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

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Dear Sir or Madam:

This is in response to a letter from M's authorized legal representatives, who have requested certain rulings on M's behalf. These rulings concern the unrelated business income tax treatment of certain activities, including M's acknowledgment in its publications and on its website of sponsoring organizations that provide benefits to M's members, and the provision of a link from M's website to such sponsoring organizations' websites.

M is an organization exempt from federal income tax under section 501(a) of the Internal Revenue Code of 1986 ("Code") as an organization described in section 501(c)(5). M is committed to the advancement and prosperity of agriculture and is comprised of many members. M is affiliated with a national organization, N. M's purposes are to better the conditions of those engaged in agricultural pursuits, to improve the grade of their products, to develop a higher degree of efficiency in the respective occupations of those engaged in agricultural pursuits, and to promote agriculture.

M engages in a wide variety of activities in furtherance of its exempt purposes, including conducting meetings and conferences and providing educational information to members regarding agricultural issues, promoting the sharing of information among members regarding common agricultural problems and concerns, providing information regarding federal and state legislative and regulatory issues affecting agriculture, and promoting youth activities that encourage future careers in agriculture. As part of its exempt functions, M regularly publishes

news publications. It accepts advertising in these publications and treats the advertising income as unrelated business taxable income under section 512(a)(1) of the Code. M also operates a website through which it provides its members and the public with up-to-date information on its activities and programs, as well as on current issues affecting agriculture.

M has arrangements with certain service providers that offer special or discounted benefits or services to M's members. Examples of such member benefit programs include a rebate arrangement with a particular automobile dealer through which members receive a rebate on their purchase of certain trucks and vans; an eyewear program through which members receive a discount on prescription eyewear purchased through certain suppliers; discounts on industrial, farm, and ranch equipment; discounts on amusement park and movie tickets; and discounts on tires and batteries. In some cases, M enters into a contract with the member service provider, however, more commonly, an affiliate of M is the contracting party.

M's membership benefits also include access to life, automobile and casualty insurance, which are provided through two insurance companies, O and P. M has entered into licensing agreements with O and P that permit those entities to use M's name and logo in return for royalties. The licensing agreements expressly provide that M is not required to provide any endorsement, promotion, or other services to those entities, and M does not provide any such services. M's wholly-owned for-profit subsidiary, Q, has entered into facilities and services agreements with O and P, pursuant to which Q provides O and P with office space, furniture, equipment and clerical services, as well as shared department services. The terms of these agreements provide that Q is to be paid for such services on a cost-plus basis with an x percent mark-up above cost, which is not less than the fair market value of the facilities and services provided.

M provides information in brochures and on its website about the companies that offer these special or discounted services and benefits to its members, other than O and P. In these cases, M simply lists the member service provider on its web page and provides information about the service or benefit. These listings are not promotional in nature and do not encourage members to use these products or services. Except in the case of R, M does not provide a link to the member service provider's website.

M's current policy is not to accept advertising from member service providers or other commercial entities on its website, although it does accept advertising from member service providers, other than O and P, in its periodicals. M charges such member service providers the same rates that it charges other third parties, and it treats all advertising revenues as unrelated business income. M also believes that it will be able to attract additional advertising in its periodicals if it offers to include web-based advertising for no additional consideration as part of its periodical advertising agreements.

Some of the providers of M's member benefit programs also sponsor activities (e.g., exhibits, breakfasts, give-aways) at M's conventions and similar events, and M reports revenue received from such sponsorship activities as qualified sponsorship payments in accordance with section 513(i) of the Code. In the case of such sponsorship arrangements, M would like to

acknowledge the sponsors on its website and to include, as part of its sponsor acknowledgments, links to the main corporate page of the sponsors' own websites.

Section 511 of the Code imposes a tax on the unrelated business taxable income of exempt organizations described in section 501(c), including those described in section 501(c)(5).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in section 512(b).

Section 512(b)(2) of the Code excludes from the computation of unrelated business taxable income royalties, whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income.

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 exempt purpose or function.

Section 513(c) of the Code provides that the term "trade or business" includes any activity, which is carried on for the production of income from the sale of goods or the performance of services.

Section 513(i)(1) of the Code provides that the term "unrelated trade or business" does not include the activity of soliciting and receiving qualified sponsorship payments.

