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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Legend:
A =
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C =
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M =
N =
U =
$X =
$Y =
$Z =

Dear :

This is in response to your ruling request of January 23, 2006, requesting the following rulings:

1. Neither M's tax-exempt status under section 501(c)(4) of the Code, nor N's tax-exempt status under section 501(c)(6) of the Code, is adversely affected by M's having merged with C or by M's having performed a novation of the C Basic Ordering Agreement (BOA).

2. Neither M's tax-exempt status under section 501(c)(4) of the Code, nor N's tax-exempt status under section 501(c)(6) of the Code, is adversely affected by M's having entered into a standing agreement with U that requires U to pay M a surcharge in connection with oil-spill responses, provided that M uses the proceeds from the surcharge solely to purchase additional indemnification insurance, to reimburse M for additional indemnification insurance purchased in a prior year, to create a reserve for future insurance payments, or to defray other spill-response-related (or response-training-related) expenses not otherwise compensated for by U.

3. Neither M's tax-exempt status under section 501(c)(4) of the Code, nor N's tax-exempt status under section 501(c)(6) of the Code, will be adversely affected by M's entering into standing agreements with other governmental entities on the same or on substantially equivalent terms as its current agreement with U, provided that M uses the proceeds from any surcharges under such agreements solely to purchase additional indemnification insurance, to reimburse M for additional

indemnification insurance purchased in a prior year, to create a reserve for future insurance payments, or to defray other spill-response-related (or response-training-related) expenses not otherwise compensated for by the contracting governmental entities.

<u>Facts</u>

M, a nonprofit membership corporation, was organized and is operated to promote the public welfare primarily by mitigating environmental damage from oil and other spills. M's sole member is N, a nonprofit membership corporation. N is operated exclusively to promote the common interests of the petroleum and energy industries and the related petroleum transportation industry, the industries composed of owners and operators of cruise ships and dry cargo vessels that utilize large nontank vessels, and the industry composed of protection and indemnity clubs and similar insuring entities that indemnify the owners and operators of large nontank vessels. By collecting dues from its members and making substantial grants to M, N supports efforts to minimize environmental damage and thereby improves the business conditions of its members.

The Internal Revenue Service approved exemption for M and N under sections 501(c)(4) and 501(c)(6) of the Code, respectively, by a ruling letter and a determination letter dated in 1990. The Service confirmed exemption for M and N under sections 501(c)(4) and 501(c)(6), respectively, by letters dated July 13, 1993, July 22, 1996, February 19, 1999, July 12, 1999, and August 8, 2001.

M and N were formed in response to a large oil spill in coastal watersand and are operated to improve the nation's ability to mitigate environmental damage caused by large oil spills. M was organized primarily to respond to oil spills beyond then-existing local response capabilities and acquired substantial dedicated resources for this purpose. Because large oil spills occur infrequently, however, most of the fixed costs of maintaining M's substantial dedicated resources are attributable to periods in which these resources are idle. Since its inception, M has invested several hundred million dollars in capital assets. In 2004, M's annual operating costs to maintain this equipment and to staff its operations (including debt service, special projects, and capital expenditures) amounted to several tens of millions of dollars.

M cannot, and does not attempt to, recover these substantial, continuing "standby" costs through fees for its services in responding to large oil spills. Instead, M depends primarily on grants from N to defray these standby costs. N, in turn, depends upon its members' dues to fund its grants to pay M's standby costs. In 2004, N members funded grants by N and made other payments to M that defrayed almost 98% of M's annual operating costs.

To reduce the burden of M's standby costs, obtain more funding, and provide additional response capabilities to better serve the public's interest, M and N have expanded their activities over the last ten years. In this regard, M has expanded its activities beyond its primary mission of responding to large oil spills to include responses to smaller spills, non-oil spills, spills outside U.S. waters, and other emergencies. M and N are also in the process of developing a new dispersant application capability and new hazardous materials response capabilities. Prior letter rulings have concluded that these new activities will not affect the exemptions of M or N.

Members of N have made prior arrangements in the form of the "Standard M Service Agreement" between M and N, under which each N member can contract with M to respond to an oil spill that is not expected to exceed 1,200 barrels. If the spill threatens to exceed 1,200 barrels, however, a non-N member having no prior arrangement with M can obtain M's services only if U or another government entity has provided M with financial assurances that M will recover its response costs. U generally has chosen to provide adequate financial assurances by contracting directly with M for individual spill responses and then passing the response costs on to the party responsible for the spill.

