



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Dear

This responds to a letter from M's authorized representatives, who have requested rulings under sections 501(c)(6) and 512 of the Internal Revenue Code on M's behalf.

Facts:

The information submitted indicates that M, a non-profit organization, is recognized as exempt from federal income tax as a business league within the meaning of section 501(c)(6) of the Code. M has more than x member institutions from many countries. Membership in M is open to institutions and entities involved in the b industry. As part of its tax-exempt purposes, M seeks: 1) to promote practices conducive to the efficient conduct of the business of its members in b, including the development and maintenance of standard documentation for b and sound f management practices; 2) to inform its members of legislative and administrative developments affecting b; and 3) to create a forum for the discussion of issues of relevance to participants in b transactions. M works with other organizations to amend statutory law to achieve a greater recognition of the enforceability of early termination and c provisions of contractual arrangements. M also provides information and guidance to foreign bodies and national authorities with responsibility for financial activity on how to reform existing legal structures to eliminate obstacles to the effective use of collateral in contractual arrangements.

M has published various standard agreements and sets of definitions for use in documenting b transactions. M's master agreements have been used by many dealers and end users of b around the world to facilitate cross-product e and to document their transactions. The master agreements allow two parties to document a wide variety of privately negotiated b transactions under a single contract. The master agreements permit the designation of an early termination date of all transactions under a single agreement following the occurrence of an event of default. After the occurrence of an event of default by one party and the early termination of a master agreement by the other party, that master agreement provides for the other party to calculate a single lump sum amount (reflecting the then positive or negative values of all transactions documented under that master agreement). This calculation of a single lump sum amount is commonly referred to as c.

M has sought advice from leading law firms in various jurisdictions around the world concerning the enforceability of c in bankruptcy for several reasons. First, it is necessary to know whether c is enforceable in bankruptcy in order to appropriately measure and manage f. Second, in order for banks acting as b dealers to maintain capital against their b positions with individual counterparties on a net rather than a gross basis, regulators in the United States and other major jurisdictions require that banks have available legal opinions addressing the enforceability of c in bankruptcy. Those regulators also require that the "c opinions" ("d") be updated annually.

M commissions the requisite d on behalf of its members. The d cover c laws in 21 jurisdictions and bilateral and multibranch transactions in 36 jurisdictions where dealers and end users contract substantial amounts of b business. These d enable M's members to reduce their f and the capital required to support their businesses. M is the only organization providing d to entities regularly engaging in b transactions.

M and N, an unaffiliated limited liability partnership, formed P in order to make use of and deliver an on-line legal information service known as Q to M's members. M entered into the transaction in order to promote its tax-exempt purposes in a more simple and efficient manner. M has a 50 percent interest in P's net income and net losses.

Q is an exclusive on-line legal information service and software product that extracts specific and limited data from, and provides access to, the d, legal memoranda on several jurisdictions, and a library compilation of relevant c legislation. The data extracts identify key issues for regulatory capital and f management purposes, enable the user to determine quickly and efficiently whether the relevant country covered by the d permits c, and refer the user to specific locations in the d for detailed answers. Q does not provide the user with legal advice on the laws of the jurisdiction covered by the d.

Q and annual updates of Q are available only to M's members through the use of a password-protected website maintained by M on behalf of P. Members subscribing to Q are charged an annual access fee based upon the type of membership in M rather than the frequency of use of, or benefit received from, Q. All subscribing members receive the same access to Q regardless of the amount of the access fee paid. M will continue to provide the d and the annual updates to all of its members only through a password-protected portion of its own website. N is permitted

to develop and sell software outside of P tailored to the specifications of individual members of M and non-members based upon e advice obtained by them and addressing e issues in jurisdictions not covered by M's d.

