IRC 501(c)(8) Fraternal Beneficiary Societies

and

IRC 501(c)(10) Domestic Fraternal Societies

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Overview

Purpose

As of December 2002, the Service was aware of 100,800 fraternal organizations. Of those, 78,000 were recognized as exempt under IRC 501(c)(8) and 22,800 as exempt under IRC 501(c)(10). This article surveys the law, regulations, issues, and positions of the Service with respect to such organizations.

In This Article

This article contains the following topics:

IRC 501(c)(8) Fraternal Beneficiary Societies

History of Fraternal Societies

Fraternal societies have existed in the U.S. at least since the 19th century. They began providing insurance-type benefits to their members around the mid-19th century. Many State laws exempted fraternal societies from insurance regulations, creating an incentive for mutual insurance companies to masquerade as fraternal beneficiary societies. *See,* GCM 38192 (Dec. 7, 1979); National Union v. Marlow, 74 F. 775 (8th Cir. 1896); B.H. Meyer, "Fraternal Beneficiary Societies in the United States," American Journal of Sociology, Vol. 6 (March 1901): 646-651, excerpted at http://historymatters.gmu.edu/d/5048.

History of the Statute

Fraternal beneficiary societies were first exempted from federal income taxation under section 38 of the Tariff Act of August 5, 1909, 36 Stat. 113 (1909). The 1909 Act exempted "fraternal beneficiary societies, orders, or associations operating under the lodge system, and providing for the payment of life, sick, accident and other benefit to the members...." The Revenue Act of 1913, Pub. L. No. 63-6, section II(G)(a), 38 Stat. 172, extended the exemption to organizations operating "for the exclusive benefit of the members of a fraternity itself operating under the lodge system."

In its current form, IRC 501(c)(8) describes fraternal beneficiary societies, orders, or associations operating under the lodge system (or for the exclusive benefit of the members of a fraternity itself operating under the lodge system), and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association, or their dependents.

Basic Requirements Under IRC 501(c)(8)

To be described in IRC 501(c)(8), an organization must meet the following requirements:

- It must have a fraternal purpose;
- It must operate under the lodge system; and
- It must provide for the payment of life, sick, accident, or other benefits.

An exception applies to separately organized insurance branches of fraternal societies. These need not operate under the lodge system, but must provide permissible benefits exclusively to members of a lodge system.

Fraternal Purpose and Activities

"Fraternal" Means a Common Tie or Goal

Since the Code does not define a "fraternal beneficiary society," we presume that Congress used the term in the ordinary sense, and according to its legal significance, at the time the 1909 Act was passed. *See* U.S. v. Cambridge Loan and Building Co., 278 U.S. 55 (1923); Commercial Travelers' Life & Accident Ass'n v. Rodway, 235 F. 370 (N.D. Ohio 1913). The court in National Union v. Marlow, 74 F. 775, 778-79 (8th Cir. 1896) summed up the nature of a fraternal beneficiary society as follows:

> A fraternal beneficiary society … would be one whose members have adopted the same, or a very similar calling, avocation, or profession, or who are working in union to accomplish some worthy object, and who for that reason have banded themselves together as an association or society to aid and assist one another, and to promote the common cause. The term "fraternal" can properly be applied to such an association for the reason that the pursuit of a common object, calling, or profession usually has a tendency to create a brotherly feeling among those who are thus engaged. It is a well-known fact that there are at the present time many voluntary or incorporated societies which are made up exclusively of persons who are engaged in the same avocation. As a general rule, such associations have been formed for the purpose of promoting the social, moral, and intellectual welfare of the members of such associations and their families, as well as for advancing their interests in other ways and in other respects…. Many of these associations make a practice of assisting their sick and disabled members, and of extending substantial aid to the families of deceased members. Their work is at the same time of a beneficial and fraternal character because they aim to improve the condition of a class of persons who are engaged in a common pursuit, and to unite them by a stronger bond of sympathy and interest.

In one case, the court found a common tie among members of an association based on their common ethnic background. It also found that members had a common goal to improve their social, moral, and intellectual welfare. *See* Hip Sing Ass'n, Inc. v. Comm'r, T.C. Memo. 1982-203. Likewise, persons who join together to promote a common interest, such as a particular method of fortune telling, can be said to have a common tie. *See* Rev. Rul. 77-258, 1977-2 C.B. 195. However, mere recitation of common ties in the governing instrument is not enough; there must be a common tie in fact among the members.