U's agreement to pay costs in responding to a spill in excess of 1,200 barrels is important to the preservation and protection of the funding base of N and the assets of M. If M were required to bear such costs in a catastrophic spill, M's funding base and assets could be jeopardized.

M's provision of spill-response services when called out by U is governed by an agreement between M and U. Prior to February of 2003, the form of agreement used by M and U contained risk allocation provisions that are substantially equivalent to the indemnity provisions in the "Standard M Service Agreement" that N members enter into with M. Owing to the risky nature of oil spills, appropriate indemnity or risk allocation provisions are essential to ensuring that M's oil-spill response assets are protected from potential liabilities that may arise from a spill response.

Historically, M's fees for responding to spills have been calculated in the same manner regardless of whether the party responsible for the spill was a member of N or was a nonmember. In other words, M would charge an N member who called out M directly the same amount (less any permissible dues credit) as it would charge U where U called out M to respond to a non-member spill. In the past, M was able to calculate the charges for its spill response to U and to N member in the same manner, because M's agreement with U provided indemnification and expense reimbursement terms comparable to those provided by N members who were able to call out M directly.

In February of 2003, M and U negotiated a new agreement. As part of this new agreement, M agreed to a cap of $X on the indemnity protection afforded by U. U believed that this cap on the indemnity would facilitate U's access to M resources in the event of spills posing a substantial threat to the environment. As interpreted by U, the federal Anti-Deficiency Act precluded U from providing indefinite indemnification. Without a reduction in the indemnification, U believed that the Anti-Deficiency Act could effectively prevent U from calling out M. U acknowledged that, given the reduced level of indemnification under the amended agreement, M would need to purchase additional indemnification insurance to cover M's increased risk and provide indemnity protection comparable to that provided in the Standard M Service Agreement. U therefore agreed to pay a per-spill surcharge that would reimburse M for those additional insurance costs, subject to an annual cap of $Y. This surcharge arrangement reflected U's preference to reimburse M for additional liability insurance as a substitute for providing indemnification comparable to that provided by other M customers under the Standard M Service Agreement. The surcharge offered a way to provide for a pass-through charge during spill responses that would cover M's past or future indemnity insurance premium expenses attributable to the additional indemnity insurance necessitated by the reduction in U's indemnity protections. The cap on the total amount of the surcharge was designed to ensure that amounts collected under the surcharge provision would be sufficient to cover, but would not exceed, M's additional expenses attributable to M's purchase of supplemental indemnity insurance and M's liability for other spill-response-related expenses no longer covered by the standing agreement with U. In practice, even the limited indemnification provision in the 2003 Agreement continued to pose a contracting challenge for U. U interpreted the 2003 Agreement as requiring it immediately to set aside $X any time U intended to call out M. Setting aside that amount proved to be unworkable for U. Accordingly, the parties entered into a new standing agreement in 2005 which eliminates the indemnification provision in its entirety.

The amount and manner in which the surcharge was calculated under the 2005 Agreement was not changed from the 2003 Agreement. To reflect that additional cost to M of purchasing an additional $X of indemnity insurance that was tied to the elimination of the $X indemnity, however, the annual cap of $Y was replaced with a per-incident cap of $Y. As with the prior agreement, the 2005 Agreement provides that the cap shall be reviewed on an annual basis to reflect usage and changes in the insurance market and the likely cost to M of additional insurance.

M anticipates that it may enter into agreements with other governmental entities that also provide surcharge and indemnity waiver provisions. These agreements may be based on a surcharge amount similar to that under the current U Agreement. Alternatively, the contracting government entity may pay a fixed percentage of M's actual incremental insurance premium on an up-front basis instead of a per-incident surcharge.

N's efforts to develop new relationships with regional oil spill response organizations ("OSRO's"), have resulted in merger with M of three regional OSRO's: A, B, and C. Prior to M acquiring their assets, all three of these regional OSRO's were themselves, like M, tax-exempt social welfare organizations described in section 501(c)(4) of the Code. As a result of these consolidations, M acquired the assets of these three regional OSRO's. The mergers will allow M to use the consolidated assets to respond to oil spills, primarily in the same geographical areas formerly served by A, B, and C. As with M's other activities, M receives funding from N to maintain M's oil spill response capability in the geographical regions formerly served by A, B, and C.

