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The 501(c)(6) Noncompliance Problem – How Many Industry and Professional Organizations Are Out of Compliance and Should Not Have Qualified for PPP Loans

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Section 501(c)(6)¹ allows for tax exemptions for non-profit organizations such as business leagues and the chambers of commerce. An organization filing under this exemption must be devoted to improving business conditions of one or more lines of business and not perform services for the benefit of individual persons. However, some organizations have been operating under the guise of a §501(c)(6) entity, while providing services for their members that, by our review, should disqualify them from exemption. To further illustrate this point, the following example shall be employed:

EXAMPLE: For the purposes of this article, assume that there is an organization which pur-

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¹ All section references herein are to the Internal Revenue Code of 1986, as amended (the "Code"), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

ports to be a §501(c)(6) organization named, Federal Academy of Knowledge in Electrical Engineering (FAKE). This organization claims to be a §501(c)(6) "business league" that is comprised of a selection of Electrical Engineers from all 50 of the United States. Each state has a separate chapter that is separately self-governing. FAKE has quarterly meetings and regularly files Amicus briefs and letters to Congressional Committees to improve circumstances for Electrical Engineers while preventing the vast majority of Electrical Engineers from becoming members or "Fellows."

FAKE had net income of \$590,000 in 2019 that it did not have to pay tax on, and has accumulated assets worth more than \$20 million from operations that it did not have to pay taxes on. FAKE members are promoted to be hired by the general public on FAKE's website and are often invited to members-only cocktail hours. The members do not pay tax on the indirect benefits they receive for being Fellows in the organization. In most states, the FAKE members are also involved in state organizations and hold their events immediately before or after the state organization events while indirectly competing to draw the most talented and compliant young Electrical Engineers into FAKE where they can be put to the best use for FAKE's purposes.

Let's assume that there are 200,000 Electrical Engineers across the United States, and only 1.5% (3,000) are members of FAKE, which FAKE refers to as "Fellows."

Eighteen of 22 of the Board of Editors for the most prominent journal in Electrical Engineering consist of FAKE Fellows. FAKE Fellows comprise 19 of 24 of the Board of Advisors at the University of New York Annual Electrical Engineering Conference, which is the most attended in the nation. 95% of the speakers at this convention are also FAKE Fellows.

The FAKE website lists the following five requirements needed in order to qualify to apply for membership:

- *The Electrical Engineer must have assisted, on average, 50 or more clients per year over the last three years;*
- *The Electrical Engineer must be well thought of in the industry and must be generally trusted by members of the state FAKE chapter where the engineer practices;*
- *The Engineer must specialize in, or must have previous experience specializing in, electrical installations, both commercial and residential.*
- *The Engineer must have resided in the United States for at least the past three years. Engineers who have lived in the United States for a time greater than one year but less than three years may still qualify for membership so long as such Engineer files a Certification of Familiarity with American Engineering Standards (CFAES).*
- *The Engineer must have been practicing for at least (12) years.*

FAKE releases a semi-annual journal that includes in-depth articles written by FAKE members and the results of studies that FAKE committees engage in. These journals are only available to members and organizations that pay to be sponsors.

FAKE's website homepage reads as follows:

The American Academy of Electrical Engineer provides an opportunity for the best and brightest in their industry to come together and learn, inspire, and grow. We are proud to only invite the top 1.5% of Engineers to become Fellows so you can trust that if you hire a FAKE Fellow, you will be treated right.

To find a FAKE Fellow near you, click [HERE](#).

WHAT IS A 501(c)(6) ORGANIZATION?

Section 501(c) provides protections for non-profit organizations, which are categorized into 29 distinct types. Section 501(c)(6) entities are those organizations that qualify as business leagues or chambers of commerce. As of March 2002, there were 71,032 §501(c)(6) organizations recognized under the I.R.C.²

² John Francis Reilly, Carter C. Hull, and Barbara A. Braig Allen, IRC 501(c)(6) Organizations, Exempt Organizations-Technical Instruction Program for FY 2003, <https://www.irs.gov/pub/irs-tege/eotopick03.pdf>.

