L. FUND RAISING

Internal Revenue Service records indicate that over 12,000 exempt organizations are listed as having fund raising as a major purpose. Since IRC 501(c)(3) organizations are designated as proper recipients of IRC 170(c)(2) charitable contributions, it seems logical that there are tens of thousands of additional organizations that engage in fund raising programs to various degrees. Further, there can be no doubt that there are thousands of organizations exempt under other subsections of IRC 501(c) that engage in fund raising projects.

This is a controversial area with generally no published guidelines. There may perhaps be no part of the exempt organizations' universe where the adage, "facts and circumstances of the individual case" is more applicable. This topic will discuss fund raising in regard to exemption, UBIT, private foundation, and charitable contribution issues.

1. An Overview

IRC 170(c)(2) allows persons to itemize donations to charitable organizations exempt under IRC 501(c)(3) both on 1040 and now 1040A returns. Many of these persons attempt to do more than just contribute money or goods. They devote their time, reputations, and energies to group fund raising projects. These groups may work directly within the organizational structure of an exempt charity. If they do, the Service rarely has any problems with the exempt status of the charity. In many situations, however, the beneficiary charity may not have the administrative means or expertise to engage directly in the fund raising activity. Instead, it provides only its name and good will to the fund raising effort. A separate organization is often set up for the purpose of raising funds.

Operation of an athletic, social, entertainment, or gambling event is a very attractive means of raising funds. Some of the more popular mediums include charity balls, benefit concerts, theater and movie premieres, horse shows, football games, antique shows, flea markets, auctions, bingo, fish, beef, and fowl frys, cocktail parties, and celebrity athletic events. Recently, in this age of a slumping real estate market, charitable organizations have even been holding lotteries with houses as prizes.

An annual event with a gate attraction provides a vehicle that naturally attracts community support and news media publicity. Such an event has a

potential work force of volunteers who share some general interest or hobby in the activity as well as being "charitably" minded. (e.g. amateur golfers helping to run a professional golf tournament for charity.) However, fund raising events often require large expenditures for the services of gate attractions and salaried fund raisers or coordinators. A fund raising event of magnitude may not be merely a collective, legally unorganized effort by community spirited individuals. Since such an effort is subject to individual liability in contract, insurance, and tort law, the collective effort may desire incorporation under appropriate state not-for-profit corporation laws. At this point, the newly formed organization often files a Form 1023 with its key District Director.

The not-for-profit incorporated annual fund raising event organization has valid reasons for applying for recognition of exemption under the federal income tax laws. Recognition under IRC 501(c)(3) often stimulates the public to attend the events and contribute to the fund raising efforts. In addition, IRC 501(c)(3) exemption has the significant effect of freeing the organization from the charitable deductibility limit provided in IRC 170(b)(2) for non-exempt corporations, although the Economic Recovery Act of 1981 has raised the limit to 10 percent of taxable income. This limit is not overcome by alleging an independent agency for the benefit of charity theory. The Service has generally held that assignments of income to charity by non-exempt corporations may not be excluded by the latter from gross income or deducted as charitable contributions except to the extent authorized by IRC 170(b)(2). See Reg. 1.61-2(c); G.C.M. 27026, 1951-2 C.B. 7; Rev. Ruls. 68-503, 1968-2 C.B. 44 71-33, 1971-1 C.B. 30, and 76-20, 1976-1 C.B. 22.

In considering the recognition of IRC 501(c)(3) exemption in any given case, the Service is bound by its organizational and operational tests. In respect to these tests, the Service historically has had problems with organizations that base their charitable status on the "destination of their incomes." As we will discuss, an organization has often been on tenuous exemption grounds when its primary activity consists of the operation of a business enterprise, regardless of the fact that all net income derived is payable to charitable beneficiaries.

The Service has had difficulties with event fund raising organizations when the events are packaged with the commercial trappings of a profit activity. Invariably, the event aspects of a representative organization are tied to high priced gate attractions. Such events are often saddled with costly administrative overheads such as payments for publicity. Also, professional promoters are often present.

These promoters allegedly work for the charitable organization, but in some cases may work for themselves at the expense of the organization.

The Service has often avoided the "destination of income" problem with the fund raising organization by distinguishing annual fund raising for charity as an activity conceptually separate from "trade or business." We have been strongly influenced by the voluntary labor and donated goods exception rules under IRC 513(a) and (c) and IRC 502 (especially after the 1969 Tax Reform Act amendments), and by the "intermittent activity for the benefit of charity" exception in the IRC 513 regulations and Congressional background

In recent years, consideration of possible exemption under IRC 501(c)(3) for annual event fund raiser exemption cases has primarily centered on the "commensurate test." Taken into conjunction with the IRC 502 and 513 exceptions, the Service has often granted IRC 501(c)(3) exemption status to the typical fund raiser if there has been a sufficient turnover of funds to charity. Unfortunately, this approach has been marked by confusion and inconsistency.

Today, fund raisers of all varieties have been subject to much public criticism. Charitable fund raisers have not been excepted. In fact, many revelations about these organizations have been published alleging gross misrepresentations, private kick backs, waste, and lack of significant charitable accomplishments. [For an investigation of the multi-billion dollar American charity industry, see "Charity USA," by Earl Bakal, Times Books (1979).]

The Service has relatively minor authority to deal with fund raising organizations except on fundamental exemption issues, and issues of unrelated trade or business income. For example, Internal Revenue Service instructions to the field on the subject of erroneous and misleading advertisements by exempt fund raisers merely advise key district officers (1) to inform the wrongdoers about Rev. Rul. 67-246, 1967-2 C.B. 104 (concerned with donations and deductions to charitable fund raising events), or (2) to put out appropriate local news releases about wrongdoers after National Office approval in cases of flagrant disregard. See IRM 7(10) 63.6 This part of the IRM along with an extract of Rev. Rul. 67-246 are reproduced as Appendixes 1 and 2.

In the past, there have been a number of pieces of legislation introduced in the Congress that would have had the effect of clarifying this area. Fund raising cases are difficult vehicles for revenue rulings because of their highly factual natures. Some legislative proposals would have required that public charity fund

raising organizations be required to have a minimum pay out similar to that required of private foundations in IRC 4942. Both the Filer Commission (1976) and the Department of the Treasury (1977) recommended that some federal regulatory control be enacted to monitor fund raising activities. However, no legislative proposals have ever cleared Congressional Committees for full House or Senate vote. There is no federal legislation on fund raising pending in the 97th Congress.

2. Basic Issues

In fund raising, several basic issue areas present themselves:

A. What criteria should be utilized in considering IRC 501(c)(3) exemption for fund raising organizations? What positions have been taken by the Service in published and unpublished form? What positions have been taken by the courts?

B. Is IRC 502 an obstacle to exemption?

C. What is the unrelated trade or business treatment of annual events for the benefit of charity carried on by otherwise exempt organizations?

D. What issues emanate from fund raising in the private foundation and charitable contribution areas?

3. The Published Service Position

Although there are no revenue rulings directly touching on the exempt status of an annual or intermittent event charitable fund raising organization and there are no examples provided in the regulations on the issue, a few revenue rulings indirectly touch upon the Service position with regard to these organizations.

For example, a community fund type of organization, which carries on no operation other than to receive contributions and incidental investment income, and to make distribution of all its income periodically to several IRC 501(c)(3) organizations, has been recognized as exempt since 1924. (I.T. 1945, III-1 C.B. 273 (1924)). The principle was restated in Rev. Rul. 67-149, 1967-1 C.B. 133.

In a multi-example revenue ruling in 1967, the Service discussed the IRC 170 charitable deductibility allowances of payments made by taxpayers in

connection with certain fund raising activities frequently employed "by or on behalf of charitable organizations." Rev. Rul. 67-246, 1967-2 C.B. 104 (also published by the Service as Publication 483). Rev. Rul. 67-246 mentions that some of these fund raising activities are charity balls, bazaars, shows, and athletic events.

Rev. Rul. 69-636 1969-2 C.B. 126, provides that the exempt status of an IRC 501(c)(7) country club will not be adversely affected if it makes its facilities available to an IRC 501(c)(3) organization for charitable fund raising activities at a charge equal to or less than cost. One inference here is that a golf tournament for the benefit of charity is permissible under IRC 501(c)(3).

One existing revenue ruling that seems on its face to address annual event fund raisers is Rev. Rul. 57-52, 1957-1 C.B. 196. The latter provide that a corporation organized for the purpose of promoting and conducting home shows, the net earnings of which inure to the benefit of a county recreational board in the form of rent for the use of its premises, is not exempt under IRC 501(c)(3). The rationale for denial is essentially IRC 502 and it must be distinguished on the basis of the implied contractual rental relationship and/or subsidiary status the organization has with its beneficiary. In any situation, because Rev. Rul. 57-52 was published long before the extensive application of the commensurate test and the Tax Reform Act of 1969 amendments to IRC 502, its validity may be doubtful today.

Rev. Rul. 75-201, 1975-1 C.B. 164, involves an organization exempt under IRC 501(c)(3) that carries on an annual fund raising dance for charity. Although the revenue ruling favorably addresses the UBIT issue, by implication, it could stand for the proposition that an organization that raises funds for charity can be exempt under section 501(c)(3).

There are also many revenue rulings concerning event organizations which may have fund raising purposes but which also present traditional IRC 501(c)(3) educational or charitable activities. Examples follow:

Rev. Rul. 67-148, 1967-1 C.B. 132, provides for the exemption, on educational grounds, of an organization carrying on, as a principal activity the reenactment of Civil War battles for which participation and spectator fees are charged.

Rev. Rul. 66-146, 1966-1 C.B. 136, holds that an entity organized and operated to make awards to prominant citizens is eligible for IRC 501(c)(3)

exemption following Box v. McCauglin, 42 F. 2d 616 (1930). It would seem that an organization conducting a testimonial dinner with paying guests, with the net proceeds distributed to charity, would find authority for exemption in Rev. Rul. 66-146.

Rev. Ruls. 67-392, 1967-2 C.B. 191 and 65-271, 1965-2 C.B. 161, stand for the principal that sponsoring cultural performances for the arts before a paying public may further the educational ends of an organization for purposes of IRC 501(c)(3).

A garden club that furthers interest and instructs on horticultural subjects through public flower shows and charges admission fees may be exempt under IRC 501(c)(3). (Rev. Rul. 66-179, 1966-1 C.B. 139).

Rev. Rul. 67-216, 1967-2 C.B. 180, provides for the exemption of an organization exclusively organized and engaged in instructing the public on agricultural matters by conducting annual public fairs. The fairs generated income from admissions and commercially provided midway shows, refreshment stands, and a rodeo.

Rev. Rul. 66-178, 1966-1 C.B. 178, provides that the Service recognizes the IRC 501(c)(3) exemption of an organization sponsoring an annual public art exhibit. The organization charged admission fees and sold a catalogue.

Finally, Rev. Rul. 71-545, 1971-2 C.B. 235, provides that an organization that conducts an international exposition commemorating historical events and cultural achievements, and exhibits products of various nations is exempt under IRC 501(c)(3).

See also other examples in the Promotion of Fine Arts and Performing Arts topic, 1982 EO CPE Textbook.

4. A Survey of Annual Event Charitable Fund Raisers

A. Social Event Fund Raisers

It is fair to say that the general public identities the charity ball as being a traditional device for annual event fund raising. Many other types of events may produce far more in revenue. Still many charity balls remain in existence. Great amounts of volunteer labor are generally involved in the preparation and operation

of a charity ball. In addition and most importantly for our purposes the balls invariably produce for charity.

On the other hand, social event fund raisers, like the other varieties discussed later, have commercial aspects and social recreation aspects. For example, in a case considered in the 1960's, a fund raising event for charity was considered in the context of an unrelated trade or business issue. [The National Office rulings and technical advice cases described in this topic are for illustrative purposes and are not to be taken as precedent.] The organization conducted an annual antique show held in a local armory which was rented for the occasion. The show was run by a paid manager, although most of the other labor necessary to prepare for and operate the event was of a volunteer nature. Income was generated from the sale of exhibit space to antique dealers ($11,000), admission charges from the public ($6,000), a "preview party" ($15,000), and from the sale of an elaborate program which emphasized the charitable aspect of the show ($9,000). In addition, income was collected from a lecture show held prior to the show which had the services of volunteer ticket sellers and a volunteer lecturer. Although there was no information with respect to the outflow of funds, the organization indicated that the net proceeds from the above income producers went to charity. No part of the sales made by the antique dealers were to be distributed to charity. The paid manager and the antique dealers (with their antiques) were analogous to the professional fund raisers and drawing card professionals, respectively, encountered in spectator event fund raising cases. In holding that the antique show was a fund raising event for charitable purposes and that it was not the operation of an unrelated trade or business, the ruling stated that:

> Many organizations exempt under section 501(c)(3) of the Code engage in various fund raising activities such as theater benefits, card parties, dances, fashion shows, or other semi-social affairs. It is our conclusion that the antique show is in the nature of a fund raising event for charitable purposes.
>
> In order to conduct a fund raising event it is necessary to present an affair to attract the public interest. In the instant case, the antique show was selected for its interest to the general public rather than to serve a business interest of the members or officers. The hiring of a manager for the antique show is analogous to the hiring of a fund raiser in connection with general drives to raise charitable contributions. Volunteer help is utilized in the performances of all functions where it is practical to use such help. Rentals from booth

space to antique dealers represent less than one fourth of the gross receipts from the show. Income from the sale of tickets to the preview party and the sale of advertising space in the program is substantially in the nature of charitable contributions.

