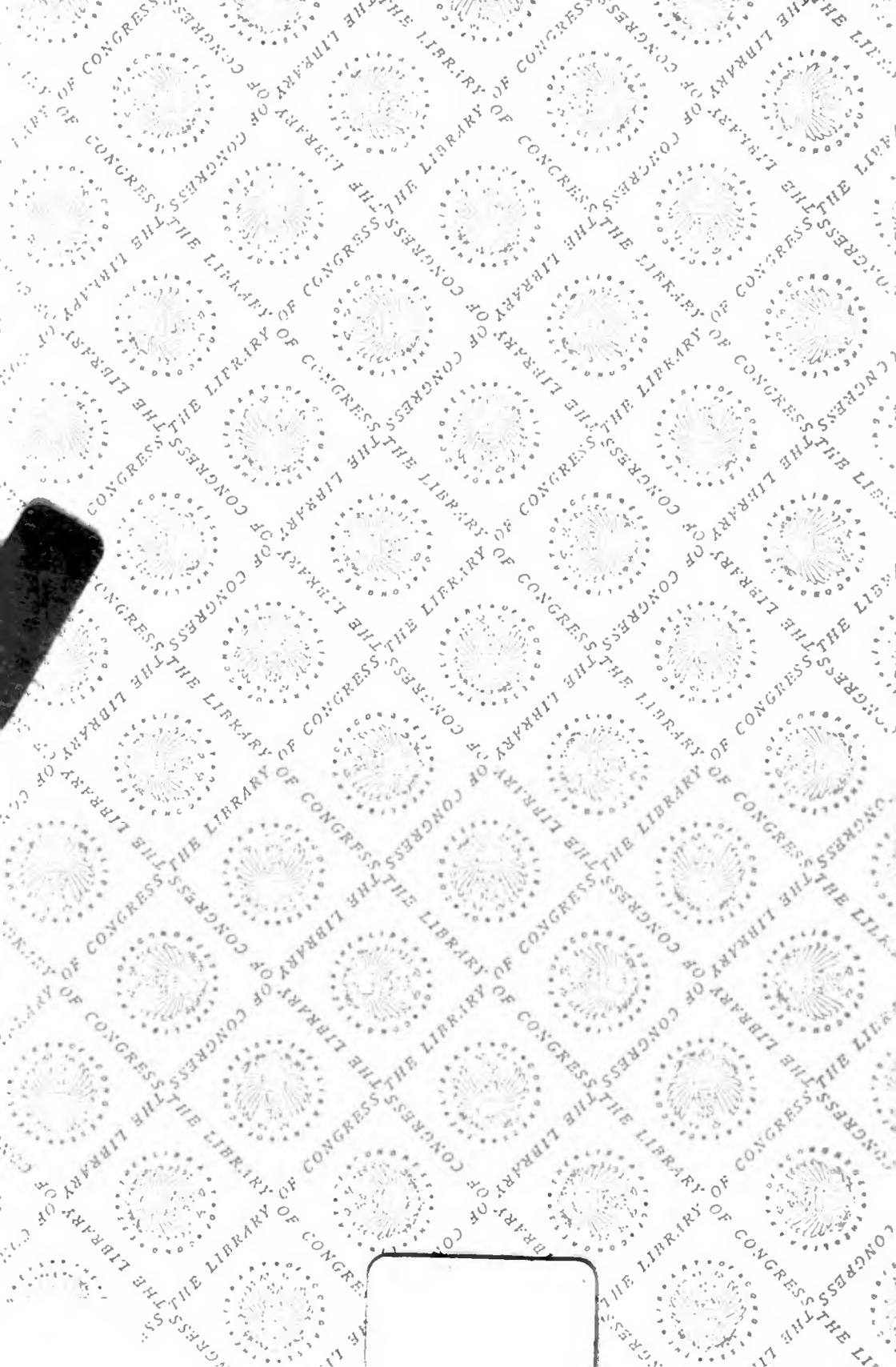
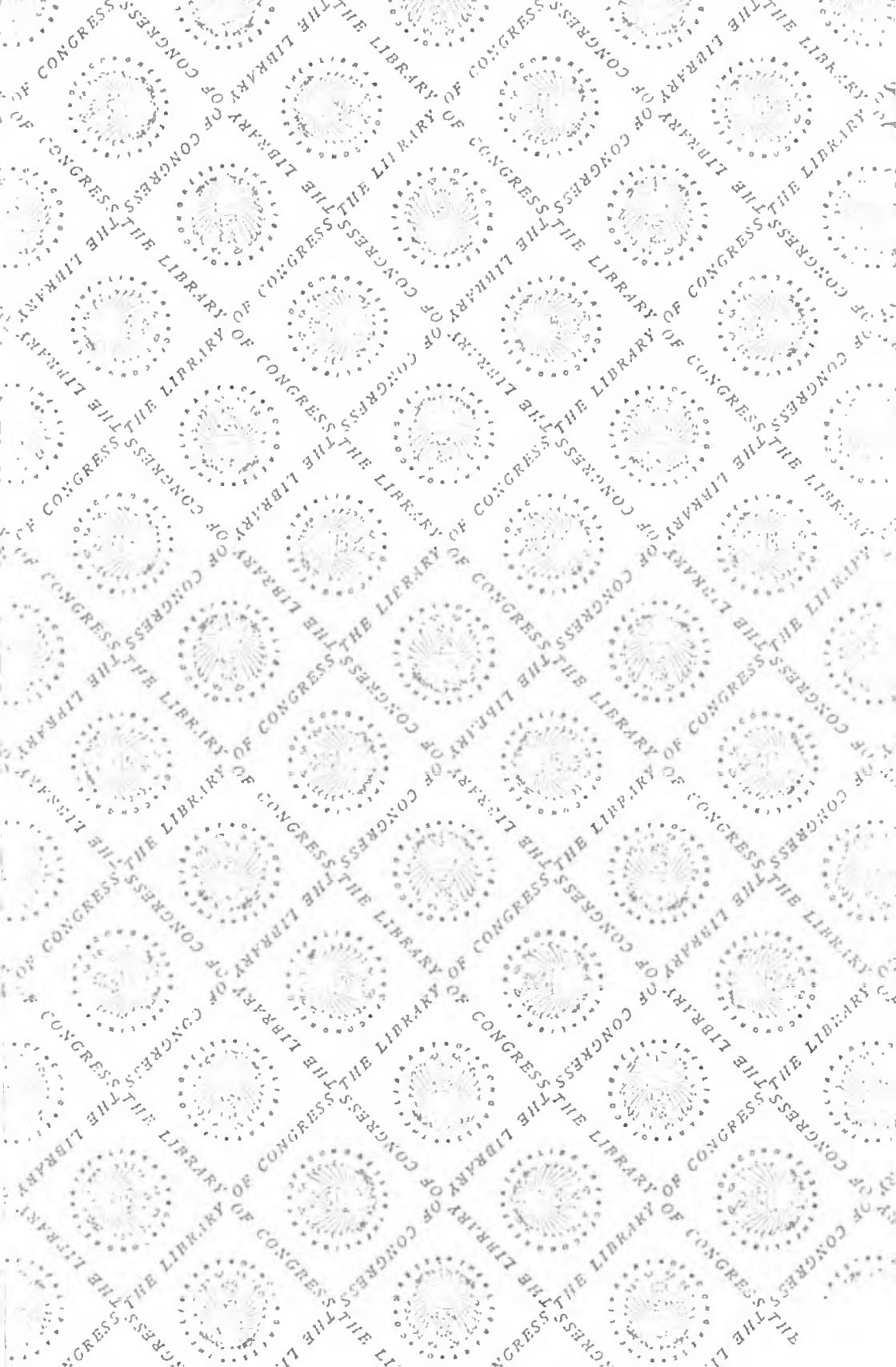


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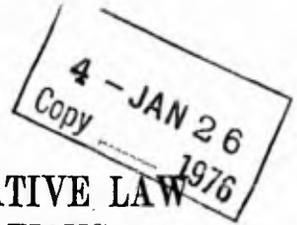
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OVERSIGHT ON FEDERAL INCORPORATIONS

*United States Congress House Committee
"on the Judiciary." Subcommittee on
Administrative Law and
Governmental Relations.*



HEARING

BEFORE THE

SUBCOMMITTEE ON ADMINISTRATIVE LAW
AND GOVERNMENTAL RELATIONS

OF THE

COMMITTEE ON THE JUDICIARY

HOUSE OF REPRESENTATIVES

NINETY-FOURTH CONGRESS

FIRST SESSION

ON

OVERSIGHT ON FEDERAL INCORPORATIONS

—
JUNE 11, 1975
—

Serial No. 20



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OVERSIGHT ON FEDERAL INCORPORATIONS

WEDNESDAY, JUNE 11, 1975

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ADMINISTRATIVE LAW
AND GOVERNMENTAL RELATIONS
OF THE COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:17 a.m., in room 2237, Rayburn House Office Building, Representative Walter Flowers [chairman of the subcommittee] presiding.

Present: Representatives Flowers, Jordan, Moorhead, and Kindness.

Also present: William P. Shattuck, counsel; and Alan F. Coffey, Jr., associate counsel.

Mr. FLOWERS. We will call this meeting to order.

We are conducting today a session by this subcommittee, prompted by an interest in the matter of Federal charters, as included in the jurisdiction of this subcommittee.

My experience as the chairman of this subcommittee indicates to me that the subcommittee could be inundated by bills in behalf of various organizations seeking Federal charter status. This situation raises a number of questions. We have been asked whether the bills are the result of attempts to avoid more strict laws of State which, at this time, have jurisdiction over certain of these organizations. On the other hand, we may ask does the effort to secure such a charter stem from a sincere desire on the part of organizations to obtain some broader status such as the Federal charter might suggest? Still, the various areas that we are interested in, cannot be particularly circumscribed because we want to receive everything that the witnesses might have to tell us on this subject.

It is my judgment that Federal charters ought to be given only with a good showing that it would be helpful; that it would be beneficial to the organization; that it would certainly not harm the public interest; that it would not circumvent the application of more stringent or strict State laws that might otherwise be applicable to the particular organization.

These are the kinds of things that I am interested in as we conduct this somewhat informal discussion, asking you people from the Department of Justice, the General Accounting Office, and the Treasury Department on this subject.

It is a search—a sincere search by the members of this subcommittee—to establish a foundation on which to judge whether we ought to report out bills granting Federal charters to any organizations who

have petitioned us in this Congress, or if we ought to conduct a review of those who might have been granted Federal charters in the past.

I would now like to yield to my distinguished colleague from California, Mr. Moorhead, for any comments he would like to make before we begin the hearing.

Mr. MOORHEAD. From what I have read on the subject of Federal charters, they really have very little meaning other than the prestige value to these individual groups that receive them.

For that reason, probably, they should be limited to truly national organizations, that are well known throughout the country.

The advantages they get from the various States, of course, usually depend on the State laws in which they are operating, even though they have the Federal charter. It is, to a great extent, dependent upon whether they are actually incorporated or not.

Some of them are incorporated in the District of Columbia and some of them in one or another of the various States in the country, but it is the prestige value, as I see it, that is the real advantage of the Federal charter, to begin with.

I would like to be advised, if in your view there are other organizations of national importance which should be granted a Federal charter.

We will be very interested in the comments that are made here today. I will not be able to be with you all morning because we are in a markup at Interstate and Foreign Commerce on the energy bill, and that has a high priority right now.

But, this is an area that this committee has been assigned and it is one that we are all interested in. We want to be sure that we have the facts before we make any future determinations.

Mr. FLOWERS. Thank you, very much, Mr. Moorhead.

To begin, then, I would like to invite Mary C. Lawton, Deputy Assistant Attorney General, of the Office of Legal Counsel, to come up and talk with us about the Department's view of this matter.

We would like to welcome you, Ms. Lawton, and we will be delighted to hear what you might have to offer to us.

TESTIMONY OF MARY C. LAWTON, DEPUTY ASSISTANT ATTORNEY GENERAL, OFFICE OF LEGAL COUNSEL, DEPARTMENT OF JUSTICE

Ms. LAWTON. Thank you, Mr. Chairman.

I appreciate the opportunity to participate in this background hearing. The Department has a definite interest in this subject and, over the years, has worked with the cognizant committees of the Congress in the development and application of appropriate guidelines.

The recent history on Federal charters probably dates from President Johnson's veto of H.R. 3329 in 1965. In the veto message he stated:

For some time I have been concerned with the question of whether we were granting Federal charters to private organizations on a case-by-case basis without the benefit of clearly established standards and criteria as to eligibility. Worthy civic, patriotic, and philanthropic organizations can and do incorporate their activities under state law. It seems obvious that Federal charters should be granted, if at all, only on a selective basis and that they should meet some national interest standard.

Other questions indicate the desirability of further study of this matter.

In the veto message, the President also commissioned the Department of Justice and the Bureau of the Budget—now Office of Management and Budget—to conduct a study of these corporations and to make some recommendations.

The summary of the results of this effort, together with the Justice Department report entitled "Legal Status of Congressionally-Chartered Organizations" were furnished to the Chairman of the House Judiciary Committee, in 1966.

For your convenience, I have attached copies of this material to my statement. While the attached material is now nearly 10 years old, it is, I believe, still substantially accurate today.

I would be happy to discuss it in more detail, or any other aspect of the study, but I have no further prepared remarks.

[The study referred to follows:]

MEMORANDUM ON STANDARDS FOR FEDERAL CHARTERING OF PRIVATE, NON-PROFIT ORGANIZATIONS

This memorandum summarizes the results of a study undertaken by the Bureau of the Budget and the Justice Department pursuant to the President's message of September 10, 1965, vetoing H.R. 3329. In that message, the President requested those agencies to examine the question of standards for chartering, and the legal status of federally-chartered organizations.

The principal findings are as follows:

No set of consistent and clear standards has been developed or used to evaluate the need for granting charters to private groups. The Congress has, however, exercised discipline in granting charters. The House Judiciary Committee makes use of informal criteria in reviewing charter proposals; e.g., its policy is not to report out bills chartering sectarian organizations. However, there is no generally agreed-upon comprehensive set of standards to guide congressional action.

Generally, federally-chartered organizations are free from Federal supervision. Many of them submit annual reports, and are required to have independent audits annually and to make reports of such audits to the Congress. Many of these reports, however, are not particularly informative and virtually no action is taken on the basis of them.

As to legal status, the organizations reviewed fall into three categories: "national corporations", "corporations of the District of Columbia", and a hybrid variety "corporations chartered in the District of Columbia." Very few legal benefits accrue from a Federal charter which do not accrue from State or District of Columbia charters. In nearly all cases the only apparent purpose of a Federal charter is to enhance the prestige of the chartered organization.

There is no definite arrangement for having executive branch agencies review specific charter proposals. Although agencies are frequently asked by congressional committees to report on pending proposals, such requests have usually been handled on a routine basis without a detailed review or investigation of the organization's activities, officers, or proposed incorporators.

Congressional responsibility for Federal charters is fragmented. Charter proposals are sometimes referred to committees other than the Judiciary Committees.

The findings support the conclusion that stricter standards should be applied in granting Federal charters. Such standards should provide that any organization granted a Federal charter should:

Be organized and operated only for charitable, literary, educational, scientific, patriotic, or civic-improvement purposes;

Be nonpartisan;

Be nonsectarian;

Be nonprofit;

Conduct activities which are of national scope and importance;

Have a name which is not substantially similar to the name of any other corporation holding a Federal charter;

Be of such unique character that a Federal charter is the only appropriate form of incorporation, or require a Federal charter in order to obtain tangible

legal benefits not obtainable under charters granted by the States or the District of Columbia ;

First have operated under a charter granted by a State or the District of Columbia for a sufficient length of time to demonstrate that its activities are clearly in the public interest. (Exceptions to this particular standard might have to be made, of course, for organizations of such unique character that a Federal charter is the only appropriate form of incorporation.)

When taken together, these suggested standards may appear to be overly strict, especially when the Congress is confronted with specific requests to charter worthy and public-spirited organizations. However, adherence to strict standards seems highly desirable, for several reasons :

As the Justice Department staff study indicates, very few tangible legal benefits ever accrue to an organization by virtue of a Federal charter.

Although the Federal Government exercises no supervision over chartered organizations, except for review of annual audit reports, granting a charter can be interpreted—rightly or wrongly—as implying the Government's approval of an organization's activities.

Even though Federal recognition of an organization and increased public awareness of its work might be in the public interest, there are other ways to achieve these aims, such as concurrent resolutions and public statements by governmental leaders.

Congressional workload has increased substantially in recent years. The Congress should not have to spend its limited time on legislation which, in most cases, is not really necessary.

LEGAL STATUS OF CONGRESSIONALLY CHARTERED ORGANIZATIONS

In response to the President's suggestion in his veto message on H.R. 3329, the Department of Justice has undertaken a brief study of the legal status of congressionally-chartered corporations. The following material, which is limited to the various charitable, patriotic, civic and educational organizations included in Title 36 of the United States Code, indicates the results of that study. It considers the Federal laws relating to such corporations, the impact of selected state laws, and the background of congressional charters.

At the outset, it should be noted that the congressionally-chartered corporations listed in Title 36, United States Code, fall into several categories. For example, the American National Red Cross, 36 U.S.C. 1 et seq., is a quasi-official agency established to carry out certain treaty obligations of the United States. Other organizations, such as the American Legion, 36 U.S.C. 41 et seq., are purely private corporations which have requested and received congressional charters.

The congressionally-chartered corporations might also be categorized by reference to the type of charter received. A number of the organizations listed in Title 36 are "national corporations", i.e., they are established as "a body corporate" without any reference to specific domicile. The American Legion is in this category. Other congressionally-chartered corporations are established as "a body corporate and politic of the District of Columbia," e.g., the Boy Scouts of America, 36 U.S.C. 21 et seq., and these are D.C. rather than national corporations. Other congressional charters use somewhat ambiguous language. The Red Cross (36 U.S.C. 1 et seq.), the Daughters of the American Revolution (36 U.S.C. 18 et seq.), the American Historical Association (36 U.S.C. 20 et seq.), the Sons of the American Revolution (36 U.S.C. 20a et seq.), and the National Yeomen F. (36 U.S.C. 139 et seq.) are established as bodies corporate "in the District of Columbia." It is not entirely certain whether they are to be considered national or D.C. corporations.¹

Courts have described the Red Cross as: a national rather than a D.C. corporation, *Osborn v. Oklahoma Tax Comm'n*, 279 P.2d 1096 (Okla. 1954) ; a D.C. corporation, *Patterson v. American National Red Cross*, 36 S.E. 2d 831 (Ga. App. 1946) ; and a "congressionally-chartered" corporation, *American National Red*

¹ The legislative history is not helpful on this point. There is no legislative history on the American Historical Association. The report on the D.A.R., H. Rept. 179, 54th Cong., 1st sess. (1896), refers simply to "a charter." The report on the S.A.R., H. Rept. 1635, 59th Cong., 1st sess. (1906), refers to "national" incorporation. The report of the Foreign Affairs Committee regarding the Red Cross, H. Rept. 3148, 58th Cong., 3d sess. (1904), refers merely to federal supervision, and the report of the District Committee on the Yeomen F., H. Rept. 2894, 74th Cong., 2d sess. (1936) is silent on this.

Cross v. Felgner Post, 159 N.E. 771 (App. Ind. 1928). Thus, it is not certain whether organizations chartered "in the District of Columbia" are to be considered national or D.C. corporations.

A. BENEFITS OF CONGRESSIONAL CHARTERS

It is important to note that the Title 36 corporations did not depend on the congressional charter for their existence. Most, if not all, of these organizations had been functioning for some time before receiving a congressional charter. For example, the Girl Scouts had incorporated in the District in 1912 and did not receive a congressional charter until 1950, S. Rept. 1321, 81st Cong., 2d sess. (1950). The National Safety Council was incorporated in Illinois in 1913, forty years before receiving a congressional charter, H. Rept. 556, 83d Cong., 1st sess. (1953). The Future Farmers of America was incorporated in Virginia in 1928, H. Rept. 2852, 81st Cong., 2d sess. (1950) and did not receive its congressional charter until 1950. Other organizations, such as the Grand Army of the Republic, existed for many years as unincorporated associations, H. Rept. 242 (68th Cong., 1st sess. (1924)). Indeed, all the organizations listed in Title 36 were apparently in existence, either as corporations or unincorporated associations, at the time the congressional charter was granted. Thus, a congressional charter, whatever other benefits it might confer, is not essential to the existence of any civic or patriotic organization.

1. Benefits under Federal Law

There would appear to be very few benefits of a congressional charter under federal law. A congressional charter does not automatically confer jurisdiction on federal courts in actions involving such corporations, 28 U.S.C. 1349. Congressionally-chartered corporations are treated separately under the Internal Revenue Code, 26 U.S.C. 501(c)(1), only if they are instrumentalities of the United States and are specifically exempted by the act of incorporation. Otherwise, charitable, educational, civic and fraternal organizations are treated equally regardless of the organizational form or method of incorporation, 26 U.S.C. 501(c)(3), (4), (8). Certain congressionally-chartered veterans' organizations are expressly entitled to recognition by the Veterans' Administration for presentation of claims, 38 U.S.C. 3402, but the Administrator may also approve other organizations for that purpose. Indeed, there seems to be no special recognition of all congressionally-chartered corporations in federal law.