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Fraternal Purpose and Activities, Continued

"Common Tie" Requires More Than Just Engaging in Social Activities

While social activities often play a significant role in a fraternal society, the requirement of a common "calling, avocation, or profession," or "pursuit of a common object" is not satisfied by the presence of social activities alone. The court in Polish Army Veterans Post 147 v. Comm'r, 24 T.C. 891, *rev'd on other grounds*, 236 F.2d 509 (3rd Cir. 1956) concluded that an organization had not established its exemption as a fraternal beneficiary society because members lacked a common tie:

> To qualify for the exemption an organization must be fraternal…. Here only the active members, comprising less than 10 per cent of the total membership of the Post, had a common tie. They, of course had the bond of having formerly served in the Polish Army. But approximately 90 per cent of the total membership of the Post were social members who were not ex-members of the Polish Armed Forces and who … had nothing in common with the active members or with each other. An organization cannot be classed as fraternal where the only common bond between the majority of the members is their membership in that organization.

Fraternal Activities Must Be Substantial

Even if the members of an organization enjoy a common tie or goal, the organization does not serve a fraternal purpose unless its members engage in fraternal activities. The court in Philadelphia and Reading Relief Ass'n v. Comm'r, 4 B.T.A. 713 (1926) cited "rituals, ceremonial, and regalia" as evidence of a fraternal purpose. Social activities are another common element of fraternal organizations.

A lodge's performance of civic, benevolent, or charitable functions may serve to establish a fraternal purpose in lieu of regular meetings and rituals. But an organization whose fraternal features are so insubstantial as to make it indistinguishable from an ordinary insurance company does not qualify under IRC 501(c)(8). *See* GCM 34607 (Sept. 13, 1971).

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Fraternal Purpose and Activities, Continued

Fraternal Activities and Benefits Must Be Primary

A fraternal beneficiary society that is described in IRC 501(c)(8) by virtue of engaging in fraternal activities and providing for the payment of life, sick, or accident benefits to its members may not then engage in unlimited non-fraternal activities or provide unlimited non-fraternal benefits and still maintain its exempt status. The non-fraternal activities and non-fraternal benefits of a fraternal beneficiary society will result in the organization's loss of exempt status unless the organization remains primarily engaged in fraternal activities and its benefits are primarily fraternal benefits. *See* GCM 38312 (Mar. 20, 1980); *compare* Rev. Rul. 73-165, discussed below under "Provision of Benefits." Such non-fraternal activities and benefits may be taxable as unrelated business.

Political Activity is Not Fraternal

Political activity is not considered a fraternal activity. But engaging in political activity does not, in and of itself, give rise to revocation of exemption. Therefore, a fraternal beneficiary society, so long as it is primarily engaged in fraternal activities and the provision of benefits to its members and their dependents within the meaning of IRC 501(c)(8), may engage in some political activities, including intervention in political campaigns on behalf of, or in opposition to, candidates for public office, without jeopardizing its exempt status. *See* GCM 34985 (Aug. 10, 1972). Nevertheless, the organization would be subject to tax on its political expenditures under IRC 527(f).

"Union-like" activities that relate to the members' working conditions are not fraternal activities. *See* GCM 38312.

Operating Under the Lodge System

"Lodge System" Defined

Reg. 1.501(c)(8)-1 provides that a fraternal beneficiary society is exempt from tax only if it is operated under the "lodge system" or for the exclusive benefit of the members so operating. An organization is "operating under the lodge system" if it is carrying out its activities under a form of organization that comprises local branches called lodges, chapters, and the like. The local branches must be chartered by a parent organization and largely self-governing. An exception applies to an organization that provides benefits to the members of a lodge; *see* Rev. Rul. 73-192, discussed below.

The court in Western Funeral Benefit Ass'n v. Hellmich, 2 F.2d 367 (E.D. Mo. 1924), stated that "by the 'lodge system' is generally understood as an organization which holds regular meetings at a designated place, adopts a representative form of government, and performs its work according to ritual." Thus, an organization that provides insurance to members of 80 to 100 lodges or organizations is not, for that reason, itself operated under the lodge system, though it may qualify for 501(c)(8) exemption as operated for the exclusive benefit of members of a lodge system. However, a former regulation defining a fraternal beneficiary society as having "an adopted ritual or ceremonial, holding meetings at stated intervals" is no longer in force. *See* GCM 34607.

Lodge System Requires a "Parent" and a Subordinate

The term "operating under the lodge system" implies, at a minimum, two active entities:

(1) A parent; and,

(2) A subordinate (referred to as a "lodge").

The court in Fraternal Order of Civitans of America v. Comm'r. 19 T.C. 240 (1952), held that an organization, incorporated in 1937, whose members voted in 1946 to separate the "National Lodge" from the parent lodge and elect national officers, was not "operating under the lodge system" prior to 1946 "in that the petitioner was the only organization of its kind in existence and the record does not show that there was any 'parent organization' separate from the petitioner." *See also* Rev. Rul. 55-495, 1955-2 C.B. 259, as modified by Rev. Rul. 75-199, 1975-1 C.B. 160; Rev. Rul. 63-190, 1963-2 C.B. 212.

