Committee Reports

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TREATMENT OF CERTAIN SPONSORSHIP PAYMENTS

**DATE:** July 23, 1992. Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

**SPONSOR:** Mr. Rostenkowski, from the Committee on Ways and Means, submitted the following

R E P O R T

(To accompany H.R. 5645)

(Including cost estimate of the Congressional Budget Office)

**TEXT:**

The Committee on Ways and Means, to whom was referred the bill (H.R. 5645) to amend the Internal Revenue Code of 1986 to exclude certain sponsorship payments from the unrelated business income of tax-exempt organizations, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. EXPLANATION OF THE BILL

1. Corporate Sponsorship Payments Received by Tax-exempt Organizations in Connection with Public Events (Secs. 1 and 2 of the Bill and Secs. 512-514 of the Code)

Present Law

Although exempt from Federal Income tax, tax-exempt organizations generally are subject to the unrelated business income tax (UBIT) on income derived from a trade or business regularly carried on

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that is not substantially related to the performance of the organizations tax-exempt functions (secs. 511-514). Contributions or gifts received by tax-exempt organizations generally are not subject to the UBIT. However, present-law section 513(c) provides that an activity (such as advertising) does not lose its identity as a separate trade or business merely because it is carried on within a larger complex of other endeavors. If a tax-exempt organization receives sponsorship payments in connection with conducting a public event, the solicitation and receipt of such sponsorship payments may be treated as a separate activity. The Internal Revenue Service (IRS) has taken the position that, under some circumstances, such sponsorship payments may be subject to the UBIT.

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In determining whether a trade or business is regularly carried on, regard must be had to the frequency and continuity with which the business activities are conducted and the manner in which such activities are pursued. Specific business activities of a tax-exempt organization will ordinarily be deemed to be regularly carried on if they manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of taxable entities. See Treas. Reg. sec. 1.513-1(c)(1).

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See United States v. American College of Physicians, 475 U.S. 834 (1986) (holding that activity of selling advertising in medical journal was not substantially related to the organizations exempt purposes and, as a separate business under section 513(c), was subject to tax).

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See Announcement 92-15, 1992-5 I.R.B. 51 (announcing proposed audit guidelines distinguishing sponsorship payments in return for which there is mere acknowledgement of sponsor and thus no UBIT liability in contrast to sponsorship payments in return for which substantial economic benefits are conferred upon the sponsor and UBIT liability may be asserted by the IRS).

Reasons for Change

The committee believes that the receipt of sponsorship payments by certain tax-exempt organizations in connection with public events (other than sporting events) they conduct should not be treated as a separate business activity subject to the UBIT if the public event is substantially related to the organizations tax-exempt purposes. In addition, to reduce uncertainty regarding application of the present-law "regularly carried on" test, it is appropriate to exclude from the UBIT sponsorship payments received by certain tax-exempt organizations in connection with other public events (including sporting events), provided the event is conducted not more than once per year during a period not exceeding 30 consecutive days.

Explanation of Provisions

Sponsorship payments

Under the provision, qualified sponsorship payments received by certain tax-exempt organizations in connection with qualified public events are excluded from the UBIT.

The term "qualified public event" is defined as any event conducted by a tax-exempt organization described in paragraph (3), (4), (5), or (6) of section 501(c), that is either:

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In addition, events conducted by State colleges and universities described in section 511(d) (2) (B) are eligible for the UBIT exception provided for by the bill.

(1) a public event (but not sporting event) that is substantially related to the exempt purposes of the organization conducting such event, or

(2) any other public event, including a public sporting event, provided that such event is the only event of that type conducted (i.e., patronized by, or broadcast to, members of the public) by such organization during a calendar year and such event does not exceed 30 consecutive days.

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The bill provides that an event will be treated as a qualified public event with respect to all qualified tax-exempt organizations that receive sponsorship payments with respect to the event if such event is a qualified public event with respect to one of such organizations, but only to the extent that such payment is used to meet expenses of such event or for the benefit of the organization with respect to which the event is a qualified public event.

Cultural and other public events (but not sporting) that are substantially related to the organization conducting the event (e.g., symphony concerts, museum exhibits, and county and agricultural fairs) are governed by the provision, even if held for more than a 30-day period. Unrelated events and sporting events are governed by the provision only if the once-a-year and 30-day requirements are satisfied. Examples of public sporting events that could be governed by the proposal include intercollegiate athletic events and golf tournaments. A cultural or other public event conducted once a year for a period that does not exceed 30 days also would be governed by the provision, even if the event is not substantially related to the exempt purposes of the organization (e.g., an annual vaudeville show conducted by a hospital or an annual auction or other fundraising event).