A management committee, consisting of two members appointed by M and two members appointed by N, manages the day-to-day business affairs of P. All voting and other determinations of the management committee require the unanimous consent of the committee members. The management committee has appointed an individual employed by an affiliate of N to serve as the chief operating officer to conduct the business of P, but P will bear only 40 percent of his salary and all related costs not to exceed \$100,000 annually. P has also agreed to pay the salary and related costs of any employee of M or N or its affiliates if that employee spends substantially all of his or her time marketing Q at the request of the management committee. M anticipates that such employee, if any, will spend no more than 10 percent of his or her time on P activities. Otherwise, neither M nor N will be charging P for the time of its officers, partners or employees devoted to P's business activities.

Rulings Requested:

The following rulings have been requested:

1. M's share of net revenues from P will not be characterized as unrelated business taxable income under section 512 of the Code.
2. M's share of net revenues from P will not jeopardize M's tax-exempt status under section 501(c)(6) of the Code.

Law:

Section 501(a) of the Code exempts from federal income taxation organizations described in section 501(c).

Section 501(c)(6) of the Code describes business leagues not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

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 provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less certain deductions which are directly connected with the carrying on of such trade or business, both subject to certain modifications.

Section 512(c)(1) of the Code requires a tax-exempt organization with a partnership interest in a partnership regularly carrying on an unrelated trade or business to include its share of the partnership's gross income and related deductions arising from such unrelated trade or business in computing its unrelated business taxable income.

Section 1.513-1(a) of the Income Tax Regulations provides that a tax-exempt organization's gross income subject to tax under section 511 is includible in the organization's computation of unrelated business taxable income if: (1) the income is derived 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 1.501(c)(6)-1 of the regulations states that a business league within the meaning of section 501(c)(6) of the Code 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.

Rev. Rul. 66-338, 1966-2 C.B. 226, describes an organization formed to promote the interests of a particular retail trade by advising members on their individual business problems. The organization's field representatives not only advise the members on improvements to the stores but also inform them about office and store supplies, fixtures, and display accessories and merchandising and electronic services available to its members at low prices. The ruling finds that the organization provides individual members with an economy and convenience in the conduct of their individual businesses by making the supplies and services available at a cheaper price than what the members would pay if they obtained the supplies and services on their own. Therefore, the activities constitute particular services to individual members as distinguished from activities aimed at improving the business conditions of the trade as a whole.

Rev. Rul. 67-182, 1967-1 C.B. 141, describes a nonprofit organization formed to establish and maintain a private library of "electric logs," maps, oil publications, and oil information services for its members' use and as an aid in their oil exploration businesses. The material for the library is furnished by the members. Membership in the organization is limited to a small group. The ruling finds that the organization is making specialized information available to its members on a cooperative basis. This serves as a convenience and economy in the conduct of their businesses. Operation of the library is an activity which constitutes the performance of particular services for individual persons. Furthermore, since membership is limited and the facilities of the organization are made available only to participating members, the organization's activities are not aimed at the improvement of business conditions in the industry as a whole. Accordingly, the ruling holds that the organization does not qualify for exemption under section 501(c)(6) of the Code.

Rev. Rul. 69-106, 1969-1 C.B. 153, describes a nonprofit organization formed and operated by a group of manufacturers to carry on research and development projects of common interest to their industry. A committee of the membership agrees on what projects will be undertaken. No research is conducted for any particular member. All research projects are financed solely by the dues of the members. The results of the research are made available only to members. Although membership in the organization is open to all businesses in the industry on an equal

basis, not all of the businesses in the industry are members. The ruling finds that, in order to be exempt under section 501(c)(6) of the Code, a research organization must make the results of its research available to all of the members of an industry. Since the organization distributes the results of its research only to its members, its activities are not aimed at the improvement of business conditions for the entire industry. Accordingly, the ruling holds that the organization does not qualify for exemption from Federal income tax under section 501(c)(6).