Another illustrative ruling in the social event fund raiser area during the 1960's involved an organization whose stated purpose was "to raise funds for equipping and furnishing a children's hospital." The only activity was holding an annual charity ball and turning over the entire net proceeds to the hospital. The facts in the case indicated that substantially all of the labor put into the activity was of a volunteer nature, and the prizes to be awarded by drawings at the ball were donated or bought at cost by local merchants. However, considerable outlay was made for such expenses as professional musicians, ballroom rental and prizes.

The following is extracted from our technical advice and represents a good vintage exposition of why a fund raising event organization qualifies for IRC 501(c)(3) exemption:

> Charitable organizations have traditionally engaged in fund raising activities as a means of raising funds to carry out their charitable purposes. In processing cases of this sort we attempt to distinguish "fund raising" from ordinary business activities by considering the nature of the activity, the purpose for which it is being conducted, how it is conducted, its frequency and the use made of the proceeds. Certain types of activities which lack the usual characteristics of regular conduct of a trade or business and which are commonly regarded as being of a "fund raising" nature do not effect the exempt status of charitable organizations.
>
> Some factors to consider in determining whether a particular activity is fund raising are the following:
>
> 1. Occasional activity of a nature not usually considered to be commercial;
>
> 2. Members volunteer substantial services, so far as practical under the circumstances;
>
> 3. Advertising in programs is of the type usually regarded as charitable contributions;

4. Merchandise which is donated or furnished at cost;

5. This does not preclude the payment of reasonable rents, fees for professional services, and reimbursement of members for out-of-pocket expenses.

Where an income-producing activity is conducted primarily in the manner set forth above, the Service takes the position that the activity is "fund-raising." A determination as to whether an activity is the primary activity of the organization claiming exemption under section 501(c)(3) depends upon all the facts and circumstances of a particular case. As a general rule, however, if an organization otherwise qualified under that section is shown, in fact, to be carrying on a charitable program reasonable commensurate with its fund raising activities, there appears to be no basis for holding that the primary activity of the organization is other than charitable. The mere fact that an organization derives its income primarily from such fund-raising activity is not considered to defeat either the primary purposes or the substantial activity tests of section 1.501(c)(3)-1(c) of the Income Tax Regulations.

Upon consideration of all of the facts of the instant case, we are of the opinion that the activities of the charity ball committee are such as to constitute fund-raising. Further, inasmuch as this organization contributes substantially all of its income to another charitable organization, we have concluded that the primary purpose of this organization is charitable, and the organization is entitled to continued exemption from Federal income tax as an organization described in section 501(c)(3) of the Code.

This case, however, does not contain a specific reference to IRC 502. Such a reference is not necessary. By distinguishing fund raising from a trade or business, we take out of consideration the trade or business threshold requisite provided in IRC 502.

In another technical advice case, a favorable ruling was issued to a fashion show event fund raiser. In this case, the stated purpose of the organization was "the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code of 1954." The only activity of the

organization was the sponsoring of annual fashion shows, the net proceeds of which were distributed to charity. Items modeled in the fashion show, along with the models, music, and entertainers, were donated by a local department store.

Along with the factors considered in the previously discussed charity ball case, the technical advice cited Reg. 1.502-1(a) in regard to determining the primary purposes of an organization by considering the size and extent of the trade or business and the size and extent of the charitable activities. In addition, there was reference to the then newly enacted 1969 amendments to IRC 502, which of course added the donated goods and services exceptions to the Feeder statute. Unfortunately, there was no information relating to financial information in the file. The technical advice concluded with the following:

> Since the fashion show is held once a year and because merchandise and services are donated and net proceeds are distributed commensurate to an exempt purpose, the fashion show constitutes an exempt fund raising activity rather than an ordinary business activity.

In a more recent technical advice from the 1970's involving a social fund raiser, the stated objective of the organization was "to raise money for charity through members, family and friends sponsoring socials, lunches and dinners, and donations for the affairs to be given for various charitable organizations." The organization's activities consisted of sponsoring social events such as "birthday parties," etc., in a clubhouse which the organization owned. A review of receipts and disbursements for a four-year period showed that a third to one-half of all moneys received were distributed to charity. After citing the pertinent regulations under IRC 501(c)(3), the technical advice noted the following:

> Many charitable organizations do not engage in active charitable undertakings themselves, but rather assist the work of religious, charitable, educational or similar organizations by contributing money to them. Providing financial assistance to such organizations is a charitable activity justifying exemption.

Although remarking that the medium utilized, i.e. birthday parties, etc., were social in nature, the technical advice found that it was the means by which funds were raised. Paraphrasing the TA, this raising of funds commensurate in scope with the organization's financial resources was a charitable activity and qualified the organization for exemption. Rev. Rul. 64-182, 1964-1 C.B. (Part 1) 186 was cited. In a ruling from the 1970's, an organization ran a beer "kegger" for the

benefit of local charities. The party produced a considerable profit and was operated by volunteer labor. It was held that the organization qualified for exemption under IRC 501(c)(3).

In another interesting case, an organization proposed operating a rock music concert for the purpose of raising money for charities. The organization claimed that 50 percent of the income collected from admissions, records, and tapes emanating from the concert would be donated to charity. The ruling, however, found that the "predominant orientation" of the organization was directed to running an unrelated trade or business, apparently not accepting the organization's charitable proposal, and denied exemption using Reg. 1.501(c)(3)-1(e) as authority.

It is clear that the commensurate test had become the controlling rationale in the area of social event fund raising cases.

B. Horse Shows

The National Office has had many horse show organization applications. Horse shows often have both the more commercial aspects of professional golf tournaments and the social recreation aspects of the charity balls. At least before the enactment of the Tax Reform Act of 1969, horse shows confronted the feeder problem under IRC 502.

In general, horse shows are entities that conceivably have standing under a number of IRC 501(c) sections. One case even suggested IRC 521. IRC 501(c)(7) consideration could be made because of the ostensible social and recreational aspects that benefit a particular horse show organization's membership. However, the once a year nature of a horse show, the lack of meetings for social reasons, the general lack of comingling within the meaning of IRC 501(c)(7), and the amounts of non-member income received would apparently foreclose an applicant organization from qualifying under the section. We are aware of no cases to date contesting this interpretation. IRC 501(c)(5) is certainly a possibility. One case recognized exemption under that section for a horse show organization that had been holding annual horse shows for over 110 years. In that case, the ruling held that the rearing, raising, and management of livestock was within the meaning of Reg. 1.501(c)(5), and since the horse show served as an incentive for improving breeds of horses, the organization qualified for exemption under IRC 501(c)(5).

IRC 501(c)(4) has provided a haven for an occasional horse show. Significantly, two IRC 501(c)(4) cases concerned fund raising efforts. In two

technical advices, the organizations were granted exemptions partly because they were fund raising projects for the benefit of local civic organizations performing social welfare activities. The primary rationale for exemption in both cases was a questionable analogy to Rev. Rul. 68-224, 1968-1 C.B. 263, which provided IRC 501(c)(4) exemption to an organization conducting an annual festival, with a rodeo featuring professional riders and livestock procured from commercial enterprises, in a particular locale deeply entrenched in Western regional customs.

Most applications for horse show exemption have been directed to IRC 501(c)(3). A typical horse show is not in itself an organization advancing education within the meaning of IRC 501(c)(3). However, a horse show might now be exempt under IRC 501(c)(3) if it meets the requirements of the amateur athletic provision. [For more information on the amateur athletic provision, see 1980 EOATRI Textbook p. 62.] Generally, an educational benefits argument is rejected because the instruction of the public and individuals on useful subjects is at best only an incidental activity of a horse show.

Usually IRC 501(c)(3) exemption for this type of organization has rested on the issue of fund raising for charity. A 1960's technical advice, for example, probably set the stage for subsequent cases. The facts indicated that the organization was established for "the purpose of operating horse shows and to do all those things necessary and proper in connection with such operation." The organization stated that its only purpose was the sponsorship of a three day annual horse show, the furthering of horsemanship in the local county, the fostering of interest in horses among area children, and the raising of funds for charitable purposes. Stressed was the substantial amount of disbursements for prize moneys, social affairs, ribbons and trophies, and the corresponding small amounts distributed to charity ($4,000 out of $75,000 in gross receipts over a five year period). Our ruling denied exemption because the organization's purposes were too broad and because a horse show is not an activity enumerated in IRC 501(c)(3), but it is apparent that it was denied because the output for charity was not commensurate in scope with its financial resources. This was not spelled out precisely except for a "compare" reference to Rev. Rul. 67-5, 1967-1 .C.B.

In another 1968 case, reliance on the commensurate test was bolder. The organization was granted IRC 501(c)(3) on the basis that the first two shows generated 11% and 20% for charity, respectively, from gross receipts. Contemporaneously with this case, the Service ruled unfavorably on a horse show by applying IRC 502. In that technical advice case, the net proceeds of the organization were to be distributed to a charity designated in advance. However,

the first year's show did not produce a profit. And thus nothing was distributed to the charitable beneficiary.

The Service found that substantial educational purposes were absent, and the horse show was indistinguishable from a business ordinarily carried on for profit subject to IRC 502. It seems apparent here, and inconsistent in light of the commensurate test utilized in other horse show cases of the time, that if the facts had indicated a substantial turnover of funds to the beneficiary charity, the organization would still have been rejected.

A different approach was followed in another 1960's case. The organization was granted exemption under IRC 501(c)(3) through the use of the following criteria:

1. an examination of all activities to include volunteer work;

2. whether the show is large or small;

3. the extent of social activities; and,

4. a complete disregard of the ratio between value of prizes and funds ultimately donated.

In another case from the 1970's, a new horse show organization was incorporated under the not-for-profit corporation law of a state for the purpose of holding an annual horse show with "the proceeds therefrom, if any, to be used to perpetuate the holding of such show as well as making contributions to charitable organizations assisting the corporation in the holding of said horse show." Because there was no information disclosing what the charitable distribution was to be, it was found that the primary purpose of the organization was the operation of a commercial business for profit. (It may have been argued that no charity existed even with distributions to the charitable organizations proposed to be benefited, because the latter were providing a quid pro quo - i.e. "assisting the corporation in the holding of said horse show.")

In a more recent case, a ruling emphasized through statistics that the subject organization collected $1,250,000 in gross receipts over a time span of seven years, but only distributed $3,000 to charity. From such statistics, little deliberation was

necessary to arrive at a denial. Pertinent reasoning was provided along the following lines:

> The certificate of incorporation does not provide that the organization is organized exclusively for charitable purposes. Operations since incorporation clearly indicate that the primary activity has been the annual promotion and conduct of an international horse show. The promotion and conduct of such a show is not of itself in furtherance of an educational or charitable purpose. Further, it is shown that charitable activities have been de minimis. Therefore, the manner of the operation indicates that the primary thrust is to conduct a successful sporting event with any profit for charity being incidental.

It would seem from this, that the commensurate test has become the basic exemption rationale for the horse show fund raiser, whether said in so many words or not.

A last case of note involved the classic situation in which the IRC 502 "feeder" factor stood in the way of exemption. Originally applying for exemption under section 101(8) of the Internal Revenue Code of 1939 (predecessor to 501(c)(4)), the applicant organization stated that its purposes were:

> to put on horse shows, to encourage the breeding and riding horses, and to support worthy charities with the proceeds from such shows.

In the 1940's, the Service denied exemption under IRC 501(c)(4) on the grounds that the funds of the organization were not expended for purposes beneficial to the community or for social welfare. The file does not show what information led to that decision. However, it was noted that the decision was thought to be predicated on a lack of proof that the grantee organization involved was an exempt organization.

Ten years after denial the organization filed for exemption as a IRC 501(c)(3) organization. The certificate of incorporation of the organization provided that:

The corporation is formed for the purpose of raising funds for the support of the children's hospital, through the sponsorship and holding of horse shows and exhibitions, the receipt of donations, ticket sales and other fund raising activities. All net proceeds collected from the organization's activities were dedicated to the hospital and to the hospital's predecessor foundation. The primary activity of the organization related to carrying on the horse show.

It was found that:

1. The show was annual, and involved tremendous amounts of volunteer time. Volunteers were local enthusiasts who solicited contributions for the prizes and trophies to be awarded at the show and to help defray additional costs related to the show.

2. Most of the work performed prior to and during the show was performed by approximately 1,000 volunteers.

3. There was repeated advertising in the show's official program that the show was being presented for the benefit of the children's hospital.

4. Income was produced from concessions, program sales, advertising sales contributions, and entrance fees. This amount excluded ticket sales to the general public totalling $97,000. The total expenses, including trophy and prize costs, resulted in a $15,000 loss. However, the loss was cancelled by contributions collected by volunteers. $99,000 was donated to the designated charity in the noted year and similar financial activities produced almost $800,000 for the hospital throughout a time span of 12 years.

