Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Contact Person:

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In Reference to:

Date: NOV 5 1998

Employer Identification Number:
Key District:

Legend:

M =
N =

Dear Applicant:

This letter is in reply to the letter, as amended, from the authorized representative of M requesting certain rulings with respect to a proposed restructuring and the proper tax treatment of income received by M under section 512(a)(1) of the Internal Revenue Code.

M is a professional organization described in section 501(c)(6) of the Code. M's primary exempt function is to develop and implement, for its members, healthcare public policy through legislation, regulation, and litigation at the state and federal levels. In addition, M provides a number of services for its members, including education, media and public information, and legal analysis and representation (non-litigation).

M states that its statewide membership is comprised predominately of organizations described in section 170(b)(1)(A)(iii) of the Code and recognized as exempt under section 501(c)(3). Most of M's members are also members of one of three regional associations which serve similar functions on a regional level and which are recognized as exempt under section 501(c)(6). The regional associations provide operational services to their members including operational management guidance, assistance with grass roots advocacy programs, and assistance with other local needs in the healthcare industry. Several board members of the regional associations are also on M's Board of Directors. Prior to M's proposed restructuring, many of M's members paid dues both to M and to one or more of the three regional organizations.

Due to rapid change in the healthcare industry and in response to financial pressures from its membership, M states that it and the three regional associations concluded that it would be necessary to restructure their activities to better serve their membership. M states that this restructuring process has several aspects:

(1) N was formed, with the three regional associations as its members, and was recognized as exempt under section 501(c)(6) of the Code. N's purpose is to provide representation and advocacy before state and federal governments on behalf of its members. N shall, acting as agent for M, bill and collect M membership dues in conjunction with its own membership dues billing and collection.

(2) To reduce the total member dues assessment, M and the three regional associations consolidated billing and collection of their state and federal and local representation and advocacy activities.

(3) M, under a service contract with N, will provide all of the administrative and professional services for the representation and advocacy functions of N and the three regional associations including state and national public policy management, representation and advocacy, legal services, public relation services, and human resource services.

(4) To streamline the membership dues billing process, a billing statement will be issued by each of the three regional associations to assess membership dues for both M and the applicable regional association. Most of the dues allocated to N will, in turn, be paid to M under the service agreement.

M states that the services it performs under the service contract with N are principally the same educational and legislative activities that it has performed historically in furtherance of its exempt function, and, as such, the services are uniquely related to its exempt purpose. M also states that these services benefit the entire healthcare industry rather than individual members in the industry, and that all of the services are ultimately financed by dues collected by the three regional associations and then allocated to N.

Section 501(c)(6) of the Code provides for the exemption from federal income tax of business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized

for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for a profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league.

Section 511(a)(1) of the Code imposes a tax on the unrelated business income of certain exempt organizations, including those exempt under section 501(c)(6).

Section 512(a)(1) of the Code provides that as a general rule, except as otherwise provided, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less certain allowable deductions and modifications.

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 the functions constituting the basis for its exemption.

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 1.513-1(a) of the regulations provides that gross income of an exempt organization subject to tax imposed by section 511 of the Code is includible in the computation of unrelated business taxable income if: (1) it is income from a trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than

through the production of funds) to the organization's performance of its exempt functions.

Section 1.513-1(b) of the regulations provides that activities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are 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 purposes of the organization. Thus, for example, activities of soliciting, selling, and publishing commercial advertising do not lose identity as a trade or business even though the advertising is published in an exempt organization periodical which contains editorial matter related to the exempt purposes of the organization.

Section 1.513-1(d)(1) of the regulations provides that, in general, gross income derives from "unrelated trade or business," within the meaning of section 513(a) of the Code, if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question--the activities, that is, of producing or distributing the goods or performing the services involved--and the accomplishment of the organization's exempt purposes.

Section 1.513-1(d)(2) of the regulations provides that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes, and is "substantially related," for purposes of section 513 of the Code, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is

granted exemption depends in each case upon the facts and circumstances involved.

M states that N provides lobbying activities for the benefit of M's membership, and that M will be reimbursed for the cost of providing these services.

Before income from an activity may be taxed as unrelated business income, the following three conditions must be satisfied: (1) the activity must constitute a trade or business; (2) the trade or business must not be substantially related to the organization's exempt purpose; and (3) the trade or business must be regularly carried on.

It is evident from the facts presented that M's activities regarding lobbying services to N are regularly carried on and that the activities may be considered to be trade or business. However, we are persuaded that M's lobbying activities are substantially related to its exempt purposes within the meaning of section 1.513-1(d)(2) of the regulations because they benefit the common business interest of M's membership as a whole and do not benefit any members in their individual capacities.

Based on the application of the above principles to the facts presented in the ruling request, we rule as follows:

(1) Amounts received by M from N for lobbying services under the service contract will not be considered to be unrelated business income taxable under section 512(a)(1) of the Code.

(2) The proposed restructuring will not affect M's status as an organization described in section 501(c)(6) of the Code.

The ruling request, as amended, contains no request with respect to the treatment of income from billing and other administrative services provided under the service contract with N.

These rulings are based on the understanding that there will be no material changes in the facts upon which they are based. Any such change should be reported to your key District Director. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records. A copy of this ruling is being forwarded to your key District Director. Except as we have specifically ruled herein, we express no opinion as to the consequences of these transactions under the cited provisions or under any other provisions of the Code.

This ruling is directed only to the organization that requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

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

Sincerely yours,

(signed) Garland A. Carter

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2