Professional Insurance Agents of Michigan v. Commissioner, 72 T. C. 745 (1979)

Income from promoting group insurance by a tax-exempt business league constitutes unrelated business taxable income if it is derived from a trade or business regularly carried on and not substantially related to the organization's exempt purpose.

Summary

Professional Insurance Agents of Michigan (PIA), a tax-exempt business league under section 501(c)(6), promoted various group insurance programs to its members and received fees for these services. The Tax Court held that these fees constituted unrelated business taxable income (UBTI) because the promotional activities were a trade or business regularly carried on and not substantially related to PIA's exempt purpose of improving business conditions for insurance agents. Additionally, a refund from an experience rating reserve was also deemed taxable income, as it was not held in trust for the members. This decision clarifies the scope of UBTI for exempt organizations engaging in promotional activities.

Facts

Professional Insurance Agents of Michigan (PIA), a tax-exempt business league, promoted various group insurance programs to its members, including errors and omissions, health, life, and disability insurance. PIA received fees from the National Association of Professional Insurance Agents and Independent Liberty Life Insurance Co. for its promotional and administrative services. PIA also received a refund of $43,227. 76 from an experience rating reserve upon termination of a group health and life policy with Time Insurance Co. The IRS determined that these fees and the refund constituted unrelated business taxable income (UBTI).

Procedural History

The IRS issued a notice of deficiency to PIA for the taxable years ending September 30, 1974, 1975, and 1976, asserting that the fees received from promoting group insurance and the experience rating reserve refund were UBTI. PIA challenged this determination in the Tax Court, which upheld the IRS's position.

Issue(s)

1. Whether the fees received by PIA for promoting group insurance programs constituted unrelated business taxable income under section 512.
2. Whether the experience rating reserve refund received by PIA upon termination of a group health and life policy constituted taxable income.

Holding

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1. Yes, because the promotional activities were a trade or business regularly carried on and not substantially related to PIA's exempt purpose.
2. Yes, because the refund was not held in trust for the members and was received under a claim of right.

Court's Reasoning

The court applied the three-prong test for UBTI under section 512: (1) the income must be derived from a trade or business, (2) the trade or business must be regularly carried on, and (3) the conduct of the trade or business must not be substantially related to the organization's exempt purpose. The court found that PIA's promotional activities satisfied all three criteria. PIA's services, though limited, were performed for the production of income, thus constituting a trade or business under section 513(c). The activities were regularly carried on, as evidenced by their ongoing nature. Finally, the court determined that the activities did not contribute importantly to the improvement of business conditions for insurance agents but rather provided a convenience to individual members, thus not being substantially related to PIA's exempt purpose. The court also rejected PIA's argument that the experience rating reserve refund was held in trust for its members, as PIA had full control over the funds and made no attempt to distribute them. The court cited North American Oil Consolidated v. Burnet, holding that amounts received under a claim of right are taxable when received, even if subject to a contingent obligation to restore them.

Practical Implications

This decision impacts how tax-exempt organizations should analyze their promotional activities. Exempt organizations must ensure that any income-generating activities are substantially related to their exempt purpose to avoid UBTI. The ruling clarifies that even limited promotional activities can be considered a trade or business if they are carried on for the production of income. Organizations should review their activities to determine if they fall within the scope of UBTI and consider restructuring them to align more closely with their exempt purpose. The decision also affects how organizations handle refunds or reserves, emphasizing that such funds are taxable unless held in a true trust for the benefit of members. Subsequent cases, such as Louisiana Credit Union League v. United States, have followed this reasoning, further solidifying the principles established in this case.

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