

Internal Revenue Service
Director, Exempt Organizations

Department of the Treasury
P.O. Box 2508 -
Cincinnati, OH 45201

Date: MAY 24 2001

Employer Identification Number:
[REDACTED]

Person to Contact - I.D. Number:
[REDACTED]

Contact Telephone Numbers:
[REDACTED]

Phone

FAX

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(6) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 897, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If we do not hear from you within the time specified, this will become our final determination.

Sincerely,

Steven Miller

Director, Exempt Organizations

Enclosures:

ENCLOSURE I

Information submitted with the organization's application indicates it was incorporated [REDACTED] in [REDACTED]. The Articles of Incorporation state the corporation is organized for the following purpose: "To maintain and operate a scientific laboratory for the purpose of polarizing, analyzing or otherwise [REDACTED] for the use and convenience of its members; and generally to foster the trade and interests of its members; and for these purposes to purchase, lease, or otherwise acquire, hold, sell, convey, mortgage or otherwise dispose of real estate and property, or any interest therein, subject to restrictions and regulations of law, and to purchase, acquire, own, hold, sell or otherwise dispose of such furniture, fixtures, supplies and other articles and appliances as may be necessary or expedient, and in general to do any and every thing necessary or proper or expedient to effectuate said purposes of the corporation."

Article I of the organization's bylaws indicate it is a membership organization. The bylaws state the members of the corporation shall be persons, firms, or corporations which are engaged in [REDACTED] [REDACTED] for [REDACTED] or which maintain at least one division whose principal activity is [REDACTED]. The bylaws further state the members shall be divided into two classes, respectively designated Class "A" and Class "B". Class "A" shall include only [REDACTED] and [REDACTED]. Class "B" shall include only [REDACTED] and [REDACTED]. The bylaws state no member may belong simultaneously to both classes, and the classification of a member shall be determined by the member's principal activity in [REDACTED].

Section 2 of the bylaws state, "No person, firm or corporation shall be eligible for membership unless, either as a [REDACTED] or a [REDACTED], the person, firm, or corporation has submitted to the [REDACTED] for polarization testing during the preceding calendar year at least [REDACTED]." The bylaws further explain that at the close of each calendar year, and prior to the annual meeting of the corporation, a statement shall be prepared showing the total number of samples submitted to the [REDACTED] during the preceding calendar year. In compiling this statement, only samples of [REDACTED], and [REDACTED] and [REDACTED] which meet the criteria of Article I, section 1, shall be considered.

[REDACTED]
[REDACTED]
Article II of the organization's bylaws provides that members of each class shall elect only members of their class to be represented on the board of directors. The board of directors shall manage the business and affairs of the Corporation.

Article VII of the organization's bylaws provide that, "No [REDACTED] assets shall be distributed to any member of the [REDACTED] except as may be owed the member in the course of normal business activities." Article VII further provides, "Upon dissolution of the [REDACTED], all net assets of [REDACTED] would be distributed to [REDACTED]"

The organization filed Form 1024 in which it stated, "[REDACTED] [REDACTED] was formed in [REDACTED] by members of [REDACTED]. It was established to improve the business conditions of its members by assisting its members in the normal business transactions of [REDACTED]. Specifically, the function of the [REDACTED] is to provide unbiased analysis of [REDACTED]. These analyses are used in the determination of the settlement price of [REDACTED]. [REDACTED] operates as a referee laboratory. The buyer and seller of [REDACTED] analyze the [REDACTED] themselves. [REDACTED] analyses (sic) the same [REDACTED] and acts as the unbiased [REDACTED] for the purpose of avoiding disputes. [REDACTED] can effectively operate as the unbiased referee because it has no profit motive and exists to serve all its members (both [REDACTED] and [REDACTED]) equally." (Form 1024, Page 2)

The organization also stated in its application for exemption. "The bulk of the [REDACTED] operating fund (approx. [REDACTED]) are derived from fees to its members (sic) from the analysis of contract [REDACTED] as described above. [REDACTED] also offers as a service to its members and industry affiliates certain other analytical services. In addition, the [REDACTED] also provides to its members other services for which no fees are charged." (Form 1024, page 2)

The organization stated currently there are [REDACTED] members of Class "A" and [REDACTED] members of Class "B". (Form 1024, page 3, item 7)

The organization's application also included the following information, "[REDACTED] was incorporated as a non-profit organization under [REDACTED] and was operated as a tax-exempt organization under the IRS rules until [REDACTED]. Tax-exempt status was lost after a [REDACTED] distribution of \$[REDACTED] was made to the members of the [REDACTED]. Reinstatement of tax-exempt status was unsuccessfully applied for in [REDACTED]"

[REDACTED]

The organization asserts that the event on which its [REDACTED] revocation of exemption was based was an isolated event and its present bylaws expressly prohibit such distributions.

