



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: **201251019**

Release Date: 12/12/2012

Date: September 24, 2012

Uniform Issue List:

511.00-00

512.00-00

513.00-00

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

Event =

Book =

Dear

This is in response to your ruling request as amended on October 13, 2009 and May 23, 2012 requesting a ruling as to whether certain revenues arising out of an event conducted by you constitutes unrelated business income within the meaning of §§ 511 through 513 of the Internal Revenue Code (Code).

Facts:

You are a corporation and are exempt from federal income tax pursuant to § 501(c)(3) and are classified as a non-private foundation under § 509(a)(2). Your Articles of Incorporation state that you were formed to operate solely for charitable purposes within the meaning of § 501(c)(3) of the Code, and in part to educate promote, encourage, and aid children and adults everywhere in the appreciation of reading and literacy. In furtherance of your exempt purpose, you develop, support and maintain a variety of programs to enhance the quality of life in your region by educating, promoting and encouraging reading and the appreciation of literature. In particular, you conduct reading outreach programs, lending library programs, and provide free books and literature to hospitals and pediatricians to promote early and continuous learning and reading. One of your activities is the annual Event held during the weekends of the two months prior to Christmas. During Event, the audience shares in the recreation of numerous events in Book.

You state that studies have shown that reading aloud is vital in developing the knowledge required for success in reading. If a child participates actively in reading aloud, the child learns new words, learns more about the world and about written language. You state that actual involvement in the story promotes a child's literacy. You have incorporated this principle into Event. You state that by recreating Book, you are furthering your exempt purposes and promoting literacy by allowing children to experience a live version of Book. You have no business relationship with the author of Book. You state that children attending the Event actively participate in the retelling of the story. Book is read aloud to the children once they

arrive at the Event. Event takes place on the weekends of the two months prior to Christmas, for a total of eleven days with three performances on each day. You promote Event by numerous means as described in your submission. Also, you established a website just for Event. There are numerous other Book related events held throughout the country and hosted by both nonprofit and for profit organizations. All of these Book events occur in the same period of the year as your Event. None occurs at any other season of the year.

Event requires extensive planning that begins several months prior to the actual activity. You state that volunteers play a prominent role in organizing and holding Event. You state that the funds you receive from Event are used to promote your literacy programming, scholarships, and grants.

Ruling Requested:

You have requested a ruling that the revenue from the sale of tickets to Event does not constitute unrelated business taxable income under § 512(a)(1).

Law:

Section 511(a) provides that organizations described in § 501(c)(3) are subject to unrelated business income tax on their unrelated business taxable income.

Section 511(a)(2)(A) provides that the tax imposed by paragraph (1) shall apply in the case of any organization (other than a trust described in subsection (b) or an organization described in section 501(c)(1)) which is exempt, except as provided in this part or part II (relating to private foundations), from taxation under this subtitle by reason of § 501(a).

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

Section 513 defines an "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need for funds) to the exercise or performance by such organization of its charitable, educational, or other exempt purposes.

Section 513(a)(1) states that the term "unrelated trade of business" does not include any trade or business in which substantially all the work in carrying on the trade or business is performed for the organization by volunteers.

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

Treas. Reg. § 1.513-1(b) provides that for purposes of § 513, the term “trade or business” has the same meaning it has in § 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Treas. Reg. § 1.513-1(c)(1) provides that in determining whether trade or business is “regularly carried on,” within the meaning of § 512, the frequency and continuity with which the activities are conducted and the manner in which they are pursued are determinative. For example, specific business activities of an exempt organization will ordinarily be deemed to be “regularly carried on” if they manifest a frequency and continuity, and are pursued in a manner generally similar to comparable commercial activities of non-exempt organizations.

Treas. Reg. § 1.513-1(c)(2)(i) provides that, where income producing activities are of a kind normally conducted by nonexempt commercial organizations on a year-round basis, the conduct of such activities by an exempt organization over a period of only a few weeks does not constitute the regular carrying on of trade or business. But where income producing activities are of a kind normally undertaken by nonexempt commercial organizations only on a seasonal basis, the conduct of such activities by an exempt organization during a significant portion of the season ordinarily constitutes the regular conduct of trade or business.

Treas. Reg. § 1.513-1(c)(2)(ii) provides that, in determining whether or not intermittently conducted activities are regularly carried on, the manner of conduct of the activities must be compared with the manner in which commercial activities are normally pursued by non-exempt organizations. 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.

Treas. Reg. § 1.513-1(d)(2) provides that a trade or business is substantially related to exempt purposes only if the business activities have a substantial causal relationship to the achievement of exempt purposes. This means that the activities must contribute importantly to the accomplishment of exempt purposes.

Treas. Reg. § 1.513-1(d)(4) provides an example where income from performance of exempt functions does not constitute gross income from the conduct of unrelated trade or business.

Example (1). M, an organization described in section 501(c)(3), operates a school for training children in the performing arts, such as acting, singing, and dancing. It presents performances by its students and derives gross income from admission charges for the performances. The students’ participation in performances before audiences is an essential part of their training. Since the income realized from the performances derives from activities which contribute importantly to the accomplishment of M’s exempt purposes, it does not constitute gross income from unrelated trade or business.

