H. IRC 512 - REGULARLY CARRIED ON

1. Introduction

The purpose of this topic on unrelated business income tax is to discuss the implications of the court decision in Suffolk County Patrolmen's Benevolent Association, Inc. v. Commissioner, 77 T.C. 1314 (1981) and to explain why it does not change the position of the Internal Revenue Service on what constitutes "regularly carried on" trade shows as conducted by organizations other than those described in IRC 501(c)(5) and (6).

A. Code Provisions

IRC 511(a)(1) imposes for each taxable year on the unrelated business taxable income of every organization described in IRC 511(a)(2) a tax as provided in IRC 511. IRC 512(a)(1) defines "unrelated business taxable income" as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less certain deductions.

There is no unrelated business taxable income unless: (1) there is a trade or business; (2) the trade or business is regularly carried on; and (3) the trade or business is not substantially related to the exercise or performance of an organization's exempt purposes. Therefore, in every case in which an exempt organization has unrelated trade or business income, a determination must be made whether the trade or business is regularly carried on before it can be concluded that the income derived therefrom is subject to tax.

B. Regulations

Reg. 1.513-1(c)(1) provides that in determining whether trade or business from which a particular amount of gross income derives is "regularly carried on" within the meaning of IRC 512, regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued. This requirement must be applied in light of the purpose of the unrelated business income tax to place exempt organization business activities upon the same tax basis as the nonexempt business endeavors with which they compete. It states that the business activities of an exempt organization will ordinarily be deemed to be "regularly carried on" if they manifest a frequency and

continuity, and are pursued in a manner, generally similar to comparable commercial activities of nonexempt organizations.

Reg. 1.513-1(c)(1) gives the general rules for determining whether an activity is "regularly carried on" and Reg. 1.513-1(c)(2) provides the application of the rules.

Reg. 1.513-1(c)(2)(i) provides that where income producing activities are of a kind normally conducted by nonexempt commercial organizations on a year-round basis, the conduct of such activities by an exempt organization over a period of only a few weeks does not constitute the regular carrying on of trade or business. The regulation states that the operation of a sandwich stand, for example, by a hospital auxiliary for only two weeks at a state fair would not be the regular conduct of trade or business, but that the conduct of year-round business activities for one day each week would constitute the regular carrying on of trade or business. According to this regulation, where income producing activities are of a kind normally undertaken by nonexempt commercial organizations only on a seasonal basis, the conduct of such activities by an exempt organization during a significant portion of the season ordinarily constitutes the regular conduct of trade or business. Citing this regulation provision, Rev. Rul. 68-505, 1968-2 C.B. 248, holds that a two-week horse racing meet featuring pari-mutuel betting conducted by an IRC 501(c)(3) county fair association is regularly carried on because it is usual to carry on such trade or business only during a particular season.

Reg. 1.513-1(c)(2)(ii) states:

> ***In determining whether or not intermittently conducted activities are regularly carried on, the manner of conduct of the activities must be compared with the manner in which commercial activities are normally pursued by nonexempt organizations. In general, exempt organization business activities which are engaged in only discontinuously or periodically will not be considered regularly carried on if they are conducted without the competitive and promotional efforts typical of commercial endeavors. For example, the publication of advertising in programs for sports events or music or drama performances will not ordinarily be deemed to be the regular carrying on of business.***

Reg. 1.513-1(c)(2)(iii) provides that certain intermittent income producing activities occur so infrequently that they will not be regarded as regularly carried

on, no matter how they may be otherwise conducted. It states that such "activities lasting only a short period of time will not ordinarily be treated as regularly carried on if they recur only occasionally or sporadically." It further states that such activities will not be regarded as regularly carried on merely because they are conducted on an annually recurrent basis. This regulation concludes with the unqualified statement that income "from the conduct of an annual dance or similar fund raising event for charity would not be income from trade or business regularly carried on."