The organization contends it is a business league within the provisions of section 501(c)(6) of the Internal Revenue Code. The organization further contends it meets the requirements of section 501(c)(6) as it has no shareholders, has never issued any stock and no part of the net earnings inure to any individual.

The organization contends that providing services to its members benefits the common interests of [REDACTED] industry as a whole. In its letter dated [REDACTED] the organization states,

"While it is true that any number of for-profit laboratories could provide analytical services similar to our [REDACTED], what makes [REDACTED] unique is that we are set up as the neutral referee [REDACTED] of [REDACTED] (as specified in the industry [REDACTED]) and as such we promote the common interests of industry members by enabling the trading of [REDACTED] without recourse to disputes and legal remedies."

In the same letter the organization also states,

"...we perform the testing as the third party regardless of the [REDACTED] of [REDACTED]. The [REDACTED] & [REDACTED] which may have different evaluations of the [REDACTED] are enabled by us to come to an agreement because we are accepted by both contractual parties as the unbiased and neutral referee laboratory. In contrast to the for-profit [REDACTED], [REDACTED] is not an agent of either party in the transaction; our funding and our administration (board of directors) is equally representative of [REDACTED] & [REDACTED] interests. Both the [REDACTED] and [REDACTED] also have the [REDACTED]. The final settlement value of the [REDACTED] is determined by averaging the closest [REDACTED] results. We thus prevent either [REDACTED] or [REDACTED] from over or under estimating the quality of the [REDACTED] and profiting thereby. We thus promote the common business interests of the industry as a whole in enabling the smooth functioning of contractual purchases of [REDACTED]."

The organization contends it meets the requirements of section 501(c)(6) because its membership is open to all in [REDACTED] who are actively engaged in the [REDACTED] or [REDACTED] of [REDACTED] to be

[REDACTED]

processed into [REDACTED]. A minimum number of [REDACTED] submissions is specified to eliminate those entities that are not active participants in [REDACTED].

The organization also contends it differs from for-profit entities excluded under section 501(c)(6) because the prices it charges for its services are set at a level calculated to cover its expenses and not to make a profit. In support of this, the organization stated it has resorted to price increases only when necessary to offset losses and to maintain a necessary minimum level of reserves.

Section 501(a) of the Code provides for the exemption from Federal income tax of organizations described in section 501(c).

Section 501(c)(6) of the Code provides exemption from Federal income tax for "Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), 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 states, "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 the 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 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."

In General Contractors' Ass'n of Milwaukee v. United States, 202 F.2d 633 (1953), exemption was denied to an association of general contractors. Among the organization's activities were services to members that included the operation of a Bureau of Quantity Survey that supplied engineering and estimating reports to members. Most of the organization's members had their own survey and estimating departments to assist in the preparation of bids for prospective contracts. However, the organization's Bureau of Quantity Survey conducted, on behalf of members, an independent survey of the quantity of material necessary for a particular project. The analysis was then made available to the member as a check against the data completed by their own survey and estimating departments. The organization stated the purpose of the Bureau was to provide "a sort of insurance" against

[REDACTED]

estimating errors. The services furnished the members a degree of certainty about their bids and contracts. The reports made by the organization would be identical in scope and purpose with one that had been prepared by a private organization. Thus, the Court found, the organization was engaged in business of a kind ordinarily conducted for-profit.

The organization's bylaws expressly prohibited any distribution of the assets or revenues to the members of the organization. The Court found the services to members constituted inurement. The Court stated that it is a familiar principle that earnings may inure to members of an association in a manner other than through distribution of dividends. Thus, where valuable services are rendered to individual members, it may be said that part of the net earnings of a taxpayer inure to the benefit of its members.

