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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: **200917042**
Release Date: 4/24/2009

Date: January 29, 2009

U.I.L. 501.06-00

Employer Identification Number:

Person to Contact and ID Number:

Contact Telephone Number:

Legend:

Association =
B =
C =
D =
E =
F =
a =
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y =
x =
w =

Dear :

This is in response to your ruling request dated a regarding whether certain payments by Association will adversely affect its exempt status under section 501(c)(6) of the Internal Revenue Code.

Facts:

Association, a business league recognized as exempt under section 501(c)(6) of the Code, is a state-wide association of Bs that is affiliated with C. Members of Association are automatically members of C, another business league exempt under section 501(c)(6).

Association brought three lawsuits (the Lawsuits) which alleged that anticompetitive and fraudulent activity damaged the compensation and employment of Bs in D and nationwide.

Association states that the Lawsuits were substantially funded by contributions from Association's members and various non-members. Association's ability to fund the Lawsuits was limited to resources available from (i) contributions from individuals and other state associations, and (ii) proceeds from a series of advances from C (the C Loans). Association

established a separate bank account for funds collected and used in connection with the Lawsuits. Association incurred substantial attorneys' fees, costs, and related expenses from the Lawsuits.

At the inception of the Lawsuits, Association entered into an agreement with members of the Association litigation committee requiring that Association distribute, insofar as practicable, a portion of any recovery to those individuals who facilitated the Lawsuits either by participating as plaintiffs or by advancing funds.

To commence the antitrust action, Association's counsel recommended that twelve individual Bs be named as plaintiffs (the Participating Plaintiffs), along with Association. Association asked some of its members, who alleged to have been terminated from their employment due to anticompetitive behavior, to participate individually in the Lawsuits. Ten such Association members elected to participate as plaintiffs (the Ten Terminated Plaintiffs).

The initial complaint prepared by Association's counsel also named two individual Association members who had not been terminated and who remained employed at the time the Lawsuits commenced – E and F (together, the Named Risk Plaintiffs). Association understands that E was told that her participation in the Lawsuits was requested by counsel because of her upcoming term as president of Association. Association further understands that F was told that her participation as a plaintiff was requested by counsel because she was employed by an employer which had terminated its Bs and which was a named defendant.

In order to facilitate the Lawsuits, and at the request of Association's attorney, the Participating Plaintiffs agreed to irrevocably assign their rights to any recovery to Association. In return for such rights and services, Association contractually agreed to pay claimed damages of certain amounts to the Participating Plaintiffs out of the proceeds of the Lawsuits. Specifically, The Participating Plaintiffs executed an irrevocable assignment (the Assignment) pursuant to which they irrevocably assigned to Association (i) proceeds which may be recovered arising out of the cause or causes of action against the prospective defendants, and (ii) the sole and exclusive right and power to conduct and to manage the litigation. Association states that, similarly, the Named Risk Plaintiffs contributed to Association their right to any proceeds that might have been received in the Lawsuits.

At about the same time, Association's Board of Directors established a litigation committee to monitor, oversee and consult with litigation counsel on behalf of Association. The committee consisted of various Association officials and the Named Risk Plaintiffs. Association and members of the committee then entered into a settlement distribution agreement that provided that there shall be a reasonable and equitable distribution of any financial recovery from the Lawsuits, insofar as practicable, in the following order of priority:

a. To pay any indebtedness undertaken by Association to finance the Litigation, including attorneys' fees and expense.

b. To compensate those prospective plaintiffs identified as Named Risk Plaintiffs up to the value of their "career loss value" as that term is defined by the actuary retained by counsel.

c. To compensate the Ten Terminated Plaintiffs, eight of whom lost severance pay benefits upon termination of their employment.

d. To rebate to members and other persons the amount of their financial contributions to Association for purposes of funding the Litigation.

Subsequently, there was a global settlement and release of the Lawsuits among all the parties to the Lawsuits. Pursuant to the settlement agreement, the defendants agreed to pay to plaintiffs $z million.