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Operating Under the Lodge System, Continued

A Lodge Can Create Its "Parent" and Form Other Lodges

Existing autonomous organizations can choose to operate under the lodge system by banding together and creating their own parent. The court in Hip Sing Association, Inc. v. Comm'r, T.C. Memo 1982-203, stated:

> There is nothing explicit in either the statute or the . . . regulation which requires that the parent organization be created first and then for the parent to create the subordinate organizations. Logic would dictate that qualification . . . should not be affected by whether the subordinate organizations form the national or the converse . . . . When the various local associations banded together formally to create a national organization, they created their own parent in the sense that a central organization must be considered to be in a position to support and give direction to its constituents . . . . With the creation of the national or central Hip Sing entity, each of the then existing local associations, including petitioner, must be deemed to have been simultaneously "chartered by the parent they created." Certainly, they were the "charter members" of the national. We conclude, therefore, that petitioner is "operating under the lodge system."

Each lodge operating under the lodge system must be recognized as a subordinate by a parent. But that does not mean that a new lodge must be created by the parent. It is possible for existing lodges to create additional lodges. In Rev. Rul. 73-370, 1973-2 C.B. 184, an organization was formed by a lodge of a fraternal beneficiary society to carry out the activities of the society within a particular geographic area. The parent authorized the local lodges to create subordinate organizations to carry its fraternal and charitable activities into additional geographical areas. The new organization operates under a charter from the local lodge, and its members must adhere to the rules and regulations of the local lodge and the laws and edicts of the parent. The ruling holds that the new organization functions as part of the lodge system of a fraternal society and, since its net earnings are devoted exclusively to charitable and fraternal purposes and it does not provide for the payment of life, sick, accident, or other benefits to its members, it is exempt under IRC 501(c)(10).

Provision of Benefits

Benefits Are Required

To be described in IRC 501(c)(8), an organization must have an established system for the payment to its members, or their dependents, of life, sick, accident, or other benefits. Rev. Rul. 76-457, 1976-2 C.B. 155, holds that an arrangement with independent insurers whereby members, on an individual application to the insurers and not automatically by virtue of membership in the organization, may obtain insurance at reduced cost does not qualify as an established system for the payment of benefits to members. However, the organization need not itself provide for insurance benefits if a parent entity or separately organized insurance branch (discussed below) provides the benefits. A fraternal organization that does not pay benefits to members may qualify under IRC 501(c)(10).

Fraternal Activities Needn't Predominate Over Provision of Benefits

Rev. Rul. 73-165, 1973-1 C.B. 224, holds that, as between fraternal purposes and the provision of benefits, fraternal purposes need not predominate. It is sufficient if both the fraternal and benefit features are present. However, an association whose fraternal features are so insubstantial as to make it indistinguishable from an ordinary life insurance company does not qualify for exemption under IRC 501(c)(8).

In Philadelphia and Reading Relief Association, 4 B.T.A. 713 (1926), the court held that an organization of railroad company employees that made payments to members who became disabled because of accident or sickness was not entitled to exemption because it was not "fraternal":

> In dealing with cases coming under [the section of the Revenue Act concerning fraternal beneficiary societies] the character of the organization must be judged by its articles of incorporation, constitution, and by-laws, or by what other instrument it is governed…. Search the petitioner's governing regulations as we may … we are unable to discover … a single fraternalistic feature in its organization. It is entirely without social features. Its membership is made up of individuals whose vocations are as numerous and diverse as the classifications of employment of a great railway system…. There is no fraternal object which moves them to seek membership in the Association, but rather the motive is mercenary. The petitioner has neither lodges, rituals, ceremonial, or regalia; and it owes no allegiance to any other authority or jurisdiction.

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Provision of Benefits, Continued

Most Members Must Be Eligible for Benefits

An organization that provides benefits to some, but not all, of its members may qualify for exemption under IRC 501(c)(8) so long as most of the members are eligible for benefits.

For instance, Rev. Rul. 64-194, 1964-2 C.B. 149, holds that exemption under IRC 501(c)(8) is not precluded where most of the members of the organization are eligible to receive the benefits provided by the organization and the benefits are paid from a separate fund maintained solely by contributions paid by the beneficial members for that purpose. In this case, the organization has two classes of membership: beneficial and social. Beneficial membership is available only to a member who joins the organization prior to his fiftieth birthday, and entitles the member to sick, accident, and death benefits. Social membership is available to any member, but is the only class of membership available to a member who joins the organization on or after the member's fiftieth birthday. Social membership carries all club privileges, but does not confer any sick, accident, or death benefits. Substantially all of the members are beneficial members. The fund from which benefits are paid to beneficial members is contributed to solely by beneficial members and is kept separately from the general funds of the organization. The ruling finds the age restriction on beneficial membership to be a reasonable means to discourage membership by those interested more in obtaining benefits than in furthering the fraternal purposes of the organization.