For purposes of the provision, "qualified sponsorship payments" received by a tax-exempt organization that are excluded from UBIT are defined as any payment made by a person engaged in a trade or business with respect to which the person will receive no substantial return benefit other than:

(1) the use of the name or logo of the persons trade or business in connection with a qualified event under arrangements (including advertising) in connection with such event which acknowledge such persons sponsorship or promote such persons products or services, or

(2) the furnishing of facilities, services, or other privileges in connection with such event to individuals designated by such person (e.g., tickets furnished to employees).

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The bills "in connection with" requirement will be satisfied only if benefits provided to the sponsor (or individuals designated by the sponsor) are provided within a reasonable time period compared to when the qualified public event itself is patronized by (or broadcast to) the public and only if the benefits are provided in a manner reasonably related to the conduct of the public event activities (e.g., providing advertising in a program or brochure distributed to event patrons, or providing special seating at the event, or related, pre- or post-event functions, to employees of the sponsor).

To prevent avoidance of the 30-day rule governing sporting events and unrelated cultural events, the Secretary of the Treasury is granted authority to prescribe regulations to prevent avoidance of the purposes of the provisions through the use of entities under common control.

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For this purpose, it is intended that organizations that conduct public events will not be treated as under common control solely as a result of their common affiliation with a national sanctioning body.

The exception provided for by the provision is in addition to other present-law exceptions from the UBIT (e.g., the exceptions for activities substantially all the work for which is performed by volunteers and for activities not regularly carried on). No inference is intended as to the tax treatment under present-law rules of sponsorship payments received in connection with events not governed by the provision (e.g., unrelated or sporting events held more than once per year or for more than 30 days). Further, no inference is intended as to events held prior to the date of enactment.

Olympics

The provision also includes the following two rules with respect to the 1996 Games of the XXVI Olympiad:

(1) In the case of a qualified amateur sports organization described in present-law section 501(j)(2) or an organization that would be so described but for the cultural events it organizes in connection with national or international amateur sports competitions, "royalty" income excluded from the UBIT includes any income received directly or indirectly by such organization if a substantial part of the consideration therefor is the right to use trademarks, designations, or similar properties indicating a connection with the Olympic Games to be conducted in 1996 or related events or the participation of the United States Olympic Team at such Games or events.

(2) Nothing in section 514 or 512(b) shall be construed as treating any amount treated as a royalty under paragraph (1) as an item of income subject to the UBIT.

Effective Date

The provision governing qualified sponsorship payments is effective for events conducted after the date of enactment. The rules governing the treatment of certain royalty income received in connection with 1996 Games of the XXVI Olympiad are effective upon the date of enactment.

2. Treatment of Amounts Received in Connection with Affinity Credit Cards (Sec. 3 of the Bill and Sec. 512 of the Code)

Present Law

Tax-exempt organizations generally are subject to the unrelated business income tax (UBIT) on income derived from a trade or business regularly carried on that is not substantially related to the performance of the organizations tax-exempt functions (secs. 511-514). However, certain types of income (e.g., interest, dividends, royalties, and certain rents) are specifically excluded from the UBIT, except where derived from debt-financed property (sec. 512(b)). In addition, exemptions from the UBIT are provided for income derived from activities substantially all the work for which is conducted by volunteers, which involves the selling of donated goods, and certain activities conducted by charities and educational organizations for the convenience of their members, students, patients, officers, or employees (sec. 513(a)).

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In addition, interest, royalties, and rents (but not interest) paid to a tax-exempt organization by certain controlled entities are subject to the UBIT in proportion to the income of the controlled entity that would have been subject to the UBIT if derived directly by the controlling tax-exempt organization (sec. 512(b)(13)).

Section 513(h) provides that, in the case of a tax-exempt charity (or war veterans organization) eligible to receive tax-deductible contributions, the UBIT does not apply to income from any trade or business which consists of exchanging with another such organization names and addresses of donors to (or members of) such organization, or renting such names and addresses to another such organization. Section 513(h) does not apply to sales or exchanges of donor or member lists to taxable organizations or among tax-exempt organizations other than tax-exempt charities (and war veterans organizations) eligible to receive tax-deductible contributions.