M's current contractual agreement with U, described above, will cover oil spill responses nationwide, including responses in the geographical areas formerly served by A, B and C. At the request of C during the merger negotiations, however, M performed a novation of C's Basic Ordering Agreement ("BOA") that was in effect between C and U prior to the merger. Through a cost reimbursement provision, C's BOA provides a broad indemnification-type protection for most liabilities to third persons not compensated for by insurance or otherwise that arise out of M's performance of the contract, subject to the availability of appropriated funds at the time and to the $Z per incident limit on Oil Spill Liability Trust Fund expenditures specified in 29 U.S.C. 9509.

Pursuant to the Agreement and Plan of Merger by and between M and C and the related Agreement between N and C, separate memberships in C ceased with the merger. The members of C prior to the merger were given the option to continue as voting members of N (if they were so prior to the merger), become nonvoting members of N, or become members of a transitional class of nonvoting members of N. Former C members who were voting members of N following the merger entered into the Standard M Service Agreement. Each C Transitional member could enter into a form of Standard M Service Contract covering the D Operational Area formerly served by C, entitling those members to access the larger pool of response assets resulting from the consolidation.

The amount of C Transitional Member's initial dues following the consolidation is based on the greater of: (i) the amount of the Transitional Members 2004 annual C dues; or (ii) the product of the Transitional Member's regional qualified barrels multiplied by the N national dues rate. The duration of the Transitional Members group is ten years, after which time it is anticipated that such members will join N as national qualified barrels members or identify alternative response capabilities.

In addition, N members who were also members of C at the time of the merger are required to pay "C heritage dues" during the ten-year transition phase. The initial amount of an N member's C heritage dues is based on the N member's C dues before the merger. The amount of an N member's C heritage dues will decline by 20 percent every two years, however, such that at the end of the ten-year transition period, an N member who is a former C member will no longer pay any C heritage dues. At the conclusion of the ten-year transition period, all N members nationally will cover the costs of the former C operations that were previously borne solely by the C Transitional Members and the N members who were also members of C.

Law:

Section 501(c)(4) of the Code provides for the exemption from federal income tax for nonprofit organizations operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2)(i) of the Income Tax Regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the community.

Section 1.501(c)(4)-1(a)(2)(ii) provides that an organization will not be considered operated primarily for the promotion of social welfare if its primary activity is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

Section 501(c)(6) of the Code provides for the exemption of business leagues, chambers of commerce, and boards of trade not organized for profit and no part of the net earnings of which inures to the benefit of any private individual.

Section 1.501(c)(6)-1 of the regulations defines a business league as an association of persons having some common business interest, the purpose of which is to promote such 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, and its activities should be directed to the improvement of business conditions in one or more lines of business as distinguished from the performance of particular services for individual members.

Revenue Ruling 69-632, 1969-2 C.B. 120, holds that an organization formed by members of a particular industry that contracts with various research organizations to develop new and improved uses for existing products of the industry may be exempt under section 501(c)(6) of the Code.

Revenue Ruling 70-187, 1970-1 C.B. 131, holds that an 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 section 501(c)(6) of the Code.

Revenue Ruling 78-69, 1978-1 C.B. 156, holds that the method of operation of a community bus service, including the need for and receipt of governmental assistance, demonstrates that such bus service was not carrying on a business for profit, even though it charged fares to its passengers.

Revenue Ruling 78-429, 1978-2 C.B. 178, the Service stated that the receipt of grants demonstrates that an airport is not carrying on a business even though the airport generates additional revenue from use of its facilities.

Revenue Ruling 79-316, 1979-2 C.B. 228, holds that a nonprofit organization whose purpose is to prevent liquid spills within a city port area and to develop a program for the containment and cleanup of liquid spills that do occur is entitled to exemption as a social welfare organization under section 501(c)(4) of the Code, provided that its services are equally available to members and nonmembers and both members and nonmembers are charged on the same basis for the cleanup services rendered.

Contracting Plumbers Cooperative Restoration Corp. v. United States, 488 F.2d 684 (2d Cir. 1973), held that an organization that repaired damage to city streets caused in the course of plumbing activities did not promote the common good, even though its activities benefited the community, because its activities were available only to repair damage caused by its members.

