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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: AFR 1 7 2001

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Ladies and Gentlemen:

This letter responds to your attorney's letter dated September 19, 2000, and previous letters requesting rulings pertaining to a proposed merger of X and Y into Z, all three of which are organizations exempt from federal income tax under section 501 (a) of the Internal Revenue Code.

X is a nonprofit corporation that is described in section 501 (c)(4) of the Code, and Y and Z are nonprofit corporations described in section 501 (c)(3). Y is classified under section 509(a)(3) as a supporting organization of X, on the basis that X would be a publicly supported organization if it were described in section 501 (c)(3). Z is classified under section 509(a)(2).

The facts presented indicate that X was initially formed to raise and distribute money to charity by conducting an annual golf tournament and an annual charity ball. X distributes the net proceeds from these events to Y, which uses the funds to make grants to other charitable organizations in the community. A portion of each ticket that X sells to the golf tournament and the charity ball represents a charitable contribution to Y. X receives these contributions on behalf of Y and promptly forwards them to Y. x's main revenues include sponsorship payments, admissions to the golf tournament and charity ball, television rights, golfer entry fees and advertising.

The operations of X and Y are conducted with substantial amounts of volunteer labor and donated use of facilities. Both X and Y have large, all-volunteer boards of directors, and significant numbers of volunteers assist the naid employees and contractors. Several golf courses provide their facilities for the tournaments at a charge that is only a small fraction of fair

rental value, to cover the cleanup and repair costs from use of the facilities. A hotel donates use of its facilities for the ball. With respect to the scope and extent of volunteer labor, the information submitted indicates that approximately 80% of staff hours provided for the golf tournament is attributable to volunteers, while approximately 60% of staff hours provided for the charity ball is attributable to volunteers.

A souvenir program including both editorial articles and advertising is published each year in connection with the golf tournament. X solicits advertising during a nine-month period before the tournament. One or more of X's paid employees sells advertising on an ongoing basis during this period. Volunteers do not conduct the advertising activity.

You state that the interrelationship between X and Y has created disadvantages such as expenses resulting from the operation of two entities instead of one, cash shortfalls, and public confusion. The organizations propose to solve these problems by having X and Y merge into Z, which, as noted previously, is described in section 501 (c)(3) of the Code. As a result of the reorganization, Z will take over the activities previously conducted by X and Y. After the merger, Z will conduct the golf tournament and the charity ball as annual fund raisers to raise money to carry out its exempt purpose of supporting charitable organizations.

Z requests rulings that the merger will not jeopardize z's status as an organization described in section 501(c)(3) of the Code, and the revenues that Z will generate from the annual golf tournament and charity ball fund raisers will not constitute unrelated business taxable income under section 512(a)(l).

Section 501 (c)(3) of the Code, in part, provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501 (c)(3)-1 (c)(l) of the Income Tax Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Rev. Rul. 64-182, 1964-1 C.B. 186, holds that an organization that derives its income principally from the rental of space in a large commercial office building and carries out its charitable purposes by aiding other charitable organizations through contributions and grants meets the requirements for recognition of exemption under section 501(c)(3) of the Code. The Revenue Ruling states that the organization was shown to be carrying on a charitable program commensurate in scope with its financial resources.

Section 511 (a) of the Code imposes a tax on the unrelated business taxable inwme of organizations described in section 501 (c).

Section 512(a)(l) of the Code defines "unrelated business taxable income" generally as gross inwme derived by any exempt organization from any unrelated trade or business regularly carried on by it, less allowable deductions, with certain modifications.

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under section 501.

Section 513(a)(l) of the Code provides that the term "unrelated trade or business" does not include any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation.

Section 513(c) of the Code provides that the term "trade or business" includes any activity that is carried on for the production of inwme from the sale of goods or the performance of services. Section 513(c) also states that an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which, may or may not, be related to the exempt purpose of the organization.

Section 1.513-l (a) of the regulations provides that gross income of an exempt organization subject to the tax imposed by section 511 is includible in the computation of unrelated business taxable inwme if: (1) it is inwme from trade or business; (2) such trade or business is regularly carried on; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Section 1.513-l(b) of the regulations provides that for purposes of section 513 of the Code, the term "trade or business" has the same meaning it has in section 162, and generally includes any activity carried on for the production of inwme from the sale of goods or performance of services. Activities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Thus, for example, activities of soliciting, selling, and publishing commercial advertising do not lose identity as a trade or business even though the advertising is published in an exempt organization periodical that contains editorial material related to the exempt purposes of the organization,

Section 1.513-l (c)(2)(ii) of the regulations provides that, 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 wmmercial 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 trade or business.

Section 1.513-1(c)(2)(iii) of the regulations provides that certain intermittent income-producing activities occur so infrequently that neither their recurrence nor the manner of their conduct will cause them to be regarded as trade or business regularly carried on, For example,

income-producing or fund raising activities lasting only a short period of time will not ordinarily be treated as regularly carried on if they recur only occasionally or sporadically. Furthermore, such activities will not be regarded as regularly carried on merely because they are conducted on an annually recurrent basis. Accordingly, income derived from the conduct of an annual dance or similar fund raising event for charity would not be inwme from trade or business regularly carried on.

Section 1.513-1(d)(2) of the regulations provides that for the conduct of a trade or business to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services must contribute importantly to the accomplishment of those purposes.

