J. UPDATE ON UBIT - TRAVEL TOURS

by
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"Travel, in the younger sort, is part of education; in the elder, a part of experience..."
Francis Bacon, 1561-1626

1. Introduction

The mere mention of the word travel can conjure up images of new and exciting vistas, journeys to distant and unfamiliar places, holidays in exotic locales. Like almost all life experiences, travel can be considered to be somewhat educational. In the area of exempt organizations, the travel tour activities of an exempt organization must be substantially related to the organization's charitable, educational, or other exempt purposes in order to be considered an exempt activity, not subject to UBIT.

The subject of exempt organizations conducting travel activities has been the focus of a significant amount of interest as of late. On June 16, 1994, the House Small Business Subcommittee on Procurement, Taxation, and Tourism held a hearing at which several small business representatives testified that exempt organizations receive unfair advantages over for-profit organizations that conduct similar activities.[1] These representatives further indicated that certain activities conducted by exempt organizations are driving their for-profit counterparts out of business as well as causing a huge reduction of the tax base. One small business representative specifically addressed the group tour industry's problems with what he termed as "unfair competition" from both exempt organizations and the federal government. As an example, he described a cultural arts organization that he alleged performed the same tour activities as 25 to 30 tax paying companies within a particular city, and yet had the advantage of performing this activity "tax free." The hearings point to a debate of great interest both to the for-profit and nonprofit communities. This debate involves the method by which the unrelated business income tax, the basic purpose of which is to "level the playing field," should apply to travel tour activities of exempt organizations.

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[1] Unfair Competition From the Public Sector and Government Supported Entities: Nonprofits, 1994: Hearings Before the Subcomm. on Procurement, Taxation, and Tourism of the House Comm. on Small Business, 103rd Cong., 2d Sess. (1994).

Historically, there has been a strict dichotomy in the treatment of travel tours for exempt organizations' purposes: a travel tour is either 1) an activity which is substantially related to, in most cases, charitable or educational purposes, or 2) a non-exempt, commercial activity that is unrelated to a charitable or educational purpose. There are organizations whose activities consist primarily of conducting travel tours. If operating the travel tour program is an activity in furtherance of a substantial non-exempt purpose, then the organization may not be described in IRC 501(c)(3). (See, generally, Better Business Bureau of Washington, DC v. United States, 326 U.S. 279 (1945).) Typically, such an organization would be operated in a commercial manner similar to a commercial travel agency and not solely for charitable or educational purposes. On the other hand, if the travel tour activities are considered to be furthering charitable or educational purposes, then an organization whose sole activity is conducting such a travel tour program would generally meet the requirements for recognition of exemption under IRC 501(c)(3).

There are also exempt organizations that conduct clearly exempt activities apart from their travel tour activities. These organizations include museums, colleges and universities, among others, as well as organizations that are described in other subsections of IRC 501(c). If an exempt organization conducts a travel tour program that is not considered to be furthering charitable or educational purposes, then the income from that travel tour program, or any segment thereof, may constitute unrelated business taxable income under IRC 512(a)(1).

The dilemma then is how to distinguish between a travel tour that is substantially related to an organization's exempt purpose and one that is not so related. This article will review the law relating to the travel tour area, with a focus on unrelated business income tax consequences attendant to IRC 501(c)(3) organizations, as opposed to issues arising in connection with qualification for recognition of exempt status. For further information on exemption issues as well as UBIT issues, see the 1979 ATRI text (Travel Tours). For information on marketing travel tours through the mail, see the 1993 CPE text (Marketing Travel Tours, Insurance, and Affinity Cards Through the Mail).

2. The Law under IRC 501(c)(3)

A travel tour will not result in UBIT if the tour is considered to be substantially related to an organization's exempt purposes. Usually, an organization that conducts travel tours is an educational organization. If so,

income attributable to such an organization's travel tours will be treated as not subject to tax, if the tours are substantially related to the educational purposes of the organization. Therefore, it is helpful to review the law regarding the types of activities that are considered to be educational.

Reg. 1.501(c)(3)-1(d)(3) defines the term "educational" as the instruction or training of the individual for the purpose of improving or developing his capabilities; or the instruction of the public on subjects useful to the individual and beneficial to the community. Reg. 1.501(c)(3)-1(d)(3)(ii) provides examples of educational organizations. These organizations include schools such as a primary or secondary school, a college, or a professional or trade school, which has a regularly scheduled curriculum, a regular faculty, and a regularly enrolled body of students in attendance at a place where the educational activities are regularly carried on. The regulations also provide that education of the public may be carried on outside the classroom. Examples given in the regulations include public discussion groups, forums, panels, lectures, correspondence courses, museums, zoos, planetariums, symphony orchestras, and other similar organizations.

