

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE-MIS No.: TAM-103019-20

Director
Exempt Organizations Examinations

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Taxpayer =
Topic =
Vendor =
Network =
Website =
X =
Y =
Z =

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ISSUE(S):

Whether income derived by Taxpayer from the operation of an online job placement service constitutes unrelated business income subject to tax under section 511 of the Internal Revenue Code.¹

Specifically:

Whether income from the activity is excluded from the computation of unrelated business taxable income as royalty income under section 512(b)(2).

CONCLUSION(S):

The income is not excluded from the computation of unrelated business taxable income as royalty income under section 512(b)(2).

Therefore, income derived by Taxpayer from the operation of an online job placement service constitutes unrelated business income subject to tax under section 511.

FACTS:

Taxpayer is exempt from federal income tax under the provisions of section 501(a), as an organization described in section 501(c)(3) and as a public charity under sections 509(a)(1) and 170(b)(1)(A)(vi).

Taxpayer is organized and operated as an association of academicians, graduate students, and practitioners of Topic to receive, administer, and expend funds for the following purposes, as stated in its articles of incorporation:

¹ The Internal Revenue Code of 1986, as amended, to which all subsequent section or “§” references are made unless otherwise indicated.

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4. To engage in any and all lawful activities incidental to the foregoing purposes except as restricted herein.

Taxpayer has classes of membership:

. Members pay membership fees although certain members pay reduced rates. Taxpayer publishes academic journals that contain articles that address various issues in the field of Topic. Articles that appear in the journals are typically submitted by Taxpayer's members. Taxpayer receives revenue from advertisements in its journals and pays unrelated business income tax on this advertising income. Due to their academic nature, the journals contain relatively few advertising pages. Taxpayer reported no other sources of unrelated business income.

Taxpayer derives substantially all of its program service revenue from:

- The licensing of journal content including archived materials. This is the largest source of revenue and represents approximately percent of total revenue.
- Membership fees, comprising approximately percent of total revenue.
- Registration fees from members and ancillary revenue relating to the annual meeting and other conferences organized by Taxpayer is the third largest source of revenue.

Members can take advantage of various activities offered by the Taxpayer including:

- Educational Resources – including print and/or online subscription to Taxpayer's journals and newsletter. Taxpayer also provides access to other educational resources.
- Networking Opportunities – includes complimentary memberships in two of Taxpayer's divisions and/or interest groups and access to various Taxpayer networking sites and directories.
- Meeting and Events – including the Annual Meeting and various conferences.
- Volunteer Leadership and Recognition Opportunities.

Job Placement Service

In addition, Taxpayer offers a job placement program that seeks to connect employers to qualified candidates, and to provide job seekers access to job opportunities. Taxpayer has operated the job placement program for more than forty years. In the late Taxpayer developed its web application and offered its placement services online. Several years later, Taxpayer began encountering technical difficulties with its web

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application; thus, in _____, Taxpayer contracted with an unrelated, for-profit vendor, Vendor, to manage the job placement program on Taxpayer's website.

The job placement program has an in-person function at Taxpayer's annual meeting but primarily functions through the online job board (Online Placement Service). Taxpayer requires an employer that wants to do in-person recruiting at Taxpayer's annual meeting to place an online posting on the Online Placement Service. Employers, recruiters, and job seekers may access the Online Placement Service. Separate fee structures exist for employers/recruiters and for job seekers who wish to make listings or purchases through the Online Placement Service.

The Online Placement Service

The Online Placement Service allows website users to post resumés, manage job searches, view job postings, view website resumés, store resumés, and monitor and manage postings. Job seekers are directed to enter their member ID number and last name to access the service. Employers can post a job by creating an account that can only be accessed with email and password information.

Job seekers are charged a non-refundable fee to list their profiles for employers seeking candidates and to view current positions available on the Online Placement Service. The Online Placement Service provides "a full featured Placement Service with a wide array of services and tools to assist applicants (job seekers) find employment opportunities." Employers are also charged fees. Prices for a single position job posting range from \$ _____ for a basic posting to \$ _____ for a featured job posting. For an additional fee of \$ _____, one network option entitles the employer to a single position job posting that is bundled for secondary exposure on all sites (meaning other online job boards) within the Network. Employers seeking to post job openings for multiple positions can choose: a two-position package, posting for 180 days, priced at \$ _____; a three-position package, posting for 365 days, priced at \$ _____; or a five-position package, posting for 365 days, priced at \$ _____. Other optional upgrades are available for additional fees. As an alternative to posting a job position, employers can purchase access to ten job seeker profiles for a 90-day period for \$ _____, twenty-five profiles for \$ _____, or sixty profiles for \$ _____. Single job seeker profiles can be purchased for \$ _____. Taxpayer is solely responsible for determining the products to be offered on the Online Placement Service and setting the price that is charged for each product including upgrades and bundling options.

The Online Placement Service exists at Website, which is a domain owned by Taxpayer and having Taxpayer's acronym in the URL. A button labeled "Placement Services" appears on the navigation screen at the top of Taxpayer's home page as well as on other pages; clicking on the button takes you to the Online Placement Service. The Online Placement Service consists of several web pages within Taxpayer's larger website. The Online Placement Service, as well as the pages describing its function on

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Taxpayer's website, all contain the same appearance and heading as the rest of Taxpayer's website. Further, the website calls these services "[Taxpayer's] Placement Services." In the description of "[Taxpayer's] Placement Services" Taxpayer's website provides that "[Taxpayer] provides a wide array of services and tools to assist applicants (job seekers) find employment opportunities and help academic and industry employers find qualified candidates to fill open positions through our partnership with [Vendor]." The description of the services states that "if you have any questions, feel free to contact the [Taxpayer] Placement Team." Taxpayer's website also lists the various options for using the Online Placement Service at various price points. There is no separate, independent website for the Online Placement Service.