In Rev. Rul. 73-386, 1973-2 C.B. 191, a nonprofit membership organization secures and supplies businesses with job injury histories of prospective employees upon request. The service is available to member and non-member businesses alike, and a charge, which was set at an amount calculated to return the organization a profit on the undertaking, is made for the service. The ruling points out that the services involved go well beyond any mere development and promotion of efficient business practices in respect to a business community as a whole. In providing the service in question, the organization is furnishing individual members of the business community with a regular commercial-type business service required and utilized in day-to-day operations of the businesses that request the service. As such, the service is not one that promotes the business interests of the members in common or as a whole, but rather is an activity that constitutes the performance of a particular service of a commercial nature for individual businesses and thus constitutes income from unrelated trade or business within the meaning of section 513 of the Code.

Rev. Rul. 78-51, 1978-1 C.B. 165, concerns a local bar association that is exempt under section 501(c)(6) of the Code. As one of its activities, the association purchases standard legal forms from the state bar association and sells them to its member attorneys at a 100 percent markup on cost. These forms are also available to all attorneys through the state bar association. The ruling finds that, by selling standard legal forms to its members, the association is furnishing individual members with a regular commercial service. The service does not promote the improvement of business conditions in one or more lines of business and, therefore, does not contribute importantly to the accomplishment of the association's exempt functions under section 501(c)(6). Accordingly, the ruling holds that the sale of standard legal forms by the association to its members is unrelated trade or business within the meaning of section 513.

Louisiana Credit Union League v. United States, 693 F.2d 525 (5th Cir. 1982), concerned a business league exempt from taxation under section 501(c)(6) of the Code. The League's membership consists of credit unions in the state of Louisiana. The League maintained and published a loose-leaf library service of all statutes, regulations and other legal materials relating to the operation of a credit union. Alternatives to the service were limited and the league made the service available to its members for a fee. In addition, the league provided data processing services and debt collection services through commercial, third party providers to its members for a fee based upon the extent of a member's use of the services. Some members did not subscribe to the data processing and debt collection services because they either had these services internally or obtained the services from a different commercial provider. The Court set out a two-step test for determining whether business activities have a substantial relationship to the exempt purposes of an organization. Under this test, an income-producing activity is substantially related to the exempt function of the organization if: (1) the activity is unique to the organization's tax-exempt purpose; and (2) direct benefits flowing from a

business league's activities inure to its members in their capacities as members of the organization.

The Court stated that the publication and maintenance by the League of a loose-leaf library service compiling all the statutes, regulations, and other legal materials pertinent to the operation of a credit union would exemplify the sort of service unique to the League's tax-exempt function. Such a service, provided to League members for a subscription fee, would bear a unique relationship to the League's purpose of promoting the development of credit unions. Presumably, alternative access to such a service would be limited, and its narrow scope would make it singularly useful to member credit unions. Any business league activity so distinctively oriented toward members seemingly would bear a substantial relationship to its purpose.

Next, the Court stated that, in evaluating the relationship between the activities and purposes of a business league, the capacity in which benefits are received by the organization's members is as important as the unique character of the organization's activities. For a substantial relationship to exist, any direct benefits flowing from a business league's activities must inure to its members in their capacities as members of the organization. Thus, when a business league's uniquely relevant activities produce inherently group benefits that accrue to its members as members, a substantial relationship exists within the meaning of section 513 of the Code.

Finally, the Court found that the data processing and debt collection services provided a benefit to only participating members and did not promote the common interest of all its members; as a result, the court affirmed that such activities were not substantially related to the league's tax-exempt purposes.

Texas Apartment Ass'n v. United States, 869 F.2d 884 (5th Cir. 1989), concerned a trade association that is tax-exempt under section 501(c)(6) of the Code. Membership in the association was open to owners of multi-family units and service companies. The Association regularly developed, reviewed and published: (1) a landlord manual containing updated information on Texas landlord and tenant law not present in other commercially available landlord manuals, and (2) standard real estate lease forms containing comprehensive legal provisions not present in other standard forms. The association sold the manual and the forms only to its members and used the materials in its educational and legislative programs. The Court found the association's development and updates of the manual and forms to be unique. In addition, the Court found that the materials and the association's educational programs and legislative efforts contributed to the standardization of rights and duties under Texas landlord-tenant law and the improvement of landlord practices and legislation in Texas. The Court held that the association's activities were substantially related to the association's tax-exempt purposes even though the association charged its members fees for the manual and forms and the fees were in direct proportion to the immediate benefit received from the materials.

