

[Exemptions]

[Federal income tax exempt status issued by IRS &/or as declared by Taxpayers]

26 U.S. Code § 501 (c)(8)



501(c)(8) — Fraternal Beneficiary Societies and Associations



Part 7. Rulings and Agreements

Chapter 25. Exempt Organizations Determinations Manual

Section 8. Fraternal Beneficiary Societies

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7.25.8.1 (09-24-1997)

Statutory Provisions

1. IRC 501(c)(8) exempts fraternal beneficiary societies:

- A. Operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and
 - B. Providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.
2. IRC 501(10) was added to the Code because some fraternal did not have an insurance feature. A fraternal society exempt under IRC 501(c)(10) is one that is described in IRC 501(c)(8) except that it does not provide benefits to members. Its earnings are devoted to religious, charitable, scientific, literary, educational, and fraternal purposes.

Note:

Any organization described in IRC 501(c)(7), e.g., a national college fraternity, is not described in IRC 501(c)(10). See reg. 1.501(c)(10)-1. Validity of regulations upheld in *Zeta Beta Tau Fraternity, Inc. v. Commissioner*, 87 T.C. 421 (1986).

7.25.8.2 (09-24-1997)

Fraternal Beneficiary Society Defined

1. Perhaps the leading judicial pronouncement of what constitutes a "fraternal beneficiary society" is in this extract from *National Union v. Marlow* 374 F. 775, 778 (1896):

a fraternal-beneficial 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. *** 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.***

7.25.8.2.1 (09-24-1997)

"Fraternal" Examples

1. An organization composed of employees of a railroad company, organized to administer a relief fund for the payment of benefits to its members in case of sickness, accident, or death, fell short of the above definition and was denied exemption. See *Philadelphia & Reading Relief Association*, 4 B.T.A. 713, at 725 (1926).
- A. One reason it failed to qualify was lack of the necessary fraternalistic element. The court noted the association's membership consisted of individuals whose vocations were as numerous and diverse as the classifications of jobs of a railroad company; membership was open to all employees of the company; the only motive for the association's existence was a mercenary one (to provide insurance benefits); and the organization had neither lodges, rituals, ceremonials, nor regalia commonly associated with fraternal associations.
2. Where the only common bond between the majority of its members was their membership in that organization, the Tax Court held that an organization cannot be classed as fraternal. See *Polish Army Veterans Post 147 v. Commissioner*, 24 T.C. 891 (1955), affirmed as to nonexempt status, 236 F.2d 509 (1956). Only 10 percent of the members had common ties as Polish war veterans, or children of such veterans, who had served in the armed forces of the Western Allies. All other dues-paying members were

admitted indiscriminately as long as they were elected to membership by a majority vote of members present at any meeting.

3. The requirement of common ties and objectives is not satisfied merely by a recitation of such purposes in the association's constitution or bylaws. It is necessary that the stated purposes be implemented or accomplished by specific acts. The Tax Court denied exemption to an organization whose constitution called for, among other things, the promotion of civic enterprises in the community. It engaged in no civic or charitable activities during the period under review. See *Fraternal Order of Civitans v. Commissioner*, 19 T.C. 240 (1952).

7.25.8.3 (09-24-1997)

Operating Under the Lodge System

1. A fraternal beneficiary society is exempt from tax only if it operates under the lodge system or for the exclusive benefit of members so operating. The Regulations under IRC 501(c)(8) states, in part, that "operating under the lodge system" means carrying on its activities under a form of organization that comprises local branches that are chartered by a parent organization and and that are largely self-governing, called lodges, chapters, or the like.
 - Existing local associations can band together formally to create a national (parent) organization. Each existing local is a charter member "deemed to have been simultaneously chartered by the parent they created." *Hip Sing Association, Inc. v. Commissioner*, T.C. Memo 1982-203.
2. Rev. Rul. 55-495, 1955-2 C.B. 259, holds that an organization which does not have a parent organization or subordinate branches does not qualify under IRC 501(c)(8) because it does not operate under the lodge system. The organization was a local association of members of the same religious faith, created to assist its members in the case of sickness and other disaster. Rev. Rul. 75-199, 1975-1 C.B. 160, modifies Rev. Rul. 55-495 to remove the conclusion that the organization qualifies under IRC 501(c)(4).
 - Organizations are considered to operate under the lodge system only when they have a parent and local organizations which are active. Mere provision in the constitution and bylaws for such bodies is not enough.
3. An organization whose sole purpose and activity is to provide life, sick, and accident benefits for its members may qualify for exemption under IRC 501(c)(8) even though it does not operate under the lodge system. It must be composed exclusively of members of a lodge of a fraternal beneficiary society operating under the lodge system. Rev. Rul. 73-192, 1973-1 C.B. 224.
4. A subordinate organization, formed and chartered by a local lodge exempt under IRC 501(c)(10), to carry on fraternal and charitable activities in a particular geographical area, may qualify for exemption under IRC 501(c)(10).
 - A. Rev. Rul. 73-370, 1973-2 C.B. 184, held such an organization functions as part of the lodge system of the fraternal society as it was formed and chartered by a local lodge, operates under the general control and supervision of that lodge, and is subject to the laws and edicts of the parent society.