2. Benefits under State Law

The benefits of a congressional charter under the laws of the various states depend upon several factors: (1) whether the congressional charter provides national or D.C. incorporation; (2) whether there is evidence of congressional intent to supersede state corporation laws; (3) whether state law recognizes a national corporation as foreign or domestic; and (4) whether state law confers special benefits on congressionally-chartered corporations.

1. It seems to be well-settled that a corporation chartered by Congress as a D.C. corporation is to be considered a domestic corporation in the District of Columbia and a foreign corporation in all other jurisdictions. 17 Fletcher, *Cyclopedia of Corporations* § 8291 (1960 Rev. Ed.); Annot. 69 A.L.R. 1346 (1930). Thus, corporations such as Boy Scouts, Girl Scouts, Blind Veterans of World War I, American War Mothers, Foundation of the Federal Bar Association, and others, chartered by Congress as D.C. corporations, receive no greater general benefits under State law than do other D.C. corporations.

As already indicated, there is some question whether "corporations chartered in D.C." are national or D.C. corporations. The court decisions regarding the Red Cross are not in accord, and the effect of state law on these corporations will be determined by the courts' construction of the incorporating statute. In *Osborn v. Oklahoma Tax Comm'n*, 279 P.2d 1096 (Okla. 1954), the question concerned the status of the Red Cross for purposes of an estate tax exemption. The court noted that a national corporation chartered by Congress is "not to be regarded as a foreign corporation but as a domestic corporation in any State or territory in which it may do business or have an office," while a D.C. corporation may be treated as a foreign corporation with respect to the States even though chartered by Congress, 279 P.2d at 1097. The court interpreted the language "body corporate and politic in the District of Columbia" as indicating the home office of the cor-

poration rather than the legal domicile, and held that the Red Cross is a national corporation. "As a national corporation, therefore, it has the privileges and immunities of a domestic corporation in Oklahoma and the bequest to it is exempt from estate transfer taxes." 279 P.2d at 1098. On the other hand, a federal court found the Red Cross to be a D.C. corporation and a citizen of the District for diversity of citizenship purposes, *Patterson v. American National Red Cross*, 101 F. Supp. 655 (S.D. Fla. 1951).

The status of those organizations chartered in D.C. is unsettled and will undoubtedly depend on the decisions of the courts in individual cases. But if they are determined to be D.C. corporations, it seems clear that they are entitled to no greater benefits under state laws than any other "foreign" corporation.

2. The benefits of national incorporation within the various states will depend, in part, upon the intent of Congress. Where Congress establishes a corporation for the express purpose of performing certain functions in several States and indicates an intent that the corporation not be subject to any burdens imposed on foreign corporations in those States, the corporation chartered by Congress must be treated as domestic rather than foreign corporation, *Fletcher, op. cit.; Texas & Pac. Ry. Co. v. Weatherby* 92 S.W. 58 (Tex. Civ. App. 1906). With regard to public or quasi-public corporations chartered to perform governmental functions, such intent of Congress can generally be ascertained. However, most of the corporations listed in Title 36 are basically private corporations and are generally expressly required to comply with state laws, see *e.g.*, 36 U.S.C. 44, 57b, 345, 374. While such corporations may be authorized by Congress to conduct their operations in any state, we are not aware of any expression of congressional intent that such corporations be treated as domestic corporations by the several states. Absent an expression of such intent, the States are free to determine the status of congressionally-chartered corporations on the basis of State law.

3. When the status of a national corporation is determined by state law, that determination will, in turn, affect the benefits incurred by reason of the congressional charter. The cases involving the status of national corporations are not uniform, *Fletcher, op. cit.*; Annot. 69 A.L.R. 1346 (1930), as supplemented, 88 A.L.R. 873 (1934); Am. Jur., Foreign Corporations §§ 8-10, 138-152. A sampling of the statutes of ten states also indicates diversified treatment of national corporations with respect to such matters as domicile, appointment of resident agents, corporate registration, taxation, and special benefits.

California. The status of Title 36 corporations under the California Corporation Code is not clear. Quasi-governmental corporations, such as the Home Owners' Loan Corporation are not required to comply with the foreign corporation provisions regarding registration and appointment of resident agents (§ 9000 *et seq.*), *HOLC v. Gordon*, 97 P.2d 845 (Cal. Dist. Ct. App. 1939); 22 Cal. Jur. 2d. Foreign Corporations § 12. But the same reasoning may not apply to Title 36 corporations, chartered as national corporations. D.C. corporations are definitely foreign corporations in California, 22 Cal. Jur. 2d., Foreign Corporations § 3.

Apparently the status of congressionally-chartered corporations is immaterial with respect to tax exemptions in California since charitable, educational and similar organizations are treated equally whether foreign or domestic, Cal. Revenue & Taxation Code § 23701 *et seq.*

There are two special provisions in California law relating to congressionally-chartered organizations. The California Corporation Code, § 9203, specifically authorizes subordinate branches of national bodies to incorporate in California, and the Military and Veterans Code, § 699.5., provides that only veterans' organizations chartered by Congress and recognized by the Veterans' Administration may assist in presenting claims before the California Department of Veterans' Affairs.

Delaware. Federal incorporation does not appear to provide any special benefits in Delaware. The Delaware Code Annotated, § 341, provides that no corporation chartered under the laws of any state or the United States may do business in Delaware until it files a copy of its charter and designates an agent. There does not appear to be any different tax treatment for national corporations nor is any special benefit conferred on congressionally-chartered corporations.

Florida. It is not clear whether national incorporation confers any special benefit in Florida. In general, Florida Stats. Ann. § 613.07, defines a "foreign corporation" as one incorporated under the laws of another state or territory or in another country. Foreign nonprofit corporations must file articles of incor-

poration and must obtain a permit to solicit funds, F.S.A. §§ 617.11, 617.22 to 617.25. The Florida Attorney General has held that the solicitation permit requirement does not apply to the Red Cross because it is a quasi-official agency of the federal government, 1956 Op. Fla. A.G. 056-30. Since the opinion stresses the special connection between the Red Cross and the government, however, it is not clear whether the opinion can be interpreted as applicable to national corporations generally. Nor, to the best of our knowledge, has this been settled.

Apparently foreign and domestic nonprofit corporations are treated equally for tax purposes in Florida, so the status of national corporations would be immaterial.

Florida law specifically recognizes congressionally-chartered veterans' organizations. No local veterans' organization can be chartered under Florida law unless it is affiliated with one of the congressionally-recognized organizations, F.S.A. § 608.61.

Illinois. Illinois law treats any nonprofit corporation which is not incorporated in Illinois as foreign. Foreign nonprofit corporations are required to obtain a certificate before doing business in the State, but once certified, they have the same rights as domestic corporations. Smith-Hurd III. Stats., Nonprofit Corporation Law, § 163a *et seq.* Apparently there are no cases involving national nonprofit corporations, but under the definition of "foreign corporations" in the Illinois law, it may be assumed that national corporations would be treated as foreign corporations.

The general tax exemption for charitable and benevolent organizations does not distinguish between foreign and domestic corporations, Smith-Hurd III. Stats., Ch. 120 § 500.

Massachusetts. Any charitable corporation organized under laws other than those of the Commonwealth of Massachusetts is a foreign corporation, Ann. Laws Mass. Ch. 181 § 1. Foreign charitable corporations must file a certificate in order to do business in the State, Ann. Laws Mass. Ch. 12 § 8E. There is a special exemption from this requirement for the Red Cross, the Grand Army of the Republic, the Spanish War Veterans, the American Legion, Disabled Veterans, Amvets, American Veterans of World War II, Military Order of the Purple Heart, Veterans of World War I and Veterans of Foreign Wars, but there is no general exemption applicable to all national or congressionally chartered organizations.

Only domestic charitable corporations are exempt from taxes in Massachusetts, Ann. Laws Mass. Ch. 59 § 5, but there is a general exemption for all veterans' organizations. (This latter exemption makes no reference to congressional charters.)

Michigan. Michigan law requires that nonprofit foreign corporations obtain a license to do business in the state and comply with the same requirements as domestic nonprofit corporations, Mich. Stats. Ann. § 21.98. It is not clear whether national corporations are to be considered foreign or domestic.

Charitable and veterans' organizations incorporated in Michigan are entitled to an exemption from the real property tax, Mich. Stats. Ann. § 7.7. These same organizations are exempt from the personal property and intangible personal property taxes and, in addition, there is a special tax exemption for the Grand Army of the Republic, the Sons of Union Veterans, the Women's Relief Corps, the Boy Scouts, the Girl Scouts, 4-H Clubs "and other similar associations," Mich. Stats. Ann. §§ 7.9, 7.556(3). It has been held that the American Legion is a "similar organization" for purposes of the tax exemption, 1953 Op. Mich. A.G. No. 1691. In that opinion, the Michigan Attorney General noted that the American Legion is federally-chartered, but the opinion turns on the construction of the Michigan statute and it is not clear whether the tax exemption would extend to all national corporations.

Michigan authorizes cities and counties to appropriate funds for the expenses of persons attending conventions of congressionally-chartered veterans' organizations, Mich. Stats. Ann. § 4.1421.

Missouri. Missouri law defines "foreign nonprofit corporations" as any such corporations not organized under Missouri Law, Vernon's Ann. M. Stats. § 355.010. Such corporations must obtain a certificate to do business in the state and, once certified, they are equal to domestic corporations, V.A.M.S. §§ 355.335, 355.340. From the language of the statute it would appear that national corporations would be considered foreign, but this matter does not appear to have been decided specifically.

There appears to be no difference in the tax treatment of foreign and domestic nonprofit corporations, V.A.M.S. §§ 143.120, 147.010.

New York. Although there is a judicial decision to the effect that a national corporation, the American Legion, was not a citizen of any state, *Gallaher v. American Legion*, 277 N.Y.S. 81 (Sup. Ct. 1934), it seems clear that any national corporation operating in New York is now considered to be a domestic corporation. The New York Civil Practice Laws and Rules, § 105(g) (McKinney) defines a "domestic corporation" as "a corporation created by or under the laws of the state, or a corporation located in the state and created by or under the laws of the United States * * *." Presumably, such a corporation would be entitled to all the rights and privileges of a New York corporation.

Oregon. The business corporation law in Oregon defines "foreign corporation" as any corporation for profit or cooperative association organized under laws other than the laws of Oregon "except any corporation organized under the laws of the United States and any corporation which is an agency of the United States." Oreg. Rev. Stats. § 57.004(7). However, the nonprofit corporation law defines "foreign corporation" as any corporation organized under laws other than those of Oregon. Thus, it would appear that nonprofit corporations organized under the laws of the United States are foreign corporations in Oregon, but we are not aware of any decision expressly determining this point.

Oregon tax laws exempt the real and personal property actually used by charitable or fraternal organizations for charitable purposes, O.R.S. §§ 307.130, 307.136, and the American Legion and Veterans of Foreign Wars are specifically included among exempt fraternal organizations, O.R.S. § 307.134. Charitable and fraternal organizations, are required to file statements in order to obtain the exemptions, O.R.S. § 307.170. Exemptions from excise and corporate income taxes are granted charitable and fraternal organizations, O.R.S. § 317.080, 318.030, 318.040. There is no apparent distinction between domestic and foreign charitable corporations.

Texas. The Texas nonprofit corporations act defines "foreign corporation" as any corporation organized under laws other than those of Texas. 3 Vernon's Ann. Tex. Civ. Stats. § 1396-1.02(2). Such corporations are required to obtain a certificate in order to do business in the State, V.A.T.S. § 1396-8.01, but once certified they are on an equal footing with domestic corporations, V.A.T.S. § 1396-8.02. It is not clear whether national nonprofit corporations are considered foreign corporations under this statute. The Texas business corporations act defines "foreign corporation" in the same terms as the nonprofit corporations act, 3A V.A.T.S. § 1.02A2, yet, under the business corporations act, federal corporations are not considered foreign corporations, 14 Tex. Jur. 2d., Corporations § 591. In *Texas v. Pac. Ry. Co. v. Weatherby*, 92 S.W. 58, 59 (Tex Civ. App. 1906), the court stated: "* * * we judicially know that the Texas and Pacific Railway Company was incorporated under the acts of the Congress of the United States, and a corporation to deriving its existence cannot, we think * * * be denominated a foreign corporation in the sense now insisted upon in behalf of appellant." The court held that the railroad was a domestic corporation which could be sued in any county in which it maintained an agent. It is not certain, however, that the same holding would apply in all circumstances or that it would apply to national nonprofit corporations such as those listed in Title 36.

Charitable and nonprofit corporations are exempt from the corporate franchise tax in Texas, 20A V.A.T.S. § 12.03, and there is no apparent distinction between foreign and domestic corporations. Similarly, benevolent lodges and certain named civic, charitable and veterans organizations (including several national corporations) are exempt from taxes, 20A V.A.T.S. §§ 1407, 7150.

No veterans' organization may be chartered in Texas using such names as "veteran," "disabled," etc., without the approval of a congressionally-chartered veterans' organization, V.A.T.S. § 5798a 2.

Miscellaneous cases. Judicial decisions regarding the status of national corporations are as varied as state statutes. In *Patterson v. American National Red Cross*, 101 F. Supp. 655 (S.D. Fla. 1951), a federal court held that the Red Cross is a citizen of the District of Columbia for diversity purposes even though it is a national corporation entitled to do business in every state. In *Pearl v. United States*, 230 F. 2d 243 (C.A. 10, 1956), the court made it clear that the Civil Air Patrol is not a federal agency for tort claims purposes, and in *Hooten v. Civil Air Patrol*, 161 F. Supp. 478 (E.D. Wisc. 1958), it was held to be a D.C. citizen and a foreign corporation in Wisconsin. In a libel action against the American Legion, the court stated: "A corporation created by an Act of Congress with authority to operate in a number of States is a citizen of the United States but

not a citizen of any State for jurisdictional purposes under Section 1332(a) (1), 28 U.S.C. [diversity of citizenship]." *Harris v. American Legion*, 162 F. Supp. 700, 705 (S.D. Ind. 1958), aff'd per curiam, 261 F. 2d 595 (C.A. 7, 1958).

Decisions in state courts are equally varied. *Gallaher v. American Legion*, 277 N.Y.S. 81 (Sup. Ct. 1934), held that the American Legion is not a citizen of any state but is subject to the jurisdiction of New York courts when it does business in that state. *D'Amore v. American Legion*, 214 N.Y.S. 2d 70 (Sup. Ct. 1961), noted that the Legion is a "federal corporation" separate and distinct from its component chapters. In *Pierce v. Grand Army of the Republic*, 20 N.W. 2d 489 (Minn. 1945), the court pointed out that the G.A.R. is a D.C. corporation and is a foreign corporation in Minnesota. The Red Cross was described as a "federal corporation" in *Ragan v. Dodge County Chapter, Red Cross*, 36 S.E. 2d 831 (Ga. App. 1946), but this fact did not entitle it to a tax exemption in Georgia. However, the fact of national incorporation was held to entitle the Red Cross to a tax exemption in *Osborn v. Oklahoma Tax Commission*, 279 P. 2d 1096 (Okla. 1954), since national corporations were found to be entitled to the same rights and privileges as domestic corporations.

3. The Prestige Value of Congressional Charters

The only benefit flowing from all congressional charters is the prestige value of national recognition. For prestige purposes, it apparently makes little difference whether the charter grants national incorporation or D.C. incorporation. Congress has recognized this fact. In chartering Amvets as a national corporation, the House Committee noted that the organization "is entitled to the standing and dignity which a national charter will afford." H. Rept. 189, 80th Cong., 1st sess. (1947). The Girl Scouts, on the other hand, were chartered as a D.C. corporation, yet the Senate Committee reported: "Because congressional charters are granted as marks of distinction to organizations whose public service is unique in scope and value, the friends of Girl Scouting believe that the deserved prestige of such a charter should be conferred on the Girl Scouts of the United States of America." S. Rept. 1321, 81st Cong., 2d sess. (1950).

The legislative history of the Acts chartering the various corporations listed in Title 36 indicates that, with few exceptions, national recognition and the accompanying prestige were the only benefits which Congress intended or expected to confer. See e.g., H. Rept. 1344, 80th Cong., 2d sess. (1960) (Blue Star Mothers); H. Rept. 2323, 85th Cong. 2d sess. (1958) (Blinded Veterans); S. Rept. 1738, 85th Cong. 2d sess. (1958) (Big Brothers of America); S. Rept. 1474, 85th Cong., 2d sess. (1958) (Congressional Medal of Honor Society).

Occasionally, however, Congress has had a more specific purpose in granting a charter. The Grand Army of the Republic was granted a charter because, as an unincorporated association, it was not legally qualified to accept bequests. H. Rept. 242, 68th Cong., 1st sess. (1924). The Red Cross was reincorporated in order to provide closer federal supervision of the organization which was officially recognized under the Geneva Treaty, H. Rept. 3146, 58th Cong., 3d sess. (1904). The Belleau Woods Memorial Association was granted a national charter because the government of France refused to recognize a D.C. corporation, S. Rept. 1166, 67th Cong., 4th sess. (1923).

The chartering of many veterans' organizations was apparently intended to provide newer organizations with the same recognition given to others. Several committee reports have referred to this in recommending charters, e.g., H. Rept. 1677, 76th Cong., 3d sess. (1940) (Spanish War Veterans); H. Rept. 1479, 85th Cong., 2d sess. (1958) (Veterans of World War I). In addition, Congress has recognized that a congressional charter can be of special benefit to veterans organizations because of specific provisions in the laws of some states: "Although a congressional charter is, therefore, not essential to the organization for the performance of its functions before the Veterans Administration, such a charter would be of great value in that it would make the Military Order of the Purple Heart eligible to participate in certain veterans' benefits which are available in some States only to congressionally chartered veterans' organizations." H. Rept. 2479, 85th Cong., 2d sess. (1958).

Except in these specific instances, however, the only apparent purpose of the congressional charter is to give recognition and additional prestige to the chartered organization. It might be added that this is the only certain effect of such a charter in all states even though national incorporation may confer additional benefits in some states.

B. BACKGROUND OF CONGRESSIONAL CHARTERS

From time to time, Congress has indicated that it applies certain standards in deciding whether to grant a charter to an organization. To the best of our knowledge, however, these standards are not set out in any single document. Nor does any distinction appear to have been made between national incorporation and D.C. incorporation.

In 1919, the report regarding the American Legion noted: "While Congress has been loath to grant special charters, it is believed that this should be an exception to the rule." H. Rept. 191, 66th Cong., 1st sess. (1919). The report emphasized the service of these men to the nation in time of war. Later, with respect to the Disabled Veterans, the Judiciary Committee commented: "In the judgment of the committee the activities of this organization bring it within the rule which the committee has adopted strictly limiting its recommendations of Federal Incorporation to organizations national in character and scope of activities and which assist in the execution of some express or implied power in the Constitution or some governmental function thereunder." H. Rept. 1271, 72d Cong., 1st sess. (1932). Both these organizations are national corporations.

The Blind Veterans of World War I, on the other hand, is a D.C. corporation. Yet the standards referred to for granting the congressional charter are similar to those which prompted the national charter of the D.A.V.: "It presents one of the cases in which the granting of a Federal charter by Congress is surely permissible without in any wise infringing upon the general policy that Federal charters should not be granted except in connection with patriotic service or in aid of national or governmental needs." H. Rept. 483, 68th Cong., 1st sess. (1924).

The standards for chartering other nation-wide organizations are not as clear as those for veterans' organizations. In recommending that the American Society of International Law be made a national corporation, the committee merely stated that in view of the history, purpose and national character of the society it was "fitting" that it should have a national charter, S. Rept. 2529, 81st Cong., 2d sess. (1950). A similar comment was made with respect to the National Conference on Citizenship, S. Rept. 239, 83d Cong., 1st sess. (1953). The National Fund for Medical Education was chartered as a D.C. corporation, yet the committee report stated: "The committee is convinced that this organization is carrying on work of vital importance to the welfare of the Nation. In view of its national character, its service to the medical life in all parts of the country, the National Fund for medical Education is uniquely qualified for a national charter." S. Rept. 377, 83d Cong., 1st sess. (1953).

Occasionally, the cooperation of a private organization with federal agencies has been stressed as a reason for granting a congressional charter. The report on the National Safety Council emphasized this and referred to "the need for a national group to coordinate safety efforts." H. Rept. 556, 83d Cong., 1st sess. (1953). Similarly, the report on the Civil Air Patrol reviewed the services of that organization to the military during World War II and commented: "The Committee on the Judiciary is reluctant to recommend national charters for the many groups seeking them. It is felt, however, that the Civil Air Patrol has especial claims to Federal recognition and support." H. Rept. 1830, 79th Cong., 2d sess. (1946).

