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INTERNAL REVENUE SERVICE

NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

No third party contact
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District Director
Key District Office (EP/EO)
Information Copy: Chief, EP/EO Division

NOV. 22, 1999

Taxpayer's Name:

Taxpayer's Address:

Employer Identification Number:

Group Exemption Number:

Years Involved:

Dates of Conferences:

LEGEND:

X =
Y =
Z =
v =
w =
x =
y =
z =

ISSUES:

1. Whether, based on the facts presented, X will maintain its exempt status under section 501(c)(19) of the Internal Revenue Code during the years under examination. If X is unable to maintain its exempt status under section 501(c)(19) during the years examined, will it qualify for exemption under section 501(c)(4)?

2. Whether contributions made to X are deductible under Code sections 170(c)(3) and 2522(a)(4) during the years under examination.

FACTS:

X is a veterans' organization, which applied for and received exemption as an organization described in section 501(c)(19) of the Code. Subsequently, X received a group exemption under section 501(c)(19) for its state councils and chapters.

During the years under examination, X was a membership organization that was comprised of two classes of members: individual and associate. Individual membership was open to all Y era veterans who served on active duty for other than training purposes, during certain periods of time. Associate membership was open to family members of individual members, friends, and the general public. Associate members joined X because of their interest in the causes that it supports. Individuals who were associate members include spouses, widows, cadets, other veterans, parents, grandparents, brothers, sisters, children, grandchildren and miscellaneous members.

Individual members had the right to vote, to serve as an officer or director, to bring motions to the Board of Directors, and to serve as national convention delegates.

Associate members had no voting rights, but could serve on committees at the National, State, and Chapter level. If an associate member attended a national convention, the associate member could attend the convention meetings but had no right to be on the convention floor with elected delegates. Associate members and individual members paid the same membership dues and received a membership card and a subscription to X's magazine.

X's president appointed an who served as a special advisor to the Board of Directors and provided informal counsel when requested on relevant issues confronting the Board. Like other associate members, the could not vote, serve as an officer or director, or serve as a national delegate. State council presidents also could appoint an to serve as a non-voting member of the state council.

As part of the examination, X's membership records were reviewed for the fiscal year ending w to establish whether it satisfied the necessary membership requirements to maintain its exemption under section 501(c)(19) of the Code. Its total membership consisted of % individual members and % associate members. X did not maintain any records as to whether the associate members are family members of an individual member, or a veteran who is not a Y veteran. To ensure compliance with the membership requirements of section 501(c)(19), X surveyed its associate members.

The survey results were based on X's membership during the first half of the fiscal year ending w. Membership as of x was % individual members and % associate members. Since not all associate members responded to the survey, X projected the results of the survey as if all associate members had responded.

The survey results showed that % of X's total membership fell into a category of other persons who do not fall within section 501(c)(19)'s membership requirements. These other persons included parents, grandparents, brothers, sisters, children, grandchildren, and the previously described miscellaneous members.

A conference was held with X's representatives, where it was suggested that X did not qualify for exemption under section 501(c)(19) of the Code and was not entitled to deductibility of contributions under sections 170(c)(3) and 2522(a)(4), because the membership requirements for these Code sections were not satisfied. X's representatives took the position that the associate members are not bona fide members and should not be included in the applicable membership calculations. The cases of National Association of Postal Supervisors v. United States, 944 F.2d 859 (Fed Cir. 1991), American Postal Workers Union, AFL-CIO v. United States, 925 F.2d 480 (D.C. Cir. 1991), and National Association of Life Underwriters, Inc. v. Commissioner, 64 T.C. Memo. 379 (1992) were cited in support of the argument that X's associate members were not bona fide members and should not be part of the membership calculation. Rev. Proc. 95-21, 1995-1 C.B. 686, and Rev. Proc. 97-12, 1997-1 C.B. 631, were also cited by X's representatives.

Subsequently, another conference was held with X's representatives, during which it was agreed that a new organization, Z, would be created, and X's associate members would be transferred to Z.