Services Provided by Taxpayer to Users of the Online Placement Services

Three employees and one independent contractor² provide services for Taxpayer relating to the operation of the Online Placement Service. One employee, the Director of Membership, Marketing, and Communications, is responsible for deciding what products and services are offered and the price points. Another employee, the Membership Services Manager, is responsible, together with an independent consultant, for ensuring that content provided by Taxpayer for the landing page and other parts of the website is accurate and updated as necessary; for processing Vendor's monthly invoice for payment; and for generally insuring that the Online Placement Service is being operated in a manner consistent with the Agreement and that members are satisfied with the Online Placement Service. The third employee is responsible for ensuring that Vendor's software interfaces properly with Taxpayer's membership database, enabling members to sign into the Online Placement Service. This role is a small part of her overall duties at Taxpayer. An independent contractor working on behalf of Taxpayer, is the primary contact for Taxpayer's placement services. The independent contractor receives and responds to questions and concerns of users of the Online Placement Service on behalf of Taxpayer. The independent contractor's work in connection with the Online Placement Service is to liaise between Taxpayer's Headquarters' staff and Taxpayer's Placement Committee to facilitate the continued operations of Taxpayer's placement services; to serve as a liaison between Taxpayer and Vendor; and to handle customer service questions and complaints in a timely fashion either by phone or email.

Taxpayer maintains a placement service team to assist members with employment opportunities. Taxpayer's website directs users to contact the Taxpayer Placement Team if they have academic questions or need more information about Taxpayer's

² The designations of "employee" and "independent contractor" are based on Taxpayer's representations; no independent evaluation has been made to determine whether these designations are accurate. The conclusions contained in this TAM do not address the worker classification status of any worker who is providing services to the Taxpayer, and whether they are employees of the Taxpayer or independent contractors.

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Placement Service. The members of the Placement Team, for purposes of customer service, is made up of the independent contractor discussed above and several volunteers in the field of Topic.

A page on Taxpayer's website includes the Terms and Conditions of Service for using the Online Placement Service. These Terms and Conditions provide that they "will form a binding contract between you...and [Vendor] governing Your use of our website and Career Centers."

Vendor Contract

Taxpayer entered into a -year contract with Vendor in , that is automatically renewed for one additional year on the same terms and conditions unless terminated. The agreement between Taxpayer and Vendor is titled "[Vendor] Website Operator Service Agreement." The agreement provides that Taxpayer is the "customer" while Vendor is the "provider." The service agreement provides that the services to be performed are for the benefit of Website, one of Taxpayer's web pages. Per the terms of the contract, Vendor hosts and manages the Online Placement Service on behalf of the customer, Taxpayer, and its website, Website.

Revenue from the Online Placement Service

Section IV discusses the fee structure between Taxpayer and Vendor. Part (b) of section IV provides that "[Vendor] will collect all fees related to [Taxpayer's] clients' use of the [Online Placement Service]." This section then provides that Vendor will remit monthly amounts that are paid by Taxpayer's clients. The agreement provides that 100 percent of the revenue earned exclusively through the use of Taxpayer's Online Placement Service are remitted to Taxpayer. Thus, Taxpayer is entitled to receive 100 percent of the revenue from employers, recruiters, and other of Taxpayer's members who post job listings or resumés exclusively on the Online Placement Service. Additionally, Taxpayer is entitled to receive 100 percent of the proceeds from all advertising displayed on the Online Placement Service.

Revenue from Other Online Placement Services

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Vendor operates many job boards for a number of organizations and specializes in cross-posting of listings on its other job boards, where relevant. When revenue was generated through the use of cross-postings either to or from other job boards hosted by Vendor, Taxpayer also received a share, less than half, of that revenue. Sales originating at Vendor's other job boards but that used the services offered by the Online Placement Service earned Taxpayer 2X percent of that revenue. Meanwhile, sales originating on the Online Placement Service of services offered by other job boards operated by Vendor earned Taxpayer X percent of that revenue.³ A report from Vendor for a single month in _____ indicates that less than three percent of the payments to Taxpayer came from cross-posting services in that month. This revenue, like that received from direct postings on Online Placement Service, was not reported on Taxpayer's Form 990-T.

Taxpayer Fees Paid to Vendor

The agreement provides that Taxpayer will pay, in consideration for the services provided by Vendor, a monthly fee of \$Y and an amount equal to Z percent of the gross sales amount for all purchases covered by the revenue sharing agreement to "cover credit card fees, billing fees, postage, materials, and handling costs." In addition to these payments, Taxpayer was also required by the agreement to integrate the Online Placement Service into Website by adding a link on Website's top navigation and by including a link on the Website homepage.

The service agreement does not mention the transfer of, or use of, any of Taxpayer's tangible or intangible assets to, or by, Vendor.

Terms within the Agreement

Section IV of the service agreement also discusses the "Services Provided." This section indicates that Vendor "shall host and manage an online job board for [Website]." The section further provides that:

"This service shall include an online job board, recruitment advertising, resume bank, career advice, resume services, coaching services, and other services related to user job searching and employer recruiting ("Career Services"). For the duration of the Agreement, [Vendor] shall be the sole and exclusive provider of said services for [Website].

[Vendor] will bill [Taxpayer's] clients, collect client fees, and provide [Online Placement Service] technical support and customer service to [Taxpayer's]

³ An addendum in late _____ changes the split of revenue from postings to and from other job boards to an even split and newly labels this revenue "royalties" while the same payments were labeled "commissions" in the _____ agreement.

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clients. [Vendor] will have the right to send client communications which are co-branded with [Taxpayer], for communications related directly to the [Online Placement Service] service, but [Vendor] shall in no event send client communications involving the marketing of other services to clients which are co-branded with [Taxpayer] without [Taxpayer's] prior written approval."