7.25.8.3.1 (09-24-1997)

Benefit Requirements for Members or Dependents

1. An entity seeking exemption under IRC 501(c)(8) must have an established system for the payment of life, sick, accident, or other benefits to its members or their dependents.
2. It is not essential that every member of a fraternal beneficiary society be covered by its program of benefits for the organization to qualify as exempt under IRC 501(c)(8).

- A. Rev. Rul. 64-194, 1964-2 C.B. 149, provides that a fraternal association having two classes of members (beneficial and social) qualifies for exemption under IRC 501(c)(8) even though its social members are not covered by its benefit program. Beneficial membership is available only to a member who joins prior to his/her 50th birthday, but social membership is available to older persons.
3. Rev. Rul. 64-194 is distinguishable from *Polish Army Veterans Post 147 v. Commissioner*, 24 T.C. 891 (1955). In that case, approximately 90 percent of the members were not entitled to benefits. The court held that the organization was not exempt under section 101(3) of the 1939 Code (corresponding to section 501(c)(8) of the 1954 and 1986 Codes) and explained that the organization could not be considered a "beneficiary" society where most of its members were not entitled to benefits.
 - A. In *Polish Army Veterans Post 147*, the organization was unable to establish a reason germane to its exempt purpose in creating a nonbeneficial class of membership.
 - B. But in Rev. Rul. 64-194, the purpose of the restriction on beneficial membership was to discourage membership of persons principally interested in obtaining benefits rather than furthering the fraternal purposes of the organization. Thus, in the latter situation, the organization has utilized a nonbeneficial classification of membership to advance the fraternal aspects of the organization.
4. The Tax Court, 37 T.C. 582, at 585 (1961), held that permissible benefits included only those insuring members against mishaps to the person. In the context of IRC 501(c)(8)(B), the Tax Court interpreted "accident" as referring to a kind of insurance. In insurance parlance, accident insurance generally means indemnification against personal injury resulting from accident. The court thus reasoned that because the terms, "life," "sick," and "accident" related to injuries to the person, "other benefits" as used in IRC 501(c)(8)(B) could include personal mishaps but not payments for loss or damage to a member's property.
5. The Ninth Circuit has held, in *The Grange Insurance Association of California v. Commissioner*, 317 F.2d 222 (1963) reversing 37 T.C. 582 (1961), that the "benefits" referred to in the statute are not limited to insuring members against personal risks (such as disability or death) but may also extend to insuring them against property loss. The appellate court held the organization, which provided fire insurance protection for the property of its member-policyholders, exempt as a fraternal beneficiary society under IRC 501(c)(8). The court pointed out that "other benefits," as used in the statute, is characterized by the terms, "life," "sick," and "accident." It reasoned that "accident" relates to the circumstances of a loss and not to the nature of the object of a loss.

Note:

As of the date of publication, the Service had not yet determined the position it will take if that issue should arise in another circuit.

7.25.8.3.2 (09-24-1997)

Relative Importance of "Lodge System" and "Benefits"

1. An exempt fraternal organization must operate under the lodge system *and* provide for an established system of benefit payments to its members and their dependents. It is not necessary that either of these features predominate. (I.T. 1516 1-2 C.B. 180 (1922).) However, both features must be substantially present; neither may be a sham.