Thus, the regulations contemplate that educational activities can be conducted outside a formal classroom setting which would be the case for an exempt organization's related travel tour. As noted above, there are organizations that conduct travel tours as a substantial part of their activities; while these types of organizations are not the main focus of this article, a review of the law pertaining to these organizations may be useful by analogy. The following revenue rulings describe two different travel tour organizations, neither of which qualified for recognition of exemption under IRC 501(c)(3).

A. Rev. Rul. 67-327, 1967-2 C.B. 187

Rev. Rul. 67-327 describes a travel tour organization that is not described in IRC 501(c)(3). The organization's purpose was to arrange group tours for students and faculty of a university in order to allow them to travel abroad. The organization assisted in forming groups of persons having a common affiliation with the university and who were interested in chartering transportation for foreign travel. As agent for each group, the organization then collected the estimated pro rata share of the charter and administrative costs. It arranged for transportation, paid the carrier, retained a sum to defray its expenses, and returned any balance to the group members. The organization had no other activities. The ruling holds that the arranging of group tours is not in itself the instruction or training of the

individual for the purpose of improving or developing his or her capabilities.

Thus, Rev. Rul. 67-327, supra, indicates that the travel tour organization was operated essentially as a commercial travel agency with no discernable deliberate attempt to educate. Rev. Rul. 69-400, 1969-2 C.B. 114, is notable here only because it refers to Rev. Rul. 67-327. Rev. Rul. 69-400 describes an organization that selected students and faculty members who were interested in a particular foreign history and culture and enrolled them at foreign universities. The organization was held to be exempt under IRC 501(c)(3). Rev. Rul. 67-327 was distinguished on its facts.

Because the facts of the above rulings appear to be diametrically opposed, there is little to be gleaned for our purposes. Whereas one organization functioned as a commercial travel agency and therefore was non-exempt, the other organization coordinated study abroad at a foreign university and was exempt under IRC 501(c)(3). The large gray area between them is where our problems lie.

B. Rev. Rul. 77-366, 1977-2 C.B. 192

This ruling provides another example of a non-exempt travel tour organization. The organization arranged and conducted winter-time ocean cruises. The organization's stated purpose was to provide a continuing education program in an atmosphere conducive to spiritual renewal for ministers, members of churches, and their families. However, its only activities consisted of the regular arranging and conducting of fourteen-day winter-time cruises on chartered ships. In addition to the usual cruise activities, the organization provided activities that furthered religious and educational purposes. The programs conducted on each cruise included a schedule of lectures, discussion groups, and special interest workshops on religious topics, at which attendance was not required.

For approximately four hours on each of the nine days the ship was at sea, theologians and religiously-oriented psychologists led lectures, discussions, and workshops. The remainder of the time was available for meals, recreational activities, and social functions. Many of the social and recreational functions were arranged as part of the cruise, and recreational facilities were readily at hand for use. The ship spent a day at each of five different ports of call where arrangements were made for general sightseeing tours and shopping opportunities. At three of the ports of call, the participants were able, through cruise-sponsored programs, to spend minor portions of their time ashore meeting with local church leaders, attending worship services, and/or visiting mission projects.

The cruises were only advertised in periodicals published by religious denominations. Clergy normally accounted for about one-fourth of those who went on each cruise.

There is no question that certain of the organization's activities, specifically the lectures, discussions, workshops, and some of the activities on shore, furthered charitable purposes. However, the substantial amount of time, energy, and other resources regularly devoted to the conduct of extensive social and recreational activities, together with the manner in which such activities were scheduled in relation to other cruise programs, demonstrated that the organization's conducting of such social and recreational activities served substantial independent purposes of a non-charitable nature. Contrast Rev. Rul. 77-430, 1977-2 C.B. 194, in which an organization conducted weekend religious retreats at a rural lakeshore site at which the participants could enjoy the recreational facilities in their limited amount of free time. Although the facilities were conducive to recreational activities, the ruling held that use of the facilities was incidental to the organization's purpose of advancing religion.

