

J. VETERANS' ORGANIZATIONS

by

Terry Berkovsky, Ted Lieber and Charles Barrett

1. Introduction

Veterans' organizations occupy a special place in the world of exempt organizations. Not only are veterans' organizations exempt from tax, contributions to them may be deductible, and they are permitted to set aside amounts that are used to pay insurance benefits to members. This combination of tax-exempt status, deductibility of contributions and the ability to pay benefits to members is relatively rare within a category of exempt organizations and is indicative of Congressional intent to provide the widest possible range of beneficial tax treatment for veterans' organizations. When coupled with the ability to engage in both lobbying activities and even political activities, it is fair to say that in many ways veterans' organizations are unequaled in the tax-exempt sector.

Nevertheless, there are many questions that arise in connection with the tax status of veterans' organizations, and relatively little published precedent is available to call upon in answering such questions. During the past few years, representatives of veterans' organizations have approached the Service and posed many questions, the answers to which are not readily apparent. Similarly, numerous issues have been identified by Key District Offices in the course of examinations of veterans' organizations. These issues have been the subject of technical advice requests, and, in response to such requests, Headquarters Office has issued a number of technical advice memoranda ("TAM's"), some of which have been made available in redacted form under IRC 6110.

As of the time this article was being drafted, the following TAM's had been released to the public: TAM 97-47-003 (July 18, 1997), TAM 98-11-003 (November 7, 1997) and TAM 98-15-061 (January 14, 1998). Each of these TAM's presents somewhat similar fact patterns involving veterans' organizations that engage in a variety of activities, and whose operations may not be consistent with certain requirements of the Internal Revenue Code. Although private letter rulings and TAM's may not be used or cited as precedent, the three TAM's offer some insight into the current thinking of the Service in connection with a broad spectrum of issues. Other TAM's are sure to follow.

An article published in the 1986 CPE text discussed the requirements for qualification for exemption of veterans' organizations described in different sections of the Code. This year's article builds upon the earlier one, while employing a question and answer ("Q & A") format addressing issues with respect to membership requirements, exempt activities, unrelated business taxable income, recordkeeping, the effect of a group ruling and deductibility of contributions.

2. Background

Prior to the passage of the Act of August 29, 1972 (Public Law 92-418, 86 Stat. 656, reproduced in 1972-2 C.B. 675), war veterans' organizations were grouped together with all other veterans' organizations, and most were recognized as exempt under IRC 501(c)(4) as social welfare organizations. Their subsidiaries, which were formed to maintain and operate their social facilities, were often recognized as exempt under IRC 501(c)(7) as social clubs.

IRC 501(c)(19) provides for the tax-exempt status of qualifying veterans' organizations and their related auxiliaries that are organized in the United States or any of its possessions. Under IRC 501(c)(19), a veterans' organization is permitted to conduct both social welfare activities, and social and recreational activities among its members without adversely affecting its tax-exempt status.

An organization is described in IRC 501(c)(19), if it satisfies the requisite membership requirements, is organized in the United States or any of its possessions, its activities further the purposes set forth in Reg. 1.501(c)(19)-1, and none of its net earnings inures to the benefit of any private shareholder or individual.

3. Membership Requirements

Membership requirements are set forth in IRC 501(c)(19). The following questions are often asked about membership:

3-1. What are the membership requirements for an organization to qualify for recognition of exemption or maintain its exemption as an organization described in IRC 501(c)(19)?

An organization's membership must be composed of at least 75 percent of past or present members of the Armed Forces of the United States (veterans) and substantially all of the other members must be:

A. Cadets or

B. Spouses, widows, or widowers of past or present members of the Armed Forces of the United States or of cadets.

3-2. What does "substantially all" mean in IRC 501(c)(19)?

In Senate Report No. 92-1082, 92nd Cong. 2d Sess., Congress stated that "substantially all" means 90 percent. Therefore, of the 25 percent of the members that do not have to be veterans, 90 percent have to be cadets, or spouses, etc., or 22.5 percent of all other members. Only 2.5 percent of the organization's total membership may consist of individuals not mentioned above.

Example: Post A has a membership of 1,000 members. The membership consists of 750 veterans, 225 spouses and 25 members of the general public. This organization would satisfy the membership requirements of IRC 501(c)(19), because at least 75 percent of its membership consists of past or present members of the Armed Forces (750 of the 1,000 members), and substantially all of its other members are cadets or spouses, widows or widowers of members of the Armed Forces (225). Under these facts, Post A's membership may include no more than 25 members of the general public.

3-3. Who are considered past or present "members of the Armed Forces" for purposes of IRC 501(c)(19)?