On the other hand, the court in Polish Army Veterans Post 147, 24 T.C. at 896, held that "an organization does not qualify as a 'beneficiary' society where most of its members are not entitled to receive any benefits." Only ten percent of the membership were "active members" and entitled to benefits.

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Types of "Life, Sick, Accident, or Other Benefits"

Rev. Rul. 86-75, 1986-1 C.B. 245, holds that whole life insurance constitutes a "life benefit" under IRC 501(c)(8) even though the member may borrow against the cash surrender value of the contract or withdraw the cash surrender value and terminate the contract.

Is property insurance a permissible benefit under IRC 501(c)(8)? In Grange Insurance Ass'n of California v. Comm'r, 317 F.2d 222 (9th Cir. 1963), reversing 37 T.C. 582 (1961), the Ninth Circuit disagreed with the Tax Court's position that "accident insurance" refers only to bodily injury. Instead, the Ninth Circuit concluded that "'accident' benefits include payment for damage to property quite as naturally as payment for injury to the person" and, therefore, "the statutory phrase 'accident or other benefits' is sufficiently broad to include payments for injuries to property as well as to the person." In considering the purpose of the exemption, the Ninth Circuit stated, "the moving consideration was the character and purpose of the organization. Nowhere have we found any indication that Congress intended the exemption to depend upon the type of benefits paid." In GCM 35639 (Jan. 28, 1974), the Service indicated an intent not to follow Grange outside of the 9th Circuit in its holding that property insurance benefits are "accident or other benefits."

In order for a benefit to be included within the term "other benefits," it must be similar in nature to protection designed to compensate for expenses resulting from injury or loss of earning power. *See* GCM 38912. "Other benefits" include a legal defense fund for charges of misconduct arising from employment (*see* Rev. Rul. 84-48, 1984-1 C.B. 133), an orphanage for surviving children of deceased members (*see* Rev. Rul. 84-49, 1984-1 C.B. 134), and annuities (*see* GCM 39575 (Nov. 18, 1986)).

The phrase "life, sick, accident or other benefits" also appears in IRC 501(c)(9) to describe permissible benefits provided by voluntary employees' beneficiary associations. In GCM 35639, the Service decided that IRC 501(c)(8) interpretations of the phrase "life, sick, accident, or other benefits" need not be construed consistently with IRC 501(c)(9) interpretations. Not only did the earliest predecessor of IRC 501(c)(8) antedate the enactment of the predecessor of IRC 501(c)(9) by some 19 years, the history and development of the organizations covered by the respective sections is sufficiently different to justify different interpretations, particularly of the scope of the phrase "other benefits" under the two sections. *See also* GCM 39212 (April 13, 1984).

Separately Organized Insurance Branches Not Operating Under the Lodge System

Must Be Operated Exclusively for the Benefit of a Fraternal Society

In addition to organizations operating under the lodge system (i.e., parents and their subordinate lodges), the Code provides exemption under IRC 501(c)(8) for entities that "operate … for the exclusive benefit of members of a fraternity itself operating under the lodge system." Such organizations are understood to be separately organized insurance branches of fraternal societies.

The separately organized insurance branch need not benefit all the members of a lodge system. For instance, it may serve the members of a single lodge. Rev. Rul. 73-192, 1973-1 C.B. 225, concerns an organization composed of members of a lodge operating under the lodge system. The organization's sole purpose is to provide for the payment of life, sick, and accident benefits exclusively for members of the lodge. Thus, even though the organization itself does not operate under the lodge system, it operates exclusively for the benefit of the members of a fraternal beneficiary society itself operating under the lodge system, and it provides life, sick, and accident benefits to the members of that society. Accordingly, the ruling holds that the organization is exempt under IRC 501(c)(8).

May Not Serve Non-Fraternal Organizations

In Western Funeral Benefit Ass'n, 2 F.2d 367, 370, the Plaintiff argued that it was carrying on its activities for the exclusive benefit of the members of many fraternities operating under the lodge system. However, the court found that Plaintiff accepted business from organizations "without any particular inquiry into the nature of the organizations or the manner in which they carried out their business." The court held that the plaintiff was not operating for the exclusive benefit of the members of a fraternity itself operating under the lodge system:

> It is contended that the policy holders of plaintiff, who are not members of duly constituted lodges, are so insignificant that that fact ought not to affect the situation in view of the general nature of plaintiff's business. This probably is true, but the plaintiff is claiming an exemption from taxation and in doing so asserts that it comes within the exemption clause of a certain statute. It does not seem to be asking too much of it that it fairly, if not strictly, bring itself within the terms of the statute.

