Veterans of Foreign Wars, Dep't of Michigan v. Commissioner, 89 T. C. 7 (1987)

A charitable organization's Christmas card program was a taxable unrelated trade or business because it was a sale of goods regularly carried on and not substantially related to its exempt purpose.

Summary

The Veterans of Foreign Wars (VFW) of Michigan ran an annual Christmas card program, sending cards to members and requesting contributions. The IRS argued the program was an unrelated trade or business, subject to tax. The Tax Court agreed, finding the program was a sale of goods, regularly carried on, and not substantially related to the VFW's exempt purpose. The court held that payments up to the suggested contribution amounts were taxable income, while excess payments were gifts. This case clarifies when a charitable solicitation can cross the line into a taxable business activity.

Facts

The VFW of Michigan contracted with Lipschutz to send Christmas cards to VFW members each year, requesting contributions of $2 in 1975 and $3 in 1976 and 1977. The cards were sent without prior orders and recipients were not legally obligated to pay. However, the accompanying materials stated the cards should not be considered unsolicited. Most members who responded paid the exact suggested amount. The program generated significant revenue for the VFW, second only to membership dues.

Procedural History

The IRS determined deficiencies in the VFW's unrelated business income tax for 1975-1977, asserting the Christmas card program was a taxable trade or business. The VFW petitioned the Tax Court, which held for the IRS, ruling the program was a taxable unrelated business.

Issue(s)

1. Whether the VFW's Christmas card program constituted a "trade or business" under IRC § 513(c)?
2. Whether the program was "regularly carried on" within the meaning of IRC § 512(a)(1)?
3. Whether the program was "substantially related" to the VFW's exempt purpose under IRC § 513(a)?
4. Whether the payments received by the VFW were "gifts" excludable from gross income under IRC § 102?

Holding

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1. Yes, because the program was carried on for the production of income and was in substance a sale of goods.
2. Yes, because the program was conducted with frequency and continuity similar to comparable commercial activities.
3. No, because the sale of cards did not contribute importantly to the VFW's exempt purpose.
4. No for payments up to the suggested contribution amounts, because they were not made with the intent to make a gift; yes for excess payments, because they were intended as gifts.

Court's Reasoning

The court applied the three-part test for unrelated business income: trade or business, regularly carried on, and not substantially related to exempt purpose. The VFW's program met all three criteria. The court found the program was a trade or business because it was carried on for profit and the transactions were in substance sales, despite the lack of legal obligation to pay. The court rejected the VFW's argument that the program was merely a solicitation of charitable contributions, noting the requested amounts closely matched the cards' fair market value. The program was regularly carried on because it occurred annually with systematic efforts to promote and carry it out. It was not substantially related to the VFW's exempt purpose because the sale of cards did not contribute importantly to that purpose. The court applied the two-part test for gifts, holding that payments up to the suggested amounts were not gifts because they did not exceed the cards' value and were not made with donative intent, while excess payments were gifts.

Practical Implications

This case demonstrates that a charitable solicitation can be treated as a taxable unrelated business if it involves the sale of goods, is regularly carried on, and is not substantially related to the organization's exempt purpose. Nonprofits should carefully structure their fundraising programs to avoid crossing this line. The case also clarifies that payments made in response to a solicitation are not automatically gifts; the dual payment rule applies, considering both the value received and the donor's intent. This decision has been followed in subsequent cases involving similar issues. Nonprofits should consult with tax counsel when designing fundraising programs that involve the distribution of goods or services to ensure compliance with the unrelated business income tax rules.

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