See also G.C.M. 36958 (December 20, 1976), in which the Chief Counsel's office considered Rev. Rul. 77-366, supra, in proposed form. The G.C.M cautioned that, with respect to the social and recreational activities described, the mere conduct of activities not directly furthering an exempt purpose will only be regarded as incompatible with exempt status if the manner and extent of such conduct demonstrate the existence of some independent non-exempt purpose. However, the relative volume of the social and recreational activities and their overall setting and scheduling precluded their being merely incidental to the furtherance of one or more exempt purposes.

Based on the above ruling and the related G.C.M., a travel tour consisting of a cruise that combines charitable and educational activities with extensive social and recreational activities will not be considered to be furthering exclusively charitable or educational purposes. The existence of substantial charitable or educational activities will not overcome the existence of a substantial non- exempt purpose. The cruise described in the ruling contained an extensive charitable and educational program and yet was considered to be non-exempt. It is conceivable, although unlikely, that a travel tour consisting of a cruise could have an extensive educational program and little or no non-charitable activities. A typical cruise is not simply a mode of transportation similar to an airplane or an automobile; rather, there are usually varied social and recreational activities that are available to

participants. As a result, a travel tour consisting of a cruise should be carefully scrutinized to determine 1) whether the primary purpose of the cruise is charitable or educational, and 2) whether there exists a substantial non-exempt purpose.

C. International Postgraduate Medical Foundation v. Commissioner, T.C.M. 1989-36

Another example of a non-exempt travel tour organization can be found in International Postgraduate Medical Foundation v. Commissioner. The Tax Court in this case held that the exempt status of a corporation under IRC 501(c)(3) was properly revoked because the corporation was not operated exclusively for exempt purposes. The corporation conducted continuing medical educational tours abroad. The purposes of the corporation consisted of 1) providing benefits to a for-profit travel agency that arranged tours for the corporation's seminars, and 2) providing sightseeing and recreational activities. The corporation was formed by the owner of the travel agency to obtain customers for his business. The owner controlled the corporation and exercised that control to benefit his travel agency.

The corporation's program consisted of taking physicians on tours throughout the world. The tours usually lasted three weeks. During this time the corporation provided continuing medical education seminars. The educational activities occurred on less than one-half of the total days of the tours. On these days, an average of 4.5 hours were devoted to educational activities. Although a compliance form existed ostensibly to record attendance, there was no indication that attendance was required at the seminars. The corporation's brochures emphasized recreational sightseeing activities and did not include educational course descriptions. The brochures indicated that groups were limited to approximately fifteen doctors and their wives. Family members and friends accompanied tours without attending any of the seminars.

(1) Substantial Non-exempt Purpose

The court, in denying exemption, found the existence of two substantial non-exempt purposes: 1) the corporation provided benefits to the for-profit travel agency that arranged tours for the corporation's seminars; and 2) the corporation also provided sightseeing and recreational activities. The existence of only one of these non-exempt purposes would have been sufficient to deny the corporation exemption. Better Business Bureau of Washington, DC v. United States, supra, (the presence of a single non-exempt purpose, if substantial in nature, will preclude exemption under IRC 501(c)(3)).

(2) Inurement and Private Benefit

Additionally, the corporation was formed by the owner of the for-profit travel agency to obtain customers for his business. Thus, the corporation benefited private interests, i.e., the owner and his travel agency; as a result, the corporation was not operated for a public purpose. The court also found that the owner controlled the corporation and exercised that control to benefit his travel agency. Although the court did not explicitly state that inurement was present, the inurement prohibition also appears to have been violated in this case.

(3) Sightseeing and Recreational Activities

Finally, citing Schoger Foundation v. Commissioner, 76 T.C. 380 (1981) and Syrang Aero Club, Inc. v. Commissioner, 73 T.C. 717 (1980), the court indicated that if the corporation's activities were directed at providing opportunities for recreational endeavors, its claim to exemption under IRC 501(c)(3) would be denied. The court stated that the corporation did not show that the recreational and sightseeing activities were insubstantial and incidental to educational purposes.

D. Rev. Rul. 70-534, 1970-2 C.B. 113

Rev. Rul. 70-534 describes an exempt travel tour organization. The organization's primary activity was conducting travel study tours that included courses taught by certified teachers on the culture of the United States, foreign countries, and nature studies.