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Separately Organized Insurance Branches Not Operating Under the Lodge System, Continued

"Primary Activities" Test Inapplicable

The requirement that separately-organized insurance branches operate exclusively for the benefit of members of a fraternity operating under the lodge system may be regarded as an exception to the "primary activities" test set forth in GCM 38312. Such insurance branches should not even be authorized to provide benefits to persons that are not members of a fraternity operating under the lodge system.
See GCM 35639.

Participation in Reinsurance Pool Not Prohibited

Rev. Rul. 78-87, 1978-1 C.B. 160, holds that an organization does not endanger its exempt status under IRC 501(c)(8) by participating in a state-sponsored reinsurance pool. Where the organization participates in the best interests of its members, any benefit to the other participating insurers is incidental, and the organization does not fail to operate for the "exclusive benefit" of the members.

IRC 501(c)(10) Domestic Fraternal Societies

History of the Statute

Section 501(c)(10) was added to the Internal Revenue Code by the Tax Reform Act of 1969, Pub. L. No. 91-172, section 121(b)(5)(A) (1969), 83 Stat. 487, 541. Prior to that, there was no exemption provided for fraternal societies operating under the lodge system that did not, in addition to their fraternal activities, also provide for the payment of life sick, and accident benefits to their members.

The Senate Committee on Finance explained the purpose of IRC 501(c)(10) as follows:

> [A] new category of exemption for fraternal beneficiary associations is set forth which applies to fraternal organizations operating under the lodge system where the fraternal activities are exclusively religious, charitable, or educational in nature and no insurance is provided for the members. The committee believes that it is appropriate to provide a separate exempt category for those fraternal beneficiary associations (such as the Masons) which do not provide insurance for their members. This more properly describes the different types of fraternal associations. S. Rep. No. 552, 91st Cong., 1st Sess. 72 (1969).

Basic Requirements Under IRC 501(c)(10)

In its current form, IRC 501(c)(10) describes domestic fraternal societies, orders, or associations that:

- Operate under the lodge system,
- Devote their net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes, and
- Do not provide for the payment of life, sick, accident, or other benefits.

IRC 501(c)(10) In Comparison With 501(c)(8) and (c)(7)

Similarities: 501(c)(10) and 501(c)(8)

Like the organizations described in IRC 501(c)(8), organizations described in IRC 501(c)(10) are fraternal societies, orders, or associations operating under the lodge system. The terms "fraternal" and "operating under the lodge system" mean the same under IRC 501(c)(10) as under IRC 501(c)(8).

Differences: 501(c)(10) vs. 501(c)(8)

Unlike organizations exempt under IRC 501(c)(8), organizations exempt under IRC 501(c)(10) are not "beneficiary" societies; that is, they may not provide for the payment of life, sick, accident, or other benefits to their members.

Because IRC 501(c)(10) organizations are prohibited from providing insurance benefits to their members, it stands to reason that there is no counterpart under IRC 501(c)(10) for the separately-organized insurance branches found under IRC 501(c)(8). Therefore, any organization purporting to operate for the exclusive benefit of the members of a 501(c)(10) organization, but that does not itself conduct fraternal activities or operate under the lodge system, would not qualify under IRC 501(c)(10). *See* Rev. Rul. 81-117, 1981-1 C.B. 346.

There are two additional requirements under IRC 501(c)(10) not found under IRC 501(c)(8):

- First, a 501(c)(10) organization must be "domestic"; that is, it must be organized in the United States. *See* IRC 7701(a)(4).
- Second, the net earnings of a 501(c)(10) organization must be devoted exclusively to fraternal purposes or to purposes that would be considered exempt purposes under IRC 501(c)(3).

IRC 501(c)(10) In Comparison With 501(c)(8) and (c)(7),
Continued

501(c)(10) vs. 501(c)(7)

IRC 501(c)(7) describes clubs organized for pleasure, recreation, and other nonprofitable purposes. Such "social clubs" offer activities that are often similar to the social activities conducted by fraternal beneficiary organizations. Social clubs are distinguishable from IRC 501(c)(10) organizations, however, in that they are generally not operated under the lodge system. Reg. 1.501(c)(10)-1 specifically excludes social clubs described in IRC 501(c)(7) from exemption under IRC 501(c)(10).

Exemption under IRC 501(c)(10) is considered more desirable than exemption under IRC 501(c)(7). For one thing, a 501(c)(10) organization is not subject to the IRC 501(c)(7) percentage limitations on non-member and investment income. For another, a 501(c)(10) organization is not subject to IRC 512(a)(3) which expounds special rules on unrelated business taxable income for IRC 501(c)(7) organizations.

