdivisions of Section 59-13-4, Utah Code Annotated, 1953. The taxpayer has contended that, in their instance, the following subsection (4) of the afore-cited statute is applicable:

“Corporations and any community chest, fund or foundation, organized and operated exclusively for religious, charitable, scientific, literary or educational purpose . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual” (see 59-13-4, U.C.A., 1953).

This statute requires that a corporation, to come within and be entitled to this exemption must, first, be organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, and, second, none of the net earnings can inure to the benefit of any private shareholder or individual. To ascertain if this corporation is organized pursuant to the foregoing provision of our code, we must determine if the Affidavit of Incorporation or the By-laws, as filed, so limit the operation that the aforesaid requirements are met. See *American Investment Corp. vs. State Tax Comm. et al* 101 Utah 189.

Of course, it is well to note here that for a corporation to be exempt from payment of the tax, it must clearly come within the provisions of the statute as set forth, for such exemption provisions are strictly construed against the corporation. *Norville vs. State Tax Comm.* 98 Utah 170, *Equitable Life & Casualty vs. State Tax Comm.* Utah (1952), 112 ALR 1441.

The affidavit of the Marriner W. Merrill Family Foundation, Inc., discloses that the corporation is organized solely and exclusively for the following purposes and with the following limitations on its method of conducting its business:

- a. The investments and assets of the corporation are to be used for *loaning* or *otherwise advancing* money and property.
- b. To any and all descendants . . . of Marriner W. Merrill.
- c. To aid and assist financially in the training of any member of the family.

The By-laws provide for the administration of the assets of the taxpayer for such loaning purposes under the following restrictions and limitations:

- a. The Board of Directors is given the power to loan or otherwise advance . . . funds for the accomplishment of the purposes of the foundation.
- b. Any member of the Marriner W. Merrill Family is entitled to borrow and receive from the foundation money as the Board of Directors may from time to time prescribe.

To support the foregoing and in affirmance thereof,

Mr. Merrill testified that the affidavit of incorporation was broad enough to permit the *loaning* of money to any descendant of Marriner W. Merrill by blood or by marriage.

We believe that the foregoing purposes and methods of operation of this corporation indicate clearly and without ambiguity that it is organized for one purpose, and one purpose only, and that is to *loan* or to *otherwise advance* money and property.

As such, and being confined to a method of operation which prohibits it from divesting itself of its assets by any method, we believe the corporation does not in substance constitute a corporation entitled to exemption under the ordinary concepts applicable in such instance. Much has been written on the equitable philosophy of exemption and it has appeared to us that the editors and writers on the subject make a basic justification for such exemption on the premise and on the condition that such exemption should be founded upon the general good which accrued to the public as a whole; that such use or activity is one which is ordinarily engaged in by the sovereign or substantially and realistically furthers the moral uplifting of society, not in a selfish and restricted field, but in the broad social sense.

The explanation of the basis of such exemption is usually phrased as follows:

“One class of tax exemptions more or less uniformly provided in the United States concerns private agencies performing functions which in the absence of such agencies would have to be undertaken by the public. The most common instance of such private agencies performing public functions

is charitable and educational institutions to some extent health agencies, usually on a charitable basis, are also involved. It is commonly accepted that if, in the absence of a private enterprise, taxation would be necessary in order to discharge a needed function, the state may properly subsidize the Institution which performs the service. A common method of subsidy is through tax exemption. (See General Theory of Tax Exemption, by the Tax Policy League, page 17).

The construction of the words of the statute should be impressed with such a philosophy. The corporation here, of course, is engaged only in *loaning* or *otherwise advancing* money or property. It is predicated upon the commercial formula of investing capital and realizing the ultimate return thereof together with the increment of interest. The foundation here does not *give* anything for the "Love of Giving." This common formula and method of conducting an enterprise certainly does not fall within the spirit and intendment of exemptions from taxation as they are understood under our law. On the contrary, the purpose of this corporation smacks wholly of an enterprise pursued with the selfish and private incentive of accumulating money and property coupled with the economic and social perpetuation of one individual's descendants.

Clearly, a loaning institution does not come within the letter, spirit wording or clear intendment of the foregoing statute.

POINT III.

LIMITING THE LOANS OR ADVANCES OF THE FOUNDATION FOR PURPOSES OF EDUCATION DOES NOT MAKE THE CORPORATION ORGAN-

IZED FOR EDUCATIONAL PURPOSES AND THEREFORE IT IS NOT AN EXEMPT ORGANIZATION UNDER THE PROVISIONS OF SECTION 59-13-4 (4), U. C. A., 1953.