IRC 7701(a)(15) defines the term "Armed Forces of the United States" as:

Military and Naval Forces and Armed Forces of the United States.-- The term "military or naval forces of the United States" and the term "Armed Forces of the United States" each includes all regular and reserve components of the uniformed services which are subject to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force, and each term also includes the Coast Guard... .

Veterans are defined as present or former members of the United States Armed Forces.

Members of the National Guard and the Reserve Forces are also considered veterans. See Rev. Rul. 60-65, 1960-1 C.B. 21. This would include members who are on active duty or are honorably separated from the National Guard.

3-4. May veterans who have been dishonorably discharged from the United States Armed Forces be considered veterans for purposes of IRC 501(c)(19)?

Persons who have been dishonorably discharged from the United States Armed Forces are not considered veterans or war veterans for purposes of determining the composition of membership.

3-5. Would a category of individuals that included social members or friends of a veterans' post jeopardize tax-exempt status under IRC 501(c)(19)?

Such a category could adversely affect exemption, if these individuals are bona fide members, and if the post fails to meet the membership requirements contained in IRC 501(c)(19). As discussed previously, the post must maintain 75 percent veteran members, and substantially all the rest must be cadets or spouses, widows, or widowers of members or cadets. No more than 2.5 percent of the membership may consist of individuals without any relation to the military, including social members.

3-6. May a post issue memberships to sons, daughters and other related individuals (non-veterans) of veterans without jeopardizing its exemption?

The post may include non-veteran sons, daughters and other related individuals as part of its membership, provided that they comprise no more than 2.5 percent of the post's total membership. A post exceeding this percentage might consider forming an auxiliary unit. See the following section on auxiliaries for a further discussion.

4. Auxiliaries

IRC 501(c)(19) also provides for the recognition of tax-exempt status for auxiliary units or societies. An auxiliary unit or society is formed for the purpose of supporting a post or organization recognized as tax-exempt under IRC 501(c)(19). Generally, an auxiliary unit or society is separately organized and has a separate Employer Identification Number (EIN).

4-1. What are the exemption requirements for an auxiliary unit or society under IRC 501(c)(19)?

To be described in IRC 501(c)(19), an auxiliary unit or society must:

- A. Be affiliated with, and organized in accordance with the bylaws and regulations of an IRC 501(c)(19) organization,
- B. Be organized in the United States or any of its possessions,
- C. All of the members must be either members of the IRC 501(c)(19) organization, or spouses of a member of such organization, or related to a member of such organization within two degrees of consanguinity. The latter requirement encompasses grandparents, brothers, sisters and grandchildren as the most distant allowable relationship, and

D. No part of the net earnings may inure to the benefit of any private shareholder or individual.

4-2. Must an auxiliary unit or society apply for recognition of tax-exempt status as an organization described in IRC 501(c)(19)?

An auxiliary unit or society must apply for recognition of exemption by submitting Application Form 1024 and must satisfy the requirements contained in Reg. 1.501(c)(19)-1(d). An IRC 501(c)(19) auxiliary unit or society must be related to a post that is described in IRC 501(c)(19).

For example, if the post is described in IRC 501(c)(4), the auxiliary unit will not be able to qualify for tax-exempt status under IRC 501(c)(19).

It should be noted that many auxiliary units are exempt under a group ruling. Before an auxiliary unit applies for exemption, it should inform the central organization that it intends to apply for its individual tax-exempt status and determine if it is already part of a group ruling.

4-3. Must an auxiliary unit or society be incorporated under federal or state law?

IRC 501(c)(19) only requires that such an organization be organized in the United States or any of its possessions. It may be an association or a corporation.

4-4. Can a youth organization which is sponsored by the post, and whose participants are all under the age of eighteen, apply for recognition of exemption?

If the auxiliary unit is a separate legal entity, meets the requirements under the Code and regulations, and submits an exemption application, it may qualify for recognition of exemption. However, such an auxiliary unit must meet the membership requirements as stated above for an auxiliary unit, unless it is an organization of cadets.

4-5. May an auxiliary unit be recognized as tax-exempt under a Code section other than IRC 501(c)(19)?

Yes. Based upon all the facts and circumstances, including the organization's activities, an auxiliary unit may qualify for recognition of exemption as an organization described in IRC 501(c)(4), (7), (8), or (10).

5. Exempt Activities

Veterans' organizations traditionally have been involved in programs such as promoting Americanism, sponsoring youth activities, providing color guards, conducting patriotic ceremonies and functions, and conducting community activities. Many veterans' organizations also conduct social activities among its membership. Questions concerning veterans' organizations pertain to what the organization's exempt activities consist of, and whether such activities relate to exempt purposes.

5-1. What are IRC 501(c)(19) purposes?