The study tours normally lasted several weeks. The tours were directed towards students but were open to all who agreed to participate in the study program; participation was mandatory during the tours. Five to six hours per day were devoted to organized study, preparation of required reports, lectures, instruction, and recitation by the students. A library of books, pamphlets, and material related to the courses being taught were carried on the tours. Examinations were administered at the end of the tours and each student was graded for the course. The State board of education allowed school credit for participation in the organization's program. The ruling holds that the organization was exempt from federal income tax under IRC 501(c)(3), because the organization was performing the instruction or training of the individual for the purpose of improving or developing his or her capabilities. Rev. Rul. 67-327,

supra, which describes a commercial travel organization, was distinguished.

The pertinent facts of this ruling can be summarized as follows:

(1) Certified teachers - the study tours were conducted by teachers and other personnel certified by a State board of education.

(2) Duration of tour - the study tours normally lasted several weeks.

(3) Potential pool of participants - the study tours were directed towards students but were open to all who agreed to participate in the study program required during the tour.

(4) Relationship of the study program to the area being visited - the study program consisted of junior college level courses related to the area being visited by the tour.

(5) Class time - five to six hours per day were devoted to organized study, preparation of required reports, lectures, instruction, and recitation by the students.

(6) Mandatory attendance - persons participating in the tour were required to attend the above classes.

(7) Reference materials availability - a library of books, pamphlets, and material related to the courses being taught were carried on the tour.

(8) Exams - examinations were administered at the end of the tour and each student was graded for the course.

(9) School credits - the State board of education allowed school credit for participation in the organization's program.

The ruling concludes as follows:

> "[s]ince the courses, which are conducted by certified teachers, consist of lectures, instruction, preparation of reports, recitation, examinations, and the issuance of grades, the organization is performing the instruction or training of the individual for the purpose of improving or developing his capabilities."

E. UBIT Implications

The above cases and revenue rulings address issues with respect to the qualification of various travel tour organizations under IRC 501(c)(3). They may also be generally useful in reference to the analysis of the situations in which an exempt organization conducts a travel tour that results in UBIT. The following section specifically addresses pertinent guidance with respect to the UBIT issue.

3. The Law under IRC 511-513

A. Statutory Framework

IRC 511 imposes a tax on the unrelated business taxable income of organizations exempt from federal income tax under IRC 501(c). IRC 512(a)(1) defines the term "unrelated business taxable income" as gross income derived by an organization from an unrelated trade or business regularly carried on by it, less the deductions directly attributable to such business activity.

IRC 513(a) defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of the purpose or function constituting the basis for its exemption.

A travel tour conducted by an exempt organization is almost always considered to be a trade or business and typically is regularly carried on within the meaning of IRC. 511 and 512(a)(1). The pivotal question then becomes whether the travel tour is substantially related, within the meaning of IRC 513(a), to the organization's exempt purpose or function.

B. Fragmentation Rule

IRC 513(c) and Reg. 1.513-1(b) provide that an activity does not lose

identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may or may not be related to the exempt purpose of the organization. This principle is commonly referred to as the "fragmentation rule."

In accordance with the fragmentation rule under IRC 513(c), it is necessary to look at each income generating activity separately and apply the UBIT rules to the activity. With respect to an exempt organization that conducts travel tours, each travel tour should be analyzed to determine, particularly, if the tour activity meets the substantially related test.

C. Rev. Rul. 78-43, 1978-1 C.B. 164

This ruling describes a travel tour activity that generates UBIT. The tours were operated by a university alumni association for members and their families. The association, working with various travel agencies, scheduled several tours annually to destinations around the world, mailed out promotional material, accepted reservations, and was paid a fee by the travel agencies on a per person basis. The association provided an employee to accompany each tour to serve as a tour leader. The travel tour program was open to all current members of the alumni association and their immediate families. Approximately ten tours were scheduled annually to various destinations around the world. There was no formal educational program conducted in connection with these tours, and they differed in no substantial way from regular commercially operated tours.

The stated purpose of the association and, the basis for its exemption under IRC 501(c)(3), was the promotion of education by assisting a given university, both financially and otherwise, and by encouraging its member alumni to do the same. It implemented this purpose principally by working to raise funds for the support of the university. It also published an alumni newsletter and maintained an alumni center for its members on the campus of the university.

The ruling holds that the tour activity is an unrelated trade or business within the meaning of IRC 513. The ruling states that the provision of travel tours is not in itself an educational activity. By making available various travel tours to its members in the manner described, the association was furnishing its members with a regularly carried on commercial service not substantially related to the educational purposes of the organization. The ruling refers to Rev. Rul. 67-327, supra. Although Rev. Rul. 67-327 addresses an exemption issue, the organization's activities described therein were strikingly similar to the alumni association's

travel tour activities. The tour activities of both organizations were virtually indistinguishable from commercial travel activities.

