## *Fraternal Order of Police, Illinois State Troopers Lodge No. 41 v. Commissioner, 83 T. C. 755 (1984)*

Advertising revenue from publications of exempt organizations constitutes unrelated business taxable income unless it qualifies as a royalty.

### Summary

In Fraternal Order of Police, Illinois State Troopers Lodge No. 41 v. Commissioner, the court determined that revenue generated from business listings in a magazine published by a tax-exempt organization constituted unrelated business taxable income under Section 511 of the Internal Revenue Code. The Fraternal Order of Police (FOP) published The Trooper magazine, which included business listings and advertisements. The court found that these listings were advertising and the publication of them was a trade or business not substantially related to FOP's exempt purposes. Furthermore, the court ruled that the receipts from these listings did not qualify as royalties under Section 512(b)(2) due to FOP's active involvement in the magazine's production.

### Facts

The Fraternal Order of Police, Illinois State Troopers Lodge No. 41 (FOP), a tax-exempt organization under Section 501(c)(8), formed the Troopers Alliance in 1975 to raise funds for member benefits. The Alliance entered into agreements with Organization Services Corp. (OSC) to publish The Trooper magazine, which contained business listings and advertisements. FOP later assumed the Alliance's role and continued publishing the magazine. The Trooper was distributed to FOP members, legislators, and others, and included two types of business listings: a directory similar to the yellow pages and larger listings resembling advertisements. FOP received a percentage of the gross advertising revenue from these listings, which were solicited by OSC's contractor. The Internal Revenue Service (IRS) determined that these receipts constituted unrelated business taxable income.

### Procedural History

The IRS issued a notice of deficiency to FOP for the tax years ending September 30, 1976, through September 30, 1980, asserting that the receipts from The Trooper's business listings were taxable as unrelated business income. FOP contested this determination in the Tax Court, arguing that the listings were not advertising and that their publication did not constitute a trade or business. The Tax Court upheld the IRS's determination, ruling that the listings were advertising and constituted a trade or business, thus subjecting the receipts to taxation as unrelated business income.

### Issue(s)

1. Whether the publication of business listings in The Trooper magazine by FOP

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constituted an unrelated trade or business under Section 513 of the Internal Revenue Code.
2. Whether the receipts from these listings qualified as royalties excludable from unrelated business taxable income under Section 512(b)(2).

**Holding**

1. Yes, because the publication of the business listings was a trade or business regularly carried on and not substantially related to FOP's exempt purposes.
2. No, because the receipts from the listings did not constitute royalties due to FOP's active involvement in the magazine's production.

**Court's Reasoning**

The court found that the business listings in The Trooper were advertising based on their content, which included slogans, logos, and trademarks similar to other commercial advertisements. The court cited Section 513(c), which includes advertising as a trade or business, and noted that FOP's activities were conducted with a profit motive. The court rejected FOP's argument that the listings did not constitute unfair competition, distinguishing this case from Hope School v. United States, where the facts were different. The court also determined that the receipts did not qualify as royalties under Section 512(b)(2), as FOP's role was not passive; it had control over the magazine's content and operations. The court relied on Disabled American Veterans v. United States, which stated that royalties must be passive income, and concluded that FOP's active involvement precluded the classification of the receipts as royalties. The court's decision was influenced by the policy of preventing tax-exempt organizations from gaining an unfair competitive advantage over taxable businesses.

**Practical Implications**

This decision clarifies that advertising revenue from publications by tax-exempt organizations is generally taxable as unrelated business income. Legal practitioners should advise exempt organizations to carefully assess whether their publication activities constitute a trade or business and whether they can be considered substantially related to their exempt purposes. The ruling also emphasizes the importance of passive income in determining whether receipts qualify as royalties, impacting how exempt organizations structure their agreements with third parties. Subsequent cases, such as United States v. American College of Physicians, have reinforced this interpretation. Exempt organizations must be cautious in their involvement in publishing activities to avoid unintended tax consequences.

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