L. RECENT ISSUES UNDER IRC 501(c)(6)

Introduction

The business and professional associations exempt under IRC 501(c)(6) constantly expand their activities to meet their own financial needs and to promote the interests of new types of commercial enterprises. This creates new factual situations not covered by the published revenue rulings. However, other sources of guidance in this area are available.

Chapter 600 of the EOHB was revised in January 1979. The new chapter lists the principal characteristics of a business league and sets forth the requirements that an organization must meet in order to be exempt under IRC 501(c)(6).

The Service's position in court cases is another basis available in analyzing the activities of a business league. The Service's position on group insurance activities is based on arguments developed in opposition to the holding in the Oklahoma Cattlemen's Association case. The Service's position that organizations promoting "a segment of a line of business" are not exempt has now been affirmed by the National Muffler Dealer's case, decided by the Supreme Court on March 20, 1979.

Congressional intent is the basis for determining the scope of the exemption conferred on sports leagues by the addition of football leagues to the list of organizations specifically named in IRC 501(c)(6). The effect of the Congressional omission of bank clearing houses from the list of named organizations must be examined in light of the position taken in individual private rulings that such organizations continue to be exempt under IRC 501(c)(6).

The Service's position in several areas of concern to professional scientific societies has recently been the subject of requests for technical advice. The issues raised in these cases include unrelated business taxable income, whether organizations should be reclassified under IRC 501(c)(6) rather than 501(c)(3), and whether charging lower prices for activities performed for an organization's members results in inurement of the organization's income to its members.

The materials presented will be helpful in analyzing many current 501(c)(6) problems. However, in some cases, especially in the area of particular services,

publication of a revenue ruling is the most effective way to resolve an issue. The National Office publishes the Service's position as new activities are brought to our attention. Among the activities the National Office is currently considering for possible publication are the receipt of fees by lawyer referral services, loans made by an association of credit unions to prevent insolvency of members, and loans by a business league to member employers to enable them to continue collective bargaining during strikes by their employees.

For a discussion on Lobbying and Political Activities carried on by IRC 501(c)(6) organizations, see those topics in this EOATRI textbook. See Health Care topic at page 222 for discussion of PSROs, recognized under IRC 501(c)(6).

1. Qualifications for Exemption

IRC 501(c)(6) provides exemption for business and professional associations "not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual."

Although the quoted portion of IRC 501(c)(6) is similar to the final portion of IRC 501(c)(3), the regulations under IRC 501(c)(6) do not contain an organizational test. Therefore, any organization which is not organized for profit may qualify for exemption under IRC 501(c)(6) if its activities establish that it is entitled to exemption.

Regs. 1.501(c)(6)-1 states that the activities of a business league should be directed to the improvement of business conditions as distinguished from the performance of particular services for individual persons. However, this statement has not been interpreted as an absolute prohibition against the furnishing of particular services.

Paragraph 615(2) of the EOHB, IRM 7751, recently published in January 1979, provides that a 501(c)(6) organization must be primarily engaged in activities or functions constituting the basis for its exemption. Paragraph 615(3) of the EOHB further specifies that a 501(c)(6) organization must be primarily supported by membership dues and other income from activities substantially related to its exempt purpose. Accordingly, less than a primary amount of a 501(c)(6) organization's activities may consist of furnishing particular services and/or engaging in unrelated trade or business.

The National Office is considering publishing a revenue ruling in support of the primary activities test. However, the operation of the principle can be seen by analyzing a series of related revenue rulings.

As noted in paragraph 615(4) of the EOHB, the performance of particular services for its members as an organization's primary activity disqualifies the organization for exemption under IRC 501(c)(6). The publication of advertising containing members' names was held to constitute the performance of particular services in Rev. Ruls. 55-44, 1955-2 C.B. 258; 64-315, 1964-2 C.B. 147; and 65-14, 1965-1 C.B. 236. Where such advertising comprised a minor or inconsequential portion of total activities, the advertising did not, by itself, disqualify the organization for exemption. However, when such advertising was the organization's primary activity (50% or more of total activity), the organization was held to be disqualified for exemption. Copies of the cited revenue rulings are reproduced following the conclusion of this subtopic.

These revenue rulings demonstrate how to analyze an activity to determine whether or not it constitutes the furnishing of particular services. An important question is who receives an immediate, tangible benefit from the activity. If the individual receives the benefit, the activity may constitute the furnishing of particular services. If the benefit is spread so broadly among the recipients that it is not possible to detect a measurable benefit to any one of them individually, then the activity might be for the promotion of the line of business as a whole. In practice, however, most situations fall in a gray area between the two extremes.

