O. RECENT DEVELOPMENTS UNDER THE UNRELATED TRADE OR BUSINESS PROVISIONS

1. Administrative Developments

a. As of the writing of this topic, no laws concerning the unrelated business income tax provisions have been enacted since those mentioned in the 1980 EOATRI. Final regulations concerning the treatment of proceeds from bingo games conducted by exempt organizations were published in the Federal Register on May 21, 1980, and a copy of the final regulations follows this topic. Proposed regulations concerning the treatment of income from qualified trade shows sponsored by certain exempt organizations were published in the Federal Register on December 9, 1980, and a copy also follows this topic.

2. IRC 512 Developments

a. Revenue Rulings

(1) Rev. Rul. 80-297, 1980-44 I.R.B. 11, considers two situations, both of which describe an exempt school that furnished the use of its tennis facilities for ten weeks during the summer. In the first situation, the school ran a tennis camp through two employees of its athletic department. The employees collected fees, scheduled courts and administered club affairs. The Rev. Rul. holds that the school's income, under these circumstances, is not excludable real property rental income under IRC 512(b)(3) due to the personal services the school provides together with the facilities. In the second situation, the school rented its tennis courts to an individual who ran a tennis club through his employees. Since the school provided only the facilities, the Rev. Rul. holds that the school's income under these circumstances is excludable rental income under IRC 512(b)(3).

(2) Rev. Rul. 80-298, 1980-44 I.R.B. 13, holds that a university's leasing of its stadium to a professional football team is an unrelated trade or business under IRC 513, and that income from this activity is not excludable as rent from real property under IRC 512(b)(3). Linen services, ground maintenance, and stadium security provided by the university pursuant to a lease preclude the income from being classified as rent under IRC 512(b)(3).

b. New Issues Considered

(1) Whether membership receipts must be allocated to circulation income in accordance with Reg. 1.512(a)-1(f)(4)(iii) in computing an exempt organization's advertising income where more than 20% of the total circulation of a periodical consists of distributions to nonmembers free of charge. The organization's publication contains commercial advertising in addition to editorial material and 75% of total circulation consists of distributions free of charge to nonmembers who share the members' common business interests.

(2) Whether all membership receipts must be included in computing circulation income of an exempt organization's periodical where the pro rata allocation method (Regs. 1.512(a)-1(f)(4)(iii)) is appropriate but membership dues are based on a sliding scale, larger members paying larger dues. All members receive the periodical which is not sold to nonmembers.

c. Royalties

In the performance of its exempt function an exempt organization may develop valuable intangible property such as a membership list, a distinctive logo, insignia, etc. An exempt organization may then solicit and negotiate licensing agreements with various businesses which authorize the commercial use of the organization's trademark, trade names, service marks, copyrights, and members' photographs, likenesses and facsimile signatures in connection with the distribution, sale, advertising, and promotion of merchandise and services offered by such businesses. The agreements may also require personal appearances by and interviews with members of the organization in connection with the endorsed product or service. Under the terms of the typical agreement, the exempt organization has the right to approve the quality or style of the licensed products and services. The income received by the exempt organization from the agreement may be based on a percentage of the gross sales of the licensed product or service or the exempt organization may receive a flat sum each year.

IRC 512(b)(2) provides that all royalties and all deductions directly connected with such income shall be excluded from the computations of IRC 512(a). Thus, royalties and directly connected deductions will not be taken into account in determining an organization's unrelated business taxable income.

Reg. 1.512(b)-1 provides that whether a particular item of income falls within any of the modifications provided in IRC 512(b) shall be determined by all the facts and circumstances of each case.

To be a royalty, a payment must relate to the use of a valuable right. Payments for the use of trademarks, trade names, service marks, or copyrights, whether or not payment is based on the use of such property, are ordinarily classified as royalties for federal tax purposes. See, Commissioner v. Affiliated Enterprises, Inc., 123 F. 2d 665 (10th Cir. 1941), cert. den. 315 U.S. 812 (1942); Commissioner v. Wodehouse, 337 U.S. 369 (1949); Rohmer v. Commissioner, 153 F. 2d 61 (2d Cir. 1946); and Sabatini v. Commissioner, 98 F. 2d 753 (2d Cir. 1938). Similarly, payments for the use of a professional athlete's name, photograph, likeness, or facsimile signature are ordinarily characterized as royalties. See, generally, Cepeda v. Swift & Co., 415 F. 2d 1205 (8th Cir. 1969); On the other hand, royalties do not include payments for personal services.

