

CHAPTER ONE

Associations, Society, and the Tax Law

§ 1.1	Introduction to Associations	2	(e)	Horticultural Organizations	13
§ 1.2	History and Evolution of Associations	4	(f)	Social Clubs	13
§ 1.3	Role of Associations in Society	6	(g)	Fraternal Beneficiary Societies	14
(a)	Professional Development and Continuous Skill-Building	6	(h)	Voluntary Employees' Beneficiary Associations	14
(b)	Information	6	(i)	Domestic Fraternal Societies	14
(c)	Standards-Setting, Codes of Ethics, and Certification	6	(j)	Teachers' Retirement Fund Associations	14
(d)	Research and Statistics	7	(k)	Benevolent Life Insurance Associations	15
(e)	Volunteerism and Community Service	7	(l)	Cemetery Companies	15
(f)	Constituent Contact	7	(m)	Veterans' Organizations	15
(g)	Giving Voice to Citizens	7	(n)	State-Sponsored Medical Care Organizations	15
(h)	Economic Impact	7	(o)	State-Sponsored Workers' Compensation Entities	16
(i)	Social and Networking Functions	8	(p)	Religious or Apostolic Organizations	16
§ 1.4	Rationales for Associations' Tax Exemption	8	(q)	Farmers' Cooperatives	16
§ 1.5	Forms of Associations	10	(r)	Shipowners' Protection and Indemnity Associations	16
§ 1.6	Other Exempt "Associations": A Comparative Analysis	10	(s)	Homeowners' Associations	16
(a)	Social Welfare Organizations	11	(t)	Quasi-Governmental Entities	17
(b)	Local Associations of Employees	12	(u)	Other Membership Organizations	17
(c)	Labor Organizations	12	§ 1.7	Comparisons to Other Exempt Organizations	17
(d)	Agricultural Organizations	13			

ASSOCIATIONS, SOCIETY, AND THE TAX LAW

The term *association* does not have legal efficacy; although used constantly, it is, like many other terms bandied about in the nonprofit sector (such as *fund*, *foundation*, or *society*), not a formal term of law (as opposed to *corporation* or *trust*). Niceties of the law aside, however, associations are plentiful, powerful, increasing in number, and a significant component of a free society and a democratic state. Current estimates are that there are over 140,000 associations in the United States; there are thousands more in other countries.¹

§ 1.1 INTRODUCTION TO ASSOCIATIONS

Dictionaries provide many definitions of the word *association*; the one that casts the term, as a noun, to mean a form of organization in essence states that an association is an organization of persons having a common interest. Synonyms are *society*, *league*, and *union*. The term, of course, derives from the verb *associate*, which means (in this context) “to join, share, or unite with others.”

The principal advocate for associations in the United States is the American Society of Association Executives (ASAE), located in Washington, D.C. This organization, generally regarded as the “association of associations,” defined the term *association* as a nonprofit organization that is “membership-based,” “private” (as opposed to for-profit or governmental), and “legally incorporated,” and has a “public benefit purpose.”² This definition is essentially correct,³ and thus, for purposes of this book:

Association is defined as a nonprofit membership organization that provides services to its members in achievement of an objective of enhancing conditions within a trade, industry, or profession, and, in the process, provides substantial benefits to the public.⁴

Members of an association can be individuals, organizations (for-profit and/or nonprofit, tax-exempt or taxable), or both.

Most associations in the United States are exempt from federal income taxation. State income taxation exemption is usually also available. The federal tax law, since 1913,⁵ characterizes most of these organizations as *business leagues*.⁶

¹ The Union of International Associations, headquartered in Brussels, Belgium, states that it is a clearinghouse for information on over 40,000 “international organizations and constituencies” (www.uia.org).

² This definition is in a brochure prepared by ASAE titled “How Associations Make a Better World,” available at www.asaenet.org/betterworld (referenced throughout as ASAE, “How Associations Make a Better World”).

³ A finicky lawyer will take issue with the third of these elements, noting (1) that the phrase “legally incorporated” is redundant, in that an entity is either incorporated pursuant to a statute or it is not (and it is difficult for an organization to be “illegally incorporated”) and, more important, (2) an organization can be an association without being incorporated.

⁴ The Department of Commerce once defined a *trade association* as a “nonprofit, cooperative, voluntarily joined, organization of business competitors designed to assist its members and its industry in dealing with mutual business problems” (Judkins, *National Associations of the United States* vii (1949)). This definition, however, excludes from the ambit of the term *association* professional societies and associations the members of which are tax-exempt organizations.

⁵ Tariff Act of October 3, 1913, 38 Stat. 114, 172.

⁶ Internal Revenue Code of 1986, as amended, section (IRC §) 501(c)(6).

§ 1.1 INTRODUCTION TO ASSOCIATIONS

(The term *association* is broader than the term *business league*.⁷) The definition of a business league in the federal tax regulations closely parallels the preceding definition of an association: a business league is an “association of persons having some common business interest, the purpose of which is to promote such common interest.”⁸ These regulations add that the activities of a business league “should be directed to the improvement of business conditions of one or more lines of business.”⁹

The case law supports this definition of a tax-exempt business league, largely in connection with analyses of the *line of business requirement*. The U.S. Supreme Court observed¹⁰ that exempt business leagues represent either an entire industry¹¹ or all components of an industry within a geographic area.¹² The Court favorably referenced an observation of the appellate court, where it was stated that it was the “manifest intention” of Congress in writing this statute to “provide an exemption for organizations which promote some aspect of the general economic welfare.”¹³ The Court also noted another opinion from the same court, where tax exemption as a business league was denied an organization because “[n]othing is done to advance the interests of the community or to improve the standards or conditions of a particular trade.”¹⁴ Another federal court of appeals reviewed these characteristics of a business league and concluded that, since Congress has left this definition undisturbed over the decades, it has been given the “imprimatur of Congress and is thus entitled to the effect of law.”¹⁵

The case law, from the outset, teaches that the essential function of an association is to be educational and informational, for its members and for others, particularly others in the line of business involved. Thus, one association, comprised of individuals engaged in shoe repair, was portrayed by a court (writing in 1947) as an entity “designed to teach the shoe repair man to be a better artisan and business man, to show him the advantages of modern advertising and the use of machinery and of proper shop layout, and in general how to render better services to the public.”¹⁶ The association was formed because “it was recognized by its members that only through improving the conditions of the shoe repair men, the quality of their workmanship, and the relations with the public could its purpose of promoting the welfare of the entire industry be accomplished.”¹⁷ This court subsequently characterized an association as a “conduit for an industrywide

⁷ See § 1.6.