As noted herein, the purpose of the Corporation is to make loans and advances to descendants of Marriner W. Merrill for educational purposes. Is the limitation labeled "education" on the loans such as would allow the exemption? We can find no precedents which would in any manner support this position, and the Courts have indicated that institutions claiming this exemption must have as its *primary* and *direct* purpose "education." Let's take first the citations given by the taxpayer's counsel on page 22 and page 23 of their memorandum. They are as follows:

"A corporation organized to maintain a band for giving free public concerts and the promotion of musical art is exempt as an educational institution, the terms not being confined to colleges and schools (I.T. 1475, I-2 C.B. 184). This bulletin of the Income Tax Division of the Internal Revenue Bureau goes on to say that the fostering of an appreciation or a desire of good music and of the promotion of musical art are actually of an educational nature.

"An association organized and operated exclusively for giving musical concerts was exempt as educational. (S.M. 1176, I.C.B. 147).

"The National Tax Association is exempt, being organized and operated exclusively for scientific and educational purposes (special rule, February 11, 1939, 393 C.C.H., Par. 6180).

"College students league, organized to bring about an open-minded consideration of social, in-

dustrial, political and international questions, was exempt as exclusively educational (I.I. 1224, I-1 C.B. 256)."

It is pertinent to note that every one of these organizations cited above actually *participated* and *engaged* in "education" as such. The corporation, on the other hand, does not itself participate in "education" and is not formed for that purpose. It has been dedicated for the sole purpose of making loans so that descendants of Marriner W. Merrill may attain higher education. All of the citations we find are along the same vein—that is, *the organization itself*, to qualify for an exemption for educational purposes, *has been actually engaged in the educational activity*—not the remote purpose of making of loans so that certain restricted persons *could attain* an education. It seems to us that such loaning activity is too far removed from the educational purpose contemplated by the statute and all of the precedents we have read would certainly indicate this distinction sound.

By way of further analogy, would a textbook manufacturer be deemed organized for educational purposes? It would seem that education in this instance would be secondary and incidental. And the same would be true of corporations organized to manufacture uniforms, supplies, desks and innumerable other items necessary and essential to our educational system. Of course, such corporations would be organized for profit purposes and therefore not exempt, but the point is, that the basic structure is secondary to education and educational purposes. The same is true of this Corporation, the main feature and primary purpose being to provide a source of funds for loans to enable the descendants of Marriner W. Merrill to

seek higher education, not in the first instance for education as such. Another strong analogy would be that of conforming the purpose of this business corporation to any lending institution—that is—their primary purpose is to make loans, while what the money is to be used for is strictly secondary and incidental to the primary purpose of making such loans.

It also seems to us that the fundamental principle on which the right of exemption rests is not present here—that is, that the institution must be rendering an essential service to the people of the commonwealth, thereby *relieving to that extent the charge on the general public*. See *Layman Foundation vs. Louisville*, 232 Ky. 259, 22 S.W. (2nd) 622. Here, the Corporation is not relieving to any extent a charge on the public by its making loans to descendants of Marriner W. Merrill. We know of no incident in history whereby any body politic has engaged in the function of loaning money to any specific group for educational purposes or even to the public as a whole for such purposes. Consequently, and we emphasize, no public purpose is here served by the Foundation's engaging in the loaning business—but only the selfish benefits accruing to the descendants of one person.

It should also be noted before passing this point, that the assets of the Corporation are theoretically *never ultimately consumed or used for the purposes of education or charity or anything else*. Its assets are merely *loaned and returned* together with interest and, therefore, there can never be a true beneficiary of any of the assets, money or property.

Therefore, by analogy and common logic, the foundation does not fulfill the requirement set forth in our act

that the corporation be formed for "educational purposes" to qualify for exemption.

POINT IV

THE CORPORATION "BENEFITS," IF LOANS COULD BE CONSTRUED AS BENEFITS, ARE AVAILABLE ONLY TO A PRIVATE, RESTRICTED AND SELFISH GROUP AND, THEREFORE, THE CORPORATION IS NOT AN EXEMPT ORGANIZATION.

As noted in the Statement of Facts, the loans or advances of the Corporation are available only to "any and all descendants or husbands or wives of such descendants of Marriner W. Merrill." The descendants of Marriner W. Merrill, of course, are a limited group. The question is, however, whether the group is so restricted and limited as to remove it from an organization which furthers society and the public, as a group, rather than the uplifting of the beneficiaries or members of the group as such members.