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See Disabled American Veterans v. Commissioner, 942 F.2d 309 (6th Cir. 1991) (holding that amounts received by a charitable organization from use of names from its mailing lists were taxable as unrelated business income and not exempt as royalties).

Reasons for Change

The committee believes that income received by a tax-exempt organization from exchanging or leasing its membership (or contributor) list or its identifying symbol for use in connection with credit (or debit) cards should be subject to the UBIT.

Explanation of Provision

Income will be subject to the UBIT if received or accrued in connection with the direct or indirect sale, exchange, lease, rental, or other grant by a tax-exempt organization of (1) the right to use the name of the organization, identifying symbol, or similar item on a credit or debit card, or (2) the right to use a list of members, customers, or contributors in connection with the issuance of credit or debit cards. The provision does not apply to credit unions exempt from tax under section 501(c)(14).

Because the provision is limited to credit (and debit) card arrangements, it does not affect the present-law rule contained in section 513(h) that excludes from the UBIT income from exchanges and rentals of donor and membership lists among tax-exempt charities (and war veterans organizations) eligible to receive tax-deductible contributions.

Income from affinity credit (or debit) card arrangements governed by the provision will be subject to the UBIT, notwithstanding any other UBIT exception, such as that for royalty income, activities not regularly carried on, or the volunteer-labor exception. The bill specifically provides that, in computing net taxable income subject to the UBIT, there shall be allowed all deductions directly connected with amounts received in connection with credit or debit cards that are governed by the provision.

No inference is intended as to the tax treatment of exchanges or rentals by tax-exempt organizations of mailing lists (or identifying symbols) other than with respect to the credit (or debit) card arrangements governed by the bill.

Effective Date

The provision is effective for amounts received or accrued after July 9, 1992.

II. BUDGET EFFECTS OF THE BILL

In compliance with clause 7 of Rule XIII of the Rules of the House of Representatives, the following statement is made about the effect on the budget of this bill, H.R. 5645, as reported.

The estimated budget effects of the bill for fiscal years 1992-1997 are as follows:

PLEASE REFER TO ORIGINAL SOURCE

III. VOTE OF THE COMMITTEE AND OTHER MATTERS TO BE DISCUSSED UNDER HOUSE RULES

a. vote of the committee

In compliance with clause 2(1)(2)(B) of Rule XI of the Rules of the House of Representatives, the following statement is made about the vote of the committee on the motion to report the bill, H.R. 5645. The bill was ordered favorably reported by voice vote.

b. other matters

In compliance with clause 2(1)(3) and 2(1)(4) of Rule XI of the Rules of the House of Representatives, the following statements are made with respect to the committee action on H.R. 5645.Oversight findings

With respect to subdivision (A) of clause 2(1)(3) (relating to oversight findings), the committee advises that it was as a result of the committees oversight activities with respect to UBIT treatment of corporate sponsorship payments received by tax-exempt organizations and income from "affinity" cards that the committee concluded that it is appropriate to enact the provisions contained in the bill.Tax expenditures

With respect to subdivision (B) of clause 2(1)(3), after consultation with the Congressional Budget Office, the committee states that the changes made to existing law by this bill as reported involve no new tax expenditures.Budget authority

With respect to subdivision (B) of clause 2(1)(3), after consultation with the Congressional Budget Office, the committee states that the changes made by the bill as reported involve no new budget authority.Congressional Budget Office estimates

With respect to subdivision (C) of clause 2(1)(3), the committee advises that the Congressional Budget Office has examined the committees budget estimates (as indicated in Part II of this report) and submitted the following statement:

U.S. Congress,

Congressional Budget Office,

Washington, DC, July 23, 1992.

Hon. Dan Rostenkowski,

Chairman, Committee on Ways and Means, House of Representatives, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has reviewed H.R. 5645, as ordered reported on July 23, 1992, by the House Committee on Ways and Means. CBO estimates that the bill would cause a negligible decrease in receipts in fiscal year 1992 and would decrease receipts by $8 million over the 1992 through 1997 period.

The bill would exclude certain sponsorship payments made to tax-exempt organizations from unrelated business taxable income and would make the income derived by the tax-exempt organizations from the use of affinity cards subject to the unrelated business income tax. The Joint Committee on Taxation estimates that these provisions would cause a decrease in receipts of less than $500,000 in fiscal year 1992, and by $8 million over the 1992 through 1997 period, and CBO concurs with these estimates.