⁸ Income Tax Regulations (Reg.) § 1.501(c)(6)-1.

⁹ *Id.* See § 2.7.

¹⁰ *Nat'l Muffler Dealers Ass'n, Inc. v. United States*, 440 U.S. 472, 482-483 (1979).

¹¹ *Citing American Plywood Ass'n v. United States*, 267 F. Supp. 830 (W.D. Wash. 1967); *Nat'l Leather & Shoe Finders Ass'n v. Comm'r*, 9 T.C. 121 (1947).

¹² *Citing Comm'r v. Chicago Graphic Arts Fed'n, Inc.*, 128 F.2d 424 (7th Cir. 1942); *Crooks v. Kansas City Hay Dealers Ass'n*, 37 F. 83 (8th Cir. 1929); *Washington State Apples, Inc. v. Comm'r*, 46 B.T.A. 64 (1942).

¹³ *Nat'l Muffler Dealers Ass'n, Inc.*, 565 F.2d 845, 846-847 (2d Cir. 1977).

¹⁴ *Produce Exchange Stock Clearing Ass'n v. Helvering*, 71 F.2d 142, 144 (2d Cir. 1934). This approach is also reflected in *United States v. Oklahoma City Retailers Ass'n*, 331 F.2d 328 (10th Cir. 1964); *Retailers Credit Ass'n of Alameda County v. Comm'r*, 90 F.2d 47 (9th Cir. 1937).

¹⁵ *The Engineers Club of San Francisco v. United States*, 791 F.2d 686, 689 (9th Cir. 1986).

¹⁶ *Nat'l Leather & Shoe Finders Ass'n v. Comm'r*, 9 T.C. 121, 126 (1947).

¹⁷ *Id.*

ASSOCIATIONS, SOCIETY, AND THE TAX LAW

cooperative exchange of . . . information.”¹⁸ A federal court of appeals observed that a tax-exempt association engages in activities consisting of “professional programming.”¹⁹

§ 1.2 HISTORY AND EVOLUTION OF ASSOCIATIONS

A term that is infrequently used these days is *guild*. The dictionary advises that a guild is an association of individuals engaged in kindred pursuits or having common objectives; the word is often preceded by the adjective *medieval*. The contemporary association (along with certain other membership groups, such as labor unions and chambers of commerce) traces its history to these medieval guilds.

Historically, these guilds were in the nature of societies or small business associations, with members being self-employed artisans or part of a small craft shop or cooperative. It has been written that “[o]ne’s view of guilds tends to be heavily colored by one’s view of political economy, since the whole history of trade, technology, intellectual property, regulated professions, social security, and professional ethics are entwined with the history of the guilds in Europe.”²⁰

Merchant guilds are thought to be the first of these entities to emerge; they began to appear in the tenth century.²¹ These organizations were formed for the mutual protection of the member merchants’ horses, wagons, and goods while traveling. As industries became more specialized, *craft guilds* came into being. This type of entity would have as its members artisans engaged in the same occupation (i.e., bakers, cobblers, stone masons, and carpenters) who associated for protection and mutual aid. These craft associations became important, to the point that individuals in a town could not practice their craft without belonging to the appropriate guild. The essential purpose of these guilds, believed to have been highly regimented in operation, was to create and maintain a monopoly with respect to particular crafts.

The guilds performed other services for their members and their families, including the provision of funeral expenses for poorer members and aid to survivors, supplying of dowries for poor girls, coverage of members with a type of health insurance, building of chapels, donating of windows to local churches and cathedrals, and watching over the morals of members (i.e., those who engaged in gambling and usury). These guilds also contributed to the emergence of Western lay education; previously, the only schools were those sponsored by monastic or cathedral institutions.

Yet, while protecting their members, the guilds also provided certain forms of protection to the consumer. Thus, craft regulations prevented poor workmanship; manufacturing processes and other trade secrets were guarded; advertising and price-cutting were forbidden; prices were regulated; sales by foreign artisans were prohibited; and the number of masters in individual guilds was limited.

¹⁸ MIB, Inc. v. Comm’r, 80 T.C. 438, 453 (1983).

¹⁹ The Engineers Club of San Francisco v. United States, 791 F.2d 686, 690 (9th Cir. 1986).

²⁰ www.en.wikipedia.org/wiki/Guild.

²¹ The following discussion is based in large part on a paper available at www.public.iastate.edu/~gbetcher/373/guilds.htm.

§ 1.2 HISTORY AND EVOLUTION OF ASSOCIATIONS

From a political viewpoint, a guild was neither sovereign nor unrelated to society outside the guild and town organization. As a collective unit, a guild might be a vassal to a bishop, lord, or king. The extent of vassalage was dependent on the degree of independence between a guild and the town in which it was located. The guilds had a close connection with the city authorities. The city council could intervene in the event of trouble between guilds; these councils could establish the hours of work, fix prices, and establish weights and measures. Guild officials were frequently appointed to serve in civic government because the guilds usually voted as a unit, raised troops for the civic militia, and paid taxes as a group. Guilds were required to perform public services, such as policing the streets and constructing public buildings and walls to defend the town or city.