Chapter 600 of the EOHB contains numerous examples of activities which have been examined to determine whether they constitute the performance of particular services. However, the list is by no means a catalogue of all of the activities engaged in by business and professional associations.

a. The text of Rev. Rul. 54-444, 1955-2 C.B. 258 is extracted below:

> An organization formed to promote the business of a particular industry and which carries out its purposes primarily by conducting a general advertising campaign to encourage the use of products and services of the industry as a whole is entitled to exemption from Federal income tax as a business league under section 501(c)(6) of the Internal Revenue Code of 1954, notwithstanding the fact that such advertising to a minor extent constitutes the performance of particular services for its members.
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> Advice has been requested whether an organization composed of retail dealers which conducts an advertising campaign for the benefit of an industry as a

whole, under the circumstances set forth below, qualifies for exemption from Federal income tax as a business league under section 501(c)(6) of the Internal Revenue Code of 1954.

The instant organization was incorporated under state law to improve the relationship between certain dealers and the public by the improvement of delivery, the maintenance of quality, and the development and maintenance of high standards of service. Membership is open to any person or association engaged in the retailing of products or equipment related to a particular industry. No part of the net earnings inures to any private shareholder or individual. The receipts are derived from assessments on members and from contributions from the national industry association. Its disbursements are for advertising, pilot surveys, an educational program and for general operating expenses. The advertising expenditures constitute approximately 60 percent of the organization's expenses.

The organization has endeavored to increase public acceptance of the industry's product for home use by advertising in newspapers, on radio and television, in the classified telephone directory, by means of pamphlets, etc. The advertisements have stressed the economical and other desirable features of the product. None of the advertising, with the exception of one newspaper advertisement and a listing in the classified telephone directory, contained the names of individual members. In these two instances the space for the members' names was paid for by the individual members and not by the organization. A substantial part of the advertising related to a 24-hour service which was supplied by contractors who were not members of the organization and which was available to all consumers regardless of whether or not they bought from a member. Most of the advertising contained the central phone number of the organization and some of the newspaper and radio advertisements urged consumers to buy from an organization member.

Section 501(c)(6) of the Code excepts from Federal income tax "Business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual."

Section 39.101(7)-1 of Regulations 118, made applicable herein by Treasury Decision 6091, C. B. 1954-2, 47, holds 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 and that the activities of such an association 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.

In Washington State Apples, Inc. v. Commissioner, 46 B. T. A. 64, acquiescence, C. B. 1942-1, 17, the apple growers of Washington organized a corporation to engage in the business of advertising and promoting the sale of apples grown and produced in the State of Washington. The United States Board of Tax Appeals, now The Tax Court of the United States, held that since the purpose of the organization was to promote the industry as a whole, and not to serve individual members, such organization was a "business league" exempt from tax under section 101(7) of the Revenue Act of 1936, the provisions of which are identical with the provisions of the statute here involved.

The purpose of the advertising campaign conducted by the instant organization was not to make a profit or to render particular services to individual members. The advertising was designed primarily for the improvement of conditions in the particular industry. Most of the benefits to members of the organization were indirect and accrued alike to members and other persons in the industry. With respect to that part of the advertising which carried the names of members or urged consumers to buy from an organization member, it may be said generally that such advertising constitutes the furnishing of particular services to members. However, in this case the advertising which carried the names of individual members or otherwise directly aided members represented only a minor portion of the total advertising expenditures and may be regarded as only incidental or subordinate to the main or principal purpose. Under these circumstances, the advertising campaign conducted by the instant organization was primarily for the benefit of the industry as a whole.

Accordingly, it is held that the organization, in conducting its advertising campaign, is engaged in activities directed to the improvement of business conditions of the particular industry as a whole as distinguished from the performance of particular services for individual persons and that it qualifies for exemption as a business league under section 501(c)(6) of the Code.

b. The text of Rev. Rul. 64-315 is extracted below:

> An association of merchants whose businesses constitute a shopping center expends its funds and engages exclusively in advertising in various newspapers and on television and radio in order to attract customers to the shopping center. This advertising contains the names of member merchants and their merchandise. Held, the organization is not entitled to exemption from Federal income tax as an organization described in section 501(c)(6) of the Internal Revenue Code of 1954.

Advice has been requested whether an association of retail dealers whose businesses constitute a "shopping center" may qualify for exemption from Federal income tax as a business league described in section 501(c)(6) of the Internal Revenue Code of 1954, under the circumstances described herein.

The organization was incorporated under state law, without capital stock, as a nonprofit corporation. Its purposes, as stated in its articles of incorporation, are to foster public relations, advertising and publicity campaigns of all kinds, to perform chamber of commerce activities and generally to promote the best interests of the merchants and citizens of the community.

The organization's activities consist of publication of an advertising newspaper hereinafter referred to as the "shopping news", advertising in other community publications, sponsorship of commercial advertising on television and radio, and certain promotions designed to attract shoppers to the shopping center. The shopping news consists primarily of advertising by individual member merchants. This type of advertising is paid for by the individual merchants. The part of the shopping news which advertises the shopping center as a whole also frequently lists the names of its member merchants who are located within the shopping center. Most of the other advertising carried in community publications contains the names of individual merchants. Also some of the radio and television commercials occasionally mention the name of a member merchant. This latter type of advertising is paid for with association funds.