The agreements are normally a means of raising operating funds for exempt organizations. They have no causal relationship to the performance of exempt purposes within the meaning of Reg. 1.513-1(d)(2). Accordingly, the income received by the exempt organization from the agreement is unrelated trade or business income under IRC 513. However, since the payments are for the use of the organization's logos, trademarks, etc., and/or its members' names, photographs, facsimile signatures, etc., such payments are excludable as royalties within the meaning of IRC 512(b)(2).

The fact that an exempt organization has the right to approve the quality or style of the licensed products and/or services does not change this result. In addition, it does not matter that payment may be based on a percentage of gross sales or may be received as a flat sum each year.

However, if the licensing agreements require the personal services of an exempt organization's members in connection with an endorsed product or service, the payments received by the organization are compensation for personal services and therefore are not royalty income within the meaning of IRC 512(b)(2) and must be taken into account in computing unrelated business taxable income.

3. IRC 513 Developments

a. Revenue Rulings

(1) Rev. Rul. 80-294, 1980-44 I.R.B. 9, holds that the sale of broadcasting rights by an organization exempt under IRC 501(c)(6) that was formed to promote interest in a particular sport, to elevate the standards of the sport as a profession, and to sponsor and conduct tournaments for the encouragement of

its members is substantially related to its exempt purposes and is not an unrelated trade or business under IRC 513.

(2) Rev. Rul. 80-295, 1980-44 I.R.B. 10, holds that the sale of exclusive broadcasting rights to athletic events by an organization exempt under IRC 501(c)(3) that was created as a national governing body for amateur athletics contributes importantly to the accomplishment of the organization's exempt purposes and therefore is not unrelated trade or business within the meaning of IRC 513.

(3) Rev. Rul. 80-296, 1980-44 I.R.B. 10, holds that the sale of broadcasting rights to an annual intercollegiate athletic event by an organization exempt under IRC 501(c)(3) that was created by a regional collegiate athletic conference of universities for the purpose of conducting an annual competitive athletic game is substantially related to the purpose constituting the basis for the organization's exemption and is therefore not income from an unrelated trade or business.

b. New Issues Considered

(1) Whether the income derived by a bar association, exempt under IRC 501(c)(6), from the publication of mandatory legal notices and advertising in a law journal it publishes is subject to tax as unrelated business income.

(2) Whether the income derived by an art museum, exempt under IRC 501(c)(3), from the sale of original works of art produced by artists whose works are also displayed in the museum is taxable as unrelated business income.

(3) Whether an auction of a particular breed of cattle sponsored by an IRC 501(c)(5) agricultural organization, formed to promote that breed, is unrelated trade or business. The auction is subject to restrictions that are designed to ensure that only outstanding representatives of the breed are sold and thus promotes the breed by fortifying the bloodline and expanding it to breeders of other cattle.

(4) Rev. Rul. 79-360, 1979-2 C.B. 236 held that the operation of health club facilities in a commercial manner by an organization exempt under IRC 501(c)(3), whose purpose is to provide for the welfare of young people, constitutes an unrelated trade or business under IRC 513. In that situation the organization operated certain facilities which were available to the public upon the payment of nominal annual dues. However, it also operated a health club program that its

members could join for an advance annual fee that was sufficiently high to restrict participation in the program to a limited number of the members of the community. The Service is currently considering whether the imposition of an annual fee for the use of all the facilities of this organization, that while not nominal is affordable by substantially all members of the community, would warrant a change in the result of Rev. Rul. 79-360.

c. Judicial Decisions

(1) The Hope School v. U.S., 80-1 U.S.T.C. 9134, 7th Circuit, 1-2-80. Income from the distribution and sale of boxed greeting cards by an exempt school was held not to be unrelated business taxable income. The organization attempted to raise funds from the sale of greeting cards through mailings to potential supporters with a request for contributions. The lower court held that this activity constituted an unrelated trade or business. The Court of Appeals found that there was no competition with taxable entities and that this sales activity fit within the "low cost articles" provision of Reg. 1.513-1(b) which states:

> On the other hand, where an activity does not possess the characteristics of a trade or business within the meaning of IRC 162, such as when an organization sends out low cost articles incidental to the solicitation of charitable contributions, the unrelated business income tax does not apply since the organization is not in competition with taxable organizations.