There are very few general standards that can be deduced from considering the nature of the Title 36 organizations or from studying the legislative history of their charters. All are nation-wide in scope, and all fit into one of several categories: veterans' organizations; civic, patriotic or historical organizations; service organizations for youth; and philanthropic organizations. There is, however, no apparent reason for singling out these organizations over others in the same category. Nor does there appear to be any pattern for distinguishing between national corporations and congressionally chartered D.C. corporations. For example, the American Legion, V.F.W., D.A.V. and Amvets are national corporations while the Grand Army of the Republic and Spanish War Veterans are D.C. corporations. Similarly, the Future Farmers of America is a national corporation while the Boy Scouts and Girl Scouts are D.C. corporations.

At present, federal supervision over congressionally chartered organizations is quite limited. All "private corporations established under federal law," as defined and listed in 36 U.S.C. 1101, are required to have independent audits annually and to have the reports of the audits submitted to Congress, 36 U.S.C. 1102, 1103. In addition, many such organizations are required to make annual

reports of their activities to the government. Most such reports are submitted to Congress, see, *e.g.*, 36 U.S.C. 28, 37, 49, 58, 65, 78n, 901, 118, 382, 955. The Red Cross is required to report annually to the Department of Defense, 36 U.S.C. 6. The Daughters of the American Revolution and the American Historical Society report annually to the Smithsonian Institution, 36 U.S.C. 18b, 20. The Naval Sea Cadets report to the Secretary of the Navy, 36 U.S.C. 1058. Beyond this, there are no general provisions for federal supervision of all Title 36 corporations.

C. SUMMARY

Congressional charters of the type found in Title 36 vary widely in background and purpose. Three different forms of incorporation have been granted by Congress but no pattern for selecting the form of any given charter is evident. Nor does the background of the various corporations indicate any fixed standards required to obtain a federal charter. There is little federal supervision over congressionally-chartered corporations.

The corporations found in Title 36 did not depend upon congressional charters for their existence. Nor are there any certain legal benefits derived from congressional charters. Organizations chartered as D.C. corporations are domestic corporations in the District and foreign corporations elsewhere. Any legal benefits flowing from national incorporation are entirely dependent upon state laws, and the law in this area is largely uncertain. There are some state laws conferring special benefits on congressionally-chartered veterans' organizations, but for the most part, the only advantage of a congressional charter is the prestige value of that charter.

Mr. FLOWERS. Thank you.

Could you tell me, in vetoing H.R. 3329 in 1965, what organization would have been granted a Federal charter?

Ms. LAWTON. I cannot remember the precise organization, Mr. Chairman. It was a youth organization, Florida-based, I believe.

Mr. FLOWERS. Counsel has furnished me with this information, it was the "Youth Council for Civic Affairs." I have not had occasion to read the entire memorandum that you have attached to your statement which will be made a part of our record here, but I shall do so.

Has the Department conducted any oversight of the charters, I might say—but, have you "reviewed"—that is a better word—oversight is our function, I believe. Have you reviewed the charters, the granting of congressional charters, over the last 10 years, with a view toward whether or not the memorandum criteria have been substantially complied with or not?

Ms. LAWTON. Well, what happened was that after we sent this report to the Congress, the two Judiciary committees, or subcommittees having jurisdiction, got together and came up with a joint set of standards which were published in 1969.

At that time, as bills were introduced to grant Federal charters, they were with great frequency—although I could not say "uniformly"—referred to the Justice Department for comment.

In those comments, we normally came back to the Congress pointing out whether or not we thought the organization was consistent with the standards that Congress, itself, had adopted.

I can remember occasionally some veterans organizations that were geared to a particular religious group would seek a charter. One of the standards Congress had adopted was that a religious organization would not be federally chartered. We would point out, that this was one of the standards. As asked, on individual chartering bills, we would respond to the Congress on such issues, but we did not set up any monitoring system for all such bills, as introduced.

Few charters, I believe, have been granted since these standards were adopted.

Mr. FLOWERS. What is the function, then, of the Justice Department on this matter?

Ms. LAWTON. We have none really, Mr. Chairman, except for that original study that the President commissioned us to do. We did the study, reported back to OMB who in turn reported to the Congress, and then the only other role we have is just this: Commenting upon these bills as they come through.

But we have no jurisdiction over these corporations, unless and until they are involved in some violation of Federal law.

Mr. FLOWERS. Such as?

Ms. LAWTON. Well, if a corporation should commit fraud or violate some criminal statute, vis-a-vis the Government, we would have jurisdiction over it, as we would of any corporation. But we have no unique jurisdiction.

Mr. FLOWERS. To your knowledge, has there ever been any prosecution of an officer, director, or of a federally chartered corporation, as such?

Ms. LAWTON. Not to my knowledge, but I could not be certain on that, Mr. Chairman.

Mr. FLOWERS. Does the Department of Justice conduct any oversight or monitoring or anything of that nature—periodic investigation of any aspects of any heretofore federally chartered organization?

Ms. LAWTON. No, sir.

Mr. FLOWERS. The only way that it would come up would be through some prosecution for violation of a Federal law?

Ms. LAWTON. That is right. We have, occasionally, been asked by private citizens to look into these organizations because they will claim that a particular election was invalid and we must respond to the citizen that we have no authority over these corporations.

Mr. FLOWERS. Does the Department of Justice maintain any file or listing or have any occasion to do that? I do not think you are charged with the responsibility of maintaining such.

Ms. LAWTON. No; the basic list is, of course, in title 36 of the U.S. Code, although it is not an all-inclusive list. I attempted to put one together in doing the study in 1965, but whatever notes I made on it are long-since gone.

Mr. FLOWERS. Well, in your personal opinion or judgment, then as an individual or, if appropriate, in your governmental capacity, would you give us the benefit of your opinion on what advantages there might be to Federal charter status for, say, an organization that might in the current time be chartered under said laws of New York, or the laws of the District of Columbia, if they decide to seek the Federal charter status?

Ms. LAWTON. Ordinarily, for most of these corporations, there is no advantage other than prestige, and what support that prestige may lend to fund solicitations or membership solicitations.

There are exceptions. Veterans organizations are recognized by State law, in many instances, only if they are a local unit of a congressionally chartered veterans organization.

So, in the case of veterans' organizations, there are specific benefits conferred by State law, by reason of the Federal charter. That is one category where a Federal charter has a substantive legal effect.

Mr. FLOWERS. You mean such things as Veterans of Foreign Wars? The American Legion?

Ms. LAWTON. Yes, it does not matter whether they are chartered in D.C., or just chartered nationally, if they have a congressional charter they get benefits under the laws of many States.

With other organizations, there is no benefit, other than prestige, except in unusual international situations. The Belleau Woods Memorial Commission was chartered by Congress because the Government of France would not recognize a D.C. corporation for purposes of maintaining the cemetery.

The Red Cross was chartered by Congress because it carries out treaty obligations of the United States and has a sort of quasi-official role. And there I think the Federal charter is important, or necessary, to the corporation itself.

But, by and large, for most of them, there is no benefit except prestige that is conferred in law.

Mr. FLOWERS. Well, Counsel furnishes me with a notation from this memorandum indicating that the Veterans Administration also, by statute, often recognizes veterans organizations who are chartered by Federal statute.

Ms. LAWTON. Yes, they are ordered by the statute to recognize the congressional charter but they may, in addition, recognize others.

Mr. FLOWERS. Right.

Well, I thank you. I do not think I have any further questions.

Mr. Moorhead has indicated he needs to leave. He might want to direct a question to you first.

Mr. MOORHEAD. Well, from the conversation so far, it is very clear that these federally chartered corporations have minimum supervision, if any at all.

Would you recommend more congressional oversight of these corporations than we have had in the past?

Ms. LAWTON. Well, where the corporation is chartered as a corporation of the District of Columbia, there is theoretical supervision under the D.C. Nonprofit Corporation Act.

But, where it is chartered simply as a body corporate, or chartered in the District of Columbia which is a legal anomaly, there is no supervision now.

States, where they consider them foreign corporations, do exercise some supervision. Where they consider them domestic corporations, they exercise somewhat less supervision.

I think that for those now having Federal charters, there may be some reason to set up a little more supervision, although I do not know of any problems that have arisen. I think the real solution is in taking care not to proliferate the number of these in the future.

Mr. MOORHEAD. Do you think there is a possibility of a need in the future for any kind of separate agency, or commission, to supervise these agencies?

Ms. LAWTON. I have not seen any need demonstrated, to date—and some of these date back, of course, through the Civil War.

Mr. MOORHEAD. We have an interesting bill in this year, H.R. 7481, which was introduced by Congressman Stanton, which proposes the establishment of a Federal corporate chartering commission that would cover large, profitmaking corporations.

Do you think this kind of a setup lends itself to this type of activity where profitmaking corporations would be included in it?

Ms. LAWTON. I think that would be very difficult.

Most States tend to separate nonprofit and for-profit corporations in their law and in their supervision. And I think that that is generally a wise decision.

Mr. MOORHEAD. Well, in looking at our responsibility, it would appear that there is very little rhyme or reason to the method of deciding which group should receive a charter and which do not. It just happens to depend on how the committee feels at the time and how things are going.

Do you think it would be wise to adopt a Federal standard of some sort? Or some rules determining which organizations are eligible for these Federal charters, and which are not?

Ms. LAWTON. Well, of course, the two Judiciary committees did informally adopt such standards in the past. It might be helpful and advisable to put that on the public record. The decision and the standards are all in committee print. They were never even printed as a formal document and they were never formally adopted by the two Houses.

I think that perhaps concurrent resolutions setting standards would—well, for one thing, reduce the number of bills being presented to you for consideration.

Mr. MOORHEAD. Well, for example, there have been several groups that do some lobbying and things of that kind, representing environmental interests, and similar issues that have applied for Federal charters in the past. And yet perhaps a determination by Congress of who gets it and who does not get it would be a tremendous stimulus for growth for the ones who are successful, and leave the others at a disadvantage.

Do you think that this is a good situation?

Ms. LAWTON. I think it puts you and your colleagues in a terrible spot, Mr. Moorhead, because it is basically going to be the more vocal and better organized organizations that are going to succeed.

And, probably they have less need of the Federal charter than the lesser-known, not-so-vocal organizations. But it would be awkward, I believe, for Congress to charter any organization which has, as a major function, lobbying. I think it would put the Congress in a very awkward position, and it has not had a precedent for this in the past. Therefore, there is less argument that an organization can make in favor of it, and I think the fewer of these things we create—because they are in a legal “no man’s land”—the better.

If there is a need, such as the Belleau Woods Memorial Commission, then obviously Congress should grant a charter. But, for most of these organizations—with the exception of veterans’ organizations—there is no legal need or benefit that they can point to.

Mr. MOORHEAD. I thank you very much. I appreciate your coming out this morning.

Mr. FLOWERS. I would like to welcome my distinguished colleague

from Texas, Ms. Jordan, and see if she would like to direct any questions to the witness?

Ms. JORDAN. Thank you, Mr. Chairman.

Mr. Chairman, I apologize for not hearing the witness' testimony. I have no questions at this time.

Mr. FLOWERS. Thank you very much. Thank you, Ms. Lawton.

Mr. SHATTUCK. May I ask a question?

Mr. FLOWERS. Yes, Counsel, go right ahead.

Mr. SHATTUCK. Mr. Chairman, if I may, I might say first of all that this memorandum that has been submitted this morning contains one of the most complete discussions that we have seen on this subject.

You make a distinction between a nationally chartered corporation, and a charter which is a Federal charter in the sense it passes Congress but is a corporation in the District of Columbia.

This apparently has some other effects as regards the position of that corporation in the various States, but this is not exactly clear. Is this correct? I mean, does it depend a good deal on the State's interpretation?

Ms. LAWTON. Yes, it depends, in part, on the State's interpretation of its own nonprofit corporation law. And it also depends on the language of the act.

As I mentioned, there are some Federal charters that refer to corporations of the District of Columbia. Now that the law sets a legal domicile in the District of Columbia and makes the corporation, therefore, a foreign corporation in all other States.

But, when the act of Congress says that this is a corporation in the District of Columbia, not "of", but "in", it is not clear in law what that means. It is not clear whether that is describing location, or describing legal domicile, or making no legal determination at all. And court decisions on that have been confused.

Mr. SHATTUCK. If it were considered to be a national corporation, without the identification in the District of Columbia, could it then be regarded as a domestic corporation in each one of the several different States?

Ms. LAWTON. Yes, it may very well. This has happened in some cases dealing with the Red Cross, but I am not sure that the cases set precedent for other corporations because the Red Cross is, as I mentioned, a quasi-official body.

It is a treaty organization on behalf of the United States. If the same came up with the Future Farmers of America, I am not sure that the courts would look at it the same way.

Mr. SHATTUCK. Your memorandum also says that a factor in this would be the expressed intent of Congress in connection with the enactment. And so therefore it would be a responsibility among others of this subcommittee to make such a fact clear?

Ms. LAWTON. Yes, the "expressed intent" in the past has not been evident.

Mr. SHATTUCK. Yes, it is another point you made that the committees have not been entirely consistent in their statements of stating the need is for the incorporation.

Ms. LAWTON. Well, if you will notice from the memorandum, it is not even consistent to what committees these proposals are assigned. Federal charters have come from Foreign Affairs. Federal charters

have come from the Committee on the District of Columbia and they have also come from Judiciary.

Mr. SHATTUCK. Well, as we now understand it, the jurisdiction is confined in this committee. However, we still have to work out some arrangements to make sure that the reports and other oversight will be in this committee and that everyone understands this. In this respect it is an in-house problem.

I think that covers it, Mr. Chairman.

Mr. FLOWERS. Thank you, Mr. Shattuck.

Mr. Coffey, minority counsel, do you have some questions to address to the witness?

Mr. COFFEY. Yes, thank you, Mr. Chairman.

I would like to get a couple of things straight, if I could, Ms. Lawton. In your answers to Mr. Shattuck, you shed some light on the issue, but I am still kind of confused.

What occurs when an organization is granted a Federal charter? Does its existing State charter—is it, in some cases, allowed to lapse? Do they dissolve themselves for purposes of State law? What occurs?

Ms. LAWTON. It varies. Some will retain both their State charter and their Federal charter. Others will allow the State charter to lapse. There is no consistent pattern there, either. The whole area lacks consistency.

Mr. COFFEY. So when the cases talk about the problem of diversity of citizenship, for example, in some instances federally chartered organizations might still be citizens of a State, as well as national corporations. Is that accurate to say?

Ms. LAWTON. Yes, that is right. There is a particular Federal statute which eliminates Federal jurisdiction solely on the basis of a national charter.

Mr. COFFEY. Right.

Ms. LAWTON. And that leaves the citizenship of the corporation to be determined. Now, if Congress grants a charter of the District of Columbia to an organization previously chartered in Illinois, and they retain both charters, then they are presumably citizens of both, for diversity purposes. If they allow the Illinois charter to lapse, they are in D.C. Where there is only the Federal charter, and it is a national charter, then citizenship will probably be determined by headquarters office, because there is simply no other means to do it in law. But it has created confusion in the past.

Mr. FLOWERS. Let me interrupt here, if I might. Under the new District of Columbia charter, does the D.C. Council and the D.C. government have the capability of issuing charters, or must that still stem from the Congress?

Ms. LAWTON. Oh, no. Congress has enacted a nonprofit corporation law for the District which permits the District to grant charters, and it grants charters every day under both the profit corporation law and the nonprofit in the normal fashion. And it could grant a charter to any of these organizations that apply as well, provided they are willing to maintain an agent for service of process in the District and to comply with the other requirements. But the D.C. Corporations Office does indeed grant charters on its own, under authority of a basic act of Congress.

Mr. FLOWERS. So there would be no occasion for—even aside from the jurisdiction having been more clearly defined under the recent provisions of the rules of the House—there would be no occasion for the District of Columbia to have jurisdiction over the issue of charters. Go ahead, Mr. Coffey.

Mr. SHATTUCK. On that point, if I just might interject, is it not correct that the new law, the nonprofit corporation law of the District of Columbia, has a specific exclusion of these particular organizations from its supervision?

Ms. LAWTON. No, it has a reference.

Mr. SHATTUCK. It has a reference which does not apply.

Ms. LAWTON. To the federally chartered; that is right.

Mr. COFFEY. The text of a charter might designate that the principal office is in the District of Columbia. That, in itself, does not necessarily make the corporation a citizen of the District of Columbia, does it?

Ms. LAWTON. No, it does not.

Mr. COFFEY. All right, thank you. No further questions.

Mr. FLOWERS. Are there any further questions? Ms. Jordan?

Ms. JORDAN. No, no thank you, Mr. Chairman.

Mr. FLOWERS. Thank you very much, Ms. Lawton, for helping us.

I would next like to call upon the General Accounting Office, represented by Mr. D. L. Scantlebury, Director of Financial and General Management; and I believe Mr. Davenport is with you, sir, and perhaps others. And if you would like to come forward and introduce them, and present to us whatever you have available, we would be delighted to hear from you.

TESTIMONY OF D. L. SCANTLEBURY, DIRECTOR, DIVISION OF FINANCIAL AND GENERAL MANAGEMENT STUDIES, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY ERNEST DAVENPORT, ASSISTANT DIRECTOR, FGMS; FRED D. LAYTON, DEPUTY DIRECTOR, FGMS; THEODORE S. SASSO, ATTORNEY; AND EDGAR G. MERSON, ATTORNEY

Mr. SCANTLEBURY. Thank you, Mr. Chairman. I am accompanied today by Mr. Fred D. Layton, Deputy Director of the Division of Financial and General Management Studies; and, as you mentioned, Mr. Ernest Davenport, who is Assistant Director of the same division, and Mr. Edgar Merson, who is from our Office of General Counsel.

Mr. FLOWERS. We are delighted to have all of you. Could you all try to speak a little louder please?

Mr. SCANTLEBURY. We are happy to be here today to discuss our work in reviewing the audit reports of federally chartered corporations for the committee. When the Congress grants the privilege and distinction of having a Federal charter, the organizations in turn have the responsibility to comply in all respects with the law granting the charter. Congress, in fulfilling its oversight responsibility, requires the organization to furnish audit reports to it.

GAO became involved in this process in August of 1959, when the chairman of the House Judiciary Committee asked GAO to review a number of audit reports submitted to the committee by federally chartered corporations. Because of the variety of reporting require-

ments found in the corporations' charters, we concluded that it would be in the Government's interest to have all federally chartered organizations follow uniform reporting requirements, and in January 1962, we recommended that the committee sponsor legislation to provide such uniform requirements. In regard to our recommendation, the chairman suggested that we draft a bill, and our draft was introduced as House bill 4223, 88th Congress, on February 26, 1963.

Hearings on this bill were held during the spring of 1963, and it was enacted as Public Law 88-504 on August 30, 1964. Under Public Law 88-504, federally chartered corporations are required to be audited annually, in accordance with generally established auditing standards, by independent certified public accountants or independent licensed public accountants. The corporations are required to submit to the Congress the report of each such independent audit not later than 6 months following the close of the fiscal year for which the audit was made.

The law also requires that the audit report set forth the scope of the audit, and include such statements as are necessary to present fairly the corporation's assets and liabilities and surplus or deficit, with an analysis of the changes therein during the year, supplemented in reasonable detail by a statement of the corporation's income and expenses during the year, including the results of any trading, manufacturing, publishing, or other commercial-type endeavor carried on by the corporation, and together with an independent auditor's opinion of those statements.

Because of the technical nature of the statements, the committee wanted help in ascertaining whether the audit reports met the reporting requirements, and fully reflected the operations and financial status of the organizations. Therefore, the committee asked GAO to examine those audit reports. Currently, we examine the audit reports for the 48 corporations specifically listed in Public Law 88-504, plus 6 additional federally chartered private organizations that the committee has forwarded to us for review.

Our reviews of the reports are generally restricted to desk reviews unless serious questions or problems arise. When this occurs, we contact the independent public accountant or the organization for clarification. The purpose of our review is to determine whether in our professional judgment, the reports meet the standards for reporting set forth in the law.

The major problems noted by us to date have been: (1) lack of timely submission of reports; (2) lack of sufficient explanations in the report; (3) financial statements which do not meet the stipulated requirements of the law; (4) audits not conducted by independent certified public accountants or independent licensed public accountants; and (5) in some few cases failure to follow generally accepted auditing standards.

When the requirements of the act are not met, we first try to get the matter resolved ourselves, if only explanatory comments are missing. If our efforts do not resolve the matter, we inform the Committee on the Judiciary, and recommend that the corporation be asked to provide additional information or correct the deficiency. Also, the committee has authorized us to discuss any audit reports deemed not to meet generally accepted auditing standards with the public accountant

who performed the audit, and further to report any unresolved matters to the American Institute of Certified Public Accountants in cases where CPA's are involved. To date, we have been able to resolve questionable cases with the independent public accountants, and have not had to refer any to the Institute.

