**Unrelated Business Activities: Introductory Guidance**

Background

Membership dues paid to a PCA-HCCN are generally tax-exempt because the related business function of an association is to provide services to members; however, Section 501(c) organizations, such as PCAs-HCCNs, may generate income from business activities unrelated to their tax-exempt purpose (e.g., providing additional services to its members for a fee). In such cases, the IRS is likely to assert that the net income generated from such unrelated trade or business activities is subject to Unrelated Business Income Tax (“UBIT”).[[1]](#footnote-1) To the extent that a PCA-HCCN has earned unrelated business income, it will be taxed at the prevailing corporate rate, putting it in the same tax position as a for-profit organization carrying on the same trade or business (this prevents exempt organizations from obtaining an unfair economic advantage).

If the conduct of unrelated trade or business activities becomes a substantial part of the PCA-HCCN’s activities, the organization's tax-exempt status will be endangered. Federal tax exemption is premised on "primary purpose" tests. An organization will not be considered to be engaged primarily in pursuing its tax-exempt purpose if more than an "insubstantial" part of its activities do not further the exempt purpose. In sum, a PCA-HCCN that departs from its exempt purpose in favor of for-profit purposes is no longer entitled to federal income tax exemption.

Advice and Recommendations[[2]](#footnote-2)

Whether or not a particular activity is an “unrelated business” is based on the facts and circumstances of the specific organization and activity. The basic test is whether the business activity contributes importantly to the organization's exempt purposes (other than in producing income). Examples of association activities that have been held to be subject to UBIT include: sale to members of supplies and forms; price guides; administration of a group insurance program; provision of mediation and arbitration services; operation of an alcohol and drug testing program for members and nonmembers; and translation services.

The IRS does not view practice management and related service activities as tax-exempt activities but, rather, as reflective of activities ordinarily carried on by a for-profit entity. As such, net income from the sale of practice management services (e.g., claims management, billing, credentialing) to health care providers who are not members of the PCA-HCCN will be subject to UBIT. In addition, net income from the sale of practice management services to PCA-HCCN also is likely to be subject to UBIT unless the sale of such services is a purpose for which the PCA-HCCN’s tax exemption was recognized.

To the extent that a PCA-HCCN generates substantial unrelated business income (potentially putting its tax exemption in jeopardy), it should consider establishing a separate “sister” organization to operate the unrelated “for-profit” business activities. Similarly, if a PCA-HCCN that is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code conducts lobbying activities in excess of the amount permitted for 501(c)(3) organizations, it may establish a separate organization (typically a Section 501(c)(4) organization) to conduct those activities.

Other reasons to establish a new corporation include:

* Protect the PCA-HCCN from potential liabilities and risks arising out of business activities;
* Provide an opportunity for outside investors/owners to participate in PCA-HCCN-related for-profit activities; and
* Provide an opportunity for the PCA-HCCN to secure a return on investment.

This last point is particularly important, in that nonprofit organizations, such as PCAs-HCCNs, that engage in business activities cannot distribute surplus earnings to their members unless the organization can document how such distributions (typically in the form of grants) furthers the PCA-HCCN’s tax-exempt purposes.

* [Unrelated business activities](http://www.healthcentercompliance.com/subscriber/pca-toolkit/volume-2/847): Sample policy and procedure
1. See Section 512 of the Internal Revenue Code. [↑](#footnote-ref-1)
2. The Authors of these materials include attorneys at the law firm of Feldesman Tucker Leifer Fidell LLP. The advice and recommendations consist of general guidance based on federal law and regulations and do not necessarily apply to all PCAs-HCCNs under all facts and circumstances. Further, these materials do not replace, and are not a substitute for, legal advice from qualified legal counsel. [↑](#footnote-ref-2)