



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:

Employer Identification Number:

Legend:

Taxpayer =

Parent =

Dear _____ :

This is in response to your letter dated August 30, 2011, in which you requested certain rulings with respect to I.R.C. § 511.

Background:

According to your ruling request you are an exempt organization under section 501(c)(6) of the Code. You have been in operation for over a decade, and you are a subsidiary of Parent, which is also exempt under 501(c)(6). Parent's main purpose is the creation and maintenance of quality standards applicable to entire industries. Parent's members include manufacturing companies that make products for which your standards apply, individual practitioners in the field, and government regulatory officials. Parent's standards are accredited American National Standards and are available to the entire industry for which they pertain. Parent also works with state and local officials concerning the adoption of its standards into law. Certification of meeting any set of standards is not required for the sale of a product in fields that Parent creates standards, however.

You were formed to conduct the testing and listing activities of Parent. Your main activities include a certification process whereby you review laboratory tests of products wishing to be certified, physically inspect the products, and physically inspect the plants where the products are made, among other things. The certification indicates that the product tested meets the standards you created for the industry. Once you certify a product as meeting the accepted standard that product is permitted to use your logo indicating to consumers that it meets the applicable standard. A majority of the manufacturers in the fields Parent has standards seek certification through you of meeting such standard. Additionally, you publish a listing of all the products that you have certified for anyone to review. Both members and non-members of Parent can put forth a product to be certified by you. Your certification processes allow regulatory officials in the industry to know that these products meet such standards without having to perform on-site testing that may otherwise be necessary to ensure public health and safety.

As part of your certification process you review reports from laboratory testing of the product. As part of your activities you also maintain your own laboratory where manufacturers can submit their products to be tested in order to apply for certification. Your laboratory is one of over thirty labs recognized by you to provide valid and reliable laboratory reports for your certification process. You also provide laboratory testing for certification of standards other than those of Parent in the same fields at the request of manufacturers. Some of the other laboratories are run as for profit companies. A lab report from one of these facilities is necessary in order to be certified by you as meeting Parent's standards. You are the only entity that certifies products as meeting the standard, however. These laboratories, including yours, run the physical tests that ensure a product meets standards for quality and safety. This testing is for certification purposes and does not substitute for regular quality control testing by a manufacturer. In fact, regular quality control by the manufacturer is one criterion for certification. You charge manufacturers for both the laboratory testing and the certification process. Your fee for testing is in the middle range of fees charged by other recognized laboratories, both for profit and non-profit. The fee for testing is based on the cost of materials and labor used in conducting the testing with a mark up added to the cost of materials. There is no difference in your fee for members and non-members of Parent.

Your board of directors consists of eight individuals all appointed by the president of Parent. All eight directors are also board members of Parent. Though legally two separate organizations most practitioners in the industries in which you operate do not regard you as such or realize that you and Parent are two entities.

Ruling Requested:

The income received by you attributable to the activities of your testing laboratory is not subject to the tax imposed on unrelated business taxable income by § 511 of the Internal Revenue Code.

Law:

Section 501(c)(6) of the Internal Revenue Code ("Code") describes business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder.

Section 511(a) of the Code imposes a tax for each taxable year on the unrelated business taxable income (as defined in § 512) of organizations described in § 501(c).

Section 512(a)(1) of the Code provides that the term "unrelated business taxable income" means the gross income derived by an organization from an unrelated trade or business (as defined in § 513) regularly carried on by it, less the deductions allowed for expenses directly connected with the carrying on of such trade or business.

Section 513(a) of the Code defines "unrelated trade or business" any trade or business the conduct of which is not substantially related (aside from the need for income or funds or the use it makes of the profits derived) to the exercise of performance by such organization of its charitable, educational, or other purpose constituting the basis for its exemption under § 501.

Section 1.501(c)(6)-1 of the Income Tax regulations ("regulations") states 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. 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.

Section 1.513-1(d)(2) of the regulations provide that a trade or business is related in the relevant sense only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes, and it is substantially related only if the causal relationship is a substantial one. Where the performance of services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from performance of services does not derive from the conduct of a related trade or business.

Section 1.513-1(d)(3) of the regulations provides that in determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must not be conducted on a larger scale than is reasonably necessary for the performance of such exempt functions.

Revenue Ruling 68-264, 1968-1 C.B. 264, defines a particular service for the purposes of § 501(c)(6) of the Code as an activity that serves as a convenience or economy to the members of the organization in the operation of their own businesses.

Revenue Ruling 70-187, 1970 -1 C.B. 131, holds that a nonprofit organization formed by manufacturers of a particular product to conduct a program of testing and certification of the product to establish acceptable standards within the industry as a whole qualifies for exemption under § 501(c)(6) of the Code. The ruling states that the organization furnishes interested manufacturers with specifications setting forth minimum quality and performance standards. Approximately ninety percent of the manufacturers in the industry participate in the program of testing and certification and the organization fixes its charges at amounts sufficient to defray only the cost of the program. The revenue ruling also states that the organization's product testing and certification to enforce its product standards is a self-regulatory measure to prevent trade abuses in the industry. The ruling concludes that the program does not constitute the performance of particular services for individual persons because the organization is engaged in activities directed to the improvement of business conditions within the industry as a whole.

Rev. Rul. 81-127, 1981-1 C.B. 357, concerns a chamber of commerce, the purpose of which is to promote the commercial, financial, industrial, and civic interests of a particular community. Its activities include the certification of the accuracy and authenticity of export documents. This service is available to members and nonmembers for the same charge. The main purpose of the certification of export documents is to provide an independent verification of the origin of exported goods. The ruling holds that the certification of export documents stimulates international commerce by facilitating the export of goods and, thus, promotes and stimulates business conditions in the community generally, thereby contributing importantly to the accomplishment of the organization's exempt functions. Therefore the activity is substantially related to organization's exempt purpose.