In Credit Managers Association of Northern and Central California v. Commissioner, 3 T.C.M. 385 (1944), the applicant corporation was denied exemption as a business league. The organization operated a credit bureau that compiled and provided credit information about customers to members on a fee basis. The Court held that the services supplied were of a sort vital to the members in the operation of their business, which they would have been compelled to purchase elsewhere or supply themselves at a greater cost, but for the existence of the organization. The Court stated, "We do not conceive the statute to extend exemption to an organization existing primarily for the convenience or economy of its members, but only to such organizations as are dedicated principally to a public or quasi-public purpose."

In Rev. Rul. 67-182, 1967-1 C.B. 141, exemption under 501(c)(6) was denied to an organization whose only activity was providing a reference library of electric logs and maps to its members. The Rev. Rul. stated that the organization was making specialized information available to members. That served as a convenience and economy in the conduct of their businesses. Operation of the library was found to be an activity that constituted the performance of particular services for individual persons.

In Apartment Operations Ass'n v. Commissioner of Internal Revenue, 136 F.2d 435 (1943), the Court denied a claim of exemption as a business league. The organization claiming exemption in the case was an association of apartment owners. The organization acted as a clearinghouse for information about tenants, operation of apartment houses, legislation affecting the business, and gave counsel and advice to members to promote their welfare. The organization also provided printed forms at cost to members, purchased goods and equipment for resale to members at prices lower than they could obtain for themselves, and published a journal containing advertisements. The organization

[REDACTED]

also represented its members in labor disputes and negotiations. The organization did not earn a profit. The Court found that the organization did not meet the description of a business league because it regularly carried on a business of the kind ordinarily conducted for profit. The court also found there was no showing that business done and services to members were merely incidental to the organization's total activities.

In Unites States of America v. Oklahoma City Retailers Association, 331 F.2d 328 (1964), the association's primary activity was a credit rating bureau for members. The organization furnished the same services to non-members and charged them the same fixed fee as required of members. The Court found that the evidence clearly established that the credit information service constituted a substantial part of the organization's activities. Therefore, the Court held, the organization did not meet the conditions imposed by the statute and regulations and was not entitled to the statutory exemption.

In Evanston-North Shore Board of Realtors v. United States, 320 F.2d 375 (1963), the organization that was held not to be exempt under section 501(c)(6) was a real estate board that operated a multiple listing system. In addition to the multiple listing system, the organization's activities included the operation of a member selection program to screen and educate new applicants, the arbitration of disputes between members, enforcement of a code of ethics, participation in the adoption and enforcement of zoning and municipal ordinances, and the support of various campaigns to maintain and improve cities. The Court ruled that the organization's operation of the multiple listing system could not be regarded as directed to the improvement of business conditions in the real estate market within the meaning of the regulations, but rather constituted the performance of a particular service for brokers participating in the service. The listing system was financed by fees charged to members based on their usage of the service. The Court considered multiple factors in reaching its conclusion that the organization was not exempt. The factor cited as the most important by the Court was the fact that the fees charged for the listing service were in approximate proportion to the benefits received by each member. The Court stated, "When each member contributes in proportion to what he receives, it is a strong indication that the benefits are inherently group benefits."

In MIB, Inc. v. Commissioner of Internal Revenue, 734 F.2d 71 (1986), an organization whose membership consisted of insurance companies was denied exemption as a business league under section 501(c)(6) of the Internal Revenue Code. The principal activity carried on by MIB was the maintenance and operation of a computerized system for compiling, storing and distributing information about applicants for life insurance. Member organizations submitted information about applicants

[REDACTED]
 [REDACTED]

relevant to insurability, such as health information. MIB compiled and stored the information. Other members who had received an application from an individual then could request a report on the applicant from MIB. MIB argues that members could compare MIB's report with the application to discover incomplete or misleading applications. MIB further argued that this created a deterrent to fraud which created benefits to the industry through reduced investigation expenses and reduced losses due to misclassification of applicants. These savings were then passed on to policyholders. MIB's funds came from fees and assessments from members based on usage and with the number of transactions. MIB also operated the Center for Medico-Actuarial Statistics that assisted in studies related to mortality, morbidity and other related issues. The Court held MIB's activities by their nature consisted of rendering particular services for individual member companies and served to benefit the individual members' businesses. The Court also stated that even though the services produced various indirect and intangible benefits for the industry as a whole, the fact remained that the rendered services were in form and substance particular services for individual member companies. According to the Court the ultimate inquiry is whether the association's activities advance the members' interests generally, by virtue of their membership in the industry, or whether they assist members in the pursuit of their individual businesses. The Court allowed that a major factor in determining whether services are "particular" is whether they are supported by fees and assessments in approximate proportion to the benefits received.