The members of these guilds were called *confraternities*—brothers helping one another. By the thirteenth century, to become a member of a guild, individuals went through three stages: apprentice, journeyman, and master. An apprentice would so serve for two to seven years, living with the master and his family, and learning the rudiments of his trade. The apprentice progressed to journeyman, who became entitled to work for compensation. A journeyman who produced a masterpiece could become a master craftsman and be voted into membership in the guild.

Others regard these guilds as less public service oriented and more focused on creating monopolies. The guilds regulated technical processes, hours of labor, wages, the number of workmen to be employed, prices, and trade practices. The number of men employed was regulated in order to keep the production of all guild shops approximately equal. The employment of improved methods of manufacture, due to new inventions or the use of water power, was discouraged unless all producers shared alike in the benefits. This type of “close supervision of trade and industry, which today is called planned economy and is branded as communism, was obviously designed to benefit not so much the consumers as the producers organized in the guilds.”²²

The guild system began to decline around the close of the 1700s, because guilds were believed to be in opposition to free trade and a hindrance to technological innovation, technology transfer, and business development.²³ Critics such as Jean-Jacques Rousseau and Adam Smith (and even Karl Marx) helped fuel the free market (*laissez-faire*) movement that made its way into the political and legal system. Because of industrialization and modernization of trades and industries, and the rise of powerful nation-states that could issue patent and copyright protections (often, in the process, revealing the trade secrets), the guilds’ power faded. By the 1800s, many former handicraft workers had been forced to seek employment in the emerging manufacturing industries, using not closely guarded techniques but standardized methods controlled by corporations.

Modern antitrust law²⁴ can be said to be derived in some respects from the statutes by which the guilds were abolished in Europe. Nonetheless, these

²² These observations are based in large part on a paper available at www.mars.acnet.wnec.edu/~grempel/courses/wc1/lectures/24guilds.html.

²³ The following analysis is based on material available at www.en.wikipedia.org/wiki/Guild.

²⁴ See § 11.6.

ASSOCIATIONS, SOCIETY, AND THE TAX LAW

guilds are the precursors of the contemporary association, which generally has as its membership a group of persons who have joined the entity voluntarily and believe that their career in their trade, industry, or profession will be enhanced by this form of cooperation with their colleagues and their involvement with the association. Also, today's tax-exempt association usually engages in member-focused activities that also provide considerable benefits to the public.

§ 1.3 ROLE OF ASSOCIATIONS IN SOCIETY

ASAE has an awareness campaign, called Associations Advance America, that is designed to impress the value of associations not just to their individual and corporate members, but to the larger society.²⁵ ASAE also has an Associations Make a Better World Campaign that seeks to promote understanding of the association model as a significant contributor to societies and economies worldwide.²⁶

(a) Professional Development and Continuous Skill-Building

ASAE observed that education is often the single most common association function. In many industries and professions, associations are the only source of continuing education.²⁷ Associations educate their members on technical and scientific matters, business practices, and legal issues; ASAE views this as elevating the quality of publicly delivered goods and services.²⁸ ASAE observed that, because of associations, the nation's workforce remains competitive and skilled in the latest techniques, trends, and technologies.

(b) Information

Associations collect and disseminate information on industries, issues, and trends, providing valuable background for policy, regulatory, and legislative decisions. By informing the public about the efficiency, quality, and safety of products and services, associations help bolster public confidence in the marketplace.

(c) Standards-Setting, Codes of Ethics, and Certification

Associations play a prominent role in setting performance, technical and safety standards, ethical codes, and professional certification programs.²⁹ These efforts help reduce the risks that consumers face in the marketplace.³⁰ Associations also save taxpayers money by engaging in these vital functions that government would otherwise have to perform. Standardization provides an international language to help shrink barriers to trade. If adopted throughout the world, standards create a large market instead of many fragmented markets.

²⁵ The following analysis is based on information available on the ASEA Web site (www.asaenet.org).

²⁶ This campaign is reflected in ASAE, "How Associations Make a Better World."

²⁷ There is an interesting parallel between the facts that the guilds were instrumental in introducing lay education (that is, education provided by an institution other than a religious one) to the public (see § 1.2) and associations as a principal or only source of continuing education in the modern era.

²⁸ This rationale underlies, for example, the special tax treatment for associations' trade shows. See § 5.9(a).

²⁹ Associations invest over \$1.1 billion annually setting and enforcing standards and certifications, according to an ASAE Foundation study, referenced on the ASAE Web site.

³⁰ Cf. discussion in text accompanied by *infra* note 35.

§ 1.3 ROLE OF ASSOCIATIONS IN SOCIETY

(d) Research and Statistics

Associations develop and disseminate valuable data that might otherwise be unavailable. Policymakers, regulators, researchers, journalists and other representatives of the media, consumer groups, and others use this information to enhance a broad understanding and analysis of the economy. Governments are often dependent on research and statistics provided by associations.

(e) Volunteerism and Community Service

Founded on the principles of volunteerism and cooperation,³¹ associations nurture involvement in society and community service. By pooling their talents and resources, association members help the needy, provide disaster relief, mentor youth, and clean up the environment. Association activities generate what is known as *social capital*—features of social organization such as networks, norms, and social trust that facilitate coordination and cooperation for mutual benefit. ASAE observed that it is not just the sum of the institutions that underpin a society, they are the glue that holds society together. Social networks can increase productivity by reducing the costs of doing business. Increasing evidence shows, ASAE reported, that social cohesion is critical for societies to prosper economically and for development to be sustainable.³²

(f) Constituent Contact

Associations are important, sometimes indispensable, intermediary organizations linking individuals and businesses with governments. Associations serve as a dual gateway: as a mechanism to convey their views to government officials and as a conduit by means of which government stays in touch with constituents.