Section 513(i)(2)(A) of the Code defines the term "qualified sponsorship payments" as any payment made by any person engaged in a trade or business with respect to which there is no arrangement or expectation that such person will receive any substantial return benefit other than the use or acknowledgment of the name or logo (or product lines) of such person's trade or business in connection with the activities of the organization that receives such payment. Such a use or acknowledgment does not include advertising such person's products or services, including messages containing qualitative or comparative language, price information, or other indications of savings or value, an endorsement, or an inducement to purchase, sell, or use such products or services.

Section 1.512(a)-1(d)(1) of the Income Tax Regulations provides that in certain cases, gross income is derived from an unrelated trade or business activity that exploits an exempt activity. One example of such exploitation is the sale of advertising in a periodical of an exempt organization that contains editorial material related to the accomplishment of the organization's exempt purpose.

Section 1.512(a)-1(f) of the regulations provides that amounts realized by an exempt

organization from the sale of advertising in a periodical constitute gross income from an unrelated trade or business activity involving the exploitation of an exempt activity; namely, the circulation and readership of the periodical developed through the production and distribution of the readership content of the periodical.

Section 1.513-1(a) of the regulations provides that gross income of an exempt organization subject to the tax imposed by section 511 of the Code is includible in the computation of unrelated business taxable income if: (1) it is income from a trade or business; (2) such trade or business is regularly carried on by the organization; 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 1.513-1(b) of the regulations provides that for purposes of section 513 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 income from the sale of goods or performance of services.

Section 1.513-1(c)(1) of the regulations 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 section 512 of the Code, 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. For example, specific 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 non-exempt organizations.

Section 1.513-1(d)(1) of the regulations provides that, in general, gross income derives from "unrelated trade or business," within the meaning of section 513(a) of the Code, if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question -- the activities, that is, of producing or distributing the goods or performing the services involved -- and the accomplishment of the organization's exempt purposes.

Section 1.513-1(d)(2) of the regulations provides that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes, and is "substantially related," for purposes of section 513 of the Code, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from

the sale of the goods or the performance of the services does not derive from the conduct of related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

Section 1.513-4(b) of the regulations provides that the provisions in this section do not apply to income derived from the sale of advertising or acknowledgments in exempt organization periodicals. The regulation states that for this purpose the term *periodical* means regularly scheduled or printed material published by or on behalf of the exempt organization that is not related to and primarily distributed in connection with a specific event conducted by the exempt organization. The regulation also provides that for this purpose printed material includes material that is published electronically.

Section 1.513-4(c)(2)(v) of the regulations provides that for purposes of this section, the term *advertising* means any message or other programming material which is broadcast or otherwise transmitted, published, displayed or distributed, and which promotes or markets any trade or business, or any service, facility, or product.

Section 1.513-4(d)(iv) of the regulations contains examples that illustrate the provisions of this section. In Example 11, an exempt organization posts a list of sponsors on its website, including the sponsor's name and Internet address, which appears as a hyperlink from the exempt organization's website to the sponsor's website. The example concludes that posting the sponsor's website address constitutes an acknowledgment. Example 12 describes an exempt organization that maintains a website containing a hyperlink to a sponsor's website where an endorsement by the exempt organization for the sponsor's product appears. The exempt organization approved the endorsement before it was posted on the sponsor's website. The example concludes that the endorsement is advertising.

Rev. Rul. 81-178, 1981-2 C.B. 135, considers the application of section 512(b)(2) of the Code to two situations in which payments are received by an exempt organization. The holding in Situation (1) is that payments for the use of the organization's trademarks, trade names and service marks are royalties under section 512(b)(2). However, in Situation (2), the holding is that payments for personal appearances and interviews are not royalties, but are compensation for personal services.

In Sierra Club, Inc. v. Commissioner, 86 F.3d 1526 (9th Cir. 1996), aff'g T.C. Memo. 1993-199 and rev'g 103 T.C. 307 (1994), the court stated that royalties in section 512(b)(2) of the Code are defined as payments received for the right to use intangible property rights, and that such definition does not include payments for services. With respect to income derived from the Sierra Club's rental of its mailing list, the court held that such income was royalty income under section 512(b)(2) and not payment for services. With respect to income derived from the Sierra Club's affinity credit card program, the court remanded for findings of fact as to whether the amounts in question constitute royalties under section 512(b)(2). The Tax Court

subsequently concluded that such amounts were royalties and therefore not taxable under section 511. See T.C. Memo. 1999-86.

