

Tax-Exempt Spinoffs?

by Robert W. Wood • San Francisco

In what may be an unfortunate turn of phrase, the tax press has begun reporting on what is undoubtedly a significant development, under the rubric of “tax-free spinoffs.” The controversy comes out of the Tax Court’s decision in *Bob Jones University Museum and Gallery, Inc. v. Commissioner*, T.C. Memo 1996-247 (1996). That case involved the long-discussed Supreme Court decision back in 1983 that Bob Jones University, with its policy of prohibiting inter-racial dating and marriage, did not qualify for tax-exempt status. See *Bob Jones University v. United States*, 461 U.S. 574 (1983).

After this institution’s tax-exempt status was revoked, the University incorporated its museum separately, requesting that the IRS recognize the museum as a tax-exempt charity. The museum and University entered into a three-year lease in 1993, under which the museum rented the building that it occupied for the past 30 years. The rent payments

Continued on Page 7

TAX-EXEMPT SPINOFFS Continued from Page 6

are below fair market value.

The lease provides that the University would continue to own all works of art and other items of personal property located in or on the leased premises, and is lending them to the museum at no cost for three years. The lease also provides that the University is obligated to pay all tax, repair and utility costs on the building. The museum, however, is responsible for routine maintenance.

The Tax Court decision goes through all of the various connections between the University and the museum. Nonetheless, the Tax Court found that the museum did not impermissibly receive private benefits, that there was nothing wrong with an overlapping board of directors (the University controls less than 50% of the votes on the museum's board), and that the two organizations did not engage in transactions in which the museum paid the University unreasonable amounts for goods and services. The benefit the University derived from the location of the museum, according to the Tax Court, was merely incidental. Repeatedly referring to the arrangement as a spinoff, the Tax Court concluded that the museum could be exempt on its own.

What's in a Name?

Quite apart from the substantive aspects of the *Bob Jones University Museum and Gallery* case, which may be considerable, readers should be aware that the spinoff terminology may be becoming looser and looser. Indeed, it is now relatively common for businesspeople to talk about "spinoffs" without specifying whether they mean taxable or not. Here, with exempt organizations, there may be an even greater lack of precision about what a spinoff means. ■

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