INTERNAL REVENUE SERVICE

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January 31, 2007

Area Manager –

Taxpayer's Name:
Taxpayer's Address

Taxpayer's Identification Number:

Years Involved:

Conference Held:

Legend:

T =
V =

Issues:

Whether funds derived by T, a state-chartered credit union described in section 501(c)(14) of the Internal Revenue Code, from the following activities should be treated as unrelated business taxable income under section 511 of the Code:

A. Sale of insurance products
B. "Interchange income" derived in connection with T's Visa credit card program

Facts:

Established in 1960, T is a state-chartered credit union which is recognized as exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(14)(A).

The purpose of T as set forth in the corporate by-laws is "to promote thrift among its members, by affording them an opportunity for accumulating payments on shares; and to make loans therefrom to its members for provident and productive purposes."

T's activities include accepting deposits from and maintaining the accounts and savings of its members. These deposit accounts include savings or share accounts on which members earn periodic dividends credited to the accounts and share draft accounts, which are transaction accounts similar to bank checking accounts. T represents that its day-to-day business operations differ from conventional banking institutions in several ways. T states that it conducts its business to reflect its non-profit mutual structure. T makes loans to its members and states that many borrowers have low incomes and might not otherwise qualify for credit from conventional for-profit banks. T also represents that it regularly issues loans for very small amounts, such as loans for auto repairs, which are typically not made by for-profit banks. T indicates that it serves smaller communities than those served by for-profit banks. T also indicates that because of its mutual, non-profit operation, all members, not just those maintaining high minimum balances, are able to earn competitive rates on their deposits and pay low banking fees.

T represents that in order to maintain its financial viability and continue to satisfy its stated purposes of promoting thrift and providing a source of low cost credit, it has endeavored to become a full service financial institution. Consequently, T offers more than just demand deposits and loans. Currently, T makes insurance products and Visa credit card program available to members. The different types of insurance are described in more detail below.

A group return was filed by the state banking department. Each credit union included in the group return is represented as a separate corporate entity that is exempt from federal income tax. T was included in the Form 990 group return on the basis that it was in fact operating as a state-chartered credit union as of the close of the tax year. There is no record of T filing a Form 990-T, Unrelated Business Income Tax Return for the year at issue.

A. Sale of insurance products

T contracted with an independent insurance company to offer credit life and credit disability insurance to its members. T and at least one employee are required to be licensed by the state department of insurance in order to offer and/or sell this insurance to members. T derives a fee based on a fixed percentage of gross premiums from the insurance company to market these products and perform certain administrative services in connection with the insurance program.

T offers credit insurance to each member when a loan application request

is made. A member's participation in the insurance program is voluntary and is not a prerequisite for the approval of a loan application. If a member elects to receive coverage, he or she will sign the required forms provided by T on behalf of the insurance company. The insurance policies provide, in pertinent part, that the outstanding loan balance subject to any cap on the insured amount will be repaid to the credit union by the insurer upon the death of a member, or by payment of, or reimbursement of, the contractual loan installments in the case of disability.

A member who elects to purchase credit insurance is required to pay the premiums to T for coverage. T prepares a premium remittance report on a monthly basis that summarizes the insurance premiums payable to the insurance company. The report identifies the gross premium charges, the administrative fee at the contract rate to be retained by T, and the net premiums to be remitted by T.

For administrative convenience and to ensure timely payment of premiums to the insurer, T adds the premium charge to each member's loan balance and remits the premiums to the insurer net of the administrative fee. T ultimately recovers the premiums as the member makes payment(s) on his or her loan. The insurance company may issue a refund to T based on the claims experience rating. T retains any refund attributable to experience rating rather than crediting members' accounts.

T also performs certain marketing and administrative services on behalf of one or more insurance companies in connection with other insurance products offered to members. Such products include, but are not necessarily limited to, accidental death and disability, credit card life and disability, and life insurance policies that any member may subscribe to and elect to pay for through his or her credit union account. These kinds of insurance are offered independently of any loans the member may have with the credit union. T derives a fee on a periodic basis for services rendered to the insurance companies. T earned fees from its insurance program in excess of $ during each of the tax years under examination.