The following was argued in support of exemption:

1. The organization satisfied the organizational test under IRC 501(c)(3) since the exclusive purpose of the organization was to raise money for the designated hospital.

2. The horse show could be characterized as a widely supported and highly successful community fund raising project for the hospital. It was reasonable for those people involved in organizing and operating the show to turn to a "natural medium" to accomplish their purpose of aiding the hospital since they were horse fanciers.

3. The organization was operated exclusively for charitable purposes under IRC 501(c)(3).

4. The horse show did not constitute a trade or business for purposes of IRC 511 through 513 because of the -

a. once a year nature of the event;

b. clear purpose of benefit to charity;

c. advertising clearly reflecting the event as one for the specific purpose of benefiting charity similar to an annual fireman's ball;

d. amount of voluntary help and time spent in the selling of the tickets, organizing and managing the show;

e. assumption by volunteers of the financial risk;

f. entire net proceeds of the ticket sales being distributed to charity; and

g. lack of prevailing indicia indicating that the operation of the show constituted a trade or business.

It would seem clear that these findings and arguments could be utilized as guidelines and the horse show would have no difficulty in obtaining exemption with a demonstration of distributions to charity commensurate with its financial resources as noted. However, in the actual above-described case, the IRC 502 "feeder" issue was raised. Many in the Service were bothered by the relationship between 502 and IRC 511-513. Essentially, concern revolved around a fundamental question as to whether the conduct of an annual fund raising event is sufficient to constitute the "carrying on of a trade or business for profit" within the meaning of IRC 502, even though such activity would not be carried on with sufficient regularity to constitute unrelated trade or business "regularly carried on" for purposes of unrelated business income tax. Although this question remains officially unanswered today, this horse show's problems were somewhat resolved by legislation in the Tax Reform Act of 1969, excluding activities with "substantially all" voluntary labor or donated goods from IRC 502 application.

C. Spectator Sporting Events

Charity sporting events are often initiated by weekend sports participants. If the proposed event is, for example, a golf tournament, golfers might volunteer their golfing knowledge and energies, and/or obtain the facilities of their country club on a cost basis. However, a practical limit exists on the amount of donated goods and/or voluntary labor that can be utilized. Invariably, athletes and organizers must be contracted and compensated for.

On the face of it, evidence of high administrative expenses and costly gate attractions stands in potential conflict with IRC 501(c)(3) and the regulations thereunder. An organization sponsoring athletic events can be exempt under IRC 501(c)(3) if it meets the amateur athletic provision enacted in 1976. If the events are solely for children, the organization may be exempt on the ground that it is preventing juvenile delinquency. See Rev. Rul. 80-215, 1980-2 C.B. 174, and Rev. Rul. 65-2, 1965-1 C.B. 227. Also, an organization can be exempt under IRC 501(c)(3) if its events are part of the educational program of an educational institution. See Rev. Rul. 55-587, 1955-2 C.B. 261, for example. Organizations which do not have any of the above aspects often request IRC 501(c)(3) exemption as charitable fund raisers. Such an organization might also apply under IRC 501(c)(4) on the grounds that the event creates community publicity, civic pride, and recreational opportunities. However, an organization operating a professional golf tournament was held to be operated in a manner similar to golf tournaments operated for profit and was denied exempt status under IRC 501(c)(4). See Rev. Rul. 74-298, 1974-1 C.B. 133. IRC 501(c)(6) exemption is also possible. Athletic event attractions, such as bowl games, may indeed promote the business interests of the community and have been carried on by chamber of commerce type organizations. In the matter of IRC 501(c)(3) exemption, the Cumulative List contains a number of Shrine Bowl football game fund raisers. Records indicate that the sole activity of the organizations was to promote annual football games between high school players of neighboring states, the net proceeds of such games being distributed to Hospitals for Crippled Children. The exemptions were granted in the early 1950's and it appears that emphasis was placed on the fact that a substantial amount of contributed services was involved in the operations of the organizations and the fact that the participants in the games were high school amateurs.

An early example of an adverse position is represented in a case where it was held that because the specific purpose for which the organization was formed was to sponsor a professional football game, and because the football game was

the only activity performed, the organization could not qualify for exemption under IRC 501(c)(3), regardless of the fact that net proceeds were to be used for charitable purposes. IRC 502 was invoked in its most undiluted form in the following manner:

> IRC 502 specifically provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under IRC 501 on the ground that all of its profits are payable to organizations which do qualify under the latter section. It is concluded, therefore, that the organization is not organized exclusively for the purposes specified in IRC 501(c)(3), and fails to meet the first part of the dual test referred to.

No financial statistics were included to indicate whether there was any actual output for charity, much less any mention of the commensurate test as later expressed in Rev. Ruls. 64-182, 1964-1 C.B. 186 and 67-5, 1967-1 C.B 123.

The above described case was noteworthy in its use and distinction of Mobile Arts and Sports Association v. United States, 148 F. Supp. 311 (1957), in which the District Court held that an organization organized and operated to sponsor the annual Senior Bowl game in Mobile, Alabama, was entitled to exemption under IRC 501(c)(3) and 501(c)(4). The court in Mobile Arts found (and this case noted) that the organization, in addition to sponsoring the football game (incidentally professional in that the players, all graduating All-Americans, were being paid for their participation), and a collegiate basketball tournament, was also sponsoring outdoor symphony concerts, ballet performances, choral singing performances, a recreation program for several thousand youths of the city, etc. These activities were either free to the public or offered at reduced admission prices. It was found that, as to the game itself, the primary objective was not necessarily to make money, but to provide some educational value and, at the very least, it was an integral part of the organization's civic and educational program. Mobile Arts was considered wrong by the Service and not acquiesced to.

Another case from the 1960's involved a youth fund. The principal issue in the case was whether or not the organization's purposes and activities in connection with the conduct of an open golf tournament precluded the organization from exemption under IRC 501(c)(3). For our purposes, the organization was a fund raiser exclusively. According to the articles of incorporation, as amended, the purposes and activities of the organization were "directed principally" to the

support of various educational and charitable programs through grants of funds received by conducting the golf tournament.

In contrast to many other vintage spectator athletic event organization cases, which typically lack financial data in respect to output for charity, this case provided impressive statistics. In a representative year, it produced gross receipts of over $60,000, of which over 90% was derived from the tournament, with distributions made for charity in the amount of $37,000. A period of a little more than 2 years demonstrated that the grants, contributions, and pledges made by the organization for charitable purposes totalled over $130,000. The financial output made it obviously difficult for the Service to apply a negative rationale and deny the organization's request for exemption.

An easy resolution of the problem was found because the organization did not in actuality conduct the tournament, regardless of the organization's stated purpose. It was found that the organization's members were conducting the tournament on their own, and did not contract for the professional golfers' services. Others assumed the risk of financial loss. In addition, we were influenced by an amendment to the organization's articles separating its role from the tournament in order "to be separate and apart from the tournament in all financial as well as administrative aspects." What remained then for the issue of exemption was an entity collecting funds from the golf tournament and distributing them for the benefit of charity, and therefore exempt under the rationale of Rev. Rul. 67-149. It was also held, however, that the organization could not be denied exemption nor be held liable for unrelated business income, if in fact the organization had conducted the tournament, because of the once a year nature of the tournament and the substantial amount of contributed services involved. In respect to whether exemption could be denied in the past, it was noted that:

> The evidence, instead, shows rather clearly that the organization was engaged in carrying on a definite and substantial charitable program reasonably commensurate with its resources and the size and extent of its activities in connection with conduct of the tournament as an income producing activity. Certainly, at least, it cannot be said that the charitable activities were substantially or significantly disproportionate to the income producing activity.

Another golf tournament case reached a different conclusion, however, on the question of IRC 501(c)(3) exemption. There it was held that

> The information also shows that your activities are carried on for the purpose of bringing people to the area and promoting it as a business and sporting area; that no profit has been derived by you from the golf tournament, that without contributed services no net income would be realized by the fund raising activities; that funds are raised for charitable social welfare purposes; and that the funds raised are destined for charitable and social welfare use. Over $250,000 is available for distribution to exempt charities.

Based on the above, this organization was granted exemption as a civic organization under IRC 501(c)(4). However, the ruling letter added that contributions received by the organization and distributed or held in trust for organizations described in IRC 501(c)(3) would be deductible as charitable contributions by donors as provided in IRC 170(c).

Another interesting case involved whether or not the annual sponsorship by the subject organization of professional football and basketball games, a professional tennis exhibition, and a Golden Gloves boxing match jeopardized the exempt status of the organization, and whether the activities constituted unrelated business activities, subject to IRC 511.

According to the facts in the case, the athletic events were fund raisers for the benefit of a separately incorporated boy's camp that provided a summer recreational camp for disturbed boys. It was found that even though the camp was a separate entity (because of the necessity of having separate financial operations and in order to receive Community Chest support), the running of the camp was still the primary activity of the subject organization, and because of this the organization was entitled to retain IRC 501(c)(3) exemption. This "integral part" type rationale was supported by findings that indicated that in addition to providing the camp with monetary support, members of the organization and board members of the camp were the same; also that the camp's property was owned by the organization; case histories of the boys were published in the organization's bulletins; the camp was visited by members of the organization at least twice a year (showing that "someone was interested in their welfare"); the boys were transported to the spectator events conducted by the organization; and that the boys were given an annual Christmas party by the organization. See Rev. Rul. 71-581, 1971-2 C.B. 236, for a similar approach involving a separately organized thrift shop. See also, Rev. Rul. 78-41, 1978-1 C.B. 148.

In the mid-1960's, the National Office received a technical advice request concerning the effect upon exemption of four organizations (two of which were IRC 501(c)(3) organizations) conducting a professional tournament for the benefit of charities.

Although the organizations concerned were also allegedly carrying on other charitable activities so that the issue related primarily to IRC 511 taxation, the discussion of fund raising activities in the TA is of interest and is extracted here:

> A number of cases involving golf tournaments of this nature have been and are being considered by this office. Where a tournament uses only amateur golfers and awards have only nominal cash value it is evident that the tournament constitutes fund raising activity. (These factors were present in the case of Golf Life World Entertainment Golf Championship, Inc. v. United States, 65-1 USTC 9174, 15 AFTR 2d 307 (1964). Where the tournament uses professional golfers, the activity becomes more questionable because of the necessity for entering into an agreement with a professional golfers association. This contractual agreement permits the professional association to determine the date of the tournament, the eligibility of the players as well as the allocation of the 'Purse' further, such an agreement prevents a conflict with another major golf tournament and assures the finest pros -- both factors being necessary for a successful tournament. While this contract infuses an atmosphere of commercialism, nevertheless, it may be equated with contracts entered into with booking agents to secure orchestras for dances, plays, ballets or other professional entertainment frequently utilized by charitable organizations as an annual or semi-annual means of raising funds with which to carry out charitable programs. Such contracts provide for supplying certain individuals or groups of individuals to perform, the arranging of a date not in conflict with other commitments of the performers and the payment of reasonable compensation for services rendered. If the entertainment being sponsored is not financially

> successful, the organization is still liable for the fees agreed to be paid under the contract entered into.

After quoting the legislative background in respect to determinations of whether a golf tournament is "regularly carried on" for purposes of IRC 511, the TA continued:

> The subject organizations have established that the golf tournament is the only golf tournament they sponsor and this only once a year, that all work necessary to the sponsoring is donated by volunteer services of its members, and that the organizations are otherwise primarily engaged in charitable or civic programs. This once-a-year nature of the affair, and the substantial extent to which the activity is carried on with contributed services, make it highly doubtful whether this activity could be sustained as being within the definition of unrelated trade or business in section 513.

Since the 1960's, the Service has generally utilized the commensurate test in spectator sporting event fund raiser cases. Although often marked by confusion and insufficient information, more recent National Office cases have been examined on the standpoint of financial output. A general observation would be that if the financial output for charity is impressive, a favorable ruling or technical advice would be issued in individual cases. Conversely, if the charitable beneficiaries were not being concretely benefited, a denial would be issued on the basis that the fund raising activity is incidental and the spectator sporting event in itself is not an activity within the purview of IRC 501(c)(3).

For example, in a case decided in the mid-1970's, an organization operating a golf tournament had almost $500,000 in income and only gave $12,000 to charity. It provided $320,000 in prize money to the golf professionals who participated. The organization was denied exempt status because it devoted large amounts of time and money to an activity that produced very little for charity. Therefore, the charitable activity was found to be secondary to the running of a golf tournament.

On the other hand, a more recent case granted exemption under IRC 501(c)(3) to an organization operating a golf tournament that contributed approximately $300,000 to charity out of an income of over $2,000,000 over a four

year period where substantial start-up expenses were shown and where the percentage amounts contributed to charity had steadily increased over the years. See also PLR 8142024.

