



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: **200634036**
Release Date: 8/25/2006
Date: April 10, 2006

511.00-00
512.00-00
513.00-00

Contact Person:

Identification Number:

Telephone Number:

Fax Number:

Employer Identification Number:

A =
B =

Dear _____ :

We have considered A's ruling request regarding its income from the operations of a convention center.

A was formed in July 1997 to analyze the desirability and feasibility of constructing a new convention and/or arena facility within B's metropolitan area. Contingent upon the outcome of that analysis, the organization broadened its mission to facility site analysis and recommendation, cost analysis, and analysis of recommendations for various funding alternatives. As the convention center project evolved, so did the mission of the organization into overseeing the construction and operation of the facility.

A is an organization described in section 501(c)(3) of the Internal Revenue Code and is classified as a publicly supported organization under sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code.

In August 2000, A adopted its bylaws to provide for its continuing role in the construction and operation of the convention center. Operations of A in its current role commenced on August 25, 2000, when B approved an Agreement and Lease with A to implement the Convention Center/Arena Redevelopment Plan. The plan provided for the issuance of bonds to finance the design and construction the convention facility and arena.

A's governing body includes five directors appointed on an alternating basis by B's mayor and B's City Council. Title to the facility and all related infrastructure assets are vested with B. Construction costs, bond proceeds, and payments are not reflected in A's financial

records as they are accounted separately by B. A's financial records include only the contributions generated from the public and its own operating expenses. When the facility opens, the revenues and expenses related to the facility's operations will also be included in its financial records. For financial reporting purposes, A is considered a component unit of B.

As part of the Agreement and Lease between A and B, A receives a subvention from B. The subvention is intended to cover operating costs and anticipated operating losses incurred from the operation of the facility. If A's fund balance exceeds a specified level, the amount of the subvention will be decreased. Upon the dissolution of A its assets will be distributed to B. A anticipates that the largest source of revenue from the operation of the convention and arena facility will be rental income. In addition to the rent, users will be charged for various services in connection with their use of the facility.

Tickets for events held at the convention center and arena will be available for sale from the facility box office, from A's exclusive ticket agencies and other ticket outlets recognized and pre-approved by A.

The facility will house a box office, which will sell tickets for all events at the convention center/arena. A will directly collect the revenue from these sales. Additionally, ticket locations at the two local universities, which will use the facility for basketball and hockey games, will also be outlets of A's box office.

The majority of events will have an outside event promoter. A will collect the ticket revenue for the promoter and then remit the revenue to the promoter, less any sales tax, and other costs as specified in A's contract with the promoter. In return for box office services and labor, A will charge the promoter % of ticket sales, up to a \$ cap. A will charge the promoter % of all sales made via credit card to cover credit card processing fees. A will also receive a % commission from event promoters for organizing group ticket sales, such as selling large blocks of tickets to local businesses. In rare cases, A may serve as the event organizer/promoter, in which case, A will retain a portion of the ticket revenue.

Each ticket sold for events at the facility will include a service charge of \$ to \$ charged to the consumer, of which B will receive \$. A will retain the remainder.

The majority of the events will also be ticketed by an outside ticketing agency. The ticketing agency will remit the ticket revenues to A, which will subsequently remit to the event promoter as indicated above. The ticketing agency will remit a royalty to A that is a stated dollar amount of the convenience charge the ticketing agency charges its customers. The ticketing agency will also pay A an annual advertising allowance to cover advertising costs incurred by A.

A has entered into a management contract with a single outside service provider ("caterer") for all sales of food and beverage at the facility, including alcoholic beverages, branded products, and all cafeteria, catering, club, concession, suite, and vending machine sales.

Under the terms of the contract, the caterer will be fully responsible for all foodservice activities and will collect all revenues and pay expenses as enumerated in the contract,

including hiring its own employees and maintaining all of its equipment and leasehold improvements. Under the agreement, the caterer will pay a fix rent, and an annual Incentive amount tied to gross receipts.

At this time, no formal plans exist for a permanent gift shop at the facility. However, it has been determined that such a gift shop would be operated under contract with an outside service provider.

The other merchandise sales that will occur at the facility will be sales of merchandise by the promoter during and immediately preceding and following the promoter's event. These sales will occur at kiosks stationed throughout the facility. The same outside service provider contracted for foodservice will operate the kiosks in most cases. As payment for the kiosks, the caterer will collect a negotiated percent of the gross merchandise sales that will in turn be passed through A, along with labor costs per the catering contract.

At certain events, the event promoter may provide its own staff. A will negotiate contracts with promoters, but A will take no part in the selection or purchase of inventory, will not bear any risk of loss, and will not staff the kiosks with its employees.