B. "Interchange income" derived in connection with T's Visa credit card program

As a member of Visa, USA, Inc (Visa), T is authorized to offer its members a Visa credit card. Visa is an association of financial institutions that issue payment cards using Visa's infrastructure and brand. T became a member of Visa through a sponsorship arrangement made by V, an organization that sponsors its member credit unions for membership in bankcard programs and arranges for the provision of credit card and debit card processing services for its membership T's membership in Visa will hereinafter be referenced using the term "Member."

By reason of being a Member, T is subject to the Visa by-laws and operating regulations which prescribe the duties and responsibilities applicable to card issuers. As a Member that issues Visa credit cards, T is authorized to enter into direct contractual relationships with its cardholders and extend credit to and collect payments from cardholders, i.e., members. T markets its Visa brand credit card, approves or rejects applications for credit cards, and performs a variety of administrative functions in accordance with the Visa operating regulations. Furthermore, T is "at risk" for credit it extends in connection with the use of the credit card and is responsible for the collection of any debt.

T's members apply for a credit card by completing a standard application form. T then approves or rejects the application based on the loan criteria that it has established. If a member is approved for a credit card, T will extend a line of credit, subject to limitations, in connection with the use of such card. Credit cards offered by T at times vary with respect to the credit line, interest rate, and benefits attendant to the card.

T has two sources of revenue from its members' use of Visa credit cards, summarized as follows:

Line of Credit – T earns interest income on the unpaid balance of any line of credit extended in connection with the Visa credit cards. The terms and conditions pertaining to the credit cards, including the interest rate charged, are set forth in the "Cardholder Agreement" executed between T and each approved member. T also receives income from certain fees and service charges as provided in the Cardholder Agreement including cash advance fees, late penalty payment fees, over limit fees and card or personal identification number (PIN) replacement fees. Although the name of the credit union and Visa logo are conspicuously present on the face of the plastic card, only T bears any loss from a member's default on his or her obligation.

Merchant Assessments – By reason of its membership in Visa and its active role in the marketing and issuance of Visa brand credit cards, T derives revenue from fees charged to retail businesses participating in the Visa payment system.

Visa processes the series of transactions that begin when a cardholder makes a purchase of goods or services using a Visa brand credit card. However, a credit card transaction cannot be consummated if the retail business at which the transaction cycle begins is unwilling to accept them. In order to foster card issuance and usage, Visa and its member institutions have developed and implemented "Visa Net", an advanced network that acts as an authorization service for Visa card transactions, as well as a clearing and settlement service to transfer payment information between parties. Technological developments, marketing, and other factors have encouraged retail businesses including

supermarkets, restaurants, chain retailers, and hundreds of thousands of other vendors and merchants (collectively referred to as the "Merchants") to accept Visa cards as a payment option.

Every transaction using a Visa card incurs costs, including, but not limited to, the point of sale ("POS") terminal(s) provided to Merchants that facilitate the transactions, the Visa network transmission lines and software that link the transaction authorization and related sales data between the Merchants and Visa, and the expense associated with the credit union's agent which may also be a Member of Visa that processes the transaction and converts it to statement form for the multiple parties involved.

Each Merchant that accepts Visa cards as a payment option must contractually agree (i.e., the "Merchant Agreement") to pay a fee related to the transaction processing costs of Visa card payments. The fees assessed against Merchants, otherwise known in the industry as "interchange income," may vary by card product, processing technology, and Merchant category but are generally based on a percentage of net sales plus a fixed transaction fee. Interchange income is generated from a payment system that operates every day of the year on a continuous basis.

The interchange income derived by Visa is apportioned among the Members that issue payment cards in accordance with a revenue sharing arrangement that credits a Member's settlement account for that portion of interchange income attributable to its cardholders' purchases. Accordingly, T derives interchange income based on the consumer purchases made by its own members using the Visa credit card.

The payment of interest charges, and related service fees, by a member of T pursuant to the Cardholder Agreement is not contingent on, although it may be derived from, credit card purchases. This is evidenced by the fact that a member may incur credit card debt, for instance by borrowing through cash advances, without generating interchange income. Likewise, a member may use his or her card to purchase goods or services, which generate interchange income to T without incurring interest charges. This is demonstrated by a member who pays the current month's charges in full thereby maintaining a "zero balance" card.

