



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

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Contact Person:

Identification Number:

Telephone Number:

UIL: 501.05-00; 513.00-00

Employer Identification Number:

Legend:

Union =  
Manager =  
Company =  
Date 1 =  
Date 2 =

Dear :

This letter is in reference to the letter dated November 30, 2010, from the authorized representative of Union. Union is requesting a ruling that its creation and operation of a proposed benefit program will not constitute unrelated trade or business for purposes of section 513 of the Internal Revenue Code (Code).

Union is an unincorporated association originally established on Date 1, pursuant to the Constitution of Union. Union states that the Constitution is the sole governing instrument of Union. The Constitution states the following:

The objects of Union are: to organize workers, to encourage an apprenticeship system and a higher standard of skill, to develop, improve and enforce the program and standards of Occupational Safety and Health, to cultivate friendship, to develop good public relationships in the community, to assist each other to secure employment, to reduce the hours of daily labor, to secure adequate pay for our work, to establish a weekly pay day, to promote the establishment of fringe benefit plans for our members through the collective bargaining process, to coordinate bargaining toward the goal of taking wages out of competition, and by legal and proper means to elevate the moral, intellectual and social conditions of all our members and to improve the trade in every way possible.

Union states that is has chartered numerous local unions and councils of workers engaged in the construction trades.

Union was recognized by the Internal Revenue Service (Service) on Date 2 as exempt from federal income tax as a labor organization under the provisions of section 101(1) of the Internal Revenue Code of 1939, which corresponds to section 501(c)(5) of the Code. Union also received group exemption status from the Service at that time.

Union states that in furtherance of its objects, through medical plans covered by the Employee Retirement Income Security Act established by its regional councils and local unions, it has long provided a wide array of benefits to its members, including a pharmacy benefit program. This program involves not just processing and paying prescription drug claims of Union members, but also developing and maintaining the prescription drug formulary, contracting with pharmacies, and negotiating discounts and rebates with drug manufacturers. Union states that currently, its medical plans engage an independent party, Manager, to be the prescription benefit manager of its pharmacy benefit program.

Union states that it conducted a study to assess the feasibility of, and potential benefits from, bringing the pharmacy benefit program "in house." The study concluded that due to the size of Union's membership, Union could realize substantial cost savings by bringing the pharmacy benefit program "in house."

Union states that in order to limit its liability from this activity for State law purposes, it proposes to form a limited liability company, Company, of which Union will be the single member and will appoint the officers and managers of Company. Union states that Company will not elect to be treated as an association taxable as a corporation and thus will be disregarded as an entity separate from its member. Union states that it will terminate its contract with Manager and that Company will commence all of the activities currently conducted by Manager through a contract with Union. Union states that the program covers at least 460,000 persons.

Specifically, Union requests a ruling that its operation of the pharmacy benefit program through Company will not be treated as unrelated trade or business with respect to Union within the meaning of section 513 of the Code.

**LAW:**

Section 501(c)(5) of the Code provides for the exemption from federal income tax of labor, agricultural, or horticultural organizations.

Section 502(a) the Code provides, as a general rule, that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

Section 511(a)(1) of the Code imposes for each taxable year on the unrelated business taxable income (as defined in section 512) of every organization described in paragraph (2).

Section 511(a)(2)(A) of the Code provides that organizations subject to tax are organizations described in section 401(a) and 501(c). The tax imposed by paragraph (1) applies to any organization which is exempt from taxation by reason of section 501(a).

Section 512(a) of the Code generally defines the term "unrelated business taxable income" to mean the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying of such trade or business, both computed with the modifications provided in subsection (b).

Section 513(a) of the Code provides, as a general rule, that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, 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 its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Section 1.501(c)(5)-1(a) of the Income Tax Regulations (regulations) provides that the organizations contemplated by section 501(c)(5) of the Code as entitled to exemption from income taxation are those which have no net earnings inuring to the benefit of any member, and have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.

Section 1.501(c)(5)-1(b)(1) of the regulations provides that an organization is not described in section 501(c)(5) of the Code if its principal activity is to receive, hold, invest, disburse or otherwise manage funds associated with savings or investment plans or programs, including pension or other retirement savings plans or programs.

Section 1.501(c)(5)-1(c) of the regulations provides that organizations described in section 501(c)(5) of the Code and otherwise exempt from tax under section 501(a) are taxable upon their unrelated business taxable income.