In Waco Lodge No. 166. Benevolent & Protective Order of Elks v. Commissioner, 696 F.2d 372 (5th Cir. 1983), the court held that the volunteer labor exception under section 513(a)(l) of the Code did not apply where compensated workers accounted for approximately 21% of the work performed.

In National Colleaiate Athletic Association v. Commissioner, 92 T.C. 456 (1989). rev'd 914 F.2d 1417 (10th Cir. 1990). A.O.D. 1991-015 (July 3,1991) (nonacct.), the Tax Court held that the NCAA's regular solicitation of program advertising at its annual basketball tournament was unrelated business regularly carried on (unlike the tournament itself, which was related business). The court reasoned that the business at issue was the sale of advertising, which is fragmented under section 513(c) of the Code from the business of circulating the program and from the overall activity of conducting the tournament, and that it was inappropriate to decide whether the business at issue was regularly carried on solely by reference to the time span of the tournament itself (less than 3 weeks). The court held that the contractor that conducted the advertising was an agent of the NCAA under the contract, and that the NCAA had failed to furnish evidence that its contractor's activity was not regularly carried on. On appeal, the 10th Circuit agreed that the business of selling advertising space was the relevant business, but reasoned that the length of the tournament was what was relevant rather than the preliminary time spent soliciting advertisements, because advertising during the tournament was what was being sold, and that the length of the tournament was sufficiently intermittent and too infrequent to compete with wmmercial solicitors of advertising. The A.O.D. noted that section 1.513-1 (b) of the regulations defines as a fragmented business the activity of soliciting, selling, and publishing advertising (soliciting and selling are not mere preparatory activities); that preparatory time may be considered as part of a business activity; and that the intermittent exceptions in the regulations are not directed to events such as the distribution of program guides and advertising over three extended weekends at a number of locations across the country and by mail.

By conducting the golf tournament and charity ball and by distributing the net proceeds from such events to charitable organizations as described above, Z will be operated exclusively for charitable purposes as required by section 501 (c)(3) of the Code. The merger of X and Y into Z will not result in Z being operated for a substantial nonexempt purpose within the meaning of section 1.501(c)(3)-1(c)(1) of the regulations. By making gifts and contributions in the manner described, Z will be conducting a charitable program commensurate in scope with its financial resources. See Rev. Rul. 64-182, supra. Under the facts and circumstances

presented, the merger of X and Y into Z will not be a transaction that will adversely affect Z's tax-exempt status under section 501(c)(3).

The annual golf tournament and the charity ball are activities carried on for the production of inwme from the providing of services, and thus constitute trade or business as defined by section 513(c) of the Code and section 1.513-1 (b) of the regulations. Also, neither the golf tournament nor the charity ball contributes importantly to the accomplishment of an exempt purpose under section 501(c)(3), and thus neither activity is substantially related to an exempt purpose under section 501(c)(3). Furthermore, although there are large numbers of volunteers who assist in carrying out both the golf tournament and the charity ball, the information presented does not support a conclusion that substantially all the work in connection with these activities has been performed without compensation. Thus, the "volunteer labor' exception under section 513(a)(l) does not apply. However, the facts presented indicate that, with the exception of advertising activities, both the golf tournament and the charity ball are intermittent activities for purposes of section 1,513-l (c)(2)(iii), and thus are not "regularly carried on" trade or business under section 513(a). Since the golf tournament and the charity ball, except for the advertising activities, are not regularly carried on, any revenues derived from such activities will not constitute unrelated business taxable income under section 512(a)(l).

With respect to the advertising activities, the solicitation, selling, and publishing of advertising in wnnection with the annual golf tournament is an unrelated trade or business that is fragmented or treated separately from the conduct of the tournament as a whole. Applying the "fragmentation rule" of section 513(c) of the Code and section 1.513-l(b) of the regulations to the golf tournament, the trade or business of selling advertising space is treated as an activity that is distinct from the trade or business of conducting the golf tournament. Although the Tenth Circuit in National Colleaiate Athletic Association v. Commissioner, supra, concluded that program advertising was not a regularly carried on trade or business, the Service position as set forth in A.O.D. 1991-015 is that such advertising activities are regularly carried on. Moreover, the regular selling of advertising is distinguishable from the type of intermittent advertising activity in connection with programs for sports events contemplated in section 1.513-l (c)(2)(ii). Under these circumstances, amounts derived from advertising contained in programs published in connection with the golf tournament will constitute unrelated business taxable inwme under section 512(a)(l).

Based on the foregoing, we rule as follows:

1. The merger of X and Y into Z will not jeopardize Z's status as an organization described in section 501(c)(3) of the Code, and

2. The revenues that Z will generate from the annual golf tournament and charity ball fund raisers, other than advertising income, will not constitute unrelated business taxable income under section 512(a)(l) of the Code. However, the revenues that Z will generate from advertising contained in programs published in connection with the golf tournament will constitute unrelated business taxable income under section 512(a)(l).

We have not been asked and we express no opinion on whether amounts received from corporate sponsors meet the requirements under section 513(i) of the Code.

Except as specifically ruled upon above, no opinion is expressed concerning the federal inwme tax consequences of the transaction described above under any other provision of the Code.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Because this letter could help resolve any future questions about Z's tax liability, Z should keep a copy of this ruling in its permanent records.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

If you have any questions, please contact the person whose name and telephone number appear in the heading of this letter.

Sincerely yours,

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2

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