

INTERNAL REVENUE SERVICE

CC:EBEO:6

November 24, 1998

UILC: 501.03-00

Number: **199910007**

Release Date: 3/12/1999

Associate District Counsel, Delaware-Maryland CC:SER:DEM:WAS

Assistant Chief Counsel CC:EBEO

Internal Revenue Service National Office Field Service Advice

This Field Service Advice responds to your memorandum dated August 28, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

Organization =

ISSUE:

What facts and legal theories should the Service consider in determining whether section 501(c)(3) status should be revoked due to a small amount of funds being contributed to charity.

CONCLUSION:

We agree with your conclusion that section 501(c)(3) status should not be revoked based solely on the small amount of funds contributed to charity, as compared to gross receipts. The "commensurate-in-scope test," as first enunciated in Rev. Rul. 64-182, should be applied as part of an analysis of the primary purpose of an organization based on the specific facts and circumstances.

FACTS:

Each of the four charities, pursuant to a contract with Organization, conducts an annual professional sports tournament and contributes the net proceeds to another section 501(c)(3) charity. The charities transfer media broadcast rights to Organization, in exchange for Organization providing of the monetary awards for the winners of each tournament. Organization requires the charities to obtain tournament liability insurance that covers Organization, to enter into certain

sponsorship contracts, and to award specified amounts of money to the sports professionals who win the tournaments.

Tournament activities are usually conducted by the charities' tournament staffs, local volunteers, employees of Organization and a management company hired by each charity. Bonuses are paid to the to the management company based on the increase in corporate sponsors and revenue of the tournaments from one year to the next. Tournaments are funded primarily by corporate sponsors and broadcast revenue. Corporate sponsors receive tickets to the tournaments, access to hospitality pavilions and celebrity dinners.

The monetary awards paid to the winning sports professionals are the largest category of tournament expenses. Purses in this sport have increased greatly in recent years in order to attract the top professionals. As a result of increased expenses, the tournament organizers have contributed only small amounts, generally less than % of gross revenues, to other section 501(c)(3) charities.

#### LAW AND ANALYSIS:

Section 501(a) exempts from federal income taxation organizations described in section 501(c)(3), including those which are "organized and operated" exclusively for charitable purposes.

An organization that confers no benefits directly on the community but exists solely for the purpose of distributing its income to other tax-exempt organizations at the discretion of its trustees or directors may itself be an organization described in section 501(c)(3). That is, the making of voluntary contributions to charity shows a charitable purpose which may suffice for section 501(c)(3) purposes. This principal was recognized in Rev. Rul. 67-149, 1967-1 C.B. 133. Although Rev. Rul. 67-149 concerned an organization whose only income was from contributions and investments, the same principle was applied in Rev. Rul. 64-182, 1964-1 C.B. 186, to an organization that derives its income principally from the rental of space in a large commercial office building that it owns and operates, and makes contributions to charitable organizations. The Service held that such an organization can itself be exempt as an organization described in section 501(c)(3), if the amount of contributions shows that it is carrying on "a charitable program commensurate in scope with its financial resources."

The commensurate-in-scope test originated with a memorandum prepared by the Exempt Organization Council concerning the application of the "primary purpose" test enunciated in Treas. Reg. §1.501(c)(3)-1(e)(1). The Exempt Organization Council took the position that an exemption under section 501(c)(3) should not be denied if the facts show that the organization is engaged in carrying on a real and substantial charitable program reasonably commensurate with its

financial resources. See Exempt Organization Council Memorandum (EOC/OP), dated Feb. 11, 1964, attached to GCM 32689, I-795 (April 27, 1964).

The commensurate-in-scope test is a factual test or test of proof of charitable purpose. The commensurate-in-scope test has been used primarily to support the recognition of exempt status under section 501(c)(3) for organizations that confer no benefits on the community, but exist solely for the purpose of distributing income to other section 501(c)(3) organizations. See Rev. Rul 1964-182; Rev. Rul. 67-149; TAM 9711003.

The charities in this case were formed for the purpose of distributing the net proceeds from the operation of annual sports tournaments to other section 501(c)(3) charities. The rapid rise in monetary awards for winners of professional events in this sport increased tournament expenses and reduced the funds available for contributions to other section 501(c)(3) charities. The primary purpose of the charities' operation of annual sports tournaments has not changed because of these increased expenses.

You have also raised questions regarding inurement and private benefit, due to the close relationship between the charities and Organization. The mere fact that payments are made to a related party is not a sufficient basis for concluding that inurement exists, especially where, as here, that party is also subject to the private inurement prohibition. Similarly, private benefit will be difficult to establish, as the "benefits" appear to flow from Organization to public charities.

The professional participants in these sports tournaments receive a large monetary award if they win. However, they may chose whether or not to participate in a particular event. The purpose of the large awards is to attract the top professionals in order to increase support for these events. There is no basis for asserting inurement or private benefit to the individual winning professionals.

Finally, you question whether the charities' earnings inure to or serve the private interests of corporate sponsors who receive certain benefits, such as tickets to tournaments and celebrity dinners. Section 513(i) provides that unrelated trade or business does not include the activity of soliciting and receiving qualified sponsorship payments. "Qualified sponsorship payments" 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 the use or acknowledgment of the name or logo (or product lines) of the person's trade or business in connection with the organization's activities. Legislative history provides that the "provision of facilities, services or other privileges by an exempt organization to a sponsor or the sponsor's designees (e.g., complimentary tickets, pro-am playing spots in golf tournaments, or receptions for major donors) in connection with a sponsorship payment will not affect the determination of whether

the payment is a qualified sponsorship payment. Rather, the provision of such goods or services will be evaluated as a separate transaction in determining whether the organization has unrelated business taxable income from the event.” H.R. Rep. No. 220, 105<sup>th</sup> Cong., 1<sup>st</sup> Sess. 475 (1997). This legislative history is consistent with Prop. Treas. Reg. §1.513-4(2)(f), 58 Fed. Reg. 5687 (1993). Therefore, we do not believe that there is inurement or private benefit on this basis.

If you have any further questions, please call (202) 622-6080.

MARY E. OPPENHEIMER

By: Regina L. Oldak  
REGINA L. OLDAK  
Assistant Chief  
Branch 6