Analysis:

At issue is whether M's provision of Q, through P, solely to its members is unrelated trade or

business or jeopardizes M's status as an organization described in section 501(c)(6) of the Code. If the activity of providing Q is determined to be related to M's exempt purpose, then the income M receives from P is not income derived from an unrelated trade or business under section 512 and M's exemption under section 501(c)(6) is not at risk if M engages in the activity.

The facts presented show that M obtains d from lawyers in various countries concerning the enforceability of c in bankruptcy. Such d are updated annually. M commissions the d on behalf of its members. M is the only organization providing d. Q will provide on-line access to the d, legal memoranda and c legislation, as well as improved searching capabilities.

Generally, gross income of an exempt organization subject to the 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.

Trade or Business

P is engaged in a trade or business within the meaning of section 1.513-1(b) of the regulations by selling Q to M's members. The d and the status of c legislation in various countries will continue to be available through a password-protected portion of M's website to members at no additional charge. P offers data extracts and text of the d, legal memoranda, and legislative updates of various countries for an annual access charge that varies according to the member's type of membership. Moreover, P will allocate all of its net losses from the sale of Q equally between M and N and 50% percent of its net income to M. Therefore, P can be deemed to be selling Q with the intent of generating income for its partners, M and N.

Regularly Carried On

The sale of Q will be regularly carried on because P will offer Q and updates of Q to M's members on an ongoing basis. In addition, M will continually contribute the right to use the updated d and related advice it commissions to P. N will develop new releases of Q software based upon such annual updates and its own information resources. P will be offering these new releases of Q to M's members. M and N will carry out marketing activities set forth by the management committee at least initially. Although P will only sell Q to M's members and not to members of the public, the marketing and sales activities of P will be of such frequency and continuity that they will be considered to be regularly carried on within the meaning of section 1.513-1(c)(1) of the regulations.

Substantially Related to Exempt Purposes

In determining whether there is a substantial relationship between the business activities in question and the accomplishment of M's exempt purposes, it is necessary to understand M's tax-exempt purposes. M's purposes include promoting practices conducive to the efficient conduct of the business of its members in b (including the development and maintenance of standard documentation for b practice), and informing members of legislative and administrative

developments affecting the b industry. As a means of accomplishing its purposes, M obtains d on behalf of its members which cover c laws and bilateral multibranch transactions. These d enable members to reduce their f and the capital required to support their businesses. Q provides access to the d, legal memoranda on several jurisdictions, and a library compilation of relevant c legislation.

According to Louisiana Credit Union League, *supra*, two factual elements are critical to finding the necessary substantial relationship between Q and M's purposes: (1) the unique nature of Q vis-à-vis M's purposes, and (2) the capacity in which benefits are received by M's members.

M's activities in connection with the sale of Q satisfy the uniqueness test because (1) there is no alternative service similar to Q available, and (2) Q will be available only to M's members and will not be distributed to the public in a commercial manner.

Q is a unique service because it is an exclusive on-line resource containing d and legal memoranda on c laws and various jurisdictions worldwide. Alternatives to Q and the d are not available elsewhere. Because only M's members will receive access to Q through a password-protected website maintained by M on behalf of P, Q will not be distributed to the public in a commercial manner. Q is an extension of M's efforts to promote the development and maintenance of sound f management practices and the efficient conduct of b transactions by its members in a new, simple and efficient manner. Q enables members to determine more easily the status of c legislation, the enforceability of c provisions, and the extent the d can be used to reduce legal and f in b transactions. Because M is the only organization providing d to its members, M's continuous review, compilation and update of c legislation and the d for Q are analogous to the compilation of the loose-leaf library service in Louisiana Credit Union League, *supra*, or the compilation of the landlord manual and sale of real estate lease forms in Texas Apartment Ass'n, *supra*, and unique to M's exempt purposes. The d and Q are distinguishable from the standard, commercially-available legal forms sold by the bar association in Rev. Rul. 78-51, *supra*.

