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EXCEPTIONS TO THE TERM "UNRELATED TRADE OR BUSINESS" UNDER SECTION 513(a)

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I. INTRODUCTION

NUMEROUS CATEGORIES of organizations are eligible for exemption from income taxation under subchapter F of the Internal Revenue Code.¹ Despite the exemption, however, charities and other exempt organizations are taxed on income from their unrelated business endeavors. Specifically, a tax is imposed on the unrelated business taxable income of otherwise exempt organizations.² Unrelated business taxable income has three components: gross income subject to the tax; the deductions directly connected with the production of such income; and various modifications which are taken into account in computing the tax.

The income subject to the tax is the gross income from an unrelated trade or business regularly carried on by the organization.³ Three criteria must be satisfied in order for the income to be subject to the tax. First, the income must be income from a trade or business, that is, "any

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¹ I.R.C. §§ 501-528 (1967 and Supp. 1984). Unless otherwise provided, all references to the Internal Revenue Code, to the Code or to specific sections refer to the Internal Revenue Code of 1954, as amended.

² I.R.C. § 511(a) (Supp. 1984). See generally J. GALLOWAY, *THE UNRELATED BUSINESS INCOME TAX* (1982). For other examples of the taxation of exempt organizations, see I.R.C. § 501(b) (Supp. 1984).

³ I.R.C. § 512(a) (Supp. 1984).

activity carried on for the production of income from the sale of goods or performance of services."⁴ Second, the trade or business must be regularly carried on.⁵ Finally, the trade or business must be an unrelated trade or business. A business of an exempt organization is considered unrelated if it is "not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption. . . ."⁶

Expenses and other items allowed under the income tax provisions of the Code are deductible in computing unrelated business taxable income only if they are directly connected with the conduct of the business.⁷ Section 512(b) contains several modifications that are applied in computing the tax. Section 512(b) specifically excludes dividends, interest, annuities, royalties, certain rents from real property and gains and losses from the sale of property in order to clarify that passive income from investments is not subject to the tax.⁸ Income from certain types of research is also excluded.⁹

The Revenue Act of 1950 enacted the unrelated business income tax.¹⁰ Prior to the inception of the tax, unrelated business activities of exempt organizations were not subject to taxation.¹¹ In addition, under prior law, a "feeder" organization that conducted a business as its sole activity was eligible for exempt status so long as all of

⁴ I.R.C. § 513(c) (Supp. 1984). *See also* Treas. Reg. § 513-1(b) (1967).

⁵ I.R.C. § 513(c). *See also* Treas. Reg. § 513-1(c) (1967).

⁶ I.R.C. § 513(a) (1967 and Supp. 1984). *See also* Treas. Reg. § 1.513-1(d) (1967). A business is considered a related business if it has a substantial causal relationship to the accomplishment of the organization's exempt purposes and contributes importantly to those purposes. § 1.513-1(d)(2) (1967).

⁷ I.R.C. § 512(a)(1) (Supp. 1984).

⁸ I.R.C. § 512(b)(1)-(3), (5) (1967 and Supp. 1984).

⁹ *Id.* at (7)-(9).

¹⁰ Revenue Act of 1950, ch. 944, § 301(a), 64 Stat. 906, 949.

¹¹ *E.g.*, *Trinidad v. Sagrada Orden de Predicadores*, 263 U.S. 578 (1924).

its profits were payable to a charitable organization.¹² The business activities of charities received considerable public and scholarly attention.¹³ The primary objection to the conduct of commercial activities by charities was that their business activities resulted in unfair competition with taxable enterprises.¹⁴ The unrelated business income tax was intended to eliminate the conduct of unrelated businesses by exempt organizations as a source of unfair competition with private enterprise.¹⁵ Additionally, the income from "feeder" organizations was not eligible for exemption.¹⁶

The 1950 Act contained three exceptions to the term unrelated trade or business. Expressly excepted from the scope of the tax were businesses carried on largely by volunteers, businesses conducted by charities primarily for the convenience of members, students, patients and others, and businesses which consist of the sale of donated merchandise. The exceptions were inserted into the Code with little comment in the legislative history.¹⁷ Presumably, Congress did not believe that the businesses covered by the exceptions were subject to the competitive abuses sought to be eliminated by the Act. It also appeared that Congress wished to exclude from taxation certain business activities such as thrift shops that had traditionally been operated by charitable institutions. The three exceptions are continued in the present statute.¹⁸

¹² *E.g.*, *C.F. Mueller Co. v. Comm'r*, 190 F.2d 120 (3d Cir. 1951), *rev'g* 14 T.C. 922 (1950); *Roche's Beach, Inc. v. Comm'r*, 96 F.2d 776 (2d Cir. 1938).

¹³ *E.g.* Blodgett, *Tax Status of Business Activities of Charities Prior to the Revenue Act of 1950*, 9 N.Y.U. INST. ON FED. TAX'N 885 (1951).

¹⁴ *See Rensselaer Polytechnic Inst. v. Comm'r*, 732 F.2d 1058, 1061 (2d Cir. 1984). Critics argued that charities could expand their businesses using tax-free profits, while the expansion of the nonexempt competitors was limited to after-tax profits. S. REP. NO. 2375, 81st Cong., 2d Sess. 28 (1950). Another source of concern was the loss of tax revenues from businesses operated by and for charitable organizations.

¹⁵ 732 F.2d at 1061.

¹⁶ *See* I.R.C. § 502(a) (1982).

¹⁷ *See* S. REP. NO. 2375, 81st Cong., 2d Sess. 29 (1950); H. R. REP. NO. 2319, 82nd Cong., 2d Sess. 110 (1950).

¹⁸ I.R.C. § 513(a) (1982). The predecessor to § 502 pertaining to feeder orga-

Exempt organizations are often advised to structure unrelated business activities to take advantage of the exceptions to the term unrelated trade or business under section 513(a). A 1983 report of the Small Business Administration, however, advocated repeal of the convenience exception on the ground that businesses covered by the exception compete unfairly with similar taxable businesses.¹⁹ Despite the importance of the exceptions to many exempt organizations and the concern of the Small Business Administration, the exceptions are rarely treated in a comprehensive fashion.²⁰

The purpose of this article is to examine the operation of the three exceptions under section 513(a). The principal issues arising under each provision will be described and analyzed. This article will also evaluate the cases and rulings applying the exceptions in order to determine whether they have been applied consistently with the intent of the unrelated business income tax or used in a manner that undermines the purpose of the tax.

