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INTERNAL REVENUE SERVICE

NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Uniform Issue List:
501.03-33
513.00-00

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification Number:

Years Involved:

Conference Held:

Legend:

M =
P =
Q =
X =

Issues:

(1) Whether M should retain its status as an organization described in section 501(c)(3) of the Internal Revenue Code.

(2) If M is not an organization described in section 501(c)(3) of the Code, whether its exempt status should be modified to section 501(c)(6).

(3) If M's exemption as an organization described in section 501(c)(3) of the Code is revoked, what should be the effective date of the reclassification?

(4) Whether income from M's sale of a particular document should constitute unrelated business taxable income under section 511 of the Code.

Facts:

M is a membership organization recognized as exempt from federal income tax under section 501(c)(3) of the Code. Its purposes, as stated in its amended Articles of Incorporation, are

to do all things necessary for the purpose of maintaining and raising the standards and ethics of the governmental x departments, agencies, and organizations; to conduct professional education activities; to promote effective centralized public x; to exchange information on products, manufacturers, policies, procedure, and general information useful to x agents; to advise the legislative bodies, federal x agencies, and the x agencies of states, counties, villages, towns, boroughs, provinces, publicly-owned utilities, public schools and colleges, prisons, governmental hospitals and other institutions, and other tax-supported x agencies, public authorities, and similar ad hoc agencies on legislation, and all problems affecting public x and the general welfare of the members and the agencies which they represent and their agents and employees; to develop and perfect standards, practices, and specifications for the use of members; and to develop and promote the acceptance and passage of uniform laws and procedures for all governmental x.

M's Articles of Incorporation also state that M's membership shall consist of both public x agencies and public x personnel. As agency members, governmental x organizations, including federal x agencies and the x agencies of states, counties, cities, villages, towns, boroughs, provinces, publicly-owned utilities, public schools and colleges, prisons, governmental hospitals and other institutions, other tax-supported x agencies, public authorities, and similar ad hoc agencies are eligible. The Articles state that each member agency shall be represented by its head or designated representative in the organization and administration of M. As individual members, public x personnel are eligible for membership. M states that all of its voting members are governmental agencies.

M's bylaws provide that M will cooperate on a professional membership or representation basis with all legislative and other public bodies, departments, private groups, academic institutions, and organizations in working toward its fundamental objectives of promoting professional development and improving the education, organization, administration, and operation of governmental x.

During the year under examination, M conducted its annual professional development forum and products exposition, educational programs, and certification programs. M states that the annual meeting provides lectures, seminars, workshops, and other educational opportunities for governmental x personnel to improve their skills and to keep up-to-date with the best industry practices and programs, as well as learn the latest information on new and revised rules and regulations affecting

governmental x. M states that the concurrent products exposition provided an opportunity for suppliers of products and services to government agencies to provide information and product demonstrations to x personnel.

M states that it sponsors a substantial set of educational programs for public x personnel, usually presented in association with local chapters. These courses involve substantial reading, attendance at programs lasting two or three days, and include a course syllabus. M states that these programs are operated independently of its certification program, in that individuals may enroll in all of the educational programs without regard to whether they are working toward certification.

M states that it conducts two certification programs, leading to designation as a P or as a Q. M states that the principal purpose of the certification programs is to achieve more effective and efficient x by public agencies through improvement of the skills of governmental x personnel, and improvement of the ability of public agencies to identify skilled and experienced x personnel. M states that the means to certification is through educational courses, self-study, experience, and successfully passing an examination; the certificate is similar to a diploma, recognizing satisfactory mastery of a recognized body of knowledge. To retain certification, individuals must be recertified at five-year intervals, based primarily on continued education, study, and contributions to the x function as a writer, seminar instructor, or workshop leader.