Section 1.513-1(b) of the regulations provides, in part, that for purposes of section 513 of the Code, the term "trade or business" has the same meaning it has in section 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Section 1.513-1(c)(1) of the regulations provides, in general, that in determining whether trade or business from which a particular amount of gross income derives is "regularly carried on," within the meaning of section 512 of the Code, regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued. Specific business activities of an exempt organization will ordinarily be deemed to be "regularly carried on" if they manifest a frequency and continuity, and are pursued in a manner similar to comparable commercial activities of nonexempt organizations.

Section 1.513-1(d)(1) of the regulations provides that 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.

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 a causal relationship to the achievement of exempt purposes (other than through the production of income); and it 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.

Rev. Rul. 75-473, 1975-2 C.B. 213, holds, in part, that a nonprofit organization that operates a dispatch hall to allocate work assignments among union members and engages in other activities appropriate to a labor organization qualifies for exemption as a labor organization under section 501(c)(5) of the Code. Citing Portland Cooperative Labor Temple Association v. Commissioner, 39 B.T.A. 450 (1939), acq., 1939-1 C.B. 28, the revenue ruling states that an organization that is engaged in activities appropriate to a labor union, even though technically not a labor union itself, may qualify for exemption under section 501(c)(5) as an exempt labor organization if its activities are appropriate union activities and are conducted as a part of the proper activities of the parent labor organization, so that it is not merely an independent undertaking.

Rev. Rul. 77-46, 1977-1 C.B. 147, describes an organization established pursuant to a collective bargaining agreement to enable members of the union to save money through a savings plan. The revenue ruling states that for an organization to qualify as an exempt labor organization, its activities must be commonly or historically recognized as characteristic of labor organizations, or be closely related and necessary to accomplishing the principal purposes of exempt labor organizations. Historically, labor organizations were primarily organized to negotiate wages, hours, and working conditions, and/or to act as mutual benefit organizations that provided death, sickness, and accident benefits to members. The revenue ruling holds that because providing savings plans is not a traditional activity for labor organizations, and the organization's activities are not closely related and necessary to accomplish the principal activities of labor organizations, the organization fails to qualify under section 501(c)(5) of the Code.

#### **ANALYSIS:**

An organization described in section 501(c)(5) of the Code must have as its principal purposes the betterment of the conditions of workers, the improvement of their products, and the development of a higher degree of efficiency in their respective occupations. Whether a particular income activity performed by an organization recognized as exempt under section 501(c) is classified as unrelated trade or business is dependent upon three factors as discussed

in section 513 and section 1.513-1 of the regulations: whether the activity is trade or business, whether the business is regularly carried on, and whether the business is substantially related to the organization's exempt purpose.

Inasmuch as the term "trade or business" generally includes any activity carried on for the production of income from the sale of goods or performance of services, the operation of a pharmacy program as described would be considered trade or business within the meaning of section 1.513-1(b) of the regulations.

Since the pharmacy program will be operated as a continuous and ongoing program, year-round, it would be considered to be "regularly carried on" within the meaning of section 1.513-1(c)(1) of the regulations.

However, it is clear from the facts presented that Union has long provided a wide array of permissible benefits to its members, and that the pharmacy benefit program has been a part of these benefits. The fact that Union is putting this program into an organization that it directly controls does not alter the fact that the program continues to be a traditional and permissible activity of Union. As discussed in Rev. Rul. 75-473, supra, this activity has a substantial causal relationship to the achievement of Union's exempt purpose. Rev. Rul. 77-46, supra, explains that an activity must be a traditional activity of a section 501(c)(5) organization in order to be considered as a 501(c)(5) activity. Providing a pharmacy program benefit for union workers is quite similar to providing death, sickness, and accident benefits to members which was approved in Rev. Rul. 77-46. For these reasons, the activity proposed by Union would not be considered to be unrelated trade or business.

**RULING:**

Accordingly, based on the facts and circumstances discussed above, we rule as follows:

Union's operation of the pharmacy benefit program through Company will not be treated as unrelated trade or business with respect to Union within the meaning of section 513 of the Code.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. Any changes that may have a bearing upon Union's tax status should be reported to the Service. Because it could help resolve questions concerning Union's federal income tax status, this ruling should be kept in Union's permanent records. Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to Union's authorized representative.

Except as we have specifically ruled herein, we express no opinion as to the consequences of this transaction under the cited provisions or under any other provision of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437,

*Notice of Intention to Disclose.* A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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

If there are any questions about this ruling, contact the person whose name and telephone number are shown in the heading of this letter.

Enclosure

Sincerely yours,

Ronald J. Shoemaker  
Manager, Exempt Organizations  
Technical Group 2