The recently enacted American Rescue Plan Act (ARPA)³ expanded PPP loan eligibility to almost all §501(c) organizations, except for §501(c)(4), social welfare groups. Section 501(c)(6) organizations were initially made eligible to receive PPP funding at the end of 2020 through the enactment of the Economic Aid Act.⁴ To qualify, a §501(c)(6) organization must have not been engaged in significant lobbying activities and must have had 300 or fewer employees.

The ARPA kept PPP loan restrictions in place for §501(c)(6) organizations engaged in significant lobbying activities, but expanded eligibility to organizations with 300 or fewer employees *per physical business location*.⁵ “Significant lobbying activities” is as “defined in section 3 of the Lobbying Disclosure Act of 1995 (2 U.S.C. 1602).”⁶ This means that organizations may qualify so long as:

1. 15% or less of annual revenues received are from lobbying;
2. 15% or less of total activities of the organization involve lobbying; and
3. \$1 million or less was spent on lobbying by the organization in the most recent full tax year (prior to February 2020).

Common examples of §501(c)(6) organizations include the U.S. Chamber of Commerce, the Better Business Bureau, and, until recently, the National Football League (NFL). The NFL made the decision to relinquish its tax-exempt status in 2015 due, in part, to heavy scrutiny from fans who believed that NFL Commissioner Roger Goodell’s roughly \$40 million salary was incredibly high for the head of a tax-exempt organization.⁷

The NFL is not the only sports league to opt-out of §501(c)(6) treatment, with the Major League Baseball Association (MLB) relinquishing its status in 2007 and the National Hockey League (NHL) also choosing to follow suit not too long after.⁸ Even if the NFL, MLB, and NHL were still qualified as tax-exempt organizations, sports leagues (along with political campaigns, and political activities groups) are among the

³ Pub. L. No. 117-2.

⁴ The Economic Aid Act refers to the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act which is apart of the Consolidated Appropriations Act, 2021, Pub. L. No 116-260, Div. N, Tit. III, §318.

⁵ ARPA, Title V, §5001.

⁶ Paycheck Protection Program Loans Frequently Asked Questions (FAQs), Q&A 57 (Mar. 12, 2021), <https://www.sba.gov/sites/default/files/2021-03/PPP-FAQs-3.12.21.pdf>.

⁷ <https://slate.com/news-and-politics/2015/04/nfl-gives-up-tax-exempt-status-now-gets-to-hide-roger-goodell-s-salary.html>.

⁸ <https://www.congress.gov/bill/115th-congress/senate-bill/3086/text>.

enumerated list of organizations that are not eligible to receive PPP loans, regardless of tax-exempt status. The PGA Tour, to the authors knowledge, still is classified as a 501(c)(6) organization despite consistently having revenues in the billions.⁹

There are, however, dozens of examples of smaller §501(c)(6) organizations with less of a nationwide or global presence that do qualify for PPP loans. These organizations often appear, at least on their face, to merely exist as promotional tools for their members. These organizations will often hold themselves out as “advancing the profession,” while simultaneously excluding admission to more-than-qualified members. This raises the question, *how are these organizations still allowed to exist under the I.R.C.?*

It is important, first, to understand the history of the §501(c)(6) tax exemption. In 1913, a predecessor to the section was passed in response to pressure from the U.S. Chamber of Commerce.¹⁰ The Chamber requested a specialized exemption and wrote the following:

Exemption is asked only for commercial organizations which are not organized for profit. These organizations receive their income from dues paid by their members, a form of voluntary tax which businessmen pay that **they may receive in common** with all other members of their communities or of their **industries** the benefits of cooperative study of local development, of civic affairs, of industrial resources, and of local, national, and international trade.¹¹