It should be noted that subsequent to the Revenue Act of 1950 additional exceptions to the term unrelated trade or business were added to the Code. The Tax Reform Act of 1976 expressly excepted from the ambit of the tax the conduct of certain entertainment events at fairs and expositions,²¹ the conduct of convention and trade shows by certain exempt organizations²² and the performance of

nizations did not contain the exceptions. See *Veterans Found. v. United States*, 178 F. Supp. 234, 238-39 (D. Utah 1959), *aff'd*, 281 F.2d 912 (10th Cir. 1960). To provide for consistent treatment of similar activities carried on by exempt organizations as part of their activities and by feeder organizations, exceptions identical to those found in § 513(a) were added to § 502, effective for taxable years beginning after January 1, 1970. Tax Reform Act of 1969, Publ. L. No. 91-172, § 121(b) (7), 83 Stat. 487, 542.

¹⁹ U.S. SMALL BUSINESS ADMINISTRATION, UNFAIR COMPETITION BY NONPROFIT ORGANIZATIONS WITH SMALL BUSINESSES: AN ISSUE FOR THE 1980s 44 (1983) [hereinafter cited as S.B.A. Report].

²⁰ For discussions of the exceptions, see B. HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS* 677-81 (4th ed. 1982); J. GALLOWAY, *supra* note 2, at 42-51.

²¹ Pub. L. No. 94-455, § 1305(a), 90 Stat. 1520, 1716-17 (codified at I.R.C. § 513(d)).

²² *Id.*

certain services for small hospitals.²³ In 1978, Congress enacted an exception for certain bingo games, effective for taxable years beginning after 1969.²⁴ These provisions were enacted in response to attempts by the Internal Revenue Service to tax activities that Congress deemed properly outside the scope of the unrelated business income tax. The later exceptions are not treated in this article.

II. THE VOLUNTEER EXCEPTION

Section 513(a)(1) applies to any trade or business in which "substantially all the work in carrying on such trade or business is performed for the organization without compensation."²⁵ Of the three exceptions to the term unrelated trade or business under section 513(a), the volunteer exception has received the most extensive treatment in the cases and rulings. It has been applied in a variety of contexts, including the conduct of bingo games,²⁶ the sale of raffle and lottery tickets,²⁷ the performance of genealogical research,²⁸ management²⁹ and consulting services,³⁰ and the sale of records,³¹ cookbooks,³² clothing,³³ and food.³⁴ Application of the volunteer exception requires a thorough understanding of the operative terms used in section 513(a)(1). The key terms are "substan-

²³ *Id.* at § 513(e).

²⁴ § 1311(a), 90 Stat. 1729-30, (codified at I.R.C. § 513(e)).

²⁵ I.R.C. § 513(a)(1).

²⁶ I.R.S. Ltr. Rul. (CCH) 7806039 (Nov. 9, 1977).

²⁷ 276 I.R.S. Ltr. Rul. (CCH) 8215033 (Jan. 15, 1982); 162 I.R.S. Ltr. Rul. (CCH) 8013050.

²⁸ 273 I.R.S. Ltr. Rul. (CCH) 8220126 (Feb. 23, 1982).

²⁹ 285 I.R.S. Ltr. Rul. (CCH) 8233048 (May 19, 1982).

³⁰ 254 I.R.S. Ltr. Rul. T.A.M. (CCH) 8201010.

³¹ *Greene County Medical Soc'y Found. v. United States*, 345 F. Supp. 900 (W.D. Mo. 1972).

³² 101 I.R.S. Ltr. Rul. (CCH) T.A.M. 7905003.

³³ 323 I.R.S. Ltr. Rul. (CCH) 8318094 (Feb. 3, 1983).

³⁴ 298 I.R.S. Ltr. Rul. (CCH) 8245074 (Aug. 1, 1982). *See also* Rev. Rul. 56-152, 1956-1 C.B. 56 (development of insurance program for municipal board); 250 I.R.S. Ltr. Rul. 8149054 (Sept. 11, 1981) (operation of an art gallery).

tially all," "work" and "without compensation." Each of these terms is examined in the following discussion.

A. "Substantially All"

The exception under section 513(a)(1) is not applicable unless "substantially all" of the work in the business is carried out by volunteers. In some cases, all of the work in the business is performed without compensation and the issue of substantiality does not arise.³⁵ In cases in which the business is conducted by volunteer and paid personnel, courts have followed one of two approaches to assess the substantiality of the volunteer effort. The first approach is objectively to evaluate the substantiality of the uncompensated work with reference to the number of hours worked. The other approach involves a subjective determination of the importance of the uncompensated work to the overall business.

The objective approach to the question of substantiality is illustrated by *Waco Lodge No. 166 v. Commissioner*.³⁶ The issue in *Waco Lodge* was whether income from weekly bingo games conducted by a fraternal lodge was subject to the unrelated business income tax.³⁷ The games were conducted by six individuals, two of whom were compensated and four of whom served as volunteers. The compensated individuals worked approximately twenty-one percent of the total hours worked at the bingo games.³⁸ Based on the time factor, the Fifth Circuit Court of Ap-

³⁵ See, e.g., Rev. Rul. 74-361, 1974-2 C.B. 159, in which a volunteer fire department held weekly dances conducted by unpaid volunteers drawn from its membership. The volunteer exception was applicable because all the work was performed without compensation. *Id.* at 160.

³⁶ 696 F.2d 372 (5th Cir. 1982).

³⁷ *Id.* The court held that the conduct of bingo games for members and their guests constituted a trade or business for purposes of the unrelated business income tax. *Id.* at 374. Section 513(f) provides that the conduct of certain bingo games is not an unrelated trade or business for purposes of the tax. I.R.C. § 513(f)(1) (Supp. 1984). Added to the Code in 1978, § 513(f) was made effective for taxable years beginning after December 31, 1969. Miscellaneous Revenue Act of 1980, Pub. L. No. 96-605, § 106(b), 94 Stat. 3521, 3524 (1980).

³⁸ 696 F.2d at 375.

peals concluded that the volunteer exception was inapplicable.³⁹ Thus, seventy-nine percent was not considered substantially all of the work for purposes of the volunteer exception.

In two rulings, the Internal Revenue Service has determined that volunteer efforts were substantial with reference to the number of hours worked. In Technical Advice Memorandum 8040014,⁴⁰ an art museum operated a gallery for the sale and rental of artworks. Volunteer labor represented approximately ninety-seven percent of the total hours worked at the gallery. The Service ruled that substantially all of the work was uncompensated within the meaning of section 513(a)(1). A social welfare organization conducted bingo games as described in Private Letter Ruling 7806039.⁴¹ The I.R.S. determined that the volunteer exception was applicable where eighty-seven percent of the work in the games was performed by volunteers.