[REDACTED] is like the organization that was denied exemption in General Contractors' Ass'n of Milwaukee v. United States. Like the organization that was denied exemption, [REDACTED] provides reports to its members that analyze materials involved in a particular business transaction. Like the organization in the case, [REDACTED]'s reports are intended to provide a check or confirmation of the member's analysis. Like the organization in the case [REDACTED] services provide the members with a degree of certainty with respect to a contractual transaction. [REDACTED] conducts an analysis of [REDACTED] that are also analyzed by the [REDACTED] and [REDACTED]. [REDACTED] stated in its letter dated [REDACTED] that the final settlement value of the [REDACTED] (to determine the sales price) is determined by averaging the closed two results. Thus, [REDACTED] services are integral to determining the contract sales price of [REDACTED]. The Court in the case determined that General Contractors' Association of Milwaukee's services were identical in scope and purpose with those provided by a private, for-profit entity. [REDACTED], by its own statements in a letter dated [REDACTED], acknowledges that the services it provides could be provided by for-

[REDACTED]

profit laboratories. Specifically, it stated, "...it is true that any number of for profit laboratories could provide analytical services similar to our Laboratory..."

The organization in General Contractors' Ass'n of Milwaukee, operated under bylaws that expressly prohibited a distribution of assets or revenues to members of the organization. Like the organization in General Contractors' Ass'n of Milwaukee, [REDACTED] bylaws provides that no assets shall be distributed to any member of the organization. [REDACTED] also has no shareholders and has never issued stock. In General Contractors' Ass'n of Milwaukee, the Court expressly stated that inurement to members may occur in a manner other than through distribution of dividends. (General Contractors' Ass'n of Milwaukee, 202 F.2d at 636) The Court went on to state that where valuable services are rendered to members, part of the net earnings has inured to the benefit of members. The Court's position in General Contractors' Ass'n of Milwaukee applies to [REDACTED]. Even though [REDACTED] does not pay dividends, it provides valuable services to members. Based on the Court's reasoning, [REDACTED] services to members constitute inurement. Section 501(c)(6) prohibits inurement of earnings to the benefit of any private shareholder or individual.

[REDACTED] is like the organization described in Credit Managers Association of Northern and Central California v. Commissioner. The Court found that the services provided by the organization to members were vital to the operations of the members' businesses and without the organization, the members would have been compelled to purchase elsewhere at a greater cost. The Court indicated it did not believe the statute extended exemption to an organization that existed for convenience or economy of members. [REDACTED]

[REDACTED] itself has stated that the services could be provided by any number of for-profit laboratories. Under the arrangements between buyers and sellers, as described by [REDACTED], the buyer and seller mutually agree to use [REDACTED] services as the referee laboratory. [REDACTED] submitted no evidence that buyers and sellers cannot mutually agree to retain a for-profit entity to act as a referee laboratory and that a for-profit can never provide a neutral analysis. Without such evidence, [REDACTED] cannot establish that its services are unique and dissimilar to services offered by for-profit laboratories.

[REDACTED] is like the organization that was denied exemption in Rev. Rul. 67-182. It is serving as a convenience and economy in the conduct of the members' businesses. [REDACTED] stated in its application, "It was established to

improve the business conditions of its members by assisting its members in the normal business transactions of [REDACTED] (Emphasis added). [REDACTED] Articles of Incorporation also contain explicit provisions that the organization was formed and operated to improve the businesses of members.

[REDACTED] is like the organization that was denied exemption in Apartment Operations Ass'n v. Commissioner. Like the organization in this case, [REDACTED] has no purpose of making a profit. [REDACTED] maintains, in its own words, "a necessary minimum level of reserves." (Letter dated [REDACTED]) The organization in Apartment Operations Ass'n v. Commissioner also maintained a small surplus to assure its continuance. The Court in this case found the organization's activities were particular services for individual persons and that these activities were the predominant functions of the organization. Thus, the Court held, the organization was not entitled to exemption. [REDACTED] stated in its application that the bulk of its operational funds (approximately [REDACTED]) are derived from fees from members for services rendered. The financial information submitted by the organization is consistent with this information.

