

ATTACHMENT 3

The Rules Governing California 501(c)(6) Business Leagues or Professional Associations

Business leagues, professional associations, and similar organizations often will qualify for exemption from taxation under Section 501(c)(6) of the Internal Revenue Code. The below article explains how an organization may qualify for exemption and what rules the organization should be aware of when conducting activities.

What is a business league?

The Internal Revenue Service defines a business league as an association of persons having a common business interest, whose purpose is to promote that common business interest. Examples of business leagues include trade associations, neighborhood business groups, associations of professionals, chambers of commerce, and boards of trade. Frequently such groups engage in periodic educational and networking events, publish newsletters of industry-relevant information, and advocate on behalf of membership before federal, state, and local government bodies.

What are the requirements for a business league to secure and maintain 501(c)(6) exempt status?

In addition to the basic criteria of a common business interest, there are six additional requirements that an association must meet to qualify for exemption:

1. **Membership:** The organization must have a membership and that membership must provide a meaningful amount of support to the organization. The membership need not be a voting membership that installs the board and has member rights under California law. However, the IRS does require that the organization be financed at least in part by membership dues and members must be involved with the organization, for example, through participation at events or contributions to educational or advocacy materials.
2. **Improvement of a line of business:** The activities of the organization must be directed to the improvement of business conditions in one or more lines of business. This is related to the requirement that the organization promote a common business interest. It is essential that the line of business include competitors within an industry. The organization's activities cannot be targeted at the advancement of a few businesses within a larger business community. In addition, the organization can promote different types of businesses within a common geographical area, such as a neighborhood business associations.
3. **Primary Activity Not Services to Individuals:** The primary activities of the organization cannot be geared toward provision of particular services to its members, other than the basic educational, advocacy, networking-type services that are part of its tax-exempt mission. The primary activities cannot be those that provide a convenience to its members, such as marketing or management services, insurance, storage, or financial assistance.
4. **No Substantial For-Profit Business Activities:** The purpose of the organization cannot be to engage in a regular business of a kind ordinarily carried on for profit, even if the business is operated on a cooperative basis or produces only sufficient income to be self-sustaining. Just as the organization cannot be established just to provide convenience services to its members, it cannot be established to run a business. This does not preclude it from having an unrelated side business, such as a retail shop or cafe, but this side business cannot constitute a substantial part of the organization's activities.
5. **Not for profit:** The organization cannot issue shares of stock that carry the right to dividends, although it will likely be able to distribute its assets to its members upon dissolution.
6. **No Private Inurement or Private Benefit:** Similar to 501(c)(3) and 501(c)(4) organizations, 501(c)(6) organizations cannot use revenue or assets to benefit insiders (such as board members or key employees) or to provide special benefits to a restricted group of private individuals. For example, the organization cannot pay more than fair market value rent to a board member for lease of office space in his or her building, or be set up to promote just one company within an industry.

The business league must continue compliance with these criteria in order to maintain its exempt status. California's Franchise Tax Board follows the Internal Revenue Service and court guidance in determining whether a business league qualifies for exemption under Section 23701e. Qualifying under these criteria will satisfy exemption under California law.

Can a business league engage in lobbying and political activity?

Yes. The IRS does not set any limit on the amount of legislative activity that a business league can conduct. In fact, lobbying can be the sole activity of a 501(c)(6) organization. However, political campaign activity must be limited and cannot be the primary activity of the organization.

Are donations to a business league deductible from my individual or business taxes?

Maybe. Donations to a business league are not deductible as charitable contributions as defined under IRC section 170(c). However, they may be deductible if they constitute an ordinary and necessary business expense.

No business expense deduction is available for the portion of dues or contributions made to a 501(c)(6) organization that furthers legislative or political activities. The organization may be responsible for providing a notice to members, at the time of payment, estimating the amount of dues or contributions that are attributable to lobbying and political activities and therefore nondeductible. The notice must be in a conspicuous and easily recognizable format. Failure to provide this notice or spending on lobbying or political activity in excess of the estimated amount may result in a proxy tax levied on the the organization.

The organization must also provide an annual disclosure through its information return on the total amount of lobbying and political activity expenditures and the total amount of dues allocable to these expenditures.

Can a business league run a revenue-generating business?

Yes, within limits. The primary purpose of the organization cannot be to run a business of a kind ordinarily carried on for profit nor to provide a service of convenience to its members. However, these rules do not completely restrict a 501(c)(6) from engaging in revenue-generating activities. For example, an organization can provide advertising for its businesses in exchange for revenue as long as the organization primarily focuses on its education and advocacy work to promote the common business interest of its members.

Generally, the for profit business of a 501(c)(6), including the provision of services to members, will be considered unrelated to the organization's tax exempt purpose and will be taxable as unrelated business income. Determining whether such business could be considered related and therefore exempt from tax is a highly fact specific analysis requiring evaluation under current law.

How do I start a business league or a professional association in California?

California requires the formation of a [California nonprofit mutual benefit corporation](#) to qualify as an exempt business league. Here are the general steps necessary for formation of a California 501(c)(6) without a voting membership:

- File Articles of Incorporation as a [California nonprofit mutual benefit corporation](#).
- Draft bylaws.
- Have an initial meeting of the board to elect initial directors, adopt bylaws, appoint officers and establish basic board policies.
- Secure a federal employer identification number.
- Open up a bank account and establish a bookkeeping system.
- File [Form SI-100](#) with the California Secretary of State within 90 days of incorporation.
- File for 501(c)(6) status with the Internal Revenue Service using [Form 1024](#).
- File for exemption with the California franchise tax board under Section 23701e using [Form 3500](#) or [3500A](#).
- Secure any necessary business licenses with local authorities.

What further resources are there on 501(c)(6) organizations?

The IRS has excellent resources on the requirements of a 501(c)(6) organization located [here](#).

Written by [Cameron Holland](#).