The association's income is derived from assessments paid by the merchants and landlords of the shopping center. The expense of publishing the shopping news represents approximately 50 percent of the organization's expenditures. Other expenditures are for other types of advertising, promotional services and expenses, office supplies, gift certificates, and special decorations, etc.

Section 501(c) of the Code describes certain organizations exempt from tax under section 501(a) of the Code and reads, in part, as follows:

> (6) Business leagues, chambers of commerce, * * * 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 reads, in part, as follows:

> 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. It is an organization of the same general class as a chamber of commerce or a 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 particular 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. * * *.

For an organization to meet the requirements for exemption as a chamber of commerce or business league within the meaning of the above-quoted provisions of the Code and regulations, the advertising in which the organization engages must benefit business in the com- ???

c. The text of Rev. Rul. 65-14 is extracted below:

> An organization formed to promote the tourist industry in its area and whose principal activity is the publication of a yearbook consisting largely of paid advertisements for its members is not entitled to exemption from Federal income tax under section 501(a) of the Internal Revenue Code of 1954 as an organization described in section 501(c)(6).

Advice has been requested whether an organization formed to promote the tourist industry in its territory and which publishes a year-book consisting largely of paid advertisements by members may qualify for exemption from Federal income tax as a business league under section 501(a) of the Internal Revenue Code of 1954 as an organization described in section 501(c)(6).

The instant organization was formed as a nonprofit corporation to promote the tourist industry in its territory. Membership consists primarily of individuals and corporations who are engaged in various business enterprises which stand to profit from the promotion of the tourist industry in the area served by the organization. Membership dues are fixed on a sliding scale arrangement which is based on the character and volume of business handled by the particular member. The organization's affairs are managed by a board of directors composed of one member from each of the several counties located in the territory covered by the organization. Its principal activity consists of publishing and distributing a tourist guidebook comprised largely of members' advertising. It also conducts a program of advertising in newspapers and other media designed to attract tourists to the various vacation spots located in the trade territory of its members. The income is derived primarily from the sale of tourist guidebooks and travel maps, members' advertising in the tourist guidebook, and membership fees. The advertisements consist of a listing of the name and address of the member-advertiser and a description of the product sold or the service rendered by the advertiser.

Section 501(c) of the Code describes certain organizations exempt from Federal income tax under section 501(a) and provides, in part, as follows:

> (6) Business leagues, chambers of commerce, real-estate boards, or boards of trade, 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 describes a business league as 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. 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.
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> The publication of advertising matter containing listings of the names of individual members constitutes advertising for the individuals so advertised and is thus considered the performance of particular services for such individuals, rather than an activity aimed at the improvement of general business conditions. Inasmuch as the principal activity of the instant organization is the publication of such advertising, it is concluded that the organization does not qualify for exemption from Federal income tax under section 501(a) of the Code as an organization described in section 501(c)(6).

2. Oklahoma Cattlemen's Association Issues

The National Office is considering publishing the position that group insurance programs do not further the exempt purposes of IRC 501(c) organizations. That position is illustrated in private letter rulings and technical advice memoranda issued by the National Office. See, for example, Private Letter Rulings 7847001 and 7840014, for further analysis.

The position in the private letter rulings is contrary to the conclusion reached in Oklahoma Cattlemen's Association, Inc. v. U.S., 310 F. Supp. 320 (W.D. Okla., 1969). Although the Cattlemen's Association was exempt under IRC 501(c)(5), its insurance activities are similar to the programs offered by many trade and professional associations.

The Cattlemen's Association was the group policy holder under a health, accident and life insurance program made available to its members. Premiums were paid by the participating members directly to the insurance company who wrote the master policy. The Association received from the company a so-called rebate of five percent on these premiums. It regularly and continuously furnished the insurance company with its membership files and allowed the use of its name and insignia by the company for the latter's use in soliciting members to buy insurance under the master policy. The Service sought to subject the Association's five percent rebates to the unrelated business income tax. The Association argued that the income was not subject to the unrelated business income tax because,

among other reasons, the insurance activity was related to the Association's exempt purpose.

The court reasoned that providing group insurance was related to the exempt purposes of the Association because it was consistent with the purposes stated in the Association's Constitution to serve, in all ways, the mutual interests and common aims of the cattlemen of Oklahoma.

The Service's view is that by acting as the group policyholder for the master insurance policy, by making its membership files company to use its name in soliciting members to buy insurance under the policy, the Cattlemen's Association was performing activities for the insurance company that enabled the group insurance program to be a commercial success. Moreover, these activities were not related to the exempt purposes of an agricultural organization. Therefore, income produced by the activities was subject to the unrelated trade or business income tax. Further, the income produced by the activities does not meet the royalty modification exception under IRC 512(b) because of the services provided by the Association. The royalty issue was not considered in the court case, but is an important matter to consider. See further discussion on this area in the Royalty Modification topic at page 531 in this EOATRI textbook.

