



Membership composition: Business league/trade association

A business league exempt under Code section 501(c)(6) organization is a membership organization characteristically supported by dues. Although an organization may receive a substantial portion or even the primary part of its income from non-member sources, membership support, either in the form of dues paid to or involvement in the organization's activities, must be *meaningful*.

For this purpose, *membership support* includes the following items:

- Amounts derived from performing the organization's exempt functions or from *substantially related* activities
- Contributions or gifts from the general public

Unrelated income is excluded in measuring the extent of membership support. Thus, for example, dues from associate members are generally not considered.

Return to Life Cycle of a Business League (Trade Association)

GCM 39108 (IRS GCM), 1982 WL 204149

Internal Revenue Service (I.R.S.)
General Counsel Memorandum

IN RE: WHETHER A BUSINESS LEAGUE OR TRADE ASSOCIATION WHICH
DERIVES INCOME PRIMARILY FROM UNRELATED TRADE OR BUSINESS IS
PRECLUDED FROM EXEMPTION UNDER SECTION 501(c)(6), EVEN THOUGH
THE ORGANIZATION IS PRIMARILY ENGAGED IN EXEMPT ACTIVITIES

Date Numbered: December 23, 1982

May 28, 1982

Section 501 -- Exemption From Tax on Corporations, Certain Trusts, etc. (Exempt v. Not Exempt)
501.00-00 Exemption From Tax on Corporations, Certain Trusts, etc. (Exempt v. Not Exempt)
501.06-00 Business Leagues, Chambers of Commerce, Real Estate Boards, or Boards of Trade
501.06-02 Conduct of Business for Profit

This GCM relates to a proposed revenue ruling. (Control No. 78-11-04690.)

CC:EE-130-79

Br2:JEHorowitz

TO: S.ALLEN WINBORNE

Assistant Commissioner, (Employee Plans and Exempt Organizations)

Attention: Director, Exempt Organizations Division

This responds to a memorandum dated October 23, 1979, from the Director, Exempt Organizations Division (E:EO) to the Director, Employee Plans and Exempt Organizations Division (CC:EE), requesting consideration of the abovereferenced proposed revenue ruling (Control No. 78-11-04690).

ISSUE

Whether a business league or trade association which derives its income primarily from unrelated trade or business is precluded from exemption under I.R.C. section 501(c)(6), even though the organization is primarily engaged in exempt activities.

CONCLUSION

The proposed revenue ruling concludes that an organization's source of income is merely one factor to be considered in determining whether the organization is primarily engaged in exempt activities. We believe that an organization described in section 501(c)(6) must be a membership organization; whether the membership requirement is satisfied is determined in part by the level of member-derived income. An organization which receives more than 50 percent of its income from unrelated trade or business may be exempt under section 501(c)(6), but only if its other sources of income indicate a meaningful degree of membership support. Thus, we believe that the proposed revenue ruling should reflect the significance of member-derived income, irrespective of whether such income represents more or less than half of the organization's income.

FACTS

In the proposed revenue ruling, the organization was formed to encourage the expansion and improvement of business conditions in a particular industry. The organization's primary activities are advocating legislation designed to improve the industry, encouraging increased use of the industry's products, and distributing information about the industry to interested individuals, businesses, and governmental agencies. The organization also conducts substantial unrelated trade or business as defined in section 513. Although more than half of the organization's annual income is derived from the unrelated trade or business activity, the organization devotes only a minor portion of its total time to the activity.

*2 In the underlying case, the organization was formed to improve business conditions in the horsebreeding industry in a particular state. Although the organization is primarily engaged in activities designed to encourage the breeding and racing of the horses, the organization also conducts an annual public sale of members' yearling horses, retaining a commission on each sale. Commissions from the sale are the organization's primary source of income. The remaining portion of the income is derived from membership dues.

An earlier version of this proposed revenue ruling, which did not discuss the significance of trade associations' sources of income, was considered and approved by this office on February 13, 1979, without the issuance of a G.C.M. As revised, the ruling now concludes that the source of income is a factor to be used in determining whether an organization is primarily engaged in exempt activities. The amount of income derived from nonexempt activities would not alone be determinative, however, as the amount of income may not accurately reflect the relative importance of nonexempt activities to the organization's overall operation. Therefore, under the proposed ruling, a business league will not necessarily be deemed nonexempt merely because it conducts unrelated trade or business which yields the primary part of the organization's income.

ANALYSIS

Section 501(a) provides exemption from federal income taxation for organizations described in section 501(c). Section 501(c)(6) describes, '[b]usiness leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues...not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.' Neither the Code nor the Regulations discuss the extent to which an organization described in section 501(c)(6) may engage in unrelated trade or business activities or the extent to which they may derive income from such activities.