ISSUE 1 - LAW:

Section 501(c)(4) of the Code provides for the exemption of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2) of the Income Tax Regulations describes the promotion of social welfare as promoting in some way the common good and general welfare of the people of the community, such as bringing about civic betterments and social improvements. An organization is not operated for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

Section 501(c)(19) of the Code provides for the exemption from federal income tax of a post or organization of veterans of the United States Armed Forces if such post or organization is:

(a) organized in the United States or any of its possessions,

(b) at least 75 percent of the members of which are past or present members of the Armed Forces of the United States and substantially all of the other members of which are individuals who are cadets or are spouses, widows, or widowers of past or present members of the Armed Forces of the United States or of cadets, and

(c) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(19)-1(c) of the regulations provides that an organization described in section 501(c)(19) of the Code must be operated exclusively for one or more of the following purposes:

(1) To promote the social welfare of the community as defined in section 1.501(c)(4)-1(a)(2) of the regulations,

(2) To assist disabled and needy war veterans and members of the United States Armed Forces and their dependents, and the widows and orphans of deceased veterans,

(3) To provide entertainment, care and assistance to hospitalized veterans or members of the Armed Forces of the United States,

(4) To carry on programs to perpetuate the memory of deceased veterans and members of the Armed Forces and to comfort their survivors,

(5) To conduct programs for religious, charitable, scientific, literary, or educational purposes,

(6) To sponsor or participate in activities of a patriotic nature,

(7) To provide insurance benefits for their members or dependents of their members or both, or

(8) To provide social and recreational activities for their members.

With respect to the membership requirements under section 501(c)(19) of the Code, in Senate Report No. 92-1082, 92nd Cong. 2d Sess., 1972-2 C.B. 713 at 715, Congress stated that "substantially all" means 90 percent. Therefore, of the 25 percent of the members that do not have to be past or present members of the Armed Forces of the United States, 90 percent have to be cadets, or spouses, etc. Thus, only 2.5 percent of a section 501(c)(19) organization's total membership may consist of individuals not mentioned above.

In National Association of Postal Supervisors v. United States, supra, the Federal Circuit affirmed the Claims Court and held that dues collected by a tax-exempt labor organization from "limited-benefit members" were unrelated business income. Limited benefit members could not vote or hold office, although an amendment to the organization's constitution allowed them to serve on committees in an advisory capacity.

In American Postal Workers Union, AFL-CIO v. United States, supra, the Service held that dues from "associate members" (i.e., non-postal members) were unrelated business income where such members were entitled to insurance benefits, but were not members in any other sense.

In National Association of Life Underwriters, Inc. v. Commissioner, supra, the court looked at the above cases for guidance in determining whether individuals were members of an association within the meaning of section 1.512(a)-1(f) of the regulations regarding the treatment of advertising income as unrelated business income. The court, in concluding that certain individuals were not members, found that the purported "members" had no right to participate in the organization's direction, had no obligation to help support the organization through regular financial contributions, and did not constitute members in the organization's articles of incorporation and by-laws.

Rev. Proc. 95-21, supra, establishes when associate member dues payments received by organizations described in section 501(c)(5) of the Code will be treated as gross income from the conduct of an unrelated trade or business under section 512.

Section 3 of the revenue procedure states that the Service will not treat dues from associate members as gross income from unrelated trade or business, unless for the relevant period, the associate member category has been formed or availed of for the principal purpose of producing unrelated business income. The revenue procedure also states that the Service will treat dues payments from associate members as not included in gross income from unrelated trade or business if the associate member category has been formed or availed of for the principal purpose of furthering the organization's exempt purposes.

Rev. Proc. 97-12, supra, amplifies and modifies Rev. Proc. 95-21, supra. Section 3.03 of Rev. Proc. 97-12 affirms that Rev. Proc. 95-21 will continue to apply to labor organizations described in section 501(c)(5) of the Code for purposes of determining whether associate member dues payments will be treated as gross income from unrelated trade or business under section 512.

ISSUE 1 - RATIONALE:

An organization must satisfy two requirements to be described in section 501(c)(19) of the Code. First, the organization must satisfy a membership test, and second, its activities must further purposes listed in section 1.501(c)(19)-1(c) of the regulations. If the membership requirements are not satisfied, then the organization will not qualify for exemption under section 501(c)(19). However, such an organization could be described in section 501(c)(4), if its activities further social welfare purposes.

The membership test under section 501(c)(19) of the Code provides that an organization's membership must be composed of the following:

a. 75% of the membership must consist of past or present members of the Armed Forces;

b. substantially all of its other members need to be individuals who are cadets or are spouses, widows, or widowers of past or present members of the United States Armed Forces or of cadets. "Substantially all" has been defined to mean 90% of the remaining 25% of the membership. Therefore, 22.5% of the organization's membership can consist of cadets, spouses, widows and widowers of cadets or members of the Armed Forces; and

c. the remaining 2.5% of the membership can be anyone.

