

Where an organization of the type described in section 501(c)(12) of the Internal Revenue Code of 1954 uses the accrual method of accounting for Federal income tax purposes, compliance with the 85 percent requirement imposed by that section must be determined pursuant to that method.

The Internal Revenue Service has been asked whether an organization that maintains its books of account on the accrual method may use that method for the purpose of determining compliance with the 85 percent requirement imposed by section 501(c)(12) of the Internal Revenue Code of 1954.

Section 501(c)(12) of the Code provides that certain types of organizations shall be exempt from Federal income tax, but only if 85 percent or more of the organization's income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

The purpose of this limitation is to assure that at least 85 percent of an organization's income is derived from its members. Although this limitation is stated in terms of income 'collected' from members, the statute is not intended to impose a requirement that an organization's income be computed on the basis of the cash receipts and disbursements method of accounting. In the case of an organization utilizing the accrual method of accounting, 85 percent or more of its income will 'consist of amounts collected from members' if 85 percent or more of its income determined under this method is derived from members.

Accordingly, the organization must compute the amounts collected from its members on the accrual method for the purpose of the 85 percent limitation of section 501(c)(12) of the Code, provided the organization determines all its income by the same method and uses such method consistently from year to year.

Permission to change from a cash method of reporting to an accrual method must be obtained in accordance with section 446(e) of the Code.