M states that the certification programs are carried out through a particular council, which is composed of representatives of M, the national association of State x officials (all of whose members are governmental employees), the United States General Services Administration, its Canadian counterpart (Supply and Services Canada), six members of the Board of Examiners (who review completed certification examinations), and one academic member. M states that with the exception of the Executive Director of M and the academic member, all members of the council are or were (two members are retired) employees of governmental agencies. M also states that many, if not most, payments of certification fees are paid by governmental agencies.

An employment advertisement by the United States General Services Administration in The Wall Street Journal. dated December 7, 1994, includes the following requirements for candidates for a particular executive position: graduation from an accredited college or university with a Bachelor's degree;

eight years of progressively responsible professional administration experience to include four years in x activities is required; a Master's degree is preferred; must possess a current certification as a P or as a certified x manager or be able to obtain certification by the second year of employment.

M states that it also publishes a bi-monthly journal, a compendium of news, feature articles, and other information of interest to public x personnel. In order to encourage purchasing personnel to expand their knowledge in the field, M states that it stocks a number of books that are available for purchase by members and nonmembers.

M states that at the request of its agency members, and in order to enable them to improve their efficiently in x products and services, M developed and publishes a particular code document. By assigning standard code numbers to particular products, governmental x agencies can perform certain necessary functions more efficiently using less overhead, reduce costs through cooperative x agreements among agencies, and analyze performance over time. M's code is available for sale to both members and nonmembers; nonmembers are charged more for the code than M's members. M states that the principal means of publishing the code is in an electronic format; however, the code is neither a computer program nor a data base, but simply a standard document published in electronic form that can be used as a data base.

Applicable Law:

Section 501(c)(3) of the Code for the exemption from federal income tax of organizations organized and operated exclusively for religious, charitable, or educational purposes so long as no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. The regulations continue that the term "charity" includes lessening of the burdens of Government.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that "educational", as used in section 501(c)(3) of the Code, relates to the instruction or training of the individual for the purpose

of improving or developing his capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 511(a)(1) of the Code imposes a tax on the unrelated business income of certain exempt organizations, including those exempt under section 501(c)(3).

Section 512(a)(1) of the Code provides that as a general rule, except as otherwise provided, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) 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 functions constituting the basis for its exemption.

Section 513(c) of the Code provides that the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services.

Section 1.513-1(a) of the regulations provides that gross income of an exempt organization subject to tax imposed by section 511 of the Code is includible in the computation of unrelated business taxable income if: (1) it is income from a trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Section 1.513-1(b) of the regulations provides that activities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Thus, for example, activities of soliciting, selling, and publishing commercial advertising do not lose identity as a trade or business even though the advertising is published in an exempt organization periodical which contains

editorial matter related to the exempt purposes of the organization.

Section 1.513-1(c)(1) of the regulations provides that in determining whether trade or business from which a particular amount of gross income derives is "regularly carried on," within the meaning of section 512 of the Code, regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued. For example, specific business activities of an exempt organization will ordinarily be deemed to be "regularly carried on" if they manifest a frequency and continuity, and are pursued in a manner generally similar to comparable commercial activities of non-exempt organizations.

Section 1.513-1(d)(1) of the regulations provides that, in general, gross income derives from "unrelated trade or business," within the meaning of section 513(a) of the Code, if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities which generate the particular income in question--the activities, that is, of producing or distributing the goods or performing the services involved--and the accomplishment of the organization's exempt purposes.

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 is "substantially related," for purposes of section 513 of the Code, only if the causal relationship is a substantial one. Thus, 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. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

Rev. Rul. 73-567, 1973-2 C.B. 178, holds that a medical specialty board formed by members of the medical profession to devise and administer written examinations and issue certificates to the successful candidates is exempt as a business league under section 501(c)(6) of the Code, but is not exempt under section 501(c)(3). The revenue ruling makes no mention of whether the candidates for certification are members of the organization, employees of the members, or members of the general public. The revenue ruling concludes that since the activities of the board consist of certifying physicians who are thereafter authorized to hold themselves out to the public as specialists, its purpose is to promote the common business interests of the physicians within the meaning of section 501(c)(6) rather than to be operated exclusively for charitable purposes within the meaning of section 501(c)(3).