D. Summary of Unpublished Service Rulings

It is clear that the attitude of the Service, at least in private letter rulings, has been generally favorable towards annual event charitable fund raising organizations in the matter of IRC 501(c)(3) exemption and IRC 511 tax liability. The cases indicate that the typical organization granted exemption may be characterized, give or take certain factors, as follows.

a. a purpose of turning over funds to other charitable organizations through the medium of an otherwise non-charitable once-a-year event which requires extensive planning;

b. the fund raising medium is carried on by community support and considerable amounts of volunteer labor (but not generally "substantially all") and donated goods or facilities that may produce the difference between profit and loss;

c. the event activity is identified with its charitable purpose and charitable beneficiaries through media news publicity, paid for promotion, programs, and community leaders;

d. invariably present is a gate attraction (entertainers, athletes, etc.) and often present are salaried or commissioned persons providing necessary services;

e. income is produced from contributions (often including program advertising income in excess of normal commercial rates), admission charges, concession sales, program sales, television broadcasts, etc., and contributions are given directly (or are claimed to be given) by the general public to the charitable beneficiaries throughout the year somewhat because of the recognition connection that the beneficiaries have with the annual events; and,

f. the organizations invariably turn over their net proceeds, to other charitable organizations except for a reserve for the following year's event.

A determination of exemption in recent times has involved the use of a commensurate test. However, the application of this test has often been marked with inconsistency and a general lack of understanding about the nature of the test. There is a general lack of uniformity as to what factual information is necessary in order to apply the test.

In conjunction with, or independent of, the commensurate test, several cases have taken the position that fund raising is not a trade or business (or unrelated trade or business), thus removing potential confrontations with the primary purpose tests under IRC 501(c)(3) and 502.

Quite readily apparent is the informal acceptance of the IRC 513 regulations intermittent activity rule and the IRC 513 "substantially all" exceptions (even before they were added to IRC 502 by TRA 1969) for use in exemption considerations.

The topic will now be directed towards the treatment of annual fund raising events under IRC 511-513, the proper basis for exemption of fund raising organizations, and problems involving private foundation and charitable contribution issues.

5. Exceptions Under the Unrelated Trade or Business Provisions

Annual event fund raising activities for charity, carried on by otherwise exempt organizations, are generally not subject to IRC 511 taxation due to exceptions under IRC 511-513 and the regulations thereunder.

In general, IRC 511 imposes a tax on the unrelated trade or business income of organizations exempt from taxation under IRC 501(c).

IRC 512 defines "unrelated trade or business income" as income from any unrelated trade or business regularly carried on by an exempt organization.

IRC 513(a) provides in essence that an "unrelated trade or business" is 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 purpose constituting the basis of its exemption under IRC 501(c)(3), except that the term does not include any trade or business:

(1) in which substantially all the work in carrying out such trade or business is performed for the organization without compensation; or

(2) which is carried on ... (by an IRC 501(c)(3) organization) ... primarily for the convenience of its members ...; or [The convenience exception is not discussed in this topic. For discussion, see college retailing topic in 1980 EOATRI Textbook, page 236, and that part of this year's health care organization topic on lab testing.]

(3) which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

Thus, an activity (the event) may be excepted directly from the statutory term "unrelated trade or business" because: (1) it is not arguably trade or business: or (2) it is substantially related to the performance or exercise of the organization's exempt purposes; or (3) it falls within the three above cited IRC 513(a) exceptions. Also, and independently, exclusion of the income produced by an annual event may be excluded under IRC 512's unrelated trade or business income on the basis that the activity is not "regularly carried on."

A. Exception From the Term "Unrelated Trade or Business"

The IRC 513(a) Regs. and Congressional background provide general interpretations of the exceptions to the term "unrelated trade or business."

1. Trade or Business

If an activity does not possess the characteristics of a trade or business within the meaning of section 162 of the Code, the tax imposed by section 511 does not apply. For example, if an organization sends out low cost trinkets in connection with the solicitation of charitable contributions, the unrelated business income tax does not apply since the organization is not in competition with taxable organizations. See section 1.513-1(b) of the regulations.

In The Hope School v. United States, 612 F 2d 298 (7th Cir. 1980), it was held that the plaintiff's distribution of packaged greeting cards, which were mailed to potential customer-donors together with a request for contributions, did not constitute a trade or business within the meaning of section 513 of the Code. The court held that the greeting cards would be considered "low cost articles" as a

matter of law. The Service does not plan to follow this decision since in our view the distribution of packaged greeting cards, including reorder forms and follow-up letters to persons who do not respond to the initial appeal is outside the intended scope of the "low cost articles" exception.

In Disabled American Veterans v. United States, 46 AFTR 2d 80 5438 (Ct. Cl. 1980), the organization operated a special solicitation program. Those who sent money were given premiums in the form of books, maps, charts or calendars. It was held that the income derived constituted income from an unrelated trade or business. The activity was held to constitute a trade or business because the premiums offered in return for the "contributions" were not priced so greatly in excess of their retail values as to deprive the activity of the trade or business character which as otherwise present. Affirmed by full U.S. Court of Claims at 81-1 USTC 9443, May 20, 1981.

2. Substantially Related

As to whether an event activity is "substantially related", there are a number of revenue rulings in the exemption context as noted in Part 3 of this topic. The term "substantially related" would, for example, include a civil war battle reenactment presented by a Civil War educational organization. See Rev. Rul. 67-148. It would also likely include the sale of refreshments at the battle reenactment to the general public since the service provides the patrons more time in which to avail themselves at the event's educational features. See Rev. Rul. 74-399, 1974-2 C.B. 172, involving a cafeteria maintained by a museum for its patrons.

The Reg. 1.513-1(d) "contribute importantly" standard has been extended to hospital gift shops, cafeterias, coffee shops, and parking lots because they constitute a means by which visitors may provide, and patients be provided with, "supportive therapy." (Rev. Ruls. 69-267, 69-268, 69-269. 1969-1 C.B. 160). For more discussion in this area, see 1979 EOATRI Textbook (Vol. 2) topic on Museum Retailing, page 502.

3. The Concept of "Substantially all" Uncompensated Labor or Donated Goods

Reg. 1.513-1(e) illustrates the IRC 513(a) exceptions with examples of a thrift shop, and a retail store operated by uncompensated labor. See Rev. Rul. 74-361, 1974-2 C.B. 59, which holds in part that a volunteer fire department holding weekly public dances with substantially all volunteer labor was not engaged in

unrelated trade or business. Rev. Rul. 80-106, 1980-1 C.B. 113, describes the "substantially all" volunteer labor thrift shop.

There is no specific percentage provided by regulations as to the meaning of the "substantially all" requirement attached to the donated goods and uncompensated labor exceptions. No revenue rulings have specified the percentage under IRC 513(a) or its counterpart IRC 502. But see Rev. Rul. 71-581, 1971-2 C.B. 236 which held pre-Tax Reform Act thrift shops to be exempt, notwithstanding the pre-1970 IRC 502 feeder prohibition. In the subject case, the thrift shops had an operation where substantially all of the goods had been donated and more than half of the work was performed without compensation. It was noted that an otherwise exempt organization carrying on such an activity would not be charged with IRC 511 tax by virtue of IRC 513(a)(3). It is apparent here that the IRC 513(a)(1) uncompensated labor exception is not applied where there is only a 50% showing.

The term "substantially all" is found elsewhere in the Internal Revenue Code and has been interpreted as 85 percent or more. For example, IRC 512(b)(2) requires that "substantially all" of the capital stock of a farmer's cooperative be held by producers. This has been held to mean that at least 85 percent should be held by producers. Rev. Rul. 73-248, 1973-1 C.B. 295.

For years prior to the 1969 Tax Reform Act, IRC 7701(a)(19) provided a definition of a building and loan association that included a requirement that such an organization have "substantially all" of its business in the acquiring of the savings of the public and investing in loans. Reg. 301. 7701-13(a)(2) interpreted this to mean 85 percent in dollar valuation.

IRC 4942(j)(3) defines an operating foundation as one which makes qualifying distributions ... directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated equal to "substantially all" of its adjusted net income ..." Regs. 53.4942(b)-1(c) provides that for purposes of the above section "substantially all" means 85 percent or more.

Finally, IRC 514(b)(A)(1) provides an exception to the term "debt financed property" for any property "substantially all" the use of which is substantially related to its exempt purpose. Again, Reg. 1.514(b)-1(b)(1)(ii) interprets the "substantially all" as 85 percent or more.

It is difficult to apply a percentage test in this exempt organizations area because of the lack of ascertainable factual details upon which a percentage can be applied. One may apply an 85 percent rule to a private foundation's adjusted net income with certainty for example, but how is 85 percent of an organization's total labor or goods measured? For example, in an annual golf tournament for charity, how is an 85 percent rule applied to a year's worth of uncompensated services by local citizens, a few months worth of compensated services by a tournament director and/or fund raiser, and four days worth of the services of the professional golfers competing for prizes?

Although 85 percent is the unofficial guideline, it is significant that few cases under IRC 513(a)(1) have applied the percentage test strictly. "Substantially all" has been applied in a general manner.

In Rev. Rul. 78-144, 1978-1 C.B. 168, an exempt organization rented machinery on a long term basis. The lease agreements required the lessee to provide insurance, pay any taxes, and pay for most repairs to the machinery. The work in connection with finding a lessee, negotiating a lease, and processing the rental payments was performed for the organization without compensation. The revenue ruling reasoned that since most of the lessees kept the equipment on a long-term basis, the volunteer work of finding lessees and negotiating leases was rarely needed. Therefore, the performance of services was not a material income-producing factor in the business and the volunteer labor exception of IRC 513(a)(1) did not apply.

In the courts, a case entertaining the concept of "substantially all" is Greene County Medical Society v. U.S. (72-2 USTC 85, 430, W.D.Mo. No. 2596, July 3, 1972; affd. CA-8, No. 72-1871, April 20, 1973). In Greene the court ignored any connection to a percentage test with "substantially all". The court held that the contested activity, the sale of novelty record albums created by uncompensated doctors, was within the "substantially all" exception because the doctors' role in the activity was the "essence of the endeavor". See also 26 Tax Lawyer 700 (Summer 1973) which said that

> the case held that the section should be construed to measure the intrinsic importance of work performed by the individuals participating in a business activity and measured, across the board, whether or not substantially all work is performed without compensation.

It should be noted that the Service does not follow the Greene case.

In Smith-Dodd Businessman's Association v. Commissioner, 65 T.C 620 (1975), the organization was operating a bingo game with individuals who were paid $ 8 a night for four hours of work. The organization argued that this amount represented reimbursement of expenses. However, the Tax Court held that the payments constituted compensation and the exception for volunteer labor was not applicable.

In a recent case, Waco Lodge No. 166, Benevolent & Protective Order of Elks v. Commissioner, Docket No. 15696-79. T.C. Memo. 1981-546, filed September 24, 1981, the Tax Court considered the "substantially all" volunteer labor exception in the context of weekly bingo games carried on by an IRC 501(c)(8) organization. According to the facts, a minimum of five persons worked the games: two collectors, two cashiers, and one caller. The caller was paid 20 of the 49 weeks that the games were played. He received $ 10.00 each night for 3 1/2 hours of work, which amounted to $ 200 over the course of the year. (Court testimony indicated that the hourly wage, $ 2.86, equalled the minimum hourly wage.) Also the organization gave the two collectors and two cashiers free drinks from the organization's bar operated by a paid bartender. In the particular year in issue, the workers consumed drinks worth $ 435.50. The caller was not given free drinks. Also, Lady Elks provided free sandwiches to the bingo players and were given $ 15.00 each as reimbursement. Also the cleanup persons, such as children of members, received a number of intermittent payments.

The organization had bingo receipts of $ 9,116.23 and gross sales from the bar of $ 3,881.03 for the taxable year, which it reported on Form 990-T as unrelated business income. It deducted as expenses, the bartender's salary, other bar costs, bingo costs, and 67 percent of expenses such as depreciation which were attributable to maintaining the organization's facilities. Included among the deductions reported on Form 990-T as bingo expenses were:

Bingo workers	-	$ 435.50
Caller	-	$ 200.00
Lady Elks	-	$ 762.59
Cleanup	-	$ 50.00

The Tax Court found that the only uncompensated labor involved the reimbursements to the Lady Elks. The court also found that the paid bartender's services constituted part of the total work performed in carrying on the games. In

regard to the collectors and cashiers, the court found that the free drinks constituted compensation. (Averaging the $ 435.50 worth of drinks consumed, each worker imbibed 3 mixed drinks, 6.3 beers, or 8.9 soda waters per night.) The court's reasoning included the following:

1. The organization gave free drinks to a limited group. The bingo players and the caller paid for their drinks. Only the collectors and cashiers received free drinks.

2. The collectors and cashiers were not entitled to free drinks every night the lodge was open, but only on the nights that they worked the bingo games.

3. The organization's cost of running the bar and lodge was increased by providing the workers with free drinks.

4. The organization could not have run the games without the services of the collectors and cashiers.

The court held that the "substantially all" exception was inapplicable.

B. Exception For Intermittent Activities

As a general rule, IRC 512 and the regulations under IRC 512 and 513 require that unrelated trade or business income must be derived from an unrelated trade or business regularly carried on. Special provision has always been made for intermittent fund raising activities since the unrelated trade or business sections were first incorporated into the Internal Revenue Code. As stated by the House Committee Report in 1950:

> Thus in determining whether the income of any exempt organization from any trade or business is subject to the Supplemental I Tax, it is first necessary to determine whether it is income from a trade or business which is regularly carried on, or the income from a sporadic activity. If a charitable organization exempt under 101(6) of the Code gives an occasional dance to which the public is admitted for a charge, hiring an orchestra and entertainers for that purpose, this would not be a trade or business regularly carried on, within the meaning of section 422. Likewise, an organization which operates a

> sandwich stand during the week of an annual county fair, it is not regularly carrying on a trade or business. (House Report No. 2319, 81st Cong., 2d Sess., 1950-2 C.B. 458, 559.