The agreement provides for some "General Terms and Conditions." These terms and conditions include an agreement that the service agreement "is not a transfer or license of software rights," and that Vendor "maintains all ownership and rights over its software, and the associated upgrades, customizations, and other materials and other technologies associated with the software." The terms and conditions also provide that Taxpayer agrees "to comply with the terms of the user agreements, privacy statements, and any other existing agreements currently in use by [Vendor] to collect and manage the content provided to [Vendor] by the job seekers and employers using [Taxpayer's] [Online Placement Service]." Finally, one of several "general provisions" in the terms and conditions provides that "the parties herein agree that they are independent contractors⁴ and will have no power or authority to assume or create any obligations on behalf of each other. This agreement will not be construed to create or imply any partnership, agency, or joint venture."

Emails Regarding the Online Placement Service

Emails from accounts associated with Taxpayer consistently refer to the Online Placement Service as Taxpayer's Online Placement Service and provide statements such as, "We strive to provide you with the highest quality...job search experience both on-site during the annual meeting, as well as, online year round." Further, emails from accounts associated with Taxpayer discuss how "we accept PayPal, Visa,...." Emails discussing payments also indicate that users directed requests for refunds to Taxpayer, where Taxpayer then directed Vendor to provide such refunds. Other emails also refer to Vendor as "our [Online Placement Service] provider." Finally, all receipts for payments made to use the online placement services were signed by the director of Taxpayer.

Email exchanges between Taxpayer and Vendor also indicate that Vendor recommended advertising strategies that Vendor was using with other parties to use to increase the number of Online Placement Service listings. These emails identify Vendor as recommending an advertising strategy where Taxpayer made the final decision on whether to follow that strategy for the Job Board.

⁴ The designation of "independent contractor" is based on Taxpayer's representations; no independent evaluation has been made to determine whether this designation is accurate. The conclusions contained in this TAM do not address worker classification status.

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Membership List

During the years in question, Taxpayer did not license or otherwise provide its membership list, mailing list, or other proprietary member data to Vendor for Vendor's use in expanding its own operations.

Disagreement

Taxpayer filed Forms 990-T for the tax years in question, but the only income reported on such transactions was the income from advertisements in its journals. Upon examination, the IRS contends that the income received by Taxpayer from the Online Placement Service should also have been reported on the Taxpayer's Forms 990-T for the years in question. Taxpayer does not dispute that the Online Placement Service activity constitutes a trade or business, that it is regularly carried on, or that it is unrelated to Taxpayer's exempt purpose. Instead, Taxpayer argues in response to the IRS examination that the Online Placement Service and the services connected therewith are not conducted by Taxpayer at all and that any income it receives from this activity constitutes royalties from Vendor's conduct of the Online Placement Service. As such, Taxpayer contends that any income received from the Online Placement Service is a royalty to Taxpayer thus excluded from unrelated business taxable income under section 512(b)(2).

LAW AND ANALYSIS:

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

Treas. Reg. § 1.512(b)-1 indicates that all the facts and circumstances of each case must be examined to determine whether a particular item of income falls within any of the modifications provided in section 512(b). As an example, the regulations state that if a payment termed "rent" by the parties is, in fact, a return of profits by a person operating the property for the benefit of the tax-exempt organization, or is a share of the profits retained by such organization as a partner or joint venturer, then the payment is not within the modification provided for rents. Thus, the actual nature of the income and not its designation by the parties is controlling.

Rev. Rul. 69-430, 1969-2 C.B. 129, describes an organization, which is exempt from Federal income tax under section 501(a), that engages primarily in activities in furtherance of its exempt purposes. It also owns the publication rights to a book. The publication and distribution of the book will not contribute in any manner to the accomplishment of the exempt purposes of the organization except for the organization's need for the income to be derived therefrom. The organization has undertaken to exploit the book in a commercial manner. It has arranged for the printing, distribution, and retail sale of the book. The organization has also arranged for

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appropriate publicity and advertising in connection with the distribution and sale of the book. The ruling holds that income from the publication and sale of a book by an exempt organization is unrelated business income; however, if it transfers its publication rights to a commercial publisher, royalty income received is not unrelated business income.

Rev. Rul. 81-178, 1981-2 C.B. 135, considers the application of section 512(b)(2) to two situations in which payments are received by an exempt organization. The ruling states that to be a royalty, a payment must relate to the use of a valuable right. Payments for the use of trademarks, trade names, service marks, or copyrights, whether or not payment is based on the use made of such property, are ordinarily classified as royalties for federal tax purposes. Situation (1) holds that payments for the use of the organization's trademarks, trade names, and service marks are royalties within section 512(b)(2). However, situation (2) holds that payments for personal appearances and interviews are not royalties but are compensation for personal services.

Texas Farm Bureau v. United States, 53 F.3d 120, 123–24 (5th Cir. 1995), determined that the activities giving rise to income were those of Texas Farm Bureau (TFB). The court put significant weight on the terms of the agreement stating, “TFB agreed to use its own offices, its influence and prestige to promote [the insurance plan], and to provide [the insurance plan] with stationary and postage, secretarial and clerical help, office supplies, furniture, and equipment. Nowhere in the agreements is a ‘royalty’ mentioned.”

In Sierra Club, Inc. v. Commissioner, 86 F.3d 1526 (9th Cir. 1996), the court stated that royalties in section 512(b)(2) are defined as payments received for the right to use intangible property rights, and that such definition does not include payments for services. With respect to income derived from Sierra Club's rental of its mailing list, the court held that such income was royalty income under section 512(b)(2) and not payment for services. The Ninth Circuit also remanded the case to the Tax Court to review whether the affinity card activities resulted in a royalty payment. In Sierra Club, Inc. v. Commissioner, 77 T.C.M. (CCH) 1569 (1999), the court discussed at length the contracts associated with the affinity card service and the services provided by Sierra Club to the contracting party and ultimately determined that the affinity card services resulted in a royalty payment to Sierra Club. See also Common Cause v. Comm'r, 112 T.C. 332 (1999).