In order to qualify as a §501(c)(6) organization, a number of requirements must be met, but a quick tour of websites found by searching words like “Academy,” “College,” “Fellows,” and “The Best” along with the name of any prominent profession may bring up an organization very similar to FAKE. In the 2008 case of *Bluetooth Sig, Inc. v. United States*, the district court cited existing precedent establishing a six-part test to determine whether an organization is consid-

ered a “business league” under §501(c)(6). This test that the court cited “requires that the entity be:”¹²

1. of persons having a common business interest;
2. whose purpose is to promote the common business interest;
3. not organized for profit;
4. that does not engage in a business ordinarily conducted for profit;
5. whose activities are 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; and
6. of the same general class as a chamber of commerce or a board of trade.

The *Bluetooth* decision noted that there is a “settled principle that exemptions from taxation are not to be implied; they must be **unambiguously proved**”¹³ Additionally, the court, citing the decision in *Tupper v. United States*, held that if the doubts regarding the applicability of an exemption are “nicely balanced,” then “exemption must be accorded its more limited interpretation.”¹⁴

Of the six factors listed above, the decision focused primarily on Factors four and five. The factor that is relevant to our analysis is the fifth, which is the requirement that the “activities are 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.”¹⁵

Bluetooth cites *Guide Int’l Corp. v. United States*, a Seventh Circuit Court of Appeals case involving a nonprofit organization seeking to qualify as a “business league” whose principal activity was the sponsorship of week-long conferences.¹⁶ The court held that the nonprofit organization, Guide International, Corp., was deemed to be in violation of the fifth factor because the primary beneficiary of the organization’s efforts was IBM. Although the organization’s stated purpose was to facilitate the use and exchange of information regarding data processing equipment in general, the court in that case found that “no single business is enhanced and [Guide International, Corp.] only benefits IBM and those individuals within vari-

⁹ <https://www.forbes.com/sites/monteburke/2013/05/08/the-pga-tour-a-not-for-profit-money-machine/?sh=3999acf35733>. The PGA Tour 2018 Form 990, *Return of Organization Exempt from Income Tax*, showing \$1.4 billion in revenue, can be found at <https://projects.propublica.org/nonprofits/organizations/520999206>.

¹⁰ John Francis Reilly, Carter C. Hull, and Barbara A. Braig Allen, IRC 501(c)(6) Organizations, Exempt Organizations-Technical Instruction Program for FY 2003, available at <https://www.irs.gov/pub/irs-tege/eotopick03.pdf>.

¹¹ John Francis Reilly, Carter C. Hull, and Barbara A. Braig Allen, IRC 501(c)(6) Organizations, Exempt Organizations-Technical Instruction Program for FY 2003 (citing *Hearings on Tariff Schedules of the Revenue Act of 1913 Before the Subcomm. of the Comm. on Finance*, 63d Cong., 1st Sess. at 2001, 2003 (1913)) (emphasis added).

¹² 2008-1 USTC ¶50,177, 4 (W.D. Wash. 2008).

¹³ *Bluetooth*, 2008-1 USTC ¶50,177 at 4 (emphasis added).

¹⁴ *Bluetooth*, 2008-1 USTC ¶50,177 at 3.

¹⁵ *Bluetooth*, 2008-1 USTC ¶50,177 at 4.

¹⁶ 948 F.2d 360 (7th Cir. 1991).

ous lines of business who use IBM mainframes.”¹⁷ Despite the fact that, at its peak, Guide International’s membership included 50% of all Fortune 1000 companies, the court held that the group did not qualify as “an exempt business league under §501(c)(6)[.]” for the above-stated reasons.¹⁸

The *Bluetooth* decision also cites *Engineers Club of San Francisco*, which found that “organizations frequently fail to qualify for business league status even though their activities confer collective benefits.”¹⁹ The *Engineers Club* opinion, which involved a San Francisco-based professional club established by and for engineers, held that the club performed services for “individual persons and organizations rather than the engineering profession as a whole.”²⁰ This prevented them from qualifying as a business league under §501(c)(6). It can be argued that providing members with free journal publications, members-only cocktail receptions, promotional advertising, and other common benefits of joining such associations would fall under the same category of services listed in *Engineers Club*.