The legislative history of this provision indicates that it was inserted at the request of an organization that conducted fund-raising campaigns in which items of negligible commercial value were used is soliciting contributions. In contrast, the organization in question distributed boxed greeting cards with substantial retail value, included reorder forms with its solicitations and sent follow-up letters to persons who did not respond to the initial appeal. We believe this to be outside the scope of the "low cost articles" exception.

(2) St. Luke's Hospital v. U.S., 80-2 U.S.T.C. 9533, U.S. Dist. Ct., Mo., 5-22-80. The court held that income received by an exempt teaching and research hospital for performing pathological diagnostic tests on samples submitted by doctors closely associated with the hospital was not taxable as unrelated business income. The court stated that the performance and interpretation of the tests by the hospital's pathology department were substantially related to its exempt

functions because the tests contributed importantly to the teaching functions of the hospital and were performed at the request and primarily for the convenience of doctors on the hospital's staff.

(3) Disabled American Veterans v. U.S., 80-2 U.S.T.C. 9568, U.S. Court of Claims, 7-23-80. The court held that premium gifts offered for sale to donors were being offered in a competitive and commercial manner and the resulting income was taxable as unrelated business income where the "contribution" required to buy the gift didn't greatly exceed the gift's retail value. In addition, receipts from the rental of lists of names from the organization's list of donors were taxable as unrelated business income and were not excludable as rent under IRC 512(b)(2).

(4) San Antonio Bar Association v. U.S., 80-2 U.S.T.C. 9594, U.S. Dist. Ct., Texas, 5-14-80. The court held that the sale at a profit of standard legal forms to attorneys and law students by a local bar association exempt under IRC 501(c)(6) was not an unrelated trade or business. The court stated that the sale of the legal forms was an activity substantially related to the bar association's exempt purpose of promoting the common business interests of the legal profession, advanced the professional interest of persons licensed to practice law and improved relations between the bench, bar and public. The court noted that the forms were continually monitored and kept current with state law, and thus advanced professionalism and competency among the members of the bar.

(5) Louisiana Credit Union League v. U.S., 46 AFTR 2d 80-6065, U.S. Dist. Ct. Louisiana, 10-31-80. The organization, exempt under IRC 501(c)(6), engaged in three separate revenue producing activities: rebates received upon the writing of new and renewal insurance policies by a company whose coverage plans the organization endorsed, a five percent commission on delinquent accounts collected by an agency whose services the organization endorsed to its members, and revenue from an electronic data processing system which the organization made available to its members. The Court held that these activities produced unrelated business taxable income and stated: "The broad rule requiring active control over an activity in order for that activity to give rise to taxable income - which rule the League distills primarily from Oklahoma Cattlemen's and San Antonio (District Dental Society) - is an incorrectly decided one. The plain language of the statute, which directs that any performance of service giving rise to income be deemed a "trade or business" allows no other conclusion. Section 513(c)." The court also found that the activities were unrelated and regularly carried on and resulted in the unrelated business income tax.

d. Sales of Appliances by Electric Cooperatives

The National Office has taken the position that income which an electric generation and transmission cooperative, exempt under IRC 501(c)(12), receives from the sale and servicing of electric appliances to member and non-member electricity customers is related to the exempt purposes of the organization. However, income received from the sale and servicing of electric appliances from nonmembers who are not electricity customers is income from an unrelated trade or business. However, any income from nonmembers is treated as nonmember income for purposes of the 85% test.

This holding is based on the fact that the exempt purpose of an electric utility cooperative under IRC 501(c)(12) is to furnish electric services at cost to members in a manner comparable to that of a public utility corporation. In addition, because IRC 501(c)(12) allows such an organization to derive less than 15% of its income from nonmembers, the exempt purpose of such an organization extends to furnishing electric service to nonmembers (not necessarily on a cost basis).