In evaluating the relationship between Q and the purposes of M, the capacity in which benefits are received by M's members is important. For a substantial relationship to exist, any direct benefits flowing from Q must inure to the members of M in their capacities as members.

Because Q serves the common business interest of M's members, and because the benefits resulting from it accrue to the members in their membership roles, a substantial relationship exists between Q and M's exempt purpose. The benefits received by members will not be directly proportional to the membership dues paid, and the activities will not be those commonly provided by for-profit organizations. Although M will charge its members a fee to access Q, the fee will be based upon the type of membership in M and not upon the frequency of use or amount of benefit received from using Q.

This is not an instance of M providing individualized advice or services tailored to the specific needs of individual members as was the case in Rev. Rul. 66-338 and Rev. Rul. 73-386, *supra*. In Rev. Rul. 73-386, for instance, an individual member could request the organization to obtain job injury histories on that member's perspective employees. Thus the organization was

performing a particular service for an individual member in the day-to-day operation of its business. In contrast, Q is not tailored to the specific needs of each subscribing member. Q provides an additional resource to the online access of the text of the d, annual updates and status of c legislation the members already have simply as part of their membership benefits. All members subscribing to Q will have access to the same materials regardless of the fee paid. Q will not be providing members with legal advice or particularized services. Members using Q would still need to analyze independently whether a particular d applies to their individual transactions. Therefore, Q does not provide M's members with individualized service at an economy or convenience; the benefits of Q are not proportionate to the fees paid by M's members; and the service is not commercially available elsewhere. Accordingly, M's activities in connection with Q are unique in promoting the efficient conduct of business in the b industry and are substantially related to M's exempt purposes.

The provision of the d and Q to M's members is distinguishable from the activities described in Rev. Rul. 67-182, *supra*. In that ruling, the organization operated as a cooperative arrangement among a limited group of industry members to share material among themselves. In M's case, M obtains the d itself for the benefit of all its members. Unlike the closed group described in Rev. Rul. 67-182, M's membership rolls are open to any entity dealing in b. M has more than x members.

The services described in Rev. Rul. 69-106, *supra*, appear similar, at first glance, to M's d services and Q. The organization in Rev. Rul. 69-106 was formed by a group of manufacturers to carry on research on development projects agreed upon by a committee of the membership. The ruling concludes that a research organization must make the results of its research available to all members of an industry in order to be exempt under section 501(c)(6) of the Code. However, the facts in the ruling are distinguishable from the facts concerning M. M is not a research organization and does not carry out research projects at the behest and for the benefit of individual members or subgroups of members. Rather, M secures d from private attorneys worldwide. The d are valuable to the entire b industry, not just to certain members. M makes the d available to all members as a member benefit. Q merely provides enhanced access to d and other information that is already available to M's members through their membership.

Based on the foregoing, M's involvement in P, which entails providing Q to M's members, is related to M's exempt purposes. Therefore, the income derived by M from P will not be deemed income derived from unrelated trade or business within the meaning of section 512 of the Code. Additionally, M's activities with respect to Q, and, consequently, the income M derives from P, will not jeopardize M's exemption under section 501(c)(6).

Conclusion:

Accordingly, based on the information submitted, we rule as follows:

1. M's share of net revenues from P will not be characterized as unrelated business taxable income within the meaning of section 512 of the Code.

2. M's involvement in P, including the provision of Q to M's members and M's receipt of a share of P's net revenues, will not jeopardize M's exemption as an organization described in section 501(c)(6) of the Code.

These rulings are made on the understanding that there will be no material changes in the facts upon which they are based.

Except as specifically ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transactions described above under any other provision of the Code.

This ruling letter 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.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to M's authorized representative. A copy of this letter should be kept in M's permanent records.

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,

Joseph Chasin
Manager, Exempt Organizations
Technical Group 2