In contrast to the objective approach of *Waco Lodge*, the United States District Court for the Western District of Missouri, in *Greene County Medical Society Foundation v. United States*,⁴² rejected various objective criteria offered by the parties to assess the substantiality of the volunteer effort in favor of a subjective evaluation. In *Greene County*, an exempt organization produced and sold recordings of songs that were written and performed by a group called the "Singing Doctors." The doctors received no compensation for their efforts, but other individuals involved in the project were compensated. The organization and the government offered comparisons of the volunteer and paid work based on the monetary value of the services rendered, the number of hours worked and the intrinsic importance of the work performed.⁴³ The district court

³⁹ *Id.*

⁴⁰ 189 I.R.S. Ltr. Rul. (CCH) T.A.M. 8040014 (Oct. 15, 1980).

⁴¹ 48 I.R.S. Ltr. Rul. (CCH) 7806039 (Feb. 10, 1978).

⁴² 345 F.Supp. 900 (W.D. Mo. 1972).

⁴³ *Id.* at 902.

declined to evaluate the validity of any of the objective criteria advanced by the parties.⁴⁴ Based on the determination that the unpaid work constituted the "essence of the entire endeavor," the court concluded that substantially all of the work was performed by the volunteers.⁴⁵

In most cases, an objective comparison based on the number of hours worked is preferable to a subjective determination of the substantiality of the uncompensated work for purposes of the volunteer exception. The use of objective criteria avoids the uncertainty and possible inconsistent treatment associated with a subjective approach.⁴⁶ Exempt organizations that seek to rely on the volunteer exception to avoid taxation of an unrelated business activity should maintain complete records of the volunteer and paid labor contributed to the business. A subjective assessment should be employed only where objective data are not available or in unusual cases where the

⁴⁴ *Id.*

⁴⁵ *Id.* The court's conclusion was based on the fact that "under this particular, and perhaps somewhat unique, factual situation the uncompensated work, including the conceiving of the project itself, the originating of the ideas for the parodies of popular songs, the writing of the lyrics, the setting of the lyrics to music, cutting of the records, and the making of personal appearances by practicing doctors to promote the records, was the essence of the entire endeavor." *Id.* See also *Louisiana Credit Union League v. United States*, 501 F. Supp. 934, 942 (E.D. La. 1980) (holding that substantially all of the work in conducting several unrelated businesses was performed by salaried individuals without indicating any basis for the conclusion).

⁴⁶ One illustration of the shortcomings of a subjective approach to determine substantiality is the treatment of lobbying activities by charitable organizations. Section 501(c) (3) expressly provides that a charity may not engage in legislative activities as a substantial part of its activities. I.R.C. § 501(c)(3) (1985). Prior to 1976, most courts favored a subjective determination of the substantiality of lobbying activities conducted by charities. *E.g.*, *Haswell v. United States*, 500 F.2d 1133, 1142 (Ct. Cl. 1974), *cert. denied*, 419 U.S. 1107 (1975). The subjective treatment made uncertain the permissible level of legislative activity and led to allegations of selective enforcement of the lobbying restriction by the I.R.S. Caplin & Timbie, *Legislative Activities of Public Charities*, 39 LAW & CONTEMP. PROBS. 183, 184 (1975). In response to widespread criticism of the treatment of lobbying activities, Congress adopted an objective statutory test based on expenditures under which certain charities can elect to have their lobbying activities governed. Tax Reform Act of 1976, P.L. 94-455, § 1307(a), (b), 90 Stat. 1520, 1720, *enacting* I.R.C. §§ 501(h), 4911.

number of hours worked does not accurately reflect the contribution of the volunteer workers.

The concept of substantiality is employed in numerous other contexts in the provisions of the Internal Revenue Code pertaining to exempt organizations. Eighty-five percent or more is commonly construed as substantially all.⁴⁷ The eighty-five percent figure is also appropriate as a guideline under the volunteer and donations exceptions. *Waco Lodge* and the rulings discussed earlier are consistent with the use of eighty-five percent as a measure of the substantiality of the uncompensated work under the volunteer exception.

B. "Work"

The Internal Revenue Service has ruled that the volunteer exception is inapplicable unless the performance of services is a material income-producing factor in carrying on the business. Revenue Ruling 78-144⁴⁸ involved a charitable organization that conducted a machine rental business. The machinery was leased pursuant to contracts that required the lessees to provide insurance, pay taxes and make most repairs. The leases were usually renewed until the machinery became obsolete. All of the work in connection with the equipment leasing was performed without compensation. The Service reasoned that the volunteer exception was not available because labor was not a material income-producing element of the machine rental business:

In this case, the only regularly recurring work in carrying on the leasing activity is the processing of the rental payments from the leases. Because the organization's experience has been that the same lessees keep the equipment

⁴⁷ E.g., Treas. Reg. §§ 1.514(b)-1(b)(1)(ii) (1958) (pertaining to debt-financed property); 1.528-4(b), (c) (1980) (pertaining to condominium management associations and residential real estate management associations); 53.4942(b)-1(c), -2(c) (2) (ii) (1972) amended T.D. 7718 (1980); T.D. 7878 (1983) (pertaining to operating foundations); 53.4945-3(b)(1) (iii), (iv) (1972) (pertaining to the tax on taxable expenditures).

⁴⁸ 1978-1 C.B. 168.

on a long-term basis, only occasionally does the work involve acquiring machinery, finding lessees, and negotiating leases. All other obligations related to the machinery have been assumed by the lessees under the terms of their leases. Thus, there is no significant amount of labor regularly required or involved in the kind of business carried on by the organization.⁴⁹

The requirement of services as a material income-producing factor was based on the only illustration of the volunteer exception given in the legislative history and the Treasury Regulations accompanying section 513(a). The example relates to an exempt orphanage that operates a retail store where substantially all of the work in conducting the business is performed without compensation.⁵⁰ According to the I.R.S., since services are a material income-producing factor in the operation of a retail store, the example indicates that Congress intended the volunteer exception to apply only in cases where services play a similar role.⁵¹

The legislative history of the Revenue Act of 1950 does not explain the basis for the volunteer exception, but merely offers the orphanage example. It is likely, however, that the volunteer exception partially reflects a Congressional judgment that volunteer efforts are unlikely to be of a size and scope to compete unfairly with similar commercial enterprises. Although certain exempt organizations command sizeable volunteer forces, this assumption is probably a valid one as applied to most organizations.⁵² If labor is not a significant factor in the

⁴⁹ *Id.*

⁵⁰ H. R. REP. NO. 2319, 81st Cong., 2d Sess. 110 (1950); Treas. Reg. § 1.513-1(e)(3) (1967).