D. G.C.M. 38949 (January 6, 1983)

The organization described in G.C.M. 38949 is a membership organization. Its tour program originated as walking tours of a particular city but had since become diversified to include travel to various parts of the world to provide participants with personal experiences of the art, history, science and culture of the area. Proposed study tours could be suggested by the organization's staff or others. These proposed tours were then evaluated by the staff to determine:

(1) the relationship of the tour to the organization's activities;

(2) the availability of qualified study leaders and lecturers;

(3) the existence of organization contacts at the area to broaden the educational value of the trip; and

(4) the connection of the proposed tour to prior tours, lectures or classes of the organization.

A professional tour operator handled the arrangements for transportation and accommodations. The tours were announced in the organization's publications, which were distributed to members. The tours were also available to the general public. Participants in the tours received reading lists and materials in advance. Tours were led by professional staff members of the organization who had expertise on the subject matter of the tours. Scholars from other organizations and lecturers from the locations of the tours often participated. Certain tours were offered in conjunction with classes of five-to-eight weeks in duration offered by the organization. In some instances, academic credits were awarded to participants at the college level.

The G.C.M. concluded that, based on the facts outlined above, the tour program was carefully structured to maximize educational goals and content. The tours were predominantly educational in character and had a substantial causal relationship to the organization's educational purposes. Therefore, the tours were not the conduct of an unrelated trade or business.

E. Private Letter Rulings

Because of the lack of precedential guidance in the area of travel tours and UBIT<$FCertain case-law, rulings, and regulations dealing with IRC 162 and travel for educational purposes could be helpful by reference but are not controlling for our purposes. Under IRC 162, travel expenses incurred away from home in connection with obtaining education are deductible only if the direct expenses of the education are deductible and the purpose of the travel is primarily to obtain that education. However, generally, the education must be for the purpose of maintaining or improving skills required by the individual's current employment. Reg. 1.162-5(e)(1).> (other than Rev. Rul. 78-43, supra), it is sometimes helpful to review PLRs that address travel tours. Though not precedential, they are helpful in providing "snapshots" of various travel tour activities. PLR 88-32-003 (May 6, 1988) describes a trip that included spouses and children of designated professionals. The PLR concludes that revenue from the spouses, children, and other companions constitutes UBIT. Although attendance at meetings appeared to be mandatory for spouses, the PLR states that there was not a sufficient nexus between the participation of the spouses, children, and companions and the educational purpose of the organization.

PLR 88-56-002 (November 18, 1988) describes an organization whose exempt activity is the provision of educational public television broadcasting. Each travel tour was designed to complement specific television programming. Tours were accompanied by experts who guided the tours and conducted lectures. Also, two employees of the organization accompanied the tour to meet with members and discuss their reactions to the tour and to the organization's programming. The PLR concluded that the organization's tour program contributed importantly to the accomplishment of its exempt educational purpose.

F. TAM 90-27-003 (March 21, 1990)

TAM 90-27-003 is particularly helpful in that it discusses selected aspects of an organization's travel tour program in great detail. Specifically, it provides an analysis of three different travel tours of the organization, only one of which was deemed to be related to exempt, educational purposes.

The organization is a membership organization which offered both domestic and international tours. The organization directly conducted the domestic tours, while the international tours utilized the services of for-profit operators. The organization had a small professional staff involved in both preparation and actual

tour operations. The staff made determinations as to which tours to sponsor, aided in the development of tour programs, prepared book lists, was responsible for fielding inquiries about the tours prior to departure and oversaw tour operations. Tours were advertised in publications issued by the organization. The organization reviewed materials distributed by tour agencies, and a representative of the organization often accompanied the tour to provide general assistance.

(1) Domestic Tours

The TAM described two domestic tours, both of which were operated by the organization itself. The educational and social/recreational aspects of the tours were highlighted as was free shopping time. Brochures setting forth the itinerary for the tours emphasized the hours of free time and the shopping. One of the tours had a formal instruction or lecture period; the other tour did not. The organization did not provide any reading lists, classroom type presentations, or special preparation prior to departure. The guides and instructors appeared to be qualified. The organization indicated that it had access to sites not readily available to other tour operators. The TAM addressed one of the domestic tours in further detail.

