

## IRS DETERMINES CERTIFICATION PROGRAMS CONSTITUTE UNRELATED TRADE OR BUSINESS FOR SECTION 501(c)(3) ORGANIZATIONS

In a recent private letter ruling, the Internal Revenue Service (“the IRS”) has determined that the certification program of an organization exempt under section 501(c)(3) of the Internal Revenue Code (“the Code”) constitutes an unrelated trade or business.<sup>1</sup> The certification program was found to be directed primarily at serving the interests of a profession and the professional and business interests of persons employed in that industry, and only incidentally served the interests of the public. The program was therefore found not to accomplish one or more of the exempt purposes of the organization under section 501(c)(3) and was subject to taxation as an unrelated trade or business.



### FACTS OF THE PRIVATE LETTER RULING

According to the IRS, an organization exempt from federal income tax under section 501(c)(3) of the Code was organized and operated exclusively for the scientific and educational purpose of advancing the theory and practice of certain disciplines. One activity the organization engaged in was creation of a certification program consisting of

- (1) exam-based testing to demonstrate mastery of a specific body of knowledge;
- (2) an extensive experience base in the performance of the work or profession certified;
- (3) continuing professional education, measured and relevant to the body of knowledge; and
- (4) review of a code of conduct and ethics.

Potential certification candidates were required to

- (a) have membership in the organization;
- (b) have membership in an equivalent professional society or organization as defined by the organization; or
- (c) be registered as a professional in the particular occupation.

In addition, the organization intended to offer workshops and education programs which would allow candidates the opportunity to increase their competence levels prior to taking the exam portion of the certification program. Candidates for certification were required to complete curriculum training through the organization or through an organization which was contracted to provide such training.

## WHAT CONSTITUTES UNRELATED TRADE OR BUSINESS INCOME?

While organizations classified under section 501(c)(3) of the Code as operating exclusively for charitable, education, and scientific purposes are exempt from federal income taxation, a tax on unrelated business income of such organizations is imposed by section 511 of the Code.<sup>2</sup> Activities which produce gross income must contribute importantly to the accomplishment of any purpose for which an organization is granted exemption; whether the activity does so depends upon the facts and circumstances of each case involved.<sup>3</sup> If the activity does not contribute importantly to the accomplishment of any purpose for which the organization is granted exemption, the income is subject to unrelated business income tax.

A certification program consisting of exam-based testing to demonstrate mastery of a specific body of knowledge and maintain high standards of excellence in the particular profession is considered by the IRS to be directed primarily towards serving the business interests of a profession rather than the interests of the public.<sup>4</sup> Therefore, any income generated by the certification program would be subject to unrelated trade or business income tax.

While a certification program may not accomplish one or more exempt purposes of an organization under section 501(c)(3) of the Code, it will not jeopardize the organization's status as a 501(c)(3) organization if it constitutes an insubstantial part of the total activities conducted.

### SUMMARY

Organizations classified under section 501(c)(3) which conduct certification programs may be subject to unrelated trade or business income tax. A certification program meant to improve the quality of or maintain high standards of excellence for a profession is considered to only incidentally serve the interests of the public. If administration of the certification program constitutes a substantial part of the total activities conducted by the organization, its status as a section 501(c)(3) organization may be affected.

2. See IRC §511.

3. Treas. Reg. §1.513-1(d)(2).

4. Rev. Rul. 73-567, 1973-2 C.B. 178.

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Washington, DC 20001-4413

Atlanta ■ Washington

Sixteenth Floor

191 Peachtree Street, NE

Atlanta, GA 30303

Tel: 404.572.6600

Fax: 404.572.6999

Sixth Floor

1001 Pennsylvania Avenue, NW

Washington DC 20004

Tel: 202.347.0066

Fax: 202.624.7222

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#### THE TAX PRACTICE GROUP

##### WASHINGTON

Michael I. Sanders (202) 624-7308

Susan A. Cobb (202) 624-7344

Nancy O. Kuhn (202) 624-7371

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