In determining whether an individual is a member of a veterans' organization for purposes of section 501(c)(19) of the Code, such an individual must be involved in the organization in

such a manner as to further the organization's exempt purposes, rather than joining to receive a personal benefit, such as the right to purchase health insurance.

Section 501(c)(19) of the Code does not define the meaning of member as being an individual who has the right to control the day-to-day operations of the organization, such as having the right to vote. Membership in a section 501(c)(19) organization is based upon analyzing the organization's organizing document, which defines the rights and obligations of membership.

X's membership requirements are governed by its constitution. For the years under examination, X's membership consisted of two classes of members: individual and associate. The individual membership is composed of veterans serving in the Y war, and the associate membership is generally composed of all non-veterans. X has satisfied the necessary veteran membership composition, as it exceeded the minimum % veteran membership requirement by being composed of % veterans. The problem with X's membership is that X did not maintain records detailing the composition of its associate membership, and specifically, whether more than 2.5% of its members were not cadets, spouses, and widows or widowers of past or present members of the United States Armed Forces, or of cadets. X surveyed its membership and was able to show that more than 2.5% of its total membership were not veterans, spouses, widows, widowers, or cadets. Thus X did not satisfy the section 501(c)(19) membership requirements for the years under examination, because it had too many associate members who did not fall within the requisite categories.

X argues that its associate members are not bona fide members and should not be part of the membership calculation for purposes of section 501(c)(19) of the Code based upon the court cases and revenue procedures mentioned previously. In particular, X asserts that the associate members have no voice in its operations and emphasizes the associate members' lack of voting rights.

X's operations are distinguishable from the court cases and revenue procedures discussed above, because X's associate members have joined X to further its exempt purposes rather than to receive personal benefits. The associate members join X because of an interest in its exempt purposes and causes. The associate members may participate in X's national convention and serve on the committee at the national convention. Furthermore, X's newsletter provides details with respect to the extensive involvement of associate members in its exempt functions. As the associate members are significantly involved in X's exempt activities and there is no evidence that the associate members joined X solely to receive personal benefits, the associate members are bona fide members for purposes of section 501(c)(19). All of the available information indicates

that the associate member category has been formed or availed of for the primary purpose of furthering X's exempt purposes. See Rev. Proc. 95-21, supra.

Even though X did not satisfy the membership requirements of section 501(c)(19) of the Code, it carried on activities that promoted the social welfare of the community within the meaning of section 501(c)(4). Thus, for the years under examination, X met the requirements for recognition of exemption as an organization described in section 501(c)(4).

On y, X transferred its associate membership into an adjunct unit, Z, which would be classified as an organization described in section 501(c)(4) of the Code. The effect of establishing Z is to allow X again to be described in section 501(c)(19) by having a 100% membership of veterans.

ISSUE 1 - CONCLUSION:

X is not exempt as an organization described in section 501(c)(19) of the Code for the years under examination, but qualifies for exemption as an organization described in section 501(c)(4) for the period beginning v and ending z. Effective y, X meets the requirements under section 501(c)(19).

ISSUE 2 - LAW:

Section 170(a) of the Code provides the general rule that there shall be allowed as a deduction any charitable contribution, as defined in section 170(c), payment of which is made within the taxable year.

Section 170(c)(3) of the Code includes within the term "charitable contribution" as used in section 170 a contribution or gift to or for the use of a post or organization of war veterans, or an auxiliary unit or society of, or trust or foundation for, any such post or organization organized in the United States or any of its possessions, and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 2522(a)(4) of the Code allows a deduction, in computing taxable gifts for the calendar year, in the case of a citizen or resident, the amount of all gifts made during such year to or for the use of posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual.

Rev. Rul. 84-140, 1984-2 C.B. 56, provides that to qualify as a war veterans' organization within the meaning of sections 170(c)(3) and 2522(a)(4) of the Code, the organization must satisfy both a membership requirement and a purposes requirement. With respect to the purposes requirement, the organization must be organized and operated primarily for purposes that are consistent with its status as a war veterans' organization. An organization satisfies the membership requirement if at least 90 percent of its members are war veterans and substantially all of the other members are either veterans (but not war veterans), or are cadets, or are spouses, widows, widowers of war veterans, veterans or cadets.

