Steamship Trade Association of Baltimore, Inc. v. Commissioner, 81 T. C. 303 (1983)

Fees received by a tax-exempt organization for administrative services that are not substantially related to its exempt purpose are subject to unrelated business income tax.

Summary

The Steamship Trade Association of Baltimore, a tax-exempt business league, managed vacation and income guarantee funds for its members, charging fees based on their payroll. The IRS argued these fees were unrelated business income. The court agreed, ruling that the administrative services, though beneficial to the members, were not substantially related to the association's exempt purpose of promoting labor-management harmony. The court emphasized that the fees were proportional to the services rendered and that the services were commercial in nature, thus subjecting them to unrelated business income tax.

Facts

The Steamship Trade Association of Baltimore, Inc. , a business league exempt under IRC § 501(c)(6), negotiated collective bargaining agreements for its 49 maritime employer-members. It also administered vacation pay and guaranteed annual income funds established by these agreements. The association collected payroll data, computed assessments, collected funds from members, disbursed benefits to employees, and reported to the union. It charged each member fees based on their hourly payroll: $0. 08 per man-hour for vacation pay administration and $0. 02 per man-hour for income guarantee fund administration. These fees constituted a significant portion of the association's gross receipts.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the association's federal income taxes for 1975, 1976, and 1977, asserting that the fees collected for administrative services constituted unrelated business income. The association petitioned the U. S. Tax Court for review. The Tax Court held that the fees were indeed unrelated business income, entering a decision for the respondent.

Issue(s)

1. Whether the fees received by the association for administering vacation pay and guaranteed annual income funds constituted unrelated business income under IRC § 512?

Holding

1. Yes, because the fees were received for services that were regularly carried on,

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were commercial in nature, and were not substantially related to the association's exempt purpose of promoting labor-management harmony.

Court's Reasoning

The court applied the three-part test for unrelated business income under IRC § 512: (1) the activity must be a trade or business, (2) regularly carried on, and (3) not substantially related to the organization's exempt purpose. The court found that the association's administrative services satisfied all three criteria. The services were commercial in nature, as they could be performed by for-profit entities. The fees were charged in proportion to the services rendered to each member, indicating a trade or business. The services were regularly carried on, as they were an ongoing part of the association's operations. Crucially, the court held that these services were not substantially related to the association's exempt purpose of promoting labor-management harmony. The court distinguished this case from Kentucky Municipal League v. Commissioner, noting that the fees here represented a larger percentage of gross receipts, the services were commercially available, and the members were for-profit entities, not tax-exempt like in Kentucky Municipal League. The court concluded that the administrative services benefited members individually rather than the industry as a whole, and thus the income was subject to unrelated business income tax.

Practical Implications

This decision clarifies that tax-exempt organizations must carefully distinguish between services that directly further their exempt purposes and those that are merely administrative or commercial in nature. Organizations should be cautious about charging fees for services that could be provided by for-profit entities, especially if those fees are a significant revenue source. The ruling may lead tax-exempt organizations to reconsider how they structure their fee arrangements and administrative services to avoid unrelated business income tax. For similar cases, courts will likely scrutinize the proportion of fees to gross receipts, the availability of the services from commercial providers, and whether the services benefit the organization's members individually or the industry as a whole. This case has been cited in later decisions to support the principle that fees for administrative services not substantially related to an exempt purpose are taxable.

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