2. Background - Revenue Rulings

There are several revenue rulings pertaining to the "regularly carried on" issue. Rev. Rul. 75-201, 1975-1 C.B. 164, holds that the sale by an IRC 501(c)(3) organization of commercial advertisements for concert books that it publishes and distributes at its annual charity ball to raise funds for an IRC 501(c)(3) symphony orchestra is not "regularly carried on." A major purpose of the organization was to raise funds for the symphony orchestra. The revenue ruling states that because the distribution of the concert books is part of an annual charity ball, the advertising income is not "regularly carried on" within the meaning of Reg. 1.513-1(c)(2)(iii). However, Rev. Rul. 75-200, 1975-1 C.B. 163, holds that the sale of advertising for a concert program during a four-month period by paid employees of an IRC 501(c)(3) organization which raises funds for an exempt symphony orchestra and publishes a weekly concert program distributed free at the symphony performances over an eight-month period is a business "regularly carried on." According to the revenue ruling, the advertising activity did not differ substantially from comparable commercial activities of nonexempt organizations. It states that it is common knowledge that many nonexempt organizations have a regular practice of publishing and distributing a seasonal series of special interest publications covering only a portion of each year with a format that includes substantial advertising.

Rev. Rul. 73-424, 1973-2 C.B. 190, holds that the sale of advertising by an IRC 501(c)(5) organization in its annual year book where a commercial firm conducted an advertising campaign for about three months of each year for the exempt organization was a "regularly carried on" activity. The revenue ruling states that although the publication was distributed only on an annual basis, the advertising solicitation required that a significant span of time be devoted to this activity. It asserts that by engaging in an extensive advertising solicitation campaign the organization was conducting competitive and promotional efforts typical of commercial endeavors and that consequently the activity manifested a

frequency and continuity and was pursued in a manner not materially different from similar commercial activities. One important fact was that the advertising in the year book was not distributed in connection with an annual fund raising event. This point is discussed in detail below.

3. Trade Shows

A. Regularly Carried On

In 1975 five revenue rulings dealing with annual trade shows were published. Rev. Ruls. 75-516, 75-517, 75-518, 75-519 and 75-520, 1975-2 C.B. 221-226. Together they demonstrate that if an exempt organization conducts a trade or convention show that is related to its exempt purpose and if the organization rents space to suppliers and exhibitors at the show, the income from the space rental is unrelated trade or business regularly carried on if the organization permits selling or order-taking by the exhibitors. For the purpose of this topic, a discussion of one of these revenue rulings, Rev. Rul. 75-517, is sufficient.

The organization described in that revenue ruling was exempt under IRC 501(c)(6). It conducted an annual week-long convention and operated a display show as an integral part of the convention to provide information on the availability of various products and services of interest to those attending the convention. At the show, suppliers and exhibitors were permitted to exhibit products and services used by the organization's members in their businesses. Rental contracts for display space were silent on sales and order-taking, but promotional materials for the show encouraged selling and order-taking. The revenue ruling holds that income derived from the rental of display space constitutes unrelated business taxable income within the meaning of IRC 512. It states that providing a sales facility does not contribute importantly to the accomplishment of the organization's exempt purpose. Regarding the "regularly carried on" issue, the revenue ruling states that the frequency and duration of the conventions, which were conducted annually and ran for a full week, made the shows comparable to trade shows or selling marts carried on by commercial organizations. It states further that the trade shows manifested a frequency and continuity and were pursued in a manner not materially different from similar commercial activities. See also Rev. Rul. 75-518, 75-519 and 75-520, 1975-2 C.B. 223-226.

B. Organizations Covered by IRC 513(d)

IRC 513(d), added to the Code by section 1305(a) of the Tax Reform Act of 1976, 1976-3 C.B. Vol. 1, 192, provides for a change in the position of the Service with respect to trade shows conducted by IRC 501(c)(5) and 501(c)(6) organizations. According to IRC 513(d), the term "unrelated trade or business" does not include certain convention and trade show activities of such organizations. The legislation was promoted by dissatisfaction with the 1975 revenue rulings that held that the income from rental of display space of trade shows was unrelated business taxable income when selling and order-taking were permitted.