(g) Giving Voice to Citizens

Government relations activities conducted by associations give members a voice in government decisions impacting their profession, trade, and cause. Associations collect and disseminate information on public policy issues, forecast how public policy issues affect their members, and help members understand and reach consensus for positions on issues. By educating legislators and regulators about issues affecting members' businesses, professions, and causes, associations help government officials make informed decisions.

(h) Economic Impact

ASAE observes that associations are "economic engines that fuel America's prosperity."³³ Associations pump billions of dollars into the economy and create hundreds of thousands of good jobs. Association meetings and conventions generate billions more in revenue for cities. Although associations are almost

³¹ See § 1.2, last paragraph.

³² Americans devote more than 173 million volunteer hours each year—time valued at more than \$2 billion—to charitable and community service programs through their associations, according to an ASAE Foundation study, referenced on the ASAE Web site.

³³ ASAE Web site.

ASSOCIATIONS, SOCIETY, AND THE TAX LAW

always tax-exempt organizations,³⁴ their operating expenditures generate billions of dollars in tax revenues annually—from property taxes, payroll taxes, sales taxes, and 35 other types of taxes.

(i) Social and Networking Functions

The ASAE analysis barely mentions the point that associations provide social and networking opportunities that enhance individuals' work and growth within their trade, industry, or profession. While this can augment the quality of goods and services produced, and improve the development of individuals' competence, there is an entertainment and social component to association life that can also lead to personal development. Associations are not supposed to be social clubs³⁵; nonetheless, associations' annual and other meetings, trade shows, and the like can spawn terrific social events, long-lasting friendships, and other interesting and enlightening experiences. Members often enjoy the inevitable board, committee, and other politics and eagerly anticipate the camaraderie found at each annual conference. Associations tend to attract the best of humanity and, for that reason alone, make wonderful clients for lawyers and other consultants.

§ 1.4 RATIONALES FOR ASSOCIATIONS' TAX EXEMPTION

There are different forms of associations.³⁶ One measure as to these distinctions is the composition of these organizations' membership. When the members of an association are entirely or primarily individuals, the presumption generally is that the entity is a business league (an IRC § 501(c)(6) organization). That is, the Internal Revenue Service³⁷ or a court will presume that an association of individuals is an organization that has the personal and career development of these members as its principal purpose, with benefits to society at large secondary at best.

Certification programs are classic illustrations of this point. It is the judgment of the IRS that the primary purpose for certification of individuals is to improve the reputation and business interests of the members of the certifying organization (or other related constituency) and the industry or profession of which they are a part. In a rare pronouncement on the point, the IRS stated that a certification program (at least the one the agency reviewed) was designed and operated principally to achieve professional standing for the profession involved and to enhance the respectability of those who become certified; benefits to the larger society were dismissed as incidental.³⁸ Moreover, the IRS concluded that

³⁴ See § 2.16.

³⁵ Social clubs can be tax-exempt by reason of IRC § 501(c)(7). See § 1.6(f).

³⁶ See § 1.5.

³⁷ The Internal Revenue Service is referenced throughout as the "IRS" or the "agency."

³⁸ IRS General Counsel Memorandum (Gen. Couns. Mem.) 39721. In general, Hopkins, "The Meaning of Tax-Exempt Status in the Work of Certification Organizations," as Chapter 1 of Schoon & Smith (eds.), *The Licensure and Certification Mission: Legal, Social, and Political Foundations* (New York: Professional Examination Service, 2000). See § 1.3(c).

§ 1.4 RATIONALES FOR ASSOCIATIONS' TAX EXEMPTION

such a certification program conducted by a charitable organization³⁹ was an unrelated business for that organization.⁴⁰

Congress has determined that business leagues are entitled to federal income tax exemption. As noted, these are entities with a membership that have a common business interest, their purpose is to promote that interest, and their activities are directed to the improvement of business conditions of one or more lines of business.⁴¹ The policy reasons underlying this exemption have not been well articulated, but it may be presumed that Congress believed—and continues to believe—that these organizations provide sufficient community and public benefits to warrant exemption.⁴²

Not all tax-exempt associations are business leagues, however. As ASAE observed, associations “represent a wide range of collective interests including professions, industry, business, and philanthropic causes.”⁴³ This reference to *philanthropic* objectives embraces associations the purposes of which are charitable, educational, religious, and/or scientific (IRC § 501(c)(3) organizations).⁴⁴ Some associations qualify for federal income tax exemption as social welfare organizations (IRC § 501(c)(4) entities).⁴⁵

There are several ways an entity can qualify as a tax-exempt charitable organization.⁴⁶ Most pertinent to the association model, however, are the *advancement* categories of charitable organizations: those that advance education, science, and/or religion.⁴⁷ For example, associations in the education context include alumni and alumnae associations,⁴⁸ honor societies,⁴⁹ gem and mineral clubs,⁵⁰ garden clubs,⁵¹ and professional societies.⁵² Associations in the scientific setting include scientific research cooperatives. Exempt religious organizations include associations and conventions of churches, and conferences of churches.⁵³

ASAE observed that, by “[b]ringing together disparate individuals, businesses, academia, and government, associations wield a collective power that is much greater than the sum of their parts.” The work of associations is “woven throughout the fabric of society; citizens, the business sector, and governments have come to depend on the social and economic benefits that associations afford.”⁵⁴

³⁹ That is, an organization described in IRC § 501(c)(3).

⁴⁰ IRS Private Letter Ruling (Priv. Ltr. Rul.) 200439043.

⁴¹ See § 1.1, text accompanied by notes 8–9.