Curiously, regulations expressing the intermittent rules were promulgated in the IRC 513 regulations instead of in the more logical IRC 512 regulations.

Reg. 1.513-1(c)(2)(ii) and (iii) provide for general and special treatment of fund raising activities as follows:

> (ii) Intermittent activities; in general. *** 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 regular carrying on of business.
>
> (iii) Intermittent activities; special rule in certain cases of infrequent conduct. *** /1/ 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 income from trade or business regularly carried on.

See also the report of the Staff of Joint Committee on Internal Revenue Taxation, 91st Cong., 1st Sess., General Explanation of Tax Reform Act of 1969 (Comm. Print 1970), pp. 67, which provides -

> The tax does not apply unless the business is "regularly" carried on and therefore does not apply, for example, in cases where income is derived from an annual athletic exhibition.

Thus the intermittent exception is applicable regardless of the year-to-year continuity, for example, with annual charity golf classics.

Generally, most of the commonly recognized annual event fund raisers are within the permissible time limits normally considered intermittent or sporadic for purposes of the special rule. For example, some annual events extend for 4 days (the golf tournaments) and many are for 1 day (charity balls, football games). See PLR 8135010 for a favorable ruling involving an annual country/western show carried on by an IRC 501(c)(4) local association of employees. If rulings in the horse and dog racing field provide any precedents, the gray area is between 7 and 11 days. Rev. Rul. 68-505, 1968-2 C.B. 248, held that a two week horse racing meet with pari-mutual betting carried on by an exempt county fair association (Rev. Rul. 67-216, 1967-2 C.B. 180) was sufficiently regularly carried on for purposes of IRC 511-513. (Rev. Rul. 68-505 has been legislatively overturned by IRC 513(d), enacted in the Tax Reform Act of 1976.)

Following the 1950 House Committee Report, Reg. 1.513-1(c)(2) provides as an example that the operating of a sandwich stand by a hospital auxiliary for only two weeks at a state fair would not be the regular conduct of trade or business.

Reg. 1.513-1(c)(2) also provides as an example that the operation of a commercial parking lot on Saturday of each week would be the regular conduct of trade or business. See also Smith-Dodd Businessman's Association, Inc. v. Commissioner, 65 T.C. 620, 624 (1975), in which the Tax Court held that weekly bingo games satisfy the frequency and continuity requirement of Reg. 1.513-1(c).

In a recent Technical Advice case, private letter ruling 8139015 dated June 25, 1981 it was ruled that a nine day antique show for charity fell into the intermittent rule under Reg. 1.513-1(c)(2)(iii).

Although, income derived from short-run fund raising events for charity is not generally includable as IRC 512 income, we must be mindful 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 purposes of the organization." (IRC 513(c); Reg. 1.513-1(b)).

For example, fund raisers may distribute a program as an important part of their event activities. These programs may be filled with commercial advertising,

the income from which may be IRC 512 income notwithstanding that the income from the sales of the program itself may fall into the intermittent activity exception. In Rev. Rul. 73-424, 1973-2 C.B. 190, the Service ruled that IRC 512 income results from the sale of advertising by an IRC 501(c)(5) organization for its annual yearbook where an independent commercial firm, under a contract covering a full calendar year, conducts an extensive advertising campaign in the organization's name, and is paid a percentage of the gross advertising receipts for selling the advertising, collecting from advertisers, and printing the yearbook. See also Rev. Rul. 75-200, 1975-1 C.B. 163 and PLR 8142024.

However, in Rev. Rul. 75-201, 1975-1 C.B. 164, an organization conducting an annual charity ball also published a program with advertising. Volunteers designed the program and solicited advertising for it. The solicitation was an intermittant activity that did not continue for an extended period. It was held that the sale of the advertising in this case was not regularly carried on.

In sum, intermittent fund raising activities carried on by otherwise exempt organizations are not generally taxable under IRC 511. As we have seen in the survey section, the special exceptions in the IRC 513 regulations that support this conclusion have also been persuasive in exemption considerations.

6. The Exemption Issue - Three Rationales

Regardless of the real and imaginary obstacles that potentially confront the fund raiser in IRC 501(c)(3) and 502, and the regulations thereunder, annual event charitable fund raising organizations may qualify for exemption.

The typical productive charitable annual event fund raiser organization has one exclusive purpose - the turning over of funds to other organizations for charitable use. Our subject organizations may in effect have two activities - the actual turning over of funds and the event from which the funds to be turned over are derived.

If the event activity is detached from fund raising, we are left with the unquestionable charitable purpose and activity of turning over funds for charitable use. Anglo-Saxon law has always equated "almsgiving" with charity. The Service has always recognized that a person deserves charitable contribution deductions for gratuitous transfers of cash and goods to charitable organizations.

In published form, we are familiar with the type of organization described in Rev. Rul. 67-149 discussed earlier. In addition, section 34(12) of Chapter 300, IRC 7751, the Exempt Organizations Handbook, provides the following:

> (1) Many charitable foundations do not engage in active charitable undertakings themselves, but rather assist the work of religious, charitable, educational, or similar organizations by contributing money to them. The foundation's funds may be dedicated to purposes, as broad as but no broader than, the purposes set out in IRC 501(c)(3). These foundations are charitable in the broad sense of the word.
>
> (2) Some charitable foundations, whose names and work are widely known, have very large endowments and dispose of millions of dollars annually. There are in addition, many foundations controlled by corporate and individual taxpayers who use them as channels for their charitable contributions. This form of indirect support of charity is itself a charitable activity justifying exemption. ...

It is doubtful whether anyone would disagree with the above in respect to the charitable fund raising event organization separate from its event activity. However, when the event activity is included, many are bothered by the ostensible trade or business aspects and find difficulty in reconciling the fund raising organization as exclusively charitable within the purview of IRC 501(c)(3).

Practically speaking, no fund raising organization can be divorced from commercial aspects. The existence of commercial activity does not preclude IRC 501(c)(3) exemption. The IRC 511 unrelated trade or business tax infers that exempt organizations can carry on trade or business activities. However, questions persist as to whether there is an upper limit to the extent of business activities carried on by IRC 501(c)(3) organizations. There are a number of modern precedents recognizing the IRC 501(c)(3) exemption of non-profit organizations which use commercial means to carry out charitable ends. The principle is embodied in the following language:

> The performance of a particular activity that is not inherently charitable may nonetheless further a charitable purpose. The overall result in any given case is

> dependent on why and how that activity is actually being conducted. (Rev. Rul. 69-572 1969-2 C.B. 119).

Published examples include Rev. Rul. 70-585, 1970-2 C.B. 585, in which an exempt organization provided housing to low and moderate income individuals; Rev. Rul. 73-313, 1973-2 C.B. 174, which recognized an organization that built facilities in order to attract doctors to an area; Rev. Rul. 74-587, 1974-2 C.B. 162, which exempted an organization giving loans to businesses located in depressed areas; [See also Rev. Rul. 81-276, 1981-47 I.R.B. 9, recognizing PSRO's under IRC 501(c)(3) and Rev. Rul. 81-284, found in the 1981-49 I.R.B., recognizing MESBIC's under IRC 501(c)(3).] Rev. Rul. 76-4, 1967-1 C.B. 121, which provides exemption for an organization that publishes and sells a journal that educates the public and encourages scientific research; Rev. Rul. 72-560, 1972-2 C.B. 248, holding exempt an organization formed to educate the public about pollution and operated to a substantial extent with proceeds from the sale of collected solid wastes to profit recycling companies; Rev. Rul. 72-559, 1972-2 C.B. 257, holding that exemption will not be precluded for an otherwise qualified organization that carries out its purposes of educating and vocationally training unemployed and underemployed individuals through the manufacturing and selling of toy products; and Rev. Rul. 66-257, 1966-2 C.B. 212, holding that an organization providing placement services to elderly unemployed persons of limited means was not barred from being recognized as exempt under IRC 501(c)(3). See also the judicial precedents noted at page 37, et. seq, of The Concept of Charity topic, 1980 EOATRI Textbook.

The above precedents are not on point with our subject organizations. Our problem area, annual event charitable fund raisers, carry on ostensibly commercial activities not as a means of doing charitable work directly, but as an end of charitable work ultimately through the disbursement of funds to other exempt organizations. Their "almsgiving" provides the connection to exemption.

Taking nothing else into consideration, the annual event charitable fund raisers may find refuge in the following -

> ...charitable organizations may, with certain exceptions and limitations not applicable here, engage in commercial endeavors for the production of income to be used for carrying on charitable programs and activities. (Rev. Rul. 73-128, 1973-1 C.B. 222).

> It seems well settled that an organization need not engage in a functional charitable activity to be organized and operated for charitable purposes within the meaning of section 501(c)(3) ...Such charitable purposes may be accomplished solely by providing funds to other exempt organizations ...Moreover, the fact that plaintiff obtains all of its income from a profit making activity does not destroy the fact that it is organized and operated for charitable purposes within the meaning of section 501(c)(3). Golf Life World Entertainment Championship v. U.S. 65-1 USTC 9174. (Noted in Survey, supra.)

The philosophy of these excerpts are embodied in the commensurate test rationale of Rev. Rul. 64-182, 1964-1 C.B. 175. If no other exemption rationale is acceptable, Rev. Rul. 64-182, will suffice in the case of many charitable annual event fund raising organizations.

There are three possible rationales supporting IRC 501(c)(3) exemption for productive annual event fund raising organizations whose events are not in themselves charitable. They are:

A. With a finding that fund raising events do not constitute a "trade or business," no confrontation exists with the primary purpose test of Reg. 1.501(c)(3)-1(e), and IRC 502.

B. With a finding that fund raising events do not fall within the definition of an unrelated trade or business as provided by IRC 513, no confrontation exists with the primary purpose test of Reg. 1.501(c)(3)-1(e), and, pursuant to logical consistency, IRC 502.

C. Accepting a presumption that fund raising events do constitute a trade or business, exemption is not precluded by a showing that the organization, through its event, is productive commensurate in scope with its financial resources and as a matter of law not organized and operated for the primary purpose of operating a trade or business within the meaning of Regs. 1.501(c)(3)-1(e) and IRC 502.

The topic will discuss each rationale in turn.

A. Charitable Fund Raising Events Do Not Constitute A Trade Or Business

It has often been argued that fund raising organizations do not participate in a "trade or business," but rather in "fund raising activities." Whether this is a viable distinction, is questionable.

"Trade or business" is not defined with precision. The problem is compounded by occasional and inconsistent interchangeable uses of the terms "trade or business" and "unrelated trade or business" which are ostensibly different in the format of the primary purpose test of Reg. 1.501(c)(3)-1(e).

Reg. 1.513-1(b) states that the IRC 511 tax has the objective of eliminating unfair competition by exempt organizations, vis-a-vis trade or business activities with non-exempt business endeavors, and this situation generally exists with

> ...any activity of a section 511 organization which is carried on for the production of income and which otherwise possesses the characteristics required to constitute a "trade or business" within the meaning of section 162 - and which in addition, is not substantially related to the performance of exempt functions - presents sufficient likelihood of unfair competition to be within the Policy of the Tax. Accordingly, for the 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 goods or performance of services.

Neither the language of IRC 162 (or its predecessor Section 23(a)), nor the regulations thereunder defines what is meant by "trade or business." Nor does it provide what particular characteristics are required to classify an activity as a "trade or business." The courts provide little material assistance. See: Deputy v. Dupont, 308 U.S. 488, 499 (1940) for example. Other sections of the Code containing reference to "trade or business" (e.g. IRC 482) also provide little insight. Rev. Rul. 81-69, 1981-1 C.B. 351, holds that a long running unprofitable "business" activity of an IRC 501(c)(7) organization did not constitute a trade or business. See social club topic in this EO CPE Textbook.

There has been consideration along the following lines:

IRC 162 and the court decisions thereunder assume that trade or business refers not to economic entities but to an income-producing process. It is the process rather than the economic structures productive of the income that is deemed relevant by the courts in determining whether or not the particular expense is deductible. This is illustrated by the fact that the courts in interpreting the meaning of the term trade or business as used in IRC 162 have shown concern not with the existence or lack of existence of economic structures ordinarily thought of as comprising business in the popular commercial sense, but instead with the aggregate of income producing economic activity associated with the expense claimed to be ordinary or necessary.

In the latter regard, an analysis of the cases under IRC 162 reveals that the principal characteristics of a trade or business for purposes of deductibility of expenses are: (1) activity regularly carried on (2) for production of income for profit (3) from sale of goods or services and (4) excepting these passive investment activities engaged in for the production of dividends, interest, royalties, and other similar types of income. Although no decided cases under IRC 162 express the character of a trade or business in precisely these terms, it is a fact that in not one case involving deductibility of expenses under IRC 162 has a deduction been denied where the expense in question was ordinary and necessary to the conduct of an activity (1) regularly engaged in (2) for the production of profit (3) from the sale of goods or services.