The main effect of IRC 513(d) is to exclude rental of display space income from the definition of unrelated trade or business if it is conducted by an IRC 501(c)(5) or IRC 501(c)(6) organization and is carried on in connection with a qualified convention or trade show.

Reg. 1.513-3(c)(2) defines a qualified trade show:

> (2) Qualified convention or trade show. For purposes of this section, the term "qualified convention or trade show" means a show that meets the following requirements"
>
> (i) It is conducted by a qualifying organization described in section 513(d)(3)(C);
>
> (ii) At least one purpose of the sponsoring organization in conducting the show is the education of its members, or the promotion and stimulation of interest in, and demand for, the products or services of the industry (or segment thereof) of the members of the qualifying organization; and
>
> (iii) The show is designed to achieve that purpose through the character of a significant portion of the exhibits or the character of conferences and seminars held at a convention or meeting.

Thus, in all but a few cases IRC 513(d) and the regulations thereunder exclude from the definition of unrelated trade or business the rental of display space at conventions and trade shows of IRC 501(c)(5) and IRC 501(c)(6) organizations.

C. Trade Shows After IRC 513(d)

If organizations described in IRC 511(a)(2) (in general, IRC 501(c) organizations) other than those described in IRC 501(c)(5) or IRC 501(c)(6), conduct a trade show, the income derived from the rental of space at the show in a situation similar to Rev. Rul. 75-517, described above, would constitute income from an unrelated trade or business regularly carried on. Thus, while IRC 513(d) makes Rev. Ruls. 75-517, 75-518, 75-519 and 75-520 inapplicable to IRC 501(c)(5) and 501(c)(6) organizations, the principles are still applicable to other exempt organizations.

4. Suffolk County Decision

A. General Discussion

Some questions have arisen concerning Suffolk County Patrolmen's Benevolent Association, Inc. v. Commissioner, 77 T.C. 1314 (1981), and the Service position regarding "regularly carried on" trade shows.

The sole issue in the Suffolk County case was whether the conduct of the activities in question during the taxable years 1974, 1975 and 1976, constituted unrelated trade or business that was "regularly carried on."

The membership of the Suffolk County Patrolmen's Benevolent Association, Inc. (PBA) consisted of law enforcement officers of the Suffolk County police district. Its purposes included promoting a fraternal spirit among its members, advancing the welfare and efficiency of the Suffolk County Police Department, and acting as the sole collective bargaining agent for all police officers in the department. During the years in issue, PBA was an organization described in IRC 501(c)(4), but subsequently it was classified as an IRC 501(c)(5) organization.

PBA entered into contracts with an independent professional promoter for the production of annual fund raising events and the presentation of professional vaudeville shows. The promoter agreed to present the shows for two nights in May of 1973 and in May of 1974. The parties entered into a similar contract for the presentation of shows for two nights each in May of 1975 and 1976.

Pursuant to the contracts, the promoter supplied without cost to PBA the complete cast and all employees of the shows, the sound system, building, and

promotional advertising. The promoter sold tickets and advance advertising for the program guides. PBA provided ticket takers and ushers and it received 28 percent of gross advertising revenues and 50 percent of the ticket revenues.

Performances took place in a local high school auditorium seating approximately 2,000 persons. The shows, designed as family entertainment, featured professional jugglers, musicians, animal acts, magicians, comedians, and singers. The price of tickets was $2.50. Each year PBA gave away approximately 2,000 tickets to Boy and Girl Scouts, senior citizens and others. Persons attending performances were offered program guides. The guides contained approximately 20 percent editorial matter with the balance consisting of advertising from local businesses, hospitals, churches, professionals, and sundry other organizations. In most instances, they included only the name, address, and telephone number of a person or organization. The price of goods was never advertised. Solicitation of the advertising for the program guides by the promoter's employees began approximately 8 to 16 weeks prior to the time of the show.

During the years in issue, the shows were the only fund raising activity of PBA. The other funds received were membership dues. The great majority of the gross receipts was derived from the sale of advertising for the guide.