> **Example 1** This tour consisted of travel to two cities located within the United States. The tour was advertised as a learning vacation. The advertisements stressed the educational, social, and recreational aspects of the tour. The tour included shopping time, leisure time, cultural events, receptions, and arranged meals. The tour spanned seven days. Out of the seven days, a total of six hours consisted of lectures, while twenty-one hours were devoted to touring. In addition to knowledgeable local guides, the organization arranged for outside experts to provide the lectures. Participation at the lectures was not mandatory.

(2) International Tours

As noted above, the international tours were conducted with for-profit operators. Generally, the tours were developed by the organization's staff. Occasionally, a for-profit tour operator prepared a tour on its own and then solicited the organization's participation. In either case, the itinerary was prepared by the organization and the tour operator. Then both parties entered into a contract to sponsor the tour. The organization indicated that it dealt with a small group of tour operators who had evidenced skill in being able to set up packages which coalesced with the organization's general goals. Tour agencies did not pay the

organization to participate in the program. Tours were often assisted by local persons at the tour site.

The contracts between the organization and the tour operators emphasized that the tours were to be conducted as part of the organization's educational program and in accordance with its general policies. The tour operator was responsible for local guides, travel arrangements, and other such matters. It was also responsible for collecting monetary "gifts" for the organization. It was not required to pay the organization if a gift was not made. The organization selected a tour leader, and edited and helped design the promotional brochures which were initially drafted by the tour operator. It had the right to approve any brochures or other materials which would be distributed regarding the trip. Most of the promotional work was done through the organization. The organization's staff was responsible for providing information to individuals who desired to take the tours. A representative of the organization generally accompanied the tour and presented materials regarding the work of the organization and its relationship to the pertinent activities carried on in other countries.

Each trip also provided for a certain amount of leisure and travel time. Some trips greatly limited the amount of free time and had highly structured lecture/discussion periods. The most structured program considered in the TAM presented special study discussion groups to a small number of individuals. Immediately after the completion of the study sessions, field trips to illustrate the subject matter were taken.

Other programs were less structured. These programs provided lectures during travel time. Although attendance at the lectures was not mandatory, the organization indicated that individuals generally attended. Some of the tours provided reading lists and, sometimes, publications. The tours that consisted of cruises had limited libraries containing materials relevant to the program. Lecture time varied from tour to tour. Sometimes, travel time was indistinguishable from leisure time. Evening leisure activities were made available by the organization as part of the package when in cities.

> **Example 2** One international tour was advertised as a study tour highlighted by seminars, discussions, and a two-day pre-departure series of lectures. A recommended reading list was provided and the tour was accompanied by an expert in the country. The tour lasted sixteen days. In total, seven hours were devoted to lectures, including the two pre-departure days. Seventy-two hours consisted of touring.

Local experts participated in the lectures. The tour also provided time for sightseeing and visits. Participation at the lectures was not mandatory.

Example 3 Another international tour to a different country was described in advertising literature as an opportunity to meet specialists engaged in activities related to the organization's purposes. The tour's descriptive literature stated that the basis of the program was the pursuit of two study topics. Each topic was the subject of two and one-half days of class sessions at a college, followed by two days of trips to sites illustrating the subject matter. Participants were provided with a recommended reading list and course books prior to departure. Instructors consisted of regular college faculty. In addition to classroom lectures during the day and some evenings and tour excursions, the program included meals and trips. The program lasted 15 days and was designed to operate in conjunction with the college. Participants attended six and one-half days of lectures on specific subjects taught by faculty members. Another four days consisted of field trips accompanied by the faculty members to sites designed to illustrate classroom work.

(3) Rationale

The TAM first concluded that the tours constituted a trade or business and that this trade or business was regularly carried on. In order to determine whether a tour is predominantly educational in character and has a substantial causal relationship to the organization's educational purposes, the TAM set forth the following as factors in an organization's favor:

(1) There is a bona fide educational methodology through a formal educational program including organized study, reports, lectures, library access, reading lists, and mandatory participation.

(2) The tour is conducted in a highly professional manner, with daily lectures and related classroom studies.

(3) The tour is arranged to allow participants to perform an intensive study of the subject of the tour and to receive academic credit at the college level when appropriate.

(4) The tour is selected for educational value and the qualifications of the tour leaders.