⁵¹ Rev. Rul. 78-144, *supra* note 48, at 168.

⁵² A report of the Small Business Administration estimated that, as of the mid-1970s, volunteer labor provided in excess of 10% of the labor force of nonprofit organizations. According to the report, this volunteer effort represented 6 billion hours, which is equivalent to 3 million full time workers. S.B.A. Report, *supra* note 19, at 9. Most of the efforts of the volunteers, however, were presumably directed toward the exempt activities of the organizations served rather than toward unrelated businesses.

conduct of a business, then the size of the business will not be limited by the need for volunteer services under the exception. Thus, while the restriction imposed by Revenue Ruling 78-144 is not required by the language of section 513(a)(1), it is consistent with the likely intent of Congress in providing the exception.

Another issue pertaining to the term “work” concerns what efforts are to be considered as part of the work of the business for purposes of the volunteer exception. For example, *Waco Lodge*⁵³ involved the applicability of the exception to the conduct of bingo games by a fraternal lodge. The lodge building, including a meeting room, bar, lounge and kitchen, was open four nights each week. A bartender who worked all four nights was paid an hourly wage. Bingo games were conducted one night per week. A caller, two collectors and two cashiers operated the bingo games. The caller was compensated twenty of the forty-nine nights during the taxable year. The other workers were uncompensated. The court included the hours worked by the bartender on bingo nights to determine the total compensated hours in connection with the bingo games.⁵⁴ The organization’s contention that the bartender should not be counted as a bingo worker was rejected because the primary bar business on bingo nights was attributable to bingo players and workers.⁵⁵ If other lodge activities involving use of the bar had also been conducted on bingo nights, it is likely that the court would have allocated only part of the bartender’s time to the bingo games, based on the ratio of bar receipts from bingo players to total bar receipts.

In Technical Advice Memorandum 8211002,⁵⁶ a membership organization of an art museum published and sold a cookbook. Volunteers performed all of the work in

⁵³ *Waco Lodge No. 166 v. Comm’r*, 696 F.2d 372, 375 (5th Cir. 1982), *aff’d*, 42 TAX CT. MEM. DEC. (CCH) 1201, 1204 (1982).

⁵⁴ 696 F.2d at 375.

⁵⁵ *Id.*

⁵⁶ 264 I.R.S. Ltr. Rul. (CCH) T.A.M. 8211002.

preparing the manuscript, including the collection of recipes and other materials, the formatting and the editing. Additional volunteer hours were devoted to processing orders and shipping cookbooks. The museum's compensated employees handled receipts from cookbook sales together with the museum's other funds. Viewing the project in its entirety, it was clear that substantially all of the work was performed by volunteers.⁵⁷ The books, however, were sold over a period of several taxable years. The question presented was whether work performed by volunteers in a prior tax year could be considered part of the work of the business in a subsequent tax year for purposes of applying section 513(a)(1). According to the Service, as a general rule each taxable period should be considered separately in determining whether substantially all of the work is performed by volunteers. The general rule, however, was not applied in the instant situation. The preparation of the manuscript in an earlier taxable year was taken into account in applying the exception because the manuscript preparation was the bulk of the work involved in the project. The Service concluded that prepublication volunteer work should be considered as part of the work of the business during each taxable year in which cookbooks from the first printing were sold. The Service did not express a view, however, as to whether the manuscript preparation could be taken into account in the sale of books from subsequent printings.

C. "*Without Compensation*"

The volunteer exception requires that substantially all of the work in the business be performed "without compensation." Major questions that arise under this term include the impact of minimal compensation on the volunteer nature of the work, whether nonmonetary benefits are considered compensation within the meaning of

⁵⁷ The preparation of the manuscript alone entailed approximately 17,000 volunteer hours. *Id.*

the statute and the propriety of reimbursing volunteers for expenses incurred in connection with their work.

In *Waco Lodge*, the collectors and cashiers who operated the bingo games were permitted free drinks from the bar on bingo nights. During the taxable year in question, these workers consumed drinks worth \$435.50. Stating that section 513(a)(1) does not refer to the magnitude of the compensation, the Tax Court treated the collectors and cashiers as compensated workers in applying the exception.⁵⁸ The Fifth Circuit Court of Appeals disagreed with the Tax Court. Noting that the value of the free drinks to each worker amounted to about \$.63 per hour, the Fifth Circuit refused to consider such a "trifling inducement" as compensation under section 513(a)(1).⁵⁹ Thus, insignificant monetary or nonmonetary benefits may be disregarded in determining whether work is performed without compensation when applying the volunteer exception.

In contrast, however, substantial nonmonetary or indirect compensation will prevent the applicability of the exception. For example, in Private Letter Ruling 7919022,⁶⁰ the monks of a monastery engaged in several unrelated businesses. Although the monks were not compensated directly for their participation in the businesses, they were provided with food, shelter, clothing and medical care for life. The Service ruled the volunteer exception inapplicable because the monks received substantial indirect compensation made possible by their collective efforts.

⁵⁸ 42 TAX CT. MEM. DEC. (CCH) at 1204-05.

⁵⁹ 696 F.2d at 374-75. See also 162 I.R.S. Ltr. Rul. (CCH) 8013049 (Jan. 7, 1980) (treating as uncompensated workers lottery ticket sellers who received certain small incentives such as free lottery tickets and eligibility for cash prizes).

⁶⁰ 115 I.R.S. Ltr. Rul. (CCH) 7919022 (Feb. 7, 1979). See also 115 I.R.S. Ltr. Rul. (CCH) 7919034 (Feb. 7, 1979); 115 I.R.S. Ltr. Rul. (CCH) 7919033 (Feb. 7, 1979); 115 I.R.S. Ltr. Rul. (CCH) 7919030 (Feb. 7, 1979); 115 I.R.S. Ltr. Rul. (CCH) 7919024 (Feb. 7, 1979); 115 I.R.S. Ltr. Rul. (CCH) 7919023 (Feb. 7, 1979); 103 I.R.S. Ltr. Rul. (CCH) 7907033 (Nov. 15, 1978); 82 I.R.S. Ltr. Rul. (CCH) 7838062 (June 21, 1978); 82 I.R.S. Ltr. Rul. (CCH) 7838061 (June 22, 1978).