⁴² Often the views of “management” are reflected in association policies. Thus, there is a corresponding tax exemption for “labor”-oriented entities (see § 1.6(c)). On occasion, the distinction between an association of individuals and a labor organization is blurred.

⁴³ ASAE, “How Associations Make a Better World.”

⁴⁴ See Hopkins, *The Law of Tax-Exempt Organizations, Eighth Edition* (Hoboken, NJ: John Wiley & Sons, 2003) (*Tax-Exempt Organizations*), Chapters 6–10.

⁴⁵ See § 1.6(a).

⁴⁶ See *Tax-Exempt Organizations*, Chapter 6.

⁴⁷ Reg. § 1.501(c)(3)-1(d)(2).

⁴⁸ Rev. Rul. 60-143, 1960-1 C.B. 192; Rev. Rul. 56-486, 1956-2 C.B. 309.

⁴⁹ Rev. Rul. 71-97, 1971-1 C.B. 150.

⁵⁰ Rev. Rul. 67-139, 1967-1 C.B. 129.

⁵¹ Rev. Rul. 66-179, 1966-1 C.B. 139.

⁵² Rev. Rul. 71-506, 1971-2 C.B. 233.

⁵³ IRC § 170(b)(1)(A)(i).

⁵⁴ ASAE Web site.

ASSOCIATIONS, SOCIETY, AND THE TAX LAW

§ 1.5 FORMS OF ASSOCIATIONS

There are essentially four forms of nonprofit organizations that the IRS recognizes as tax-exempt entities: corporation, unincorporated association, trust, and limited liability company.⁵⁵ Only the first two of these four forms are suitable for tax-exempt associations. The main distinction between the two entities is the protection against personal liability that the corporate form provides.⁵⁶

Nearly all tax-exempt associations have a common feature: a membership. The members of an exempt association may be individuals, for-profit businesses, tax-exempt organizations, or a combination of these entities. If the membership of an association is primarily or solely comprised of individuals, then, as noted, it will likely be regarded as a business league. Nonetheless, if the primary purpose⁵⁷ of such an association is charitable, educational, and/or scientific, the organization may be exempt as a charitable, educational, and/or scientific entity in the nature of a *professional society*.

If the members of an association are all or principally for-profit businesses, the entity will unavoidably constitute a business league. Where all or most of the members of an association are tax-exempt organizations, the association will likely have the same federal tax exemption as its members (assuming the members all have the same exempt status). As examples, an association of exempt colleges and universities will itself be a charitable and/or educational organization; an association of exempt scientific research organizations will be a charitable and/or scientific organization.

Associations sometimes are cast as representing a trade, an industry or business, or a profession. Thus, often there are references to *trade associations*, *business associations*, and *professional associations*. The federal tax law, however, does not make these distinctions, and the concepts of the business league usually apply equally to all three categories of entities. In some circumstances, nonetheless, a professional association may be organized and operated so that it is charitable, educational, and/or scientific in nature, in which case it may be portrayed as a *professional society*.

**§ 1.6 OTHER EXEMPT "ASSOCIATIONS":
A COMPARATIVE ANALYSIS**

There are at least 68 types of organizations that are tax-exempt pursuant to federal law.⁵⁸ About one-third of these categories of entities are likely to have a membership—a structural element that is almost always obligatory for a business league.⁵⁹ Narrowing the range of federal tax exemption, then, there are about 25 types of exempt organizations (including business leagues,⁶⁰ chambers

⁵⁵ *Tax-Exempt Organizations*, § 4.1.

⁵⁶ In general, Hopkins, *Planning Guide for the Law of Tax-Exempt Organizations: Strategies and Commentaries* (Hoboken, NJ: John Wiley & Sons, 2004), Chapter 1.

⁵⁷ See *Tax-Exempt Organizations* § 4.4.

⁵⁸ *Tax-Exempt Organizations*, App. C.

⁵⁹ The statute, after all, refers to a business league as an "association of persons" (IRC § 501(c)(6)).

⁶⁰ See § 2.4.

§ 1.6 OTHER EXEMPT “ASSOCIATIONS”: A COMPARATIVE ANALYSIS

of commerce,⁶¹ boards of trade,⁶² real estate boards,⁶³ and professional football leagues⁶⁴) that tend to have and serve a membership, that is, that usually confer services and/or other benefits on a collective basis. Generically, they are all *associations*.

(a) Social Welfare Organizations

Federal statutory law provides tax exemption for “[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.”⁶⁵ The term *social welfare* is commensurate with the “common good and general welfare” and “civic betterments and social improvements.”⁶⁶ The promotion of social welfare does not include activities that primarily constitute “carrying on a business with the general public in a manner similar to organizations which are operated for profit.”⁶⁷ An organization is not operated primarily for the promotion of social welfare if its “primary activity is operating a social club for the benefit, pleasure, or recreation of its members.”⁶⁸ To qualify as an exempt social welfare organization, the activities of the organization must be those that benefit a community in its entirety, rather than merely benefit the organization’s membership or other select group of individuals or organizations.⁶⁹

Tax-exempt social welfare organizations and exempt business leagues have three shared characteristics: a prohibition on the provision of benefits to particular persons, on for-profit business activities, and on private inurement. The fundamental difference between them is that the exempt social welfare organization must have the primary purpose of serving a *community*,⁷⁰ while the primary purpose of an exempt business league is to provide services to those within a *line of business*.

Indeed, a membership structure can preclude tax exemption as a social welfare organization. That is, an organization can be found to not qualify as an exempt social welfare organization because it is operating primarily for the benefit of its members rather than for the purpose of benefiting the community as a

⁶¹ See § 2.11.

⁶² See § 2.12.

⁶³ See § 2.13.

⁶⁴ See § 2.14.

⁶⁵ IRC § 501(c)(4). See *Tax-Exempt Organizations*, Chapter 12.