Reg. 1.501(c)(19)-1(c) defines the purposes of veterans' organizations as:

- A. Promoting the social welfare of the community,
- B. Assisting needy and disabled veterans, widows, or orphans of deceased veterans,
- C. Providing entertainment, care and assistance to hospitalized veterans or members of the Armed Forces of the United States,
- D. Perpetuating the memory of veterans and comforting their survivors,
- E. Conducting programs for religious, charitable, scientific, literary, or educational purposes,
- F. Sponsoring or participating in patriotic activities,
- G. Providing insurance benefits to members or members' dependents, or
- H. Providing social and recreational activities for members.

5-2. What type of social activities do IRC 501(c)(19) organizations normally conduct?

Social and recreational activities are exempt activities if conducted with post members. Such activities may include:

- the operation of a bar and/or restaurant,
- gambling, and
- dinners and dances.

5-3. Is the joint use of a post's facilities and the joint participation in the social and recreational activities of a post by members of the post and its officially recognized auxiliary unit or society permitted under IRC 501(c)(19)?

The auxiliary units and societies that have been recognized as tax-exempt under IRC 501(c)(19) support the post and, as one of the purposes of IRC 501(c)(19) organizations is to provide social and recreational activities for their members, the inclusion of the auxiliary units and societies in such activities would be a related activity.

5-4. What type of activities would be considered promoting social welfare of the community as described in Reg. 1.501(c)(4)-1(a)(2)?

The following are examples of some of the activities conducted by veterans' organizations that are promoting social welfare:

Example 1: The purchasing of equipment and uniforms for a youth athletic team would further the exempt purposes of the post. Sponsoring youth activities promotes social welfare whether or not the activity is limited to the members' dependent children. Such activities are appropriate post activities.

Example 2: Sponsoring a local recreational team for nonmember adults would generally not constitute an exempt activity within the meaning of IRC 501(c)(19). However, if it were part of a community program or an international competition, it might be considered a social welfare activity.

Example 3: Allowing other community organizations such as the Lions Club, a public school organization, or a community group to use the post facility.

Example 4: Sponsoring various youth activities, such as Boy Scouts, Girl Scouts, youth units of the post, and providing scholarships for students.

Example 5: Donations to charities described in IRC 501(c)(3), such as hospitals, the Red Cross, and the Community Chest.

Example 6: Visiting sick or hospitalized members, veterans and their families.

5-5. If each post member must sell ten tickets to nonmembers to a post's weekly dance and/or dinner, would such an event be an exempt activity under IRC 501(c)(19)?

Such dinners and dances would not be exempt activities, as they do nothing to further IRC 501(c)(19) purposes. Such activities would not adversely affect exemption, if they are not the primary activities of the post. Such activities may be subject to the unrelated business income tax ("UBIT"), unless the activities meet one of the exceptions. See the section on UBIT, *infra*.

5-6. Must participants in post-s ponsored activities, such as a post baseball team, be members of the post or over 21 years of age?

There is no requirement that only members of a post or persons over 21 may participate in a post-sponsored activity. The main issue is whether the activity is one that is appropriate for an organization described in IRC 501(c)(19).

5-7. Are the following activities consistent with the requirements under IRC 501(c)(19):

- A. Reviewing proposed legislation that may affect veterans, at both the federal and state levels,**
- B. Testifying before a governmental body with respect to such legislation, and**
- C. Informing members about the proposed legislation?**

Representing all veterans before legislative bodies concerning legislation that affects veterans as a whole has historically been a function of veterans' organizations. These activities are consistent with the requirements under IRC 501(c)(19).

5-8. Would the operation of gambling devices for the pleasure and recreation of a post's members and guests affect the post's tax-exempt status, if the operation of such gambling devices is illegal under state or local law?

Gambling provided for the pleasure and recreation of members and their bona fide guests would further the social and recreational purposes of an IRC 501(c)(19) organization. Operation of gambling devices that are limited to members and their bona fide guests, even if illegal under state or local law, would be consistent with the requirements under IRC 501(c)(19). However, if the illegal gambling is available to members of the general public, such activity might result in negative tax consequences.

6. Unrelated Business Income Tax

In general, an exempt organization is subject to UBIT on revenues derived from the conduct of a regularly carried on trade or business that is not substantially related to its exempt purposes. In the area of veterans' organizations, the majority of questions relating to UBIT involve the operation of a bar or restaurant, and gambling.

6-1. What exclusions from UBIT relating to the operation of a bar and restaurant, and gambling, are most typically useful for veterans' organizations?