A has extensive plans for contracting with sponsors on both a long-term and single event basis. Long-term sponsors will enter into an industry exclusive sponsorship contract with A, which will grant the sponsor the right to be the exclusive sponsor from their respective industry. In most cases, the sponsors will be afforded permanent signage and/or artwork within the facility. The signage will not make comparative statements about the sponsor's product. For example, A has entered into such a contract with a beverage provider to be the exclusive provider of soft drink products at the facility in exchange for donated menu boards and other signage for the facility. Similarly, an agreement is in place with a bank to be the exclusive provider of automated teller machines at the facility. A will also enter into short-term contracts with sponsors. The media available to those sponsors, in return for their sponsorship, include signage placed directly over the tunnel leading to team locker rooms at sporting events, LED ribbon panels located along the facade of the arena seating levels, scoreboard signage, concourse signage and other prominent areas within the arena as well as the convention center.

Parking at the facility will be available only for event patrons and will not be available to the public for daily parking. The parking facility will not be operated with a profit motive. A will retain percent of the revenues to maintain and staff the parking facility and will remit the remaining percent to B.

Because of the national scale sporting events planned for the facility, broadcasting vehicles will be provided a location to park and have access to electricity. The broadcasting companies will pay A a fixed fee for access to this service.

A business center housed within the facility will be available for users of the facility only. It will not be open for general public use. The center will include copy machines, fax machines, telephone connections, etc. The center will not be staffed, but rather the machines will accept

credit cards from customers. The same company contracted to provide audio/visual services will maintain and stock the center. A will receive % of each month's gross revenues in excess of \$.

A will offer the right to purchase suite and club seating at the arena. The amount paid to purchase suite and club seating will include both a tax-deductible donation component as well as a non-deductible component representing the fair value of the goods and services received by the purchaser. One of the local universities that will use the facility has chosen to retain the right to sell suite and club seating and parking spaces for its events and has agreed to reimburse A an annual stipend to cover A's lost revenue.

A has entered into a contract with a third party for the naming rights to the facilities. The contract will be for a period of time with the option to renew the contract at the end of the term. In return for a specified yearly royalty payment, the private party will determine the official name of the facility. The receipts from this contract have been identified to be remitted to A in accordance with the first amendment of the Agreement and Lease between A and B.

The facility will house banks of pay telephones operated by a telephone company. A will receive a percentage of the gross revenues collected by the phone company. Similarly, a local bank will provide, operate, and maintain automated teller machines at the facility, and A will receive a per-transaction amount from the bank.

The following rulings have been requested:

1. The facility rental activities will not constitute an unrelated trade or business under section 513 of the Code and will not be subject to the tax imposed under section 511 of the Code as the activity is substantially related to A's exempt purposes.
2. That the additional charges to the facility users to cover various services in connection with the use of the facility, such as additional security services, medical services and insurance, do not constitute an unrelated trade or business under section 513 of the Code and will not be subject to the tax imposed by section 511 of the Code as the activities are substantially related to A's exempt purpose.
3. The labor and services provided by A's employees will not constitute an unrelated trade or business under section 513 of the Code and will not be subject to the tax imposed by section 511 of the Code as the activities are substantially related to A's exempt purpose.
4. That the facility equipment rental will not constitute an unrelated trade or business under section 513 of the Code and will not be subject to the tax imposed by section 511 of the Code as the activities are substantially related to A's exempt purpose.
5. That the income received for each equipment item rented and the hourly fee for ballroom rigging and audiovisual work will not constitute an unrelated trade or business under section 513 of the Code and will not be subject to the tax imposed by

section 511 of the Code as the activities are substantially related to the A's exempt purpose.

6. That freight services charges will not constitute an unrelated trade or business under section 513 of the Code and will not be subject to the tax imposed by section 511 of the Code as the activities are substantially related to A's exempt purpose.
7. The sale of tickets will not constitute an unrelated trade or business under section 513 of the Code and will not be subject to the tax imposed by section 511 of the Code as the activities are substantially related.
8. The catering, concessions, and vending activities will not constitute an unrelated trade or business under section 513 of the code and will not be subject to the tax imposed by section 511 of the Code as the activities are substantially related to A's exempt purpose.
9. The sale of merchandise will not constitute an unrelated trade or business under section 513 of the Code and will not be subject to the tax imposed by section 511 of the Code as the activities are substantially related to A's exempt purpose.
10. That the income from the sponsorship agreements will not constitute an unrelated trade or business under section 513 of the Code and will not be subject to the tax imposed by section 511 of the Code as the activities are substantially related.
11. That income generated from the parking garage and parking lots will not constitute an unrelated trade or business under section 513 of the Code and will not be subject to the tax imposed by section 511 of the Code as the activities are substantially related to A's exempt purpose,
12. The fees charge for parking and electricity charge to broadcasting vehicles will not constitute an unrelated trade or business under section 513 of the code and will not be subject to the tax imposed by section 511 of the Code as the activities are substantially related to A's exempt purpose.
13. The services provided by the business center will not constitute an unrelated trade or business under section 513 of the Code and will not be subject to the tax imposed by section 511 of the Code as the activities are substantially related to A's exempt purpose.
14. The sale of suite and club seating rights will not constitute an unrelated trade or business under section 513 of the code and will not be subject to the tax imposed by section 511 of the Code as the activities are substantially related to A's exempt purpose.
15. The income generated from naming rights will not constitute an unrelated trade or business under section 513 of the Code and will not be subject to the tax imposed by

section 511 of the Code as the activities are substantially related to the A's exempt purpose

