Common Cause v. Commissioner, 112 T. C. 332 (1999)

Mailing list rental payments can be treated as royalties, excluded from unrelated business taxable income, except for the portion that compensates list brokers.

Summary

Common Cause, a tax-exempt organization, rented its mailing list and argued that the rental payments were royalties, not subject to unrelated business income tax (UBIT). The IRS disagreed, asserting the payments were from an unrelated trade or business. The Tax Court held that, except for the list brokerage commissions, the payments were royalties and thus excluded from UBIT under Section 512(b)(2). The decision clarified that the activities of list managers and computer houses were royalty-related, while list brokers' activities were not, and their compensation was not attributable to Common Cause.

Facts

Common Cause, a tax-exempt organization, rented segments of its mailing list to third parties (mailers) for a fee. The rental process involved a list manager (Names in the News) who promoted and coordinated the rentals, and a computer house (Triplex Direct Marketing Corp.) that produced copies of the list. The rental fee included commissions for the list manager, list brokers, and a fee for the computer house. Common Cause argued that these payments were royalties, not subject to UBIT.

Procedural History

The IRS determined deficiencies in Common Cause's federal income taxes for the years 1991-1993, asserting that the mailing list rentals constituted an unrelated trade or business. Common Cause petitioned the Tax Court, which held in favor of Common Cause, ruling that the list rental payments, except for the list brokerage commissions, were royalties excluded from UBIT.

Issue(s)

1. Whether the mailing list rental activities of Common Cause constitute an unrelated trade or business under Section 511(a)(1)?
2. If so, whether the list brokers, list manager, and computer house used by Common Cause are its agents for carrying on such a business?
3. Whether the mailer's list rental payments to Common Cause are royalties excluded from unrelated business taxable income under Section 512(b)(2)?

Holding

1. No, because the activities related to the list rental, except for those of the list brokers, were royalty-related and thus not an unrelated trade or business.

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2. No, because the list brokers, list manager, and computer house were not agents of Common Cause for the purpose of carrying on a list rental business.
3. Yes, because, except for the list brokerage commissions, the mailer's list rental payments were royalties excluded from UBIT under Section 512(b)(2).

Court's Reasoning

The court analyzed whether the list rental payments qualified as royalties under Section 512(b)(2). It relied on Revenue Ruling 81-178, which defines royalties as payments for the use of valuable rights. The court found that all activities related to the list rental, except for those of the list brokers, were royalty-related. The list manager's promotional activities, the computer house's production of list copies, and Common Cause's review of rental transactions were all considered necessary to exploit and protect the list's value. The court distinguished these from the list brokers' activities, which were deemed services provided solely for the mailers' convenience and not attributable to Common Cause. The court also rejected the IRS's arguments that the absence of a written licensing agreement or the enactment of Section 513(h) should preclude royalty treatment.

Practical Implications

This decision provides clarity on how tax-exempt organizations can structure mailing list rental transactions to avoid UBIT. Organizations should ensure that their list rental agreements clearly delineate payments as royalties, excluding any portion related to list brokerage services. The ruling also impacts how organizations engage with list managers and computer houses, emphasizing that these entities' activities can be considered royalty-related and not subject to UBIT. Practitioners should advise clients on the importance of separating list brokerage commissions from other fees and maintaining control over the rental process to avoid agency relationships that might trigger UBIT. Subsequent cases, such as Sierra Club, Inc. v. Commissioner, have further developed the law in this area, reinforcing the principles established in Common Cause.

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