While, as stated above, there are many important factors to consider, *Bluetooth* states the “ultimate inquiry [is] whether the association’s activities advance the members’ interests generally, by virtue of their membership in the industry, or whether they assist members in the pursuit of their individual businesses.”²¹ Many of the organizations herein described, and countless others that are not discussed in this article, host exclusive events and publish exclusive content only available to members of the organization.

The court in *Bluetooth* ultimately ruled that Bluetooth did not meet the fifth factor because the Bluetooth trademark is only available to members who pay the appropriate listing fee. The court held that “when each member contributes in proportion to what he receives, it is a strong indication that the benefits received are not ‘inherently’ group benefits.”²² The service provided by Bluetooth in this case was “something of value offered to all comers on the condition that they pay for it, and the benefits [were] in proportion to the contribution[.]”²³ and thus Bluetooth was not found to be a §501(c)(6) organization. Many §501(c)(6) organizations provide access to their perks solely to members who are required to pay

dues, offer time or services, or provide something else of value in exchange for inclusion into the organization. Such organizations would fail the test laid out in *Bluetooth*.

Going back to the real world, according to FAKE’s website, the organization serves many purposes, including “to maintain an international group of Engineers with skill and experience in the practice of designing, testing, and implementing electrical equipment” and “to unite Engineers whose character and ability helps achieve the purposes of the Academy.” These two purposes in particular are relevant in regards to potential discriminatory practices, given that many exemplary Engineers will never be extended an invitation to join FAKE.

If FAKE’s stated purposes included to “improve and reform the industry’s standards and procedures,” it would be considered valid for purposes of determining qualification. It is, however, important to consider whether these efforts will primarily “improve and reform” the profession for its members, and whether this purpose is secondary to the benefits that these exclusionary groups provide only to its members. Remember that under the *Bluetooth* holding, taxpayers seeking a tax exemption must prove unambiguously that they are entitled to such exemption, meaning that the burden is on the organization to prove a primary focus on benefiting the Electrical Engineering practice as a whole.

BENEFIT TO INDIVIDUAL v. BENEFIT TO INDUSTRY

Rev. Rul. 73-411, which involved a shopping center merchant’s association, indicates that an organization that serves “a closed, nonpublic aggregation of commercial enterprises” instead of a community may not be eligible for 501(c)(6) status.”

For example, if FAKE’s benefits, including the above-mentioned cocktail hours and promotion on its website, are only available to its “Fellows,” it can be said that the benefits only aid one small group (the 3,000 FAKE Fellows) which creates competition with a greater number of Engineers within the industry who do not have the same opportunity.

The “aggregation” rule referenced in Rev. Rul. 73-411 was discussed in PLR 200506025, in which the IRS held that so long as membership to an organization is relatively open to all individuals in an industry or profession, the limiting of benefits solely to members may be acceptable. Membership in FAKE, however, is clearly not open to anyone in the industry, as is discussed further below.

While a majority of §501(c)(6) organizations have open registration, many have pre-requisites to entry that make them not “relatively open to all individuals

¹⁷ *Guide Int’l Corp.*, 948 F.2d at 362.

¹⁸ *Guide Int’l Corp.*, 948 F.2d at 362.

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

²⁰ *Engineers Club of San Francisco*, 791 F.2d at 690.

²¹ *Bluetooth*, 2008-1 USTC ¶50,177 at 3-4.

²² *Bluetooth*, 2008-1 USTC ¶50,177 at 8.

²³ *Bluetooth*, 2008-1 USTC ¶50,177 at 9.

in the industry.” Some examples of pre-requisites that members must meet in order to join include the following:

1. Must have attended at least five meetings of the organization as a “junior member” prior to applying for Fellowship;
2. The Applicant must complete, on average, 100 hours of community service or charity work per annum for five years before joining;
3. Applicant must have lived in the United States for at least the last three years;
4. The individual that nominates a new member to the organization must have had 10 years of experience after graduating from their highest degree in the field;
5. Complete 250 hours of continuing education in the field.