Rev. Rul. 74-117, 1974-1 C.B. 128, holds that an organization formed to implement an orderly change of administration of the office of Governor of a State, by assisting the Governor-elect during the period between his election and inauguration, through screening and selecting applicants for State appointive offices, and preparing a legislative message and program reflecting the party's platform and budget, is an "action" organization under section 1.501(c)(3)-1 of the regulations, and does not qualify for exemption. As stated in the facts of this case, the State will officially provide similar services to the executive after the inauguration, but has never provided these services prior to any inauguration. The revenue ruling concludes that the government is the party best qualified to decide whether a particular activity is sufficiently in the public interest to warrant its recognition as a legitimate function of government, and unlike some other jurisdictions, this particular jurisdiction has not seen fit to provide services of the type described above for the Governor-elect and thus has not recognized such activities as functions of government prior to his inauguration. Thus, the activities of the subject organization are not relieving any burden of the government.

Rev. Rul. 85-2, 1985-1 C.B. 178, holds that an organization providing legal assistance to guardians *ad litem* who represent abused and neglected children before a juvenile court that requires their appointment lessens the burdens, of government and, therefore, qualifies for exemption under section 501(c)(3) of the Code. The revenue ruling states that a determination of whether an organization is lessening the burdens of government requires consideration of whether the organization's activities are activities that a governmental unit considers to be its burdens, and whether such activities actually "lessen" such governmental burden. The revenue ruling continues that in order

to determine whether an activity is a burden of government, the question to be answered is whether there is an objective manifestation by the government that it considers such activity to be part of its burden. The fact that an organization is engaged in an activity that is sometimes undertaken by the government is insufficient to establish a burden of government. Similarly, the fact that the government or an official of the government expresses approval of an organization and its activities is also not sufficient to establish that the organization is lessening the burdens of government. The interrelationship between the organization and the government may provide evidence that the government considers the organization's activities to be its burden. A favorable working relationship between the government and the organization is strong evidence that the organization is actually "lessening" the burdens of the government. The revenue ruling states that to determine whether the organization is actually lessening the burdens of government, all of the relevant facts and circumstances must be considered.

In Indiana Crop Improvement Association, Inc. v. Commissioner, 76 T.C. 394 (1981), *acq*. 1981-2 C.B. 1, the Tax Court found that the organization was described in section 501(c)(3) of the Code because it was lessening the burdens of government. The organization's primary activity was the certification of crop seed within the State of Indiana; a substantial amount of time was also spent conducting scientific research in seed technology and providing instructions in modern seed technology in conjunction with Purdue University. The State of Indiana did not have a department of agriculture to regulate agricultural products within the State and delegated by law agricultural regulatory functions to Purdue University and the director of the Purdue University Agricultural Experiment Station; the function of seed certification was in turn delegated to Indiana Crop Improvement Association, Inc. The Tax Court found that: (1) as the official seed certifying agency for Indiana, the organization was directly assisting the U.S. Department of Agriculture rather than promoting the economic interests of commercial seed producers and commercial farmers; (2) the seed certification research and testing was either pursuant to the organization's delegated authority or in conjunction with Purdue University rather than being carried on as an incident to commercial operations; and (3) the organization's educational programs on good farm management through the use of modern seed technology, available to anyone interested, did not benefit only the business interests of commercial seed producers and commercial farmers, but rather was educational within the meaning of section 1.501(c)(3)-1(d)(3) of the regulations.