Both the interchange program and cardholder loan program incur a variety of expenses directly related to the type of income that each business produces. Due to the size and complexity of the credit card program, T contracts directly and indirectly through V with an outside vendor that is able to capture and process data related to the interchange program, from access to the Visa network that records credit card purchases, and the cardholder program from information furnished by T. The processing vendor, ("Vendor"), maintains a separate settlement account to record the interchange income and related

expenses pertaining to T as well as the expenses attributable to the cardholder program.

T receives a statement from the Vendor on a monthly basis that details the amount of interchange income credited to its account and the itemized charges related to both the interchange and cardholder programs. Expenses charged to T in connection with the interchange program include authorization fees, transaction processing fees, and marketing fees, including scoreboard redemption fees. Expenses incurred and charged by the Vendor to administer certain functions of T's cardholder loan program include statement and notice fees, security fees and pass-thru postage and delivery fees. Other expenses such as card issuance, file residency, maintenance and inquiry appear to be allocable to both the interchange and cardholder programs. Additional fees, royalties, and assessments may be charged to T directly by Visa or indirectly through the Vendor as they pertain to one or both programs.

T maintains separate general ledger accounts to record the interest income and interchange income derived from credit card transactions. During each tax year under examination, T derived gross interchange income in excess of $

Law:

Section 501(a) of the Internal Revenue Code ("Code") provides, in part, that organizations described in section 501(c) are exempt from federal income tax.

Section 501(c)(14)(A) of the Code specifically exempts from federal income tax credit unions without capital stock organized and operated for mutual purposes and without profit.

Section 1.501(c)(14)-1 of the Income Tax Regulations ("regulations") provides, in part, that credit unions (other than Federal credit unions described in section 501(c)(1) of the Code) without capital stock, organized and operated for mutual purposes and without profit, are exempt from tax under section 501(a).

State-chartered credit unions were first acknowledged as exempt from federal income tax in a 1917 Opinion of the Attorney General. The Attorney General considered credit unions organized under the laws of the Commonwealth of Massachusetts. The Attorney General's opinion described the purposes of credit unions existing at that time:

> [I]t is apparent that the purpose of these financial associations is to help people save and to assist those in need of financial help whose credit may not be established at the larger banks. In reality, they are fundamentally similar and supplemental to the existing agencies for promoting thrift,

namely, the savings banks and cooperative banks, except on a much smaller scale.

The Attorney General's opinion also described some of the operations of credit unions--making loans in appropriate amounts to members, "on which a low rate of interest is charged," and that "[p]rompt payment of obligations is a fundamental requirement..." The opinion described in detail the procedures by which members' savings were held by the credit union, and how the members earned interest on their deposits. The opinion also pointed to the democratic character of the governance of these early credit unions by their members: "At the annual meeting of the association each member (shareholder and depositor) has but one vote..."

After review of the features and operations of these early Massachusetts credit unions, the Attorney General's opinion held that state-chartered credit unions would be exempt from federal income tax. See 31 U.S. Op. Atty. Gen. 176 (1917).

The legal analysis of the Attorney General's 1917 opinion was adopted in Treasury regulations issued in 1918, and this remained the official basis for the tax exempt status of state-chartered credit unions until the Revenue Act of 1951 granted express statutory tax-exempt status to state-chartered credit unions. However, the Revenue Act of 1951 removed tax exemption from savings and loan associations, cooperative banks, and mutual savings banks. The legislative history of the act suggests that the reason these entities lost their exemption was because of their increasing similarity to commercial banks and the resulting loss of their original characteristic of mutuality. Specifically referring to the early days of these institutions, the legislative history states:

> "The fact that the members were both the borrowers and the lenders was the essence of the "mutuality" of these organizations." See generally S. Rep. No. 781 (Sept. 18, 1951), reprinted in U.S. CODE CONG. & AD. SVC. 1969, 1991-97.