College Fraternities

Although college fraternities are often operated under a lodge system, they are specifically excluded by Reg. 1.501(c)(10)-1 from qualifying under IRC 501(c)(10). In Zeta Beta Tau Fraternity v. Comm'r, 87 T.C. 421 (1986), an IRC 501(c)(7) local chapter of a national fraternity sought exemption from tax on its investment income by changing its classification to a fraternal society under IRC 501(c)(10). The court held that the possibility of using tax-free investment income for recreational purposes would violate Congressional intention in framing IRC 501(c)(10) and that the regulation is a reasonable interpretation of the statute. *See also* GCM 37179 (June 24, 1977); GCM 39378 (June 26, 1985).

Unrelated Business Taxable Income and Social Activities

Social and Recreational Activities: Member Participation

Organizations described in IRC 501(c)(8) and IRC 501(c)(10) are subject to tax on their unrelated business taxable income (UBTI) under IRC 511. Fraternal organizations have traditionally engaged in social and recreational activities to complement their purely fraternal activities.

The operation of a bar, restaurant, or general meeting hall is an accepted social and recreational activity in which fraternal organizations may engage. In addition, gambling, to the extent that fraternal members participate, is considered recreational in nature and a suitable activity of fraternal organizations.

Rev. Rul. 69-68, 1969-1 C.B. 153, holds that gambling (even if illegal) is a proper activity for social clubs exempt under IRC 501(c)(7) because it supplies pleasure and recreation to members and guests, even if it has an additional purpose of raising money.

Sale of Alcoholic Beverages

The sale of alcoholic beverages to members for consumption on the premises is considered to be related to the purposes of a fraternal organization. On the other hand, the sale of alcoholic beverages to members for consumption off the premises should be considered unrelated trade or business. *See* TAM 8641001 (June 5, 1986).

Use of Facilities by Non-Members

When a fraternal organization allows or solicits non-members to make use of its social and recreational facilities, there is the potential for the fraternal organization to exceed the bounds of its exemption.

This is especially the case where the activity is of a continuous or recurring nature, such as the operation of a bar and restaurant. If the bar or restaurant is opened to the public, and, over time, is generally known to be available to the public, it risks becoming a regular commercial business.

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Participation of Non-Members: E.g., in Gambling Activities

A fraternal organization may provide social and recreational activities to its members. Guests of members may also participate in the organization's activities or make use of its facilities so long as the guest is being entertained by the member. However, a non-member is not being "entertained" merely because he or she accompanies a member.

When non-member "guests" spend their own funds to participate in gambling activities operated by fraternal organizations, they are not being entertained by the member. If a non-member incurs a charge to participate in a social or recreational event or to make use of a social or recreational facility, the non-member is considered to be entertained by a member only if the member pays the charge.

Thus, when a guest gambles with his own money, the fraternal organization is providing recreational activities directly to a non-member rather than as a service to members. When a fraternal organization provides recreational activities, such as gambling, to non-members directly, those activities do not have a substantial causal relationship to the organization's exempt purpose of providing social and recreational activities to the member. As a result, the activity may be considered unrelated trade or business. *See, e.g.*, Waco Lodge No. 166, Benevolent & Protective Order of Elks v. Comm'r, T.C. Memo. 1981-546.

Further, under certain circumstances, gambling activity may essentially be a predominantly public activity and only incidentally a member activity, such as when 80 percent of the receipts of gambling come from non-members who are not even participating as guests of members but simply as members of the public. In that case, the entire activity, including participation by members, would be considered unrelated trade or business because the gambling is not being conducted primarily as a recreation for members.
See GCM 39061 (Nov. 21, 1983).

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Unrelated Business Taxable Income and Social Activities,
Continued

Hall Rental Income

Fraternal organizations commonly raise funds through hall rental and catering. The rental of the hall itself, while an unrelated trade or business if regularly carried on, may meet the exception to unrelated business taxable income (UBTI) for rents from real property under IRC 512(b)(3). *See* Rev. Rul. 69-178, 1969-1 C.B. 158. However, payments for the use of rooms or other space are not rents where services are also rendered to the occupant, if the services are primarily for the occupant's convenience and are not usually rendered in connection with the rental of rooms for occupancy only. *See* Reg. 1.512(b)-1(c)(5); Rev. Rul. 69-69, 1969-1 C.B. 159.

Catering Is Unrelated Business

Catering is a service primarily for the occupant's convenience and not usually rendered in connection with the rental of rooms for occupancy only. However, the catering may be analyzed separately from the rental of space if there is a separate charge paid in accordance with a separate agreement between the parties. Income from catering incidental to the hall rental would be taxable as unrelated trade or business income if volunteer labor is not employed in the provision of services and the catering is regularly carried on. *See* TAM 9605001 (Oct. 9, 1995).