The TAM concluded that the first two examples were not organized study programs with an educational methodology or formal educational program of study, reports, library access, reading lists (available in example 2), examinations leading to academic credit, or mandatory attendance and therefore did not meet the first factor. Of the seven day tour in the first example, only six hours were devoted to formal lectures with 21 hours of touring. Assuming eight hours of available time per day, only 6/56 or approximately ten percent of the total time of the tour was devoted to formal lectures.

Of the sixteen day tour in example 2, only seven hours were devoted to formal lectures with 72 hours of touring. Again assuming eight hours of available time per day, only 7/128 or approximately five percent of the total time of the tour was devoted to formal lectures. The TAM indicated that tours taken with knowledgeable guides are to some extent educational, especially when combined with lectures. However, the standard is not whether the tour is somewhat educational, but whether there is a substantial causal connection between the tour and the achievement of an educational purpose. The first two tours also fulfilled social and recreational purposes and failed to rise to the level of being predominantly educational in character.

In analyzing the third example, the TAM indicated that the program had many of the elements of an educational methodology, including formal and organized study programs with reading lists, books supplied in advance, and classroom study with field trips conducted by qualified instructors. Although there were some recreational activities, there was no time built into the schedule for shopping or leisure. A <u>significant part</u> of the program consisted of organized study of particular course areas delivered through formal instruction by knowledgeable, qualified instructors as well as field trips conducted in close conjunction with the lecture programs. This organized program was aimed at providing participants with an intensive study of the subject. Of the fifteen day tour, 52 hours or about 40 percent of the time were devoted to formal lectures with another 32 hours devoted to accompanying lectures. The TAM assumed that attendance was required at the classes.

G. <u>Facts and Circumstances Test</u>

The above review of the law on travel tours indicates that the current method for determining whether a particular travel tour activity generates UBIT is the use of a facts and circumstances test. Each travel tour activity must be analyzed on a case-by-case basis. Additionally, the fragmentation rule under IRC 513(c) and Reg. 1.513-1(b) indicates that each travel tour conducted by an organization should be analyzed separately. Although there does not appear to be a particular set of facts and circumstances that is determinative, there are certain important factors that should be considered in analyzing the UBIT implications of a specific travel tour.

(1) Bona Fide Educational Methodology

The existence of a bona fide educational methodology helps to distinguish a travel tour that does not result in UBIT from one that does. Facts that point to a traditional educational activity help to discern a deliberate intent to educate as opposed to the casual receipt of knowledge. Factors include a formal educational program including organized study, reports by participants, lectures, library access, reading lists, and mandatory participation. For example, facts indicating a substantial relationship to an exempt educational purpose would be the availability of reference materials. These materials could consist of a library of books, pamphlets, and material related to the courses being taught which are carried on the tour. Supplemental reading material which is readily available to participants evidences an intent to educate.

Mandatory attendance at the educational programs is a strong positive factor indicating the existence of an exempt educational purpose. If persons participating in a tour are required to attend classes, this fact suggests that the tour has in place a formal educational program. Another factor that points to a traditional, formal educational methodology is the administration of examinations and the grading of students for the course that is provided on the tour.

(2) Structure and Design of the Tour

This factor indicates that if a travel tour is structured as a traveling college course, then the tour activity would not result in UBIT. The tour should be conducted in a highly professional manner, with daily lectures and related classroom studies. The lack of structure and the provision of substantial amounts of free time for social and recreational activities will weigh against a finding of the tour activity as educational for purposes of excluding the income from UBIT. Additionally, the provision of an extensive, structured social and recreational

program points to the existence of UBIT. The duration of the tour does not appear to be controlling for purposes of determining the existence of UBIT; study tours can typically last for several days or several weeks and may or may not generate UBIT.

Study tours can be directed towards a certain pool of participants such as students or they can be open to the general public. An important factor, however, would be a requirement that all persons participating in the tour would formally agree to participate in the structured study program during the tour.

The use of a for-profit travel agency by the organization is not determinative of the existence of UBIT. Rather, one should examine the organization's role in choosing a tour and creating the itinerary as well as the overall development of the tour. If the organization's focus in developing the tour is primarily educational, then the tour would be an exempt activity despite the use of a commercial travel organization.

(3) Intensive Study of the Subject of the Tour and Academic Credit

The amount of class time in a travel tour should be substantial in relation to the other tour activities. An insubstantial amount of class time will indicate that the tour is not primarily educational. Thus, an analysis of this factor will involve a review of the actual time spent on the educational activities of the tour. Quite simply, the more time devoted to organized study, preparation of required reports, lectures, instruction, and recitation by the students, the more likely the tour will not be considered to generate UBIT. Additionally, the scheduling of pre-and-post tour classes, or a formal class provided in conjunction with the tour such as a college semester course, strengthens the tour's educational character.