Veterans' organizations may exclude from UBIT income from a trade or business that is not regularly carried on (IRC 512(a)(1)), income from certain bingo games (IRC 513(f)) and income where substantially all the work is performed without compensation (IRC 513(a)(1)).

6-2. May members of a parent organization who are members of a post be granted privileges to use the facilities of and to participate in social and recreational activities at other posts of the parent organization without generating unrelated business taxable income ("UBTI") for those posts of which they are not members?

One of the purposes of an IRC 501(c)(19) organization is to provide social and recreational activities for its members, and the inclusion of members of the parent organization's posts in such activities would be a related activity. Therefore, members of the parent organization's posts could participate in the social and recreational activities of a related post without generating UBTI.

6-3. Can members of a parent organization's auxiliary unit or society be granted privileges by a post with which it is affiliated to use the facilities and to participate in social and recreational activities of that post without generating UBTI for the post?

The auxiliary units and societies described in IRC 501(c)(19) support IRC 501(c)(19) posts. The inclusion of the members of an auxiliary in the social and recreational activities of the post would not generate UBTI, as such participation furthers the social and recreational purposes of the post.

6-4. Can a member of a post bring his or her family to a post's weekly social function without generating UBTI?

Yes, as such participation would further the purpose of providing social activities for the members.

6-5. Can members of a youth auxiliary unit be granted privileges by a post with which it is affiliated to use the post's facilities and to participate in social and recreational activities of the post without generating UBTI?

If the youth auxiliary unit is described in IRC 501(c)(19), its members' participation in the social and recreational activities of the post would be substantially related to the post's exempt purposes, and income from such participation would not be taxable. If the youth auxiliary unit is a sponsored youth activity, the use of the post facility would not generate UBTI if it furthered exempt purposes.

Example. The members of a youth unit that is not described in IRC 501(c)(19) are permitted to bring their friends and dine in the restaurant whenever they choose. Such activity would not be substantially related and would result in UBTI.

6-6. Are social functions for members and their bona fide guests, such as spaghetti dinners, breakfasts and dances, considered to be a trade or business that is "regularly carried on" for purposes of UBIT, solely because they are conducted weekly?

One of the purposes of an IRC 501(c)(19) organization is to provide social and recreational activities for its members. Therefore, social functions that include bona fide guests (generally defined as individuals whom the member invites and for whom the member pays) would be substantially related to the post's exempt purposes. However, based upon particular facts and circumstances, activities that a post treats as a social function may actually constitute a trade or business that is regularly carried on (even on a weekly basis) and, thus, income derived therefrom would result in UBTI.

6-7. Are fundraisers that are open to the general public, such as spaghetti dinners, breakfasts and dances, considered a trade or business which is "regularly carried on" for purposes of UBIT solely because they are conducted weekly?

If the activity is not a related activity, and is a regularly carried on trade or business, a nonmember attendee who pays would not be considered a bona fide guest of a member. Under these circumstances, income from nonmembers would constitute UBTI, unless an exception, such as that for volunteer labor under IRC 513(a)(1), is available.

Example. Weekly dances open to the public would be "regularly carried on," and, unless conducted by substantially all volunteer labor, income derived therefrom would result in UBTI.

It should be noted that tips and wages not paid in money may be considered compensation for services and may result in an activity being subject to UBIT.

6-8. Is income from nonmembers subject to UBIT when access to the bar and dining facilities is restricted by use of a key card system, or the doorman checks membership cards upon entry? Members of the general public unaccompanied by a member are not admitted, nor are guests allowed to pay their bills separately.

When Congress enacted IRC 501(c)(19), which provides a specific exemption for veterans' organizations, social and recreational activities for the members was one of the purposes permitted. Here, the use by nonmembers is incidental to the use by members. The only way a nonmember may gain admission to the bar or restaurant is if he or she is a bona fide guest of a member. In this case, such income is derived from providing social and recreational activities for members and would not be subject to UBIT.

UBIT was instituted because there is a legitimate concern about the potential for abuse when an exempt organization has an unfair advantage over its nonexempt competitors. In this case, the facts do not suggest such abuse. The presence of the guests is in furtherance of one of the organization's exempt purposes, the provision of social and recreational activities for its members. Therefore, under these facts, receipts attributable to guests accompanied by members do not constitute UBTI.

6-9. Can members of a post baseball team and members of a visiting post baseball team purchase food and beverages at the post without generating UBTI?

Whether the income generated would be UBTI would depend upon whether the activity was related to the post's exempt purposes. Such activities involving youth may be related. If the activity were for adults, there might be a different result. All the facts and circumstances would be considered, as required by Reg. 1.513-1(d)(2).

Example. Where an adult sports team, including nonmembers, is sponsored by the post and after the games team members have full use of the bar and restaurant, income from nonmembers would be subject to UBIT.

6-10. Can a member of a post sell tickets to unrelated persons to attend a social function of the post without generating UBIT?

Selling tickets to unrelated persons would not make that person a bona fide guest of the member. Generally, such income would be subject to UBIT unless the activity met one of the exceptions. If the activity were conducted by substantially all volunteers, there would be no UBTI.

Example. A post member who is a volunteer sells tickets to his neighbor for a shrimp dinner. The dinner is prepared and served, and the facility is cleaned by volunteers. This activity would meet the volunteer labor exception under IRC 513(a)(1).

6-11. Does advertising a social function to the public by "word of mouth" affect whether the social function is deemed to generate UBIT?

No. The main determining factors would be whether the activity is related to the organization's exempt purposes, whether the activity is only for the members, and who performs the work to conduct the activity.

6-12. Is the income generated by the rental of a post's recreational hall to a nonmember subject to UBIT?

Generally, rental income is excepted from UBIT under IRC 512(b)(3), unless services are provided for the convenience of the occupant, or the facility is debt-financed within the meaning of IRC 514.

Income from a bona fide member of a post for use of a recreational hall for social and recreational purposes is considered related income for purposes of UBIT, whether or not services are provided, or the facility is debt-financed.

6-13. Employees are used to operate a bar and dining facility that is open to the public on a limited basis. Will the income from such bar and dining facility be subject to UBIT, or is the activity related to the exempt purposes of the post, as the activity is providing social activities for the members?

While providing such activities to the general public may arguably provide the members with social and recreational activities, it is also furthering the general public's social and recreational interests. Therefore, if the activities are primary, they may adversely affect the post's exempt status.

Assuming that the activities are not primary, income from the bar and dining facilities would be subject to UBIT, as providing social and recreational activities to the public is not an exempt activity under IRC 501(c)(19). All income derived from the public would be subject to UBIT.

6-14. A post has a membership base of 97.5% military personnel (veterans, Armed Forces personnel and spouses), and 2.5% non-veterans. Use of the bar is solely by members. Would the income from the non-veteran members be subject to UBIT?

Exempt income would include any income derived from members. Assuming the non-veterans are a class of bona fide members described in the post's creating document or by-laws, they would be considered members for UBIT purposes, as their membership is within the requirements of IRC 501(c)(19). Therefore, the income from the non-veteran members would not be subject to UBIT.

6-15. Would the income from the operation of a bar by a post, with a membership base of 97.5 percent military personnel and 2.5 percent of non-veterans, where over 55 percent of the income is derived from the general public having no military connection, be subject to UBIT?

Yes. Assuming that the post still meets the requirements for recognition of exemption under IRC 501(c)(19), income derived from the general public would be subject to UBIT.

6-16. Would income from selling liquor or food to members or the public for consumption off the premises be subject to UBIT?

All income from selling liquor and food for consumption off the premises would be subject to UBIT, as such activities are not furthering social and recreational activities. If the off premises selling of food or liquor is substantial, exemption could be adversely affected.

6-17. Would income be subject to UBIT when a post operates a thrift shop using volunteers?

Generally, operating a thrift shop would not be considered an unrelated trade or business based on the donated merchandise exception under IRC 513(a)(3). Where the activity is conducted by substantially all volunteers, it would meet another exception to UBIT under IRC 513(a)(1).

6-18. Active duty military personnel are allowed to use the post bar and restaurant on a regular basis without becoming members. Is income from the active duty military personnel exempt function income or is it subject to UBIT?

This income would be subject to UBIT. The active duty military personnel are eligible to be post members and, as they are not members, they should be treated as part of the general public. Under these facts the post is not providing entertainment, care and assistance to hospitalized veterans or members of the Armed Forces of the United States, which would be considered an exempt function.

6-19. Would income from poker machines in a post bar and from "Las Vegas Nights" every month be subject to UBIT?

If the activity is limited to members and bona fide guests, the income would not be subject to UBIT. However, if the activity is open to the public, it will generally be subject to UBIT. See the publication on Exempt Organizations Conducting Gaming, Publication 3079, for detailed information on when such income is subject to UBIT, what records must be maintained, what taxes may be applicable, and what tax forms must be submitted.

6-20. Does advertising contained in flyers, newsletters and programs generate UBIT?

Yes, unless one of the exceptions to UBIT is met.

6-21. Would a post that operates a golf course, swimming pool and a snack bar, which are open to the public, further the social welfare of the community, or would the income be subject to UBIT?

Generally, operating a golf course, swimming pool and snack bar, which are open to the public, would be furthering the public's social and recreational interests, not those of the members. Income from such activities would be subject to UBIT. All the facts and circumstances would have to be considered in determining whether such activities further the social welfare of the community.

6-22. A post has a reciprocal agreement with other veterans' organizations in the area regarding the use of its post facilities. Would income from veterans belonging to other veterans' organizations be subject to UBIT?

Income received under such reciprocal agreements from other veterans' groups would be subject to UBIT.

6-23. Are there any times that income from veterans belonging to other veterans' organizations would not be subject to UBIT?

Yes. Whether or not the income is related to exempt purposes would depend upon the facts and circumstances.

For example, local X and Y posts co-sponsor a patriotic event such as a parade and assemble at one or the other's canteen either before or after the event. The canteen is open to provide food and beverages for the participants. In that instance sales of food and beverages would meet the substantially related test.

6-24. Is income from the use of a hotel facility operated by an IRC 501(c)(19) organization for nonmember active duty military personnel subject to UBIT?

The use of the hotel facility operated by a veterans' organization for nonmember active duty military personnel does not in and of itself have a substantial causal relationship to any exempt purpose described in IRC 501(c)(19). Generally, income from such use would constitute UBTI and be subject to tax. Use of the hotel facility by active duty military personnel during a national emergency or armed conflict could further social welfare and, under such circumstances, could be a related activity based upon the facts and circumstances.

A hotel with a bar, restaurant and meeting rooms operated for use of the members would be substantially related, as it provides social and recreational activities for the members, i.e., a place for its members including those from out of town to gather for social and recreational activities.

6-25. Would income from the sale of liquor bottles, bearing the organization's emblem, be subject to UBIT?

The sale of liquor bottles bearing the organization's emblem does not have a substantial causal relationship to any IRC 501(c)(19) exempt purpose. Income from such sales would be subject to UBIT.

6-26. Would the provision of commercial type banquet services to civic and community groups be considered unrelated trade or business?

The provision of banquet services by a post to civic and community groups does not have a substantial causal relationship to any exempt purpose described in IRC 501(c)(19). Income from such use would constitute UBTI.

6-27. Would the provision of banquet services to member-s ponsored groups be considered unrelated trade or business?

The provision of such services to members is considered related to the organization's exempt purpose of providing social and recreational activities for its members. Thus, when a member sponsors a group, whether a civic group or for a private party, the income would be considered related.

6-28. Are membership dues from the posts that are not recognized as exempt, taxable to the parent as UBIT?

No. This income would be considered related to exempt purposes.

7. Recordkeeping

IRC 6001 provides that every person/organization liable for any tax imposed by the Code, or for the collection thereof, shall keep adequate records as the Secretary of

Treasury or his delegate may from time to time prescribe. Recognized accounting methods should be used to provide the required information.

Veterans' organizations need to maintain records, not only on activities, but also on sources of income and expenses. The following are the most often asked questions regarding recordkeeping:

7-1. What type of records must be maintained to show the composition of membership within the meaning of IRC 501(c)(19)?

A post must maintain a list of members and the category of membership (veteran, degree of relation, or non-veteran or non-relative). If a post receives deductible contributions, it must also maintain a list of members and their dates of service.

7-2. What type of records are required for auxiliary units to show that the composition of their membership meets the IRC 501(c)(19) requirements?

Auxiliary units must maintain a list of members and show their relation to the veteran post member. An auxiliary member must be related to the post member within two degrees of consanguinity.

7-3. What type of records should be maintained to show post patriotic and social welfare activities?

Records should be maintained to indicate monthly activities, individuals participating in the activities (members, auxiliary, social members, youth groups, etc.), number of people participating in the activity (e.g. eight members, two social members). If the activity is a fundraiser, records should show who conducted the activity, and whether or not volunteers provided services. Records of activities can include post meeting minutes, historian's records, activity books, commander's books, house committee reports, and reports to the parent organization.

7-4. Must a post document that a member has made a purchase of food or beverage or is it sufficient to document only purchases made by nonmembers? In other words, is it reasonable to assume that all purchases are member purchases unless records indicate that the purchase is made by or on behalf of a nonmember?

The Service requires that an organization maintain such books and records that are sufficient to establish the amount of gross income, source of gross income, deductions, credits, expenses, or other matters by activity. Activities would include the restaurant and bar sales, bingo, pull tabs, gaming devices, and fundraisers such as shrimp dinners, etc. At the point of sale or service, there should be a methodology in place to determine whether the income is from members or nonmembers, and whether the activity is related

or unrelated to the organization's exempt purposes. Absent adequate records, it is assumed the income is from nonmembers. If the activity is considered related and not subject to UBIT, records must be maintained to show why the activity is related or why the income would be excluded from UBIT.

For example, if the income were from bingo, it would not be subject to UBIT, assuming that the requirements under IRC 513(f) are met. If the income were from the selling of United States flags, it would be related.

7-5. Volunteers are used to conduct post fundraisers, however, the post pays employees for security and accounting. What records are required to show that these fundraisers are not subject to UBIT?

Records would be required to show the number of volunteers, the hours spent in planning and conducting the activity, and how many paid employees are used. If the paid employees are full-time employees, a reasonable allocation of time spent on the fundraising activity may be made. Records of the income and expenses related to the fundraiser must be maintained.

7-6. When the bar and dining facility are open to the general public, what type of records are required?

As the use of the facility is for both post members and the general public, then income derived from the public would be subject to UBIT. A post would need to maintain records of gross income and expenses.

However, if the post facility is primarily for the members, and an occasional member of the general public uses the facility, a separate record of the gross receipts from members and from nonmembers must be maintained in order to determine what amount of income would be subject to UBIT.

7-7. Should a post maintain a record of activities and the number of members, auxiliary members, volunteers and employees involved in each activity?

Yes. This is necessary to determine whether the post is operating for exempt purposes, and for determining whether an unrelated activity is subject to UBIT.

7-8. How would a post account for income and expenses from joint fundraising activities with the auxiliary?

When an activity is conducted jointly, a reasonable method must be used to determine how to allocate income and expenses. An acceptable accounting method should be used. If income and expenses are prorated, records should show that the allocation method used is reasonable.

Example. If a spaghetti dinner/fundraiser is conducted using primarily volunteers from the post and the auxiliary, the income and expenses could be prorated based upon the number of volunteers from each that were involved in conducting the activity.

7-9. Why should a post maintain records clearly identifying revenues from each source and expenses related to each source?

IRC 6001 requires the maintenance of adequate records. If adequate records are not maintained, exemption may be jeopardized. It is also necessary to maintain records clearly identifying revenues from each source and expenses related to each source to determine what income is exempt function income and what income is subject to UBIT.

7-10. As an auxiliary supporting a specific post, is it necessary to maintain records of the auxiliary's activities?

Yes. An auxiliary must maintain records to show that its activities and funds are used to support the post. Records should include not only the activity, but also how many members conducted and/or participated in the activity. If it is a fundraiser, records should show how many members conducted the activity, and whether the activity was conducted by volunteers.

7-11. Why should a post maintain records on employees when the post is tax-exempt?

Tax-exemption under IRC 501(c) exempts an organization from income tax on related income. It does not exempt such an organization from tax on unrelated business income, employment tax, Social Security and Medicare under the Federal Insurance Contributions Act, or excise tax on certain gambling income.

7-12. Is a formal set-aside of amounts paid by members for insurance required in order for this income to be excluded from UBIT?

Under IRC 512(a)(4), UBTI of an IRC 501(c)(19) organization does not include any amounts attributable to payments of life, sick, accident, or health insurance with respect to members or their dependents which is set aside for purposes of providing for the payment of insurance benefits or for purposes specified in IRC 170(c)(4). A formal set-aside of amounts paid by members is not required for the income to be excluded from

UBIT. However, the organization must maintain adequate records describing the amount set aside and the use of the set aside funds. Note that IRC 170(c)(4) purposes are specifically limited to religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

8. Group Rulings

A group ruling provides for tax exemption under IRC 501(c) on a group basis for subordinate organizations affiliated with and under the general supervision or control of a central or "parent" organization. Each of the subordinates covered by the group ruling is relieved from filing its own application for recognition of tax exemption. The procedures for obtaining a group ruling are set forth in Rev. Proc. 80-27, 1980-1 C.B. 677.

8-1. If a subordinate post exempt under a group ruling has less than 75 percent past or present members of the Armed Forces, is there any adverse effect on exempt status of the subordinate post and/or group ruling?

When a subordinate post no longer has 75 percent past or present members, it no longer meets the requirements for tax exemption under IRC 501(c)(19). It is not eligible to receive any of the benefits resulting from such tax-exempt status. Such organization should inform its parent and the IRS that it does not qualify for tax exemption.

Such post should be deleted from the group ruling by its parent for failure to meet the membership requirements. The post could still maintain its affiliation with the parent, but would not be exempt as a subordinate post under the parent's group ruling.

If the parent continues to have 75% veterans and substantially all the other members are cadets or spouses, widows, or widowers of past or present members of the Armed Forces, there would be no adverse effect on the parent's exemption.

8-2. May a veterans' organization with an IRC 501(c)(19) group ruling include its auxiliary units in its group exemption as members.

