BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
) No. 84A-506-MW
BUILDING INDUSTRY ASSOCIATION )
OF SUPERIOR CALIFORNIA )

For Appellant: Ronald J. Clark
Certified Public Accountant

For Respondent: Jon Jensen
Counsel

## O P I N I O N

This appeal is made pursuant to section 25666[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Building Industry Association of Superior California against proposed assessments of additional franchise tax in the amounts of $1,397.97 and $755.46 for the income years 1978 and 1979, respectively.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

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The question presented by this appeal is whether income from appellant's insurance activities was unrelated business taxable income.

Appellant is a tax-exempt trade association most of whose members are small businesses. Appellant's general purpose "is to promote 'greater development, knowledge and efficiency in the conduct of the building industry.'" (App. Br. at 2.) To this end, appellant has committees dealing with building code changes, consumer affairs, and legislation. It also sponsors safety programs for its members and home tours and products shows for the public. Group insurance programs are also provided for members; it is these insurance programs which have given rise to the present controversy.

Appellant maintains group medical, hospitalization, dental, and life insurance programs for its members and their employees. A separate board of trustees administers these plans. Master policies for these plans are written by an independent insurance agent, but appellant apparently writes all individual policies. One full-time employee of appellant enrolls members, handles questions, collects and pays over the premiums to the insurance brokers, and handles all claims. Appellant receives a monthly fee of $3.50 from each policyholder to cover its administrative costs in connection with this insurance. In 1979, appellant received gross fees of $20,133, or 3.7 percent of gross income, and in 1978, $40,279, or 8.6 percent of gross income.

Appellant also negotiated a master policy for group worker's compensation insurance with Continental Insurance Company (Continental). Individual policies, however, were written by independent agents chosen by each policyholder. Appellant apparently only publicized and endorsed this insurance, servicing of the policies being handled by Continental and the independent agents. Appellant receives 5 percent of all dividends, plus all dividends forfeited by businesses which ceased being appellant's members, for its services in connection with this insurance. Appellant's share of dividends was $11,211 in 1978 and $29,452 in 1979.

Respondent determined that appellant's income from these insurance programs, less associated expenses, was taxable as unrelated business taxable income. The net revenues from all insurance activities which

respondent contends are taxable totaled $15,533 in 1978 and $29,452 in 1979.

The "unrelated business taxable income" of an exempt organization is subject to both state and federal taxation. (Rev. & Tax. Code, § 23731; I.R.C. § 511.) "Unrelated business taxable income" means the gross income of an organization from an unrelated trade or business which it regularly carries on, less the deductions directly connected with the conduct of the trade or business. (Rev. & Tax. Code, § 23732, subd. (a)(1); I.R.C. § 512(a)(1).) An "unrelated trade or business" is a trade or business the conduct of which is not substantially related to the exercise or performance by an exempt organization of the functions or purpose which qualifies it for exemption. (Rev. & Tax. Code, § 23734.) The federal regulations, which also apply to the state statutes (Cal. Admin. Code, tit. 18, reg. 26422), state that income of an exempt organization is unrelated business taxable income if: (1) the income is from trade or business; (2) the trade or business is regularly carried on by the organization; and (3) the conduct of the trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions. (Treas. Reg. § 1.513-1(a).)

Appellant contends that the income from its insurance activities was not unrelated business taxable income under the test of the regulations. It argues that the activities (1) did not amount to a trade or business because appellant had "no power over the possible financial result" (App. Br. at 2) and it did not have "significant" amounts of income from its activities as compared to the income received by organizations in cases cited by respondent; (2) the activities were not regularly carried on for a profit; and (3) the activities were substantially related to appellant's exempt functions of "promoting knowledge and efficiency in the industry and among its membership ..." (App. Br. at 2) and the "establishment of harmonious and equitable relations between employers and employees. ..." (App. Br. at 3.)

Respondent relies primarily on two United States Courts of Appeals cases. In both Carolinas Farm & Power Equipment Dealers v. United States (699 F.2d 167 (4th Cir. 1983)), and Professional Ins. Agents of Michigan v. Commissioner (726 F.2d 1097 (6th Cir. 1984)), insurance premium rebates received as fees for promotional and

administrative services provided by tax-exempt organizations in connection with group insurance programs which they provided or endorsed were held to be unrelated business taxable income under the provisions of Regulation section 1.513-1.

We believe that appellant's insurance activities constituted a trade or business under the pertinent statutes and regulations. Section 23734a states that, for purposes of section 23734, "trade or business" means any activity carried on for the production of income from the sale of goods or the performance of services. Section 513(c) of the Internal Revenue Code contains the same definition for federal tax purposes. Both the dividends received from the insurance company and the administrative fees received from members were amounts received by appellant for services which it provided. Appellant apparently used the profits for its own purposes rather than refunding any amounts to its members. We find that these insurance activities were "carried on for the production of income from ... the performance of services," and, therefore, appellant was engaged in a trade or business.

It is to us beyond question that these activities were regularly carried on. Appellant had one full-time employee who handled the group medical insurance program and there is *no* allegation that its promotion and endorsement of the worker's compensation insurance plan was not ongoing and continuous.

We also believe that these activities were not substantially related to appellant's exempt purposes. Treasury Regulation section 1.513-1(d)(2) requires that an activity bear a substantial causal relationship or contribute importantly to the achievement of the organization's exempt purposes in order to be considered substantially related. The performance of services which benefit individual members rather than the members as a group or the industry as a whole has been held to be not substantially related for exempt purposes. (Professional Ins. Agents of Michigan v. Commissioner, supra, 726 F.2d at 1103; Carolinas Farm and Power Equipment Dealers v. United States, supra, 699 F.2d at 171; Louisiana Credit Union League v. United States, 693 F.2d 525, 536 (5th Cir. 1982).)

Although there may have been some group benefit in appellant's insurance activities, it was, at best,

tangential. The insurance activities were clearly designed to benefit the individual members who elected to use the programs and to generate revenue for the appellant. Therefore, appellant's insurance activities were not substantially related to appellant's exempt functions.

Because all three requirements of Treasury Regulation section 1.513-1(a) are met, we must conclude that respondent properly determined that appellant's income from insurance activities was unrelated business taxable income. Respondent's action, therefore, must be sustained.

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## O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Building Industry Association of Superior California against proposed assessments of additional franchise tax in the amounts of $1,397.97 and $755.46 for the income years 1978 and 1979, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of February, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman

Conway H. Collis, Member

William M. Bennett, Member

Ernest J. Dronenburg, Jr., Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9