If we endorsed this view of tying "trade or business" with a characteristic requirement that "it must be regularly carried on," annual fund raising events would not be a trade or business as that term is used in the exempt organization provisions of the Code and regulations.

In any situation, it would follow that if a questioned activity is not a trade or business, no troublesome confrontations exist with the primary purpose test and standards of Reg. 1.501(c)(3)-1(e), and IRC 502. In addition, the event activity would not fall under the IRC 513 definition of unrelated trade or business.

Appealing as this approach may be, we will probably always be confronted with problems unless all the appropriate regulations are specifically amended (or at least consistently interpreted). Without such changes, an annual charitable fund raising event is a "trade or business" because it is an example of "any activity carried on for the production of income from the sale of goods or the performance of services."

B. Charitable Fund Raising Events Are Not An "Unrelated Trade Or Business"

Notwithstanding a finding that a fund raising event is a trade or business, a plausible exemption rationale is that such a trade or business is not an "unrelated trade or business."

Reg. 1.501(c)(3)-1(e) provides that an organization cannot be recognized under IRC 501(c)(3) if it is organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in IRC 513.

As discussed in part 5A of this topic, IRC 513(a)(1) and (3) and Regs. 1.513-1(e) and 2(b) provide exceptions from the term unrelated trade or business if substantially all of the work in carrying on the trade or business is performed without compensation or if substantially all of the goods that are part of the trade or business have been received as gifts or contributions.

It would follow that the primary purpose test of Reg. 1.501(c)(3)-1(e) is never confronted if the activity in question is not an unrelated trade or business because it falls within one of the special exceptions in the IRC 513 definitions.

A similar finding can be made for purposes of IRC 502. Although the latter is worded in terms of "trade or business," instead of "unrelated trade or business," the IRC 513(a)(1) and (3) exceptions are found in IRC 502(b)(2) and (3). We have to assume that IRC 513 and IRC 502 are compatible with one another. This was the 1969 intent of Congress:

> Under prior law, an organization (known as a 'feeder' organization) operated primarily to carry on a trade or business for profit has not been exempt even though all of its profits were payable to one or more exempt organizations (sec. 502). On the other hand, the unrelated trade or business tax does not apply to business in which substantially all the work in carrying on the business is performed for the organization without compensation or a business (such as a thrift shop) which sells merchandise, substantially all of which is received by the organization as gifts or contributions (sec. 513(a)(1) and (3)). These exceptions may not have applied to feeder

> organizations under prior law. The Act specifically extends these exceptions to such businesses, regardless of whether the business is run for the benefit of one or more exempt organizations, even though in a separate organization or otherwise. (Staff of Joint Committee on Internal Revenue Taxation, 91st Cong., 1st Sess., General Explanation of Tax Reform Act of 1969 (Comm. Print 1970) p. 69.)

This approach although technically valid, suffers in practical application. As pointed out, the concept of "substantially all" does not lend itself easily to typical cases. In addition, judging by the Service's opposition to the Green "essence of endeavor" approach, it may be extremely difficult to find "substantially all" in any exempt organization situation where facts reveal anything more than a de minimis amount of commercial activity with paid performances/or goods.

C. Commensurate Test

If we accept a presumption that annual charitable fund raising events do constitute a trade or business (or an unrelated trade or business), but find that the fund raising organizations through these events produce commensurately in scope with their financial resources, exemption cannot be legally denied under IRC 501(c)(3). This is true because a commensurately producing typical fund raising organization cannot be held to be organized or operated for the primary purpose of operating a trade or business for purposes of Reg. 1.501(c)(3)-1(e) or IRC 502.

1. Commensurate Test Rationale

If we assume that annual charitable fund raising events constitute a trade or business (or unrelated trade or business), we confront two characteristics that the Service has traditionally believed to be contrary to IRC 501(c)(3) exemption. First, the Service has opposed allowing exemption to charitable organizations which carry on business activities to a substantial extent. With respect to a fund raising organization whose most visible activity is the carrying on of an impressive annual event (the trade or business), we are confronted with this problem.

Second, because fund raising organizations are by their nature donative charities, it becomes impossible to avoid colliding with the so called "destination of income" test.

The destination test originated with Trinidad v. Sagrada Orden de Predicadores, etc., 263 U.S. 578 (1924), III-1 C.B. 270 (Jan.-Jun. 1924), and it has disturbed Service personnel since it was first imprecisely interpreted.

Ignoring the full meaning of the Supreme Court in the Trinidad case, the Service and various lower courts construed the destination test to simply mean that the test of a business oriented charitable organization's exemption is based on the destination of its income instead of the source of its income.

In a series of court cases involving taxable years prior to 1951 the decisions were generally in favor of charitable exemption to organizations even though their sole activity was engaging in commercial business, and their only basis for exemption rested in the fact that their profits were payable to other exempt organizations. (Noted examples include Roche's Beach, Inc., v. Commissioner, 96 F. 2d 776 (1938); C.F. Mueller Company v. Commissioner 190 F. 120 (1951).)

Even today the leading treatises in charity law still entertain the destination notion -

> The question is not whether the institution may receive a profit, but what disposition is to be made of the profit, if any, which may be received. If the profits are to inure to benefit individuals, the institution is not charitable. But if the profits, if any, are to be applied wholly to charitable purposes, the institution is charitable. Scott on Trusts II (Section 366, 1967).
>
> In determining whether an activity is organized for educational purposes and so exempt from social security taxes, the purposes for which it spends its income and not the means whereby it obtains income are conclusive, and hence a fair association is exempt. Southeastern Fair Association v. U.S., 1943, 52 F. Supp. 219, 100 Ct. Cl. 216.
>
> If it will, in the opinion of the court, result in a sufficiently widespread distribution of public benefits, the trust should be supported as charitable. Bogert's Trusts and Trustees (Second Ed. 1967, Chapter 19, Sec. 367).

In 1950, Congress enacted IRC 502 which, in effect, amounted to only a very narrow statutory restriction on the exemption aspirations of donative business activity charities. However, in post-1950 cases, the Government confronted charitable organizations carrying on extensive business activities and continued its opposition to the destination test. Using a broad interpretation of IRC 502, the Government was supported in Veterans Foundation v. U.S. 178 F. Supp. 234 (1959), aff'd. 281 F.2d 912 (1960), in which a subsidiary organization was cloaking its commercial activity with the exempt character of its parent. However, reexamination of our position was in order when the Court of Claims rejected our position in Sico Foundation v. U.S., 295 F. 2d 924 (1961).

As a result the Service published the commensurate test Rev. Ruls. 64-182, 1964-1 C.B. 186, (Pt. 1) and 67-5, 1967-1 C.B. 123.

The commensurate test does not amount to a return to the "destination of income" test of yesterday's court encounters, but instead provides an interpretation of what the Supreme Court originally meant in Trinidad. If a thorough analysis of the Trinidad case is made to include a reading of that part of the decision which follows the "destination" language, and especially those cases that are cited therein, we see an exposition of the IRC 501(c)(3) organizational and operational tests adopted to business charity situations.

The relevant section of Trinidad (p. 581 (1924)) follows:

> Whether the contention is well taken turns primarily on the meaning of the exceptions clause, before quoted from taxing act. Two matters apparent on the face of the clause go far toward settling its meaning. First it recognizes that a corporation may be organized and operated exclusively for educational purposes, and yet have a net income. Next it says nothing about the source of the income, but makes the destination the ultimate test of exemption. Evidently the exemption is made in recognition of the benefit which the public derives from corporate activities of the class named and is intended to aid them when not conducted for private gain. Such activities cannot be carried on without money, and it is common knowledge that they are largely carried on with money received from properties dedicated to their pursuit. This is particularly

> true of many charitable, scientific, and educational corporations and is measurably true of many religious corporations. Making such properties productive to that end that the income may be thus used does not alter or enlarge the purposes for which the corporation is created and conducted. This is recognized in University v. People (99 U.S. 309, 324), where this court said: 'The purpose of a college or university is to give youth an education. The money which comes from the sale or rent of land dedicated to that object aids this purpose. Land so held and leased is held for school purposes, in the fullest and clearest sense.' To the same effect is Methodist Episcopal Church, South v. Hinton (92 Tenn., 188, 200). And in our opinion the excepting clause, taken according to its letter and spirit, proceeds on this view of the subject.

In retrospect, the "destination of income" language in Trinidad should not have been taken merely to provide a catchall phrase for use in justifying charitable exemption. The Trinidad opinion as a whole, read in conjunction with the cases cited therein prompts us to find that we were never required to rest exemption determinations merely on a finding that profits from business activity income were destined for charity or that net proceeds were to go to charity. Instead, Trinidad obligated us to settle charitable exemption issues on whether the business charity was legally devoted to a charitable purpose and whether the organization is operationally faithful to that purpose exclusively, only one aspect of which is its distribution of net proceeds.

In summation, aside from IRC 502, if we were to assume that the event activity of an annual event fund raising organization is a trade or business, IRC 501(c)(3) exemption cannot be precluded if the organization is carrying on a charitable program commensurate in scope with its financial resources.

2. The Commensurate Test With Feeder Factor

Feeder considerations have often played a part in IRC 501(c)(3) exemption cases involved with annual event charitable fund raiser organizations.

A first reading of IRC 502 produces confusion. One is prompted to ask how an organization operated for the primary purpose of carrying on a trade or business for profit, which is specifically prohibited by Reg. 1.501(c)(3)-1(e), may qualify

for IRC 501(c)(3) exemption regardless of whether or not all of its profits are payable to exempt organizations.

The answer to such a question is not ascertainable in logic, nor may it be found in historical record. It is enough that both IRC 502 and Reg. 1.501(c)(3)-1(e) contain "primary purpose" language which can be utilized consistently and in conjunction with the commensurate test.

IRC 502 was originally enacted in 1950 as a complement to the contemporaneously enacted unrelated trade or business tax provisions. The statute's intention was to make it impossible for an exempt organization to evade IRC 511 tax by setting up a business subsidiary that would "donate" back everything it earned.

One school of thought within the Service believes that IRC 502 should be directed only against business subsidiary organizations of exempt organizations. Support for this position can be found in Reg. 1.502-1(b) and in feeder revenue rulings (e.g. Rev. Ruls. 57-52, 1957-1 (C.B. 196; 68-26, 1968-1 C.B. 272; 69-528, 1969-2 C.B. 127, 73-165, 1973-1 C.B. 224), all of which present situations involving business subsidiary organizations only.

Whatever the validity of narrowing feeder application to business subsidiaries of exempt organizations, the IRC 502 statutory language extant is not restrictive on its face and must be looked at as potentially applying to all business charities, including nonsubsidiary organizations.

A strict interpretation of the feeder statute has been made in respect to "payable."

Significance behind "payable" in the context of IRC 502 may lie with analogy to IRC 170. As stated by DeJong v. Commissioner, 62-2 USTC 9794, 309 F2d 373, (9th Cir. 1962) -

> The value of a gift may be excluded from gross income only if the gift proceeds from a 'detached and disinterested generosity or out of affection, admiration, charity or like impulses', and must be included if the claimed gift proceeds primarily from the 'constraining force of any moral or legal duty' or from the 'incentive of anticipated benefit of an economic nature.' We must

> conclude that such criteria are clearly applicable to a charitable deduction under 170.
>
> In respect to true feeder organizations, no 'detached or disinterested generosity' exists when they are legally required by their articles of incorporation, or otherwise, to turn over all their profits to "donee" organizations. See also Crosby Value and Gage Company v. Commissioner, 67-2 USTC 9569, 380 F. 2d 146 (1st Cir. 1967); Cert. denied, 389 U.S. 976 (1967).

Therefore, from this we can draw the conclusion for our purposes, that if the fund raiser organizations are allowed any sort of discretion in paying over funds to charitable beneficiaries, they would avoid IRC 502. However, the typical fund raising event organization is organized and operated for the purpose of distributing proceeds to other exempt organizations. In fact, if the tenets of the commensurate test are to be applied consistently, the fund raising organization should be obligated to turn over all of its funds.

This returns us to the initial problem presented in the beginning of this subsection in respect to reconciling Reg. 1.501(c)(3)-1(e) with IRC 502. This can be done in conjunction with the commensurate test, supported by the unique facts that made typical fund raisers productive.

Essentially, IRC 502 roadblocks are removed in respect to business charities, including annual event fund raiser organizations, by finding that such organizations have a primary purpose that is not the carrying on of a business for profit.

Authority is derived from precedents involving cooperative investment organizations. In Rev. Rul. 69-528, 1969-2 C.B. 127, the subject organization was operating an investment service business for the benefit of exempt organizations who were charged a fee. Finding that the business was an end unto itself and that all profits were payable to exempt beneficiaries, Rev. Rul. 69-528 denied exemption through application of IRC 502.

In Rev. Rul. 71-529, 1971-2 C.B. 234, the same facts existed except that the beneficiary organizations were charged substantially below cost for the service, because operations were subsidized by private foundation funds. Instead of the investment business being held as an end unto itself, it was found to be an activity providing an essential function for charitable organizations. It was held to be

exempt under IRC 501(c)(3). When the subject organization in Rev. Rul. 71-529 no longer needed subsidization, exemption was no longer tenable. IRC 501(f) was enacted to provide exemption.