Association disbursed that portion of the settlement proceeds necessary to pay (i) attorneys' fees and costs arising from the Lawsuits, and (ii) obligations to C under the C loans. As of a, Association retained approximately $y million of the gross settlement payment made to it (the Net Settlement Proceeds) pursuant to the global settlement of the Lawsuits, plus interest earned thereon.

Association understands that E was terminated from her position after she joined the Lawsuits. She found alternative employment 15 months later. Association understands that F received severance for six months and she obtained alternative employment nine months later. Association alleges, and E and F state, that their terminations resulted from their participation as plaintiffs in the Lawsuits and their outspoken participation in plaintiffs' attempts to report and prosecute defendants' misconduct.

Pursuant to the settlement distribution agreement, an independent actuary has determined the amount of actual damages he believes E and F incurred arising from their terminations. In particular, the actuary has determined the amount (the Named Risk Career Loss Value) as $x for E, and $w for F.

Association asserts that its participation in the Lawsuits resulted in numerous benefits to it and the public. The anticompetitive acts of the defendants were publicized, defendants were enjoined from further illegal conduct, the federal government prevailed in related litigation and received several million dollars in False Claims Act damages, and the reputation and power of Association to obtain benefits for its members were augmented.

Association proposes to pay as damages to each of the Named Risk Plaintiffs the Named Risk Career Loss Value in the amount determined by the actuary as the Named Risk Career Loss Value.

Association proposes to pay as damages to each of the Ten Terminated Plaintiffs an amount equal to the amount of the severance payment lost by such plaintiff upon his or her termination.

Association proposes to pay each Contributor (whether or not an Association member) the amount such Contributor contributed to fund the Lawsuits. Association intends to pay the contributors to the Lawsuits on a *pro rata* basis in proportion to each contributor's contributed amount and not to exceed the amount contributed by each such contributor.

Rulings Requested:

1. Association's prospective payments to the Participating Plaintiffs will not constitute prohibited inurement and will not disqualify Association from qualification for recognition of exemption under section 501(c)(6) of the Code.
2. Association's prospective payments to the contributors to the Lawsuits will not constitute prohibited inurement and will not disqualify Association from qualification for recognition of exemption under section 501(c)(6).

Law:

Section 501(c)(6) of the Code provides for the exemption from federal income tax of 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 1.501(c)(6)-1 of the Income Tax Regulations provides that a business league 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.

In Rev. Rul. 67-175, 1967-1 C.B. 139, noxious fumes from a factory in a region were damaging crops and trees with widespread effect on the agricultural economy of the area. The organization hired attorneys to represent individual property owners, some of whom were members of the organization, in a suit for an injunction requiring the factory to take necessary steps to prevent the air pollution. The Service ruled that the prosecution of the injunction suit under the circumstances described was an activity promoting the common business interest of the members of the organization and was directed toward the improvement of business conditions in a particular line of business. Accordingly, the organization's exemption as one described in section 501(c)(6) of the Code was not affected by subsidizing the lawsuit.

Rev. Rul. 77-206, 1977-1 C.B. 19, holds that cash rebates made by an exempt business association to member and nonmember exhibitors who participate in the association's annual industry trade show, that represent a portion of an advance floor deposit paid by each exhibitor to insure the show against financial loss, and which are made to all exhibitors on the same basis, and which may not exceed the amount of the deposit, do not adversely affect the association's exempt status under section 501(c)(6) of the Code.

Rev. Rul. 81-60, 1981-1 C.B 335, holds that a refund of excess dues to members of an exempt agricultural organization in the same proportion as the dues are paid does not constitute

inurement under section 1.501(c)(5)-1 of the regulations, and therefore does not disqualify an organization from exemption under section 501(c)(5)of the Code. The revenue ruling states that this position is consistent with the treatment of organizations exempt under section 501(c)(6), under the rationale of King County Insurance Association, 37 B.T.A. 288 (1938). That case stated that *pro rata* refunds of excess dues to members do not affect an association's status as an exempt business league.