This issue is one of degree insofar as the restriction or limitation of the group or the members of the organization for exemption is concerned. (See *Amy Hutchinson Crellin vs. Commission*, 46 B. T. A. 1152). The cases which have been decided by the courts and the Board of Tax Appeals on this point appear, on their own facts, to be inconsistent and irreconcilable in the application of any set rule. However, we believe that the inconsistency arises, not by reason of the rule itself, but by reason of the equities involved in the specific fact situation. In other words, the courts do not defeat an organization from coming within the exempt category merely by reason of the fact alone that the benefits accruing from the organization pass to

a restricted group, if a general public purpose is served. For example, the authorities cited by the taxpayer show generally that when the purposes of the corporation are for "*public charities*" the "restricted group" doctrine is given a broad interpretation.

On the other hand, there are cases in which the group is so restricted that the organization is obviously organized for private and restricted purposes, and in these instances, regardless of the "charitable purpose," the courts have not swayed in refusing the exemption. For instance, in the Crellin case above cited, the trustor provided, among other things, that the benefits of the trust could be received by certain named grandnieces and grandnephews of the trustor for *educational purposes*. The Board held that the trust was not organized exclusively for public purposes and the clause allowing for trust benefits to accrue to the designated beneficiaries removed the organization from the exempt category. A case which involved facts similar to those here considered was treated by the Board in the James Sprunt Benevolent Trust, 20 B.T.A. 19. In the Sprunt case the organization was created to provide benefits for the support of those of the trustor's *children and descendants* "who may be destitute" and the Board held that this organization was created for a private, selfish and restricted group and purpose and, therefore, did not come within the rule as to public grouping and was not an exempt organization.

The taxpayer's counsel has cited the case of Emerit E. Baker, Inc. 40 B.T.A. 555, in which case he contends the Board granted exemption to a "restricted group." In the Baker case a corporation was organized to provide annuity payments to Baker's widow and education expenses of

certain designated relatives. In addition, however, broad public purposes were outlined for the use of the funds in the corporation for charitable and educational purposes. The court held that these broad public purposes would not be jeopardized by removing the corporation from its tax exempt status merely by reason of the subsidiary and incidental purposes of providing annuity payments to the widow and *educational payments to the relatives*. We respectfully submit to the court that if the Merrill corporation had broad public purposes for charitable and educational benefits accruing to an unrestricted group in addition to the present benefits of *loans to the relatives* of Marriner W. Merrill, the Baker case would be a precedent to control in this situation. But the precise point upon which the Baker case went before the court, that is, that the benefits accruing to the restricted group of relatives characterized the exempt status of the donor is the *sole purpose* of this corporation and not an incidental pursuit of broad public benefits. The court there stated:

“Trusts or corporations organized and operated for the benefit of the donor’s relatives or in general for personal and private purposes, rather than for public charities, are not within the statute. See James Sprunt Benevolent Trust, Harry C. Dubois 31 B.T.A. 239.”

It seems obvious that the facts in the Sprunt and Baker cases, insofar as they pertain to the relationship of the class benefited, and the facts here considered, are identical and the obvious conclusion based on precedent is that this corporation must be held to be an organization created for private rather than public purposes and, therefore, is not exempt under the statute.

REPLY TO THE ARGUMENT OF THE PLAINTIFF

The taxpayer's brief is replete with cases and argument which lends substance to exempting those organizations devoted to and dedicated for the moral, spiritual and economic uplifting of that minority of society less fortunate than those in the donative position. It is characteristic in a society based upon the principles of a republican form of government that assistance, charity and love should spring, not from the grace of the sovereign, but from the love of a compassionate society. In such a public trust, and founded upon these principles, organizations are relieved of their right and responsibility of supporting through the payment of their just proportion of the tax burden, those institutions which create, protect and foster their existence. The corporation here, we respectfully submit, has been conceived, is dedicated and is restricted to pursuing the purpose of assuring and perpetuating the economic position of the descendants of one individual. Our society has never supported an exemption on this basis, nor should it support it now. We would like to draw the attention of this Court to the numerous citations set forth in plaintiff's brief with the reminder to this Court that this corporation has never even contemplated divesting itself of its assets. Nothing is given to even the descendants of the members, donors, or shareholders of this corporation. Can this be said to be, under these facts, a *charitable institution*? What does this corporation *give*?

We believe that the substance of the argument is best placed in its correct proportion if the corporation, as such, is hypothetically removed from the argument, and the question is then stated: Can an individual be declared

to be exempt from the payment of taxes because he makes loans to his relatives so they can attain and pursue a higher education?

We respectfully submit that the decision of the State Tax Commission, declaring that the Marriner W. Merrill Family Foundation, Inc. is a corporation subject to the payment of the franchise tax of the State of Utah, should be affirmed.

Respectfully,

C. PRESTON ALLEN,
General Counsel.