In Oregon State University Alumni Association, Inc. v. Commissioner and Alumni Association of the University of Oregon, Inc.v. Commissioner, 193 F.3d 1098 (9th Cir. 1999), the court held that payments made by a bank to the alumni associations were not payments for promotional and management services associated with their mailing lists, but were royalty payments excluded from unrelated business taxable income under section 512(b)(2) of the Code.

In Common Cause v. Commissioner, 112 T.C. 332 (1999), the court found that, with the exception of the list brokerage activities, all the list rental transaction activities were royalty-related, and therefore, each rental payment constituted a royalty excluded from unrelated business taxable income under section 512(b)(2) of the Code. The court found that the parties involved in the transaction engaged in activities to exploit and protect the mailing list, and thus, the activities were royalty-related. The parties included the list manager, the list owner (petitioner), the company that stored the rental list, and the list brokers. Moreover, the court found that the list broker's activities were provided solely to the mailers and solely for their convenience, and that the list broker was not an agent of Common Cause. See also Planned Parenthood Federation of America, Inc. v. Commissioner, T.C. Memo 1999-206.

As noted previously, organizations described in section 501(c)(5) of the Code are subject to tax on their unrelated business income under section 511. In order for such an organization's income to be subject to the unrelated business income tax, three requirements must be met: (1) the income must be from a trade or business; (2) the trade or business must be regularly carried on; and (3) the conduct of the trade or business must not be substantially related to the organization's exempt purpose or function. See section 1.513-1(a) of the regulations. If these three requirements are met, it is then necessary to consider whether any of the special exceptions to unrelated trade or business (such as the exception for qualified sponsorship payments under section 513(i)) or any of the modifications (such as the exception for royalties under section 512(b)(2)) are applicable.

Here, M has arrangements with third-party service providers that offer special or discounted services and benefits to M's members. M provides these programs in order to attract and retain members, who are interested in and who support the purposes of M and to create a strong membership base that actively participates in M's exempt activities. Consistent with these goals, M publicizes the availability of such services and benefits to its members and to potential members by describing the services and benefits and by providing the contact information for each service provider. M does not currently charge service providers a fee for such listings, and it does not intend to charge a fee for a link from its website to the websites of the service providers. These services and benefits are only available to M's members, and not the general public. Based on the foregoing information, M's listing of information about service providers in its publications and on its website, and its providing of a link from its website to the websites of the service providers is not a trade or business within the meaning of section 513(c) of the Code, and does not constitute an unrelated trade or business under section 513(a).

M receives from O and P licensing revenues, which are treated as royalties under section 512(b)(2) of the Code. M proposes to list information about O and P on its publications and brochures, and on its website, and to provide links to their websites as part of the listings. M states that the proposed listings and links will be a mechanism through which M will communicate the availability of these services and benefits to its members. M represents that it does not provide personal or other services to O and P in connection with its licensing arrangements, and Q provides any such services on a fair market value basis. Under these circumstances, the above-described listings and links will not cause any portion of M's licensing revenues from O and P to be treated other than as royalties under section 512(b)(2). See Rev. Rul. 81-178, supra, and Sierra Club, Inc v. Commissioner, et al., supra.

M receives from the service providers licensing revenues, which are treated as royalties under section 512(b)(2) of the Code. M states that the income it derives from the sale of periodical and banner advertising to the service providers at M's customary rates is unrelated business taxable income under section 512(a)(1). M has represented that the advertising arrangements with the service providers will be determined on a separate and independent basis from the licensing arrangements with service providers. In the case of advertisers, such as O and P, that are also licensees of M, the advertising and royalty arrangements will be governed by separate agreements and the amounts of the royalty and advertising payments will be determined on a separate and independent basis. Licensees will not be treated more (or less) favorably than other organizations wishing to purchase advertising space in M's periodicals or on its website. Under these circumstances, the sale of advertising will not adversely affect the treatment of licensing revenues as royalties under section 512(b)(2). See Rev. Rul. 81-178, supra, and Sierra Club, Inc. v. Commissioner, et al., supra.