We do not as a rule make a review of the corporations' constitutions and bylaws, and our review would not disclose whether requirements of the act for electing officers and establishing such records have been met. These records would be available to the independent public accountant and should be reviewed by him as a part of his audit. As to taxable status, this is a matter which each corporation must resolve with the Internal Revenue Service by compliance with certain code sections. Our office does not get involved in checking the organization's compliance with IRS regulations.

One of the problems we have had is making sure that all reports that are required to be submitted to the Congress are being submitted due to the fact that some reports may be submitted and referred to other committees. Late last year, a questionnaire was mailed by the committee to organizations covered by Public Law 88-504 to determine whether they had submitted audit reports in accordance with the law. Many reports were received from organizations that had not previously met the reporting requirements. In the near future, we expect to submit a draft of another letter to be sent by the committee reminding those organizations that still have not complied with their auditing and reporting responsibility. We would suggest that further exploration be done to assure that all organizations that are required to submit reports to the Congress are actually doing so.

Mr. FLOWERS. I thank you very much, and your statement will be very helpful, I think, in giving us, along with other material, a guide to go on.

Let me just ask this. Can you think of any purposes that might not readily meet the eye to prompt an organization to seek Federal charter status, as opposed to, say, chartering under the laws of one or the other of the State jurisdictions?

Mr. SCANTLEBURY. We did some research into this, and generally our findings were consistent with what the Department of Justice witness previously stated.

Mr. FLOWERS. Prestige?

Mr. SCANTLEBURY. Prestige seems to be the principal reason for seeking it.

Mr. FLOWERS. From what you have said, it would be my judgment—and correct me if you think I am wrong—that with the over the shoulder look that you people are giving these organizations, and the requirement of the annual submissions, that possibly they are being checked more thoroughly at the Federal charter level than they would be at almost any State charter level.

Mr. SCANTLEBURY. I really have no information on that, Mr. Chairman.

Mr. FLOWERS. You cannot make a comparison on that basis?

Mr. SCANTLEBURY. I just do not know what the States are doing.

Mr. FLOWERS. Well, from my own former legal practice in at least one State of this Union of ours, I would say, if you do any looking

over, you are doing more than would be the practice in that State anyway; and perhaps that is true, or not true, of other States.

I have no further questions, sir. I thank you very much for being with us. I yield to Ms. Jordan.

Ms. JORDAN. Yes, sir. Thank you for your testimony.

Could you tell me how many people employed in your office have, as a part of their function, the overview of the audit reports of these federally chartered organizations?

Mr. SCANTLEBURY. The majority of this work is done by Mr. Davenport.

Ms. JORDAN. One person can do the job?

Mr. SCANTLEBURY. Yes; and Mr. Layton and I have become involved in it occasionally. I guess the majority of the work arises when there is a question in a particular report, where we feel that either all of the requirements of law have not been met, or the audit report leaves some questions unanswered that we feel necessary to follow up on. But that is about it. I would say probably our effort is about 1 man-year.

Ms. JORDAN. The thrust of my question is to try to determine whether you are expending energy and man-hours which could be more appropriately applied to maybe other substantive matters than this responsibility which you are charged with carrying out.

Mr. SCANTLEBURY. Well, it is a question of what matters are the most important for us to do by the Congress. We are not legally required to do this. We have done it at the request of the committee, and we do raise a number of questions, and I think it does indicate to the federally chartered corporations that they do have to submit a sound audit report and that somebody is looking at them, and that they do have to be carefully audited. And I believe that having such organizations carefully audited is an important function.

Ms. JORDAN. And you can see a sufficient rationale for a Federal charter being issued, that there is enough national interest or Federal interest for this function to continue on the part of the Federal Government?

Mr. SCANTLEBURY. I had not addressed that subject, really.

Ms. JORDAN. Would you address it?

Mr. SCANTLEBURY. Well, I really have not—I do not think we have an opinion on that particular matter. What we do think is that if the Congress, in its wisdom, grants a Federal charter, that perhaps it is worthwhile for the Congress to maintain some surveillance over those corporations to see that they do follow the requirements, and that they are carefully audited.

Ms. JORDAN. If you find substantive problems with the audit report, is it within the purview of your authority to recommend that a Federal charter be withdrawn?

Mr. SCANTLEBURY. We have not had any situations like that. I think we might do that if we felt that there were very serious things going on within that organization. Our work has not, to date, indicated anything of that seriousness.

Mr. FLOWERS. If I might interrupt the gentlelady, an example may be that it is going to age out at some point. The United Spanish War Veterans noted in the material filed this morning. I would think that at some point in time there would not be anybody remaining in an organization, unless it allows for the survivors, or something of that sort.

Ms. JORDAN. It would seem that that one would atrophy from its own weight.

How much money is involved? Can you give me an average figure? These 48 corporations that have some oversight function by this committee; how much cash money are we talking about—pennies, nickels, dollars?

Mr. SCANTLEBURY. It varies a great deal. I do not have that information readily available. We could provide it for the record. Actually, we do not have reports from all of the—you know, there are still some of the 48 that are listed in the act that have not submitted reports. There are seven of them, and so we do not have information on those seven.

Mr. FLOWERS. You mean, that have never submitted reports?

Mr. SCANTLEBURY. They have not recently, anyway. We do not have any record of them.

Mr. FLOWERS. They are in direct violation of the law.

Mr. SCANTLEBURY. Yes, they are, sir. As I mentioned in my testimony, we are drafting another letter for the committee to send out.

Mr. FLOWERS. Could you tell us who those seven are?

Mr. SCANTLEBURY. Yes. Would you tell them which ones they are?

Mr. DAVENPORT. These are the ones that we have no report on. Now, there is the possibility that they may have gone to another committee or something, but this is indicating we have no report on it, and one of them is the Girl Scouts of America. The Grand Army of the Republic, the Ladies of the Grand Army of the Republic, the National Women's Relief Corps Auxiliary to the Grand Army of the Republic, the National Yeoman.

Ms. JORDAN. I am especially interested in the Girl Scouts. How long has it been since they submitted a report?

Mr. DAVENPORT. I do not have a date on that. As I prefaced my remarks, it is possible that it may have been reported to another committee, but it has not come to us through the subcommittee here. So this is a question we would have to resolve before we could give an answer to that.

Ms. JORDAN. I do not think I have any other questions, Mr. Chairman.

Mr. FLOWERS. Thank you, Ms. Jordan.

I would like to yield to my distinguished colleague from Ohio, a new member of the subcommittee, and welcome him, and ask Mr. Kindness if he has any questions.

Mr. KINDNESS. Thank you, Mr. Chairman.

I want to apologize for being in and out this morning because of a schedule conflict. If I have missed something in your testimony and ask a question that is redundant, I do apologize.

I am curious about the time involved in these audit reviews and whether you have any information, even estimated information, as to the amount of time and cost that is involved in conducting these audit reviews.

Mr. SCANTLEBURY. Our time is about 1 man-year.

Mr. KINDNESS. About 1 man-year; and if all of the corporations did report, that would be increased somewhat, but not significantly.

Mr. SCANTLEBURY. I do not believe it would be significantly.

Mr. KINDNESS. I take it then that in the course of the audit reviews, there is not a spot check of factual information? Or, is there a spot check?

Mr. SCANTLEBURY. No, sir.

Mr. KINDNESS. No field work, then, is involved in the audit reviews?

Mr. SCANTLEBURY. No. What we do is we look at the audit report, see that it meets the requirements of the law and that they have all of the financial statements, that there is an opinion of a properly qualified accountant-auditor, and if there are questions that appear in our review, we try to follow them up and get them resolved so that we feel that the audit report accurately tells the story of the financial operations of the organization during the preceding year.

Mr. KINDNESS. Do you feel that the process involved here is really adequate for you to reach a valid conclusion with respect to whether or not there is compliance with the charter provisions, and the law under which they are chartered?

Mr. SCANTLEBURY. Yes, the law has certain—I am not sure about whether it is—it meets the requirements of the law, Public Law 88-504, which sets forth what the audit reports are supposed to contain.

Mr. KINDNESS. Thank you, Mr. Chairman.

I yield the balance of my time.

Mr. FLOWERS. Thank you, Mr. Kindness.

I thank you, sir, for being with us.

We have a quorum call. I am going to ask the indulgence of the subcommittee for a couple of more minutes and see if we can conclude this.

I want to thank all of you gentlemen from GAO for being with us. If, in retrospect, you think of anything else, our record will be open for a letter or any comment further that you might be able to send to us. We invite you to do so. We are searching for a rational basis on which to consider the bills before us. This is a new jurisdiction for our subcommittee.

I would like to invite, if we could, for just a few moments, Mr. Tedesco, Joseph Tedesco, of the Treasury Department to come forward, sir. I apologize for the lack of time that we have. The House is to be called in at 11 o'clock today, and it was unbeknownst to us when we scheduled this meeting.

Welcome to the subcommittee. We will be delighted to hear what you have to offer.

If you have a written statement that you would like to have submitted for the record and just make whatever comments you think would be appropriate in the time furnished you, that would be fine.

TESTIMONY OF JOSEPH A. TEDESCO, DIRECTOR, EXEMPT ORGANIZATIONS DIVISION, INTERNAL REVENUE SERVICE, ACCOMPANIED BY HOWARD M. SCHOENFELD, TECHNICAL ADVISER TO THE ASSISTANT COMMISSIONER FOR EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS; RONALD MOORE, ASSISTANT BRANCH CHIEF, EMPLOYMENT TAX DIVISION; AND MILTON CERNY, CHIEF, RULINGS SECTION OF TECHNICAL BRANCH OF EXEMPT ORGANIZATIONS DIVISION

Mr. TEDESCO. Thank you, Mr. Chairman.

Mr. Schoenfeld is the technical adviser to the Assistant Commissioner for Exempt Organizations and Employee Plans. As you see, we have a prepared statement.

Mr. FLOWERS. It will be admitted to the record.

Mr. TEDESCO. Thank you, sir.

Mr. Schoenfeld will read it and he will try to answer some questions for you.

Mr. FLOWERS. I think maybe we had just better admit it to the record because of the limited time available. If you could summarize it, perhaps, in a few moments we are debating amendments to the energy bill today, and I think we will have to conclude the meeting in approximately 5 minutes.

[The prepared statement of Mr. Schoenfeld follows:]

STATEMENT OF HOWARD M. SCHOENFELD, INTERNAL REVENUE SERVICE,
ACCOMPANIED BY JOSEPH A. TEDESCO AND MILTON CERNY

Mr. Chairman, my name is Howard M. Schoenfeld. I am with the Internal Revenue Service and am the Technical Advisor to the Assistant Commissioner for Employee Plans and Exempt Organizations. With me are Joseph A. Tedesco and Milton Cerny. Mr. Tedesco is Director of the Exempt Organizations Division and he has responsibility for overseeing the examination and technical functions of the Service in the exempt organizations area. Mr. Cerny is Chief of the Rulings Section in the Technical Branch of the Exempt Organizations Division and his office is responsible for making technical determinations and issuing ruling letters with respect to exemption from Federal income tax.

I would like to pass on to you this morning a brief overview of the Federal tax laws affecting Federally chartered organizations, particularly regarding those dealing with organizations exempt from income tax. Mr. Tedesco, Mr. Cerny, and myself will then attempt to answer whatever questions you and the other members may have.

Section 501(a) of the Internal Revenue Code of 1954 provides for the exemption from Federal income tax of organizations described in section 501(c). Section 501(c)(1) refers to "corporations organized under Act of Congress, if such corporations are instrumentalities of the United States and if, under such Act, as amended and supplemented, such corporations are exempt from Federal income taxes."

From this section, it can be seen that to qualify for exemption under section 501(c)(1), it is necessary that the corporation be an instrumentality of the United States and that the act creating it, as well as its supplements and amendments, specifically provide that the corporation be exempt from Federal income tax. Thus, we think it can be stated that qualification under section 501(c)(1) does not bestow to an organization any greater tax benefit than that granted under the specific Act of Congress organizing the corporation.

The importance of the requirement that supplements and amendments specifically provide for exemption from Federal income tax can be seen from the situation of the Federal Savings and Loan Associations. These were exempt from tax under the Homeowner's Loan Act of 1933, but section 313 of the Revenue Act of 1951 repealed that exemption by amendment section 5(h) of the 1933 Act, with the result that for taxable years beginning after December 31, 1951, such associations are not exempt.

To be recognized as exempt from Federal income tax under section 501(c)(1), there are no statutory or administrative requirements, as exist in other types of exempt organizations, prescribing the manner in which an organization secures an exemption letter from the Internal Revenue Service. If an organization desired such a ruling, it would simply write in and make that request to our National Office. Moreover, such organizations are excepted from having to file the annual exempt organization information returns with the Service.

Examples of the type of entities that are recognized as being exempt from Federal income tax under section 501(c)(1) are: the Commodity Credit Corporation, the Federal Deposit Insurance Corporation, the Federal National Mortgage Association, the Federal Reserve Banks, and the Federal Credit Unions. As indicated before, none of these organizations have any continuing return reporting responsibilities to the Internal Revenue Service. Furthermore, since these organizations are in fact exempt from tax under the statute creating them and are not subject to the unrelated business income tax applicable to other categories of section 501 organizations in general, we did not include them in our general audit program for exempt organizations.

Aside from the question of exemption from Federal income tax, the Service sometimes gets involved in deciding whether contributions to such an organization are deductible. The governing rule here may be found in section 170(c) (1) of the Code, which defines the term "charitable contribution" as, . . . a contribution or gift to or for the use of—(1) A state or possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if a contribution or gift is made for exclusively public purposes. . . ." Thus, as with other governmental units, a contribution, to be deductible, must satisfy the requirement that it be made for exclusively public purposes.

If a Federally chartered corporation would fail to qualify under section 501(c) (1), it may still qualify for exemption from Federal income tax under some other paragraph of section 501(c). Its eligibility under any of those provisions would depend on the particular facts and circumstances in each case, with no special consequence resulting from the fact that it is Federally chartered as opposed to being State chartered.

In an effort to determine how Federally-chartered organizations are usually treated under the exemption provisions, we have made a review of our available files. From those records, it would appear that most of the organizations which we could identify as being Federally-chartered and recognized as tax-exempt qualified as "exclusively charitable" organizations under section 501(c) (3). These are some examples:

The Smithsonian Institution, American National Red Cross, and the Boy Scouts of America.

We have also found that Federally-chartered organizations have been recognized as exempt social welfare organizations under section 501(c) (4) and an example is the Reserve Officers Association of the United States; under section 501(c) (6), relating to trade associations, an example is the National Education Association of the United States.

In addition to the income tax exemption and charitable contribution deduction provisions, there are some highly technical provisions pertaining to Federal instrumentalities regarding their liability for employment taxes. As a general rule, however, section 501(c) (1) organizations that are wholly- or partially-owned instrumentalities are not subject to FUTA tax liability but are subject to FICA tax liability.

In summary, unless the corporation's organizing Act specifically provides for an exemption from tax, we in the Internal Revenue Service would treat a Federally-chartered organization in the same manner as any other type of organization. If the corporation's organizing Act specifically provides for income tax exemption, we accord the organization classification under section 501(c) (1). Otherwise, to be exempt, the organization must meet all the conditions for exemption established for the particular paragraph under section 501(c).

I thank you for this opportunity to appear before you today. If there are any questions, Mr. Tedesco, Mr. Cerny, or myself will attempt to answer them.

Mr. SCHOENFELD. Thank you, Mr. Flowers.

Let me introduce the other gentlemen at the table for you. This is Mr. Cerny, at the far left, and Mr. Moore, who is with the Internal Revenue Service as well.

Our contacts and our experience with federally chartered organizations are really divided into two groups: Those that are exempt from Federal income tax under section 501(c) (1) of the Internal Revenue Code of 1954, and those that are not. If you are exempt under section 501(c) (1), you are exempt because there is a specific statute from Congress which says that you are exempt. All section 501(c) (1) of the Internal Revenue Code does is acknowledge that there is a Federal statute somewhere else that says that organization is exempt. These we refer to as Federal instrumentalities. If there are ever amendments to the organizing act creating this corporation, then this specific provision requiring or calling for the—

Mr. FLOWERS. Give me an example of one of those.

Mr. SCHOENFELD. The Federal Reserve Banks are examples of federally chartered organizations that are exempt under section 501(c) (1).

We have other kinds of organizations which are federally chartered, but which are not exempt under section 501(c) (1), and they usually do not meet the qualification there because there is not a statute that specifically says they are exempt from Federal income tax. An example in this category would be the Smithsonian Institution, the American National Red Cross, the Boy Scouts of America. These are organizations that are exempt from Federal income tax under some other provision of section 501(c) other than section 501(c) (1), and we have other examples of organizations that are federally chartered which meet the express requirements of other provisions under section 501(c), as, for example, the Reserve Officers Association. There is a veterans organization that is exempt under section 501(c) (4). The National Education Association is an example of a trade association, a professional association that is exempt under section 501(c) (6).

As to the first class of organizations, section 501(c) (1) organizations, we have no special rules regarding our recognition of them. We do not even include them in our general audit programs. They are exempt by Congress. There are no administrative requirements of the Internal Revenue Service that these organizations have to comply with.

As to the other organizations, they are expected to fully comply with all of the conditions for exemptions relating to exempt organizations of the category under which they are exempt.

Mr. FLOWERS. That is a good, concise statement.

Do you have, in your work in connection therewith, any particular problems? Do you have any comments you would like to make?

You have listened to the other testimony. You know what our purposes are in conducting this hearing. Do you have any comment at all?

Mr. SCHOENFELD. No, sir. I do not know. I do not know if any of the other gentlemen do.

Mr. TEDESCO. I do not think we have any comments to make on that, Mr. Chairman. If it is exempt pursuant to an act of Congress, it is exempt, and we apply the statutory law and rules to those that are not specifically exempt, just as we would to any other organization.

Mr. SHATTUCK. They have to comply with your regulations under this particular section of the law.

Mr. TEDESCO. That is right. We apply the same rules we would apply to a corporation that is not necessarily chartered by the Congress.

Mr. FLOWERS. It appears to me that our inquiry really is not in this area.

Thank you very much for being with us.

I apologize for the shortness of our meeting with you. But I think you satisfied us in a very short time.

Your statement will be made a part of the record.

I thank you all for being with us.

This will conclude our hearing on this matter.

The subcommittee will meet at the next scheduled time.

[Whereupon, at 11:11 a.m., the subcommittee recessed, to reconvene upon the call of the Chair.]

[Subsequent to the hearing, the following letter with enclosure was submitted for the record:]

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Washington, D.C., June 12, 1975.

Mr. WILLIAM P. SHATTUCK,
Office of General Counsel, Judiciary Committee, House of Representatives, Rayburn Office Building, Washington, D.C.

DEAR MR. SHATTUCK: We appreciate the opportunity to have appeared and presented testimony before the Subcommittee on Administrative Law and Government Relations on June 11, 1975.

I have enclosed for your information a copy of a booklet that describes the various subclassifications of organizations exempt from Federal income tax and identifies the rights and responsibilities of those organizations when exemption is recognized.

Sincerely yours,

J. A. TEDESCO,
Director, Exempt Organizations Division.

Enclosure.

How to Apply for Recognition of Exemption for an Organization

Publication 557

1975
Edition

Department
of the
Treasury
Internal
Revenue
Service



1. Procedures for Obtaining Recognition of Exemption

This booklet describes the rules and procedures for organizations that seek to obtain recognition of exemption from Federal income tax. This chapter explains the procedures you must follow to obtain an appropriate ruling or determination letter recognizing such exemption, as well as certain other information that applies generally to all exempt organizations. To qualify for exemption under the Internal Revenue Code you must be organized for one or more of the purposes specifically designated in the Code.

Check the index at the end of this booklet to determine whether your organization is described herein and read the chapter that applies to your type of organization for the specific information you must submit when applying for recognition of exemption.

The reference chart, located on page 19 of this booklet, is simplified for your convenience, to locate at a glance the section of the Internal Revenue Code under which your organization qualifies for exemption, the required form for application, the annual return to be filed, and whether or not a contribution to such an organization will be deductible by a donor. It also gives a description of the organization and the general nature of its activities.

Any correspondence with the Internal Revenue Service (in requesting forms or otherwise) will be greatly expedited if you indicate in your correspondence the Code section that you think applies to your organization.

An organization that claims to be exempt, but has not yet established its exempt status, should file Form 990. In such cases, the organization must indicate on Form 990 that the return is being filed in the belief the organization is exempt under section 501(c), but that the Internal Revenue Service has not yet recognized such exemption.

Certain organizations that may qualify for exemption are not discussed in this publication. These are mutual insurance companies, farmers' cooperatives, corporations organized to finance crop operations, religious and apostolic associations, cooperative hospital service organizations, corporations organized under Acts of Congress, teachers' retirement fund associations, and employee funded pension trusts created before June 25, 1959. If you think your organization is in one of these categories, contact your District Director for further information.

Even though an organization is recognized as tax exempt, it may still be liable for tax on its unrelated business income, which is income from a trade or business that is not

substantially related to the charitable, educational, or other purpose constituting the basis for its exemption. An exempt organization that has \$1,000 or more gross income from an unrelated business must file Form 990-T, *Exempt Organization Business Income Tax Return*. (See the instructions for Form 990-T.) In addition, private foundations (defined in Chapter 2) are subject to taxes on net investment income, and may be subject to special taxes on self-dealing transactions, excess business holdings, etc.

Application for tax-exempt status must be filed with the District Director for the district in which the organization's principal office or place of business is located. The addresses of the District Director for each district are shown on page 20. If the application is submitted to the wrong office, it will be forwarded to the correct office and the applicant will be notified accordingly. The application will be returned by the district office where filed to one of 16 key Internal Revenue Service district offices for processing.

Requests other than applications for recognition of exemption (for example, requests involving leader organizations, application of excise taxes to activities of private foundations, taxation of unrelated business income, etc.) should be forwarded to the Commissioner of Internal Revenue, Washington, D.C. 20224.

A ruling or determination letter will be issued in advance of operations if your organization can describe its proposed operations in sufficient detail to permit a conclusion that it will clearly meet the particular requirements of the section of law under which exemption is claimed.

A restatement of an organization's purposes or a statement that it will operate in furtherance of such purposes will not satisfy the requirements for an advance ruling. The description of proposed operations must fully describe the activities in which the organization expects to engage (including standards, procedures, or other means adopted or planned for carrying out the activities, its expected sources of funds, and the nature of its contemplated expenditures).

With reference to expected sources of funds, it should be shown whether support will be from public or private sources. Also, the nature of the support should be explained, that is, whether contributions, grants, or other. If income from fund raising events, ticket sales, rentals, or other business or investment sources is anticipated the nature of the venture or revenue-producing enterprise should be explained.

The nature of contemplated expense should be shown, in case of expenditures directly in furtherance of exempt purposes, as distinguished from administrative and general operating expenses, an explanation

should be furnished as to the selection criteria to be followed with respect to recipients.

Where an organization does not supply information of the nature previously mentioned, or fails to furnish a sufficiently detailed description of its proposed activities to permit a conclusion that it will clearly be exempt, a record of actual operations will be required before a ruling or determination letter is issued.

Where an application for recognition of exemption does not contain the required information, the application may be returned to the applicant without being considered on its merits with an appropriate letter of explanation. In the case of an application under section 501(c)(3) of the Internal Revenue Code, the applicant will also be informed of the time within which the completed application must be resubmitted in order to be considered as a timely notice as described in Chapter 2.

An exemption ruling or determination letter will not ordinarily be issued if an issue involving the organization's exempt status is pending in litigation or before the Appellate Division of the Internal Revenue Service.

Your application for recognition of exemption will be considered by the key District Director who will either issue a determination letter to your organization or refer the application to the National Office.

If a question arises that is not specifically covered by statute, regulation, or Treasury Decision, or by a ruling, opinion, or court decision published in the Internal Revenue Bulletin, the key District Director will refer the application to the National Office. The National Office will consider the application, issue a ruling directly to your organization, and send a copy to the key District Director. If you receive a National Office ruling that is unfavorable to your organization, you will be informed of the basis for the conclusion and of your rights to file a protest and to a conference in the National Office. After reconsidering the application, the protest, and any information developed in conference, the National Office will affirm, modify, or reverse the original conclusion, issue a ruling to your organization, and send a copy to the key District Director.

If you receive an unfavorable determination letter from the key District Director, you will similarly be informed of the basis for the conclusion and of your rights to file a protest and to a conference in the key district office. If, after considering your protest and any information developed in conference, the key District Director maintains his position and you do not agree, the file will be referred to the National Office. You may waive your right to a district office conference and request referral of the matter directly to the National Office. In such a case, you are required to file a statement setting forth the facts, law, and

arguments in support of your application. In addition, you will be asked to specify whether you desire a conference in the National Office if an adverse decision is indicated. The key District Director will inform your organization of the outcome.

Effective date of exemption. Recognition of exemption is effective as of the date of formation of an organization if, during the period prior to the date of the ruling or determination letter, its purposes and activities were those required by the law. See Chapter 2 for the special rule for organizations applying for recognition of exemption under section 501(c)(3) of the Internal Revenue Code. Upon obtaining recognition of exemption, the organization may file a claim for a refund of income taxes paid for the period for which its exempt status is recognized.

If an organization is required to alter its activities or substantially amend its charter to qualify, the ruling or determination letter recognizing exemption will be effective as of the date specified therein.

A ruling or determination letter recognizing exemption may not be relied upon if there is a material change inconsistent with exemption in the character, the purpose, or the method of operation of the organization.

Forms of application for recognition of exemption. Most organizations seeking recognition of exemption must file an application on forms specifically prescribed by the Internal Revenue Service. These are Forms 1023 and 1024. Some organizations are not required to submit specific application forms. The application your organization is required to submit is specified in the chapter in this publication dealing with your organization and also on the chart on page 19.

The purposes and proposed activities of your organization should be described in its articles of organization or other statements accompanying the application form. You should study the chapter in this publication that applies to your organization to determine the information to be provided. That chapter will inform you of the purposes and the proposed activities that you must set forth in the material to be forwarded upon application.

Additional material required from all organizations. If your organization issues capital stock, you should provide the following information:

- 1) Class or classes of stock;
 - 2) Number and par value of shares;
 - 3) Consideration for which issued;
 - 4) Whether your certificate of organization authorizes dividends on any class of stock, and
 - 5) Whether any dividends have been paid.
- You should submit a copy of your organization's stock certificate.

You should also submit any additional information necessary to clarify the nature of your organization. Some examples of such additional material are representative copies of advertising placed, copies of publications such as magazines distributed, and copies of written material used for expressing views on proposed legislation. Copies of leases, contracts, or agreements your organization entered into should be submitted.

Each application for recognition of exemption must be accompanied by a conformed copy of your organization's articles of incorporation, trust instrument or other enabling instrument, as well as a copy of by-laws or other similar code of regulations. You must also attach a classified statement of receipts and expenditures, and a balance sheet for the current year and the three immediate prior years (or such years the organization was in existence, if less). This does not preclude requesting financial data for more than 4 years, if the facts and circumstances warrant it. Neither bank statements nor ledger sheets will be acceptable for this purpose unless they are not classified. Profit and loss or other similar operating statements are not acceptable since they do not show all receipts and expenditures. You must also furnish a statement of proposed activities if the application form requires it. Every attachment should show the name and address of your organization, the date, an identifiable heading, and that it is an attachment to the application form.

If your organization's name has been officially changed by amendment to your existing document, you should attach a conformed copy of such amendment to the application.

Employer identification Number. Every exempt organization is required to have an Employer Identification Number, whether or not it has any employees. If your organization does not have an Employer Identification Number, your application for recognition of exemption should be accompanied by a completed Form SS-4, *Application for Employer Identification Number*.

Funds in foreign countries. If any of your funds are (or will be) expended in foreign countries, attach a statement setting forth the following:

- 1) The manner in which and by whom recipients are or will be selected;
- 2) The names of recipient organizations and/or purposes for which the funds are or will be expended;
- 3) The extent to which you control or will control expenditure of funds donated by you to foreign organizations and whether there is or will be any required reporting of such expenditures to you; and

4) Whether contributions are or will be solicited by you and earmarked for specific foreign distributees.

For prompt action on your application for recognition of exemption, you should be certain that all the statements, instruments, and other material previously described have been submitted in every particular with your organization's application form. Be sure that every statement required by the application form is attached. Unless all the required documents have been provided with your application, you may have to resubmit it or you may otherwise encounter a delay in obtaining recognition of exemption.

Requests for withholding of information. Any information submitted in the application or in support of it that relates to any trade secret, patent, process, style of work, or apparatus, may upon request be withheld from public inspection if the Commissioner determines that the disclosure of such information would adversely affect the organization. Your request must:

- 1) clearly identify the material to be withheld (the document, page, paragraph, and line);
- 2) include the reasons for your organization's position that the information is of the type that may be withheld from public inspection; and
- 3) be filed with the documents in which the material to be withheld is contained.

Power of attorney. If your organization expects to be represented in person or by correspondence by an agent or attorney, you must file a power of attorney specifically authorizing the agent or attorney to represent your organization.

An application may be withdrawn at any time prior to the issuance of a ruling or determination letter upon the written request of a principal officer of your organization. However, the withdrawal will not prevent the information contained in the application form being used by the District Director in any subsequent audit or examination of your organization's returns. The information forwarded in an application will not be returned to your organization.

Oral requests for recognition of exemption will not be considered by the Internal Revenue Service.

Group exemption letter. If your organization is one chapter or unit in a large organization controlled by a central organization (for example, a church, the Boy Scouts, or a fraternal organization), you should check with the central organization to see if it has been issued a group exemption letter. If the central organization has been issued a group ex-

emption letter that covers your organization, you will not be required to file a separate application.

If your organization is itself a central organization with affiliated subordinates under its control, it may apply for a group exemption letter. Such a ruling would recognize the exemption not only of the central organization, but of its subordinates.

Besides submitting information to obtain recognition of its own exemption, the central organization must submit the following information on behalf of the subordinates to be included in the group exemption letter:

- 1) A letter signed by a principal officer of the central organization setting forth or including as attachments:
 - a) Information verifying that the subordinates to be included in the group exemption letter are affiliated with the central organization; are subject to its general supervision or control; are eligible to qualify for exemption under the same paragraph of section 501(c) of the Code, though not necessarily the paragraph under which the central organization is exempt; and are not private foundations, if the application for a group exemption letter involves section 501(c)(3) of the Code;
 - b) A description of the principal purposes and activities of the subordinates;
 - c) A sample copy of a uniform governing instrument (such as charter or articles of association) or in its absence, copies of representative instruments;
 - d) An affirmation to the effect that, to the best of his knowledge, the subordinates are operating in accordance with the stated purposes;
 - e) A statement that each subordinate to be included in the group exemption letter has furnished written authorization to the central organization;
 - f) A list of subordinates to be included in the group exemption letter to which the Service had already issued an outstanding ruling or determination letter relating to exemption; and
 - g) If the application for a group exemption letter involves section 501(c)(3) of the Code, an affirmation to the effect that, to the best of his knowledge and belief, no subordinate to be included in the group exemption letter is a private foundation as defined in section 509(a) of the Code.
- 2) A list of the names, mailing addresses, and employer identification numbers of subordinates to be included in the group exemption letter.

An incorporated subordinate unit of a central organization may be included in a group exemption letter if the central organization submits evidence to show that it maintains

adequate control over the incorporated subordinate unit, and that the subordinate is otherwise qualified.

Separate fund—contributions to which are deductible. An organization that is exempt from Federal income tax other than as an organization described in section 501(c)(3) of the Internal Revenue Code (see Chapter 2) may, if it desires, establish a fund, separate and apart from its other funds, exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals.

If the fund is organized and operated exclusively for such purposes, it may qualify for exemption as an organization described in section 501(c)(3) of the Internal Revenue Code, and contributions made to it will be deductible as provided by section 170 of the Internal Revenue Code. A fund of this character must be organized in such a manner as to prohibit the use of its funds upon dissolution, or otherwise, for the general purposes of the organization creating it. Please read Chapter 2, for the requirements for section 501(c)(3) organizations that were organized after October 9, 1960.

Deduction for contributions. For information about income tax deduction for charitable contributions please see Publication 526, *Income Tax Deduction for Contributions*.

Information returns. Every organization exempt from Federal income tax under section 501(c) of the Code must file an annual information return on Form 990 (or 990-PF) except:

- 1) A church, an interchurch organization of local units of a church, a convention or association of churches, or an integrated auxiliary of a church such as a men's or women's organization, religious school, mission society, or youth group;
- 2) A religious order on its activities which are exclusively religious;
- 3) An organization (other than a private foundation, discussed later) having gross receipts in each taxable year that are normally not more than \$5,000. The gross receipts of an organization are normally not more than \$5,000 if the average of the gross receipts received by the organization in the immediately preceding three years, including the year for which the return would be filed, is \$5,000 or less;
- 4) A mission society sponsored by or affiliated with one or more churches or church denominations, more than one-half of the activities of which society are conducted in, or directed at persons in, foreign countries;
- 5) A State institution, the income of which is excluded from gross income under section 115(a) of the Code; or

6) A corporation organized under an Act of Congress that is exempt under section 501(c)(1) of the Code.

Private foundations exempt under section 501(c)(3) must file Form 990-PF. These organizations are defined in the next chapter. Form 990 or 990-PF must be filed on or before the 15th day of the fifth month following the close of your organization's annual accounting period with the Internal Revenue Service Center, 11801 Roosevelt Boulevard, Philadelphia, Pennsylvania 19155.

If an organization fails to file Form 990 or 990-PF by the due date, it will have to pay \$10 for each day after the due date until the return is filed (not to exceed \$5,000) unless it can be shown that the failure was due to reasonable cause.

For more information on the filing requirements, please see the instructions for Form 990, 990-PF and 990-AR, which may be obtained from your District Director's office.

A group return on Form 990 may be filed by a central, parent, or like organization for two or more local organizations filing a separate Form 990. Please see the instructions for Form 990 and 990-AR for the conditions under which this procedure may be used.

2. Charitable, Religious, Educational, Scientific, Literary, etc., Organization

[Code Sec. 501(c)(3)]

An organization may qualify for exemption from Federal income tax if it is organized and operated exclusively for one or more of the following purposes:

- Charitable,
- Religious,
- Scientific,
- Testing for public safety,
- Literary, Educational or
- Prevention of cruelty to children or animals.

Examples of such organizations are non-profit old age homes, parent-teacher associations, charitable hospitals or other charitable organizations, alumni associations, schools, chapters of the Red Cross or Salvation Army, boys' clubs, and churches.

All Organizations

The following discussion describes certain information to be provided upon application for recognition of exemption by all organizations created for any of the purposes described earlier. As to additional information to be provided by particular types of organizations, see *Specific Organizations*, later in this chapter.

Application for recognition of exemption must be filed on Form 1023. See Chapter 1 and the instructions accompanying Form 1023 for the procedures to be followed in applying.

Most organizations described in this chapter that were organized after October 9, 1969, will not be treated as tax exempt unless they apply for recognition of exemption by filing Form 1023 with the District Director. Such organizations will not be treated as tax exempt for any period before they file the Form 1023, unless they file the form within 15 months from the end of the month in which they were organized. Thus, if your organization was organized after October 9, 1969, and it is not a type of organization described in the next paragraph, you should file Form 1023 within the time specified above. If the application is filed within this time, your organization's exemption will be recognized retroactively to the date it was organized. Otherwise, exemption will be recognized only for the period after the application is received by the Internal Revenue Service. An extension of time for filing Form 1023 may be granted by the District Director if your request is timely and you demonstrate that additional time is needed.

Some organizations created after October 9, 1969, are not required to file Form 1023. These are churches, their integrated auxiliaries, and conventions or associations of churches; and organizations having annual gross receipts normally not more than \$5,000, and which are not private foundations (discussed later). These organizations are automatically exempt if they meet the requirements described in this chapter. However, if such an organization wants to establish its exemption with the Internal Revenue Service and receive a ruling or determination letter recognizing its exempt status, it should file Form 1023 with the District Director. Subordinate organizations (other than private foundations) included in an application for an original or supplemental group exemption letter need not file a separate Form 1023.

You should also read the section in this chapter on *Private Foundations* for the additional notice required from an organization in order for it not to be presumed to be a private foundation, and for the additional statement required from a private foundation claiming to be a private operating foundation.

Form 1023 and accompanying statements must show that:

- 1) The organization is organized exclusively for, and will be operated exclusively for, one or more of the purposes (charitable, religious, etc.) specified earlier.
- 2) No part of its net earnings will inure to the benefit of private shareholders or individuals, and

3) it will not, as a substantial part of its activities, attempt to influence legislation, or participate to any extent in a political campaign for or against any candidate for public office.

You must establish also that your organization will not be organized or operated for the benefit of private interests, such as the creator or his family, shareholders of the organization, other designated individuals, or persons controlled, directly, or indirectly, by such private interests.

Articles of organization. Your organization must include a conformed copy of its articles of organization with the application for recognition of exemption. This may be its trust instrument, corporate charter, articles of association, or any other written instrument by which it is created.

The articles of organization must limit the organization's purposes to one or more of those described in the first paragraph of this chapter, and must not expressly empower it to engage, otherwise than as an insubstantial part of its activities, in activities which are not in furtherance of one or more of those purposes. (These conditions are referred to as the "organizational requirement.")

You should be aware that section 501(c)(3) of the Internal Revenue Code is the provision of law that grants exemption to the organizations described in this chapter. Therefore, the organizational requirements may be met if the purposes stated in the articles of organization are limited in some way by reference to section 501(c)(3) of the Internal Revenue Code.

The requirement that your organization's purposes and powers must be limited by the articles of organization is not satisfied if the limitation is contained only in the by-laws or other rules or regulations. The requirement is not satisfied by statements of your organization's officers that you intend to operate only for exempt purposes. Also, the organizational requirement is not satisfied by the fact that your actual operations are for exempt purposes.

In interpreting an organization's articles, the law of the State where the organization was created is controlling. Where an organization contends that the terms of the articles have a different meaning under State law than their generally accepted meaning, such meaning must be established by a clear and convincing reference to relevant court decisions, opinions of the State attorney general, or other appropriate State authorities.

The following are examples illustrating the organizational requirement:

Example 1. Articles of organization that state that an organization is formed exclusively for "literary and scientific purposes within the meaning of section 501(c)(3) of the

Internal Revenue Code of 1954," appropriately limit an organization's purposes.

Example 2. An organization that, by the terms of its articles, is formed "to engage in research" without some further descriptive or limitation will not be properly limited as to its purposes since all research is not scientific within the meaning of this chapter.

Example 3. A stated purpose in an organization's articles "to receive contributions and pay them over to organizations that are described in section 501(c)(3) and exempt from taxation under section 501(e) of the Internal Revenue Code" is sufficient.

Example 4. If a stated purpose in the articles is the conduct of a school of adult education and its manner of operation is described in detail, such a purpose will be satisfactorily limited.

Example 5. If the articles state the organization is formed for "charitable purposes," without any further description, such language will ordinarily be sufficient since the term "charitable" has a generally accepted legal meaning. On the other hand, if the purposes are stated to be "charitable, philanthropic, and benevolent," the organizational requirement will not be met since the terms "philanthropic" and "benevolent" have no generally accepted legal meaning and, therefore, the stated purposes may, under the laws of the State, permit activities that are broader than those intended by the exemption law.

Example 6. If the articles state an organization is formed "to promote American ideals," or "to foster the best interests of the people," or "to further the common welfare and well-being of the community," without any limitation or provision restricting such purposes to accomplishment only in a charitable manner, the purposes will not be sufficiently limited. Such purposes are vague and may be accomplished other than in an exempt manner.

Example 7. A stated purpose "to operate a hospital" is a purpose broader than the exempt purposes previously described. A hospital, even though operated on a non-profit basis, may not necessarily qualify for exemption as a charitable institution.

Example 8. An organization that is expressly empowered by its articles "to carry on social activities," or "to engage in a business, joint venture, or partnership," or "to buy, sell and deal in real or personal property, patents, licenses, trademarks and franchises," or "to engage in any undertaking conducive to carrying out or in aid of the stated purposes," will not be sufficiently limited as to its power, even if its articles state that it is organized and shall be operated exclusively for charitable purposes.

Example 9. Articles that expressly empower an organization to exercise all powers

conferred by State law, with no provision limiting it to the exercise of only such powers as are in furtherance of exempt purposes, do not meet the organizational requirement because the State grant of powers may authorize activities, to more than an insubstantial extent, that are not in furtherance of one or more exempt purposes.

Assets of an organization must be permanently dedicated to an exempt purpose. This means that should an organization dissolve, its assets must be distributed for an exempt purpose described in this chapter, or to the Federal Government or to a State or local government for a public purpose. If the assets could be distributed to members or private individuals or for any other purpose, the organizational test is not met.

To establish that your organization's assets will be permanently dedicated to an exempt purpose, the articles of organization should contain a provision insuring their distribution for an exempt purpose in the event of dissolution. Although reliance may be placed upon State law to establish permanent dedication of assets for exempt purposes, your organization's application probably can be processed much more rapidly if its articles of organization include a provision insuring permanent dedication of assets for exempt purposes.

If a dissolution provision is not included in the articles and an organization relies on operation of law, it must submit a brief, outlining either the State statutes that govern or the judicial decision relied upon.

If a State statute or judicial decision is relied upon, it must clearly insure that the assets will be distributed only for a purpose described in this chapter. The mere fact that a recipient organization is nonprofit will not satisfy the test.

If a named beneficiary is to be the distributee, it must be one that would qualify and would be exempt within the meaning of this chapter at the time the dissolution takes place. Since the named beneficiary at the time of dissolution may not be qualified, may not be in existence, or may be unwilling or unable to accept the assets of the dissolving organization, a provision should be made for distribution of the assets for one or more of the purposes specified in this chapter in the event of any such contingency.

The articles of organization may not expressly authorize your organization to distribute earnings to any private shareholder or individual, or participate in a political campaign for or against any candidate for public office, or devote a substantial part of its activities to influence legislation.

You should also read the section in this chapter on Private Foundations for the spe-

cial provisions required in a private foundation's governing instrument in order for it to qualify for exemption.

Sample Articles of Organization

The following are examples of a charter and a declaration of trust that contain the required information as to purposes and powers of the organization and disposition of its assets upon dissolution. You should bear in mind that requirements for these instruments may vary under applicable State law.

Draft A

Articles of Incorporation of

The undersigned, a majority of whom are citizens of the United States, desiring to form a Non-Profit Corporation under the Non-Profit Corporation Law of —, do hereby certify:

First: The name of the Corporation shall be—

Second: The place in this State where the principal office of the Corporation is to be located is the City of —, — County.

Third: Said corporation is organized exclusively for charitable, religious, educational, and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code of 1954 (or the corresponding provision of any future United States Internal Revenue Law).

Fourth: The names and addresses of the persons who are the initial Trustees of the corporation are as follows:

Name	Address
------	---------

Fifth: No part of the net earnings of the corporation shall inure to the benefit of, or be distributable to, its members, trustees, officers, or other private persons, except that the corporation shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth in Article Third hereof. No substantial part of the activities of the corporation shall be the carrying on of propaganda, or otherwise attempting to influence legislation, and the corporation shall not participate in, or intervene in (including the publishing or distribution of statements) any political campaign on behalf of any candidate for public office. Notwithstanding any other provision of these articles, the corporation shall not carry on any other activities not permitted to be carried on (e) by a corporation exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 (or the corresponding provision of any future United

State Internal Revenue Law) or (b) by a corporation, contributions to which are deductible under section 170(c)(2) of the Internal Revenue Code of 1954 (or the corresponding provision of any future United States Internal Revenue Law).

[If reference to Federal law in articles of incorporation imposes a limitation that is invalid in your State, as in California, you may wish to substitute the following for the last sentence of the preceding paragraph: "Notwithstanding any other provision of these articles, this corporation shall not, except to an insubstantial degree, engage in any activities or exercise any powers that are not in furtherance of the purposes of this corporation."]

Sixth: Upon the dissolution of the corporation, the Board of Trustees shall, after paying or making provision for the payment of all of the liabilities of the corporation, dispose of all of the assets of the corporation exclusively for the purposes of the corporation in such manner, or to such organization or organizations organized and operated exclusively for charitable, educational, religious, or scientific purposes as shall at the time qualify as an exempt organization or organizations under section 501(c)(3) of the Internal Revenue Code of 1954 (or the corresponding provision of any future United States Internal Revenue Law), as the Board of Trustees shall determine. Any such assets not so disposed of shall be disposed of by the Court of Common Pleas of the county in which the principal office of the corporation is then located, exclusively for such purposes or to such organization or organizations, as said Court shall determine, which are organized and operated exclusively for such purposes.

In witness whereof, we have hereunto subscribed our names this — day of — 19—

Draft B

The ——— Charitable trust Declaration of Trust made as of the — day of — 19—, by —, of —, and — of —, who hereby declare and agree that they have received this day from —, as Donor, the sum of Ten Dollars (\$10) and that they will hold and manage the same, and any additions to it, in trust, as follows:

First: This trust shall be called "The ——— Charitable Trust."

Second: The trustees may receive and accept property, whether real, personal, or mixed, by way of gift, bequest, or devise, from any person, firm, trust, or corporation, to be held, administered, and disposed of in accordance with and pursuant to the provisions of this Declaration of Trust; but no gift, bequest or devise of any such property shall be received and accepted if it is conditioned or limited in such manner as to require the dis-

position of the income or its principal to any person or organization other than a "charitable organization" or for other than "charitable purposes" within the meaning of such terms as defined in Article Third of this Declaration of Trust, or as shall in the opinion of the trustees, jeopardize the Federal income tax exemption of this trust pursuant to section 501(c)(3) of the Internal Revenue Code of 1954, as now in force or afterwards amended.

Third: A. The principal and income of all property received and accepted by the trustees to be administered under this Declaration of Trust shall be held in trust by them, and the trustees may make payments or distributions from income or principal, or both, to or for the use of such charitable organizations, within the meaning of that term as defined in paragraph C, in such amounts and for such charitable purposes of the trust as the trustees shall from time to time select and determine; and the trustees may make payments or distributions from income or principal, or both, directly for such charitable purposes, within the meaning of that term as defined in paragraph D, in such amounts as the trustees shall from time to time select and determine without making use of any other charitable organization. The trustees may also make payments or distributions of all or any part of the income or principal to States, territories, or possessions of the United States, any political subdivision of any of the foregoing, or to the United States or the District of Columbia but only for charitable purposes within the meaning of that term as defined in paragraph D. Income or principal derived from contributions by corporations shall be distributed by the trustees for use solely within the United States or its possessions. No part of the net earnings of this trust shall inure or be payable to or for the benefit of any private shareholder or individual, and no substantial part of the activities of this trust shall be the carrying on of propaganda, or otherwise attempting, to influence legislation. No part of the activities of this trust shall be the participation in, or intervention in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

B. The trust shall continue forever unless the trustees terminate it and distribute all of the principal and income, which action may be taken by the trustees in their discretion at any time. On such termination, the trust fund as then constituted shall be distributed to or for the use of such charitable organizations, in such amounts and for such charitable purposes as the trustees shall then select and determine. The Donor authorizes and empowers the trustees to form and organize a nonprofit corporation limited to the uses and purposes provided for in this Declaration of

Trust, such corporation to be organized under the laws of any State or under the laws of the United States as may be determined by the trustees; such corporation when organized to have power to administer and control the affairs and property and to carry out the uses, objects, and purposes of this trust. Upon the creation and organization of such corporation, the trustees are authorized and empowered to convey, transfer, and deliver to such corporation all the property and assets to which this trust may be or become entitled. The charter, bylaws, and other provisions for the organization and management of such corporation and its affairs and property shall be such as the trustees shall determine, consistent with the provisions of this paragraph.

C. In this Declaration of Trust and in any amendments to it, references to "charitable organizations" or "charitable organization" mean corporations, trusts, funds, foundations, or community chests created or organized in the United States or in any of its possessions, whether under the laws of the United States, any state or territory, the District of Columbia, or any possession of the United States, organized and operated exclusively for charitable purposes, no part of the net earnings of which inures or is payable to or for the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which do not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office. It is intended that the organization described in this paragraph C shall be entitled to exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954, as now in force or afterwards amended.

D. In this Declaration of Trust and in any amendments to it, the term "charitable purposes" shall be limited to and shall include only religious, charitable, scientific, literary, or educational purposes within the meaning of those terms as used in section 501(c)(3) of the Internal Revenue Code of 1954 but only such purposes as also constitute public charitable purposes under the law of trusts of the State of ———.

Fourth: This Declaration of Trust may be amended at any time or times by written instrument or instruments signed and sealed by the trustees, and acknowledged by any of the trustees, provided that no amendment shall authorize the trustees to conduct the affairs of this trust in any manner or for any purpose contrary to the provisions of section 501(c)(3) of the Internal Revenue Code of 1954 as now in force or afterwards amended. An amendment of the provisions of this Article Fourth (or any amendment to it) shall be

valid only if and to the extent that such amendment further restricts the trustee's amending power. All instruments amending this Declaration of Trust shall be noted upon or kept attached to the executed original of this Declaration of Trust held by the trustees.

Fifth: Any trustee under this Declaration of Trust may, by written instrument, signed and acknowledged, resign his office. The number of trustees shall be at all times not less than two, and whenever for any reason the number is reduced to one, there shall be, and at any other time there may be, appointed one or more additional trustees. Appointments shall be made by the trustee or trustees for the time in office by written instruments signed and acknowledged. Any succeeding or additional trustee shall, upon his acceptance of the office by written instrument signed and acknowledged, have the same powers, rights and duties, and the same title to the trust estate jointly with the surviving or remaining trustee or trustees as if originally appointed.

Nona of the trustees shall be required to furnish any bond or surety. Nona of them shall be responsible or liable for the acts or omissions of any other of the trustees or of any predecessor or of a custodian, agent, depository or counsel selected with reasonable care.

The one or more trustees, whether original or successor, for the time being in office, shall have full authority to act even though one or more vacancies may exist. A trustee may, by appropriate written instrument, delegate all or any part of his powers to another or others of the trustees for such periods and subject to such conditions as such delegating trustee may determine.

The trustees serving under this Declaration of Trust are authorized to pay to themselves amounts for reasonable expenses incurred and reasonable compensation for services rendered in the administration of this trust, but in no event shall any trustee who has made a contribution to this trust ever receive any compensation thereafter.

Sixth: In extension and not in limitation of the common law and statutory powers of trustees and other powers granted in this Declaration of Trust, the trustees shall have the following discretionary powers:

e) To invest and reinvest the principal and income of the trust in such property, real, personal, or mixed, and in such manner as they shall deem proper, and from time to time to change investments as they shall deem advisable; to invest in or retain any stocks, shares, bonds, notes, obligations, or personal or real property (including without limitation any interests in or obligations of any corporation, association, business trust, investment trust, common trust fund, or invest-

ment company) although some or all of the property so acquired or retained is of a kind or size which but for this express authority would not be considered proper and although all of the trust funds are invested in the securities of one company. No principal or income, however, shall be loaned, directly or indirectly, to any trustee or to anyone else, corporate or otherwise, who has at any time made a contribution to this trust, nor to anyone except on the basis of an adequate interest charge and with adequate security.

b) To sell, lease, or exchange any personal, mixed, or real property, at public auction or by private contract, for such consideration and on such terms as to credit or otherwise, and to make such contracts and enter into such undertakings relating to the trust property, as they consider advisable, whether or not such leases or contracts may extend beyond the duration of the trust.

c) To borrow money for such periods, at such rates of interest, and upon such terms as the trustees consider advisable, and as security for such loans to mortgage or pledge any real or personal property with or without power of sale; to acquire or hold any real or personal property, subject to any mortgage or pledge on or of property acquired or held by this trust.

d) To execute and deliver deeds, assignments, transfers, mortgages, pledges, leases, covenants, contracts, promissory notes, releases, and other instruments, sealed or unsealed, incidental to any transaction in which they engage.

e) To vote, to give proxies, to participate in the reorganization, merger or consolidation of any concern, or in the sale, lease, disposition, or distribution of its assets; to join with other security holders in acting through a committee, depository, voting trustee, or otherwise, and in this connection to delegate authority to such committee, depository, or trustee and to deposit securities with them or transfer securities to them; to pay assessments levied on securities or to exercise subscription rights in respect of securities.

f) To employ a bank or trust company as custodian of any funds or securities and to delegate to it such powers as they deem appropriate; to hold trust property without indication of fiduciary capacity but only in the name of a registered nominee, provided the trust property is at all times identified as such on the books of the trust; to keep any or all of the trust property or funds in any place or places in the United States of America; to employ clerks, accountants, investment counsel, investment agents, and any special services, and to pay the reasonable compensation and expenses of all such services in addition to the compensation of the trustees.

Seventh: The trustee's powers are exercisable solely in the fiduciary capacity consistent with and in furtherance of the charitable purposes of this trust as specified in Article Third and not otherwise.

Eighth: In this Declaration of Trust and in any amendment to its, references to "trustees" mean the one or more trustees, whether original or successor, for the time being in office.

Ninth: Any person may rely on a copy, certified by a notary public, of the executed original of this Declaration of Trust held by the trustees, and of any of the notations on it and writings attached to it, as fully as he might rely on the original documents themselves. Any such person may rely fully on any statements of fact certified by anyone who appears from such original documents or from such certified copy to be a trustee under this Declaration of Trust. No one dealing with the trustees need inquire concerning the validity of anything the trustees purport to do. No one dealing with the trustees need see to the application of anything paid or transferred to or upon the order of the trustees of the trust.

Tenth: This Declaration of Trust is to be governed in all respects by the laws of the State of ———.

Trustee—

Trustee—

Specific Organizations

In addition to the information previously described, you should (in every case) submit a description of the activities to be engaged in by your organization. Following is a description of the information to be provided by specific types of organizations.

Charitable organizations. If your organization is applying for recognition of exemption as a charitable organization, it must show that it is organized and operated for purposes beneficial to the public. Examples of this type of organization are those which are organized for:

- Relief of the poor, the distressed, or the underprivileged;
- Advancement of religion;
- Advancement of education or science;
- Erection or maintenance of public buildings, monuments, or works;
- Lessening the burdens of Government;
- Lessening of neighborhood tensions;
- Elimination of prejudice and discrimination;
- Defense of human and civil rights secured by law; and
- Combating community deterioration and juvenile delinquency.

Following is a description of the information to be provided as to proposed activities by

certain specific organizations. Such information is in addition to the articles of incorporation, the additional material described in Chapter 1, and other statements requested on Form 1023. Each of the following organizations must submit the information described.

Charitable organization supporting education. Submit information showing how your organization supports education—for example, contributes to an existing educational institution, endows a professorial chair, contributes toward paying teachers' salaries, or contributes to an educational institution to enable it to carry on research. If the organization awards or plans to award scholarships, you should submit information relative to the following:

- 1) Criteria used for selection of recipients, including the rules of eligibility;
- 2) How and by whom the recipients are or will be selected;
- 3) If awards are or will be made directly to individuals, whether information is required assuring that the student remains in school;
- 4) If awards are or will be made to recipients of a particular class, for example, children or employees of a particular employer, whether any preference is or will be accorded an applicant by reason of the parent's position, length of employment, or salary; whether as a condition of the award the recipient must upon graduation accept employment with the company, and whether the award will be continued irrespective of termination of the parents' employment; and
- 5) A copy of the scholarship application form and any brochures or literature describing the scholarship program.

Hospital. If you are organized to operate a charitable hospital, attach a statement including the requirements for admission to practice on the staff, and the policy on patient admissions, including whether you maintain an emergency room open to all and whether you have any restrictions on the admission of medicare or medicaid patients.

If your hospital was transferred to you from proprietary ownership:

- 1) Submit an appraisal of the facility;
- 2) State the relationship between the former owners of the hospital and your Board of Trustees;
- 3) Set forth the names of the active and courtesy staff members of the proprietary hospital, as well as the names of your medical staff members after the transfer to nonprofit ownership; and
- 4) List the names of any doctors who continued to lease office space in the hospital after its transfer to nonprofit ownership, the amount of rent paid, and submit an appraisal

showing the fair rental value of the rented space.

Clinic. If you are organized to operate a clinic, attach a statement including:

- 1) A description of the facilities and services;
- 2) To whom the services are offered, i.e., the public at large or a specific group;
- 3) How charges are determined, i.e., on a profit basis, to recover costs, or at less than cost;
- 4) By whom administered and controlled;
- 5) Whether any of the professional staff (that is, those who perform or will perform the clinical services) also serve or will serve in an administrative capacity; and
- 6) How compensation paid the professional staff is or will be determined.

Old age home. If you are organized to operate a home for the aged, submit:

- 1) A description of the facilities and services provided or to be provided the residents, including the residential capacity of the home and whether the facilities are specifically designed to meet the needs of aged persons;
- 2) The criteria for admission to the home;
- 3) Charge for admission (entrance fee and/or monthly charge) and whether payable in a lump sum or on an installment basis;
- 4) How charges are or will be determined, i.e., on a profit basis, to recover costs, or at less than cost, and whether the charges are based on providing service at the lowest feasible cost to the residents;
- 5) Whether all residents are or will be required to pay fees;
- 6) Whether any residents are or will be accepted at lower rates or entirely without pay and, if so, how many;
- 7) Whether residents are or will be discharged if unable to pay;
- 8) Whether Federal mortgage financing has been applied for and if so, the type;
- 9) Whether health care will be provided to the residents, either directly or through some continuing arrangement with other organizations, facilities, or health personnel; and
- 10) Copies of admission applications and/or any other literature or brochures descriptive of the home, its facilities, and admission requirements.

Community fund. Provide information showing that your organization is formed to raise a community fund to support major family relief and service agencies in the community, and to contribute to the maintenance of essential collateral services of other agencies in an effort to conserve family life in a certain city and its vicinity.

Community nursing bureau. Provide information showing that your organization will be operated as a community project and will receive its primary support from public contributions to maintain a nonprofit register of qualified nursing personnel including graduate nurses, unregistered nursing school graduates, licensed attendants and practical nurses for the benefit of hospitals, health agencies, doctors, and individuals.

Organization providing loans. If you make or will make loans for charitable and educational purposes, submit the following information:

- 1) An explanation of the circumstances under which such loans are or will be made;
- 2) Criteria for selection, including the rules of eligibility;
- 3) How and by whom the recipients are or will be selected;
- 4) Manner of repayment of the loan;
- 5) Security required, if any;
- 6) Interest charged, if any, and when payable; and
- 7) Copies in duplicate of the loan application and any brochures or literature describing the loan program.

Public interest law firms. If your organization was formed to litigate in the public interest, such as in the area of protection of the environment, you should submit information relative to the following:

- 1) How the litigation can reasonably be said to be representative of a broad public interest rather than a private one;
- 2) Whether the organization will accept fees for its services;
- 3) Whether the organization will achieve its objectives through a program of disruption of the judicial system, illegal activity, or violation of applicable canons of ethics;
- 4) A description of the cases litigated or to be litigated and how they benefit the public generally;
- 5) Whether the policies and program of the organization are the responsibility of a board or committee representative of the public interest, which is not controlled by employees or persons who litigate on behalf of the organization nor by any organization that is not itself an organization described in this chapter;
- 6) Whether the organization is operated, through sharing of office space or otherwise, in a manner so as to create identification or confusion with a particular private law firm; and
- 7) Whether there is an arrangement to provide, directly or indirectly, a deduction for the cost of litigation which is for the private benefit of the donor.

Religious organization. Submit information showing that your organization is a church, synagogue, association or convention of churches, religious order or religious organization that is an integral part of a church, and that it is engaged in carrying out the functions of a church, or it is otherwise organized and operated exclusively for religious purposes.

Scientific organizations. You must show that your organization's research will be carried on in the public interest. Scientific research will be considered to be in the public interest if the results of such research (including any patents, copyrights, processes, or formulas) are made available to the public on a nondiscriminatory basis; if the research is performed for the United States or a State, county, or municipal government; or if the research is carried on for one of the following purposes:

- 1) Aiding in the scientific education of college or university students;
- 2) Obtaining scientific information that is published in a treatise, thesis, trade publication, or in any other form that is available to the interested public;
- 3) Discovering a cure for a disease; or
- 4) Aiding a community or geographical area by attracting new industry to the community or area, or by encouraging the development or retention of an industry in the community or area.

Scientific research, for exemption purposes, does not include activities of a type ordinarily incidental to commercial or industrial operations as, for example, the ordinary inspection or testing of materials or products, or designing or construction of equipment, buildings, etc.

If you engage or plan to engage in research submit the following:

- 1) An explanation of the nature of the research;
- 2) A brief description of research projects completed or presently being engaged in;
- 3) How and by whom research projects are determined and selected;
- 4) Whether you have or contemplate contract or sponsored research and, if so, names of past sponsors or grantors, terms or grants or contracts, together with copies of any executed contracts or grants;
- 5) Disposition made or to be made of the results of your research, including whether preference has or will be given to any organization or individual either as to results or time of release;
- 6) Who will retain ownership or control of any patents, copyrights, processes or formulas resulting from your research; and
- 7) A copy of publications or other media showing reports of your research activities.

Only reports of your research activities or those conducted in your behalf, as distinguished from those of your creators or members conducted in their individual capacities, should be submitted.

Literary organizations. Besides the provisions to be included in the articles of organization, you should explain your literary activities fully. If your organization is established to operate a book store or engage in publishing activities of any nature (printing, publication or distribution of your own material or that printed or published by others and distributed by you), explain fully the nature of the operations, including whether sales are or will be made to the general public, the type of literature involved, and how such activities are related to your stated purposes.

Educational organizations. The term "educational" relates to the instruction or training of the individual for improving or developing his capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community. Advocacy of a particular position or viewpoint may be educational providing there is a sufficiently full and fair exposition of pertinent facts to permit an individual or the public to form an independent opinion or conclusion. Mere presentation of unsupported opinion is not educational.

The following types of organizations may qualify as educational:

- 1) An organization, such as a primary or secondary school, a college, or a professional or trade school, that has a regularly scheduled curriculum, a regular faculty, and a regularly enrolled student body in attendance at a place where the educational activities are regularly carried on;
- 2) An organization whose activities consist of conducting public discussion groups, forums, panels, lectures, or other similar programs;
- 3) An organization that presents a course of instruction by means of correspondence or through the utilization of television or radio; or
- 4) A museum, zoo, planetarium, symphony orchestra, or other similar organization.

If your organization wishes to obtain recognition of exemption as an educational organization such as that set forth above, or on the basis of any other educational activity, submit complete information as to the manner in which it carries on or plans to carry on its educational activities, i.e., by conducting a school, by panels, discussions, lectures, forums, radio and television programs, or through various cultural media such as museums, symphony orchestras, art exhibits, etc. In each instance, explain by whom and where conducted, admission fees, if any, and

submit a copy of pertinent contracts, agreements, publications, programs, etc.

If you are organized to conduct a school, submit full information regarding your tuition charges, number of faculty members, number of full and part-time students enrolled, courses of study and degrees conferred, together with a copy of your school catalog.

Private educational institutions should also submit information to establish clearly that the institution does not and will not discriminate against applicants on the basis of race. Where a school has not clearly established that it is operating under a bona fide racially nondiscriminatory policy as to students, it must, in order to qualify for exemption, take affirmative steps to demonstrate that it will so operate in the future. The school must show that a racially nondiscriminatory policy as to students has been adopted, has been made known to all racial segments of the community served by the school, and is being administered in good faith. The school may use any effective method to publicize its racially nondiscriminatory policy to all racial segments of the community, but the method used must be documented in its application. (In certain cases, specific publication requirements have been established by court order.)

College book stores, restaurants, and other on-campus organizations should submit information to show they are controlled by and serve primarily members of the faculty and student body, and, if not, by whom controlled and to whom their services are made available.

An alumni association should establish that it is organized for the purpose of promoting the welfare of the university with which it is affiliated, is subject to the control of the university as to its policies and destination of funds and is operated as an integral part of the university, or is otherwise organized to promote the welfare of the college or university. If your association does not possess these characteristics, it may nevertheless be exempt as a social club if it meets the requirements described in Chapter 7.

An athletic organization must submit evidence that it is engaged in activities such as directing and controlling interscholastic athletic competitions, conducting tournaments, and prescribing eligibility rules for contestants. If your organization is not exempt as an educational organization, it may be exempt as a social club described in Chapter 7. Raising funds to be used for travel and other activities to interview and persuade prospective students with outstanding athletic ability to attend a particular university does not evidence an exempt purpose.

Associations devoted to the prevention of cruelty to children or animals must submit

articles of organization including the material described above and a detailed description of their purposes and proposed activities. An example of the type of purpose to be shown is an aim to prevent children from working in hazardous trades or occupations or otherwise protecting them.

Private Foundations

Every organization that qualifies for tax exemption as an organization described in this chapter is a "private foundation" unless it falls into one of the categories specifically excluded from the definition of that term. Organizations which fall into the excluded categories, discussed later, are generally those which either have broad public support or actively function in a supporting relationship to such organizations. Organizations which test for public safety are also excluded.

The Tax Reform Act of 1969 imposes a 4% tax on the net investment income of private foundations and subjects them to several new restrictions and requirements. For example, the Act restricts self-dealing between private foundations and their substantial contributors; it requires the distribution of foundation income for charitable purposes; it limits their holdings of private businesses; it provides some certainty that their investments will not be jeopardized by financial speculation; and it contains provisions to assure that their activities are restricted to those which further their exempt purpose. Violations of these provisions give rise to excise taxes and penalties against the private foundation and, in some cases, its managers, its substantial contributors, and certain related persons. A detailed discussion of these and other items relating to private foundations is contained in Publication 578, *Tax Information for Private Foundations and Foundation Managers*, which may be obtained from your Internal Revenue office.

An organization is not a private foundation if it is:

- 1) A church or a convention or association of churches;
- 2) A school;
- 3) A hospital;
- 4) A medical research organization operated in conjunction with a hospital;
- 5) A governmental unit;
- 6) An organization operated for the benefit of a college or university owned or operated by a governmental unit;
- 7) An organization that normally receives a substantial part of its support from a governmental unit or from the general public;
- 8) An organization that normally receives no more than one-third of its support from gross investment income and receives more than one-third of its support from contribu-

tions, membership fees, and gross receipts from activities relating to its exempt function—subject to certain exceptions:

9) An organization operated solely for the benefit of and in connection with one or more of the organizations previously described in Items 1 through 8, but not controlled by disqualified persons other than foundation managers;

10) An organization operated solely for the benefit of one or more organizations that are exempt as civic leagues or social welfare organizations (Chapter 3), local associations of employees (Chapter 9), labor, agricultural, or horticultural organizations (Chapter 5), or business leagues or similar organizations (Chapter 6). However, the exempt organization benefited must meet the support tests described in Item 8, and the organization operated to benefit such organization must not be controlled by disqualified persons other than foundation managers; or

11) An organization organized and operated to test for public safety.

A more detailed description of the types of organizations excluded from the definition of "private foundation," as well as definitions of "disqualified person," "foundation manager," and other terms, may be found in the Instructions for Forms 990 and 990-AR, which may be obtained from your Internal Revenue office.

Even if an organization falls within one of the categories excluded from the definition of "private foundation," it will be presumed to be a private foundation, with some exceptions, unless it notifies the Internal Revenue Service within a certain time that it is not a private foundation. This notification requirement applies to an organization regardless of when it was organized. However, the notification requirement does not apply to:

- 1) churches, their integrated auxiliaries, and conventions or associations of churches (which are not presumed to be private foundations);
- 2) any organization having annual gross receipts normally not more than \$5,000 (which, if a public charity, is not presumed to be a private foundation); and
- 3) subordinate organizations (other than private foundations) included in an application for an original or supplemental group exemption letter, provided the parent or supervisory organization submits a notice covering the subsidiaries.

If an organization is required to file the notice which was previously discussed, it must do so within 15 months from the end of the month in which it was organized.

If your organization is newly applying for recognition of exemption as an organization described in this chapter (section 501(c) (3)

of the Code) and you wish to establish that your organization is not a private foundation, you should complete part VII of your exemption application (Form 1023). An extension of time for filing this notice may be granted by the District Director if your request is timely and you demonstrate that additional time is needed.

A private foundation cannot be tax exempt nor will contributions to it be deductible as charitable contributions unless its governing instrument contains special provisions in addition to those applicable to all organizations described in this chapter.

A private foundation must conform its governing instrument to the new requirements by the end of its first taxable year beginning after March 29, 1973, unless a judicial proceeding was begun by the foundation before March 30, 1973, to reform its governing instrument to comply with the requirements. If an organization received a final ruling or determination letter before December 29, 1972, holding it to be a private foundation, it must conform its governing instrument by the end of its first taxable year beginning at least 91 days after it received the ruling or determination letter, unless a judicial proceeding to conform was begun within 90 days after receipt of the latter. Certain organizations claiming status as medical research organizations or community trusts, but are determined to be private foundations, must conform their governing instruments within their first taxable year beginning at least 91 days after regulations under section 170 pertaining to such organizations become final, unless judicial proceedings to conform are begun within 90 days after the regulations become final.

The special governing instrument provisions must be in effect by the end of the tax year of the foundation (or judicial proceedings instituted which are successful within a reasonable time), in order for donors to deduct gifts or bequests made to the foundation after the earlier of 90 days after the organization receives a final ruling or determination letter holding it to be a private foundation; or March 29, 1973, or, in the case of certain medical research organizations and community trusts, 90 days after regulations under section 170 regarding such organizations become final.

The following samples of governing instrument provisions illustrate the special charter requirements that apply to private foundations. Draft A is a sample of provisions in articles of incorporation; Draft B, a trust indenture.

Draft A

General

- 1) The corporation shall distribute its income for each taxable year at such time and

in such manner as not to become subject to the tax on undistributed income imposed by section 4942 of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

2) The corporation shall not engage in any act of self-dealing as defined in section 4941(d) of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

3) The corporation shall not retain any excess business holdings as defined in section 4943(c) of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

4) The corporation shall not make any investments in such manner as to subject it to tax under section 4944 of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

5) The corporation shall not make any taxable expenditures as defined in section 4945(d) of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

Draft B

Any other provisions of this instrument notwithstanding, the trustees shall distribute its income for each taxable year at such time and in such manner as not to become subject to the tax on undistributed income imposed by section 4942 of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

Any other provisions of this instrument notwithstanding, the trustees shall not engage in any act of self-dealing as defined in section 4941(d) of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws; nor retain any excess business holdings as defined in section 4943(c) of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws; nor make any investments in such manner as to incur tax liability under section 4944 of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws; nor make any taxable expenditures as defined in section 4945(d) of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

A private foundation need not amend its governing instrument to include the special provisions if a State law has been enacted which requires the private foundation to act or refrain from acting so as not to subject it to the taxes imposed by Code sections 4941, 4942, 4943, 4944, and 4945; or if a State law has been enacted which treats the required provisions as contained in the private foundation's governing instrument.

Some private foundations qualify as "private operating foundations." These are a type of private foundation which, although lacking general public support, make qualifying distributions directly for the active conduct of their educational, charitable, and religious purposes, as distinct from merely making grants to other organizations for these purposes.

Most of the restrictions and requirements that apply to private foundations also apply to private operating foundations. However, there are advantages to being classified as a private operating foundation. For example, a private operating foundation (as compared to a private foundation) can be the recipient of grants from a private foundation without having to distribute the funds received currently within one year, with the funds nevertheless qualifying as expenditures of income by the donating private foundation; charitable contributions to a private operating foundation qualify for a higher charitable deduction limit on the donor's tax return; and, although a private operating foundation is required to spend or use substantially all of its income for the active conduct of its educational or charitable purposes, it is not subject to the minimum payout requirement that applies to private foundations, nor is it required to expend its entire income.

A private operating foundation is a private foundation that spends 85% or more of its income directly for the active conduct of the educational, charitable, religious, or other purposes for which it is organized and operated. The organization must also meet one of three other tests.

The first of these alternative tests, the "assets test," requires that at least 65% of the assets of the organization be devoted directly to the active conduct of activities constituting the foundation's charitable, educational, or other similar exempt purpose or to functionally related businesses. This test is intended to apply to organizations such as museums.

The second alternative test, the "support test," requires the organization to derive at least 85% of its support (other than gross investment income) from five or more exempt organizations and from the general public. However, not more than 25% of the organization's support (other than gross investment income) may be received from any one of these exempt organizations, and not more than half of its support may come from its investment income. This test is intended to apply to special-purpose foundations, such as learned societies and associations of librarians.

The third alternative test, the "endowment test," requires the organization to make qualifying distributions directly for the active conduct of activities constituting its charita-

ble, education, or other similar exempt purpose in an amount not less than two-thirds of its minimum investment return. (The minimum investment return is currently 5% for organizations organized after May 26, 1969 and 5.5% for organizations organized before May 27, 1969. These percentages apply to taxable years beginning in 1974, and are subject to change.) This test is intended to apply to organizations, such as research organizations, which actively conduct charitable activities but where their personal services are so great in relationship to charitable assets that the cost of those services cannot be met out of small endowments.

If you are newly applying for recognition of exemption as an organization described in this chapter (section 501(c)(3) of the Code) and you wish to establish that your organization is a private operating foundation, you should complete part VIII of your exemption application (Form 1023).

Annual report. Every private foundation having at least \$5,000 of assets of any time during a taxable year must file an annual report, Form 990-AR, *Annual Report by Private Foundation*, may be used for this purpose. This annual report must be made available by the foundation managers for public inspection; notice of its availability must be published by the foundation; and a copy of it must be furnished to State officers. There are penalties imposed for failure to comply with these requirements.

This private foundation annual report is required in addition to the annual return, Form 990-PF, discussed in Chapter 1.

For more information about the private foundation annual report and the other requirements previously mentioned, please see the instructions for Forms 990-PF and 990-AR, which may be obtained from your District Director's office.

Contributions to domestic organizations described in this chapter, except organizations testing for public safety, are deductible as charitable contributions on the donor's Federal income tax return.

3. Civic Leagues and Social Welfare Organizations

[Code Sec. 501(c)(4)]

If your organization is not organized for profit and will be operated exclusively for the promotion of social welfare, it should file Form 1024 to obtain recognition of exemption from Federal income tax. This chapter describes the information to be provided by such an organization when it applies for recognition of exemption. For procedures to be followed in applying, see Chapter 1.

Examples of types of organizations that are considered to be social welfare organizations are civic associations and volunteer fire companies.

Nonprofit operation. You must submit evidence that your organization is organized and will be operated on a nonprofit basis. Of course, such evidence, including the fact that your organization is organized under a State law relating to nonprofit corporations, will not in itself establish a social welfare purpose.

Promotion of social welfare. To establish that your organization is organized exclusively for the promotion of social welfare, you should submit evidence with your application that it will operate primarily to further (in some way) the common good and general welfare of the people of the community (such as by bringing about civic betterments and social improvements) or to improve the welfare of mankind.

Political activity. If you submit proof that your organization is organized exclusively for the promotion of social welfare, its chances for obtaining exemption will not be lessened by evidence that its social welfare objectives require legislation and that it will attempt to bring about such legislation.

If social activities will be the primary purpose of your organization, you should not file an application for exemption as a civic league or organization but should file for exemption as a social club described in Chapter 7.

Specific Organizations

The following information should be contained in the application form and accompanying statements of certain types of civic organizations.

Volunteer fire companies. If your organization wishes to obtain exemption as a volunteer fire company or similar organization, you should submit evidence that its members are actively engaged in fire fighting and similar disaster assistance, whether it actually owns the fire fighting equipment, and whether it provides any assistance for its members, such as death and medical benefits in case of injury to them.

Community associations. A membership organization formed by a real estate developer to own and maintain common green areas, streets, and sidewalks, and to enforce covenants for preserving the appearance of the development, should show that it is operated for the benefit of all the residents of the community. The term "community" refers to a geographical unit recognizable as a governmental subdivision, unit, or district thereof.

The association should submit evidence that use and enjoyment of areas such as

roadways and parkland, etc., that it owns and maintains is extended to the general public and not restricted to its members. It should show that it does not engage in activities directed to exterior maintenance of private residences.

Other organizations. If, for example, your organization is seeking exemption on the basis of its crime prevention activities, it should submit evidence of a program of prevention, suppression, and punishment of crime, such as by encouraging the efficiency of a municipal police force.

You may also demonstrate a social welfare purpose for your organization by showing an intention to encourage industrial development of a community by leasing plant facilities to incoming industries primarily to relieve unemployment in a chronically depressed area.

Donations to volunteer fire companies are deductible on the donor's Federal income tax return, but only if made for exclusively public purposes. Contributions to other civic leagues or organizations generally are not deductible as charitable contributions for Federal income tax purposes.

4. War Veterans' Organizations

[Code Sec. 501(c)(19)]

A post or organization of war veterans may file Form 1024 to obtain recognition of exemption from Federal income tax. You should follow the general procedures outlined in Chapter 1, and also submit the information described below. Examples of groups that would qualify for exemption are posts or auxiliaries of the American Legion, Veterans of Foreign Wars, or similar organizations.

Your application should show:

- 1) that the post or organization is organized in the United States or any of its possessions;
- 2) that at least 75% of the members are war veterans, and that substantially all (at least 90% of the other members are veterans (but not war veterans), or cadets, or wives, husbands, widows, or widowers of war veterans or others listed here; and
- 3) that no part of the net earnings inure to the benefit of any private shareholder or individual.

An auxiliary unit or society of, or a trust or foundation for, a war veterans' organization may apply for recognition of exemption if the parent organization meets the above requirements.

Donations to war veterans' organizations are deductible as charitable contributions on the donor's Federal income tax return.

5. Labor, Agricultural¹ and Horticultural Organizations

[Code Sec. 501(c)(5)]

If you are a member of an organization that wishes to obtain recognition of exemption from Federal income tax as a labor, agricultural, or horticultural organization, you should submit an application on Form 1024. In addition, you should follow the procedure for obtaining recognition of exempt status as described in Chapter 1 and submit the information described in this chapter.

A labor organization is an association of workmen, usually in the form of a labor union, council, or group, that is organized to protect and promote the interests of labor in connection with employment.

Agricultural and horticultural organizations are connected with raising livestock, forestry, crops, the cultivation of useful or ornamental plants, and similar pursuits.

You must indicate in your application for exemption and accompanying statements that your organization will not be permitted to distribute net earnings for the benefit of any member.

Contributions to labor, agricultural, and horticultural organizations are not deductible as charitable contributions on the donor's Federal income tax return.

Labor Organizations

Required purposes. To show that your organization has the purpose of a labor union, you should include in the articles of organization or accompanying statements (submitted with your exemption application) information establishing that the organization is organized to carry out the normal functions of labor unions, which, in general, are collective bargaining in matters of wages, hours, and working conditions of labor, and adjusting differences between employers and workmen. The activities need not be limited to collective bargaining activities, as long as they are such as would normally further the interests of labor in connection with employment.

Composition of membership. While a labor organization is generally composed of employees or representatives of the employees in the form of collective bargaining agents and similar employee groups, evidence that an organization's membership consists mainly of workers does not in itself indicate an exempt purpose. You must show in your application that your organization has the purposes just described.

Benefits to members. The payment by a labor organization of death, sick, accident, and

similar benefits to its individual members with funds contributed by its members, if made under a plan that has as its object the betterment of the conditions of the members, does not in itself cause denial of exemption as a labor organization.

Agricultural and Horticultural Organizations

Agricultural organizations may be quasi-public in character and are often designed to encourage the development of better agricultural and horticultural products through a system of awards, using income from entry fees, gate receipts, and donations to meet necessary expenses of upkeep and operation. Where the activities are directed towards the improvement of marketing or other business conditions in one or more lines of business, rather than improvements of production techniques or the conditions of individuals, the organization must qualify as a business league or board of trade, or other organization discussed in Chapter 6.

The primary purpose of exempt agricultural and horticultural organizations must be shown in their applications to relate to techniques of production, betterment of conditions of those engaged in agriculture or horticulture, development of efficiency, or improvement of the grade of products.

Following are some examples of activities that would demonstrate a devotion to agricultural or horticultural purposes:

- 1) Promoting various cooperative agricultural, horticultural, and civic activities among rural residents by a state and county farm and home bureau;
- 2) Exhibiting livestock, farm products, and other characteristic features of agriculture and horticulture;
- 3) Testing soil for members and non-members of the farm bureau on a cost basis, the results of the tests and other recommendations being furnished to the community members to educate them in soil treatment; and
- 4) Guarding the purity of the breed of Welsh ponies.

6. Business Leagues, Chambers of Commerce, Real Estate Boards and Boards of Trade

[Code Sec. 501(c)(6)]

If your association wishes to obtain recognition of exemption from Federal income tax as a nonprofit business league, chamber of commerce, real estate board or board of trade, it should file an application for recognition of exemption on Form 1024. For a dis-

cussion of the procedure to be followed see Chapter 1.

Your organization must indicate in its application form and attached statements that it is not organized for profit or organized to engage in an activity ordinarily carried on for profit, and that no part of its net earnings will inure to the benefit of any private shareholder or individual.

A **business league**, in general, is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. Trade associations and professional associations are considered to be business leagues.

A **chamber of commerce** is usually composed of the merchants and traders of a city.

A **board of trade** often consists of persons engaged in similar lines of business. For example, a nonprofit organization formed to regulate the sale of a specified agricultural commodity to assure equal treatment of producers, warehousemen, and buyers would be a board of trade.

A **stock or commodity exchange** is not a business league, chamber of commerce, real estate board, or board of trade.

General purpose. You must indicate in the material submitted with your application that your organization will be devoted to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. It must be shown that the conditions of a particular trade or the interests of the community will be advanced. Merely indicating the name of the organization or the object of the local statute under which it is created is insufficient to demonstrate the required general purpose.

A **common business interest** of all members of the organization must be established by the application documents.

Examples of activities that would tend to illustrate a common business interest are:

- 1) Promotion of higher business standards and better business methods, and encouragement of uniformity and cooperation by a retail merchants association;
- 2) Promotion of the interest of the business community by educating the public in the use of credit;
- 3) Establishment of uniform casualty rates and compilation of statistical information by an insurance rating bureau operated by casualty insurance companies;
- 4) Establishing and maintaining the integrity of a local commercial market;

5) Operation of trade publication primarily intended to benefit an entire industry; and

6) Encouragement of the use of goods and services of an entire industry.

Improvement of business conditions generally must be shown to be the purpose of the organization. This is not established by evidence of particular services to individual members, such as advertising that carries the name of members, conduct of trade shows to effect a selling operation, operation of a real estate multiple listing system, or operation of a credit reporting agency.

Contributions to organizations described in this chapter are not deductible as charitable contributions on the donor's Federal income tax return. They may be deductible as trade or business expenses, if ordinary and necessary in the conduct of the taxpayer's business.

7. Social and Recreation Clubs

[Code Sec. 501(c)(7)]

If your club is organized and operated exclusively for pleasure, recreation, or other similar non-profitable purposes, and wants to obtain recognition of exemption from Federal income tax, it should submit an application on Form 1024.

In applying for recognition of exemption, you should submit the information described in this chapter. Also see Chapter 1 for the procedures to be followed.

College alumni associations that are not described in Chapter 2, college fraternities operating chapter houses for students, country clubs, amateur hunting, fishing, tennis, swimming and other sports clubs, dinner clubs that provide a meeting place, library, and dining room for members, hobby clubs, garden clubs and variety clubs are typical organizations which should file for recognition of exemption on Form 1024.