Private Letter Ruling 7840014 is an illustration of how Oklahoma Cattlemen's case has been applied to other cases. The ruling concerns an association of persons engaged in the home building industry. The association was exempt under IRC 501(c)(6). It sponsored several insurance programs for its members, including a workmen's compensation program provided through an insurance company. The association received a fee from the insurance company for providing its members information about the insurance plan.

The association argued that its activities in connection with the insurance program were minimal, passive in nature, and related to its purpose of promoting the mutual benefit of its members and maintaining high standards in the home building industry. The Association further argued that Oklahoma Cattlemen's Association was the only case law providing precedent on the issue and that the Service should follow the line of reasoning adopted by the court in that case.

The National Office declined to follow the Oklahoma Cattlemen's Association case and issued a technical advice memorandum which concluded that the insurance activity was unrelated to the association's exempt purpose. Rather

than improving business conditions generally, the insurance plan merely provided direct benefits to participating members of the association as individuals.

A number of published revenue rulings support the Service's position. See Rev. Ruls. 60-228, 1960-1 C.B. 200; 66-151, 1966-1 C.B. 152; 72-431, 1972-2 C.B. 281; and 74-81, 1974-1 C.B. 135.

Rev. Rul. 74-81 describes an organization whose principal activity was providing its members with group workmen's compensation insurance. The revenue ruling concludes that the organization was not entitled to exemption under IRC 501(c)(6).

3. National Muffler Dealers Association

The Service has consistently denied exemption to organizations with a restricted membership of firms or individuals engaged in the marketing of a particular franchised product or a product bearing a particular trademark or trade name since this does not constitute a "line of business".

In Pepsi-Cola Bottlers' Association, Inc. v. U.S. 369 F.2d 250 (7th Cir., 1966), the court held that the Association, whose members were engaged in the bottling and sale of a single franchised soft-drink product, qualified for tax exemption under IRC 501(c)(6).

The Service does not follow the decision in the Pepsi-Cola case. See Rev. Ruls. 58-294, 1958-1 C.B. 244 and 68-182, 1968-1 C.B. 263. Rev. Rul. 68-182 states as follows: "It is the position of the Service that organizations promoting a single brand or product within a line of business do not qualify for exemption under section 501(c)(6) of the Code."

In American Plywood Association v. U.S., 267 F. Supp. 830 (1967), an association of plywood manufacturers owned a trademark licensed for use only by its members. It conducted an advertising campaign. Its advertising referred to the trademark. However, the advertising did not refer to individual members by name. Since the individual members were not named, the court concluded that the organization was not performing particular services in the form of advertising for its members and held that the Association was exempt under IRC 501(c)(6).

The Service took the opposite position in Rev. Rul. 70-80, 1970-1 C.B. 130. Citing Pepsi-Cola Bottlers and Rev. Rul. 68-182, Rev. Rul. 70-80 holds that a

nonprofit trade association of manufacturers whose principal activity is the promotion of its members' products under the association's registered trademark does not qualify for exemption under IRC 501(c)(6).

The Service's position has now been affirmed by National Muffler Dealers Association, Inc. v. U.S., 440 U.S.___, (March 20, 1979). In its decision the Court reviewed the specific facts of a "Pepsi-Cola" type case and affirmed the decision of the Court of Appeals.

The Court of Appeals held in 565 F.2d 845 (2d Cir., 1977), that a trade association of "Midas Muffler" dealers, formed to protect themselves against a new management structure, did not qualify as a business league under IRC 501(c)(6) because its activities were not directed to the improvement of business conditions of a "line of business." The Association's purpose was described as the promotion of the best interest of muffler dealers generally and membership was open to muffler dealers other than "Midas Muffler" dealers. However, since its inception all members had been Midas Muffler franchisees. They had received benefits such as insurance programs, a newsletter, and an annual convention. In upholding the denial of the Association's exemption, the Court of Appeals stated--

> "applying the 'line of business' requirement with a sensitivity to the general considerations which underlie it, we have little difficulty in concluding that the Association does not merit an exemption. First, the Association does not draw its franchisee members from a broad base. Indeed, all bear a well-defined business relationship to a single private firm - Midas International Corporation. And the Association's activities reflect its limited constituency. It has endeavored solely to serve the interests of Midas dealers in their day-to-day dealings with their franchisor. The bulk of the muffler industry, in short, is excluded. To the extent that the Association is successful in improving conditions for its members, it does so partially at the expense of non-Midas dealers, who will find themselves facing stronger competition."

The Supreme Court granted a writ of certiorari and considered several arguments advanced by the Association which attempted to show that the Service's position narrowed the scope of the exemption granted by Congress in enacting IRC 501(c)(6). The Court examined the legislative history of the section and considered

whether the "line of business" requirement, as set forth by the Service in the regulations and in the court cases and revenue rulings cited above, was a reasonable interpretation of the statutory section.