In February 1979 we agreed with your proposed revenue ruling's conclusion to the effect that an organization may engage in unrelated trade or business as a substantial portion of its activities so long as it remains primarily engaged in activities or functions which constitute the basis for exemption under section 501(c)(6). Your revised proposed revenue ruling now additionally discusses the extent which an organization which is primarily engaged in exempt activities may derive income from its unrelated trade or business.

We believe it to be well settled that the original extension of tax-exempt status to chambers of commerce and similar organizations designed to promote the trade and commerce of a community was intended to cover membership organizations of a type characteristically supported by dues. For example, statements submitted by the Chamber of Commerce concerning the relevant portion of the Income Tax Act of 1913 made explicit references to the 'association' and 'membership' character of the organizations in question. The membership character of the organization for which exemption was asked is also implicit in repeated allusions to 'chambers of commerce' as being representatives of the type of organizations for which exemption was sought. On the matter of the income characteristics of such organizations, the Chamber emphasized that:

*3 Exemption is asked only for commercial organizations which are not organized for profit. These organizations receive their income from dues paid by their members, a form of voluntary tax which business men pay if they may receive in common with all other members of their communities or of their industries

the benefits of cooperative study of local development, of civic affairs, of industrial resources, and of local, national, international trade.

See, Briefs and statements, Senate Committee on Finance, 63d Cong. 1st Sess. 2001 (1913). We think it obvious that, in enacting section 501(c)(6), Congress was responding to the representation of the Chamber of Commerce that the section was intended to apply only to membership organizations which further the common business interests of their members and which are financed through membership dues. The legislative history of the statute, and the rules of statutory construction applicable to subchapter F, provide that only membership organizations supported by membership dues or assessments are included in the term of the exemption. 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, we believe that an organization which has demonstrated a pattern of non-membership support must necessarily fail a critical test of exemption under section 501(c)(6).

Other publications to which we have referred in the past support the conclusion that trade associations and business leagues, as they were known at the time of enactment of the original exempting statute, were membership organizations and were primarily supported by membership dues. *See, e.g., United States Department of Commerce, Trade and Professional Association of the United States 3-4 (1942); National Industrial Conference Board, Inc., Trade Associations-Their Economic Significance and Legal Status 7-16 (1925); and American Trade Association Executives, Handbook (1924). These same authorities indicate that trade associations, in addition to receiving member-derived income, have traditionally engaged in a variety of activities which produce income. Thus, it cannot be maintained that Congress intended to extend exemption only to those associations which derive 100 percent of their income from membership and related sources. The question thus focuses on the amount of non-membership income that is consistent with section 501(c)(6) status.*

We do not think it is possible to draw an exact standard which will determine in all cases whether the association under consideration receives excessive unrelated income; such a single standard would likely be inadministrable and would be difficult to defend in litigation. However, we think that the Service can at least require that the organization be membership supported to a meaningful extent. In general, we believe that exemption should be denied if the organization has developed a history of deriving its principal support from sources unrelated to the exempt purpose, and has not demonstrated a meaningful history of support from membership dues and income from activities related to its exempt purpose. That position would accommodate the continued exemption of a trade association that derived the primary part of its income from a nonrecurring unrelated activity, but which has remaining sources of income and activities that indicate that the organization is operated and supported by the membership. We can suggest a few basic guidelines that may be useful in determining whether the requisite 'meaningful' membership support exists.

*4 First, unrelated income should be excluded in measuring the extent of membership support. Any income derived from the performance of the organization's exempt functions or from 'substantially related' activities should be treated as membership income. Second, contributions or gifts from the general public should be treated as membership income. As such gifts are not occasioned by the organization's performance of unrelated activities, it would seem inappropriate to treat them as income from nonexempt sources. These principles should insure that only income from activities which are carried on for purposes unrelated to the basis for exemption will be considered inconsistent with the membership support requirement. That requirement may be applied with some flexibility, so that an organization which is overwhelmingly engaged in related activities, and has a high degree of member involvement in the activities, would not be disqualified merely because less than half of its income is from member sources. We think the 'meaningful' test should compare the sources of income, the amount of membership participation in related activities, and the extent to which unrelated activities are pursued. At the least, however, an organization should establish that it receives enough member-derived income so that it may in fact be considered to be membership supported and not existing independently of the degree of members' participation.

Accordingly, we disagree with the conclusion of the proposed revenue ruling and do not favor its publication, as it suggests that the source of income is merely one factor to be considered in determining whether an organization is primarily engaged in activities for which exemption was granted. It is our position that an organization otherwise described in section 501(c)(6) may not be exempt under that section if it does not derive at least a meaningful amount of its income from membership sources. Our conclusion rests upon the facts as presented in the proposed revenue ruling. However, we would not oppose the publication of a ruling that reflects the membership support requirement and in which the organization's support is so clearly based on nonmembership sources that exemption would not be justified.

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