Deductibility of Contributions

Contributions For Charitable Purposes Are Deductible

IRC 170(c)(4) provides that, in the case of a contribution or gift by any individual, the term "charitable contribution" includes a contribution or gift to or for the use of a domestic fraternal society, order, or association, operating under the lodge system, but only if such contribution or gift is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Contributions for fraternal or social purposes are not deductible.

Procedural Issues

General Issues

Because both IRC 501(c)(8) and IRC 501(c)(10) organizations operate under the lodge system, they display certain characteristics that are not commonly found in other types of exempt organizations.

The relationship of the parent to its subordinate lodges is responsible for many of the distinctive characteristics, and also raises issues in the following areas:

- Applications for recognition of exemption;
- Group exemptions; and,
- Group returns.

Recognition of Exemption—No Deadline for Application

Organizations that claim exemption under IRC 501(c) are subject to the general requirement to file a Form 1024 application in order to establish their exemption. Reg. 1.501(a)-1(a)(2) and (3).

There is no deadline imposed by the Code for a fraternal beneficiary society or a domestic fraternal society to apply for recognition of exemption under IRC 501(c)(8) or IRC 501(c)(10), as there is for organizations seeking recognition under IRC 501(c)(3) (*see* IRC 508(a)), IRC 501(c)(9), (17), or (20). *See* IRC 505(c).

An organization claiming exempt status, but not yet recognized as exempt, must file Form 990 if it believes itself exempt. *See* Reg. 1.6033-2(c).

Sometimes the Service is not aware of an organization until it files a Form 990 information return. A return filed by an organization that has not previously applied for exemption on Form 1024 is processed at the Service Center and placed in EO/BMF Status 36 (non 501(c)(3), (9) or (17) filers – no official exemption).

Group Exemptions

While an individual lodge may file an application for recognition of exemption on its own behalf, it is common for the fraternal parent organization to apply for a group exemption covering its subordinate lodges.

For exemption purposes, a subordinate lodge does not have to be exempt under the same Code section as its parent, although it usually is. For example, an organization that is exempt under IRC 501(c)(8) because it provides life, sick, or accident benefits to its members may be the "parent" of a lodge that does not provide such benefits and is, therefore, exempt under IRC 501(c)(10). Similarly, an organization exempt under IRC 501(c)(10) may be the parent of an IRC 501(c)(8) lodge. In either case, the parent must recognize the lodge as its subordinate.

Rev. Proc. 80-27, 1980-1 C.B. 677, section 4.023, requires that the lodges covered under a group exemption letter all be exempt under the same paragraph of IRC 501(c), though not necessarily the paragraph under which the parent is exempt. Thus, for example, a parent could obtain a group exemption for its subordinate lodges that are described in IRC 501(c)(8). If one or a few of the lodges under such parent are described in IRC 501(c)(10) instead, those lodges could either apply for their own individual exemption or the parent could obtain a separate group exemption for the 501(c)(10) lodges.

Change to Another Code Section May Be Appropriate

An organization that is recognized as exempt as an organization described in IRC 501(c)(8), but that is found to no longer provide life, sick, accident, or other benefits, should be considered for reclassification under IRC 501(c)(10) so long as it is operating under the lodge system and otherwise meets the requirements of IRC 501(c)(10).

If the organization were part of a group ruling of 501(c)(8) lodges, upon reclassification to IRC 501(c)(10), it would no longer be covered under such group ruling, and, if it wanted to receive a determination letter, would have to apply for its own exemption or be made part of a group exemption of 501(c)(10) lodges.

Similarly, an organization that is recognized as exempt under IRC 501(c)(10), but that is found to be providing life, sick, accident, or other benefits, should be considered for reclassification under IRC 501(c)(8), again assuming that it is operating under the lodge system.

If an organization does not meet the requirements for exemption under IRC 501(c)(8) or 501(c)(10) because, for instance, it is no longer operated under the lodge system, consideration should be given to reclassifying such organization under IRC 501(c)(4) or IRC 501(c)(7).

If an organization is no longer described in any subsection of IRC 501(c), revocation of the organization's exempt status is appropriate. Revocation procedures are found in IRM 4.75.16 and IRM 4.75.20.

Procedural Issues, Continued

Insurance Premiums as Gross Receipts

Generally, exempt organizations are required to file annual information returns (Form 990) if their annual gross receipts are normally more than $25,000.

In determining whether its gross receipts reach the $25,000 threshold, a lodge may disregard insurance premiums received from members in certain instances. Rev. Rul. 73-364, 1973-2 C.B. 393, holds that the insurance premiums are not gross receipts where the parent organization operates the insurance program and issues policies to the individual members, and the local lodge merely collects the premiums and forwards the premiums to the parent, without asserting any right to use them or otherwise deriving benefit from their collection.