PBA's primary argument was that even if the show was a trade or business it was not "regularly carried on." The court agreed and decided in favor of PBA. It stated that the annual fund raising activity was substantially the same as those identified in the regulations and legislative history of IRC 511 through 513 as being "intermittent," and not "regularly carried on" and almost identical to the example in Reg. 1.513-1(c)(2)(ii) which states that the publication of advertising for sports events or music or drama performances is not "regularly carried on." The court concluded that it was merely an "intermittent activity" to which Congress did not intend the tax on unrelated business taxable income to apply and it cited Reg. 1.513-1(c)(2)(iii) which states that some activities occur so infrequently that neither their recurrence nor the manner of their conduct will cause them to be considered regularly carried on. Thus, the court considered the conduct of the shows as similar to an annual dance or similar fund raising event. According to the court, while the regulations do not define "intermittent," it is clear from both the language and the examples therein that activities conducted once a year, albeit annually recurrent, come within the meaning of that term. The court did not mention that there are no comparable commercial organizations that conduct shows of this kind for only two days a year.

The court stated that although the shows covered a total of at least 6 years under the contracts, constituted a trade or business, and were commercial in nature, that did not mean that they were regularly carried on. It stated that an intermittent activity is not regularly carried on regardless of the manner in which it is conducted and that even if the shows continued annually into the indefinite future, the regulations specifically provide that the annually recurrent nature of an intermittent activity would not cause it to be regarded as regularly carried on.

The court also concluded that it was reasonable for an exempt organization to hire professionals in an effort to insure the success of a fund raiser and that there is no indication in the regulations or the legislative history that the use of professionals would cause an otherwise intermittent activity to be considered regularly carried on. As to the 8 to 16 weeks spent preparing for the shows, the court asserted that neither the regulations nor the legislative history mention time apart from the duration of the event itself and the fact that an organization seeks to insure the success of a fund raising venture by beginning to plan and prepare for it earlier should not adversely affect the tax treatment of income derived from the venture. Regarding the size of the promoter's advertising solicitation staff, composed of 15 to 25 persons, the court concluded that the number of persons involved in the preparation of the activity, professional or amateur, was not a controlling factor in determining whether the activity itself is regularly carried on or intermittent. Regarding Rev. Rul. 73-424, which involved income derived from a commercially controlled and directed advertising solicitation program that lasted for three months, the court observed that the publication was not distributed in connection with any other fund raising event or tied in with any other organization activity of that kind. The court also felt that the facts of the case before it were "substantially similar in all material respects" to those in Rev. Rul. 75-201 that concerned the sale of advertisements for a concert book that was prepared for and distributed at an annual ball except that the solicitation of advertisements for the concert book was done by volunteers whereas the solicitation of advertising in PBA's program guides was done by professionals. The court did not consider that distinction determinative.

5. Distinction Between Annual Fund Raisers and Trade Shows

One view of Suffolk County [IRS has not announced whether or not it acquiesces in this case] is that it bars imposition of the unrelated business income tax on income from annual convention and trade show activities of exempt organizations on the basis that such activities are not "regularly carried on." (As previously discussed, the tax on most trade show activities by IRC 501(c)(5) and

IRC 501(c)(6) organizations is already barred by IRC 513(d).) We do not agree with this view because activities conducted at conventions and trade shows are fundamentally different from fund raising activities as typified in Suffolk County.

In Suffolk County we are presented with a case in which advertising in the program guides is intimately tied in with a fund raising activity (the vaudeville shows). Reg. 1.513-1(c)(2)(ii) and (iii) reflects the attempt to establish a special exclusionary rule for broad application to substantially all fund raising activities that are not conducted more than once a year and that are also part of some special fund raising event or affair that does not continue on any one occasion for substantially longer than an ordinary dinner dance or the like. As the court stated, the activities described in the regulations are almost identical to the activities in Suffolk County.

