National Collegiate Athletic Association v. Commissioner, T.C. Memo. 1990-37 (1990)

Income derived by a tax-exempt organization from advertising in game programs for its major events constitutes unrelated business taxable income (UBTI) when the advertising activity is regularly carried on through an agent, and such income does not qualify for the royalty exception to UBTI.

Summary

The National Collegiate Athletic Association (NCAA), a tax-exempt organization, contracted with Lexington Productions (Host) to publish and sell advertising in programs for the 1982 Men's Division 1 Basketball Championship Tournament. The Tax Court determined that the income NCAA received from program advertising was unrelated business taxable income (UBTI) because the advertising activity was regularly carried on through its agent, Host, and the income did not qualify as royalties. The court emphasized that the sale of advertising space is a distinct trade or business and that using an agent does not automatically make the activity intermittent. Furthermore, the income was not a royalty because NCAA's involvement was not passive, and Host provided services beyond merely using NCAA's rights.

Facts

The NCAA, a tax-exempt organization, sponsors numerous college athletic championships, including the Men's Division 1 Basketball Championship Tournament. To generate revenue for the tournament, the NCAA contracted with Host to publish game programs and sell advertising space within them for the 1982 Final Four games and regional rounds. Under the contract, Host was designated as the NCAA's "exclusive agent" for advertising sales and was responsible for all aspects of advertising solicitation, creation, billing, and collection. The NCAA's involvement was minimal, primarily limited to recommending story ideas and reviewing a few proposed advertisements for compliance with contractual restrictions. The NCAA received a percentage of the net revenues from advertising sales.

Procedural History

The Internal Revenue Service (IRS) determined that the income the NCAA received from program advertising was unrelated business taxable income and issued a notice of deficiency. The NCAA challenged this determination in the Tax Court.

Issue(s)

1. Whether the income received by the NCAA from the sale of advertising in game programs for the 1982 Men's Division 1 Basketball Championship Tournament constituted unrelated business taxable income under Section 512

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of the Internal Revenue Code.
2. If the income is considered unrelated business taxable income, whether it is excludable from taxation as a royalty under Section 512(b)(2).

Holding

1. Yes, the income from program advertising is unrelated business taxable income because the advertising activity was "regularly carried on" by the NCAA through its agent, Host.
2. No, the income is not excludable as a royalty because the NCAA's role was not passive, and the income was not solely for the use of intangible rights.

Court's Reasoning

The court applied a three-pronged test to determine if income is UBTI: (1) Is it income from a trade or business? (2) Is the trade or business regularly carried on? (3) Is the conduct of the business substantially related to the organization's exempt purpose? The court found that selling advertising space is a "trade or business" distinct from the exempt function of the NCAA. While the NCAA argued its role was passive and the activity was intermittent, the court emphasized the agency relationship with Host. The contract explicitly designated Host as the NCAA's "exclusive agent" and granted NCAA control over advertising content. The court stated, "In sum, the contract manifested an intent (1) that Host would act on petitioner's behalf in conducting the sale of advertising and (2) that petitioner could control Host's activities, elements of an agency relationship." Because Host acted as the NCAA's agent, Host's regular advertising activities were attributed to the NCAA. The court distinguished this case from situations involving truly intermittent activities. Regarding the royalty exclusion, the court determined that the income was not a royalty because it was not solely for the passive use of NCAA's intangible rights. Host provided active services in soliciting, creating, and selling advertising. The court noted, "By contrast, the agreement in this case imposed a duty upon Host to perform certain services on petitioner's behalf and under petitioner's control."

Practical Implications

This case clarifies that tax-exempt organizations cannot easily avoid UBTI on advertising revenue by contracting out the sales activities to an agent. The "regularly carried on" element of UBTI can be met even if the exempt organization itself is not directly involved in the day-to-day operations if it exercises control through an agency relationship. Organizations must carefully structure their agreements to ensure that income from advertising is either substantially related to their exempt purpose or truly qualifies as passive royalty income. The case highlights that the royalty exception is narrowly construed and generally does not apply when the organization or its agent actively engages in the business activity generating the income, even if it involves the use of the organization's name or logo. Later cases have cited NCAA v. Commissioner to reinforce the principle that

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advertising revenue is generally UBTI unless a specific exception applies and to emphasize the importance of analyzing the nature of the relationship between the exempt organization and any third parties involved in income-generating activities.

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