Rev. Rul. 68-73, 1968-1 C.B. 251, concerns whether an organization qualifies for exemption where it ministers on the non-medical needs of patients of a proprietary hospital by reading to patients, writing letters to the patients, and providing other similar personal services in an effort

to improve their mental well-being and physical comfort. The revenue ruling concludes that the organization qualifies for exemption because improving the well-being and physical comfort of the patients are charitable acts. The revenue ruling also concludes that the fact that these activities are performed in a proprietary hospital is not material. It is the patients who are the primary beneficiaries, and any benefits to the hospital are merely incidental.

Rev. Rul. 68-505, 1968-2 C.B. 248, concerns a tax-exempt county fair association that conducts a two-week horse racing meet featuring pari-mutuel betting. Because the races are carried on in a manner similar to commercial race tracks, they constitute a trade or business. The business is regularly carried on because it is usual to carry on such trade or business only during a particular season.

Analysis:

Many organizations recognized as exempt from federal income tax must nevertheless pay tax on income from a trade or business that is unrelated to their exempt purposes. Section 511(a)(1) imposes a tax for each taxable year on the unrelated business taxable income of every organization described in § 511(a)(2) which includes organizations described in § 501(c)(3). Section 512(a)(1) defines "unrelated business taxable income" as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less certain deductions.

Section 1.513-1(a) provides that gross income of an exempt organization subject to the tax imposed by § 511 is includible in the computation of unrelated business taxable income if: (1) it is income from a trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions. If an exempt organization has an unrelated trade or business, a determination must be made whether the trade or business is regularly carried on before it can be concluded that the income derived therefrom is subject to tax. However, revenue derived from activities performed without compensation is not taxed as unrelated taxable income. § 513(a)(1).

First, we must determine if the income is from a trade or business. Section 1.513-1(b) provides, generally, that trade or business is an activity which is carried on for the production of income from the sale of goods or the performance of services. Here, your promotional efforts are typical of the promotional efforts of non-exempt organizations. The information you provided indicates that you engage in extensive promotion of Event. Also, there are numerous other Book related activities held throughout the country and hosted by both nonprofit and for profit organizations. All of these Book activities occur in the same period of the year as your Event. None occurs at any other season of the year. Where income-producing activities are of a kind normally undertaken by nonexempt commercial organizations only on a seasonal basis, the conduct of such activities by an exempt organization during a significant portion of the season ordinarily constitutes the regular conduct of trade or business. See Treas. Reg. § 1.513-1(c)(2)(i). You conduct your Event during a significant portion of the season during which similar events are undertaken by nonprofit and for profit organizations. Thus, the Event constitutes a trade or business.

Second, we must determine if such trade or business is regularly carried on by the organization. In determining whether intermittently conducted activities are regularly carried on, Treas. Reg. § 1.513-1(c)(2)(ii) states that the manner of conduct of the activities must be compared with the manner in which commercial activities are normally pursued, and, in particular, whether such activities are conducted with the competitive and promotional efforts typical of commercial endeavors. Here, Event takes place on the weekends of the two months prior to Christmas, for a total of eleven dates with three performances per date. As noted above, you promote the Event through out the year. Additionally you have shown that nonexempt commercial organizations promote Book only on a seasonal basis, every year. Thus, based on the foregoing, the Event is regularly carried on within the meaning of Treas. Reg. § 1.513-1(c). See Rev. Rul. 68-505, 1968-2 C.B. 248 (the business is regularly carried on because it is usual to carry on such trade or business only during a particular season.)

The last criterion is that the conduct of such trade or business is not substantially related, other than through the production of funds, to the organization's performance of its exempt functions. Revenue derived from activity that promotes or is substantially related to an exempt purpose is not otherwise subject to the unrelated business income tax. However, revenue derived from a trade or business 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 of such organization's exempt purpose or function is taxed. Characterization of a business activity as related or unrelated requires an examination of the relationship between the activity in question and the accomplishment of an organization's exempt purposes. Treas. Reg. §1.513-1(d)(1). A trade or business is "related" if the conduct of the business activity has a causal relationship to the achievement of an organization's exempt purposes; for the business to be considered a substantially related, the causal relationship must be a substantial one. The conduct of the business activity must contribute importantly to the accomplishment of the organization's exempt purposes. Treas. Reg. § 1.513-1(d)(2).

For your activities to escape taxation as unrelated business income, your Event must contribute directly and importantly to the accomplishment of one or more of your exempt purposes. You were formed to aid, encourage, and promote literacy, reading, and imagination in children and adults. You state that one of the key methods of encouraging literacy is to show children how much enjoyment they can derive from books. Event is literature brought to life. It provides a unique opportunity for a child to experience the wonder of literature by living the part of the main character in Book. You have provided information in your ruling submission that, among other things, establishes that children are encouraged to be interactive during Event and Book is read to the children at Event. Your activities show that Event is substantially related and furthers your exempt purpose of promoting literacy, reading and imagination in children and adults and therefore, amounts received from the sale of tickets to Event is not subject to the unrelated business income tax. See Rev. Rul. 68-73, and Treas. Reg. § 1.513-1(d)(2), Example (1), supra.

Ruling:

Based on the foregoing, Event is not considered an unrelated trade or business by reason of § 513(a)(1) and, therefore, revenue from the sale of tickets to the Event does not constitute unrelated business taxable income within the meaning of § 512(a)(1).

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This ruling will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Theodore R. Lieber
Manager, Exempt Organizations
Technical Group 3

Enclosure
Notice 437