Group Returns

A lodge that is part of a group exemption may satisfy its annual reporting requirement by being included in a group return filed by its parent. The lodge must provide its parent with the information required on a Form 990. The parent may file an annual group return on behalf of all or some of its subordinate lodges covered by a group exemption letter. *See* Reg. 1.6033-2(d).

If the information provided by the lodge to its parent for inclusion in a group return is found to be sufficiently incomplete or inaccurate that the Agent would not consider the filing requirement to have been met for the subordinate, the Agent has the option of securing a delinquent Form 990 from the lodge and imposing inaccurate return penalties under IRC 6652; however, the parent may have "reasonable cause" for the inaccurate return. The Agent has several other possible courses of action.

Group Returns (continued)

If the Agent questions whether the lodge will file complete and accurate information in the future, the Agent can recommend the lodge for future audit. If the Agent finds that the parent has experienced repeated problems getting complete and accurate return information from a lodge, the Agent should follow IRM 4.75.24.4(3) and counsel the parent that only cooperating lodges can be included in their group exemption roster.

The Service also has the right to revoke the lodge from the group exemption under Rev. Proc. 80-27, section 7.033; the Agent may want to recommend this course of action for a non-compliant lodge. *See also* Rev. Rul. 59-95, 1959-1 C.B. 627.

Locating the Organization

Many lodges are small organizations run by volunteer officers. If the Agent has difficulty locating the organization after considering the actions listed in IRM section 4.75.22.13.1 (Locating the Organization), the agent should attempt to obtain contact information through the lodge's parent.

Contacting a lodge's parent should not be considered a third party contact. Since many small lodges are covered under a group exemption, the parent is required by Rev. Proc. 80-27 to provide the Service certain information on an annual basis in order to maintain a group exemption letter.

In order for a parent to establish a group exemption, the parent is required under section 5.032 of Rev. Proc. 80-27 to provide the Service with a list of the names, mailing addresses, street addresses if different, and employer identification numbers of subordinates included in the group exemption letter. In addition, section 6.012 requires the parent to submit annually the following lists:

- Subordinates that have changed names or addresses during the year;
- Subordinates no longer to be included in the group exemption because they have ceased to exist, disaffiliated, or withdrawn their authorization to the central organization; and
- Subordinates to be added to the group exemption because they are newly organized or affiliated or they have newly authorized the central organization to include them.

Each list must show the names, mailing addresses, street addresses if different, and EINs of the affected subordinates.

Procedural Issues, Continued

Termination

If the Agent finds that an organization has gone out of business, termination is appropriate. *See* IRM 4.75.16.

Termination is an administrative act that creates a rebuttable presumption that the organization is no longer in business. It should be used only when the Service believes that the organization is no longer in existence.

Even though the Service may publicly treat the organization as nonexistent, its exempt status is not affected by the act of termination. Termination is not the same as revocation. The organization may rebut the presumption by showing that it is operational. Since termination is not a determination on the merits, the rebuttal would not require the new organization to file a new application to re-establish exemption.

Statute of Limitations on UBTI

What triggers the beginning of the Statute of Limitations period on UBTI? Rev. Rul. 69-247, 1969-1 C.B. 303, holds that the Service will follow a 1966 decision of the Tax Court that the filing of a Form 990 begins the Statute if the following three requirements are all met:

1. The Taxpayer has disclosed sufficient facts on the Form 990 to apprise the Service of the potential existence of UBTI.

2. The return states the nature of the income-producing activity with sufficient specificity to enable the Commissioner to determine whether the income is from an activity related to the organization's exempt purpose.

3. The return discloses the gross receipts from this activity.

Group Return and Statute for UBTI

A subordinate lodge is required to file an individual Form 990-T return if it is liable for tax on UBTI. This is the case even if a subordinate satisfied its Form 990 filing requirement through inclusion in a group return. The group return would start the statute period for the subordinate's unfiled Form 990-T if the group return disclosed sufficient facts concerning the subordinate's UBTI as indicated in Rev. Rul. 69-247.

Procedural Issues, Continued

Form 990 and UBTI	In 1979, the Service added questions to Form 990 asking whether the organization has unrelated business income in the gross amount of at least $1,000 and if so, whether it filed a Form 990-T. A negative answer to the first question could suspend the running of the Statute of Limitations on the theory that the Taxpayer has not disclosed sufficient facts to apprise the Service of the potential existence of UBTI.
References	IRM 4.76.17 EO Examinations Guidelines: Fraternal Beneficiary Societies Exempt Under Sections IRC 501(c)(8) and IRC 501(c)(10) IRM 7.25.8 Fraternal Beneficiary Societies “Fraternal Beneficiary Societies and Fraternal Societies,” 1980 CPE 92