Rev. Rul. 84-140 states that the term "war veterans" means persons, whether or not present members of the United States Armed Forces, who have served in the Armed Forces of the United States during a period of war (including the Korean and Vietnam conflicts). Rev. Rul. 84-140 does not further define "period of war." A definition of "war veterans" appears in section 1.501(c)(19)-1(b)(1) of the regulations. Section 1.501(c)(19)-1 of the regulations, which was promulgated on October 7, 1976, T.D. 7438, 1976-2 C.B. 156, was in effect at the time Rev. Rul. 84-140 was published. (Section 501(c)(19) of the Code was later amended to eliminate the "war veterans" requirement.) Therefore, the definition of "war veterans" in Rev. Rul. 84-140 follows the definition of "war veterans" that was used for purposes of section 501(c)(19).

Rev. Rul. 78-239, 1978-1 C.B. 162, states that for purposes of defining "a period of war" under section 1.501(c)(19)-1(b)(1) of the regulations, the Service will follow the dates set forth in 38 U.S.C. section 101. For purposes of defining "a period of war" under sections 170(c)(3) and 2522(a)(4) of the Code and Rev. Rul. 84-140, the Service follows the dates of periods of war as set forth in 38 U.S.C. section 101.

ISSUE 2 - RATIONALE:

To qualify as a war veterans' organization within the meaning of sections 170(c)(3) and 2522(a)(4) of the Code, the organization must satisfy both a membership requirement and a purposes requirement. With respect to the purposes requirement, the organization must be organized in the United States and operated primarily for purposes that are consistent with its status as a war veterans' organization.

The organization described in Rev. Rul. 84-140, supra, had the following purposes:

(a) Furthering, encouraging, promoting and maintaining comradeship generally among persons who are or have been members of the Armed Forces;

(b) Honoring and perpetuating the memory of deceased veterans and members of the Armed Forces and aiding and comforting their survivors;

(c) Encouraging public interest in and maintaining the ideals of the Armed Forces by sponsoring and participating in activities of a patriotic nature, and

(d) Aiding hospitalized, disabled and needy war veterans and their dependents. However, the organization did not provide insurance benefits to its members.

In addition, Rev. Rul. 84-140 states that the fact that an organization of veterans qualifies as exempt from income tax under section 501(a) of the Code does not, of itself, mean that contributions to such organization are deductible under sections 170(c)(3) and 2522(a)(4) of the Code.

For the years under examination, the associate members are considered bona fide members. For those years, X did not qualify to receive contributions that are deductible under sections 170(c)(3) and 2522(a)(4), as the 90% war veterans test was not satisfied.

Section 2.01 of Rev. Proc. 82-39, 1982-2 C.B. 759, provides that it is the responsibility of an organization receiving contributions to ensure that its character, purposes, activities, and method of operation satisfy the qualification requirements of section 170(c) of the Code in order for contributors to have the assurance that their contributions are deductible at the time made.

Section 3.01 of Rev. Proc. 82-39 provides that where an organization listed in or covered by Publication No. 78 ceases to qualify as an organization contributions to which are deductible under section 170 of the Code and the Service subsequently revokes a ruling or determination letter previously issued to it, contributions made to the organization by persons unaware of the change in the status of the organization generally will be considered allowable if made on or before the date of an appropriate public announcement, such as publication in the Internal Revenue Bulletin, stating that contributions are no longer deductible. However, the Service is not precluded from disallowing a deduction for any contribution made after an organization ceases to qualify under section 170, where the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for, or aware of, the activities or deficiencies on the part of the organization that gave rise to the loss of qualification.

For the years under examination, X did not qualify as an organization described in section 170(c)(3) or 2522(a)(4) of the Code. However, pursuant to Rev. Proc. 82-39, deductions by contributors that did not have the requisite knowledge of the status of the organization will be allowed until a public statement is made concerning the organization's loss of section 170(c)(3) status.

ISSUE 2 - CONCLUSION:

Contributions to X are not deductible under sections 170(c)(3) and 2522(a)(4) of the Code for the period beginning v and ending z, but contributions made by contributors that did not have the requisite knowledge regarding the status of the organization during this period are deductible. As of y, X satisfies the requirements of sections 170(c)(3) and 2522(a)(4) and contributions will be deductible to the extent the contributors satisfy the requirements of sections 170 or 2522, whichever applies.

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

-END-