

Audit Technique Guide – Business Leagues – IRC 501(c)(6)

Introduction

This Audit Technique Guide includes specific information to identify and develop issues commonly encountered during the examination of an IRC Section 501(c)(6) organization.

This guide supplements the guidelines contained in IRMs 4.75.2 through 4.75.6. It's not intended to restrict you in identifying issues or using examination techniques not included here.

This discussion doesn't contain detailed technical information on IRC Section 501(c)(6) organizations. Review the technical information in IRM 7.25.6, Business Leagues.

Background

IRC Section 501(c)(6) provides the exemption of business leagues and similar organizations whose:

- Purpose is to promote the common business interest of its members
- Net earnings don't inure to any member's benefit
- Purpose isn't to engage in a regular business of a kind ordinarily carried on for profit
- Principal activity isn't performing particular services for individuals

Note: A business league's activities that constitute performing particular services to members may result in revocation of exemption if they are primary activities. If they aren't primary activities, any income generated by them may be unrelated business income (UBI).

Membership Requirements

A tax exempt business league's members are persons with a common business interest. Membership support of membership dues and involvement in the organization's activities must be at a meaningful level. Membership support is not support from membership categories formed to produce UBI.

Examination Guidelines – Membership Requirements

Ask the following questions and appropriate follow-up questions during the initial contact or initial interview:

- What are the membership requirements?
- Does the organization have different classes of memberships?
- If so, what are the membership requirements for each class of members?

Read the articles of incorporation, bylaws, etc. for the membership requirements to verify membership is limited to persons with a common business interest.

Review lists of members and activities to ensure that actual membership isn't only a segment of a line of business.

Note: Activities which relate only to a segment of a line of business may indicate that membership, while theoretically open to all, is in operation, limited to a segment of a line of business.

Review membership solicitation materials to determine requirements, classes of memberships, and benefits.

Inurement

The net earnings of an IRC Section 501(c)(6) business league may not inure to the benefit of any member.

Not inurement: Distributing cash to members of only a rebate of their paid dues isn't inurement if the business league pays the distribution in the same proportion as the dues are paid. Business income distributed directly to members, however, is considered to be inurement.

Examination Guidelines – Inurement

Review the organizational documents, membership solicitation materials, minutes, contracts with employers, to identify the types of benefits provided to officers and members.

Review the organization's employment contracts, Forms W-2, Wage and Tax Statement, and other employment records to determine the number and duties of the organization's employees and the reasonableness of salaries and benefits.

Review the disbursement journal to identify any payments to members and determine the reason for payments.

Unrelated Business Income (UBI)

Business leagues frequently have UBI, which may be their primary source of income. These sources may include:

- Coupon redemption services
- Commercial advertising in the organizations publications
- Certain management fees
- Multiple listing services
- Sales of standardized forms to members
- Associate member dues
- Convention or trade show income not from a qualified convention or trade show (See Treas. Reg. 1.513-3.)

Examination Guidelines – Unrelated Business Income (UBI)

Read the minutes, newsletters, and other publications. Look for indications of particular services to members and other unrelated activities.

Review publications to determine whether they contain advertising, which may:

- Subject the organization to the tax on UBI
- Name the products or services of members only (See Treas. Reg. 1.512(a)-1(f), Rev. Rul. 64-315, 1964-2 C.B.147, and Rev. Rul. 65-14, 1965-1 C.B. 236).

Check the organization's website for advertising and other indications of unrelated trade or business activities.

Review any accounts involving non-member income or other income. This income may be due to a regular business of a kind ordinarily carried on for profit.

Analyze income from members (other than dues) to identify any payments for particular or individualized services.

Review the dues account in the cash receipts journal for associate member dues. (See Rev. Proc. 97-12, 1997-1 C.B. 631).

Compensation

Officers and employees of IRC Section 501(c)(6) business leagues may receive various forms of compensation. The underreporting of compensation is a common problem encountered when examining tax exempt business leagues.

Failure to include or properly include the correct taxable amount in wages results in additional compensation. Likely sources include:

- Bonuses
- Expense reimbursements under a non-accountable plan
- Employer provided vehicles
- Taxable fringe benefits

To be excludable from an employee's gross income and wages under an accountable plan, an employer's reimbursement of a work-related expense must meet three requirements:

1. **Business connection:** The expense must be related to the employer's business and otherwise deductible by the employee as a trade or business expense. Also, the employer's payment to the employee must be separate from the employee's wages, or specifically identified.
2. **Substantiation:** The employee must submit documentation to substantiate the amount of the expense and its business purpose within a reasonable period.
3. **Return of excess:** If the employer gives the employee an expense allowance before the he incurs the expense, or the employee's reimbursed amount otherwise exceeds the properly substantiated amount, the employee must return any amount in excess of the substantiated expense within a reasonable period.

A non-accountable plan is a reimbursement arrangement that doesn't meet one or more of the three requirements listed above. Expenses reimbursed under a non-accountable plan are included in employee income and wages.

Note: See Treas. Reg. 1.62-2(c) for requirements for an accountable plan.

Examination Guidelines – Compensation

During the initial interview, ask about bonuses, fringe benefits, and expense reimbursements for employees.

