

A corporation organized and operated for the primary purpose of operating and maintaining a purchasing agency for the benefit of its otherwise unrelated members who are exempt from Federal income tax as charitable organizations, is engaged in business activities which would be unrelated activities if carried on by any one of the tax-exempt organizations served. Therefore, the corporation is not entitled to exemption under section 101(6) of the Internal Revenue Code.

Advice is requested whether a corporation organized and operated for the primary purpose of operating and maintaining a purchasing agency for the benefit of its otherwise unrelated members who are exempt from Federal income tax as charitable organizations, is itself exempt from Federal income tax under the provisions of section 101 of the Internal Revenue Code.

The purposes of the instant organization are to secure for hospitals and other charitable institutions the advantages of cooperation in establishing uniform standards as to quality and kind of supplies and the purchasing of the same in accordance with definite specifications and agreements; also to promote the economical and efficient administration of hospitals and other institutions and to establish and maintain a central purchasing agency. Any hospital or similar institution not conducted for profit and engaged in whole or in part in charitable work is eligible for membership. The organization's income is derived from dues, cash discounts on purchases for members, and service charges. Substantial profits are realized by the organization from these operations. Only a portion of such profits are distributed by the organization to its members.

Section 101 of the Code provides in part that:

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under any paragraph of this section on the ground that all of its profits are payable to one or more organizations exempt under this section from taxation. * * *

Section 39.101-2 of Regulations 118 construing such section of the law provides in part that if a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization, for example, a subsidiary organization which is operated for the sole purpose of furnishing electric power used by its parent organization, a tax-exempt educational organization, in carrying on its educational activities. However, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be

an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the subsidiary is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations.

In determining whether an organization is subject to tax under the Federal statutes the facts involved in each case must be carefully considered. In the instant case the activities of the organization concerned consist primarily of the purchase of supplies and the performance of other related services for the several otherwise unrelated charitable organizations that constitute its membership. It is apparent that such activities in themselves cannot be termed charitable, but are ordinary business activities.

Under the provisions of section 101 of the Code an organization which is operated for the primary purpose of carrying on a trade or business for profit is not exempt from Federal income tax, notwithstanding that any profits derived are payable to one or more exempt organizations. Furthermore, under the regulations which interpret such section, it is clear that a corporation formed to service several tax-exempt organizations is not itself exempt if the services performed would be unrelated activities if carried on by any one of the tax-exempt organizations served.

Accordingly, it is held that a corporation organized and operated for the primary purpose of operating and maintaining a purchasing agency for the benefit of its otherwise unrelated members, who are exempt from Federal income tax as charitable organizations, is engaged in business activities which would be unrelated activities if carried on by any one of the tax-exempt organizations served. Therefore, the corporation is not entitled to exemption under section 101 of the Internal Revenue Code.