Oregon State University Alumni Ass'n v. Commissioner, 71 T.C.M. 1935 (1996), aff'd, 193 F.3d 1098 (9th Cir. 1999), held that activities in connection with an affinity credit card program generated royalty income under section 512(b)(2). The activities were primarily undertaken to protect the association's relationship with its members and to keep alumni aware of their ties to the university.

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In State Police Ass'n of Massachusetts v. Commissioner, 72 T.C.M. (CCH) 582 (1996), aff'd, 125 F.3d 1 (1st Cir. 1997), the court held that income from advertising in the annual publication of a section 501(c)(5) labor organization of state troopers was unrelated business taxable income. The organization contracted with Publisher to conduct advertising on the organization's behalf. The organization argued that the contract designated Publisher as an independent contractor and not as the organization's agent; that the organization had no control over Publisher's personnel or business activities; that Publisher agreed to indemnify the organization from liability resulting from Publisher's activities; and that the contract guaranteed a minimum payment to the organization, shifting the risk of loss to Publisher. The court noted that the manner in which the parties to an agreement designate their relationship is not controlling. The court concluded that the agreement set forth an agency relationship in substance between Publisher (and its subcontractors) and the organization. Publisher acted on the organization's behalf because Publisher had the authority to use the organization's name in soliciting advertising, and collected payments made payable to Association. Publisher was subject to Association's control because the organization reserved the right (1) to enter Publisher's offices at any time without prior notice to verify compliance with agreement and (2) to approve advertisements, and Publisher reported weekly to Association on payments received. Thus, Publisher's activities were attributable to Association in determining whether Association's advertising activities were regularly carried on. The appellate court noted that the facts, taken as a whole, solidly supported the finding that Publisher acted as Association's agent, noting that the Association retained tight control over the method and manner of solicitation, the sales pitch, the identity of solicitors, the financial aspects of the arrangement, the use of the Association's name, the advertising formats, and the contents of the yearbook.

Arkansas State Police Ass'n v. Commissioner, 81 T.C.M. (CCH) 1172 (2001), aff'd, 282 F.3d 556 (8th Cir. 2002), involved an exempt organization (EO) that entered into a "Royalties and Licensing Agreement" with a publisher to publish the EO's official magazine containing articles and advertising. Publisher solicited the ads in the EO's name. The EO approved the sales pitches, ads, and editorial content. Publisher bore all production costs, paid the EO an annual fee, and received 73% of the proceeds. The EO received 27%. The court rejected the EO's royalty argument, reasoning that the EO substantially participated in and maintained control over significant aspects of the publication. The court distinguished certain mailing list and affinity credit card cases as involving minimal activity on the EO's part. See also Fraternal Order of Police v. Comm'r, 87 T.C. 747 (1986), aff'd, 833 F.2d 717 (7th Cir. 1987).

In New Jersey Council of Teaching Hospitals v. Commissioner, 149 T.C. 466 (2017), the Tax Court held that fees received by a section 501(c)(3) teaching hospital under contracts with third-party vendors represents payments for services, not for the use of intangible property, and thus did not constitute "royalties" within the meaning of section 512(b)(2). One vendor provided debt collection services and the other provided group purchasing programs. The hospital had "marketed and administered" the group

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purchasing programs and the activity was not substantially related to its educational purposes. Further, the fees received from the debt collection services were subject to unrelated business income tax, because the revenues generated did not accomplish its charitable mission. Nowhere in the debt collection agreement did the hospital license the debt collection company to use its intangible property or obligate itself to make intangible property available to the company. Therefore, the fees received by the hospital under the agreement could not be regarded as royalties. Moreover, the revenues from the group purchasing programs were subject to unrelated business income tax because there was "no substantial causal relationship between the achievement of the hospital's exempt purposes and the sale of pharmaceutical supplies" to members of the general public or to private patients of physicians practicing in a building owned by the hospital. The court relied heavily on the language of the contract noting that the contract did not reference the use of an intangible asset. Since the exclusions under section 512(b)(2) did not apply, the court held that the fees were subject to unrelated business income tax because they were derived from a regularly carried on, unrelated trade or business.

National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949), evaluates whether or not a wholly owned subsidiary of a corporation is an agent, or has the same identity as, the parent corporation such that all income is taxed at the parent level. In making this determination, the Court created what have come to be known as the "six National Carbide factors" for agency:

"[1] Whether the corporation operates in the name and for the account of the principal, [2] binds the principal by its actions, [3] transmits money received for the principal, and [4] whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal are some of the relevant considerations in determining whether a true agency exists. [5] If the corporation is a true agent, its relations with its principal must not be dependent on the fact that it is owned by the principal if such is the case. [6] Its business purpose must be the carrying on of the normal duties of an agent." Id. at 437.

Treas. Reg. § 1.513-4(f), Example 12, indicates that a hyperlink from a charity's website to a for-profit's website that includes an endorsement by the charity of the for-profit's merchandise on the for-profit's website constitutes advertising; this advertising is taxable to the charity to the extent of the fair market value of the advertising.

Taxpayer, as an organization exempt under section 501(c)(3), is subject to the tax imposed by section 511 on its unrelated business taxable income (as defined in section 512). Sections 511(a)(1) and 511(a)(2)(A). Taxpayer does not dispute that the Online Placement Service activity constitutes a trade or business, that it is regularly carried on, or that it is unrelated to Taxpayer's exempt purpose. A regularly carried on, unrelated trade or business is generally subject to tax unless one of the modifications in section 512(b) apply. Taxpayer contends that the revenue received from Vendor constitutes royalty income under section 512(b)(2).

