Rev. Rul. 69-528, 1969-2 C.B. 127

An organization regularly carrying on an investment service business that would be unrelated trade or business if carried on by any of the exempt organizations on whose behalf it operates, is not exempt under section 501(a) of the Code.

Advice has been requested whether the organization described below qualifies for exemption from Federal income tax under section 501(a) of the Internal Revenue Code of 1954 as an organization described in either section 501(c)(2) or section 501(c)(3) of the Code.

The organization was formed to provide investment services on a fee basis exclusively to organizations exempt from Federal income tax under section 501(c)(3) of the Code. It receives funds from the participating exempt organizations, invests in common stocks, reinvests income and realized appreciation, and upon request liquidates a participant's interest and distributes the proceeds to the participant.

The organization is free from the control of the participants and has the absolute and uncontrolled discretion in (1) investment of the property, (2) sale of investments and reinvestment of the proceeds, (3) payment of taxes and liens, (4) distributions of income and principal or the addition of accumulated income to principal, and (5) dealing with the property and managing the funds as if it were absolute owner thereof. In addition, a participant's ownership interest in the property does not entitle such participant to the whole or any part of the property or the right to call for a partition, division, or accounting of the property.

Section 502 of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under section 501 on the ground that all of its profits are payable to one or more organizations exempt from Federal income tax under section 501.

Section 1.502-1(b) of the Income Tax Regulations provides that a subsidiary organization of an exempt organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt

since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations.

Providing investment services on a regular basis for a fee is trade or business ordinarily carried on for profit. If the services were regularly provided by one tax-exempt organization for other tax-exempt organizations, such activity would constitute unrelated trade or business. Based upon the above-cited statute and regulations, it is held that this organization is not exempt under section 501(a) of the Code as an organization described in either section 501(c)(2) or section 501(c)(3) since it is regularly carrying on the business of providing investment services that would be unrelated trade or business if carried on by any of the tax-exempt organizations on whose behalf it operates.

Compare Revenue Ruling 56-267, C.B. 1956-1, 206, which holds that where, under certain specified conditions, exempt employees' trust pool their funds in a group trust to provide diversification of investment, the group trust may qualify as an exempt employees' trust and the exempt status of the separate trust will not be adversely affected. That Revenue Ruling specifies that in order to meet the qualification requirements under section 401(a) of the Code, the group trust must itself be adopted as a part of each employer's pension or profit-sharing plan, and that the group trust instrument must prohibit that part of its corpus or income which equitably belongs to any participating exempt employees' trust from being used for or diverted to any purpose other than for the exclusive benefit of the employees or their beneficiaries who are entitled to benefits under such participating trust. Under such conditions, one or more trusts may form part of a qualified plan, referred to in section 401(a), and maintain exemption under section 501(a).