FEB 10 2000

200020056

INTERNAL REVENUE SERVICE

NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Acting Area Manager
District Office

Uniform Issue List:
501.06-02
513.00-00

OP:E:EO:T2

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification Number:

Year(s) Involved:

Date of Conference:

Legend:

M =
N =
O =
P =
Q =

Issues:

1. Whether M continues to qualify as a membership organization exempt under section 501(c)(6) of the Internal Revenue Code, and

2. Whether M is engaging in a regular business of a kind ordinarily carried on for profit within the meaning of section 513.

Facts:

M was incorporated on February 27, 1987, and was recognized as exempt from federal income tax as an organization described in section 501(c)(6) of the Code. M's stated purposes in its Articles of Incorporation include the promotion, through educational, cultural, and charitable activities, of understanding, dialogue, and bonds of friendship between the American people and the people of O; and to take other appropriate action in furtherance of such purposes. M's Articles also provide that M shall have three

331

classes of members, academic, individual, and corporate; any individual, corporation, or foundation having an interest in promoting understanding, dialogue, and friendship between the American people and the people of O; the membership fee will be established by the Board of Directors and will be at such a level as to encourage a broad cross section of the interested public to become members. A later amendment to the Articles provided a fourth category of membership: nonprofit organizations. M states that it is affiliated to three organizations: N, recognized as exempt under section 501(c)(6); P, recognized as exempt under section 501(c)(3); and Q, an independent nonprofit organization, located in another country, whose purpose is to foster and promote commercial relationships between and among firms and businesspersons in that country and O.

In its application for recognition of exemption, M stated that it exists to provide a national focus of concern and resources to enhance relations between America and O; M was established with the participation of American friends of O to bring people and organizations from both countries together through programs and activities that widen cooperation and strengthen the ties of friendship and understanding between the United States and modern O. M stated that its activities would focus on individual and institutional efforts which involve people from both countries and their organizations, and that its efforts would include:

(1) Organizing for better cooperation between the two cultures at the regional, state, and local levels in the United States;

(2) Establishing cooperative exchanges between experts in the two societies in the scientific, health, and medical care areas;

(3) Fostering cooperation between educational institutions in the United States and O to improve mutual understanding at all levels of education;

(4) Developing and sponsoring exchange programs in the visual and performing arts;

(5) Preparing and implementing programs involving people from both O and America from various fields that will address current social issues confronting both of the societies;

(6) Developing a better understanding by people in both O and America of the respective economic systems in order to improve the economic cooperation between the two countries;

(7) Preparing and disseminating information to the business communities that will improve the opportunities for trade and investment cooperation between O and the United States;

(8) Exploring areas where benefits from technology exchanges can be derived to the mutual benefit of both O and the United States;

(9) Organizing exchange programs between O and the United States that will foster a better mutual understanding of the similarities and differences in the two political systems; and

(10) Developing programs, both exchange and educational, that will seek to bridge the cultural differences between the two peoples to achieve better cooperation and understanding across a broad spectrum of areas.

M's primary activity is to provide the required certification of origin ("clearing document" for shipment) to American suppliers of goods and services. These American suppliers export their goods and services to O, which requires the certifications, and the Consul General of O has designated M as a certifying agent for goods being exported from the United States to O. M states that it is the only authorized organization in the United States to certify commercial and legal documents related to transactions between the United States and O, and that documents certified by other organizations are not recognized by the Consulates of O in the United States. M's regulations for the certification of commercial and legal documents provide for certain certification fees, which provided over 95 percent of M's total revenue for the year under examination.

In reply to a request from the Service for copies of promotional membership materials, M submitted a copy of a directory (first published in the year under examination) and a brochure which it provides to each member and prospective members. The directory states that joint membership in M and N is open on an annual fee basis to corporations and other business entities with commercial interests in O, as well as

other interested organizations, institutions, and individuals. In its brochure, which includes a membership application, M states that it is its policy that whenever a client's account reflects a total payment of a certain amount or more, then a certain portion of such payment will be automatically allocated towards that client's annual membership fee. That portion is equal to a full dues payment for all members except corporations.