7.25.8.3.3 (09-24-1997)

Effect of Business Activity

1. For taxable years beginning after December 31, 1969, IRC 501(c)(8) and IRC 501(c)(10) organizations are subject to the tax on unrelated business income. See IRM 7.27.4, on Unrelated Business Income.

7.25.8.3.4 (09-24-1997)

Contributions

1. IRC 170(c)(4) permits an individual to deduct a contribution or gift to a domestic fraternal society, order, or association, operating under the lodge system, 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.

7.25.8.3.5 (09-24-1997)

Change in Status

1. Where an organization loses its exemption as a fraternal society, order, or association because of a change in its form of organization or method of operation, it must file tax returns and compute its tax liability in the same manner as other taxpayers.
2. In *The Royal Highlanders v. Commissioner*, I.T.C. 184 at 186 (1942), an organization lost its exemption as a fraternal beneficiary society when it changed its form of organization and became a mutual legal reserve life insurance company. The question arose whether that portion of its earnings which was attributable to the contracts and other assets acquired prior to the change in status should continue to be exempt from income tax. To the taxpayer's theory that this income should continue to be exempt because, regardless of mutualization, all contracts written while a fraternal society continued to be strictly fraternal contracts, the court responded:

The fact that the fraternal policies issued by petitioner prior to May 4, 1937, still remained fraternal policies after it became a mutual legal reserve life insurance company, does not justify the claimed exemption. Section 101 [of the Revenue Acts of 1936 and 1938, predecessor to section 501 of the 1954 and 1986 Codes], *supra*, grants exemption from taxation to certain 'organization.' Prior to May 4, 1937, petitioner was an exempt organization inasmuch as it was a fraternal beneficiary society operating under the lodge system, and issuing policies providing for the payment of life, sick, accident, or other benefits to its members or their dependents. When on May 4, 1937, it changed its form of organization and ceased to operate under the lodge system, it no longer met the requirements of the statute.

There is no provision in section 101, *supra*, granting a partial exemption from tax and we are not at liberty to read any such provision into it.

3. In some circumstances an organization losing exemption under IRC 501(c)(8) may qualify under IRC 501(c)(10).

7.25.8.4 (09-24-1997)

Applications for Recognition of Exemption

1. Generally, both parent and subordinates which seek exemption from federal income tax under IRC 501(c)(8) or IRC 501(c)(10) must file applications for recognition of exempt status on Form 1024.
2. A parent seeking a group exemption ruling under IRC 501(c)(8) or IRC 501(c)(10) for itself and its subordinates must submit the information required by Rev. Proc. 80-27, 1980-1 C.B. 677.
3. A subordinate covered by a group exemption letter need not separately apply for recognition of exemption.

7.25.8.5 (09-24-1997)

Digests of 501(c)(8) Published Rulings

1. Operating Under the Lodge System—The M association which provides for the payment of life, sick, accident or other benefits to members or their dependents, but does not operate under the lodge system, or

for the exclusive benefit of the members of an organization so operating, is not entitled to exemption from federal income tax as an organization described in IRC 501(c)(8). The M association falls within a class ordinarily associated with organizations not organized for profit, but operated exclusively for the promotion of social welfare, and is exempt from federal income tax as an organization described in IRC 501(c)(4). Rev. Rul. 55-495, 1955-2 C.B. 259. Modified by Rev. Rul. 75-199, 1975-1 C.B. 160, to remove the IRC 501(c)(4) qualification for years beginning after June 2, 1975.