In many cases, even after meeting pre-requisites like those described above, the professional is still required to be nominated by an active member of the organization and cannot be denied by a certain number of members in his or her state or regional organization. In practice, some of the most qualified individuals in their respective fields have been rejected for some reason or another and remain, indefinitely, outside of the respective organization. Being blackballed after every member of the state organization has seen the application can be a very embarrassing and damaging event. It is illegal to discriminate in the United States with respect to membership organizations like these on the basis of race, color, national origin, sex, or disability, but discrimination is hard to prove when a confidential blackball system is used. These organizations might have far fewer minority group members than the mainstream profession as a result thereof. Disabled individuals who cannot attend meetings physically, for example, have almost no chance of being accepted into these organizations.

The six factor test listed in *Bluetooth* states that the membership requirements must be limited to persons with a “common business interest.”²⁴ The membership requirements for FAKE are arguably extremely non-inclusive by limiting membership to “the top 1.5% of Engineers[.]” Limiting membership to just these elite individuals makes it hard to conceive and justify a common business interest.

Organizations that restrict important industry information and data solely to its members may disqualify such organization from qualifying under §501(c)(6).²⁵ If the information that an organization offers solely to

its members is crucial to all members of the profession, the organization will not qualify under §501(c)(6). One caveat, however, is that if the information or data offered by the organization is publicly available and the organization simply formatted or consolidated the information or data, distributing this information exclusively to members is no longer a non-exempt activity.

FAKE places some but not all of the resources created and maintained by the organization up on their website for all to view, regardless of membership. This may be helpful for FAKE in finding that they fall within the scope of §501(c)(6), though the delay in providing the content to non-members will be considered. Not all organizations are as transparent with their publications, however, with many placing its content behind a paywall or only allowing access for non-members to a portion of the full text.

It is also important to note that imparting general information about industry business conditions is permitted and meetings may be the only activity of the association, so long as “there is a business-related agenda.” This means that if FAKE disseminated information to its members through journals and at conventions, this alone does not mean that the organization is in violation of §501(c)(6).

Trade associations and business leagues may promote the interests of its members through advertising, but these advertising endeavors for §501(c)(6) organizations must be tailored to benefit the whole industry as opposed to the individuals or entities that belong to the organization.²⁶ As mentioned above, the FAKE website touts its Fellows as having “the best and brightest in their industry,” which may be seen as casting aspersions on the majority of Engineers who are not entitled to join.

PROFESSIONAL RESPONSIBILITY ISSUE

To what extent do attorneys and certified public accountants who are involved in the representation of, or even membership in, such organizations risk licensing, malpractice, or possibly even criminal law implications for signing Form 990, *Return of Organization Exempt from Income Tax*, tax returns and furthering the intents and purposes of conduct that is violative of the tax law? Given the widespread disregard for these rules, it may be appropriate for the IRS to offer an amnesty period to organizations which are not in compliance.

CONCLUSION

Based on the above analysis and multiple websites, there are a number of organizations that should be

²⁴ *Bluetooth*, 2008-1 USTC ¶50,177 at 4.

²⁵ See Rev. Rul. 69-106.

²⁶ See Rev. Rul. 55-444.

concerned about the validity of their §501(c)(6) status, for reasons beyond potential PPP loan qualification. In researching for this article, it was staggering just how many §501(c)(6) organizations operate like those described above. What remains to be seen is just how many of these business leagues will qualify to receive funds through the second round of the PPP.

What started as a way for the U.S. Chamber of Commerce to be exempt from taxation may possibly turn out to be a national epidemic of significant proportions where the “haves” are successfully keeping out the “have nots” with the financial help of the Treasury, professional journals, and academic institutions who support them.

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