Speaking for himself and five other members of the Court, Mr. Justice Blackmun concluded that the "line of business" limitation is well grounded in the origin of section 501(c)(6) and in its enforcement over a long period of time. The distinction drawn here, that a tax exemption is not available to aid one group in competition with another within an industry, is but a particular manifestation of an established principle of tax administration.

4. Professional Sports Leagues

In 1966 Congress amended IRC 501(c)(6) to include professional football leagues. See section 6(a) of P.L. No. 89-800, 1966-2 C.B. 649, 655. The amendment left open the question of whether other professional sports leagues should share in this statutory exemption.

Volleyball, basketball and other team sports have professional leagues similar to those of football teams. Like professional football leagues, these leagues supervise and promote the business of the teams comprising their membership. Teams joining the league operate under a franchise. The league formulates rules and requirements that each team must meet in order to retain its franchise. The league receives a portion of each team's gate receipts.

Even though these similarities exist, an analysis of the circumstances surrounding the enactment of the football amendment indicates that other sports leagues may not be intended beneficiaries of the statutory change in IRC 501(c)(6).

The football amendment arose in the context of the then pending merger of the National and American Football Leagues. Conf. Rep. 2308, 1966-2 C.B. 958, describes the effect of several amendments in relation to the combined league.

The report gives no indication of an intention to extend the amendment to other sports leagues. Antitrust considerations and the effect of the merger on a football league's pension fund are discussed. The report also notes that professional football leagues had already been held to qualify for tax exemption under IRC 501(c)(6).

It, therefore, appears that the amendment was enacted simply as a form of additional protection for the football leagues, whose primary concern was securing exemption from Federal antitrust laws for the proposed merger. This interpretation is supported by a report of the Staff of Joint Comm. on Int. Rev. Tax., 89th Cong. 2d. Sess., in Summary of Senate Amendments to H.R. 17607 6 (1966), which states that the amendment "probably is declaratory of existing law."

If Congress was concerned only with the problems of professional football leagues, the 1966 amendment would have no effect on the exemption of other professional sports leagues. Therefore, it may be necessary to employ the criteria normally used in examining other organizations seeking IRC 501(c)(6) exemption as professional sports leagues. Merely being "similar to" a professional football league may not entitle an organization to exemption.

Because of the similarities between sports league franchise operations and the franchise operations in the National Muffler Dealer's case, the National Office may re-examine the proper treatment for all sports leagues after consideration of the effect of the National Muffler Dealer's case decided March 20, 1979.

5. Bank Clearing Houses

In a given commercial area a number of banks which are otherwise unrelated will have many customers exchanging checks. This creates a flow of transactions between the various banks where these customers have checking accounts.

If each transaction between their customers must be settled individually by a transfer of funds between banks, a few checks a day can be handled. However, if the banks have some way of knowing of the collective offsets they have against each other, only a minimal transfer of funds between the banks will be necessary to balance the offsetting claims.

Bank clearing houses perform this function for member banks. Utilizing automated and computerized techniques they offset each bank's claims against the others and thus facilitate the exchange of commercial paper between the banks and the payment of resulting balances.

Organizations engaged in bank clearing house activities were formerly described in the regulations. See Treas. Reg. 45, Art. 518, Revenue Act of 1918. The Revenue Act of 1928, in dealing with exempt business leagues, removed all references to bank clearing house associations and all references to clearing houses

were removed from the regulations. However, the Service continued its practice of granting exemption to bank clearing houses.

The regulations adopted under the Revenue Act of 1928 contained the language which has been carried forward, with minor modifications. Regs. 1.501(c)(6)-1 provides that the activities of an exempt business league "should be directed to the improvement of business conditions or to the promotion of the general objects of one or more lines of business as distinguished from the performance of particular services for individual persons." The phrase "individual persons" has been interpreted to include entities such as trusts, corporations, and associations.

It is difficult to reconcile the prohibition against furnishing particular services with the exemption of bank clearing houses, since they are providing direct and tangible economic benefits to member banks to assist them in the individual conduct of their operations. Nonetheless, the banking community has long relied on private rulings as authority for the view that bank clearing houses are exempt under IRC 501(c)(6).

In order to gather factual information which would be useful in analyzing this problem, the National Office included section 5.02(d) in MS 75G-33 issued in January 1978. Section 5.02(d) of MS 75G-33 directed each Key District to conduct an examination of at least one organization engaged in clearing house activities.

The results of the examinations were submitted to the National Office under technical advice procedures. Some cases produced little information concerning the nature of the specific activities engaged in by the clearing houses and were returned to the District Offices for further development.

No consistent factors have yet been discerned in clearing house operations which would serve as a basis for distinguishing their activities from the furnishing of particular services. However, if any change in the Service's treatment of clearing houses is undertaken by the National Office, consideration will have to be given to the extensive reliance placed by the entire banking community on the present tax exempt status of these associations.

