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IRS LTR: Foundation's Website Is a Periodical.

The IRS ruled that a private operating foundation's website that publishes material that used to be in the organization's now-defunct print publication is a periodical for purposes of the unrelated business income tax cost allocation rules.

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Employer Identification Number: * * *

Dear * * *:

This is in response to the ruling request dated November 21, 2011, submitted by your authorized representative regarding whether your website constitutes a "periodical" for purposes of the unrelated business income tax costs allocation rules of section 1.512(a)-1(f) of the Income Tax Regulations.

FACTS

You are an organization described in section 501(c)(3) of the Code. You are classified as a private operating foundation described in section 4942(j)(3), operated for educational purposes.

For several years your primary activity has been publishing an educational magazine. Originally, you published a print version every other month. More recently, to reduce costs and increase readership, you discontinued the print version and now publish the content exclusively on your website, free of charge. The website includes essentially the same kind of content, addressing the same or similar subjects that appeared in the print version of the magazine. The website contains all of the material available in the former print version, plus new features such as documentary videos that can only exist in an online form. All past articles are archived and searchable on your website. You represent that the website is updated regularly, at least weekly. It appears from recent posts on the website that it is updated ordinarily every business day. Each article shows its publication date.

Although you receive grants and contributions, you are supported, in part, by advertising revenues. You employ and/or contract with writers, researchers, a creative director and an editorial director to

produce the editorial content of the website (as you did for the print magazine). You also incur expenses for website maintenance and overall administration.

LAW

Section 511 of the Code imposes a tax on the unrelated business taxable income of exempt organizations described in section 501(c).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in section 512(b).

Section 513(a) of the Code 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 such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt purpose or function.

Section 513(c) of the Code provides that the term "trade or business" includes any activity, which is carried on for the production of income from the sale of goods or the performance of services.

Section 1.512(a)-1(d)(1) of the regulations provides, in pertinent part, that in certain cases, gross income is derived from an unrelated trade or business which exploits an exempt activity. One example of such exploitation is the sale of advertising in a periodical of an exempt organization which contains editorial material related to the accomplishment of the organization's exempt purpose. Except as specified in subparagraph (2) of this paragraph and paragraph (f) of this section, in such cases, expenses, depreciation and similar items attributable to the conduct of the exempt activities are not deductible in computing unrelated business taxable income.

Section 1.512(a)-1(d)(2) of the regulations provides, in pertinent part, that where unrelated trade or business activity is of a kind carried on for profit by taxable organizations and where the exempt activity exploited by the business is a type of activity normally conducted by taxable organizations in pursuance of such business, expenses, depreciation and similar items which are attributable to the exempt activity qualify as directly connected with the carrying on of the unrelated trade or business activity.

Section 1.512(a)-1(f) of the regulations provides that under section 513 and 1.513-1, amounts realized from the sale of advertising in a periodical constitute gross income from an unrelated trade or business activity involving the exploitation of an exempt activity, namely the circulation and readership of the periodical developed through the production and distribution of the readership content of the periodical. Thus, subject to the limitations of paragraph (d)(2) of this section, where the circulation and readership of an exempt organization periodical are utilized in connection with the sale of advertising in the periodical, expenses, depreciation, and similar items of deductions attributable to the production and distribution of the editorial or readership content of the periodical shall qualify as items of deductions directly connected with the unrelated advertising activity. Subparagraphs (2) through (6) of this paragraph provide rules for determining the amount of unrelated business taxable income attributable to the sale of advertising in exempt organization periodicals.

Section 1.513-4 of the regulations provides rules for qualified sponsorship payments, and excepts from such rules the income from the sale of advertising or acknowledgements in exempt organization periodicals. A "periodical" is defined as regularly scheduled and printed material

published by or on behalf of an exempt organization that is not related to and primarily distributed in connection with a specific event conducted by the organization. For this purpose, printed material includes material that is published electronically.

In section 1.513-4(f) of the regulations, Example 11, W, a symphony orchestra, maintains a Web site containing pertinent information and its performance schedule. The Music Shop makes a payment to W to fund a concert series, and W posts a list of its sponsors on its Web site, including the Music Shop's name and Internet address. W's Web site does not promote the Music Shop or advertise its merchandise. The Music Shop's Internet address appears as a hyperlink from W's Web site to the Music Shop's Web site. W's posting of the Music Shop's name and Internet address on its Web site constitutes acknowledgment of the sponsorship. The entire payment is a qualified sponsorship payment, which is not income from an unrelated trade or business.

In section 1.513-4(f) of the regulations, Example 12, X, a health-based charity, sponsors a year-long initiative to educate the public about a particular medical condition. A large pharmaceutical company manufactures a drug that is used in treating the medical condition, and provides funding for the initiative that helps X produce educational materials for distribution and post information on X's Web site. X's Web site contains a hyperlink to the pharmaceutical company's Web site. On the pharmaceutical company's Web site, the statement appears, "X endorses the use of our drug, and suggests that you ask your doctor for a prescription if you have this medical condition." X reviewed the endorsement before it was posted on the pharmaceutical company's Web site and gave permission for the endorsement to appear. The endorsement is advertising. The fair market value of the advertising exceeds 2% of the total payment received from the pharmaceutical company. Therefore, only the portion of the payment, if any, that X can demonstrate exceeds the fair market value of the advertising on the pharmaceutical company's Web site is a qualified sponsorship payment.

ANALYSIS

Advertising income derived by exempt organizations in connection their periodicals is subject to the tax on unrelated business income. As noted above, rules for the determination of unrelated business taxable income derived from the sale of advertising in exempt organization periodicals are contained in section 1.512(a)-1(f) of the regulations.

Section 1.513-4 of the regulations holds that the term periodical means regularly scheduled and printed material published by or on behalf of an exempt organization that is not related to and primarily distributed in connection with a specific event conducted by the exempt organization, and for this purpose, printed material includes material that is published electronically. In section 1.513-4(f), Examples 11 and 12, the rules for qualified sponsorship payments rather than periodical advertising were applied to the exempt organization's website, indicating that a website is ordinarily not regarded as a periodical. In your case, however, you argue for treatment of your website as a periodical so that you may use your excess readership costs to offset your advertising income like commercial publications do.

We agree. Your primary purpose and function is to publish educational information, which you do on the website. Your prior print periodical has in effect moved onto the website. The website is operated similarly to that of many newspapers and magazines with an online presence, with new material published regularly and old content also readily available. Under the circumstances, the website serves the function of a traditional periodical and should be treated as such.

RULING

Based on your representations, we rule that your website meets the definition of the term “periodical” which appears at section 1.513-4 of the regulations. Thus, the website constitutes a periodical for purposes of the unrelated business income tax cost allocation rules of section 1.512(a)-1(f).

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

Except as specifically ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transactions described above under any other provision of the Code.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative. A copy of this letter should be kept in your permanent records.

If there are any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Theodore R. Lieber

Manager, EO Technical Group 3

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