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The term “royalty” is not defined by section 512(b)(2) or the regulations thereunder. Nevertheless, to be a royalty, a payment must relate to the use of a valuable right. See Rev. Rul. 81-178. Payments for the use of trademarks, trade names, service marks, or copyrights, whether or not payment is based on the use made of such property, are ordinarily classified as royalties for federal tax purposes. Id. Similarly, payments for the use of a professional athlete's name, photograph, likeness, or facsimile signature are ordinarily characterized as royalties. Id. A royalty is a payment for the right to use an intangible asset and does not include payments for services. See, e.g., Sierra Club, 86 F.3d 1526. For example, payments for personal appearances and interviews are not royalties but are compensation for personal services. See Rev. Rul. 81-178. Cases have held that certain affinity credit card programs, in which an organization licenses its name and logo for use by a bank on a credit card, or the sale of mailing lists, generate royalties under section 512(b)(2) that are exempt from unrelated business income tax. See, e.g., Sierra Club, 86 F.3d 1526; Oregon State Alumni Ass’n, 71 T.C.M. 1935. Whether a particular item of income is royalty income depends on the facts and circumstances. Treas. Reg. § 1.512(b)-1.

Taxpayer contends that any payments remitted to it from Vendor are in the form of royalties for the Vendor's use of Taxpayer's name, trademarks, website address, and mailing list. Taxpayer states that the Online Placement Service is Vendor's trade or business. Taxpayer further states that the Online Placement Service technology belongs to Vendor who also manages the Online Placement Service and collects payments for use of the Online Placement Service.

The facts and circumstances surrounding the production of income for Taxpayer through the Online Placement Service do not support Taxpayer's contention, however.

Name and Trademarks

First, there does not appear to be any transfer to or use of Taxpayer's name and/or trademarks by Vendor. In New Jersey Council, 149 T.C. at 477, the court reasoned that “Nowhere in the agreement does petitioner license [the contracting party] to use its intangible property or obligate itself to make intangible property available to [the contracting party]. Indeed, the agreement makes no reference whatever to tangible or intangible property owned by petitioner. That being so, it is hard to see how the fees petitioner received under the agreement could be regarded as ‘royalties.’” Similarly, in this case, there is no mention of Taxpayer's tangible or intangible property to be used by Vendor in any agreement. The lack of discussion of intangible properties was a major factor in the decision by the court in New Jersey Council, 149 T.C. at 476–77, to determine that the amounts paid to the organization in that case were not royalties. Further, Website is not a Vendor web page with Taxpayer's name on it, but rather is a part of Taxpayer's web pages that uses a code owned by Vendor.

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Income Share

Taxpayer receives 100 percent of the income from users of the Online Placement Service that exclusively use the online placement services offered through Taxpayer's website, minus a nominal, Z percent fee that pays for credit card transaction fees. The fact that Taxpayer receives almost all of the income, including advertising income, from users exclusively using the Online Placement Service on Taxpayer's website indicates that the Online Placement Service is Taxpayer's activity. A royalty represents a payment made to the owner of property for permitting another to use the property. Sierra Club, 86 F.3d at 1531–32. In Sierra Club, 86 F.3d at 1528, the taxpayer received as little as 50 percent of the income from a member's use of an affinity card, far lower than the 100% minus an administrative fee from the Online Placement Service. The percentage of sales from the Online Placement Service on Taxpayer's website, for the one month of statistics provided to the IRS, furthers this argument as over 97 percent of the users of the Online Placement Service on Taxpayer's website exclusively used this Online Placement Service; thus, nearly all of the income from Online Placement Service went to Taxpayer, indicating that the Online Placement Service is Taxpayer's activity and not that of Vendor for which Taxpayer received a royalty.

Further, Taxpayer bore the cost of the credit card transaction fees to collect that income. The credit card transaction fees are a cost of operating the Online Placement Service. Bearing the cost of operations is a strong indicator that those operations are the ultimate responsibility of Taxpayer. As such, these costs also indicate that the Online Placement Service is Taxpayer's activity and not that of Vendor.

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Service Agreement

In Sierra Club and New Jersey Council, the agreement between the parties was discussed at length by the courts and was significant in the final conclusions of the courts in both cases. In New Jersey Council, 149 T.C. at 476–77, the court noted as part of the determination that a royalty did not exist in that the agreement was titled a service agreement and discussed the services to be provided. The Service Agreement between Taxpayer and Vendor provides several items indicating that the Online Placement Service is Taxpayer’s business and that Taxpayer contracted with Vendor to provide services to further Taxpayer’s unrelated trade or business. While not necessarily dispositive of the type of arrangement created by the agreement, as noted in New Jersey Council, the terms and language used in the agreement are relevant in determining the intentions of the parties to the agreement. First, in this case, the agreement in effect for the tax years in question calls itself a “Website Operator Service Agreement” indicating that the parties believed the contract to be outlining the terms of services provided by Vendor and not a licensing agreement. Next, in defining the parties involved, the agreement refers to Vendor as the “provider” while Taxpayer is called the “customer” indicating that services will be provided by Vendor for the benefit of Taxpayer. In contrast, a licensing agreement would establish that Taxpayer’s intangibles would be provided for the benefit of Vendor. Further, the agreement provides that the services to be provided will be for Taxpayer’s website rather than indicating that Taxpayer’s website is being provided for the benefit of Vendor’s business.