In deciding whether banner advertising on M's website is periodical advertising, it is necessary to determine whether the website is a periodical for purposes of section 1.512(a)-1(f) of the regulations. This regulation provides special rules for computing the tax on unrelated business income in the case of an exempt organization's sale of advertising in a periodical. Section 1.513-4(b) specifically provides that the corporate sponsorship regulations do not apply to advertising or acknowledgments in periodicals of exempt organizations. The term *periodical* is generally defined as regularly scheduled or printed material published by or on behalf of an exempt organization. Here, the periodical advertising regulations under section 1.512(a)-1(f) would apply to M's sale of banner advertising on its website only where such advertising is part of a periodical that appears on-line. If such advertising appears on M's website generally, and not as part of an on-line periodical, section 1.512(a)-1(f) would not apply.

M has stated that it may offer to include advertising on its website for no additional consideration as part of periodical advertising arrangements. Although M may choose to charge those who advertise in its periodicals no additional consideration for advertisements appearing on its website, such website advertising undoubtedly will have some separate value that may or may not have to be included in the computation of periodical advertising under section 1.512(a)-1(f) of the regulations. As noted above, these regulations would apply to advertising on M's website only where such advertising is part of a periodical that appears on-

line. These regulations would not apply if the advertising appeared on M's website generally, and not part of an on-line periodical. Under these circumstances, if an advertiser pays M an amount that is attributable only to periodical advertising (including on-line periodical advertising), section 1.512(a)-1(f) would apply to the entire payment, and no allocation between periodical and non-periodical advertising would be necessary. On the other hand, if an advertiser pays M an amount that is attributable to both periodical advertising and advertising that appears on M's website generally, an allocation would have to be made between periodical and non-periodical advertising.

In defining a "qualified sponsorship payment," section 513(i)(2)(A) of the Code distinguishes between an acknowledgment and advertising. An acknowledgment of a sponsor's name and logo (or product lines) is consistent with treatment of a sponsor's payment as a qualified sponsorship payment, while advertising falls outside the exception to unrelated trade or business under section 513(i). For purposes of the rules applicable to corporate sponsorship, *advertising* is defined in section 1.513-4(c)(2)(v) of the regulations as any message or other programming material which is broadcast or otherwise transmitted, published, displayed or distributed, and which promotes or markets any trade or business, or any service, facility, or product. Section 1.513-4(d)(iv), Example 11, addresses a situation in which a sponsor's name and Internet address appear as a hyperlink from an exempt organization's website to the sponsor's website. The Example concludes that this constitutes an acknowledgment. In the instant case, M's provision of a link to a sponsor's website in connection with the acknowledgment of a sponsorship payment will not be treated as advertising, but constitutes an acknowledgment under section 513(i)(2)(A).

Based on the above facts, we rule as follows:

1. M's listing of information about third-party providers of services to M's members in M's publications and brochures and on its website is not a trade or business within the meaning of section 513(c) of the Code and will not constitute an unrelated trade or business under section 513(a).

2. M's providing of a link from its website to the websites of third-party providers of services to M's members as part of its listing of information about such service providers is not a trade or business within the meaning of section 513(c) of the Code and will not constitute an unrelated trade or business under section 513(a).

3. M's listing of information about O and P in M's publications and brochures and on its website, and its providing of a link to O's and P's websites as part of the website listing, will not cause any portion of M's licensing revenues from those companies to be treated other than as royalties under section 512(b)(2) of the Code.

4. M's income from the sale of periodical and banner advertising to third-party providers of services to M's members at its customary rates, including to O and P on an exclusive basis, constitutes unrelated business taxable income under section 512(a)(1) of the Code, and the sale of such advertising will not cause any portion of

M's licensing revenues from such service providers to be treated other than as royalties under section 512(b)(2).

5. M's sale of banner advertising on its website is not periodical advertising within the meaning of section 1.512(a)-1(f) of the regulations, provided such advertising is not part of an on-line version of M's periodicals.

6. No allocation between periodical and non-periodical advertising (including on-line periodical advertising) must be made, where an advertiser pays M an amount that is attributable only to periodical advertising; section 1.512(a)-1(f) of the regulations would apply to the entire payment. An allocation between periodical and non-periodical advertising must be made, where an advertiser pays M an amount that is attributable to both periodical advertising and advertising that appears on M's website generally.

7. M's providing of a link to a sponsor's website in connection with an acknowledgment of a sponsorship payment will not be treated as advertising, but constitutes an acknowledgment within the meaning of section 513(i)(2)(A) of the Code and will not constitute an unrelated trade or business under section 513(a).

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

Except as specifically ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transactions 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 M's authorized representatives. A copy of this letter should be kept in M's 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 there are any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Robert C Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3