It is clear that reimbursement of expenses incurred by workers in their volunteer efforts is not treated as compensation under section 513(a)(1). For example, the "Singing Doctors" in *Greene County* were considered uncompensated even though they were reimbursed for travel expenses in connection with the recording project.⁶¹ Similarly, in Technical Advice Memorandum 8040014, the reimbursement of out-of-pocket expenses incurred by members in procuring artworks for the sales and rental gallery was not considered to be compensation under the exception.⁶²

III. THE CONVENIENCE EXCEPTION

Section 513(a)(2) excepts from the definition of unrelated trade or business any trade or business "which is carried on, in the case of an organization described in section 501(c)(3) or in the case of a college or university described in section 511(a)(2)(B), by the organization primarily for the convenience of its members, students, patients, officers, or employees. . . ."⁶³ The convenience exception has three principal components. First, only charities and certain colleges and universities may take advantage of the exception. In addition, the trade or business must be conducted primarily for the convenience of persons in the specified categories. Lastly, the persons whose convenience is served must be persons in the specified categories. Each of these components is discussed below.

⁶¹ *Greene County Med. Soc'y Found. v. United States*, 345 F.Supp. 900, 902 (W.D. Mo. 1972).

⁶² 189 I.R.S. Ltr. Rul. (CCH) T.A.M. 8040014. *Accord* Waco Lodge No. 166 v. Commissioner, 42 TAX CT. MEM. DEC. (CCH) 1202, 1203 (1981), *aff'd*, 696 F.2d 372 (5th Cir. 1982) (reimbursement of Lady Elks who provided free sandwiches on bingo nights not considered compensation).

⁶³ I.R.C. § 513 (a)(2) (Supp. 1984). The exception also applies to a trade or business conducted by a local association of employees described in § 501(c)(4) organized before May 27, 1969 "which is the selling by the organization of items of work-related clothes and equipment and items normally sold through vending machines, through food dispensing facilities, or by snack bars, for the convenience of its members at their usual places of employment. . . ." *Id.*

A. *Limited Eligibility*

All organizations subject to the unrelated business income tax may take advantage of the volunteer and donations exceptions. In contrast, the convenience exception is available only for charitable organizations described in section 501(c)(3) and state colleges and universities described in section 511(a)(2)(B).

Although the limited eligibility for the convenience exception is clear from the statute, it was reiterated in a recent ruling by the I.R.S. In Technical Advice Memorandum 8429010,⁶⁴ the Service considered whether various activities of an agricultural organization described in section 501(c)(5) generated unrelated business taxable income. One of the organization's activities was the purchase of supplies at wholesale for resale to its members. The organization claimed that the sale of supplies was undertaken primarily for the convenience of its members.⁶⁵ The Service ruled that income from the sale of supplies was subject to taxation because the sales activity was not related to the exempt purposes of the organization. With regard to the application of the convenience exception, the Service stated that the exception does not apply to a section 501(c)(5) organization unless the organization is also a section 501(c)(3) organization.⁶⁶

B. *"Primarily for the Convenience Of"*

In order to be subject to the exception under section 513(a)(2), the trade or business must be carried on primarily for the convenience of persons in the specified categories. The use of the term "primarily" recognizes that a trade or business may be pursued for more than one

⁶⁴ 386 I.R.S. Ltr. Rul. (CCH) T.A.M. 8429010.

⁶⁵ *Id.* The organization also sold seed to corn producers, an activity that was ruled to be related to its exempt purposes. The organization stated that the sale of supplies was convenient for small producers because they could obtain lower prices from the organization and because they could pick up their supplies along with the seed. *Id.*

⁶⁶ *Id.*

purpose. If a business serves multiple purposes, the exception is not available unless the primary purpose is the convenience of members, patients or others.

In *American College of Physicians v. United States*,⁶⁷ an organization of physicians published a journal of scholarly articles pertaining to the practice of internal medicine. Each issue of the journal contained advertising relating to medical products and classified notices regarding employment opportunities in medicine. The government sought to tax the income from the commercial and classified advertising as unrelated business taxable income. One of the issues considered by the Court of Claims was the applicability of the convenience exception to the advertising business.⁶⁸ The court held that the exception did not apply, partially because the primary purpose test was not satisfied.⁶⁹ According to the court, any convenience to the readers of the journal was incidental to the primary purpose of raising revenue from the sale of advertising.⁷⁰

The term "primarily" refers to the purpose of the business activity rather than to the persons whose convenience is served. Revenue Ruling 68-374⁷¹ involved the sale of pharmaceutical supplies by a hospital pharmacy. Sales to hospital patients represented the primary source of the pharmacy's income. A small percentage of income was derived from members of the general public who were not patients of the hospital. Since the pharmacy received its income principally from hospital patients, it might be assumed that the pharmacy business is operated

⁶⁷ 83-2 U.S.T.C. ¶ 9652 (Cl. Cl. 1982), *rev'd on other grounds*, 743 F.2d 1570 (Fed. Cir. 1984).

⁶⁸ The primary issue in the case was whether the sale of advertising was related to the exempt purposes of the organization. The Court of Claims held that the advertising was not related because it did not contribute importantly to the organization's exempt function. 83-2 U.S.T.C. at 88,339. This conclusion was reversed on appeal in a surprising departure from the traditional position of the courts and the Service with regard to advertising. 743 F.2d 1570.

⁶⁹ 83-2 U.S.T.C. at 88,340.

⁷⁰ *Id.* See also 375 I.R.S. Ltr. Rul. (CCH) T.A.M. 8418002 (exception inapplicable where primary purpose of sale of advertising was generation of income rather than convenience of members).

⁷¹ Rev. Rul. 68-314, 1968-2 C.B. 243.

primarily for the convenience of the patients within the meaning of section 513(a)(2). The Service, however, considered the pharmacy to be engaged in two distinct businesses: the sale of pharmaceutical supplies to patients and the sale of pharmaceutical supplies to nonpatients. The sale of supplies to patients is covered by the convenience exception.⁷² In contrast, the sales to nonpatients generate unrelated business taxable income.⁷³

On at least one occasion, the I.R.S. has urged an unnecessarily strict interpretation of the phrase "primarily for the convenience of." The decision in *St. Luke's Hospital v. United States*⁷⁴ addressed the taxability of income derived by a hospital from the performance of pathology tests. The tests were conducted largely for staff physicians in connection with their private practices. The District Court for the Western District of Missouri held that the private pathology testing was related to the exempt purposes of the hospital because the testing contributed importantly to its teaching function.⁷⁵ As an independent basis for refusing to tax the income in question, the district court concluded that the convenience exception applied to the pathology testing.⁷⁶ The government contended that the exception was inapplicable because the performance of the tests was not primarily necessary for the convenience of the staff doctors. The court rejected the government's attempt to impose a necessity requirement. According to the court, the hospital did not need to demonstrate the other alternatives were unavaila-

⁷² *Id.*

⁷³ An earlier revenue ruling suggests a contrary approach. In Rev. Rul. 55-676, 1955-2 C.B. 266, 267, a university owned a laundry and dry cleaning plant "which is operated primarily to serve the student body and members of the faculty, although the general public may be served." The Service ruled that the business was operated primarily for the convenience of the university's students, officers and employees within the meaning of § 513(a)(2). *Id.* It is clear that the I.R.S. would not presently follow Rev. Rul. 55-676 to the extent that it implies that services for or sales to persons not within the specified categories are subject to the convenience exception.