The earning of school credits under the auspices of, for example, the State board of education or the allowance of school credit for participation in the organization's program by a college or university is another strong factor in favor of finding the presence of an exempt purpose.

(4) Selection of Tour for Educational Value and Qualifications of Tour Leaders

This factor involves the relationship of the area being visited and the corresponding study program to the organization's primary purpose. If the study program consists of courses related to the area being visited by the tour, and both

the program and the area being visited evidence a strong nexus to the organization's exempt purposes, these factors would indicate that a travel tour activity does not generate UBIT. An organization should choose an area for its relation to its exempt purpose and not for recreational purposes.

Additionally, if certified teachers are used, such as teachers and other personnel certified by a State board of education, then this is good evidence of an exempt educational purpose. If the tour guide is considered to be an expert in the particular field of study, whether or not indigenous to the geographic area being visited, this is also a factor in the organization's favor.

In choosing a tour area, it is not controlling that a similar tour could also be purchased on the open market. The educational component of the tour is the crucial issue, as well as whether a significant amount of educational activity takes place. Regarding the marketing of the tour, the offering of tours to the general public does not automatically indicate the existence of UBIT. However, targeting a particular class of participants, specifically, the persons typically involved in other aspects of the organization's activities, would help to establish a substantial relationship to the organization's exempt purposes. Brochures and other marketing publications should provide detailed information on the educational aspects of the tour, such as course descriptions, reading lists, and the participation of skilled instructors. Brochures that stress the recreational and sightseeing aspects of the tour will indicate a commercial purpose, notwithstanding assertions to the contrary. Such marketing of a tour in a commercial manner would point to the existence of UBIT.

H. Other Issues Relating to Travel Tours

(1) Royalties

IRC 512(b)(2) excludes from the computation of unrelated business taxable income all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property and all deductions directly connected with such income.

A travel company could pay an exempt organization for the use of its name in connection with a travel tour, and the payments to the organization would generally be characterized as exempt royalties. However, the use of an exempt organization's mailing list in addition to the use of its name may cause complications. The issue of whether payments for the use of a mailing list are

subject to UBIT is the subject of litigation in Sierra Club, Inc. v. Commissioner, 103 T.C. 307 (1994), appeal docketed, No. 95-70112 (9th Cir. Jan. 30, 1995). See also Sierra Club, Inc. v. Commissioner, T.C.M. 93-199.

(2) Travel Tour Fees

Some travel tour fees include a "mandatory contribution" (an oxymoron) that an organization may claim is tax-deductible. Generally, such contributions are not made out of disinterested generosity and instead are part of the tour fee. See, for example, the discussion of the IRC 170 issue in TAM 90-27-003, supra. Generally, that sort of solicitation is problematic and the deduction will be disallowed. A travel tour organization should provide evidence that there is no follow-up policy for those who choose not to make the contribution.

(3) Income to Instructors

Employees of an exempt organization, who function as tour guides or instructors during a travel tour, are often provided free room and board for the duration of the tour. If these individuals are employees of the organization during the rest of the year, and the organization itself is conducting the tour, then room and board would generally be excluded from their income. However, room and board provided to the employees' spouses would generally be treated as income to the employees.

For more specific information on such matters, including spousal travel expenses, see Reporting Compensation on Form 990, at page 195.

4. Conclusion

In analyzing the issue of travel tours and UBIT, examiners should request adequate documentation of an organization's educational intent. Organizations that conduct travel tours should keep contemporaneous records of their travel tour activities. Then, the documented information can be analyzed in terms of the facts and circumstances test discussed above. No one factor is controlling for purposes of determining whether a particular tour results in UBIT. The facts and circumstances test involves the careful weighing of all relevant information, including factors which may not have been addressed in this article. Additionally, the application of the other UBIT rules should be examined.

The Exempt Organizations Division is currently in the process of

determining whether precedential guidance might be useful in the area of travel tours and UBIT. The present standard is necessarily cumbersome in light of the fragmentation rule under IRC 513(c) and Reg. 1.513-1(b), where each travel tour conducted by an organization would have to be analyzed separately for UBIT purposes. In light of the interest in this area by the for-profit and non- profit sectors, any potential guidance would hopefully be useful to Service personnel and representatives of exempt organizations.