Present-day section 501(c)(14)(A) – as enacted in 1951 – incorporates the requirements of mutuality and non-profit operation which formed the basis for the Attorney General's recognition of credit unions' tax-exempt status in 1917. Accordingly, the basic purposes of the credit union tax exemption remain essentially the same today as they were in 1917. Based on the Attorney General's opinion, the basis for exemption is the provision of savings accounts and loans to members who may not be served by banks in a non-profit and mutual manner.

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations otherwise exempt from federal income tax under section 501(c).

Section 512(a)(1) of the Code provides that the term "unrelated business taxable income" means, with certain modifications, the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less allowable deductions.

Section 513(a) of the Code defines the term "unrelated trade or business" in the case of any organization subject to tax imposed by section 511, as any trade or business the conduct of which is not substantially related (aside from the need of such organization for the income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt function.

Section 1.513-1(a) of the regulations provides that gross income of an exempt organization subject to the tax imposed by section 511 of the Code is, with certain exceptions, includable in the computation of unrelated business taxable income if (1) it is income from trade or business, (2) such trade or business is regularly carried on by the organization, and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Section 1.513-1(b) of the regulations provides that the term "trade or business" has the same meaning it has in section 162 of the Code, and generally includes any activity carried on for the production of income from the sale of goods or the performance of services.

Section 1.513-1(c)(1) of the regulations states that in determining whether a trade or business is "regularly carried on" within the meaning of section 512 of the Code, regard must be had to the frequency and continuity with which the activities are conducted and the manner in which they are pursued. Hence, for example, specific business activities will ordinarily be deemed "regularly carried on" if they manifest a frequency and continuity, and are pursued in a manner generally similar to comparable commercial activities of nonexempt organizations.

Section 1.513-1(d)(1) of the regulations provides that gross income is derived from "unrelated trade or business" within the meaning of section 513(a) of the Code, if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between the business activities that generate the particular income in question - the activities, that is, of producing or distributing the goods or performing the services involved - and the accomplishment of the organization's exempt purposes.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is

"related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income), and it is "substantially related," for purposes of section 513, only if the causal relationship is a strong one. Thus, for the conduct of a trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those exempt purposes.

Whether activities contribute importantly to an organization's exempt purposes depends in each case upon the facts and circumstances involved.

In Louisiana Credit Union League, 693 F.2d 525 (5th Cir. 1982), a business league described in section 501(c)(6) of the Code engaged in several activities including the endorsement of insurance to its members. The court analyzed whether these activities were substantially related to the business league's exempt purpose under section 501(c)(6) of advancing the credit union movement, in order to determine whether income generated from those activities resulted in unrelated business income to the business league. In its analysis, the court stated that the "'substantial relationship' determination is necessarily a fact-based inquiry." Id. at 535. The court also noted that the regulations under section 513 require a case-by-case identification of the exempt purpose, an analysis of how the activity contributes to that purpose and an examination of the scale on which the activity is conducted. The League promoted the purchase of insurance policies from a particular carrier, providing the carrier with convenient services in the marketing and administration of its programs. The court stated that the League's endorsement of group insurance plans was principally motivated by a desire to raise revenue. The court also discussed at length the distinction between group and individual benefit. The court said the distinction between inherently group benefits and individual benefits is analogous to the aggregate/entity concept familiar in partnership taxation.

> Just as a member of a partnership may enjoy benefits in his separate capacities as partner and non-partner, so may a member of the ..[League may]...enjoy benefits both as a League member and as an individual credit union. Only those activities that benefit the credit unions in their capacities as League members can be considered substantially related to the League's exempt function. This group benefit standard also accords with the requirement that a business league seek to improve the conditions of an entire line of business rather than perform discrete services for individuals. See Treas. Reg. Section 1.501(c)(6)-1. When the activities of a business league are directed toward the achievement of the common business interest of its members, the benefits that accrue to its members are inherently group benefits.

Id. at 536. The court continued its analysis by stating that insurance endorsement and administration is not the sort of unique activity that satisfies the substantial relationship test, nor is its benefits group-related. Id. at 536. Rather than merely advising members of the availability and desirability of insurance coverage to credit unions generally, the league promoted the purchase of polices from a particular carrier. The court affirmed the district court's rationale that the league's insurance activities did little more than generate revenue. Because the league's endorsement was basically a fundraising activity, it was by definition unrelated business activity under section 513(a). Id. at 537. Therefore, the court concluded that the League's insurance activities were not substantially related to its tax-exempt purpose of advancing the credit union movement. Rather, the connection between the furtherance of the credit union movement and the selling of insurance was at best tangential.