Rev. Rul. 71-581, 1971-2 C.B. 236, provides the following rationale to support the exemption of pre-Tax Reform Act of 1969 thrift shops:

> X, a nonprofit organization, operated a thrift shop. X was organized by a group of nonprofit organizations described in section 501(c)(3) of the Code and all of X's profits were payable to these organizations. Substantially all of the merchandise sold by X had been contributed and more than half of the work in operating the thrift shop was performed without compensation. Paid employees were reasonably compensated for their services.
>
> Section 502 of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under section 501 on the ground that all of its profits are payable to one or more organizations exempt under section 501.
>
> Had the activity described above been carried on directly by any one of the exempt organizations, any profit therefrom would have been excluded from taxation under section 511 of the Code by the provisions of section 513(a)(3) of the Code. X was organized as a separate corporation to operated the thrift shop in order to insulate the assets of the exempt organizations from any potential liability arising out of the operations of the thrift shop and to enable X to have a separate governing body and organizational structure composed of persons interested in aiding the exempt organizations principally through volunteer work in connection with the operation of the thrift shop.
>
> The primary purpose for which X was operated was to serve the group of exempt organizations by

> performing an essential function for them; that is, to solicit contributions of goods on behalf of the exempt organizations and to convert the contributed goods to cash for charitable uses with a minimum of expense by the use of volunteer labor. X was organized as a separate corporation only to secure the organizational advantages described above.
>
> Accordingly, it is held that X is not precluded from qualifying for exemption under section 502 of the Code prior to its amendment by the Tax Reform Act of 1969. X may qualify as an organization described in section 501(c)(3) of the Code, if it otherwise meets the requirements of that section.

The rationale expressed above is readily applicable to typical annual event charitable fund raisers. They otherwise meet the requirements of IRC 501(c)(3) exemption when they are carrying on a program of charitable giving commensurate in scope with their financial resources. They are not subject to IRC 502 because the feeder statute does not apply to an organization that has a primary purpose that is not the carrying on of a business for profit. The primary purpose of annual event charitable fund raisers is to serve other charitable organizations, whether in a subsidiary role or not, by raising funds in their behalf for charitable use through annual events, carried on by considerable amounts of gratuitous support (labor, goods, and money).

For additional reading in this area, see "Charity and Commerce: Section 501(c)(3) - How Much Unrelated Business Activity," by Kenneth C. Eliasberg, 21 Tax Law Review 53 (1965).

3. The Commensurate Test - The Viable Rationale

The three exemption rationales presented all presuppose that a representative fund raiser is productive. Producing for charitable use is a requirement that should be ultimately satisfied. As an example, an annual charitable fund raising event organization that produces nothing for charitable giving should not be granted exemption without extenuating circumstances, regardless of whether all labor involved in the running of the event was uncompensated. To say otherwise would have the effect of recognizing exemption for fruitless endeavors. It will suffice to point out here that an organization alleging a charitable purpose must in fact show

a charitable activity. If the charitable purpose is fund raising, then a program of charitable giving must be demonstrated. Without such a demonstration, the organization is carrying on an activity that has no connection to IRC 501(c)(3).

The commensurate test has been used as the dominant rationale for fund raising event exemption cases in recent years, but its application has been more often than not marked with confusion and inconsistency. In the following section we will attempt to make the test more understandable by considering some possible guidelines.

Our final note here is that the commensurate test is generally applicable only to IRC 501(c)(3). For example, there is no analogous authority under IRC 501(c)(4) comparable to Reg. 1.501(c)(3)-1(e).

Reg. 1.501(c)(4)-1(a)(2) provide in effect only an activities test. If an organization's primary activity is that of a business, notwithstanding generation of a commensurate amount of income for social welfare use, it would be difficult to justify recognition under IRC 501(c)(4).

7. Application of the Commensurate Test in Fund Raiser Exemption Cases

A. General

The commensurate test should be applied pursuant to our traditional organizational and operational requirements.

The organizational test for fund raising organizations is the same as that used for any other organization applying under IRC 501(c)(3).

Whether an organization is carrying on a real and substantial program reasonably commensurate in scope with its financial resources and capabilities is an essentially factual matter. A threshold consideration rests on an organization's production of funds distributed for charitable use or, in the case of a new organization, what is proposed to be distributed. A new organization applying for exemption should be expected to submit a proposed budget, and describe in detail financial expectations. In addition, it should demonstrate that it has a concrete plan for achieving its purpose. See discussion of Reg. 1.509(a)-3(d)(3)(iv) in the next subsection.

The amount of money distributed, however, even if required pursuant to a certificate of incorporation dictate of "net proceeds to charity," is not the end of all in exemption considerations, regardless of its quantitative significance. If it were, we would fall into the catchall "destination of income" test.

Under the commensurate test, even ostensibly high returns for the benefit of charity, in respect to gross income received may not be enough to justify IRC 501(c)(3) exemption. On the other hand, an unproductive showing may not necessarily preclude exemption.

In any situation the program of charitable giving is important and it would be very useful to devise a standardized percentage formula that could be applied to a fund raiser's financial input and output. Unfortunately, this is impossible. The facts and circumstances of individual cases are varied. The method of operation of different types of fund raisers necessarily involves different ratios of costs and receipts. For example, a charity ball organization may have a small but wealthy base of guaranteed supporters from which to draw large sums for contributions and admissions with a minimum of expense. On the other hand, an organization carrying on a football game for charity, may be required to spend large amounts for promotion, etc. Also, sporting event fund raisers, an amateur event in which the player/gate attractions compete for trophies and which is conducted with substantially all uncompensated labor, may turn over 60 percent of its gross receipts to charity. This, however, may be a de minimis product in respect to a productive professional event with only a 25 percent turn over. Another consideration may be the nature of the organization's cause itself. An organization, for example, raising money for health research to combat an "unpopular" illness may have fund raising costs that are far in excess of the considered average due to the fact that many people who would otherwise be expected to do volunteer work fear that they will be identified as having the illness.

There are other considerations. Should funds submitted directly to the beneficiary charities, undoubtedly provided because of the stimulation/recognition factor created by a particular fund raising event, be included in output? If so, how is it determined what funds are directly attributable to the fund raising event effort? In addition how would you plug into the formula losses of expected income due to unexpected low attendance, inclement weather, inadvertant or honest good faith overspending on promotion, or an unanticipated drop in contributions. The start-up expenses of a new organization should also be considered.

In essence, no percentage formula can be formulated. Instead, a threshold factor of charitable giving should be fully analyzed in context with all the operative facts involved. Exemption determinations should be based on the presence or absence of factors indicating whether or not non-charitable purposes or private benefits are being furthered by the annual event charitable fund raising organizations. The determinations that must be made in the fund raising area are factual in nature and must be made on a case by case basis.

B. The Productive Fund Raiser - Other Primary Purposes

In conjunction with the commensurate test, IRC 501(c)(3) and its regulations provide that an organization whose purpose includes benefiting private interests is not organized or operated exclusively for charitable purposes. In respect to the past treatment of annual event charitable fund raisers the inurement and private benefit issues have raised more problems than others because of the typical presence of salaried or commissioned fund raisers or tournament directors and gate attractions (salaried entertainers or athletes who compete for prizes).

The fund raiser organizations typically have many charity and community spirited individuals and groups who gratuitously donate their time and energies to perform sundry activities. Uncompensated labor may assist in selling tickets, soliciting contributions, monitoring crowds, working concessions, obtaining advertising, etc. In addition, the organization may be the recipient of facilities donated for a nominal fee, free mass media reporting, perhaps even the assistance of celebrities working without fees These, of course, are the elements that make the difference between profit and loss. However, there are limits to success with the use of voluntary labor.

Fund raising event organizations need gate attractions to draw the public. They may need professional fund raiser/tournament directors in order to put the event activity together. Professional publicity and publication services are necessary. In sum, certain essential services that cannot be practically obtained gratuitously must be paid for.

The presence of salaried or commissioned fund raiser personnel and contracted drawing cards do not in themselves prejudice the exemption aspirations of fund raising event organizations. While it is clear that an organization of a commercial character that exists only for the benefit of its members or organizers cannot be exempt from taxation even though it pays no dividends and devotes its entire profits to charity University Oil Products v. Campbell, 181 F.2d 451, 7th

Cir. (1950), it is also clear that an organization that pays substantial fees and commissions to its agents is not deprived of nonprofit tax exempt status so long as such fees and commissions can be characterized as "reasonable compensation." Forest Lawn Memorial Park Association v. Commissioner, 45 B.T.A. 1091 (1941).

An analogous situation is discussed in Rev. Rul. 73-126, 1973-1 C.B. 220, which held that an exempt organization's payment of reasonable pensions to retired employees at the discretion of its board of directors does not adversely affect its exempt status. The ruling provides the following language:

> The payment of pensions to retired employees is an accepted method of employee compensation used by many public and private organizations. Since the payments for the pensions in this case are reasonable compensation in light of the surrounding circumstances, they are a proper expense in the operation of the organization's charitable program and do not constitute the improper use of the organization's charitable resources, nor do they constitute inurement of the organization's net earnings to private individuals within the meaning of section 501(c)(3) of the Code.

As evidenced by Rev. Rul. 73-126, something more than "reasonable compensation," a concept which we shall return to, is involved in the relationship between exempt organizations and their employees It must be clear that the employees of the employer organizations are in fact employees instead of persons with a proprietary interest in the organization.

In Rev. Rul. 69-383, 1969-2 C.B. 113, the exempt status of a hospital was considered in the context of its contractual arrangement with a radiologist for his professional services. Facts indicated that the doctor had no control over, or management authority with respect to, the hospital itself. The parties entered into a contract after arm's-length negotiations, agreeing that the doctor would be reasonably compensated on the basis of a fixed percentage of income received for his services.

On the basis of these facts, the ruling held that the arrangement did not jeopardize the exempt status of the hospital.

For our special interest here, Rev. Rul. 69-383, provides the following -

> Under certain circumstances the use of a method of compensation based upon a percentage of the income of an exempt organization can constitute inurement of net earnings to private individuals. For example, the presence of a percentage compensation agreement will destroy the organization's exemption under IRC 501(c)(3) of the Code where such agreement transforms the principal activity of the organization into a joint venture between it and a group of physicians Lorain Avenue Clinic v. Commissioner, 31 T.C. 141 (1958), or is merely a device for distributing profits to persons in control (Birmingham Business College v. Commissioner 276 F.2d 476 (1960).)

In respect to fund raising organizations, therefore, a finding should be made that it is truly the organization that has the exclusive proprietary interest. The role of the professional fund raiser (or gate attraction) must be that of an employee, contracted for pursuant to arm's-length bargaining, to perform specific services. When the employee(s) is(are) found to be a controlling element in the arrangement and is(are) merely using the organization as a vehicle to carry on an activity for personal profit, prima facie evidence of inurement exists requiring denial of IRC 501(c)(3) exemption to the organization. (See, for examples, Rev. Ruls. 69-266, 1969-1 C.B. 151, 80-106, 1980-1 C.B. 113, and 81-94, 1981 C.B. 330.) See also Promotion of Fine Arts and Performing Arts topic in this EO CPE Textbook and the Health Care Organization topic in the 1981 EO CPE Textbook, page 8 et seq. For an interesting judicial opinion, see John Marshall Law School v. U.S., 1981-2 USTC 9514, June 24, 1981.

Support for this principle may be found by analogy in the income tax area in respect to the prohibition against assignments of income to charity by non-exempt persons as a means to exclude the latter from gross income.

In the income tax area, the proceeds of a "charity" event are either (1) taxable to the promoters (or performers) as proceeds of an assignment of income or (2) are not taxable to the promoter if the income is genuinely the income of a charitable organization.

In general, situation (1) applies when the promoter has entered into an agreement with a charitable organization under the terms of which the facilities of the promoter are operated by him as agent for the charitable organization, and all

proceeds are received by him on account of the charitable organizations. Situation (2) applies when the charitable organization is the actual promoter of the event. See for example Rev. Rul. 68-503, 1968-2 C.B. 44, Rev. Rul. 72-542, 1972-1 C.B. 37, and Rev. Rul. 77-121, 1977-1 C.B. 17.

Guidelines can be found by analogy in the regulations under IRC 509(a)(2) which are concerned with factors to be taken into account in issuing advance rulings to newly created organizations that are publicly supported and carry on fund raising activities.

Reg. 1.509(a)-3(d)(3)(iv) provide the following –

> In the case of an organization which carries on fund-raising activities, whether the organization has developed a concrete plan for solicitation of funds from the general public on a community or area-wide basis; whether any steps have been taken to implement such plan; whether any firm commitments of financial or other support have been made to the organization by civic, religious, charitable or similar groups within the community; and whether the organization has made any commitments to, or established any working relationships with those organizations or classes of persons intended as the future recipients of its funds.

The elements of "concrete plan," "implementation," "commitments of support," and "working relationships" in the cited regulation all point to requirements of long term active participation and control on the part of the exempt organization as opposed to a passive or secondary voice in respect to the work loads of its salaried or commissioned employees (or contracted gate attractions).