The sale of appliances may cause the organization to operate more efficiently by increasing the "load factor", which results in more economical use of generation, transmission and distribution facilities which had been constructed to serve the "peak" needs of members. Numerous cases (see State v. San Antonio Public Services Co., Tex. Com. App., 69 S.W. 2d 38 (1934) support the position that there is a causal relationship between the sale and service of appliances and the operation of a public utility business.

An exempt electric cooperative under IRC 501(c)(12) does not correspond in all respects to the public utilities involved in these cases (see above). However, these cases describe how the sale of appliances increases the load factor of the utilities, increases operating efficiency and benefits customers by making available appliances and electric service, through the appliances, which consumers such as rural users might not otherwise obtain. Thus, the sale and servicing of electric appliances for customers has a substantial causal relationship to the achievement of an electric cooperative's exempt purposes and is substantially related within the meaning of IRC 513.

4. IRC 514 Developments

a. New Issues Considered

(1) Whether acquisition indebtedness results from an exempt organization making the mortgage payments on property subject to a mortgage, where the property is acquired by devise. The organization did not assume or agree to pay the indebtedness secured by the mortgage, nor make any payment for the equity in the property owned by the decedent.

b. Judicial Decisions

(1) Elliot Knitwear Profit Sharing Plan v. Commissioner, 80-1 U.S.T.C. 9176, 3rd Cir., 1-28-80. An exempt profit sharing plan purchased securities on margin to increase the funds available for distribution to its members (employees.) For such purchases, the plan incurred indebtedness with respect to their acquisition. The court agreed with a prior decision of the Tax Court that such securities purchased on margin were debt-financed property within the meaning of IRC 514(b)(1) and that income from the sale of the securities was subject to the unrelated business income tax.

(2) Marprowear Profit Sharing Trust v. Commissioner, 74 T.C. 80 (8-25-80). The court held that the organization was subject to the unrelated business income tax on account of its operation of a shopping center. Funds acquired from the founding corporation that were used to purchase the shopping center were held to be loans to the trust rather than advance contributions for the purpose of determining the amount of acquisition indebtedness.

5. Articles of Interest

a. "College and University Leasing Activities Evoke IRS Scrutiny." A. Jan Behrsin, 57 Taxes July 1979, pp. 431-434. The author inquires into whether a college or university's leasing revenue falls within the scope of the unrelated business income tax provisions.

b. "Remuneration Earned by Members of Religious Orders: Is it Taxable?", James L. Wittenbach, 57 Taxes August 1979, pp. 553-559. Relates the implications of IRC 61, the withholding provisions and the unrelated business income tax to members of a religious order performing services for the church, performing services for a charitable organization other than the church, and performing "secular" services in the private sector.

c. "Vow of Poverty Rulings and Update on Unrelated Business." Charles W. Whelan, 23 Catholic Lawyer Summer 1978, pp. 201-209. Reviews the background and status of vow of poverty rulings and the unrelated business income of church organizations.

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1 [T. D. 7699]

Treatment of Proceeds From Bingo Games

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the treatment of proceeds from bingo games conducted by tax-exempt organizations. Changes in the applicable tax law were made by the Act of October 21, 1978. The regulations provide tax-exempt organizations with the guidance needed to comply with that Act and would affect tax-exempt organizations that conduct bingo games.

DATE: The regulations are effective for taxable years beginning after December 31, 1969.

FOR FURTHER INFORMATION CONTACT:
Charles Kerby of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:EE-180-78 (202-566-3422) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On August 28, 1979, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 513 and 527 of the Internal Revenue Code of 1954 (44 FR 50361). The amendments were proposed to conform the regulations to sections 301 and 302 of the Act of October 21, 1978 (92 Stat. 1702). Three comments were received from the public. No hearing was held. After consideration of all comments, the proposed regulations under section 513 are adopted as revised by this Treasury decision. The proposed amendments to the regulations under section 527 remain as proposed regulations. It is intended that the proposed amendments will be adopted by the Treasury decision to be published with respect to the proposed

regulations under section 527 that were published in the Federal Register on November 24, 1976 (41 FR 51840).