2. Club for members; sick and death benefits—A nonprofit organization (not operated under the lodge system) which maintains a social club for members and also provides sick and death benefits for members and their beneficiaries, does not qualify for exemption from federal income tax either as a social club under IRC 501(c)(7), a civic league under IRC 501(c)(4), or fraternal beneficiary society under IRC 501(c)(8). Rev. Rul. 63-190, 1963-2 C.B. 212.
3. Beneficial and social members—An organization operating as a fraternal beneficiary society under the "lodge system" which has two classes of members, but only one is eligible to receive benefits, is exempt from federal income tax under IRC 501(c)(8) provided that there is a legitimate reason for restricting benefit payments to a certain membership class and the benefit fund from which payments are made is segregated from the organization's general fund so that there is no inurement of income from non-beneficial members to pay benefits to beneficial members. Rev. Rul. 64-194, 1964-2 C.B. 149.
4. Fraternal and insurance features—A fraternal beneficiary society operating under the lodge system and providing member benefit payments may qualify for exemption regardless of whether fraternal or insurance features predominate, as long as both features are present; I.T. 1516 superseded. Rev. Rul. 73-165, 1973-1 C.B. 224.
5. Supreme support organization—An organization not operating under the lodge system, whose sole activity is to provide life, sick, and accident benefits exclusively for members of a fraternal beneficiary society operating under the lodge system, may qualify for exemption. Rev. Rul. 73-192, 1973-1 C.B. 224.
6. Information returns; insurance premiums as gross receipts—In determining whether the gross receipts of a local lodge of a tax-exempt fraternal beneficiary society are not more than \$5,000 and whether it is excepted, as provided in IRC 6033(a)(2)(A)(ii), from the requirements for filing information returns, insurance premiums collected from its members, maintained separately without use or benefit, and remitted to its parent organization which issued the insurance contracts are not gross receipts of the local lodge. Rev. Rul. 73-364, 1973-2 C.B. 393.
7. Mutual sick and death benefits—A nonprofit organization that restricts its membership to individuals of good moral character and health belonging to a particular ethnic group residing in a stated geographical area and provides sick benefits to members and death benefits to their beneficiaries is not exempt under IRC 501(c)(4) for tax years beginning after June 2, 1975; Rev. Rul. 55-495 modified. Rev. Rul. 75-199, 1975-1 C.B. 160.
8. Optional insurance—A domestic fraternal beneficiary society of farmers operated under the lodge system that does not itself provide for the payment of life, sick, accident, or other benefits to its members, but arranges with insurance companies to provide optional insurance to its members and devotes its net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes does not qualify for exemption under IRC 501(c)(8) but does qualify under IRC 501(c)(10). Rev. Rul. 76-457, 1976-2 C.B. 155.
9. State-sponsored reinsurance pool—A fraternal beneficiary society that conducts an insurance operation for its members in all 50 states does not lose its exempt status under IRC 501(c)(8) by participating in a state-sponsored reinsurance pool that protects participating insurers from excessive losses on major medical health and accident insurance. Rev. Rul. 78-87, 1978-1 C.B. 160.

10. Legal defense fund for law enforcement officers—A fraternal beneficiary society, composed of law enforcement officers and operating under the lodge system, that provides legal expenses to defend members accused of criminal, civil, or administrative misconduct arising in the course of their employment, provides "other benefits" within the meaning of IRC 501(c)(8). Rev. Rul. 84-48, 1984-1 C.B. 133.
 11. Orphanage for deceased members' dependent children—A fraternal beneficiary society that operates an orphanage for surviving children of deceased members provides "other benefits" within the meaning of IRC 501(c)(8). Rev. Rul. 84-49, 1984-1 C.B. 139.
 12. Whole life insurance with investment features—Whole life insurance constitutes a life benefit under IRC 501(c)(8) even though the policies contain investment features such as cash surrender value and policy loan. Rev. Rul. 86-75, 1986-1 C.B. 245.
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7.25.8.6 (09-24-1997)

Digests of 501(c)(10) Published Rulings

1. Subordinate organization formed by local lodge—A nonprofit, subordinate organization, formed and chartered by a local lodge of a fraternal beneficiary society exempt from tax under IRC 501(c)(10) to carry on the fraternal and charitable activities of the society in a particular geographical area, is also exempt. Rev. Rul. 73-370, 1973-2 C.B. 184.
2. Promotion of fortune telling method—A domestic fraternal society operating under the lodge system, which does not provide life, sick, accident, or other benefits, whose members are interested in the use of and philosophy behind a method of attempting to divine the future, and whose net income is used to provide instruction on the use of the method, maintain a reference library, and supply information on the method to the public, qualifies for exemption under IRC 501(c)(10). Rev. Rul. 77-258, 1977-2 C.B. 195.
3. Separate support organization—An organization that does not conduct any fraternal activities or operate under the lodge system, but does operate exclusively for the benefit of members of certain related domestic fraternal societies operating under the lodge system, does not qualify for exemption under IRC 501(c)(10). Rev. Rul. 81-117, 1981-1 C.B. 346.

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