16. The revenue received from outside vendors that provide telephones and ATMs for the convenience of persons attending functions at the facilities are not an unrelated trade or business under section 513 of the Code and will not be subject to the tax imposed by section 511 of the Code as the activities are substantially related to A's exempt purpose

Section 501(a) of the Internal Revenue Code provides that an organization shall be exempt from taxation if it is an organization described in subsection (c) or (d) of the same section. Subsection (c) of section 501 includes in its list of organizations qualifying for tax-exempt status under section 501(a) organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-I(d)(2) of the Income Tax Regulations provides that the term charitable as used in section 501(c)(3) of the Code is to be construed in its generally accepted legal sense and may include erection or maintenance of public buildings, monuments, or works and lessening the burdens of government.

Revenue Ruling 85-1, 1985 C.B. 177 provides that the determination is based upon the following two considerations whether the organization's activities are activities that a governmental unit considers to be its burdens, and whether such activities actually "lessen" such governmental burden.

An activity is a burden of the government if there is an objective manifestation by the government unit that it considers the activities of the organization to be its burden. Such consideration may be evidenced by the interrelationship between the governmental unit and the organization. In this context, the lessening of the burdens of government is determined by considering all relevant facts and circumstances; however a favorable working relationship between the government and the organization is strong evidence that the organization is actually "lessening" the burdens of the government.

Section 511 of the Code imposes tax on the unrelated business taxable income of organizations described in section 501(a). Unrelated Business Taxable Income is defined in section 512 of the Code as the gross income derived by any organization from unrelated trade or business, as defined in section 513 of the Code, regularly carried on by it, less the deductions allowed by the same chapter, which are directly connected with the carrying on of such trade or business.

Section 513 of the Code provides that unrelated trade or business is any trade or business, the conduct of 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 by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Section 1.513-1(d)(1) of the regulations states that the determination of whether a trade or business is substantially related to an organization's exempt purpose necessitates an examination of the relationship between the business activities that generate the particular income in question and the accomplishment of the organization's exempt purposes.

Section 1.513-1(d)(2) of the regulations states that a trade or business is related to an organization's exempt purpose, in the relevant sense only where the conduct of the business activities has casual relationship to the achievement of exempt purposes and it is "substantially related." For purposes of the definition under section 513 of the Code, the casual relationship should be a substantial one. For the conduct of trade or business to be substantially related to exempt purposes, the performance of services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Whether activities producing gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

Section 1.513-1(d)(3) states that the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function that they purport to serve.

Since its formation, A has overseen the implementation, design, construction, and operation and maintenance of a convention center and arena facility owned by B. B considers the operation of the facility to be its burden, a requirement set out in Revenue Ruling 85-1, supra. B assisted in the creation of A as an organization and as the project has progressed, vested in A an increasing level of responsibility for the facility. B maintains control over the organization through its appointment of the board of A and through its funding of the project via general obligation bonds. B has also contributed to the financial operations of A by providing an annual subvention to cover operation costs. A is considered a component unit of B for financial reporting purposes. B makes available on its website public notification of A's monthly board meetings and agendas.

If B had chosen to retain the burden of constructing and operating this facility, it would have engaged in the same types of activities because each of the activities enumerated above are essential to the operation of such a facility in a manner consistent to and competitive with other such facilities of this caliber. Because B is a governmental entity, it would not have been subject to the unrelated business income tax on its income from these activities. B instead passed its burden on to A.

A's purpose has now evolved into the operation of the facility. Addressed individually, the income producing activities carried on by A in operation of the convention center would likely be deemed unrelated to the accomplishment of a typical charitable organization's exempt purpose. However, when considering the facts and circumstances and the nature, scope and motivation for the activities, each is necessary for the accomplishment of A's charitable purpose of lessening the burdens of government. Therefore, the activities carried on by A are related to its purpose as an organization described in section 501(c)(3) of the Code and not subject to the tax imposed under section 511 of the Code.

This ruling is based on the understanding that there will be no material change in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Service. 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.

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

Because this letter could help resolve future questions about your federal tax responsibility, please keep a copy of this ruling 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.

Sincerely yours,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements