

Notice of Proposed Rulemaking Travel and Tour Activities of Tax Exempt Organizations

REG-121268-97

AGENCY: Internal Revenue Service
(IRS), Treasury.

ACTION: Notice of proposed rulemak-
ing.

SUMMARY: This document contains
proposed regulations clarifying when the
travel and tour activities of tax exempt or-
ganizations are substantially related to the
purposes for which exemption was
granted. These proposed regulations are
intended to augment the guidance that
currently exists with respect to travel
tours and the unrelated business income
tax.

DATES: Written comments and requests
for a public hearing must be received by
July 22, 1998.

ADDRESSES: Send submissions to:
CC:DOM:CORP:R (REG-121268-97),
room 5226, Internal Revenue Service,
POB 7604, Ben Franklin Station, Wash-
ington, DC 20044. Submissions may be
hand delivered between the hours of 8
a.m. and 5 p.m. to: CC:DOM:CORP:R
(REG-121268-97), Courier's Desk, In-
ternal Revenue Service, 1111 Constitution
Avenue NW, Washington, DC. Alternat-
ively, taxpayers may submit comments
electronically via the internet by selecting
the "Tax Regs" option on the IRS Home
Page, or by submitting comments directly
to the IRS internet site at [http://www.irs.
ustreas.gov/prod/tax_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html).

FOR FURTHER INFORMATION CON-
TACT: Robin Ehrenberg, (202) 622-6080
(not a toll-free number).

SUPPLEMENTARY INFORMATION:

Back ground

An organization generally exempt from
tax under section 501(a) of the Internal
Revenue Code ("Code") must pay tax on
its unrelated business taxable income, as
defined in section 512. Section 512(a)(1)

defines unrelated business taxable income
("UBTI") as the gross income derived by
any organization from any unrelated trade
or business (as defined in section 513)
regularly carried on by the organization,
less the deductions which are directly
connected with the conduct of the trade or
business. Gross income from an unre-
lated trade or business and any deductions
directly connected to that trade or busi-
ness are both computed in accordance
with the general income tax rules of chap-
ter 1 of the Internal Revenue Code, sub-
ject to the modifications provided in sec-
tion 512(b).

Section 513(a) generally defines an un-
related trade or business as any trade or
business the conduct of which is not sub-
stantially related (aside from the need of
an organization for income or funds or the
use it makes of the profits derived) to the
exercise or performance by the organiza-
tion of its charitable, educational, or other
purpose or function constituting the basis
for its exemption under section 501.

A "trade or business" is defined in Sec-
tion 1.513-1(b) of the Income Tax Regu-
lations as having the same meaning it has
for purposes of section 162, and "gener-
ally includes any activity carried on for
the production of income from the sale of
goods or performance of services." The
key test of whether an activity constitutes
a trade or business is whether the activity
was conducted with a profit motive. See
U.S. v. American Bar Endowment 477
U.S. 105 (1986); *Professional Insurance
Agents of Michigan v. Commissione* 726
F.2d 1097 (6th Cir. 1983); *National Water
Well Association v. Commissione* 92 T.C.
75 (1989). The regulations further pro-
vide that an activity conducted for the
production of income does not lose its
character as a business "merely because
[it is] 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 pur-
poses of the organization." This "frag-
mentation rule," as it is commonly
known, may result in different treatment
of related activities under the unrelated
business income tax.

Section 1.513-1(d)(2) of the Income
Tax Regulations provides that a trade or
business is "substantially related" to ex-

empt purposes only where the conduct of
the business activities has a substantial
causal relationship to the achievement of
the exempt purposes (other than through
the production of income) of the organi-
zation conducting the trade or business.
Thus, a trade or business is substantially
related for purposes of section 513 only if
the conduct of the trade or business con-
tributes importantly to the accomplish-
ment of the organization's exempt pur-
poses.

In recent years, taxpayers and Congress
have asked the IRS to publish guidance
addressing questions relating to the unre-
lated business income tax treatment of in-
come generated from travel tours con-
ducted by tax exempt organizations. Al-
though the IRS has issued a number of
revenue rulings addressing situations in
which tax exempt organizations sponsor
travel tours, most of these rulings have
analyzed whether an organization that of-
fers travel tours as its primary activity can
qualify as a charitable or educational or-
ganization described in section 501(c)(3)
of the Code.

Rev. Rul. 67-327, 1967-2 C.B. 187,
holds that an organization whose purpose
is to arrange group tours for students and
faculty of a university in order to allow
them to travel abroad does not qualify for
exemption because the organization oper-
ates essentially as a commercial travel
agency. The ruling concludes that the or-
ganization's activities are not "educa-
tional" as that term is defined in Treas.
Reg. § 1.501(c)(3)-1(d)(3)(i)(a), because
they do not provide instruction or training
of individuals for the purpose of improv-
ing or developing their capabilities.

In contrast, in Rev. Rul. 69-400, 1969-
2 C.B. 114, an organization that selects
students and faculty members interested
in a certain foreign history and culture
and enrolls them at foreign universities
and arranges for on-site tours conducted
by local scholars that complement class-
room studies, is held to be exempt. Rev.
Rul. 69-400 distinguishes Rev. Rul. 67-
327 on the basis that the organization in
the later ruling is arranging for instruction
not just travel.

Rev. Rul. 70-534, 1970-2 C.B. 113,
describes an organization that conducts
travel study tours as its primary activity.

Tours are geared toward students, but others can take the tours as long as they participate in the mandatory study programs. Organized study, taught by certified teachers, is conducted five to six hours a day, and a library of materials related to the courses being taught is available. Exams are given, each student is graded and a state board of education allows credit for a student's participation in the study tour program. The revenue ruling concludes that the organization furthers educational purposes because it performs training and instruction for the purpose of allowing individuals to improve and develop their capabilities, and is, therefore, described in section 501(c)(3).

Rev. Rul. 77-366, 1977-2 C.B. 192, concerns an organization that arranges and conducts ocean cruises for ministers, church members and their families for the purpose of providing continuing education in an atmosphere supporting spiritual renewal. The organization's activities include lectures, discussions, workshops and some shore activities that further charitable purposes. However, because of the extensive resources the organization devotes to social and recreational programs, the scheduling of those programs relative to the schedule for the exempt purpose programs, and other facts and circumstances, the organization was held to be also serving a substantial nonexempt purpose and, therefore, not to qualify for exemption as an organization described in section 501(c)(3).

The Tax Court applied a similar analysis to an organization operating a mountain lodge when it held that the organization failed to qualify as a religious organization described in section 501(c)(3). Although religious activities were offered to guests in addition to a wide range of recreational activities, guests were not required to participate in the religious activities, and the record failed to show that the recreational activities were insubstantial. See *The Schoger Foundation v. Commissioner*, 76 T.C. 380 (1981).

In contrast, Rev. Rul. 77-430, 1977-2 C.B. 194, holds that an organization conducting weekend retreats is furthering its stated purpose of advancing religion. Individuals come to participate in a program of seminars, lectures, prayer sessions and meditation led by ministers and priests

that are scheduled on an hourly basis throughout the day. Recreational activities are not scheduled, but are available to participants during their limited free time. Under these facts and circumstances, the ruling holds that the facilities are being used to advance religion and that recreational activities are incidental to the accomplishment of this purpose.

The revenue rulings all focus on the degree of educational or religious content participants are expected to receive in each travel program in determining whether the activity serves an exempt purpose. The same approach was taken in the one ruling that has specifically addressed the application of the unrelated business income tax to income generated by travel tours. Rev. Rul. 78-43, 1978-1 C.B. 164, describes the travel tour activity of a university alumni association. The association's program of approximately ten tours per year is open to all current members and their immediate families and is planned with various travel agencies. Each travel agency pays a per person fee to the association. The tours do not include any formal educational program and do not differ substantially from commercially operated tours. Rev. Rul. 78-43 concludes that there is no causal relationship between arranging the travel tours described in the ruling and the achievement of an exempt purpose. Accordingly, the ruling holds that the sale of tours to members is an unrelated trade or business within the meaning of section 513.

These proposed regulations are intended to augment the guidance that currently exists with respect to travel tours and the unrelated business income tax. The proposed regulations also provide additional guidance regarding the fragmentation rule and the distinctions that may be necessary among different tours or activities that are part of a single organization's travel program.

The IRS and Treasury are soliciting comments on these proposed regulations. In particular, because the IRS relies heavily on review of records to determine whether an organization's trade or business activities further an exempt purpose, comments are requested on whether the IRS should specify the types of records organizations should keep to establish the activity's purpose.

Explanation of Provisions

The proposed regulations add a new §1.513-7 providing that the determination of whether travel tour activities of tax exempt organizations are substantially related to an organization's exempt purposes is a question of facts and circumstances. The proposed regulations set forth a series of examples to illustrate how various facts and circumstances would be analyzed.

Proposed Effective Date

These regulations are proposed to be effective for taxable years beginning after the date final regulations are published in the **Federal Register**. For prior taxable years, the IRS will continue to apply principles of existing law.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Robin Ehrenberg, Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.513-7 is added to read as follows:

§ 1.513-7 Travel and tour activities of tax exempt organizations.

(a) Travel tour activities that constitute a trade or business, as defined in § 1.513-1(b), and that are not substantially related to the purposes for which exemption has been granted to the organization constitute an unrelated trade or business with respect to that organization. Whether travel tour activities conducted by an organization are substantially related to the organization's exempt purpose is determined by looking at all relevant facts and circumstances. Section 513(c) and § 1.513-1(b) also apply to travel tour activity. Application of the rules of section 513(c) and § 1.513-1(b) may result in different treatment for individual tours within an organization's travel tour program.

(b) *Examples*. The provisions of this section are illustrated by the following examples:

Example 1. O, a university alumni association, is exempt from federal income tax under section 501(a) as an educational organization described in section 501(c)(3). As part of its activities, O operates a travel tour program. The program is open to all current members of O and their guests. O works with travel agencies to schedule approximately 10 tours annually to various destinations around the world. Members of O pay \$X to the organizing travel agency to participate in a tour. The travel agency pays O a per person fee for each participant. Although the literature advertising the tours encourages O's members to continue their lifelong learning by joining the tours, and a faculty member of O's related university is invited to join the tour as a guest of the alumni association, none of the tours includes any scheduled instruction or curriculum related to the destinations being visited. By arranging to make

travel tours available to its members, O is not contributing importantly to the accomplishment of its educational purpose. Rather, O's program is designed to generate revenues for O by regularly offering its members travel services. Accordingly, O's tour program is an unrelated trade or business within the meaning of section 513(a) of the Code.

Example 2. N is an organization formed for the purpose of educating individuals about the geography and culture of the United States. It is exempt from federal income tax under section 501(a) as an educational and cultural organization described in section 501(c)(3). N engages in a number of activities to accomplish its purposes, including offering courses and publishing periodicals and books. As one of its activities, N conducts study tours to national parks and other locations within the United States. The study tours are conducted by teachers and other education professionals. The tours are open to all who agree to participate in the required study program. The study program consists of community college level courses related to the location being visited by the tour. While the students are on the tour, five or six hours per day are devoted to organized study, preparation of reports, lectures, instruction and recitation by the students. Each tour group brings along a library of material related to the subject being studied on the tour. Examinations are given at the end of each tour and N's state board of education awards academic credit for tour participation. Because the tours offered by N include a substantial amount of required study, lectures, report preparation, examinations and qualify for academic credit, the tours clearly further N's educational purpose. Accordingly, N's tour program is not an unrelated trade or business within the meaning of section 513(a) of the Code.

Example 3. R is a section 501(c)(4) social welfare organization devoted to advocacy on a particular issue. On a regular basis throughout the year, R organizes a travel tour for its members to Washington, D.C.. The tours are priced to produce a profit for R. While in Washington, the members follow a schedule according to which they spend substantially all of their time over several days attending meetings with legislators and government officials and receiving briefings on policy developments related to the issue that is R's focus. Bringing members to Washington to participate in advocacy on behalf of the organization and learn about developments relating to the organization's principal focus is substantially related to R's social welfare purpose. Therefore, R's operation of the travel tours does not constitute an unrelated trade or business.

Example 4. S is a membership organization formed to foster cultural unity and to educate X Americans about X, their country of origin. It is exempt from federal income tax under section 501(a) and is described in section 501(c)(3) as an educational and cultural organization. Membership in S is open to all Americans interested in the X heritage. As part of its activities, S sponsors a program of travel tours to X. All of S's tours are priced to produce a profit for S. The tours are divided into two categories. Category A tours are trips to X that are designed to immerse participants in the X history, culture and language. The itinerary is designed to have participants spend substantially all of their time while in X receiving instruction on the X language, history and cultural heritage. Destinations are se-

lected because of their historical or cultural significance or because of instructional resources they offer. Category B tours are also trips to X, but rather than offering scheduled instruction, participants are given the option of taking guided tours of various X locations included in their itinerary. Other than the optional guided tours, Category B tours offer no instruction or curriculum. Even if participants take all of the tours offered, they have a substantial amount of time free to pursue their own interests once in X. Destinations of principally recreational interest, rather than historical or cultural interest, are regularly included on Category B tour itineraries. Based on the facts and circumstances, sponsoring Category A tours is an activity substantially related to S's exempt purposes, and does not constitute an unrelated trade or business with respect to S. However, sponsoring Category B tours does not contribute importantly to S's accomplishment of its exempt purposes and is designed to generate a profit for S. Therefore, sponsoring the Category B tours constitutes an unrelated trade or business with respect to S.

Michael P. Dolan,
Deputy Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on April 20, 1998, 2:48 p.m., and published in the issue of the Federal Register for April 23, 1998, 63 F.R. 20156)