In Professional Insurance Agents of Michigan v. Comm'r., 78 T.C. 246 (1982), aff'd 726 F.2d 1097 (6th Cir. 1984), the court held that promotional and administrative fees and an experience rating reserve refund received by a business league described in section 501(c)(6) of the Code for promoting group insurance programs for its members constituted unrelated business taxable income under section 512(a)(1). In holding that the business league's activities were not substantially related, the court considered whether the league's insurance activities contributed importantly to the league's exempt purpose of advancing the common business interests of independent insurance agents. The court stated the burden is on the taxpayer to show that the challenged activities contribute directly and importantly to the improvement of conditions in a particular line of business. The court noted that the petitioner's insurance activities did little more than generate revenue for the association and provided members with a convenient and economical service in the operation of their agencies. As such, they stood in sharp contrast to petitioner's educational and legislative activities, which served the broader purpose of improving the general business environment in which insurance agents operated. Thus, the court found petitioner's activity of promoting insurance was not substantially related to its exempt purpose.

In La Caisse Populaire Ste. Marie (St. Mary's Bank) v. U.S., 563 F.2d 505 (1st Cir. 1977), the Government unsuccessfully challenged the exempt status under section 501(c)(14)(A) of the Code of an organization chartered as a credit union by the State of New Hampshire. The Government maintained that the organization was not exempt because it offered a wide variety of services typically offered by nonexempt full service banks, and was therefore not organized or operated as a credit union. Among these services were checking accounts, mortgage loans, banking by mail, safe deposit boxes and a night depository. This case focused solely on the taxpayer's exemption under section 501(c)(14) and did not address the provisions of sections 511 through 513.

In Alabama Central Credit Union v. U.S., 646 F. Supp. 1199 (N.D. Ala. 1986), a credit union described in section 501(c) (14) of the Code offered cancer and group life insurance to its individual members. The issue was whether commissions the credit union received from servicing these particular types of insurance policies constituted unrelated business income under section 512. The court did not reach the issue for jurisdictional reasons; however, it stated in a footnote that the petitioner would have lost on the merits of this issue because the policies benefited the insured without any reference to the member's loans or accounts with the credit union. That court stated in dicta that cancer and group life insurance offered by a credit union to its members would result in unrelated business table income for the following reasons:

1. Petitioner earned commissions for servicing cancer and group life insurance policies;
2. These policies were for the express benefit of the insured without any reference to the member's loans or accounts with the credit union;
3. Petitioner derived no benefit from the policies other than commission on the sale of said policies earned from the insurance companies which issued the policies;
4. The sale of the cancer and group life insurance policies referred to had no substantial, causal relationship to petitioner's exempt purposes; and
5. The sale of the policies bore no relationship to petitioner's function as a credit union.

Id. at 1208, n. 14.

Rev. Rul. 69-282, 1969-1 C.B. 155, provides that an organization must be formed and operated under the state law governing the formation of credit unions to qualify for exemption under section 501(c)(14) of the Code as a state-chartered credit union.

Rev. Rul. 72-37, 1972-1 C.B. 152, provides that to qualify as a credit union exempt from income tax under section 501(c) (14) (A) of the Code an organization must, in addition to being formed and operated under a state credit union law, operate without profit and for the mutual benefit of its members. The revenue ruling clarified Rev. Rul. 69-282, stating that a state charter is a threshold requirement for exemption but not the sole requirement.