6. Professional Scientific Organizations

a. UBIT Issues

Research and testing programs are carried on by some 501(c)(3) and 501(c)(6) organizations. When conducted in order to serve the public interest, such activities may be "scientific" within the meaning of IRC 501(c)(3). See Regs. 1.501(c)(3)-1(b)(5)(i). When somewhat similar activities are conducted by a 501(c)(6) organization, they may be directed toward the improvement of business conditions in a particular industry and, therefore, within the scope of IRC 501(c)(6).

In Rev. Rul. 70-187, 1970-1 C.B. 131, a nonprofit organization formed by manufacturers of a particular product conducted a program of testing and certification of the product to establish acceptable standards within the industry as a whole. The organization was held to be exempt under IRC 501(c)(6).

However, when testing or research activities benefit private interests rather than the industry as a whole, they constitute the performance of particular services. In Rev. Rul. 69-106, 1969-1 C.B. 153, a nonprofit manufacturers' organization that conducted research in projects of common interest to the industry, but made its results available only to its members rather than to the industry as a whole was held not to qualify for exemption under IRC 501(c)(6).

Even though an organization's testing or research activities may constitute the performance of particular services, the organization will retain its exempt status if its other activities are its primary activities and are within the scope of IRC 501(c)(6). However, income produced by the particular service activities will be subject to the unrelated business income tax. If activities subject to the unrelated business income tax become the organization's primary activities, it cannot retain its exempt status.

Rev. Rul. 78-70, 1978-1 C.B., 159, describes a board of trade. As its principal activity, the organization provided grain analysis laboratory services to members and nonmembers at the same charge. The organization was supported almost entirely from the substantial profits of the laboratory, which was a kind customarily carried on for profit. The revenue ruling holds that the organization did not qualify for exemption under IRC 501(c)(6).

b. IRC 501(c)(3) vs. IRC 501(c)(6)

Some cases involve the proper classification of professional or scientific membership organizations under IRC 501(c)(3) or 501(c)(6). If classified under 501(c)(3) substantial reduced mailing rates generally follow. For a discussion on

the special mailing rates for certain nonprofits see the topic at page 568 of this EOATRI Textbook.

There are two basic causes of the difficulty in classifying some organizations under IRC 501(c)(3) or 501(c)(6). The first problem is caused by the apparent similarity between the activities of some organizations exempt under the two sections. An example of such situations is found in the area of research and testing, discussed in the preceeding section.

The second cause of problems in this area is that many 501(c)(6) organizations engage in significant educational and community improvement activities. Therefore, some of their activities may actually further 501(c)(3) purposes.

When this type of classification problem arises, the various activities engaged in by the organization must be examined in order to determine the organization's purpose in conducting each activity. The presence of a single noncharitable or noneducational purpose, if substantial in nature, will preclude exemption under IRC 501(c)(3) regardless of the number or importance of truly charitable or educational purposes. See Better Business Bureau v. U.S., 326 U.S. 279 (1945), Ct. D. 1650, C.B. 1945, 375.

In using this approach all of the relevant facts and circumstances of the particular case must be considered. Rev. Ruls. 71-504, 1971-2 C.B. 231; 71-505, 1971-2 C.B. 232; and 71-506, 1971-2 C.B. 233, are examples of the type of analysis which should be used.

In Rev. Rul. 71-504 a city medical society exempt under IRC 501(c)(6) sought reclassification under IRC 501(c)(3). Among its activities the society maintained an extensive library, provided educational lectures and counseling services, and published a monthly journal containing educational materials. The society also provided patient referral services for its members, maintained a grievance committee to hear complaints and to settle disputes between member doctors, presented the society's views on legislative matters germane to its members' professional interests, conducted a public relations program, and held meetings concerned with matters affecting the promotion and protection of the practice of medicine. The purpose of the second group of activities was neither educational nor charitable in nature. Since the society had substantial noncharitable and noneducational purposes it was not exempt under IRC 501(c)(3).

A similar analysis was applied and a similar conclusion reached in the case of a city bar association in Rev. Rul. 71-505.

In Rev. Rul. 71-506 an engineering society which engaged in scientific research in the areas of heating, ventilating, and air conditioning was held to be exempt under IRC 501(c)(3). The society maintained a full-time paid staff to conduct scientific investigations in the area of its interest. The research findings were used by members of the engineering profession, architects, scientists, teachers, and students in studying subjects related to the society's field of interest. The circumstances indicated that the research was not being conducted in a commercial manner or simply for the benefit of the society's individual members. Therefore, its research activities furthered scientific and educational purposes within the meaning of IRC 501(c)(3).

c. Services to Other Exempt Organizations

The Service is considering for possible publication the following issue: whether an exempt scientific organization jeopardizes its exempt status under IRC 501(c)(3) where it receives income from making its publishing facilities available to other subgroups within the profession to enable them to publish their individual journals. Facts in the case indicate that all of the smaller societies were also exempt under IRC 501(c)(3).