Section IV of the Service Agreement, “Services Provided,” provides the greatest evidence in the agreement that Vendor is acting as a service provider in aid of Taxpayer’s unrelated trade or business. The court in Texas Farm Bureau, 53 F.3d at 124, concluded that a royalty did not exist by saying “the plain language of the agreements demonstrates that the agreements were strictly for services and did not contemplate a royalty payment.” Here too, the language of the agreement demonstrates a contract for services and not a royalty payment. This section provides the services to be provided by Vendor. These services include hosting and managing an online placement service for Taxpayer’s website. This section further provides that Vendor “will bill [Taxpayer’s] clients, collect client fees, and provide Online Placement Service technical support and customer service to [Taxpayer’s] clients.” This language indicates that the users of the Online Placement Service are Taxpayer’s clients and not those of Vendor (who considers Taxpayer to be its customer). This language also indicates that even though fees for the online placement services may have been paid directly to Vendor, such collection of fees was done on behalf of Taxpayer as part of the services for which Vendor was paid under the agreement. Notably, this section provides only that Vendor will provide services and does not discuss any activities to be provided by Taxpayer. Instead, this section discusses fees to be paid by Taxpayer to include a monthly fee to be paid to Vendor and a credit card/invoicing fee to “cover all credit card fees, billing fees, postage, materials, and handling costs” associated with

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collecting fees on Taxpayer's behalf. The presence of a monthly fee to Vendor adds to the contention that the agreement was for services to be provided by Vendor in consideration for monthly payments by Taxpayer for the use of those services rather than an agreement for Vendor to use Taxpayer's intangible assets.

Section IV also discusses a revenue splitting arrangement as part of the income that may be earned by either party on fees paid to use the online placement services. The heading for the revenue sharing section provides that Vendor "will collect all fees related to [Taxpayer's] clients' use of the Online Placement Service. [Taxpayer] will be entitled to monthly commissions...on these collected fees." This revenue splitting arrangement indicates that Taxpayer will receive 100 percent of the income from users of the Online Placement Service that exclusively use the online placement services offered through Taxpayer's website. The language of this section refers to users as Taxpayer's clients and indicates that Vendor collects users' fees on behalf of Taxpayer. Far from being a royalty, payments remitted by Vendor to Taxpayer represent the collection of fees by Vendor paid to Taxpayer for use by individuals and employers of Taxpayer's services.

The description of services provided and the lack of discussion of intangible assets makes Taxpayer's agreement with Vendor similar to the agreement described in New Jersey Council that was determined not to be an agreement for a royalty. Given that (1) the agreement calls itself a "service agreement," (2) calls Taxpayer the customer of those services, (3) describes only services to be provided for the benefit of Taxpayer, and (4) does not discuss the exchange of intangible properties at all, such agreement should be understood by its terms, rather than being viewed erroneously as a license agreement for royalties.

Other Facts and Circumstances

The agreement also needs to be considered within the context of the overall operation of the online placement services on Taxpayer's website. Prior to the agreement, Taxpayer operated its job placement services on its own for over two decades. Then, Taxpayer operated an online job placement service for several years before it ran into technical difficulties. Because of these technical problems, Taxpayer contracted with Vendor.

Further, Taxpayer provides significant services for its job placement activity. The prices for using the Online Placement Service services, as well as the varying products and services that can be purchased through the Online Placement Service, are determined by Taxpayer for all users of the Online Placement Service. Taxpayer also determines the content, type, and timing of any advertising for the Online Placement Service. Taxpayer ensures that its landing page and other parts of its website, which includes the Online Placement Service, are accurate and updated as necessary. Taxpayer processes Vendor's monthly invoice for payment. Taxpayer ensures that the Online Placement Service is being operated in a manner consistent with the Agreement and

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that its members are satisfied with the Online Placement Service. One of Taxpayer's employees is responsible for ensuring that Vendor's software interfaces properly with Taxpayer's membership database, enabling members to sign into the Online Placement Service. Furthermore, Taxpayer maintains a small team that offers career and resumé advice as part of its online placement services to assist members with employment opportunities. On behalf of Taxpayer, these individuals offer advice directly to the users of the Online Placement Service, as well as responding to questions and concerns, in a timely fashion either by phone or email. Taxpayer's website directs users to contact the Taxpayer Placement Team if they have academic questions or need more information about Taxpayer's Placement Service. All of these facts suggest that the online placement services offered through Taxpayer's website are a continuation of the services offered, without the use of a vendor, in prior tax years. See Rev. Rul. 69-430. This fact distinguishes Taxpayer's situation from that found in Sierra Club, where the taxpayer never offered, and could not offer, the affinity credit card program on its own.

Other facts about the operation of the Online Placement Service also indicate that Taxpayer considers the Online Placement Service to be its trade or business and that users of the Online Placement Service consider themselves to be paying for a service provided by Taxpayer. First, the Online Placement Service is operated as part of Taxpayer's web pages. The web pages containing and discussing the Online Placement Service are indistinguishable from the other web pages on Taxpayer's website. The URL used for the web pages containing and discussing the Online Placement Service also contain Taxpayer's name in acronym form in the same manner as all other pages on Taxpayer's website. Further, these webpages refer to the Online Placement Service as "[Taxpayer's] Placement Services." Users of the Online Placement Service only have a few indications of the presence of Vendor in the operation of the Online Placement Service. These indications include a small logo at the bottom right of the Online Placement Service pages that indicate that the Online Placement Service is "hosted by [Vendor]." These indications also include statements on the web pages describing the service as Taxpayer's who has "partnered with [Vendor] to provide a full-featured Placement Service," and a statement in the Terms and Conditions of using the Online Placement Service that the terms represent the full agreement between the user and Vendor. These statements are consistent with, if not indicative of, the online placement services being the trade or business of Taxpayer. Additionally, the first two statements provide no indication to users of the online placement services that they are services provided by anyone other than Taxpayer. These statements leave the impression that Taxpayer holds itself out as providing the online placement services.