That an organization does not earn a profit does not in and of itself qualify an organization for exemption under section 501(c)(6). Indeed, section 1.501(c)(6) of the Income Tax Regulations states, "An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for 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." (Emphasis added)

[REDACTED] contends that it offers its services to non-members and some services to members free of charge. In this way [REDACTED] is like the organization that was found not to qualify for exemption in United States of America v. Oklahoma City Retailers Association. The organization in this case provided credit reports to members and non-members for a fixed fee. The Court determined that providing services to non-members is still the performance of particular services for individual persons, which is prohibited under the Income Tax Regulations.

[REDACTED] is also like the organization held not to be exempt in Evanston-North Shore Board of Realtors v. United States. [REDACTED] provides services to members on a fee for transaction basis, meaning members pay a fee for each transaction. The Court placed great significance on the fact that fees charged were in approximate proportion to the benefits received by the recipients. The Court indicated that when each member contributes in proportion to what it receives, it is a strong indication that the

benefits received are not group benefits. (Evanston-North Shore Board of Realtors, 331 F.2d at 331) Information submitted with the application indicated that the more samples a member submitted, the more fees they would incur. [REDACTED] operational guidelines are found in its bylaws and provide for a monitoring of frequency of use that includes an annual summary. Members who do not submit a minimum number of samples, may according to the bylaws, lose their active membership status.

[REDACTED] also indicated that a contractual requirement for analysis at its facility is a standard industry practice. This indicates that the more transactions and contracts conducted by buyers and sellers, the greater the number of services provided to members. According to Evanston-North Shore Board of Realtors, this indicates benefits are directed to individual members rather than the group as a whole.

[REDACTED] is like the organization in MIB, Inc. v. Commissioner in multiple ways. Like [REDACTED], MIB provided reports to members that were used to effect the business transactions of individual members. Whereas, MIB provided reports compiled from information submitted by other members, [REDACTED] reports based on samples submitted by the requesting members. This difference is minor. Specifically, MIB advanced the same argument before the Court that [REDACTED] now advances. [REDACTED] has stated, as did MIB, that by providing services to individual members, the industry as a whole gains significant benefits. MIB argued its services deterred fraud thereby reducing costs to industry members. [REDACTED] argues that its services enable the trading of [REDACTED] without recourse to disputes and legal remedies which, in turn, allows for the smooth functioning of contractual purchases of [REDACTED]. The Court in MIB, Inc. v. Commissioner was very clear that even if the activities of an organization produce indirect and intangible benefits for the industry as a whole, it does not alter the fact that the rendered services are in form and substance particular services for individual persons. (MIB, Inc., 734 F.2d at 77) In this instance, even though [REDACTED] services may enable a smoother functioning of [REDACTED] purchases, as well as possibly reducing litigation, [REDACTED] is still rendering particular services to members. The services are of value to the individual members who will incur less litigation expense and have a greater assurance of receiving or paying fair prices for products.

The [REDACTED] claims industry-wide participation from buyers and sellers. In MIB, Inc. v. Commissioner, the Court stated that while 'industry-wide participation defeats the inference that some members have been treated specially or given a competitive advantage, it

[REDACTED]

does not resolve the nature of the services received. (MIB, Inc., 734 F.2d at 78) The Court indicated a major factor in determining whether services are particular is whether they are supported by fees and assessments in approximate proportion to the benefits received.

Even though the organization offers some services free of charge, as well as the fact that it has developed new procedures for use by the industry, its principal activity remains testing and analyses services for a fee. In addition, the other activities such as development of testing procedures, are an intangible benefit not capable of being measured. In its ruling in MIB, Inc. v. Commissioner, the Court stated, "Where the direct benefits are 'tangible' and the other benefits incapable of accurate measurement, the fact that the organization's principal activity is supported by service charges seems of greater, not lesser, import." (MIB, Inc., 734 F.2d at page 80)

Conclusion

[REDACTED] is operated in the manner of a for-profit entity. The organization's activities are the provision of particular services to individual members. The organization's activities further the business interests of the individual members. This constitutes inurement, which is impermissible under section 501(c)(6). Therefore, [REDACTED] is not exempt under section 501(c)(6) of the Internal Revenue Code.