Rev. Rul. 67-4, 1967-1 C.B. 121, recognizes that publication of scientific and medical literature may further educational and scientific purposes if (1) the content of the publication is educational, (2) the preparation of material follows methods generally accepted as "educational" in character, (3) the distribution of the materials is necessary or valuable in achieving the organization's exempt purposes, and (4) the manner in which the distribution is accomplished is distinguishable from ordinary commercial publishing practices.

The question posed in the type of situation described above is whether the nature of the services provided and the interrelationship of the smaller societies to the larger one provides the basis for distinguishing the larger society's activities from those of an ordinary commercial publisher.

d. Inurement to Members

In order to offset their publishing costs, and as an inducement to attract and retain members, many professional scientific organizations charge nonmember

subscribers a higher price for their publications than the price charged members. They may also set institutional and individual rates.

Paragraph 642(2) of the EOHB issued in January 1979 notes that such a pricing policy does not necessarily result in inurement of income to an exempt organization's members. If it can be shown that members' dues have been used to support the publishing or other activity, and the difference in price reasonably reflects that support, the lower price to members would not be considered inurement of income. However, where the difference in price is achieved through a system of rebates to members, but not to nonmembers, there may be inurement of income when the rebate does not reflect the value of the support for that activity through the payment of membership dues.

Similar factors must also be considered in a case where nonmember institutions pay higher rates for goods or services than that charged individual members of the organization. The receipts from the institutions may, in effect, be used to pay part of the actual cost of each individual member's lower priced subscription.

The savings to the individual member may be viewed as reducing the organization's operating profits on its publications. Thus, a portion of the organization's net income may inure to each individual and/or member receiving the benefit of the organization's differential price policy.

Both IRC 501(c)(3) and 501(c)(6) contain prohibitions against the inurement of the exempt organization's income to individuals. Therefore, the practice of charging higher prices to institutions may jeopardize an organization's exempt status. Whether, and in what circumstances, exemption will be jeopardized is a problem that will be considered by the National Office.

7. Lawyer Referral Services

The discussion that follows considers lawyer referral organizations for exemption eligibility under IRC 501(c)(3), 501(c)(4), and 501(c)(6). This discussion is meant as an arguable brief and not to be thought of as Service position.

a. Characteristics of a Lawyer Referral Service Organization

A lawyer referral service organization is generally a nonprofit corporation created by one or more bar associations in a metropolitan area to provide lawyer referral services. The organization generally guides a large number of persons who have no attorneys into law offices and helps to establish the lawyer-client relationship. Any member of the public in need of an attorney may visit or call the organization.

A member of the organization's staff counsels individuals who seek advice concerning their problems. If it appears that legal services will probably be necessary to resolve the problem the organization arranges an appointment for the individual with an attorney. This initial appointment is for a minimum of one-half hour and the individual is asked to pay a nominal referral fee substantially less than the normal fee charged for a half-hour appointment. The attorney subsequently remits the referral fee to the organization. Any additional services performed by the attorney after the initial appointment are governed by a normal lawyer-client contractual relationship with which the organization has no connection. Any operating deficits of the organization are defrayed by the bar associations.

b. Applicable Law and Rationale

(1) IRC 501(c)(3) status

In Rev. Rul. 71-505, 1971-2 C.B. 232, the Service held that a city bar association was not exempt from Federal income taxation under IRC 501(c)(3). The association conducted a number of activities primarily directed at the promotion and protection of the practice of law. These activities were found not to be in furtherance of charitable or educational purposes. That ruling relied in part on the principle, expressed in Better Business Bureau v. United States, 326 U.S. 279 (1945), Ct. D. 1650, C.B. 1945, 375, that the presence of a single purpose not specified in IRC 501(c)(3), if substantial in nature, will destroy exemption under that paragraph regardless of the number or importance of truly exempt purposes. The same result was reached in Rev. Rul. 71-504, 1971-2 C.B. 231, which involved a city medical society carrying on substantial activities directed at promotion of the medical profession.

It is a clearly established principle of the law of charity that a purpose is not charitable unless it is directed to the public benefit. Not every purpose which is beneficial to the community, however, is deemed charitable. As a general rule, providing services of an ordinary commercial nature in a community, even though the undertaking be conducted on a nonprofit basis, is not regarded as conferring a

charitable benefit on the community unless the service directly accomplishes one of the established categories of charitable purposes.

In this case, it may be argued that the lawyer referral service does not directly accomplish any of the established categories of charitable purposes. The program is open to all members of the community, and thus is not operated exclusively for the relief of the poor, distressed, or underprivileged. The organization's activities are directed toward assisting individuals in obtaining preventive or remedial legal services covering the gamut of everyday legal problems, and, as such, are not designed to eliminate prejudice or discrimination or to defend human and civil rights secured by law. Therefore, the lawyer referral service does not confer a charitable benefit on the community.

Although the lawyer referral service provides some public benefit, a substantial purpose of the program is promotion of the legal profession. This is a noncharitable purpose, and, in accordance with Regs. 1.501(c)(3)-1(a) and the Better Business Bureau case, it precludes exemption under IRC 501(c)(3). Thus, it may be argued, the organization is not exempt from Federal income tax under IRC 501(c)(3).

