

Proposed Rule Making

DEPARTMENT OF THE TREASURY

Internal Revenue Service

[26 CFR Part 1]

TREATMENT OF INCOME FROM UNRELATED TRADE OR BUSINESS

Notice of Proposed Rule Making

Notice is hereby given that the regulations set forth in tentative form below are proposed to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury or his delegate. Prior to the final adoption of such regulations, consideration will be given to any comments or suggestions pertaining thereto which are submitted in writing, in duplicate, to the Commissioner of Internal Revenue, Attention: CC:LR, T., Washington, D.C. 20224, within the period of 30 days from the date of publication of this notice in the *FEDERAL REGISTER*. Any person submitting written comments or suggestions who desires an opportunity to comment orally at a public hearing on these proposed regulations should submit his request, in writing, to the Commissioner within the 30-day period. In such case, a public hearing will be held, and notice of the time, place, and date will be published in a subsequent issue of the *FEDERAL REGISTER*. The proposed regulations are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

[SEAL] SHELDON S. COHEN,
Commissioner of Internal Revenue.

In order to clarify the meaning of the terms "unrelated business taxable income" and "unrelated trade or business" as they relate to certain exempt organizations, the Income Tax Regulations (26 CFR Part 1) under sections 513 and 512 of the Internal Revenue Code of 1954 are amended as follows:

PARAGRAPH 1. Paragraphs (b) and (c) of § 1.513-1 are respectively redesignated as paragraphs (e) and (f), and § 1.513-1 is otherwise amended to read as follows:

§ 1.513-1 Definition of unrelated trade or business.

(a) *In general.* As used in section 512 the term "unrelated business taxable income" means the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the deductions and subject to the exceptions, additions, and limitations provided in section 512. Section 513 specifies with certain exceptions that the phrase "unrelated trade or business" means, in the case of an organization subject to the tax imposed by section 511, 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 (or, in the case of an organization described in sec. 511(a)(2)(B), to the exercise or performance of any purpose or function described in sec. 501 (c)(3)). (For certain exceptions from this definition, and a special rule for certain publishing businesses, see paragraphs (e) and (f) of this section. For a special definition of "unrelated trade or business" applicable to certain trusts, see sec. 513(b).) Therefore, unless one of the specific exceptions of section 512 or 513 is applicable, gross income of an exempt organization subject to the tax imposed by section 511 is includible in the computation of unrelated business taxable income if (1) it is income from trade or business, (2) 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 and (3) such trade or business is regularly carried on by the organization.

(b) *Trade or business.* For the purposes of section 513 the term "trade or business" has the same meaning it has in section 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services. The term "trade or business" thus is not limited to integrated aggregates of assets, activities and good-will which comprise businesses for the purposes of certain other provisions of the Internal Revenue Code. Activities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Thus, for example, the regular sale of pharmaceutical supplies to the general public by a hospital pharmacy does not lose identity as trade or business merely because the pharmacy also furnishes supplies to the hospital in accordance with its exempt purposes. Similarly, activities of soliciting, selling, and publishing commercial advertising do not lose identity as trade or business even though the advertising is published in an exempt organization periodical which contains editorial matter related to the exempt purposes of the organization.

(c) *Regularly carried on.* (1) *General principles.* In determining whether trade or business from which a particular amount of gross income derives is

"regularly carried on," within the meaning of section 513, regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued. This requirement must be applied in light of the fundamental purpose of the unrelated business income tax to place the business activities of exempt organizations upon the same tax basis as commercial endeavors with which they compete. Hence, 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 nonexempt organizations.

(2) *Application of principles.*—(i)

Normal time span of activities. 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. For example, the operation of a sandwich stand by a hospital auxiliary for the 2-week period of an annual state fair would not be the regular conduct of trade or business. However, the conduct of year-round business activities for one day each week would constitute the regular carrying on of trade or business. Thus, the operation of a commercial parking lot on Saturday of each week would be the regular conduct of trade or business. 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. For example, the operation of a track for horse racing for several weeks each year would be considered the regular conduct of trade or business because it is usual to carry on such trade or business only during a particular season.

(ii) *Commercial attributes of intermittent activities.* 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 nonexempt 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. For example, the sale of advertising in programs for