Comments on the Proposed Regulations

Two of the three comments received from the public objected to Example (1)(ii) of Section 1.513-5(c)(3) of the proposed regulations. That example illustrates Section 1.513-5(c)(1) of the proposed regulations and provides that where the laws of a State prohibit all forms of gambling activity, including bingo games, a bingo game conducted by a tax-exempt organization in the State constitutes unrelated trade or business regardless of whether, or to what degree, the State law is enforced. The commentators suggested that bingo should not be considered an illegal activity if State gambling statutes are not generally enforced against tax-exempt organizations that conduct bingo games.

To determine whether bingo is illegal in a given State, the Internal Revenue Service must necessarily look to State statutes and decisions of the State courts interpreting those statutes. It would not be appropriate for the Internal Revenue Service to independently determine that a statute proscribing gambling is, nevertheless, not the law of the State. In the legislative history of the Act of October 21, 1978, Congress specified that the requirement of section 513(f)(2) that an organization not conduct bingo games in violation of State or local law was "designed to ensure that no Federal tax benefit is provided for activities which are conducted illegally." H. Rep. No. 95-1608, 95th Cong., 2nd Sess. 6 (1978), 1978-2 C.B. 395, 397. Accordingly, the final regulations are not materially different from the proposed regulations on this point.

The other comment received from the public suggested that the regulations contain a clear, concise example of a bingo game that would be excluded from the term "unrelated trade or business" under section 513(f). The final regulations contain such an example. In addition, the examples in the final regulations have been clarified.

Drafting Information

The principal author of this regulation is Charles Kerby of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and

Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of Amendments to the Regulations

Accordingly, Section 1.513-5, as set forth in the August 28, 1979, notice of proposed rulemaking is adopted, except that paragraph (c)(3) thereof is revised to read as follows:

Section 1.513-5 Certain bingo games not unrelated trade or business.

* * * * *

(c) *Limitations.* * * *

(3) *Examples*. The application of this paragraph is illustrated by the examples that follow. In each example, it is assumed that the bingo games referred to are operated by individuals who are compensated for their services. Accordingly, none of the bingo games would be excluded from the term "unrelated trade or business" under section 513(a)(1).

Example (1). Church Z, a tax-exempt organization, conducts weekly bingo games in State O. State and local laws in State O expressly provide that bingo games may be conducted by tax-exempt organizations. Bingo games are not conducted in State O by any for-profit businesses. Since Z's bingo games are not conducted in violation of State or local law and are not the type of activity ordinarily carried out on a commercial basis in State O, Z's bingo games do not constitute unrelated trade or business.

Example (2). Rescue Squad X, a tax-exempt organization, conducts weekly bingo games in State M. State M has a statutory provision that prohibits all forms of gambling including bingo games. However, that law generally is not enforced by State officials against local charitable organizations such as X that conduct bingo games to raise funds. Since bingo games are illegal under State law, X's bingo games constitute unrelated trade or business regardless of the degree to which the State law is enforced.

Example (3). Veteran's organizations Y and X, both tax-exempt organizations, are organized under the laws of State N. State N has a statutory provision that permits bingo games to be conducted by tax-exempt organizations. In addition, State N permits bingo games to be conducted by for-profit organizations in

city S, a resort community located in county R. Several for-profit organizations conduct nightly bingo games in city S. Y conducts weekly bingo games in city S. X conducts weekly bingo games in county R. Since State law confines the conduct of bingo games by for-profit organizations to city S, and since bingo games are regularly carried on there by those organizations, Y's bingo games conducted in city S constitute unrelated trade or business. However, X's bingo games conducted in county R outside the city S do not constitute unrelated trade or business.

* * * * *

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of Internal Revenue.

Approved: April 21, 1980.

Donald C. Lubick,
Assistant Secretary of the Treasury.

PART 1--INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Section 1.513-5 is added as follows:

Section 1.513-5 Certain bingo games not unrelated trade or business.

(a) *In general*. Under section 513(f), and subject to the limitations in paragraph (C) of this section, in the case of an organization subject to the tax imposed by section 511, the term "unrelated trade or business" does not include any trade or business that consists of conducting bingo games (as defined in paragraph (d) of this section).

(b) *Exception*. The provisions of this section shall not apply with respect to any bingo game otherwise excluded from the term "unrelated trade or business" by reason of section 513(a)(1) and Section 1.513-1(e)(1) (relating to trades or businesses in which substantially all the work is performed without compensation).

(c) *Limitations*--(1) Bingo games must be legal. Paragraph (a) of this section shall not apply with respect to any bingo game conducted in violation of State or local law.

(2) *No commercial competition*. Paragraph (a) of this section shall not apply with respect to any bingo game conducted in a jurisdiction in which bingo games are ordinarily carried out on a commercial basis. Bingo games are "ordinarily carried out on a commercial basis" within a jurisdiction if they are regularly carried on (within the meaning of Section 1.513-1(c)) by for-profit organizations in any part of that jurisdiction. Normally, the entire State will constitute the appropriate jurisdiction for determining whether bingo games are ordinarily carried out on a commercial basis. However, if State law permits local jurisdictions to determine whether bingo games may be conducted by for-profit organizations, or if State law limits or confines the conduct of bingo games by for-profit organizations to specific local jurisdictions, then the local jurisdiction will constitute the appropriate jurisdiction for determining whether bingo games are ordinarily carried out on a commercial basis.

(3) *Examples*. The application of this paragraph is illustrated by the examples that follow. In each example, it is assumed that the bingo games referred to are operated by individuals who are compensated for their services. Accordingly, none of the bingo games would be excluded from the term "unrelated trade or business" under section 513(a)(1).

Example (1). Church Z, a tax-exempt organization, conducts weekly bingo games in State O. State and local laws in State O expressly provide that bingo games may be conducted by tax-exempt organizations. Bingo games are not conducted in State O by any for-profit businesses. Since Z's bingo games are not conducted in violation of State or local law and are not the type of activity ordinarily carried out on a commercial basis in State O, Z's bingo games do not constitute unrelated trade or business.

Example (2). Rescue Squad X, a tax-exempt organization, conducts weekly bingo games in State M. State M has a statutory provision that prohibits all forms of gambling including bingo games. However, that law generally is not enforced by State officials against local charitable organizations such as X that conduct bingo games to raise funds. Since bingo games are illegal under State law, X's bingo games constitute unrelated trade or business regardless of the degree to which the State law is enforced.

Example (3). Veteran's organizations Y and X, both tax-exempt organizations, are organized under the laws of State N. State N has a statutory provision that permits bingo games to be conducted by tax-exempt organizations. In addition, State N permits bingo games to be conducted by for-profit organizations in city S, a resort community located in county R. Several for-profit organizations conduct nightly bingo games in city S. Y conducts weekly bingo games in city S. X conducts weekly bingo games in county R. Since State law confines the conduct of bingo games by for-profit organizations to city S, and since bingo games are regularly carried on there by those organizations, Y's bingo games conducted in city S constitute unrelated trade or business. However, X's bingo games conducted in county R outside of city S do not constitute unrelated trade or business.

(d) *Bingo game defined*. A bingo game is a game of chance played with cards that are generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a preselected pattern such as a horizontal, vertical, or diagonal line, or all four corners. The first participant to form the preselected pattern wins the game. As used in this section, the term "bingo game" means any game of bingo of the type described above in which wages are placed, winners are determined, and prizes or other property is distributed in the presence of all persons placing wagers in that game. The term "bingo game" does not refer to any game of chance (including, but not limited to, keno games, dice games, card games, and lotteries) other than the type of game described in this paragraph.

(e) *Effective date*. Section 513(f) and this section apply to taxable years beginning after December 31, 1969.

[FR Doc. 80-15609 Filed 5-20-80; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[EE-155-78]

Income From Trade Shows

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains a proposed regulation relating to the treatment of income from qualified trade shows sponsored by certain exempt organizations. Changes to the applicable tax law were made by the Tax Reform Act of 1976. The regulation would provide the public with the guidance needed to comply with that Act and would affect certain exempt organizations that sponsor trade shows. The proposed regulation would also conform the regulations to changes in the tax law concerning the time for filing an exempt organization's income tax return.

DATES: Written comments and requests for a public hearing must be delivered or mailed by February 9, 1981. The amendments are proposed to be effective for taxable years beginning after October 4, 1976, with respect to qualified convention and trade show activities. Changes concerning the time for filing income tax returns are proposed to be effective for taxable years beginning after November 10, 1978

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (EE-155-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Joel E. Horowitz of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (202-566-6212, not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 513(d) of the Internal Revenue Code of 1954. These amendments are proposed to conform the regulations to section 1305 of the Tax Reform Act of 1976 (90 Stat. 1716) and section 6 of the Act of November 10, 1978 (Pub. L. 95-628, 92 Stat. 3630) and are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Prior Law

The unrelated business income tax is imposed on certain organizations described in sections 401(a) and 501(c) to ensure that an exempt organization can not exploit its status in commercial competition with nonexempt persons. Before passage of the Tax Reform Act of 1976, certain activities in connection with the operation of convention and trade shows were considered unrelated trade or business activities. Income from these activities, therefore, may have been includable in the unrelated business taxable income of the organization and thereby subject to the tax imposed by section 511(a).

Prior to passage of Pub. L. 95-628, exempt organizations were treated as domestic or foreign corporations for purposes of the time for filing income tax returns.

Present Provisions

Section 1305 of the Tax Reform Act of 1976 provides that qualified public entertainment activities and qualified convention and trade show activities, conducted regularly by specified exempt organizations, will not be considered unrelated trade or business. In order to receive such treatment under the regulations, the convention or trade show activity would have to be carried on by a qualifying organization described in section 513(d)(3)(C) and Section 1.513-3(c)(1) in conjunction with a convention, meeting or trade show that is sponsored by the qualifying organization and is described in section 513(d)(3)(B) and Section 1.513-3(c)(2).

As proposed, Section 1.513(b) states that convention and trade show activities (as defined in paragraph (c)(4)) which are carried on by organizations described in sections 501(c)(5) or (6) (such as labor organizations or business leagues), but which are not otherwise qualified under this section, will be considered unrelated trade or business. The proposed rules would result in exclusion of

receipts derived from all traditional activities carried on at a qualified show from an organization's unrelated business taxable income.

Treas. Reg. Section 1.6072-2(c) is proposed to be amended to reflect the change in the time for filing an exempt organization's tax return. An exempt organization now must file its return on or before the fifteenth day of the fifth month following the close of its taxable year.

Comments and Requests for a Public Hearing

Before adopting this proposed regulation, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

Drafting Information

The principal author of this proposed regulation is Joel Horowitz of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing this regulation, both on matters of substance and style.

Proposed Amendments to the Regulations

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. There is added immediately after Section 1.513-2 the following new section:

Section 1.513-3 Qualified convention and trade show activity.

(a) *Introduction*--(1) In general. Section 513(d) and Section 1.513-3(b) provide that convention and trade show activities carried on by a qualifying organization in connection with a qualified convention or trade show will not be treated as unrelated trade or business. Consequently, income from qualified convention and trade show activities, derived by a qualifying organization that sponsors the qualified convention or trade show, will not be

subject to the tax imposed by section 511. Section 1.513-3(c) defines qualifying organizations and qualified conventions or trade shows. Section 1.513-3(d) concerns the treatment of income derived from certain activities, including rental of exhibition space at a qualified convention or trade show where sales activity is permitted, and the treatment of supplier exhibits at qualified conventions and trade shows.

(2) *Effective date*. This section is effective for taxable years beginning after October 4, 1976.

(b) *Qualified activities not unrelated*. A convention or trade show activity, as defined in section 513(d)(3)(A) and Section 1.513-3(c)(4), will not be considered unrelated trade or business if it is conducted by a qualifying organization described in section 513(d)(3)(C) and Section 1.513-3(c)(1), in conjunction with a qualified convention or trade show, as defined in section 513(d)(3)(B) and Section 1.513-3(c)(2), sponsored by the qualifying organization. Such an activity is a qualified convention or trade show activity. A convention or trade show activity which is conducted by an organization described in section 501(c)(5) or (6), but which otherwise is not so qualified under this section, will be considered unrelated trade or business.

(c) *Definitions--(1) Qualifying organization. Under section 513(d)(3)(C), a qualifying organization is one which*--

(i) Is described in either section 501(c)(5) or (6), and

(ii) Regularly conducts as one of its substantial exempt purposes a qualified convention or 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 promotion and stimulation of interest in, and demand for, the products and 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.

(3) *Show*. For purposes of this section, the term "show" includes an international, national, state, regional, or local convention, annual meeting or show.

(4) *Convention and trade show activity*. For purposes of this section, convention and trade show activity means any activity of a kind traditionally carried on at shows. It includes, but is not limited to--

(i) Activities designed to attract to the show members of the sponsoring organization, members of an industry in general, and members of the public, to view industry products or services and to stimulate interest in, and demand for such products and services;

(ii) Activities designed to educate persons in the industry about new products and services or new rules and regulations affecting the industry; and (iii) Incidental activities, such as furnishing refreshments, of a kind traditionally carried on at such shows.

(d) *Certain activities--(1) Rental of exhibition space.* The rental of display space to exhibitors (including exhibitors who are suppliers) at a qualified trade show or at a qualified convention and trade show will not be considered unrelated trade or business even though the exhibitors who rent the space are permitted to sell or solicit orders.

(2) *Suppliers defined*. For purposes of subparagraph (1), a supplier's exhibit is one in which the exhibitor displays goods or services that are supplied to, rather than by, the members or the qualifying organization in the conduct of such members' own trades or businesses. The purpose of the display must be to educate such members in the development of products and services or rules and regulations affecting the qualifying organization.

(e) *Example*. The provisions of this section may be illustrated by the following examples:

Example 1. X, an organization described in section 501(c)(6), was formed to promote the construction industry. Its membership is made up of manufacturers of heavy construction machinery many of whom own, rent, or lease one or more digital

computers produced by various computer manufacturers. X is a qualifying organization under section 513(d)(3)(C) that regularly holds an annual meeting. At this meeting a national industry sales campaign and methods of consumer financing for heavy construction machinery are discussed.

In addition, new construction machinery developed for use in the industry is on display with representatives of the various manufacturers present to promote their machinery. Both members and nonmembers attend this portion of the conference. In addition, manufacturers of computers are present to educate X's members. While this aspect of the conference is a supplier exhibit (as defined in paragraph (d) of this section), income earned from such activity by X will not constitute unrelated business taxable income to X because the activity is conducted as part of a qualified trade show described in Section 1.513-3(c).

Example 2. Assume the same facts as in Example 1, but the only goods or services displayed are those of suppliers, the computer manufacturers. Selling and order taking are permitted. No member exhibits are maintained. Standing alone, this supplier exhibit (as defined in paragraph (d)(2) of this section) would constitute a supplier show and not a qualified convention or trade show. In this situation, however, the rental of exhibition space to suppliers is not unrelated trade or business. It is conducted by a qualifying organization in conjunction with a qualified convention or trade show. The show (the annual meeting) is a qualified convention or trade show because one of its purposes is the promotion and stimulation of interest in, and demand for, the products of the industry through the character of the annual meeting.

Example 3. Y is an organization described in section 501(c)(6). The organization conducts an annual show at which its members exhibit their products and services in order to promote public interest in the line of business. Potential customers are invited to the show, and sales and order taking are permitted. The organization secures the exhibition facility, undertakes the planning and direction of the show, and maintains exhibits designed to promote the line of business in general. The show is a qualified convention or trade show described in paragraph (c)(2) of this section. The provision of exhibition space to individual members is a qualified trade show activity, and is not unrelated trade or business.

Example 4. Z is a qualifying organization described in paragraph (c)(1) of this section that sponsors an annual show. As the sole activity at the show, suppliers to the members of Z exhibit their products and services. Selling and order taking is permitted. The show is a supplier show and is not a qualified convention or trade show described in paragraph (c)(2). Thus, the organization's provision of exhibition space is not a qualified convention and trade show activity. Income derived from rentals of exhibition space to suppliers will be unrelated business taxable income under section 512.

Par. 2. Section 1.6072-2 is amended by revising paragraph (c) to read as follows:

Section 1.6072.2 Time for filing returns of corporations.

* * * * *

(c) *Exempt organizations*. For taxable years beginning after November 10, 1978, the income tax return required under section 6012 and 1.6012-2(e) of an organization exempt from taxation under section 501(a) (other than an employee's trust under section 401(a)) shall be filed on or before the fifteenth day of the fifth month following the close of the organization's taxable year.

William E. Williams,

Acting Commissioner of Internal Revenue.

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