⁷⁴ 494 F. Supp. 85 (W.D. Mo. 1980).

⁷⁵ *Id.* at 90.

⁷⁶ *Id.* at 92.

ble to the physicians for the pathology tests but was only required to show that the tests were conducted primarily for the convenience of the physicians.⁷⁷

The *St. Luke's Hospital* case is also significant because it elaborated on the meaning of the term "convenience." The district court found that the performance of the tests by the hospital's pathology department served the convenience of the physicians in several respects. Most of the staff physicians who used the testing service maintained offices across the street from the hospital. The physical proximity made it easy for the doctors to transfer specimens, consult with the pathologists and review slide specimens. If the tests indicated a need for hospitalization, the same pathologist would be available to review further tests on the patient. Finally, the doctors relied on the high quality of work done at the hospital. All of these factors indicated that the pathology tests were performed primarily for the convenience of the hospital medical staff.⁷⁸

C. *The Specified Categories*

In order to be excepted from the term "unrelated trade or business" under section 513(a)(2), a business must be conducted for the convenience of the organization's members, students, patients, officers or employees.⁷⁹ Several cases and rulings have considered whether persons whose convenience is served were individuals within the relationships specified in the statute.

Considerable attention has been focused on the meaning of the term "patients" for purposes of the convenience exception. In Revenue Ruling 68-376,⁸⁰ the I.R.S. gave examples of contexts in which persons who purchase pharmaceutical supplies from a hospital pharmacy will be considered patients within the meaning of section

⁷⁷ *Id.* at 93.

⁷⁸ *Id.* at 92.

⁷⁹ I.R.C. § 513(a)(2) (1985).

⁸⁰ 1968-2 C.B. 246.

513(a)(2). The following persons qualify under the ruling as patients of a hospital: (1) a hospital inpatient; (2) a person receiving general or emergency diagnostic, therapeutic or preventive health services from hospital outpatient facilities; (3) a person directly referred to hospital outpatient facilities by a private physician for specific diagnostic or treatment procedures; (4) a person who refills a prescription written during the course of treatment as a hospital patient; (5) a person receiving medical services from a hospital administered home care program; and (6) a person receiving medical services in an extended care facility affiliated with the hospital.⁸¹ The illustrations from the ruling indicate that a person's status as a hospital patient depends on his relationship to the hospital and its facilities. A buyer-seller relationship between a pharmacy patron and a hospital pharmacy is clearly not sufficient to classify the patron as a patient of the hospital for purposes of the exception.⁸²

In *Carle Foundation v. United States*,⁸³ a hospital pharmacy sold pharmaceutical supplies to a nonexempt clinic and its patients. The hospital was staffed almost entirely by doctors from the clinic located within the hospital complex. The hospital and the clinic shared certain facilities, equipment and services. The Seventh Circuit Court of Appeals held that the patients of the clinic were not patients of the hospital for purposes of the convenience exception.⁸⁴ Since the sale of pharmaceutical supplies to the clinic and its patients did not further the hospital's exempt purposes, income from the sales was subject to the tax under section 511.⁸⁵

In contrast to *Carle Foundation*, Technical Advice Memo-

⁸¹ *Id.* at 247-48.

⁸² Rev. Rul. 68-374, 1968-2 C.B. 243, 244.

⁸³ 611 F.2d 1192 (7th Cir. 1979), *rev'g* 78-1 U.S. Tax Cas. (CCH) ¶ 9369 (E.D. Ill. 1978).

⁸⁴ 611 F.2d at 1196. *Accord* Rev. Rul. 68-375, 1968-2 C.B. 245.

⁸⁵ *Id.* at 1198.

randum 8349006⁸⁶ illustrates an arrangement in which patients of a proprietary clinic were also deemed patients of a hospital. In the memorandum, virtually all of the clinic patients received laboratory or other testing at the hospital and the clinic was an integral part of the hospital's facilities.⁸⁷ Pharmaceutical sales to the clinic's patients were covered by the convenience exception because such patients were also patients of the hospital.⁸⁸

The meaning of the term "members" as used in section 513(a)(2) is subject to some controversy. In *St. Luke's Hospital*,⁸⁹ a hospital performed pathology tests for staff physicians in connection with their private practices. The government contended that the convenience exception was not applicable because the physicians were neither members nor employees of the hospital under section 513(a)(2).⁹⁰ Adopting a broad definition of the term "members," the district court stated that such term "refers to any group of persons limited in size who are closely associated with the entity involved or who are necessary to the achievement of the organization's purposes."⁹¹ The doctors were members of the hospital under this definition because they were indispensable to its operation.⁹² The court justified its construction of the term "members" in the following manner:

[G]iving members a broader meaning than the excessively literal meaning advocated by defendant is consistent with the legislative purpose underlying the unrelated business provisions and consistent with the rule requiring a liberal interpretation of statutory provisions which favor tax exemption. By permitting exempt organizations to furnish services to people closely associated with the achievement of its goals, the exempt purposes of the organization are

⁸⁶ 354 I.R.S. Ltr. Rul. (CCH) T.A.M. 8349006. See also 259 I.R.S. Ltr. Rul. (CCH) 8206093 (Nov. 10, 1981).

⁸⁷ 354 I.R.S. Ltr. Rul. (CCH) T.A.M. 8349006.

⁸⁸ *Id.*

⁸⁹ *St. Luke's Hosp. v. United States*, 494 F. Supp. 85 (W.D. Mo. 1980).

⁹⁰ *Id.* at 87.

⁹¹ *Id.* at 92.