Analysis

Revenue Ruling 79-316, 1979-2 C.B. 228, holds that preventing and cleaning up liquid (primarily oil) spills that endanger marine life and befoul recreational beaches and shorefront property are activities designed to benefit all inhabitants served by the community. Similarly, Revenue Ruling 66-221, 1966-2 C.B. 220, holds that an organization that is engaged in fighting fires and related activities promotes the common good and general welfare of the people of the community as a whole. M's historical purpose and operations are consistent with these authorities.

Services provided by an organization exclusively, or at a preferential price, to its contributors or members do not promote the common good or general welfare even though they may incidentally benefit a community. See Contracting Plumbers Cooperative Restoration Corp. v. United States, 488 F.2d 684 (2d Cir. 1973), holding that an organization that repaired damage to city streets caused in the course of plumbing activities did not promote the common good, even though its activities benefited the community, because its activities were available only to repair damage caused by its members.

In contrast, where an otherwise qualifying organization's services are made available on an equal basis to all members of the community, it will qualify as a social welfare organization. In Revenue Ruling 79-316, supra, the Service held that a nonprofit spill response organization qualified as a social welfare organization described in section 501(c)(4) of the Code, in part because the organization did not limit its activities to cleaning up spills by its members. See also Revenue Ruling 78-69, 1978-1 C.B. 156, which held that an organization providing bus service qualified as a social welfare organization in part because its services were available to all members of the community. M's historical activities fall within the scope of these Rulings.

M and N represent the following: (1) that the C merger furthers the inter-related goals of expanding M's oil-spill response capabilities, reducing the burden of M's standby costs, and providing a broader base of funding for ongoing and anticipated costs related to expanded and improved efficiencies of M's activities; (2) that the merger provides opportunities to eliminate unnecessary redundancies in operations, thereby increasing cost efficiency in operations; (3) that scarce capital that was previously spent on duplicative resources can now be redeployed to more optimal uses resulting in a higher level of overall spill-response capability, in terms of both quality and extent; and (4) at the same time, the merger provides the opportunity for better coordination of existing resources, which results in an improved state of spill-response readiness. As such, the merger with C facilitates the promotion of the common good and general welfare of the people of the communities threatened by spills of oil or other hazardous materials. See Revenue Rulings 79-316 and 66-221, supra.

M will receive funding from N to maintain M's oil spill response capability in the geographical regions formerly served by C. Like the organizations described in Rev. Rul. 79-316 and Rev. Rul. 78-69, supra, M will continue to charge N members and non-members alike the same for response services rendered, including any response services provided by M using the consolidated oil spill response assets. The consolidated assets are not, and will not, be used except in connection with M's oil spill response activities and in accordance with M's exempt purposes.

Following the merger, the C Transitional Members now have immediate contractual access to the (much larger) consolidated pool of response assets, rather than just the regional OSRO assets for which they previously contracted. Establishing this transitional membership class is a reasonable approach to providing an appropriate length of time to transition the former C members into the N membership, while at the same time ensuring that M's funding base is not compromised in the long run. The differences in dues between classes do not result from a structure designed to benefit one class of members at the expense of another.

M's novation of the C BOA is merely the assumption of an existing agreement between C and U that governed C's provision of oil spill response services to U in the D Operational Area formerly served by C. U is agreeable to continuing this pre-existing arrangement and continuing it is consistent with, and will further, the accomplishment of M's exempt purposes in the same manner, and for the same reasons, as the new U-M Agreement.

By making it easier for U to call out M to respond to spills, the new contractual arrangement between U and M will facilitate the promotion of the common good and general welfare of the people of the communities threatened by spills of oil or other hazardous materials. See Revenue Rulings 79-316 and 66-221, supra. As noted in the May 7, 2003, and September 16, 2005, letters from U, the amended U-M agreement "is consistent with, and supportive of U's spill response programs and interests." Accordingly, the new standing agreement with U is consistent with, and will further, the exempt purposes of M.

Like the organizations described in Revenue Rulings 79-316 and 78-69, supra, M's oil spill response services will continue to be made available, on a nondiscriminatory basis, to U and other federal agencies, states, members of N, and any other person or entity responsible for a spill. The terms of the new contractual arrangement with U are not identical to the terms in the Standard M Service Agreement with N members, in that U contract provides for a surcharge as a substitute for the indemnity in the N member service agreement. This does not, however, result in a preferential price to N members. N members do not pay the surcharge because they are: (i) providing additional indemnification protections that U is no longer providing; and (ii) are compensating M for certain equipment damage and similar costs that are not covered in the contracts with U.