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Direct Communications

Additionally, the language used in direct communications from Taxpayer indicates that Taxpayer treated the online placement services as its trade or business. First, advertisements that went out to Taxpayer's members continued the use of "[Taxpayer's] Placement Services." Other communications from Taxpayer refer to the Online Placement Service as "*our* job board" and, regarding pricing, provide that "we only have a 90-day posting..." (emphasis added). Another communication on the Online Placement Service from Taxpayer provides that "we strive to provide you with highest quality...job search experience both on-site during our annual meeting, as well as, online year-round." (emphasis added.) This last statement joins the Online Placement Service with the job search activities conducted by Taxpayer at its annual meeting, with which Vendor did not participate, suggesting that both the online and in-person placement services are conducted by the same entity, Taxpayer. Other communications from Taxpayer to Online Placement Service users refer to Vendor as "our job board provider" and state that "we use [Vendor] as our online job board provider." Finally, receipts for users of the online placement services are signed by the director of Taxpayer indicating to users that they are doing business with Taxpayer. Communications from the users also indicate that these users believe the Online Placement Service to be Taxpayer's trade or business. These statements, and others, indicate that Taxpayer holds the online placement services out as its trade or business and not that of Vendor.

The terms of Taxpayer's contract with Vendor, the appearance of Taxpayer's website and the Online Placement Service, the language used by Taxpayer in communications with the public, the public's view of who conducted the activity, the fact that Taxpayer conducted the Online Placement Service itself for many years, the control and many services provided by Taxpayer in connection with the Online Placement Service, and the overall divide of sources of income all point to the fact that the Online Placement Service trade or business is conducted by Taxpayer who outsources certain operations to Vendor on Taxpayer's behalf.

Mailing List

Taxpayer argues that providing a link on its website to the Online Placement Service is no different than providing mailing lists to Vendor and requires less effort than providing mailing lists. The rental of mailing lists may constitute royalty income under section 512(b)(2). See Sierra Club, 86 F.3d 1526. However, the facts and circumstances do not indicate that Taxpayer has rented its mailing list to Vendor. By providing a link, Taxpayer is not providing a mailing list to Vendor so that Vendor can contact members on the list. Taxpayer is providing a link so that its members who choose to, can click on the link to use the Online Placement Service. The link is merely a way to navigate on Taxpayer's own website. Additionally, Treas. Reg. § 1.513-4(f), Example 12, illustrates

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a situation where one independent website is linked to another independent website; the guidance does not consider a link as the provision of mailing lists.

Alternatively, if the Online Placement Service is treated as separate from Taxpayer's website, which we do not believe to be the case, the precedent indicates that there are still consequences to providing a link; these consequences include possible advertising activity that is typically an unrelated business activity, as in Treas. Reg. § 1.513-4(f), Example 12. In this instance, Taxpayer would be generating unrelated business income from advertising for Vendor. If links could be viewed as the sale of mailing lists, as Taxpayer contends, then any link to a for-profit entity on any exempt organization's website could be viewed as exempt royalty income; yet for the most part, unless exempt as corporate sponsorship, these links constitute advertising that is subject to unrelated business taxable income. See Treas. Reg. § 1.513-4(f), Example 12.

Additionally, Taxpayer has, in the past, sold portions of its mailing list using a third-party entity in the business of selling mailing lists. In this case, there is no use of this same third-party entity in the provision of the link. These facts indicate that Vendor is not paying Taxpayer to provide a link, or for the use of Taxpayer's mailing list. Rather, the link is a navigation tool on Taxpayer's own Website that leads users to Taxpayer's own Online Placement Service.

Agency

Despite the language of the service agreement discussed above, Taxpayer puts significant weight on language found later in the agreement.

Taxpayer points to paragraph c), "No Agency," of Item 7, "General Provisions" that provides that "the parties agree that they are independent contractors⁵ and will have no power or authority to assume or create any obligation or responsibility on behalf of each other. This Agreement will not be construed to create or imply any partnership, agency, or joint venture." Taxpayer points to this language to indicate that Vendor's efforts in collecting fees and hosting and managing the Online Placement Service cannot be on Taxpayer's behalf. Similar to the other terms of the agreement, however, this language alone is not controlling. State Police Ass'n of Mass., 125 F.3d at 7. Taxpayer also points to the language found in the "Terms and Conditions" for individuals to use the Online Placement Service posted on Taxpayer's website. These terms provide that the "Terms and Conditions" "form a binding contract between you...and [Vendor]." This language is not inconsistent with the activities of an agent acting on Taxpayer's behalf, however. As such, this language cannot outweigh the body of factors discussed above.

⁵ The designation of "independent contractor" is based on Taxpayer's representations; no independent evaluation has been made to determine whether this designation is accurate. The conclusions contained in this TAM do not address worker classification status.

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Further, Taxpayer points to the National Carbide principles to indicate that Vendor is not the agent of Taxpayer and that, therefore, Vendor's efforts cannot be in furtherance of Taxpayer's trade or business. Even if Taxpayer's assertion is correct, we do not agree that the question of whether or not Vendor is an agent is controlling in this issue.

National Carbide is primarily used to determine whether a subsidiary corporation should be ignored as the agent of the parent and was not used in cases such as State Police Ass'n of Massachusetts; nevertheless, using these principles indicates that users of the online placement services viewed Vendor as an agent of Taxpayer and believed Vendor to be Taxpayer's agent.

Six Factor Test

The "six National Carbide factors" for agency include:

"[1] Whether the corporation operates in the name and for the account of the principal, [2] binds the principal by its actions, [3] transmits money received for the principal, and [4] whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal are some of the relevant considerations in determining whether a true agency exists. [5] If the corporation is a true agent, its relations with its principal must not be dependent on the fact that it is owned by the principal if such is the case. [6] Its business purpose must be the carrying on of the normal duties of an agent." 336 U.S. at 437.