⁶⁶ Reg. § 1.501(c)(4)-1(a)(2)(i).

⁶⁷ Reg. § 1.501(c)(4)-1(a)(2)(ii).

⁶⁸ *Id.* See § 1.6(f).

⁶⁹ Reg. § 1.501(c)(4)-1(a)(2)(i). A tax-exempt social welfare organization must reflect a “community movement designed to accomplish community ends” (*Erie Endowment v. United States*, 316 F.2d 151, 156 (3rd Cir. 1962)).

⁷⁰ In practice, this requirement of services to a *community* is often ignored; prime examples of this are the national advocacy organizations that are exempt by reason of IRC § 501(c)(4). Nonetheless, this element of exemption continues to be invoked by the IRS on occasion; in one instance, an organization that claimed to be an agency providing home health care services to residents of five facilities was in fact merely a registry that matched the needs of residents with independent service providers for a fee, causing the IRS to deny recognition of tax exemption in part on the ground that the entity did not serve a requisite community (Priv. Ltr. Rul. 200544020).

ASSOCIATIONS, SOCIETY, AND THE TAX LAW

whole.⁷¹ Consequently, where organizations provide substantially different benefits to the public as compared to its members, they are not *primarily* devoted to the promotion of social welfare.⁷² In essence, even though there may be aspects of the organization that greatly benefit society, “if the majority of the organization’s services benefit private members,” the organization cannot qualify under this category of exemption.⁷³

Thus, a membership-based organization involved in the provision of housing for veterans did not qualify as a tax-exempt social welfare organization. A court wrote that the entity “does, of course, furnish housing to a certain group of citizens but it does not do so on a community basis”; this activity was cast as a “public-spirited but privately devoted endeavor.”⁷⁴ The court continued: “Its work in part incidentally redounds to society but this is not the ‘social welfare’ of the tax statute.”⁷⁵ It added that classification as “‘civic’ or ‘social’ depends upon the character—as public or private—of the benefits bestowed, of the beneficiary, and of the benefactor.”⁷⁶

(b) Local Associations of Employees

Federal statutory law provides tax exemption for “local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality.”⁷⁷ The net earnings of these organizations must be devoted primarily to charitable, educational, and recreational purposes.

Thus, this type of organization provides services for local groups of employees. Organizations that provide services primarily for the convenience of members, serve as a cooperative buying service, or function as an employee benefit organization cannot qualify for tax exemption as local associations of employees.

(c) Labor Organizations

Federal statutory law provides tax exemption for “labor organizations.”⁷⁸ The principal purpose of an exempt labor organization is the betterment of working conditions of individuals engaged in a common pursuit and the development of

⁷¹ E.g., *Contracting Plumbers Co-op Restoration Corp. v. United States*, 488 F.2d 684 (2d Cir. 1973) (where a plumbers’ cooperative was denied exemption pursuant to IRC § 501(c)(4) because its benefits were proportional to its members’ financial involvement); *American Women Buyers Club, Inc. v. United States*, 338 F.2d 526 (2d Cir. 1964) (where an association was held to not be exempt by reason of IRC § 501(c)(4) inasmuch as a majority of its benefits were provided to its members and it did not promote social welfare).

⁷² *Vision Service Plan v. United States*, 2006-1 U.S.T.C. ¶ 50,173 (E.D. Cal. 2005) (where the organization’s benefits it provided to the public were found to be incidental; its primary purpose was held to be to serve its paying members (subscribers)).

⁷³ *Id.*

⁷⁴ *Comm’r v. Lake Forest, Inc.*, 305 F.2d 814, 818 (4th Cir. 1962).

⁷⁵ *Id.*

⁷⁶ *Id.* Tax exemption pursuant to IRC § 501(c)(4) is sometimes accorded to organizations that promote health or are part of the health care field, yet that fact alone does not guarantee this category of exemption (e.g., *IHC Health Plans, Inc. v. Comm’r*, 325 F.3d 1188 (10th Cir. 2003)).

⁷⁷ IRC § 501(c)(4). See *Tax-Exempt Organizations*, § 18.3.

⁷⁸ IRC § 501(c)(5). See *Tax-Exempt Organizations*, § 15.1.

§ 1.6 OTHER EXEMPT “ASSOCIATIONS”: A COMPARATIVE ANALYSIS

a higher degree of efficiency in the particular occupation.⁷⁹ The most common of these organizations is the labor union. The private inurement doctrine is applicable with respect to labor organizations.

Thus, just as the tax-exempt business league works to improve conditions within a line of business, the exempt labor organization works to better the working conditions of groups of workers. From the larger perspective, the management-labor dichotomy is reflected in these two types of exempt organizations: the business league represents the employers, and the labor organization serves the employees.

(d) Agricultural Organizations

Federal statutory law provides tax exemption for “agricultural” organizations.⁸⁰ This category of organization must have as its principal object the betterment of the conditions of those involved in the exempt pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in the particular occupation.⁸¹ The private inurement doctrine is applicable in this setting.

A tax-exempt agricultural organization usually has a membership; those served by the entity must represent a significant portion of the interested agricultural community. As is the case with the exempt business league, the performance of services directly on behalf of an individual member is not improvement of the grade of a person’s product or development of a higher degree of efficiency in a person’s agricultural-related pursuits. Nonetheless, as is true for exempt business leagues, where an activity only incidentally benefits individual members, tax exemption as an agricultural entity is available.

(e) Horticultural Organizations

Federal statutory law provides tax exemption for “horticultural organizations.”⁸² This type of exempt organization essentially has the same characteristics as the exempt labor and agricultural organizations.⁸³ An illustration of an exempt horticultural organization is a garden club formed for the purpose of betterment of the conditions of individuals engaged in horticultural pursuits and improving their products.

