TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

200223067

Date: MAR 13 2002

Contact Person:

Identification Number:

Telephone Number:

Uniform Issue List Numbers:
501.06-00
512.00-00
513.03-00

T:EO:B2

Employer Identification Number:

Legend:

M =
N =
O =
P =
Q =
m =

Dear Applicant:

This letter is in reference to the letter dated May 16, 2001, from the authorized representative of M, in which M requested a ruling with respect to whether a proposed activity will be unrelated trade or business under section 513 of the Internal Revenue Code or will jeopardize its exempt status under section 501(c)(6).

M is an organization recognized by the Internal Revenue Service as exempt from federal income tax as a business league under section 501(c)(6) of the Code. M is a national organization representing the interests of m organizations and associations of m organizations across all sectors of the economy. While M's members are engaged in many different businesses, they share the common interest of expanding their businesses in an m way. M's membership includes m businesses in the fields of housing, health care, finance, insurance, childcare, agricultural marketing and supply, rural utilities, purchasing and consumer goods and services, as well as associations of m organizations.

M promotes voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education, training, and information; cooperation among m organizations; the m way of doing business; the economic betterment of the members of m organizations; economic empowerment through mutual self-help; and the role of m organizations in enhancing the marketplace by setting high standards of excellence, innovation, and service.

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M states that consistent with its mission, it entered into negotiations with O to sponsor a new, restricted particular domain on the Internet. M formed N, a limited liability company with M as the sole member, to contract with O for the right to act as the sponsoring organization. N is not a corporation and has not elected to treat itself as an association for federal tax purposes. N will be responsible for making policy decisions about which entities will be entitled to register in the new particular domain and for providing registry and registrar services. N intends to subcontract the provision of registry and registrar services to P, a m Internet services provider. The contract will compensate P a fixed fee per registration, which is expected to reflect the fair market value of the services being provided by P.

M states that in order to raise funds to support its sponsorship of the new domain and to facilitate the anticipated registration of a large number of names when the new domain begins its operations, M has offered m organizations the opportunity to become "founders." Founders will be entitled, among other things, to submit names for registration prior to the new domain's operation, and have these names placed in a queue to resolve when the domain starts operations. In keeping with its mission to uphold the integrity of m organizations, M will protect the domain so that only m organizations, associations of m organizations, and others related to the m movement will be allowed to register.

In addition, N and P will form a taxable corporation, Q, that will initially be equally owned by N and P to offer value added services to m organizations that have registered. N will grant Q a non-exclusive royalty bearing license at fair market value rates to use registry data as well as intellectual property such as logos, brands, and copyrighted material. M states that such value added services will enhance the ability of m organizations around the world to conduct business to business commerce, develop integrated marketing strategies, conduct m education and governance, and provide a continuous learning environment for adaptation of new technologies. Examples of value added services include, but are not limited to, education and governance services, website design and management, m certification, and selling advertising to names on the registry. M also states that profit, loss, and cash flow of Q will be allocated between N and P in direct proportion to their respective capital contributions. Further, M states that no financial, personnel, or other assets of M or N will be used in connection with the operation of Q, except on an arm's length basis, and such involvement will constitute only a minor portion of M's and N's operations.

M's purpose is to develop, advance, and protect m enterprise. M's goal is to ensure that the public recognizes m organizations as a unified, strong, and distinct sector of the economy. M has worked to develop new m organizations both in the United States and in developing countries. N will donate a portion of the registration fees to help people with limited resources to bridge the digital divide so that they can create m enterprises that generate sustainable incomes through e-commerce.

M will work to protect the integrity of m enterprise by defining what constitutes an m organization so that only true m organizations and associations of m organizations will be allowed to register for, obtain, and keep the new domain name. The domain will help Internet users immediately identify m organizations online and educate them that m organizations form a distinct and strong sector of the economy, worthy of their own domain. Further, m organizations will be able to more easily identify and communicate with one another. The domain may

heighten awareness of the m way of doing business as well as spur the creation and development of new m organizations. Such organizations will be identified as a separate sector of the economy.

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. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for a 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.

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 512(b) of the Code provides that the modifications referred to in section 512(a)(1) include, in part, (1) the exclusion of all dividends, interest, and annuities, and all deductions directly connected with such income, and (2) the exclusion of all royalties (including overriding royalties) and all deductions directly connected with such income.

Section 512(b)(13)(A) of the Code provides that, in general, if an organization (in this paragraph referred to as the "controlling organization") receives or accrues (directly or indirectly) a specified payment from another entity which it controls (in this paragraph referred to as the "controlled entity"), notwithstanding sections 512(b)(1) and (2), the controlling organization shall include such payment as an item of gross income derived from an unrelated trade or business.

Section 512(b)(13)(C) of the Code provides that for purposes of this paragraph, the term "specified payment" means any interest, annuity, royalty, or rent.

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.

Section 301.7701-2(c)(2) of the regulations provides that, in general, a business entity that has a single owner and is not a corporation is disregarded as an entity separate from its owner for federal tax purposes unless the entity elects to treat itself as an association for federal tax purposes.