PLEASE REFER TO ORIGINAL SOURCE

The bill would affect receipts and thus would be subject to pay-as-you-go procedures under Section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985. As a result, the estimate required under Clause 8 of House Rule XXI is attached.

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If you wish further details, please feel free to contact me or your staff may wish to contact John Stell at 226-2720.

Sincerely,

Robert D. Reischauer,

Director.Congressional Budget Office Estimate

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The applicable cost estimate of this Act for all purposes of sections 252 and 253 of the Balanced Budget and Emergency Deficit Control Act of 1985 shall be as follows:

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An estimate of H.R. 5645, as ordered reported by the Committee on Ways and Means on July 23, 1992. This estimate was transmitted by the Congressional Budget Office on July 23, 1992.

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Oversight by Committee on Government Operations

With respect to subdivision (D) of Clause 2(1)(3), the committee advises that no oversight findings or recommendations have been submitted to the committee by the Committee on Government Operations regarding the subject of this bill.

Inflationary impact

In compliance with clause 2(1)(4), the committee states that the enactment of this bill is not expected to have any inflationary impact on prices and costs in the operation of the national economy.

IV. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

\* \* \* \* \* \* \*Subtitle A Income Taxes

\* \* \* \* \* \* \*CHAPTER 1 NORMAL TAXES AND SURTAXES

\* \* \* \* \* \* \*Subchapter F Exempt Organizations

\* \* \* \* \* \* \*PART III TAXATION OF BUSINESS INCOME OF CERTAIN EXEMPT ORGANIZATIONS

\* \* \* \* \* \* \*

SEC. 512. UNRELATED BUSINESS TAXABLE INCOME.

(a) \* \* \*

(b) Modifications. The modifications referred to in subsection (a) are the following:

(1) \* \* \*

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(16)(A) Notwithstanding any other provision of this part, any amount received or accrued in connection with the direct or indirect sale, exchange, lease, rental, or other grant of

(i) the right to use the name of the organization, identifying symbol, or similar item on a credit or debit card, or

(ii) the right to use a list of members, customers, or contributors in connection with the issuance of credit or debit cards,

shall be included as an item of gross income derived from an unrelated trade or business regularly carried on by the organization. There shall be allowed all deduction directly connected with amounts so included under this subparagraph.

(B) Subparagraph (A) shall not apply to a credit union exempt from tax under section 501(c)(14).

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SEC. 513. UNRELATED TRADE OR BUSINESS.

(a) \* \* \*

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(i) Treatment of Certain Sponsorship Payments.

(1) In general. The term "unrelated trade or business" does not include the activity of soliciting and receiving qualified sponsorship payments with respect to any qualified public event.

(2) Qualified sponsorship payments. For purposes of this subsection, the term "qualified sponsorship payment" means any payment by any person engaged in a trade or business with respect to which there is no arrangement or expectation that such person will receive any substantial return benefit other than

(A) the use of the name or logo of such persons trade or business in connection with any qualified public event under arrangements (including advertising) in connection with such event which acknowledge such persons sponsorship or promote such persons products or services, or

(B) the furnishing of facilities, services, or other privileges in connection with such event to individuals designated by such person.

(3) Qualified public event.

(A) In general. For purposes of this subsection, the term "qualified public event" means any event conducted by an organization described in paragraph (3), (4), (5), or (6) of section 501(c) or by an organization described in section 511(a)(2)(B) if such event is

(i) a public event (other than a sporting event) the conduct of which is substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exempt purposes of the organization conducting such event, or

(ii) any public event not described in clause (i) but only if such event is the only event of that type conducted by such organization during a calendar year and such event does not exceed 30 consecutive days.

An event shall be treated as a qualified public event with respect to all organizations referred to in the preceding sentence which receive sponsorship payments with respect to such event if such event is a qualified public event with respect to 1 of such organizations; except that a payment shall be treated as not being from an unrelated trade or business by reason of this sentence only to the extent that such payment is used to meet the expenses of such event or for the benefit of the organization with respect to which such event is a qualified public event (determined without regard to this sentence).

(B) Exempt purpose. For purposes of subparagraph (A), the term "exempt purpose" means any purpose or function constituting the basis for the organizations exemption under section 501 (or, in the case of an organization described in section 511(a)(2)(B), the exercise of performance of any purpose or function described in section 501(c)(3)).

(4) Regulations. The Secretary shall prescribe such regulations as may be necessary to prevent the avoidance of the purposes of this subsection through the use of entities under common control.

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