Rev. Rul. 60-228, 1960-1 C.B. 200, interprets the substantially related requirement of section 513. An organization exempt from federal income tax as an agricultural organization described in section 501(c)(5) of the Code promoted wider insurance coverage among its members and other local farmers, including life, casualty, and fire insurance. The insurance programs are provided by several insurance companies, but the organization's administrative and secretarial staff is assigned to the work. The organization receives an overall fee from the insurance company for office and other services rendered them in

connection with the insurance programs. The revenue ruling provides that a trade or business is substantially related to an organization's exempt activities if the principal purpose of the trade or business furthers these exempt purposes. However, in this case, such activities are not usually associated with the functions of an agricultural organization and normally would not be carried on by such an organization in furtherance of its exempt purposes. Therefore, these activities are not substantially related to the organization's exempt purposes. Thus, the income resulting from these activities is subject to tax under section 511.

Analysis

In determining whether an income-producing activity is an unrelated trade or business, it is necessary to show that (1) there is a trade or business, (2) the trade or business is regularly carried on, and (3) the conduct of the trade or business is not substantially related to the organization's exempt purpose or function. See section 1.513-1 (a) of the regulations.

T has agreed that the activities at issue are trade or business that is regularly carried on. Therefore, the sole issue is whether each activity is substantially related to the organization's achievement of its exempt purposes.

Gross income is derived from an unrelated trade or business if the conduct of the trade or business is not substantially related (other than through production of funds) to the purposes for which exemption is granted. Section 1.513-1(d)(1) of the regulations. Determination of the substantial relationship issue requires an examination of the relationship between the business activities which generate the particular income in question, and the accomplishment of the organization's exempt purposes. Id. The regulations further state that for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Section 1.513-1(d)(2) of the regulations. See also Prof'l Ins. Agents of Michigan, supra, (insurance activity was not substantially related because activity did little more than generate revenue and provide members with a service and did not further taxpayer's exempt purpose of improving business conditions); and Louisiana Credit Union League, supra, (League's endorsement of group insurance plans was principally motivated by a desire to raise revenue, and at best was only tangentially related to the furtherance of the League's exempt purpose of improving business conditions of one or more lines of business. The court found the requisite substantial relationship lacking.)

For T's activities to escape taxation as unrelated business income, the activities must contribute directly and importantly to the accomplishment of one or more of T's exempt purposes—promotion of thrift and providing low cost credit

for its members through mutual and nonprofit operation. Section 1.513-1(d)(2) of the regulations. See also Prof'l Ins. Agents of Michigan, supra. We address each of the activities below.

Insurance

T argues that the sale of credit disability insurance is directly related to the credit union's specific exempt purposes of fostering thrift among the members (including both the extension of credit to members on reasonable terms, and encouraging savings among the members), and providing services to members on a mutual basis. T further maintains that credit insurance, which is an integral part of a member loan transaction, is a mechanism for assuring the prompt repayment of debts in situations where the financial resources of the borrower, and the borrower's family, become strained as a result of disability.

The facts do not show how sales of credit disability insurance contribute directly and importantly to accomplishing T's exempt purposes. Credit disability insurance is not required for the approval of a loan. In fact, credit disability insurance is not available to members on certain types of loans, such as mortgage and other real estate loans. The member decides whether to purchase credit disability insurance based on his or her own assessment of whether the insurance will provide a benefit to that individual member. The individual member benefits in that the member need not worry about paying a loan to T in the event of disability. While there is also a benefit to the credit union as the beneficiary, the facts do not show how the sale of credit disability insurance otherwise contributes importantly and directly to accomplishing T's exempt purposes, other than through the production of income. Availability of credit disability insurance does not encourage savings or assist T in offering low cost credit.

T does not take into consideration the need for this insurance by members. T performs no studies to determine which members may need credit disability insurance, and there is no required corresponding counseling to members who may have more need than others. Although T's staff may recommend insurance based on the level of personal and family resources, these recommendations are not mandatory in specific cases and coverage is not required in these cases.

Applying the factors of Alabama Central Credit Union, supra, T (1) earns commissions for providing credit disability insurance; (2) sells policies for the express benefit of the insured albeit with reference to a member's loan with the credit union; (3) derives some benefit from the credit disability insurance but the primary benefit is production of income, both through the commission on the sale of the insurance earned and the bonuses paid to T employees; (4) the insurance referred to has no substantial, causal relationship to T's exempt purposes; and (5) the insurance bears no relationship to T's function as a credit union.