As the May 7, 2003, and September 16, 2005, letters from U confirm, the surcharge is merely "a substitute for providing indemnification comparable to that provided by other M customers under the standard form M Service Agreement." The proceeds from the surcharge are dedicated solely to defraying the cost of additional indemnity insurance purchased by M to offset the increased risk from the elimination of the indemnity, or to reimburse M for certain other spill-response costs not otherwise covered by the agreement with U (but which are covered in M's contracts with N members). Thus, the difference in the dollar amounts paid by N members and U is a function of the lack of a comparable indemnification and the less-favorable expense-reimbursement provisions in M's agreement with U.

Although the charges under the agreements are different, when the contract is viewed as a whole, M's services are being provided to N members and government entities on comparable terms. In substance, the cost of the services provided by M is the same for both N members and U. Whereas the costs of the indemnification are borne directly by N members, M passes through the costs it incurs on U's behalf to pay for the incremental insurance costs attributable to the lack of a comparable indemnification. As such, M's services are not being provided at a preferential price to N members, notwithstanding that the surcharge in U contract does not apply to them.

Although M may provide some oil-spill-response services that also may be offered by for-profit entities, M's oil-spill-response activities will not be carried on as "a business with the general public in a manner similar to organizations which are operated at a profit" within the meaning of section1.501(c)(4)-1(a)(2)(ii) of the Regulations. Like the airport in Revenue Ruling 78-429, and the bus service in Revenue Ruling 78-69, M will continue to depend on grants from N to fund its oil spill response operations, both in M's service area and in the area formerly served by C. The surcharge arrangement in the current U-M Agreement will not change this fact. The surcharge provided under the contract with U merely enables M to cover the costs of additional insurance and other expenses resulting from the elimination of the indemnity previously provided by U to M. If U were to continue to provide an indemnity comparable to the indemnity which N members provide under the Standard M Service Agreement, the surcharge would not be imposed. Accordingly, the surcharge will not have the effect of decreasing the amount of grant funding from N relative to prior contractual agreements with U that did not provide for the surcharge. Therefore, as was the case before the agreement was amended, M will not be carrying on a business in a manner similar to for-profit entities.

N qualifies for tax-exempt status under section 501(c)(6) of the Code because its activities benefit the entire industry as a whole as well as the environment in general. Any N member that received oil-spill-response services from M would be required to pay separately for those services. Thus, N members do not receive particular services. As discussed above, the surcharge requirement in the current standing agreement with U does not alter this conclusion, because the surcharge reflects the additional cost of insurance necessary to protect against the risks covered by the indemnity that U no longer provides but which N members continue to provide to M.

Conclusion

We rule that, based on the information submitted:

1. Neither M's tax-exempt status under section 501(c)(4) of the Code, nor N's tax-exempt status under section 501(c)(6) of the Code, is adversely affected by M's having merged with C or by M's having performed a novation of C's Basic Ordering Agreement.

2. Neither M's tax-exempt status under section 501(c)(4) of the Code, nor N's tax-exempt status under section 501(c)(6) of the Code, is adversely affected by M's having entered into a standing agreement with U that requires U to pay M a surcharge in connection with oil-spill responses, provided that M uses the proceeds from the surcharge solely to purchase additional indemnification insurance, to reimburse M for additional indemnification insurance purchased in a prior year, to create a reserve for future insurance payments, or to defray other spill-response-related (or response-training-related) expenses not otherwise compensated for by U.

3. Neither M's tax-exempt status under section 501(c)(4) of the Code, nor N's tax-exempt status under section 501(c)(6) of the Code, will be adversely affected by M's entering into standing agreements with other governmental entities on the same or on substantially equivalent terms as its current agreement with U, provided that M uses the proceeds from any surcharges under such agreements solely to purchase additional indemnification insurance, to reimburse M for additional indemnification insurance purchased in a prior year, to create a reserve for future insurance payments, or to defray other spill-response-related (or response-training-related) expenses not otherwise compensated for by the contracting governmental entities.

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, which 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 organizations 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.

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 tax representative.

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.

Sincerely,

Ronald J. Shoemaker
Manager, Exempt Organizations
Technical Group 2

Enclosure: Notice 437