Rev. Rul. 67-264, 1967-2 C.B. 196, discusses the qualification for exemption under section 501(c)(6) of the Code of an association of nonprofit consumer cooperatives. The association's purposes are to promote the cooperative method of service, production, and distribution; to spread knowledge of the history, principles, and methods of the cooperative movement; to encourage the formation of cooperatives; and to unite consumer cooperative societies. Membership is open to any organization organized and operated on a nonprofit cooperative basis. Its activities consist of uniting nonprofit consumer cooperative societies; encouraging and assisting in the formation of local cooperatives; educating the public on the principles and methods of cooperation; carrying on technical training for cooperative advisors, workers, and administrators; collecting and publishing information on cooperatives and allied subjects; holding a national congress of delegates from member societies; and maintaining a service of research and information on legislation affecting cooperatives. The revenue ruling concludes that the association is engaged in activities promoting the cooperative method of doing business. It promotes the common business interest. Accordingly, the association qualifies for exemption under section 501(c)(6).

Rev. Rul. 68-264, 1968-1 C.B. 264, holds that primary activities that constitute a regular business of a kind ordinarily carried on for profit will preclude exemption from federal income tax under section 501(c)(6) of the Code. In this case, the organization is providing particular services to members and nonmembers as its primary activity.

From the information that has been presented, it is clear that M's primary activities are to promote the m manner of engaging in business. M's members share the common interest of expanding their businesses in an m manner. M states that the establishment of N to oversee the effective administration of the new, restricted particular domain on the Internet and the registration and maintenance of names in that domain are a critical part of M's strategy to further its mission and its long-term goals on behalf of its member m organizations. M states that its goal is to ensure that the American public recognizes m organizations as a unified, strong, and distinct sector of the economy, and that the activities of N contribute importantly to the accomplishment of its purposes. M states that the activity of registration and maintenance of names in the new domain will be a critical part of its purpose to develop, advance, and protect m enterprise through being able to distinguish m organizations from other organizations and will aid M's mission to increase public understanding of the m sector.

M states that, historically, the integrity of the m enterprise has been jeopardized by businesses that have claimed that they are m organizations to take advantage of strong consumer trust that exists for m organizations. Upholding the integrity of a particular industry/profession is an activity properly engaged in by organizations that are exempt under section 501(c)(6) of the Code. In order to meet the exception from unrelated business income tax under section 513(a), the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. M's goals are within the intendment of section 501(c)(6) of the Code in the same manner as the organization discussed in Rev. Rul. 67-264, supra. The registration and maintenance of names in the new domain are substantially related to M's purposes within the meaning of section 1.513-1(d)(2) of the regulations because M's purposes are to represent the interests of m organizations and to uphold the integrity of m organizations.

Since N is a limited liability company, with M as the single member, and is not a corporation and is not electing to be treated as an association for federal tax purposes, it is considered to be a disregarded entity within the meaning of section 301.7701-2(c)(2) of the regulations.

As stated in Rev. Rul. 68-264, supra, only when an organization exempt under section 501(c)(6) of the Code engages primarily in an activity that is not considered to be an exempt activity within the meaning of section 501(c)(6) will exemption be jeopardized. From the facts presented and representations made, there is no indication that M will be engaging primarily in any activity that is not considered to be an exempt activity under section 501(c)(6).

Any payment of dividends by Q to N will not constitute unrelated business taxable income under section 512(a)(1) of the Code because such amounts will be excluded under section 512(b)(1). Dividends will be excluded from the computation of unrelated business taxable income regardless of whether the rules under section 512(b)(13) for controlled organizations are applicable in this instance. Dividends do not fall within the definition of "specified payment" under section 512(b)(13)(C). In addition, M has stated that N will receive royalty payments from Q for the right to use the registry data to offer value added services, and that it understands that such payments will be subject to unrelated business income tax if N controls Q within the meaning of section 512(b)(13)(A).

Accordingly, based on the facts and circumstances concerning the proposed transaction as stated above, we rule as follows:

(1) N, formed and wholly owned by M, will be treated as a disregarded entity such that its activities will be ascribed to M and all items of income and expense incurred by N will be treated as items of income and expense of M.

(2) The activities of N as described, including but not limited to, the registration and maintenance of names in the particular domain, will not constitute unrelated trade or business to M under section 513 of the Code and will not adversely affect M's tax exemption under section 501(c)(6).

(3) Dividends received by N from Q will not be unrelated business taxable income to M, whether or not Q is a controlled organization, and M's tax exemption under section 501(c)(6) of the Code will not be jeopardized as a result of N's ownership of Q, Q's activities as described, or N's receipt of dividends from Q.

These rulings are based on the facts as they were presented and on the understanding that there will be no material changes in these facts. Any such change should be reported to the Tax Exempt and Government Entities (TE/GE) Customer Service Office. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records. A copy of this ruling is being forwarded to the TE/GE Customer Service Office.

Except as we have specifically ruled herein, we express no opinion as to the consequences of this transaction under the cited provisions or under any other provision of the Code.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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

Sincerely yours,

(signed) Terrell M. Berkovsky

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2