Look for discussions of the payment of bonuses in the minutes. Common examples include:

- Holiday bonuses
- Performance related bonuses
- Non-cash bonuses (e.g. gift certificates)

Review the employee handbook for information about the organization's expense reimbursement policy.

Determine whether the organization maintains an accountable plan. Pay close attention to expense allowances, expense accounts, and similar arrangements.

Inspect vouchers and other employee-provided documentation.

Check the disbursement journal for payments to employees in addition to payroll checks. Look for payments for:

- The same amount made each month, and
- Even dollar amounts (for example, \$50.00, \$120.00, etc.)

Review any restrictions on using employer provided vehicles for personal purposes. (See Treas. Reg. 1.61-21 for a discussion of the value of the personal use of an employer provided vehicle.)

Review employment contracts, employee handbooks, etc. for benefits the organization offers to identify taxable fringe benefits. Fringe benefits are taxable unless specifically excluded by the IRC. Examples of taxable fringe benefits include:

- Club dues
- Nonqualified deferred compensation arrangements
- Group term life insurance in excess of \$50,000
- Employer-provided meals and lodging that do not satisfy the requirements for any exclusion from gross income under the IRC (such as under IRC Sections 119, 132(d) or 132(e))
- After-tax employee contributions to benefit plans

Legislative Activities

IRC Section 501(c)(6) business leagues may participate in lobbying, as a sole activity, if it is germane to accomplishing its exempt purpose; in other words, promoting the common business interests of its members.

A IRC Section 501(c)(6) business league's lobbying expenditures may be subject to IRC Section 6033(e) requirements, which imposes a notice requirement and proxy tax on the lobbying expenditures.

Examination Guidelines – Legislative Activities

Interview the organization's officers and review the minutes, newsletters, websites, and correspondence to identify any legislative activities.

Determine whether any lobbying is related to the organization's exempt purpose.

Determine whether any officials of the organization are registered lobbyists.

Review any contracts with outside lobbyists to determine the extent and the nature of this lobbying.

- Review additional payments to officers, attorneys, etc. for lobbying expenditures disguised as compensation.
- Determine whether the business league is subject to the reporting requirements of IRC Section 6033(e).
- Review dues statements of applicable business leagues to determine whether they properly reported amounts used for lobbying.
- Inspect Form 990-T filed by business leagues which elected not to or failed to provide this notification to verify the proxy tax under IRC Section 6033(e)(2)(A) was properly calculated.

Political Activities

A business league which otherwise qualifies for exemption under IRC Section 501(c)(6) isn't disqualified merely because it engages in some political activity.

An IRC Section 501(c)(6) business league's political expenditures may be subject to the requirements of IRC Section 6033(e), which imposes a notice requirement and proxy tax on the political expenditures of certain business leagues.

IRC Section 527 (f) imposes a tax on the direct political expenditures of organizations exempt from tax under IRC Section 501(a) including business leagues described in IRC Section 501(c)(6).

An exempt business league's separate segregated fund used to conduct its political activities is treated as a separate organization subject to IRC Section 527.

Political Activities – Examination Guidelines

Interview the officers and review the minutes, newsletters, websites, and correspondence to identify possible political activities the organization conducts or the existence of a separate segregated political fund.

Analyze the following accounts for possible political expenditures:

- Legal fees
- Bonuses
- Printing
- Advertising, and
- Entertainment

Analyze bank statements, disbursement journals, etc., to identify whether the organization maintained a separate segregated fund to make political expenditures.

IRC Section 527 Filing and Notice Requirements

If the organization made expenditures for political purposes or maintained a separate segregated political fund, verify that the organization filed all returns and/or reports required by IRC Section 527.

If Forms 1120 POL were	Then
Filed	Inspect the organization's copies of the returns and/or reports and determine whether an examination is warranted.
Not filed	Secure the delinquent returns and/or reports and determine whether an examination is warranted.

Caution: Public Law 106-230, 106th Congress, 2nd Session (2000) made substantive changes to the filing and notice requirements of IRC Section 527 political organizations and funds. Therefore, review IRC Section 527, Treas. Regs. Section 1.527, IRM 7.27.11 and conduct independent research to determine whether there have been any new developments in this area.

IRC Sections 162(e) and IRC 6033(e)– Notification Requirements

Certain legislative and political expenditures and dues payments made to specific exempt organizations for these expenditures aren't deductible as ordinary and necessary business expense per IRC Section 162(e).

Certain exempt organizations must disclose the amount of legislative and political expenditures to which IRC Section 162(e)(1) applies and provide a notice to any person paying dues to which those expenditures are allocable (IRC Section 6033(e)). The notice must contain an estimate of the portion of the dues allocable to those expenditures or the organization must pay a proxy tax. See IRM 7.27.12, IRC Section 6033(e)(2) - Proxy Tax on Lobbying and Political Expenditures, for a further explanation of the technical requirements of IRC Section 6033(e).

Violations of Other Federal Statutes

Be alert to the activities of the organization, any affiliated organization and/or of any officer or trustee that would violate:

- 18 USCS sections 664, or 1954 (about theft, embezzlement, manipulation of trustee funds)
- 2 USCS section 441b (about illegal political contributions)

Note: If you find possible violations of these statutes, prepare Form 5666, EP/EO Information Report and send to the TE/GE classification and case assignment function.