(f) Social Clubs

Federal statutory law provides tax exemption for “[c]lubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes.”⁸⁴ Generally, this exemption is extended to social and recreational clubs that are supported primarily by membership fees, dues, and assessments. These entities must have a membership comprised of individuals, personal contacts, and fellowship; a commingling of the members

⁷⁹ Reg. § 1.501(c)(5)-1(a)(2).

⁸⁰ IRC § 501(c)(5). See *Tax-Exempt Organizations* § 15.3.

⁸¹ Reg. § 1.501(c)(5)-1(a)(2).

⁸² IRC § 501(c)(5). See *Tax-Exempt Organizations* § 15.3.

⁸³ See §§ 1.6(c) and 1.6(d), respectively.

⁸⁴ IRC § 501(c)(7). See *Tax-Exempt Organizations*, Chapter 14.

ASSOCIATIONS, SOCIETY, AND THE TAX LAW

must constitute a material part in the operation of this type of organization. The private inurement doctrine is applicable in this context.

The primary purpose of a tax-exempt social club, then, is to provide a range of social and recreational services to its members, who are individuals. While country clubs, dinner clubs, and swim, tennis, and golf clubs set the norm for the exempt social club, the concept of this type of exempt entity is considerably broader and embraces organizations such as flying clubs, collegiate fraternities and sororities, and gem and mineral clubs.

(g) Fraternal Beneficiary Societies

Federal tax statutory law provides tax exemption for certain “[f]raternal beneficiary societies, orders, or associations.”⁸⁵ These entities generally operate under the lodge system and pay life, sick, accident, or other benefits to their members and their dependents.⁸⁶ The use of the words *fraternal* and *beneficiary* in this context connote an organization—that is, an association of individuals—who have the same or similar calling, avocation, or profession, or who are otherwise working in unison to achieve some worthy objective.

(h) Voluntary Employees’ Beneficiary Associations

Federal tax statutory law provides tax exemption for “[v]oluntary employees’ beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries.”⁸⁷ This type of entity, more an employee benefit fund than an authentic association, must be an association of employees having a common employer (or affiliated employers).⁸⁸ Eligibility for membership in a voluntary employees’ beneficiary association may be restricted by geographic proximity or by objective conditions or limitations reasonably related to employment. The private inurement doctrine is applicable.

(i) Domestic Fraternal Societies

Federal tax statutory law provides tax exemption for certain “[d]omestic fraternal societies, orders, or associations.”⁸⁹ These entities operate under the lodge system, and devote their net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes; they do not provide life, sick, or similar benefits to their members.⁹⁰

(j) Teachers’ Retirement Fund Associations

Federal tax statutory law provides tax exemption for “[t]eachers’ retirement fund associations of a purely local character.”⁹¹ This exemption is available as long as

⁸⁵ IRC § 501(c)(8). See *Tax-Exempt Organizations* § 18.4(a).

⁸⁶ Reg. § 1.501(c)(8)-1.

⁸⁷ IRC § 501(c)(9). See *Tax-Exempt Organizations* § 16.3.

⁸⁸ Reg. § 1.501(c)(9)-2(b).

⁸⁹ IRC § 501(c)(10). See *Tax-Exempt Organizations* § 18.4(b).

⁹⁰ Reg. § 1.501(c)(10)-1.

⁹¹ IRC § 501(c)(11). See *Tax-Exempt Organizations* § 16.7.

§ 1.6 OTHER EXEMPT “ASSOCIATIONS”: A COMPARATIVE ANALYSIS

there is no private inurement (other than through payment of retirement benefits) and the organization’s income consists wholly of amounts received from public taxation, amounts received from assessments on the teaching salaries of members, and investment income.

(k) Benevolent Life Insurance Associations

Federal tax statutory law provides tax exemption for “[b]enevolent life insurance associations of a purely local character.”⁹² These associations basically operate to provide life insurance coverage to their members, albeit at cost because of the requirement that income be collected solely for the purpose of meeting losses and expenses.

(l) Cemetery Companies

Federal tax law provides tax exemption for “[c]emetery companies owned and operated exclusively for the benefit of their members.”⁹³ Generally, this type of exempt organization owns a cemetery, sells lots in it for burial purposes, and maintains these lots (along with any unsold ones) in a state of repair and upkeep appropriate for a final resting place. Its members are owners of the lots who hold them for bona fide burial purposes and not for purposes of resale. The private inurement doctrine is applicable to these types of organizations.

(m) Veterans’ Organizations

Federal tax law provides tax exemption for a “post or organization of past or present members of the Armed Forces of the United States” that satisfy certain criteria.⁹⁴ An exempt veterans’ organization must operate primarily to promote the social welfare of a community; assist disabled and needy veterans and members of the U.S. armed forces and their dependents, and the widows, widowers and orphans of deceased veterans; provide entertainment, care, and assistance to hospitalized veterans or members of the U.S. armed forces; carry on programs to perpetuate the memory of deceased veterans and members of the armed forces, and comfort their survivors; conduct programs for religious, charitable, scientific, literary, or educational purposes; sponsor or participate in activities of a patriotic nature; provide insurance benefits for their members or dependents thereof, or both; and/or provide social and recreational activities for their members.⁹⁵ The private inurement doctrine is applicable to these organizations.

(n) State-Sponsored Medical Care Organizations

Federal tax law provides tax exemption for certain state-sponsored membership organizations to provide medical care coverage for certain uninsurable individuals.⁹⁶ To qualify for exemption, these individuals, who must be residents of the

⁹² IRC § 501(c)(12)(A). See *Tax-Exempt Organizations* § 18.5(a).

⁹³ IRC § 501(c)(13). See *Tax-Exempt Organizations* § 18.6.

⁹⁴ IRC § 501(c)(19). See *Tax-Exempt Organizations* § 18.10.