⁹² *Id.* at 92-93.

directly furthered and the [competitive] effects of the activity restricted.⁹³

The Internal Revenue Service does not follow the broad definition of members enunciated in *St. Luke's Hospital*. Technical Advice Memorandum 8131063⁹⁴ involved facts virtually identical to the facts in *St. Luke's Hospital* in that the hospital performed laboratory testing for staff physicians in connection with their private practices. The Service stated that, despite the important role staff physicians played in the hospital's operation, they were not members of the hospital within the meaning of section 513(a)(2).⁹⁵ The Service ruled that the convenience exception was inapplicable and the income from laboratory testing performed for the staff physicians in their private practices was subject to taxation.⁹⁶

Although the broad definition of "members" favored by the *St. Luke's Hospital* court may have achieved a result consistent with the purpose of the exception, the literal construction followed by the I.R.S. in Technical Advice Memorandum 8131063 is likely to prevail in most forums. Section 513(a)(2) lists five categories of individuals whose convenience must be served by the conduct of the business.⁹⁷ Staff physicians who are not employees of a hospital do not fall within the generally accepted definitions of any of the specified categories. Patients and employees of a hospital would meet the definition of members under the *St. Luke's Hospital* case because such groups are necessary to the achievement of a hospital's purposes. Yet patients and employees are expressly provided for under the statute.⁹⁸ The listing of specific categories reflects a Congressional intent to exclude from the scope of the exception businesses that serve the convenience of individuals not falling within the accepted definitions of the catego-

⁹³ *Id.* at 93.

⁹⁴ 232 I.R.S. Ltr. Rul. (CCH) T.A.M. 8131063.

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ I.R.C. § 513(a)(2) (1985).

⁹⁸ *Id.*

ries. Moreover, the definition of members under *St. Luke's Hospital* might lead to an unwarranted expansion of the scope of the exception. Under that definition, for examples, alumni of a university or patrons of an art museum might be considered members for purposes of the exception. Such an extension of the exception to the individuals not expressly provided for might lead to the type of unfair competition sought to be restricted by the unrelated business income tax.

The Court of Claims adopted a restrictive approach to the term "members" in *American College of Physicians*,⁹⁹ in which the court discussed the applicability of the exception to medical and classified advertising in a medical journal. According to the Court of Claims, the exception is not available unless the business is conducted for the convenience of the organization's members "in their capacity as members."¹⁰⁰ The court explained the distinction between the readers of the journal in their capacities as physicians and the readers in their capacities as members of the organization:

The members' interests as members concern such matters as attending the College's educational functions, participating in research and testing, disseminating health information to the public and promoting quality medical education. The members' interests as physicians are much broader and include all of the aspects of medical practice.¹⁰¹

The Court of Claims concluded that the advertising in the journal had no connection with the members in their capacities as members of the organization, although it may serve the convenience of the members in their capacities

⁹⁹ *American College of Physicians v. United States*, 83-2 U.S. Tax Cas. (CCH) ¶ 9652 (Ct. Cl. 1983), *rev'd*, 743 F.2d 1570 (Fed. Cir. 1984). The Court of Claims stated that under a broader construction "there would be no end to the types of goods or services an organization could provide its members while avoiding tax on the income so derived." U.S. Tax Cas. (CCH) at 88,340.

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

as physicians.¹⁰²

A citation to *St. Luke's Hospital in American College* implied that the Court of Claims viewed the decision in *St. Luke's Hospital* as consistent with its approach to the term "members."¹⁰³ In *St. Luke's Hospital*, however, the hospital performed pathology tests for staff physicians in connection with their private practices.¹⁰⁴ The testing services furthered the convenience of the physicians in their capacities as private physicians rather than in their capacities as staff members of the hospital. Thus, contrary to the implication of the Court of Claims, the *St. Luke's Hospital* case does not support the Court of Claims' construction of the term "members."¹⁰⁵

The restriction adopted by the court in *American College* is not required by the language of section 513(a)(2). Rather, the statute apparently assumes that a business carried on for the convenience of members will not involve the type of unfair competition sought to be eliminated by the tax either because it is sufficiently related to the organization's exempt function or sufficiently limited in scope. The restrictive approach to the convenience exception in *American College* should not be followed because it is not supported by the language of the Code and is not necessary to accomplish the intent of the unrelated business income tax.

¹⁰² *Id.* The convenience exception would not have applied even absent the court's construction of the term "members" because the advertising was conducted primarily to raise funds rather than for the convenience of the members. *Id.*

¹⁰³ *Id.*

¹⁰⁴ 494 F. Supp. at 87.

¹⁰⁵ *Cf.* Rev. Rul. 69-69, 1969-1 C.B. 159, which involved an organization formed to promote the arts. Among its activities were the leasing of studio apartments to artists and the operation of a dining hall for the benefit of the tenants. *Id.* A few of the artists who leased apartments were members of the organization. The convenience exception was not applicable because occupancy in the apartments was not primarily for the convenience of members. *Id.* The language of the ruling suggests that the exception would have been available if the apartments had been leased only to members who were artists. If so, the activity would have served the interests of the members in their capacities as artists and individuals rather than in their capacities as members of the organization.

The persons whose convenience is served under section 513(a)(2) must stand in one of the specified relationships to the organization that is seeking to apply the exception. Revenue Ruling 81-19¹⁰⁶ involved an organization formed to assist a university. The activities of the organization included the receipt of contributions for the benefit of the university and the management of vending machine facilities on the university campus. If the university operated the vending facilities itself, the business would be covered by the convenience exception. The exception does not apply, however, when one organization conducts a business for the convenience of students or employees of another organization.¹⁰⁷ Nonetheless, income from the vending facilities was not subject to taxation because the activity was found to be related to the organization's exempt purpose.¹⁰⁸

D. S.B.A. Proposal to Repeal Exception

In a 1983 report, the Small Business Administration argued that, despite the unrelated business income tax, commercial activities of exempt organizations are competing unfairly with taxable businesses in such areas as merchandise sales, health care, travel, research and data processing.¹⁰⁹ Among other solutions to the perceived problem, the S.B.A. advocated the repeal of the convenience exception.¹¹⁰ According to the report, activities covered by the exception "should be sufficiently related to the purpose or function of the nonprofit [organization] so that a special exemption is not needed to allow them to be conducted without taxation."¹¹¹

¹⁰⁶ 1981-1 C.B. 353.

¹⁰⁷ *Id.* at 354.

¹⁰⁸ *Id.*

¹⁰⁹ S.B.A. Report, *supra* note 19, at 1.

¹¹⁰ *Id.* at 44. The report also advocated: (1) a higher tax on unrelated business activities; (2) the prohibition of unrelated business activities; (3) a stricter definition of what constitutes a related business; and (4) a specific limit on the level of business activities. *Id.* at 42-44.