(2) IRC 501(c)(4) Status

Although the organization may be deemed to promote social welfare by facilitating general access to the legal profession and by encouraging persons with legal problems to seek professional assistance, again a substantial purpose of the referral service is promotion of the legal profession itself. This purpose is clearly more than merely incidental to any social welfare purpose, particularly since the organization's services are not provided without charge and are not intended to provide a continuing means of obtaining legal advice, but rather are intended simply to put members of the public in touch with reputable members of the legal profession. Where the primary benefits of an organization's activities are directed at the members of the organization itself, and where any benefit to the community at large is incidental thereto, such organization is not operated exclusively for the promotion of social welfare within the meaning of IRC 501(c)(4). See also Rev. Rul. 75-199, 1975-1 C.B. 160; Rev. Rul. 55-311, 1955-1 C.B. 72. In this case, the major benefits of the organization's activities flow to the legal profession rather than to the general public. Thus, it may be argued, the organization does not qualify for exemption under IRC 501(c)(4).

(3) IRC 501(c)(6) Status

Operation of the lawyer referral service in the manner described does, however, promote the common business interest of the legal profession within the metropolitan area. The principal purpose of the program is to introduce individuals to the use of the legal profession in hopes that at a future date they will enter into lawyer-client relationships on a paying basis as a result of the experience. Because of this purpose, individuals pay a nominal referral fee substantially below normal rates for a half-hour appointment. Thus, the organization's activities are designed to improve conditions within the legal profession as distinguished from performing particular services for individuals within the meaning of the regulations and it may be thus argued that the organization is exempt from Federal income tax under section 501(c)(6) of the Code.

Rev. Rul. 74-308, 1974-2 C.B. 168, and Rev. Rul. 61-170, 1961-2 C.B. 112, held organizations providing referral services for tow truck operators and nurses, respectively, not exempt under IRC 501(c)(6). Unlike those organizations, which serve primarily to locate customers for service businesses, this organization provides more than a mere business referral service that is simply a convenience and economy to members of the legal profession. Rather, it provides at a nominal charge counseling by its staff as to the nature of the individual's legal problem and the possible resolution of that problem that may or may not require retention of an attorney. Therefore, Rev. Ruls. 61-170 and 74-308 are distinguishable from the present situation.

The Service is considering publishing in this area.

8. Loans to Members by an IRC 501(c)(6) Organization

a. Loans to Members by a Credit Union Association

In Rev. Rul. 76-38, 1976-1 C.B. 157, the Service discussed whether a nonprofit organization formed to maintain the good will and reputation of credit unions in a particular state by making interest free loans to assist credits unions in financial difficulty could be exempt under IRC 501(c)(6).

The organization's membership consisted of substantially all credit unions in the state. The organization maintained a fund for assistance to credit unions having financial difficulty so that their members would not lose deposits upon liquidation. It made interest free loans to such credit unions and placed no restriction on their use of these funds. The revenue ruling holds that the organization did not qualify

for exemption under IRC 501(c)(6) because there was no assurance that the loans would be used solely to protect the interests of threatened depositors, but might merely be used in supporting the borrower's general operations.

Since the protection of members' accounts depends upon a credit union continuing its general operations, the analysis in Rev. Rul. 76-38 is somewhat confusing. The National Office is considering publishing in this area.

b. Loans to Member-Employers

Rev. Rul. 65-164, 1965-1 C.B. 238, describes an organization whose membership was made up of individuals and business firms engaged in a particular industry. The organization conducted collective bargaining with employees and labor groups for its members, promoted settlement of labor disputes, and thereby prevented strikes and lockouts. The revenue ruling holds that the organization qualified for exemption under IRC 501(c)(6). The basis of the holding is that the organization's activities furthered the common business interests of its members with respect to common labor problems.

The National Office is presently considering whether to extend the rationale of Rev. Rul. 65-164 to the following fact situation:

An organization whose membership is similar to that of the organization described in Rev. Rul. 65-164 engages in a loan program for the benefit of members experiencing cash flow problems because of a strike. The purpose of the loan program is to enable members to withstand the pressures of a strike and present a united front against union demands. This would appear to be an activity which furthers the same purposes as those approved in Rev. Rul. 65-164, but publication may be necessary to indicate and further explain that position to 501(c)(6) organizations contemplating similar activities.

Conclusion:

The typical business league engages in community improvement activities, educational programs, and at least some unrelated trade or business. However, its primary purposes and activities are generally devoted to the improvement of business conditions in a particular profession or within a common commercial or geographic area.

In analyzing the issues under IRC 501(c)(6) close attention has to be paid to the details of a particular organization's operations. Most of the issues involving business leagues are resolved on the basis of all of the facts and circumstances in a particular case.

Business leagues are constantly developing new activities in an effort to advance the interests of the commercial and professional entities they represent. Therefore, the sphere of activities which is appropriate for a business league must also be considered as an evolving concept.