Looking at the facts with respect to credit disability insurance, the sale of credit disability insurance is not substantially related to T's exempt purposes. The available information indicates that the sale of insurance is primarily: 1) for the purpose of generating income to T and some of its employees; and 2) for the benefit of the insured rather than for the benefit of T's membership. Based on all of the facts and circumstances, T's activities with respect to the sale of credit disability insurance do not contribute importantly to accomplishing T's exempt purposes. Therefore, the sale of credit disability insurance is not substantially related to T's exempt purposes and amounts received therefrom are subject to UBIT.

T argues that making AD&D and other types of insurance available to members is substantially related to the credit union's exempt purpose of promoting thrift by providing basic financial protection to members on a mutual basis. T also argues that these insurances facilitate prompt repayment of loans on a mutual basis by protecting the individual member's financial security.

The facts do not show how T's sales of these insurances contribute directly and importantly to T's exempt purposes. T has not demonstrated that sales of insurance encourage savings by members who purchase it. T has also not provided information showing that the sale of insurance aids a member in obtaining credit or reduces the cost of providing credit to members. The facts do not demonstrate that the sale of insurance to individual members advances T's mutual operation. Insurance provides a financial protection to an individual. The individual's purchase of insurance does not provide a benefit to the members as a whole. The legislative history of section 501(c)(14)(A) of the Code indicates that mutuality is tied to the same members being the borrowers and lenders in loan transactions rather than the general principles that T espouses. S. Rep. No. 781 (Sept. 18, 1951).

T has not stated how the sale of insurance to an individual provides a mutual benefit to T's members. The facts also do not show how sale of insurance benefits the members of the credit union as a whole. A member may purchase insurance without obtaining credit or a loan from T. If a member of T receives accidental dismemberment insurance payments, the member may use the insurance payments as he or she wishes rather than saving them or paying off an obligation to T. In the case of accidental death, the member's beneficiary may or may not be a member of T and also may use the payments as he or she desires.

In Alabama Central Credit Union, supra, the court stated in dicta several factors cited above relevant to the "substantially related" inquiry. In this case, T (1) earns commissions for servicing AD&D insurance policies; (2) sells policies for the express benefit of the insured without any reference to the member's

loans or accounts with the credit union; (3) derives no benefit from the policies other than commission on the sale of the policies earned from the insurance companies which issued the policies; (4) the sale of the insurance policies referred to has no substantial, causal relationship to T's exempt purposes; and (5) the sale of the policies bears no relationship to T's function as a credit union.

Based on all of the facts and circumstances, T's activities with respect to the sale of insurance do not contribute importantly to accomplishing T's exempt purposes. The insurance sold benefits an individual and T receives no benefit other than the production of income. Therefore, the sale of insurance is not substantially related to T's exempt purposes and amounts received therefrom are subject to unrelated business income tax (UBIT).

"Interchange income" derived in connection with T's Visa credit card program

Making interest-bearing loans to members is a traditional activity of exempt credit unions. Credit unions originally made unsecured personal loans to members. Because of changes in the financial marketplace and the expanded needs of financial institution customers, today all the types of loans made by T – including personal loans to members; first mortgage loans and second-mortgage or home equity loans, secured by residential real estate owned by the member; small business loans; auto loans, secured by the automobile owned by the member whose purchase is financed by the loan; and credit card loans – are recognized as substantially related to the exempt purposes and functions of T.

Similarly, activities attendant on these loan programs are also substantially related to T's thrift-encouragement and mutual member service purposes. Credit card loans are extended to members as a component of the overall credit card program, and ultimately the member lending program as a whole, maintained by T. Accordingly, the credit card program is substantially related to T's exempt purposes. Therefore, any net income, after deduction of related expenses, arising from the card program, specifically including but not limited to the interchange fees generated by merchant purchases, is not subject to unrelated business income tax.

Conclusions

For reasons set forth above, we conclude that the income received by a section 501(c)(14) credit union from the sale of insurance products is not substantially related to the furtherance of T's exempt purposes and therefore is subject to UBIT.

"Interchange income" derived by T in connection with its Visa credit card program is substantially related to the performance of T's exempt function and, therefore, does not constitute unrelated business income subject to the tax imposed by section 511(a) of the Code.

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

- END -