⁹⁵ Reg. § 1.501(c)(19)-1(c).

⁹⁶ IRC § 501(c)(26). See *Tax-Exempt Organizations* § 18.14.

ASSOCIATIONS, SOCIETY, AND THE TAX LAW

state involved, must be unable to acquire medical care coverage for their medical condition through insurance or from a health maintenance organization, or able to acquire the coverage only at a rate that is substantially in excess of the rate for the coverage through the membership organization. The private inurement doctrine is applicable to these organizations.

(o) State-Sponsored Workers' Compensation Entities

Federal tax law provides tax exemption for certain state-sponsored organizations that reimburse their members for losses arising under workers' compensation acts.⁹⁷ To be eligible for this exemption, an organization must be established before June 1, 1996.

(p) Religious or Apostolic Organizations

Federal tax law provides tax exemption for certain "[r]eligious or apostolic associations or corporations."⁹⁸ These entities must have a common treasury or community treasury. These associations may engage in business for the common benefit of their members. The members must include in their annual gross income their entire pro rata shares, whether distributed or not, of the taxable income of the association.

(q) Farmers' Cooperatives

Certain farmers' cooperatives are eligible for exemption from federal income taxation.⁹⁹ These cooperatives are farmers', fruit growers', or like associations organized and operated on a cooperative basis for the purpose of (1) marketing the products of members or other producers and returning to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them; or (2) purchasing supplies and equipment for the use of members or other persons and turning over the supplies and equipment to them at actual cost plus necessary expenses.¹⁰⁰

(r) Shipowners' Protection and Indemnity Associations

Federal tax law provides tax exemption for nonprofit "shipowners' mutual protection and indemnity associations."¹⁰¹ The private inurement doctrine is applicable with respect to these organizations.

(s) Homeowners' Associations

Federal tax law provides tax exemption for certain condominium management associations, residential real estate management associations, and timeshare associations.¹⁰² These associations enable their members (usually individual homeowners) to act together in managing, maintaining, and improving areas where they live.

⁹⁷ IRC § 501(c)(27)(A). See *Tax-Exempt Organizations* § 18.15(a).

⁹⁸ IRC § 501(d). See *Tax-Exempt Organizations* § 8.7.

⁹⁹ IRC § 521. See *Tax-Exempt Organizations* § 18.11.

¹⁰⁰ Reg. § 1.521-1.

¹⁰¹ IRC § 526. See *Tax-Exempt Organizations* § 18.12.

¹⁰² IRC § 528. See *Tax-Exempt Organizations* § 18.13

§ 1.7 COMPARISONS TO OTHER EXEMPT ORGANIZATIONS

(t) Quasi-Governmental Entities

The concept of tax exemption extends to a variety of governmental and quasi-governmental organizations. These entities range from the states to nonprofit organizations that have a unique relationship with one or more governmental departments, agencies, or instrumentalities. There are essentially four ways an organization can achieve exemption in this context: (1) by constituting a state or a political subdivision of a state; (2) by reason of having its income excluded from federal income taxation, when the income is derived from the exercise of an essential governmental function and the income accrues to a state or political subdivision of the state¹⁰³; (3) by classification as an instrumentality of a state; or (4) by reason of being an integral part of a state, city, or similar governmental entity.¹⁰⁴

For these organizations that are structured as associations, the most likely basis for tax exemption is the third one. The IRS frequently classifies entities pursuant to the exclusion rule, such as associations of public school districts, other units of state and local governments, and political subdivisions.

(u) Other Membership Organizations

Still other tax-exempt organizations have a membership (or patronage) structure. This is the case, for example, for college and university alumni and alumnae associations,¹⁰⁵ cooperative hospital service organizations,¹⁰⁶ cooperative service organizations of operating educational organizations,¹⁰⁷ and charitable risk pools.¹⁰⁸ Still other exempt organizations may have a membership structure, such as charitable, educational, scientific, and religious entities¹⁰⁹ and political organizations.¹¹⁰

§ 1.7 COMPARISONS TO OTHER EXEMPT ORGANIZATIONS

The tax exemption category (if any) that is most suitable for a particular collective-type organization is obviously dependent in large part on application of the primary purpose test.¹¹¹ Various cooperative entities, employee benefit funds, advocacy organizations, fraternal and veterans' groups, and other entities are, as noted, eligible for tax-exempt status. Often the entirety of what an organization does operationally will dictate the availability of any exemption. An organization may have more than one category of exempt function, with the principal one leading to any exemption, such as an entity that has some educational activities but predominant social and recreational functions.

¹⁰³ IRC § 115.

¹⁰⁴ See *Tax-Exempt Organizations* § 18.17.

¹⁰⁵ These entities are tax-exempt by reason of IRC § 501(c)(3).

¹⁰⁶ IRC § 501(e). See *Tax-Exempt Organizations* § 10.4.

¹⁰⁷ IRC § 501(f). See *Tax-Exempt Organizations* § 10.5.

¹⁰⁸ IRC § 501(n). See *Tax-Exempt Organizations* § 10.6.

¹⁰⁹ IRC § 501(c)(3). See *Tax-Exempt Organizations*, Chapters 6–10.

¹¹⁰ IRC § 527. See *Tax-Exempt Organizations*, Chapter 17.

¹¹¹ See § 2.3.

ASSOCIATIONS, SOCIETY, AND THE TAX LAW

Many collective organizations are clearly not business leagues. Those that are generically the closest to business leagues are labor, agricultural, and horticultural organizations. This is because, just as business leagues have the primary purpose of promoting a common business interest, these other three types of organizations must have as their principal object the betterment of the conditions of those engaged in the exempt pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in the particular occupation.¹¹²

¹¹² Reg. § 1.501(c)(5)-1(a)(2).