Rationale:

M states that its principal purpose is to lessen the burdens of government and that the operation of a certification program is not necessarily inconsistent with exemption under section 501(c)(3) of the Code. M states that its only voting members are governmental agencies and that the vast majority of its revenues are paid by governmental agencies who pay membership dues, provide funding for their employees to attend M's educational programs, and pay for the certification of their employees. M states that the purpose of its certification program is to provide education and training to public x personnel to enable them to make x decisions that make more effective and efficient use of taxpayer dollars; enhanced credibility and professionalism necessarily follow M's program, but these results are only incidental consequences and are not the purpose of the programs. M also argues that if the individual employees were its members and if they paid for the education and certification, then the purpose of the programs might be to promote common business interests; the governmental agencies who are members, however, pay for the education of their employees and, often, for their certification. Thus, M states, the programs primarily serve the governmental agencies' interests, and only incidentally benefit the participating employees.

M contends that further evidence of the participation of governmental agencies in the certification program is found in the fact that M's certification programs are administered by a separate council that is comprised primarily of employees of governmental agencies.

A determination of whether an organization is lessening the burdens of government requires consideration of whether the organization's activities are activities that a governmental unit considers to be its burdens, and whether such activities actually "lessen" such governmental burden. Merely providing a service to governmental agencies for a fee is usually not considered to be lessening the burdens of government. An organization that provides funds to a county's law enforcement agencies to police illegal narcotics traffic lessens the burdens of government, and, therefore, is described in section 501(c)(3) of the Code. Rev. Rul. 85-1, 1985-1 C.B. 177. Similarly, an organization that provides legal assistance to guardians *ad litem* who represent abused and neglected children before a juvenile court that requires their appointment lessens the burdens of government and is also described in section 501(c)(3). Rev. Rul. 85-2, supra. As stated in Rev. Rul. 74-117, supra, the government is the party best qualified to decide whether a particular activity is

sufficiently in the public interest to warrant its recognition as a legitimate function of government.

In this case, several governments have made it fairly apparent that they consider the training, education, and certification of their public x personnel as a legitimate function of government. Not only by supporting M through membership dues, educational fees, and certification fees, by virtue of making up the entire voting membership of M and having the primary representation on the council carrying out M's certification programs, the governments are indicating that the education is necessary for their employees in the x function. Also, the governments are keeping control of all of M's activities even though M is an organization independent of the governments. Although not reflected directly in the administrative file, there is no evidence that the various governments have any other internal training facilities for the purpose of x training. Also, as noted in The Wall Street Journal personnel advertisement, the government is using designations originated and certified by M. M is distinguishable from the organization discussed in Rev. Rul. 73-567, supra, due to the fact that the primary recipient of the benefits of the training are the employees of governments, who use their training directly for the benefit of their respective governments. For these reasons, M is considered to be lessening the burdens of government.

Before income from an activity may be taxed as unrelated business income, the following three conditions must be satisfied: (1) the activity must constitute a trade or business; (2) the trade or business must not be substantially related to the organization's exempt purpose; and (3) the trade or business must be regularly carried on.

M's code document was requested by its governmental agency members and is being used regularly by the various governments. It was developed by M, published by M, and is available for sale by M to its members and nonmembers. As indicated in Indiana Crop Improvement Association, Inc. v. Commissioner, Rev. Rul. 74-117, and Rev. Rul. 85-2, all supra, the government is the party best qualified to decide whether a particular activity is sufficiently in the public interest to warrant its recognition as a legitimate function of government. For these reasons, M's use of the code document is related to M's exempt purpose of lessening the burdens of government. Since the activity is related to M's exempt purpose, the questions of whether the activity constitutes trade or business and whether it is regularly carried on need not be discussed.

Conclusions:

(1) M should retain its status as an organization described in section 501(c)(3) of the Code.

(2) The question of whether M meets the requirements for exemption under section 501(c)(6) of the Code is moot.

(3) The question regarding the effective date of revocation of exempt status under section 501(c)(3) of the Code is moot.

(4) M's income from its sale of its commodity code is related to its exempt purpose and is not unrelated business taxable income under section 511 of the Code.

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

- END -