Rev. Proc. 2009-1, 2009-1 I.R.B. 14, provides that the Service does not issue letter rulings in certain areas because of the factual nature of the problem.

Rev. Proc. 2009-3, 2009-1 I.R.B. 115, similarly states that rulings will not be issued on any matter in which the determination requested is primarily one of fact. The revenue procedure also states that rulings will not be issued on the tax effect of a transaction if any part of the transaction is involved in litigation among the parties affected by the transaction.

In Lyeth v. Hoey, 305 U.S. 188, the Supreme Court held that amounts received in settlement of a lawsuit have the same character, for federal tax purposes, as the judgment amounts that the taxpayer would have received if it had prevailed.

Analysis:

i. Whether the Payments to the Contributors Constitute Permissible Rebates or Refunds.

It is well settled that a nondiscriminatory *pro rata* refund of dues is not inurement to members. The Service has ruled that an exempt business league may generally make cash distributions to its members without loss of exemption where such distributions represent no more than a reduction in dues or contributions previously paid to the league to support its activities. Rev. Rul. 77-206, supra.

The proposed payments to contributors will merely return to the contributors their *pro rata* portion of contributions to Association used to finance the Lawsuits. These proposed payments will be made to both Association members and nonmembers without discrimination. The proposed payments (1) will be made on a *pro rata* basis in proportion to the amount of contributions made by Contributors, and (2) will not exceed the amount of such contributions.

As such, these payments represent a permissible nondiscriminatory, *pro rata* refund of prior contributions.

ii. Whether payments to the Named Risk Plaintiffs and the Ten Terminated Plaintiffs constitute inurement.

At the beginning of the Lawsuits, Association and the Participating Plaintiffs entered into an Assignment contract respecting their respective rights and duties. The Participating Plaintiffs agreed to assign to Association whatever damages they might recover, and to allow Association to direct the Lawsuits. In return, Association agreed to pay all Lawsuits expenses, direct the

Lawsuits, and pay the Participating Plaintiffs negotiated amounts. The Ten Terminated Plaintiffs agreed to receive the amounts they would have received as severance but for their participation in the Lawsuits. Association represents that the Named Risk Plaintiffs agreed to a different negotiated formula amount that reflected their different circumstances, including their participation on the litigation committee, and their apparent difficulty in finding comparable new employment after their termination from the jobs with their employers.

Association represents that if the plaintiffs had prevailed in the Lawsuits, the Participating Plaintiffs' recoveries on the antitrust and other claims could have amounted to many times the settlement amount. Association also represents that by entering into the Assignment contract, the Participating Plaintiffs gave up this potentially larger recovery and entered into a contract to accept a lesser recovery. For federal tax purposes, any amounts paid to the Participating Plaintiffs have the same character as the amounts they might have recovered if they had prevailed in the Lawsuits. Lyeth v. Hoey, supra.

Whether the amounts of the contemplated payments to the Named Risk Plaintiffs and the Ten Terminated Plaintiffs constitute the actual amount of damages suffered by each Participating Plaintiff and whether these amounts are in any case reasonable and do not constitute inurement present factual questions on which the Service declines to rule under Rev. Procs. 2009-1 and 2009-3, supra.

Ruling:

Based on the information submitted, we rule as follows:

> Association's prospective payments to the Contributors will not constitute prohibited inurement and will not disqualify Association from qualification for recognition of exemption under section 501(c)(6).

This ruling will be made available for public inspection under action 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling 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 by others as precedent.

This ruling is based on the understanding there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon your tax status should be reported to the Service. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

Because this letter could help resolve any future questions about tax consequences of your

activities, you should keep a copy of this ruling in your 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.

In accordance with the Power of Attorney and Declaration of Representative currently on file with the Service, we are sending a copy of this letter to your authorized representative.

Enclosure: Notice 437

Sincerely yours,

Ronald J. Shoemaker
Manager, Exempt Organizations
Technical Group 2