A veterans' organization may have more than one category of members as stated above. The creating document or by-laws should define the membership requirements and rights of each category of members. The 75 percent veteran members must be maintained, and auxiliary members may account for no more than 25 percent of the total membership.

8-3. May members of subordinate posts, exempt under a group ruling, be granted privileges to use the facilities of and to participate in social and recreational activities at each and every subordinate post exempt under the same group ruling without jeopardizing exemption of any subordinate post?

Members of the various posts exempt under the same group ruling may use the facilities of and participate in the social and recreational activities of other posts exempt under the same group ruling. No post would jeopardize its exemption if it allows this activity.

9. Deductible Contributions to Veterans' Organizations

IRC 170(c)(3) provides an income tax deduction for contributions to a post or organization of war veterans if it is organized in the United States or any of its possessions, and no part of its net earnings inures to the benefit of any private shareholder or individual. As this section explains, an IRC 501(c)(19) organization may, in some cases, be entitled to receive contributions that are deductible under IRC 170(c)(3).

9-1. Are all contributions to an IRC 501(c)(19) organization deductible under IRC 170(c)(3)?

No. The requirements are different for tax exemption under IRC 501(c)(19) and for deductibility of contributions under IRC 170(c)(3). To be eligible to receive tax deductible contributions under IRC 170(c)(3), a veterans organization must satisfy both a membership requirement and a purposes requirement. See Rev. Rul. 84-140, 1984-2 C.B. 56. With respect to the membership requirement, the fact that a small percentage of the members of an organization have not served in the Armed Forces will not, of itself, preclude the organization from being classified as a war veterans' organization under IRC 170(c)(3), provided that at least 90% of its members are war veterans and substantially all of the other members are either veterans, or are cadets, or are spouses, widows, or widowers of war veterans, veterans, or cadets. "War veterans" are defined in Rev. Rul. 84-140 as persons who have served in the United States Armed Forces during a period of war. The periods of war are specified in 38 U.S.C. sec. 101 and Rev. Rul. 78-239, 1978-1 C.B. 162. With respect to the purposes requirement, the organization must be organized and operated primarily for purposes consistent with its status as a war veterans' organization.

In contrast, the members of an IRC 501(c)(19) organization need not be war veterans. However, at least 75% of the members must be past or present members of the United States Armed Forces and substantially all of the other members must be cadets or spouses, widows, or widowers of past or present members of the Armed Forces or of cadets.

Here is an example of an IRC 501(c)(19) organization not eligible to receive tax deductible contributions:

An IRC 501(c)(19) organization has 1,000 members. The membership is composed of 750 war veterans, 150 individuals currently enlisted in the Army, and 100 spouses of

the currently enlisted members. Contributions to the organization are not deductible under IRC 170(c)(3) because it does not satisfy the 90% war veterans test.

Here is an example of an IRC 501(c)(19) organization that is eligible to receive tax deductible contributions:

Same facts as previous example, except 900 of the members are war veterans within the meaning of IRC 170(c)(3), and the remaining 100 members are spouses, widows, or widowers of war veterans.

9-2. May a taxpayer deduct travel expenses incurred in his or her performance of official duties as an uncompensated officer and member of an IRC 501(c)(19) organization?

Yes, but only if the organization satisfies the requirements of IRC 170(c)(3).

9-3. Are auxiliary members included as members for purposes of the IRC 170(c)(3) membership test?

When an auxiliary is separate from a war veterans' organization, its members are not included as members for purposes of the IRC 170(c)(3) membership test. When auxiliary members are not in a separate organization, they may be included as members for purposes of the IRC 170(c)(3) membership test. This may cause the organization to fail the membership test.

9-4. Would an IRC 501(c)(19) organization formed primarily to provide social and recreational activities (bar and restaurant for its members) meet the purposes requirement of IRC 170(c)(3)?

No. Even though an organization formed primarily to operate a bar and restaurant for its members may meet the requirements of IRC 501(c)(19), it does not meet the requirements of IRC 170(c)(3) because its primary purpose is not consistent with its status as a war veterans' organization. Therefore, contributions to the organization are not deductible under IRC 170(c)(3). In Rev. Rul. 84-140, the Service states that an organization with the following purposes meets the requirements of IRC 170(c)(3):

- A. Furthering comradeship among persons who have been members of the Armed Forces,
- B. Honoring the memory of deceased veterans and members of the Armed Forces and aiding and comforting their survivors,

C. Encouraging patriotism, and

D. Aiding hospitalized, disabled, and needy war veterans and their dependents.

9-5. May a taxpayer deduct contributions to an auxiliary described in IRC 501(c)(19)?

Yes, if the primary purpose of the auxiliary is to support a post or organization of war veterans described in IRC 170(c)(3).