Returning to the concept of "reasonable compensation," separate from the factor of control (or proprietary interest), it is noted that in the income tax area, the Service does not generally challenge deductions for compensation paid to employees who have no proprietary interest, or a negligible one, in their employers. This is true because when an employee's compensation is established pursuant to arm's-length negotiation, it is presumed to be reasonable. (See IRC 162 and Reg. 1.162-7.)

On the other hand, Exempt Organizations exemption cases require evidence of exclusive charitable purpose and activity. Employee salaries should be examined as an independent factor, notwithstanding an evidentiary lack of employee proprietary interest. For example, an organization established for charitable ends may distribute so much of its gross income as salaries that the organization may truthfully be said to exist as much for the benefit of its employees as for any other purpose. Oregon Physicians Service v. S.W. Horn, 349 P.2d 831, 838, (1960). In any situation, reasonable compensation questions are ordinarily resolved by comparisons. We are, however, aided by recent state legislation in this area. At present, many of the states have enacted or are enacting a new breed of charitable solicitation statute in response to contemporary revelations about certain fund-raising "charities" siphoning off as much as 90 percent of monies collected for fund raising expenses. These new statutes may resolve many of the public criticisms previously mentioned.

Some of the statutes require that an organization engaging in charitable fund raising register with a particular state office along with the professional fund raisers who work for the organization in fund raising activities. The statutes may include requirements that prohibit misrepresentations such as erroneous tax deduction claims. Most importantly, for our purposes here, some of these statutes place limits on the percentage of gross receipts that may be received by the professional fund raiser as compensation. The percentage most often noted is 15 percent. Stiff sanctions are imposed on organizations and persons for violations.

According to Giving USA, Bulletin Number 1, January 1981, a publication of the American Association of Fund-Raising Counsel, Inc., there are 33 states plus the District of Columbia with statutes aimed directly at charitable solicitations. Thirteen of these states have fixed percentage limitations on amounts that can be devoted to administrative costs. Of these 13 states, 10 permit exceptions, if it can be shown that a greater percentage than that allowed by statute should be permitted for expenses and administration.

It would seem that these laws, where applicable, could be helpful to Service personnel in developing reasonableness of compensation issues. A computation of these laws has been included in this topic as Appendix 3, reprinted through permission of the American Association of Fund-Raising Counsel, Inc., New York, New York.

There may be constitutional problems however with some of these state statutes as evidenced by the U.S. Supreme Court in Village of Schaumberg v.

Citizens for a Better Environment, 444 U.S. 620 (1980). The issue presented in that case was the validity, under the First and Fourteenth Amendments, of a municipal ordinance prohibiting the solicitation of contributions by charitable organizations that do not use at least 75 percent of their receipts for charitable purposes. Those purposes were defined to exclude solicitation expenses, salaries, overhead, and other administrative expenses. The Court determined that charitable appeals for funds may involve a variety of speech interests -- communication of information, dissemination and propagation of views and ideas, and advocacy of causes--that are within the First Amendment's protection. The court held the 75 percent requirement of the ordinance plainly insufficient to governmental interests to justify its interference with protected speech. The ordinance was therefore held to be unconstitutionally overbroad.

On the other hand, some state statutes and our commensurate test avoid a strict percentage limitation on solicitations and could therefore be more akin to the ordinance upheld in National Foundation v. Fort Worth, 415 F. 2d 41 (5th Cir. 1969), cert denied, 396 U.S. 1040 (1970). That ordinance permitted organizations with excessive solicitation costs to demonstrate the reasonableness of such costs in order to obtain solicitation permits.

C. The Unproductive Fund Raiser

We must be ever mindful of Mr. Jonson's adage about the "last refuge of scoundrels." Instead of "patriotism," the last refuge of an alleged charitable organization is often fund raising for some worthy cause when other arguments for charitable exemption fail. An unproductive charitable fund raiser deserves special consideration under the commensurate test.

For example, an annual event fund raising organization, otherwise qualified for exemption, may attempt to characterize its annual dinner dances or social balls as charitable fund raising events, even though these activities, over a period of years, have been shown to always lose money or merely break even. The basis for denial in such situations might include both a failure of charitable accomplishment rationale and a showing that the organization engages in activities that further a non charitable purpose - recreational purposes, for example.

Consider also Help The Children Inc. v. Commissioner, 28 TC 1128 (1957), which is not an annual event charitable fund raiser case, but which does provide an excellent presentation of the principles involved in the unproductive fund raiser.

Help the Children, Inc., a nonprofit organization organized under state law for the purpose of raising funds for charity, applied for exemption under IRC 501(c)(3). Its activities consisted of running bingo games [It is noted that now many bingo activities do not constitute unrelated trade or business. See IRC 513(f).] to carry out its charitable purpose. However, the net effect of its fund raising was extremely small as evidenced by its paltry distribution of funds to charity.

Instead of dismissing the organization on the basis of lack of accomplishment, the court attacked the issue with thorough analysis.

The opinion spelled out the organization's financial activities for the taxable years in question, 1953 and 1954. Gross receipts from bingo card sales, soda bar, and miscellaneous activities amounted to $316,645.45 in 1953 and $309,973.47 in 1954. Major expenditures in 1953 were $236,696.74 for bingo prizes, $25,603.25 for salaries and $42,000 for rental of the bingo hall. The expenditures in 1954 were approximately the same. The organization's "charitable" program consisted of contributions to the extent of $2,880 in 1953 and $3,873.20 in 1954, 75% of which were paid directly to individual doctors. Only $615 in 1953 and $1,418.25 in 1954 was actually distributed to 9 assorted bona fide charitable organizations.

The organization was otherwise qualified for exemption with a governing board of uncompensated stockholders.

The court implied that the employees were reasonably compensated. The court held that the organization was not entitled to IRC 501(c)(3) recognition and used the following language -

> Petitioner did not operate any charitable institutions. Its principal activity was the profitable operation of bingo games on a business or commercial basis. The principal source of gross receipts was from the fixed charge or donation assessed against each player for the use of bingo cards. Petitioner also realized some additional income from the operation of a soda bar and miscellaneous activities.
>
> The record shows that one of the purposes for which petitioner was operated was to engage in commercial activities for profit. Furthermore, the major

portion of its contributions was to individual doctors who performed services at city-operated free baby clinics. Clearly such payments were for noncharitable purposes.

Help The Children does not use the language of the commensurate test, but in effect applies it. The organization alleged fund raising for charity but was unproductive. The court found that the organization's principal activity was a trade or business significantly furthering non-charitable purposes. In effect, Help The Children, Inc. was not operating a real and substantial charitable program commensurate in scope with its financial resources.

D. Practical Approach in Applying Commensurate Test to Annual Charitable Fund Raising Event Exemption Cases

[The 10-step approach is not shown here]

8. Private Foundation Issues

A. IRC 509(a)(2) Support

An organization that is granted exempt status under IRC 501(c)(3) must also be classified under IRC 509(a). Under IRC 509(a)(2), support consisting of gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity that is not unrelated trade or business (within the meaning of IRC 513) is generally considered to be good support for purposes of determining that the organization is not a private foundation.

As we have seen the income derived by many fund raising organizations is not considered to be income from an unrelated trade or business because the events are not regularly carried on. The term "regularly carried on" is mentioned in IRC 512 and not in IRC 513. However, the definition of "regularly carried on" is found in the IRC 513 regulations. Therefore an unanswered issue is whether an organization whose income is not taxed as unrelated business income because the activity from which the income is derived is not regularly carried on could also have this income classified as permissible IRC 509(a)(2) support. Of course, if the fund raising event was carried on with substantially all donated labor or goods, the activity would not constitute an unrelated trade or business under IRC 513 and the income derived would be classified as permissible IRC 509(a)(2) support.

B. Fund Raising and IRC 4943

Even if an organization were classified as a private foundation, it would not need to be concerned that a fund raising event activity would be classified as a "business enterprise" under IRC 4943. Reg. 53.4943-10(a)(1) provides that the term "business enterprise" includes the active conduct of a trade or business that is regularly carried on for the production of income from the sale of goods or the performance of services and that constitutes an unrelated trade or business under IRC 513.

Further, if the private foundation did engage in a regularly carried on active business (as opposed to an intermittent fund raising activity) and it was run with substantially all volunteer labor it would not be classified as a "business enterprise." Reg. 53.4943-10(b) provides that the term "business enterprise" does not include a "functionally related business" as defined in IRC 4942(j)(5). Reg. 53.4942(a)-2(c)(3)(iii)(a)(1) provides that the term "functionally related business" is a trade or business that is not "unrelated trade or business" as defined in IRC 513. Since a regularly carried on business run with substantially all uncompensated labor is excepted from the term unrelated trade or business under IRC 513, it would be classified as a functionally related business. Rev. Rul. 76-85, 1976-1 C.B. 357, also provides that assets from such a business would be excluded from the minimum investment return under IRC 4942(e).

9. Deductibility and Fund Raising

We will raise one final thought that may help prevent abuse, inadvertence, and a loss of federal tax dollars. Rev. Rul. 67-246 (or Publication 483) attached as Appendix 1, provides rules for charitable deductibility of "contributions" to IRC 501(c)(3) organizations. Among the rules are prohibitions against "deductions" for contributions to organizations in which there is a "quid pro quo," a prohibition which may be largely unenforceable against donors, particularly small contributors. It is suggested that exemption letters or examination correspondence involving fund raising organizations, which receive income from the sale of admissions, or which receive "contributions" for the exchange of premiums, magazines, etc., include a special deductibility paragraph, containing a caveat informing them to operate within the spirit of the rules of Rev. Rul. 67-246. We have attached as Appendix 4 suggested pattern paragraphs for use when appropriate. One of the suggested paragraphs is an extract from Rev. Rul. 80-286, 1980-2 C.B. 179, which holds that an organization formed to foster the cultural and educational development of children by arranging for and participating in the temporary exchange of children between families of a foreign country and the U.S.

qualifies for exemption under IRC 501(c)(3). The extract is the charitable deductibility holding of the revenue ruling and we believe the language may be tailored for use in many appropriate situations involving fund raising organizations.

10. Concluding Remarks

Both the lack of judicial guidance and the highly factual nature of the cases make it difficult to publish in the fund raising area. It is believed that this topic has presented some guidelines that would be of assistance in the development of cases both from the determination (or ruling) and examination standpoints. As a final note, there is a possibility that some guidelines may ultimately emanate from the publication of final regulations under IRC 4911. The latter, relating to the tax on excess expenditures to influence legislation precludes charitable organizations from including fund raising unit expenditures from the amount base ("exempt purpose expenditures") from which permissible lobbying expenditures are determined. It would seem that some useful definitions on fund raising may come out of the regulations project.

[APPENDIX 1, 2, and 3 not shown here]

APPENDIX 4

Suggested Pattern Paragraphs
For Fund Raising Determinations, Rulings, and Correspondence

1. Contribution deductions are allowable to donors only to the extent that their contributions are gifts, with no consideration received. Dues, subscriptions, ticket purchases, and similar payments may not necessarily qualify as deductible contributions, depending on the circumstances.

2. In the event you carry on fund raising activities, such as sales of merchandise or admission tickets to benefit performances, you may not represent that the full purchase price of such item entitles the patron to a deduction for federal income tax purposes. In those cases in which your fund raising activity is designed to solicit payments which are in part a gift and in part the consideration for goods, services, or other benefits, you must determine in advance of solicitation the amount to be attributed as the consideration and the amount to be attributed as a gift. You should clearly indicate these respective amounts in the publicity for such activity and upon any ticket, receipt, or other evidence issued in connection with payment. Moreover, the amount attributable to the consideration must reflect that fair market value of such goods, services, or other benefits and be reasonable in comparison with those for which there are established charges.

3. Extract from Rev. Rul. 80-286, 1980-2 C.B. 179

Section 170(a) of the Code provides that there shall be allowed as a deduction, subject to certain limitations any charitable contribution as defined in section 170(c), payment of which is made within the taxable year. Section 170(c)(2)(B) defines a charitable contribution to include a contribution or gift to or for the use of a corporation organized and operated exclusively for educational purposes.

Although the term "contribution" is not defined either in the Code or in the Income Tax Regulations, it is well established judicially that in order to be deductible under section 170 of the Code, a contribution must qualify as a gift in the common law sense of being a voluntary transfer of property without consideration. To the extent a transferor receives or can expect to receive, for the money or property he or she transfers, a financial or economic benefit, as distinguished from the incidental benefit that inures to a donor as a member of the general public, then no deduction under section 170 is allowable. Singer v. United

States, 449 F. 2d 413 (Ct., Cl. 1971); Rev. Rul. 67-246, 1967-2 C.B. 104 Rev. Rul. 76-185, 1976-1 C.B. 60.

Accordingly, the fees paid by families participating in the exchange program are not deductible as charitable contributions under section 170 of the Code. Further, the expenses incurred by a participating United States family contributing to the support, maintenance, and cultural enrichment of the foreign child while the child is a member of the United States family's household for the exchange duration are not deductible as charitable contributions under section 170.

However, contributions from members of the general public, as well as contributions from a family that exceed the fair market value of services received from the family's participation in the exchange program, will be deductible under section 170 of the Code in the manner and to the extend provided therein.