

Internal Revenue Service

# memorandum

date: December 16, 1999

to: Acting EO Area managers

from: Director, Exempt Organizations Division

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subject: Royalties - Mailing Lists and Affinity Credit Cards

The question of whether income from the rental of mailing lists and affinity credit card arrangements is subject to the unrelated business income tax has been an issue in many exempt organizations cases, including at least eight court cases, four of which have been decided in the past year.

With one exception, all of the court cases have been decided in favor of the taxpayer, i.e., the income from such arrangements is royalty income excluded by IRC 512(b)(2), rather than payment for services.

While we believe that in certain cases the income represents a payment for services provided by the exempt organizations, and the use of intangible property (the organization's name and membership), it is now clear that courts will continue to find the income to be excluded royalty income unless the factual record clearly reflects more than unsubstantial services being provided. Thus, further litigation in cases with facts similar to those decided in favor of the taxpayer should not be pursued. Accordingly, the suspense on these cases is being lifted as of the date of this memorandum and districts should close the cases.

Cases should be resolved in a manner consistent with the existing court cases. A list of the court cases is attached.

In the cases decided in favor of the taxpayer, the facts showed that the involvement of the exempt organization was relatively minimal, and the organizations generally hired outside contractors to perform most services associated with exploitation of the use of intangible property. Thus, courts concluded that the payment was for the intangible property rather than for the services of the organization's members or employees. In the one case decided in favor of the government - *Disabled American Veterans v. United States*, 650 F.2d 1178 Ct. Cl. (1981) - the organization's employees provided extensive services in connection with the list rentals.

Language in at least one of the court cases suggests that it may have been possible to allocate the payment between services and the intangible, but since the Service did not make the argument, the court did not consider it. The issue of allocation in these situations is currently under consideration in the National Office.

If you encounter a case in which the organization provides extensive services, or the facts indicate a good case for allocating the payment between services and the intangible, you may want to discuss the case with Charles Barrett (202) 622-8152, or Jay Rotz (202) 622-8100 of this office, and consider requesting technical advice.