(1) Vendor operates in the name of Taxpayer. This is indicated by the fact that the Online Placement Service is called "[Taxpayer's] Placement Services" and is found on Taxpayer's website using a URL with Taxpayer's acronym in it. The fact that Taxpayer receives 100 percent of the revenue from sales provided to users of the Online Placement Service made through the Online Placement Service and the fact that the agreement calls these users "[Taxpayer's] clients" indicates that Vendor operated for the account of Taxpayer. (2) Vendor's actions bind Taxpayer to the extent that when Vendor accepts payments and personal information from users of the Online Placement Service, Taxpayer is bound by Vendor's user agreements, privacy statements, and other existing agreements used by Vendor with users of the Online Placement Service. This binding is explicitly stated in Item 3 of the "General Terms and Conditions" in the agreement between Taxpayer and Vendor. (3) As indicated in the revenue sharing portion of section IV of the agreement, Vendor transmits to Taxpayer money received on Taxpayer's behalf. (4) While Vendor continues to own the code and software used to create the software, as discussed earlier, Taxpayer pays Vendor to use these assets in a manner similar to a lessee of office space. Furthermore, the Online Placement Service exists on a domain name belonging to Taxpayer using Taxpayer's trademarks. In this way, the receipt of income is attributable to assets owned or leased by Taxpayer. (5) Since Vendor is not a subsidiary of Taxpayer, principle [5] does not apply. Finally, (6) Vendor was in the business of offering hosting and managing services to job board

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providers; thus, Vendor was in the business of being an agent. The fact that this is Vendor's business is evidenced by the terms of the service agreement, which labels Vendor as "provider" and Taxpayer as the "customer." The fact that Vendor hosts similar job boards for other organizations in a similar manner is also evidence of this fact. Furthermore, communications between Taxpayer and Vendor during the tax years in question indicate that Vendor reached out to Taxpayer to suggest methods of advertising the online placement service that Vendor uses for other clients. These communications indicate that Vendor is in the business of providing these services on behalf of its "customers," who are the organizations controlling job boards rather than the users of the job boards. Taking all of the "National Carbide factors" into account further indicates that, despite the language in Taxpayer's agreement, Vendor acted on behalf of Taxpayer as its agent.

Taxpayer's activities and service agreement with Vendor are similar to those found in State Police Ass'n of Massachusetts where the court stated "The manner in which the parties to an agreement designate their relationship is not controlling. A true agency relationship may be established despite the parties' designation to the contrary." In that case the court determined that "the agreements manifested an intent that [the contracting parties] would act on behalf of petitioner in conducting the sale of advertising...the agreements provided a payment collection procedure in which 'All checks or money orders received as a result of the solicitation shall only be made payable to * * * [petitioner].' By providing [the contracting parties] with the authority to use petitioner's name and to collect petitioner's solicitation payments, the agreements authorized those companies to act on behalf of petitioner in conducting the sale of advertising." As discussed above, these facts are synonymous with Taxpayer's situation indicating that similar to the organizations in State Police Ass'n of Massachusetts, Vendor acts as Taxpayer's agent when collecting fees on Taxpayer's behalf.

Website Address

Taxpayer also points to item 2 in "General Terms and Conditions" of the agreement, which provides that "At all times...[Vendor] maintains all ownership and rights over its software...and technologies associated with the software. [Vendor] retains the right to all content, code, data, and other materials created as a result of this Agreement and/or usage of its software." Taxpayer points to this language to indicate that the operation of the Online Placement Service must be that of Vendor since Vendor continues to own the software used to run the Online Placement Service. This argument fails to discuss that the web address for the Online Placement Service is not transferred or licensed to Vendor. Similar to the names and trademarks, the agreement does not discuss, nor do any other facts indicate, that Vendor has licensed the use of Taxpayer's website. Rather, the agreement and the facts discussed above indicate that Taxpayer is paying to use property owned by Vendor – Vendor's code - in furtherance of Taxpayer's trade or business conducted on Taxpayer's web pages. In fact, Taxpayer conducted the

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Online Placement Service itself for several years before contracting with Vendor to service the information technology of the Online Placement Service. Before the Online Placement Service, Taxpayer conducted placement services for over twenty years, and continues to provide in-person placement services that now require the use of the Online Placement Service. Vendor merely provides software and services to Taxpayer so that the Online Placement Service will run correctly.

Utilizing the information technology (IT) services of another organization does not generally transfer ownership of a website or a website's activities to the IT service organization. For example, if an organization used the software of another organization to run various parts of its website, the organization would still be considered the licensee of its website domain and the owner of all the activities on that domain. Taxpayer has created an online site where members can search for jobs and employers can post jobs. The activity belongs to Taxpayer; the software to operate this activity belongs to Vendor. In this case, the fact that Taxpayer operated the Online Placement Service initially and keeps that Online Placement Service on its website indicates that the Online Placement Service is Taxpayer's activity and that Taxpayer pays fees to Vendor to service that activity.

Conclusion

Because the conduct of the online placement services is a trade or business of Taxpayer, the income from the online placement services stems primarily from the fees paid by the users of the Online Placement Service, as well as advertising, rather than the licensing of Taxpayer's website, trademarks, and members list. Accordingly, the income from the Online Placement Service is not a royalty payment from Vendor to Taxpayer. This decision is made on the weight of the facts and circumstances in this case; however, not all factors are needed and no single fact is necessarily dispositive. The income from the Online Placement Service activity is taxable under section 511 as income from an unrelated trade or business and not excludable under the royalty modification found in section 512(b)(2).

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.