In American Plywood Ass'n v. United States, 267 F. Supp. 830 (W.D. Wash. 1967), the court considered whether the plaintiff's quality control activities was the performance of particular

services for individual members. The court found that the individual and personal benefits enjoyed by members of the Association because of its quality control services were inherently group benefits in that quality control insures safe plywood, a prerequisite to its acceptance by the public and accounting for plywood manufacturing being a great industry. All benefits to individuals derived from such services were found to be clearly incidental to the main purpose, and reason for, plaintiff's activity in providing them.

In Louisiana Credit Union League v. United States, 693 F.2d 525 (5th Cir. 1982), the court provides that for a substantial relationship to exist, any direct benefits flowing from a business league's activities must inure to its members in their capacities as members of the organization. The court concluded that debt-collection, data processing, and insurance endorsement and administration are not the sort of unique activities that satisfies the substantial relationship test, nor are the benefits inherently group related. Rather than merely advising its members of the availability and desirability of insurance coverage to credit unions generally, the League promoted the purchase of policies from a particular carrier. Because the benefits of the debt collection activities accrued only to certain credit unions, these activities constituted the performance of services of a commercial nature for individual members rather than the promotion of a common business interest with inherently group benefits.

Analysis:

In order for income to be taxed under § 511 of the Code that income must be attributable to a trade or business that is regularly carried on, and which is not substantially related to the exempt purpose of the organization. §§ 512, 513. Here, you derive income from the running of a laboratory that tests manufactured products for quality and safety levels inherent in the product. This activity is conducted on the same level as it is conducted by over thirty other organizations, some of which conduct such services for profit. Additionally, you charge a fee that is in the middle of the range of fees charged by other laboratories. These factors all lead to the fact that your laboratory activities are a trade or business. Furthermore, you conduct such testing on a constant basis year round, therefore you regularly carry on your trade or business.

The only question remaining as to whether revenue from your laboratory testing is taxable income is whether this activity is substantially related to your exempt purpose. Section 1.513-1 provides that a trade or business is related in the relevant sense only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes, and it is substantially related only if the causal relationship is a substantial one. This section goes on to conflate a causal relationship with contributing importantly to an exempt purpose. Furthermore, in order for a trade or business to be substantially related it must be conducted in a commiserate scope and manner to accomplishing an organization's exempt purpose. § 1.513-1(d)(3).

The Service has provided a revenue ruling discussing similar issues to your situation illuminating § 513. Rev. Rul. 70-187, supra, provides that an organization that provides testing and certification to a large majority of an industry, regardless of membership status, and allows certified organizations to display a logo indentifying the certification does not have to pay unrelated business income tax under § 511. Additionally, the organization in Rev. Rul. 70-187, supra, only charged an amount needed to cover cost of testing the products, and the testing did not supplement or replace the regular testing used by manufacturers in the production of their product. Similar to the organization in Rev. Rul. 70-187, supra, you set uniform standards for

products in your industry. In fact, you set such standards for multiple industries, and make such standards available to the public, manufacturers, and government officials; you conduct testing to assure that products in your industry meet those specifications; you offer your testing and certification to all manufacturers in the industry regardless of membership status; your standards and the certification are accepted throughout the United States and internationally for your entire industry; your testing does not replace or supplement ordinary testing and inspection procedures by the manufacturer; and you serve a self-regulatory function for the industries in which you operate. The fact that your standards are all American National Standards demonstrates the level to which your standards are accepted for your entire industry.

Rev. Rul. 81-127, supra, is also analogous to your situation. In that ruling the organization provided verification services for export documents for a fee to members and non-members. The organization's purpose was to increase international commerce and the independent verification of products export origin helped further that purpose by providing confidence in the origin of products. The organization charged the same fee for members and non-members. Analogously, your purpose is to further the quality and standards found in your industry and your testing and certification activities create confidence in the products of your industry. Additionally, you also charge members and non-members the same fee for the testing. Similar to the organization in Rev. Rul. 81-127, supra, and the organization in American Plywood, 267 F. Supp. 830, your testing and certification, while for individual manufacturers, benefit the entire industry by ensuring a greater consumer experience with the products as well as aiding regulators in maintaining the applicable safety standards. The benefit of your testing then goes to your members, and non-members, in their capacity as members and not to just the individual manufacturers being tested since the reputation of the entire industry is raised with the higher standards of more manufacturers. See Louisiana Credit Union League, 693 F.2d 525; American Plywood, 267 F. Supp. 830 (noting that the increased sales of plywood was put ahead of the increased sales of any general maker of plywood was a positive factor). Additionally, the fact that your lab provides testing for other organization's standards within the same fields indicates a desire to support the quality of the industry as a whole rather than merely furthering the commercial viability of your own standard. Cf. Bluetooth SIG, Inc. v. U.S., 611 F.3d 617 (9th Cir. 2010) (denying exemption to an organization seeking to provide specific trademark standards and testing to see if they met such standards on the grounds that the organization was seeking to promote a commercial designation rather than support the telecommunications industry as a whole).

Ruling:

The income received by you attributable to the activities of your testing laboratory for years 2010 and later is not subject to the tax imposed on unrelated business taxable income by § 511 of the Internal Revenue 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 by others as precedent.

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. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Ronald Shoemaker
Manager, Exempt Organizations
Technical Group 2

Enclosure
Notice 437