Law:

Section 501(c)(6) of the Code provides for the exemption from federal income tax of 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 provides 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. 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.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less certain allowable deductions and modifications.

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the function constituting the basis of its exemption.

Section 1.513-1(d)(2) of the regulations provides that trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes; and it is "substantially related" only if the causal relationship is a substantial one. The regulation continues that for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Rev. Rul. 73-411, 1973-2 C.B. 180, in discussing the exempt status of a shopping center merchants' association under section 501(c)(6) of the Code, describes in detail the history of section 501(c)(6) and the types of organizations described therein. In the case of a chamber of commerce or similar organization, the common business interest required by section 1.501(c)(6)-1 of the regulations is usually the general economic welfare of a community, and it has been accepted that an organization seeking exemption under section 501(c)(6) as a chamber of commerce must be one whose efforts are directed at promoting the common economic interests of all the commercial enterprises in a given trade community. Trade associations or business leagues under section 501(c)(6) are similar to chambers of commerce, except that they serve only the common business interests of the members of a single line of business or of the members of closely related lines of business within a single industry. The revenue ruling also stresses that section 501(c)(6) organizations are membership organizations and that the membership is voluntary and open generally to all businesses and professional persons in the business community.

Rev. Rul. 81-127, 1981-1 C.B. 357, holds that the certification of export documents by a chamber of commerce exempt under section 501(c)(6) of the Code, under the circumstances described, is not unrelated trade or business within the meaning of section 513. The organization's primary purpose is to promote the commercial, financial, industrial, and civic interests of a particular community, and its activities include the certification of the accuracy and authenticity of export documents. The main purpose of the certification of export documents is to provide an independent verification of the origin of exported goods, and the

organization only certifies documents representing goods of United States origin. The revenue ruling notes that the certification of products to establish acceptable standards within an industry as a whole has been considered to be an appropriate activity within the meaning of section 501(c)(6) as described in Rev. Rul. 70-187, 1970-1 C.B. 131. The revenue ruling also states that the organization's 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 the purpose constituting the basis for the organization's exemption.

Rationale:

Based on the statutory construction of section 501(c)(6) of the Code, it is a well established principle that section 501(c)(6) is intended to apply only to membership organizations which further the common business interests of their members and which are financed, at least in part, through membership dues. The legislative history of this statute, and the rules of statutory construction applicable to that section of the Code dealing with exempt organizations, provide that only membership organizations supported by membership dues or assessments are included in the term of the exemption under section 501(c)(6). Thus, an organization which is not in fact membership supported lacks the most significant characteristic common to organizations for which exemption was provided under section 501(c)(6). Accordingly, as generally discussed in Rev. Rul. 73-411, supra, an organization which has demonstrated a pattern of non-membership support must necessarily fail a critical test of exemption under section 501(c)(6).

To be a membership organization, and to determine whether an organization meets the requisite meaningful membership support to be described as an organization within the meaning of section 501(c)(6) of the Code, any income derived by the organization from the performance of its exempt function(s) or from "substantially related" activities is usually treated as membership income. Unrelated income is excluded from the definition of membership support. As described above, M is primarily supported by certification fees, a portion of which are automatically allocated to annual membership fees. In the

same manner as the organization described in Rev. Rul. 81-127, supra, the certification fees are received from an activity that contributes importantly to the accomplishment of M's exempt functions. Thus, the income has a substantial causal relationship to the achievement of exempt purposes, and is therefore considered to membership support.

As provided under section 513(a) of the Code and section 1.513-1(d)(2) of the regulations, income received from trade or business that is substantially related to the exempt purposes of the exempt organization in question is not defined as unrelated business taxable income. M's certification activities, as explained in Rev. Rul. 81-127, supra, meet the requirements under section 513 of the Code to be considered as substantially related to M's exercise of the function constituting the basis of its exemption.

Conclusions:

(1) M continues to qualify for exemption as a membership organization under section 501(c)(6) of the Code.

(2) M is engaging in an activity that is related to its exempt purposes, which is thus not considered to be a regular business of a kind ordinarily carried on for profit within the meaning of section 513.

A copy of this technical advice memorandum is to be given to M. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

- END -