Disabled American Veterans v. Commissioner, 94 T. C. 60 (1990)

Payments for the use of intangible assets by tax-exempt organizations can be classified as royalties and excluded from unrelated business taxable income (UBTI).

Summary

The Disabled American Veterans (DAV) rented portions of its donor list to other organizations, receiving payments in return. The issue was whether these payments were 'royalties' exempt from UBTI or 'rents' subject to tax. The court held that the payments were royalties, as they were for the one-time use of the intangible asset (the donor list). The decision clarified that royalties do not need to be passive income to be excluded from UBTI, impacting how tax-exempt organizations classify income from licensing intangible assets.

Facts

The Disabled American Veterans (DAV), a tax-exempt organization under section 501(c)(4), maintained a donor list to solicit contributions. From 1974 to 1985, DAV permitted other organizations to use names from this list for their mailings in exchange for payment. These payments were treated as income from an unrelated trade or business. DAV argued these were royalties, excluded from UBTI under section 512(b)(2), while the Commissioner argued they were rents, subject to UBTI.

Procedural History

The Commissioner determined deficiencies in DAV's federal income tax for the years 1974-1985. After concessions, the issue of whether payments from DAV's list rental activities were royalties or rents was tried. The court denied the Commissioner's motion for partial summary judgment based on collateral estoppel, citing a change in legal climate due to Rev. Rul. 81-178, which affected the interpretation of royalties under section 512(b)(2).

Issue(s)

1. Whether payments received by DAV for the use of names from its donor list are royalties, excluded from UBTI under section 512(b)(2), or rents, subject to UBTI?

Holding

1. Yes, because the payments were for the one-time use of an intangible asset (the donor list), and royalties do not need to be derived from passive sources to be excluded from UBTI.

Court's Reasoning

The court interpreted section 512(b)(2) broadly, aligning with Rev. Rul. 81-178,

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which defined royalties as payments for the use of intangible assets. The court rejected the argument that royalties must be passive income to be excluded from UBTI, noting that Congress did not include such a requirement in the statute. DAV's activities to maintain and improve its donor list were seen as enhancing the value of the intangible asset, not changing the nature of the payments from royalties to rents. The court emphasized that the payments were solely for the licensing of the donor list, not for services, and thus were royalties under the law. The decision also considered precedent and the statutory structure, concluding that section 512(b)(2) excluded all royalties connected to an unrelated trade or business, regardless of the level of activity involved in generating them.

Practical Implications

This decision allows tax-exempt organizations to classify payments received for the use of their intangible assets as royalties, potentially reducing their tax liabilities by excluding such income from UBTI. Legal practitioners should note that active management or enhancement of an intangible asset does not preclude the classification of payments as royalties. This ruling may influence how organizations structure their licensing agreements and report income, potentially affecting fundraising and business strategies. Subsequent cases like National Collegiate Athletic Assn. v. Commissioner have distinguished this ruling by focusing on whether payments are truly for the use of an intangible or for services rendered.

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