¹¹¹ *Id.* at 44.

An analysis of the cases and rulings applying the exception, however, reveals that in virtually all instances the exception has been applied to businesses that are in fact related to the exempt purposes of the organizations. In *St. Luke's Hospital*, for example, the outside pathology testing was a related business because it contributed importantly to the hospital's teaching function. The government contended, however, that the hospital should be barred under the variance rule from relying on the related nature of the business because the teaching function argument was not raised in the claim for refund.¹¹² Although the court saw no procedural barriers to the claims made by the hospital, it applied the convenience exception as an independent basis for holding that the income from the testing was not subject to the unrelated business income tax.¹¹³

Many of the cases and rulings applying the convenience exception involve pharmaceutical sales by hospital pharmacies. As discussed previously, the Service and the courts have evolved a definition of the term "patient" for purposes of the exception that requires a significant relationship between the person purchasing pharmaceutical supplies and the hospital and its services. The sale of pharmaceutical supplies by a hospital to its patients promotes the hospital's exempt purpose of providing medical care to its patients. Thus, the convenience exception is not required to exempt pharmaceutical sales to patients from the scope of the tax.

Furthermore, with the exception of the broad definition of the term "members" in the *St. Luke's Hospital* case, section 513(a)(2) has been applied in a manner consistent with the purpose of the unrelated business income tax. In some cases unnecessarily strict constructions have been adopted. For example, the Court of Claims in *American College* stated that the exception is inapplicable unless the

¹¹² *St. Luke's Hospital*, 494 F. Supp. at 91.

¹¹³ *Id.* at 91-93.

business serves the convenience of the organization's members in their capacities as members.

The exception plays a relatively minor role in the unrelated business income tax scheme because the exception typically applies to businesses that are related to the exempt purposes of the organizations. Although related businesses of exempt organizations may offer competition to taxable businesses, Congress chose not to subject related businesses to taxation. Consequently, contrary to the recommendation of the Small Business Administration, it is neither necessary nor desirable to eliminate the convenience exception.

IV. THE DONATIONS EXCEPTIONS

Under section 513(a)(3), the term "unrelated trade or business" does not include any trade or business "which is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions."¹¹⁴ The principal terms under the exception are "merchandise," "substantially all" and "gifts and contributions." The donations exception has received little attention in the cases and rulings.

A potential issue under the donations exception relates to the distinction between the sale of merchandise and the performance of a service. For example, in Revenue Ruling 78-145,¹¹⁵ the Service ruled that the sale by an exempt blood bank of blood plasma from donors is an unrelated trade or business in certain contexts.¹¹⁶ The applicability of the donations exception was not examined in the ruling. If blood plasma is considered merchandise, then income from the sale of blood plasma from donors should not be subject to taxation under the exception. Conversely, the donations exception is not applicable if the sale of blood plasma is treated as the performance of a service rather than the sale of a product.

¹¹⁴ I.R.C. § 513(a)(3) (1954).

¹¹⁵ 1978-1 C.B. 169.

¹¹⁶ *Id.* at 170.

Section 513(a)(3) is not applicable unless “substantially all” of the merchandise is donated to the organization. Technical Advice Memorandum 8122007¹¹⁷ involved an organization formed to provide employment, training and rehabilitation to handicapped persons. The organization operated goodwill stores for the sale of items that were contributed to it and refurbished by its employees in conjunction with their training. Under state law, used mattresses and pillows cannot be resold without fumigation. Thus, donated mattresses and pillows were sold by the organization for fumigation. It repurchased only enough mattresses needed to facilitate the sale of bedroom furniture refurbished by its employees. The sale of the repurchased mattresses represented less than five percent of the total sales. The Service ruled that substantially all of the merchandise was donated within the meaning of section 513(a)(3).¹¹⁸ The interpretation of the term “substantially all” under section 513(a)(1) and other related provisions under subchapter F is relevant to the construction of the identical term under the donations exception.¹¹⁹ Technical Advice Memorandum 8122007 is consistent with the eighty-five percent guideline suggested previously.

The legislative history of section 513(a)(3) clearly indicates that the donations exception was intended to exempt thrift shops from the scope of the unrelated business income tax.¹²⁰ The exception is most frequently applied in the context of selling donated consumer items such as clothing, furniture and furnishings in retail thrift stores.¹²¹ The language of section 513(a)(3), however, does not limit the donations exception to the traditional

¹¹⁷ 223 I.R.S. Ltr. Rul. (CCH) T.A.M. 8122007.

¹¹⁸ The Service also ruled that the sale of purchased mattresses was related to the organization's exempt function because it was an essential part of the sale of donated bedroom sets refurbished by its employees. *Id.*

¹¹⁹ See *supra* notes 35-48 and accompanying text.

¹²⁰ S. REP. NO. 2375, 81st Cong., 2d Sess. 29 (1950). See also Treas. Reg. § 1.513-1(e).

¹²¹ *E.g.*, Rev. Rul. 71-581, 1971-2 C.B. 236; 223 I.R.S. Ltr. Rul. (CCH) T.A.M. 8122007.

thrift shop setting. For example, in Private Letter Ruling 8116095,¹²² an organization proposed to solicit for resale contributions of home heating oil from consumers who had converted to gas heat. The I.R.S. ruled that the proposed fundraising activity would be subject to the donations exception.¹²³

V. CONCLUSION

Of the three exceptions to the term "unrelated trade or business" under section 513(a), the volunteer exception appears to be most widely used by exempt organizations to escape taxation of activities that would otherwise be subject to the unrelated business income tax. The convenience exception typically applies to businesses that would not be subject to tax because they are related to the exempt purposes of the organizations. The primary use of the donations exception is in the thrift shop context for which it was designed.

The exceptions have not operated to circumvent the purpose of the unrelated business income tax but have been applied in a manner that is consistent with the apparent intention of Congress in including them in the Revenue Act of 1950. Consequently, exempt organizations should be encouraged to take advantage of the exceptions to minimize their income tax liability.

¹²² 217 I.R.S. Ltr. Rul. (CCH) 8116095 (Jan. 23, 1981).

¹²³ In 264 I.R.S. Ltr. Rul. (CCH) T.A.M. 8211002, a membership organization of an art museum published and sold a cookbook. All recipes included in the cookbook were donated. The I.R.S. declined to consider the applicability of the donations exception because it ruled that the publication and sale of the book was excepted from the unrelated business income tax under § 513(a)(1).