A convention or trade show conducted by an exempt organization is a different matter. Trade or convention shows (i.e., the seminars, conferences, and educational exhibits) are typically in furtherance of the exempt purpose of the exempt organizations that conduct them. For example, an IRC 501(c)(3) membership organization might conduct an educational convention for its members where meetings and seminars are conducted. At the convention, commercial suppliers lease space where they display, discuss, and sell their wares in a manner similar to that described in Rev. Rul. 75-517. The income obtained by providing a sales facility for exhibitors is an exploitation of the convention (the exempt activity) and is not an integral part of any fund raising event. In addition, the rental of exhibition space to suppliers is not itself a fund raising event within the contemplation of Reg. 1.513-1(c)(2). The principal purpose of the rental of exhibition space is to enable suppliers to sell their products to those attending the show.

Further, the operation of a typical trade show by an exempt organization, including the rental of exhibit space, is carried out in the same manner as shows conducted by nonexempt organizations. Thus, it cannot be claimed that the income activity is not "regularly carried on" within the meaning of Reg. 1.513-1(c)(2)(ii) on the basis that it is conducted without the competitive and promotional efforts typical of commercial endeavors. Moreover, typically the frequency and duration of an exempt organization's convention or show is indistinguishable from commercial trade shows normally conducted by nonexempt organizations.

While we do not believe that exempt organization trade shows are any different from commercial shows in frequency and duration, even if there is some

difference it would not result in a different conclusion on taxability of display space income. This conclusion is based on the fact that all the time spent on the activity has to be taken into consideration, as the following analysis shows.

As previously discussed, income derived from an annual dinner dance or similar fund raising event is not regularly carried on. Reg. 1.513-1(c)(2)(iii). This holding is not affected by the fact that several months might be spent by the exempt organization or others in preparation for the fund raising event. In other words, in determining whether fund raising events qualify for nontaxable status under the regulations, the time spent in preparation for the event does not count - only the length of time of the event is taken into consideration.

This is an exception to the normal rule that all the time spent on an activity must be taken into account in determining regularity. However, the regulations intended to carve out an across-the-board special exception for fund raising events lasting a very short time. It is common knowledge that many, if not most, of such events involve months of planning and preparation. Thus, it must be concluded that the regulations in the case of fund raising intended to ignore the planning and preparation time because failure to do so might result in a "regularly carried on" activity.

The court in Suffolk County dealt with this question as follows:

> Second, respondent makes much of the fact that petitioner, as well as the producer and the promoter, spent a great deal of time negotiating and organizing the fundraising activities. The time spent annually preparing for the vaudeville shows and the program guide was 8 to 16 weeks. Apparently, respondent includes in the duration of an activity the time necessary to organize and prepare for it. But, nowhere in the regulations or the legislative history of the tax on unrelated business income is there any mention of time apart from the duration of the event itself. Planning for large annual church bazaars or fairs often begins shortly after one is completed - almost a year in advance. The fact that an organization seeks to insure the success of its fundraising venture by beginning to plan and prepare for it earlier should not adversely affect the tax treatment of the income derived from the venture.

In the absence of a dinner dance or similar fund raising event, all of the time spent on the income producing activity is normally taken into account in

determining whether the activity is "regularly carried on." Rev. Rul. 73-424, which was previously discussed, demonstrates this rule. It describes an IRC 501(c)(5) organization that annually distributes its year books, which contain advertising, to all its members. The organization entered into a contract with a commercial firm for the solicitation of the advertising in the name of the IRC 501(c)(5) organization. The advertising campaign was normally carried on for about three months of the year. Although the publication was distributed only on an annual basis, Rev. Rul. 73-424 takes advertising campaign time into account and concludes that the unrelated trade or business (the advertising activity) "was regularly carried on." The advertising campaign time is taken into account because the advertising activity is not fund raising within the meaning of Reg. 1.513-1(c)(2)(iii) and does not relate to a fund raising activity. Had the year book in Rev. Rul. 73-424 been distributed at an annual fund raising ball, we believe that the result would have been different.

Based on this analysis, the current thinking in the National Office with respect to the normal trade or convention trade show carried on by an exempt organization, regardless of the time over which the show is conducted, is that the rental of display space is "regularly carried on" because it is necessary to include all the time spent in arranging for such rentals in making that determination. This should not be viewed at this time as a final and definitive Service position, however. Cases involving this issue should be treated as unprecedented and should be referred to the National Office.