No part of the organization's net earnings may inure to the benefit of any person having a personal and private interest in the activities of the organization.

To show that your organization possesses the characteristics of a "club" within the meaning of the exemption law, you should submit evidence with your application that personal contact, commingling and fellowship exist among members. Members must be bound together by a common objective directed toward pleasure, recreation, or similar non-profitable purposes.

Fellowship need not be present between each member and every other member of a club if it constitutes a material part in the life of the organization. A statewide or nation-

wide organization that is made up of individual members but is divided into local groups satisfies the requirement if fellowship constitutes a material part of the life of each local group.

The membership in a social club must be limited. To indicate that your organization possesses an identity of purpose that would characterize it as a club, you should submit evidence with your application that there are limitations on admission to membership consistent with the character of the club.

Support. In general, your club should be supported solely by membership fees, dues, and assessments. However, if otherwise entitled to exemption, your club will not be disqualified because it receives revenue from members through the use of club facilities or in connection with club activities.

Pleasure, recreation and other nonproftable purposes must be shown in the application to be the objectives of your club. This should be indicated by provisions in your organization's articles of organization and/or in its bylaws.

The term "other nonproftable purposes" means other purposes similar to pleasure and recreation. For example, a club that, in addition to its social activities, has a plan for the payment of sick and death benefits is not operating exclusively for pleasure, recreation, and other nonproftable purposes, since the purpose of such a plan is not a purpose of the same general character as pleasure and recreation.

Business activities. If your club will engage in business, such as making its facilities available to the public or selling real estate, timber, or other products, it will generally be denied exemption. However, evidence submitted with your application form that your organization will provide meals, refreshments, or services only to its own members or their dependents or guests will not cause denial of exemption.

Evidence that your club's facilities will be open to the general public (persons other than members or their dependents or guests) may cause denial of exemption. Your club will not be denied exemption merely because the general public on occasion will be permitted to participate in its affairs, provided you show that such participation will be incidental to and in furtherance of its general club purposes and the income therefrom will not inure to members.

However, if your organization will make its facilities available to the general public on a regular, recurring basis, and if it will derive more than an incidental amount of gross receipts therefrom, exemption will be denied.

Solicitation by advertisement for public patronage or your organization's facilities is prima facie evidence that it is engaging in busi-

ness and not operating exclusively for pleasure, recreation, or social purposes.

Summary of information on business activities. If your organization will engage in transactions of any kind with nonmembers, you should submit evidence with your application to show that:

- 1) Such activities are incidental to and in furtherance of the exempt purpose of the organization (other than just by raising funds);
- 2) The activities will be isolated rather than recurrent transactions;
- 3) Gross receipts will be approximately the same as costs and expenses attributable to the activities;
- 4) The amount of proceeds from the activities is small in comparison with gross income from all sources; and
- 5) Net earnings will not inure to the benefit of members.

Fraternity foundations. If your organization is a foundation formed for the exclusive purpose of acquiring and leasing a chapter house to a local fraternity chapter or sorority chapter maintained at an educational institution, and does not engage in any social activities, it should file its application on Form 1024. Also, see Chapter 13.

Donee to exempt social and recreation clubs are not deductible as charitable contributions on the donor's Federal income tax return.

8. Fraternal Beneficiary Societies and Domestic Fraternal Societies

[Code Sec. 501(c)(8) and 501(c)(10)]

This chapter describes the information to be provided upon application for recognition of exemption by two types of fraternal societies. The major distinction between fraternal beneficiary societies and domestic fraternal societies is that the former provide for the payment of life, sick, accident, or other benefits to their members or their dependents, while the latter do not. The procedures to be followed in applying for recognition of exemption are described in Chapter 1.

If your organization is controlled by a general organization, you should check with your controlling organization to determine whether your unit has been included in a group exemption letter. If so, you need not apply for individual recognition of exemption.

Fraternal Beneficiary Societies

A fraternal beneficiary society, order, or association should file an application for recognition of exemption from Federal income tax

on Form 1024. The application and accompanying statements should establish that the organization:

- 1) is a "fraternal" organization;
- 2) Operates under the lodge system or for the exclusive benefit of the members of a fraternal organization itself operating under the lodge system; and
- 3) Provides for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

The information to be submitted to show that your organization fulfills these requirements is described in the following paragraphs.

Operation under lodge system. You must establish that your organization will operate under the lodge system or for the exclusive benefit of members of a fraternal organization operating under the lodge system.

Operating under the lodge system means carrying on activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like.

Payment of benefits. You must show in your application that your society has an established system for the payment of life, sickness, accident, or other benefits to its members or their dependents.

All members, not only a particular class of members, must be eligible for the benefits in order to sustain exemption.

The benefits must be limited to members and their dependents. If members will have the ability to confer benefits to other than themselves and their dependents, exemption will not be recognized.

While the society is required to have an established system of paying benefits, it is not mandatory that such a system provide only for fixed benefits or such as can be reduced to a specific amount.

Domestic Fraternal Societies

A domestic fraternal society, order, or association may file an application for recognition of exemption from Federal income tax on Form 1024 if it indicates on the form that application is being made under section 501(c)(10). The application and accompanying statements should establish that the organization:

- 1) is a domestic "fraternal" organization;
- 2) Operates under the lodge system;
- 3) Devotes its net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes; and
- 4) Does not provide for the payment of life, sick, accident, or other benefits.

Donations by an individual to a domestic fraternal beneficiary society or fraternal society operating under the lodge system are deductible as charitable contributions but only if used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

9. Employees' Associations

[Code Sec. 501(c)(4), (9), (17)]

This chapter describes the information to be provided upon application for recognition of exemption by the following types of employees' associations:

A local association of employees whose membership is limited to employees of a designated person or persons in a particular municipality, and whose income will be devoted exclusively to charitable, educational, or recreational purposes.

A supplemental unemployment benefit trust whose primary purpose is providing for payment of supplemental unemployment benefits; and

A voluntary employees' beneficiary association, (including Federal employees associations) organized to pay life, sick, accident, and similar benefits to members or their dependents, or designated beneficiaries, if no part of the net earnings of the association inures to the benefit of any private shareholder or individual. For taxable years beginning before January 1, 1970, a voluntary employees' beneficiary association, except one whose membership is limited to Federal employees or officers, did not qualify for exemption unless 85% or more of its income was collected from members and their employers to make such benefit payments and meet expenses.

The application form to be filed and the information to be provided by your organization are described later in this chapter. The procedures to be followed in applying for exemption are described in Chapter 1.

Donations to these organizations are not deductible as charitable contributions on the donor's Federal income tax return.

Voluntary Employees' Beneficiary Associations

An application for recognition of exemption as a voluntary employees' beneficiary association must be filed on Form 1024. The material submitted with the application must show that your organization:

- 1) is a voluntary association of employees;
- 2) will provide for payment of life, sick, accident, or other benefits to members or their dependents or designated beneficiaries;

3) will not allow any of its earnings to inure to the benefit of any private individual or shareholder except in the form of scheduled benefit payments; and

4) in taxable years beginning before January 1, 1970, except for a Federal employees' association, collected at least 85% of its income from members for the sole purpose of making benefit payments and meeting expenses.

The voluntary nature of your organization is demonstrated by evidence showing that there is voluntary compliance by the employees in the benefit program, and that employees are not required to be members of the organization.

The 10% non-employee limitations. You must establish that for each year for which your organization is requesting exemption, not more than 10% of its total membership is composed of persons other than employees.

The benefits may cover employees of different firms, even though in the usual case the membership consists of employees of the same firm. It is not necessary that employers of members be in the same line of business.

Furloughed or retired employees may be allowed coverage, as long as you show that they did qualify as employees prior to being in an inactive status. Whether contributions are being made by or for such individuals does not affect your organization's eligibility for recognition of exemption.

Payment of benefits. The information submitted with your application must show that your organization will pay life, sick, accident, supplemental unemployment or other benefits, either through a plan calling for direct payment to the beneficiary or through the purchase of a group insurance policy from a commercial insurer. Benefits may be in the form of medical, clinical, or hospital services or the furnishing of transportation for medical care as well as in the form of money payments.

Supplemental Unemployment Benefit Trusts

A trust or trusts forming part of a plan providing for the payment of supplemental unemployment compensation benefits must file its application for recognition of exemption on Form 1024. A conformed copy of the plan of which the trust is a part should be attached to the application.

Types of payments. You must show that the supplemental unemployment compensation benefits will be benefits paid to an employee because of his involuntary separation from his employment (whether or not such separation is temporary) resulting directly from a reduction-in-force, discontinuance of a plant or operation, or other similar conditions. In ad-

dition, sickness and accident benefits (but not vacation, retirement or death benefits) may be included in the plan if these are subordinate to the unemployment compensation benefits.

Diversion of funds. It must be impossible under the plan to divert any of the corpus or income of the trust to any purpose other than the payment of supplemental unemployment compensation benefits (or sickness or accident benefits to the extent just explained).

Discrimination in benefits. Neither the terms of the plan nor the actual payment of benefits may be discriminatory in favor of the company's officers, stockholders, supervisors, or highly paid employees.

Local Employees' Associations

A local employees' association may apply for recognition of exemption from Federal income tax if it can submit evidence that:

- 1) it is of a purely local character;
- 2) its membership is limited to employees of a designated person or persons in a particular municipality; and

3) its net earnings are required by its articles of organization, constitution, or by-laws to be devoted exclusively to charitable, educational, or recreational purposes. A local association of employees that has established a system of paying welfare benefits to its members will not qualify for exemption, since the payment of these benefits is not considered as being for charitable, educational, or recreational purposes.

Application for recognition of exemption as a local association of employees must be filed on Form 1024.

10. Cemetery Companies

[Code Sec. 501(c)(13)]

If your organization wishes to obtain recognition of exemption from Federal income tax as a cemetery company or a corporation chartered solely for the purpose of the disposal of bodies by burial or cremation it should file application on Form 1024. For the procedure to be followed, see Chapter 1.

An organization that seeks recognition of exemption as a cemetery company should submit evidence with its application that it is owned and operated exclusively for the benefit of its lot owners who hold lots for bona fide burial purposes and not for purposes of resale. It should show also that it is nonprofit and that the general nature of its activities will be to own a cemetery, sell lots therein, and maintain these and unsold lots in a state of repair and upkeep appropriate to a final resting place.

If your organization is a corporation chartered solely for the purpose of the disposal of bodies by burial or cremation, you should show that it is not permitted by its charter to engage in any business not necessarily incident to that purpose. The sale of monuments, markers, vaults and flowers solely for use in the cemetery is permissible if the profits from such sale are used to maintain the cemetery as a whole and do not inure to any private individual.

All statements and documents required by Form 1024 should be submitted in detail in order for prompt action to be taken on your application.

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

Disposition of income. You should show that your organization's earnings are or will be disposed of only in one or more of the following ways:

- 1) For ordinary and necessary expenses of operation, maintenance, and improvement of the cemetery or crematorium;
- 2) As payment for cemetery property; and
- 3) For creating a fund for perpetual care of the cemetery or a reasonable reserve for any ordinary or necessary purpose.

Ordinary and necessary expenses in connection with the operation, management, maintenance, and improvement of the cemetery are permitted, as are reasonable fees for the services of a manager.

Payments for cemetery property. Payments may be made for amortization of indebtedness incurred on the purchase of land, but may not be in the nature of profit distributions. You must show the method used to finance the purchase of the cemetery property and that the purchase price of the land at the time of its sale to the cemetery was not unreasonable.

Common and preferred stock. A cemetery company that issues common stock may qualify for exemption only if no dividends may be paid, the payment of dividends is legally prohibited, either by the corporation's charter or by applicable State law, and in the event of dissolution or redemption of common stock prior to dissolution, the shareholders cannot receive an amount that exceeds their capital contribution.

Preferred stock may be issued if the dividends are fixed at a rate not higher than 8% or the State legal interest rate, whichever is greater, on the value of the consideration received by the corporation. The articles of organization must provide that the preferred stock is to be retired or paid as soon as sufficient funds are realized from sale. They also must provide that funds not required for divi-

dends or retirement of the stock are to be used for the care and improvement of the cemetery property.

A perpetual care organization, including, for example, a trust organized to receive, maintain, and administer funds that it receives from a nonprofit tax-exempt cemetery pursuant to State law and contracts, may apply for recognition of exemption on Form 1024, even though it does not own the land used for burial. However, the income from such funds must be devoted exclusively to the perpetual care and maintenance of the nonprofit cemetery as a whole, and no part of the net earnings may inure to the benefit of any private shareholder or individual.

In addition, a perpetual care organization not operated for profit, but established as a civic enterprise to maintain and administer funds, the income of which is devoted exclusively to the perpetual care and maintenance of an abandoned cemetery as a whole, may also apply for tax exemption.

Care of individual plots. Where funds are received by a cemetery company for the perpetual care of an individual lot or crypt, a trust is created that is subject to Federal income tax. Any trust income that is used or permanently set aside for the care, maintenance, or beautification of a particular family burial lot or mausoleum crypt is not deductible in computing the trust's taxable income.

Donations to exempt cemetery companies. Corporations chartered solely for burial purposes, and perpetual care funds are deductible as charitable contributions on the donor's Federal income tax return.

11. Local Benevolent Life Insurance Association, Mutual Irrigation and Telephone Companies, and Like Organizations

[Code Sec. 501(c)(12)]

Each of the following organizations may apply for recognition of exemption from Federal income tax by submitting an application on Form 1024.

Benevolent life insurance associations of a purely local character and like organizations.

Mutual ditch or irrigation companies and like organizations; and

Mutual or cooperative telephone companies and like organizations.

The information to be provided upon application by each of these organizations is de-

scribed in this chapter. For information as to the procedures to be followed in applying for exemption, see Chapter 1.

General requirements. Organizations classifiable under this section are those organized and operated on a mutual or cooperative basis. Their income must be used solely to cover losses and expenses, with any excess being returned to members or retained for future losses and expenses. At least 85% of their income must be collected from members for the sole purpose of meeting losses and expenses. A life insurance organization must also be of a purely local character.

A "like organization" is a mutual organization that performs a service comparable to that performed by any one of the organizations listed at the beginning of this chapter.

Mutuality. These organizations are associations of persons and/or organizations banded together to provide themselves a mutually desirable service approximately at cost and on a mutual basis. To maintain the essential characteristic of mutuality, if that of democratic ownership and control, they must be so organized and operated that their members have the right to choose the management, to receive services substantially at cost, to receive a return of any excess of payments over losses and expenses, and to share in any assets upon dissolution.

The interests of members in the savings of the organization must be determined in proportion to their business with the organization. Upon dissolution, gains from the sale of appreciated assets must be distributed to all persons who were members during the period the assets were owned by the organization, in proportion to the amount of business done during that period. The bylaws must not provide for forfeiture of a member's rights and interest upon withdrawal or termination.

Membership. Membership of a mutual organization consists of those who join the organization to obtain its services, acquire an interest in its assets, and have a voice in its management. In a stock company, the stockholders are members. Membership may include distributors who furnish service to individual consumers. However, it does not include the individual consumers served by the distributor. A mutual service organization may serve nonmembers as long as at least 85% of its income is collected from members. However, a mutual life insurance organization may have no policyholders other than its members.

Losses and expenses. In furnishing services substantially at cost, an organization must use its income solely for paying losses and expenses. Any excess income, not retained in reasonable reserves for future losses and expenses, belongs to members in proportion

to their patronage or business done with the organization. If such patronage refunds are retained in reasonable amounts for purposes of expanding facilities, retiring capital indebtedness, acquiring other assets, etc., the organization must maintain records sufficient to reflect the equity of each member in the assets acquired with the funds.

Dividends. Dividends paid to stockholders on stock or the value of a capital equity interest constitute a distribution of profits and are not an expense within the term "losses and expenses." Therefore, a mutual or cooperative association whose shares carry the right to dividends will not qualify for exemption. However, this prohibition does not apply to the distribution of the unexpended balance of collections or assessments remaining on hand at the end of the year to members as patronage dividends or refunds prorated to each on the basis of their patronage or business done with the organization. Such distribution represents a reduction in the cost of services rendered to the member.

The 85% requirement. All of the above organizations must submit evidence with their application that they receive at least 85% of their income in collections from their members for the sole purpose of meeting losses and expenses (defined earlier). Membership, for this purpose, has the same meaning as that described earlier.

Annual basis. The 85% requirement is applied on the basis of an annual accounting period. Failure of an organization to meet the requirement in a particular year precludes exemption for that year.

Types of income. Gain from the sale or conversion of the organization's property is not considered an amount received from members in determining whether the organization's income consists of "amounts collected from members."

The 85% income test relates to gross income. Therefore, capital losses sustained in the same year in which the organization realizes capital gains cannot be used to reduce such gains for purposes of this test.

Example. The books of an organization reflect the following for the calendar year:

Collections from members	\$2,400
Short-term capital gains	600
Short-term capital losses	400
Other income	None
Gross income (\$2,400 + \$600 - \$400)	100%
Collected from members (\$2,400)	80%

Since amounts collected from members do not constitute at least 85% of gross income, the organization is not entitled to exemption from the Federal income tax for the year.

Voluntary contributions in the nature of gifts are not taken into account for purposes of the above 85% computation.

Other tax-exempt income, besides gifts, is considered as income received from other than members in applying the 85% test.

If the 85% test is not met, your organization, if classifiable under this section, will not qualify for exemption as any other type of organization described in this publication.

Local Life Insurance Associations

A benevolent life insurance association or an organization seeking recognition of exemption on grounds of similarity to a benevolent life insurance association must submit evidence upon applying for recognition of exemption that it will be of a purely local character, that its excess funds will be refunded to members or retained in reasonable reserves to meet future losses and expenses, and that it meets the 85% gross income requirement. To establish that it is of a purely local character, it should show that its activities will be confined to a particular community, place, or area, irrespective, however, of political subdivisions. Evidence that the activities of an organization are limited only by the borders of a State or any other political subdivision will not establish that it is purely local in character.

Nonprofit organization. An insurance organization's application should contain evidence that it is not a stock company whose shares carry the right to dividends. Refer to the earlier discussion of *Dividends*.

A copy of each type of policy issued by your organization should be included with the application for recognition of exemption.

Organizations similar to local benevolent life insurance companies, including those that in addition to paying death benefits also provide for the payment of sick, accident, or health benefits, should file applications for recognition of exemption on Form 1024. However, an organization that pays only sick, accident, or health benefits, but not life insurance benefits, is not an organization similar to a benevolent life insurance association, and should not apply for recognition of exemption as described in this chapter.

A burial and funeral benefit insurance organization can apply for recognition of exemption as an organization similar to a benevolent life insurance company if it establishes that the benefits are paid in cash and if it is not engaged directly in the manufacture of funeral supplies or the performance of funeral services. An organization that provides its benefits in the form of supplies and services is not a "life insurance company." Such an organization may seek recognition of exemption from Federal income tax, however, as a mutual insurance company other than life. Contact your Internal Revenue office for further information.

Mutual or Cooperative Associations

Mutual ditch, irrigation and telephone companies. In addition to local life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies, and like organizations should file application on Form 1024. These organizations, however, need not establish that they are of a purely local character. They may serve noncontiguous areas.

"Life organization" is a term generally restricted to organizations that perform a service comparable to mutual ditch, irrigation, and telephone companies such as mutual water, communications, electric power, or gas companies all of which satisfy the 85% test. Examples are an organization organized for the protection of river banks against erosion whose only income consists of assessments against the property owners concerned, a non-profit organization providing and maintaining a two-way radio system for its members on a mutual or cooperative basis, and a local light and water company organized to furnish light and water to its members.

Associations operating a bus for their members' convenience, providing and maintaining cooperative housing facilities for the personal benefit of individuals, or furnishing a financing service for purchases made by members of cooperative organizations, are not "like organizations."

Donations to an organization described in this chapter are not deductible as charitable contributions on the donor's Federal income tax return.

12. Credit Unions and Other Mutual Financial Organizations

[Code Sec. 501(c)(14)]

If your organization wishes to obtain recognition of exemption as a credit union without capital stock, organized and operated under State law for mutual purposes and without profit, it should file an application including the facts, information, and attachments described in this chapter. In addition, it should follow the procedure described in Chapter 1.

Federal credit unions organized and operated in accordance with the Federal Credit Union Act, as amended, obtain exemption through a group exemption letter issued to the Bureau of Federal Credit Unions of the Department of Health, Education, and Welfare. They are not discussed further in this publication. Contact your District Director for further information.

Certain other mutual financial organizations may file applications for recognition of exemption from Federal income tax. They are organizations formed before September 1, 1957, without capital stock and operated for mutual purposes without profit to provide reserve funds for, and insurance of, shares or deposits in:

- 1) domestic building and loan associations;
- 2) cooperative banks (without capital stock organized and operated for mutual purposes and without profit); or
- 3) mutual savings banks (not having capital stock represented by shares).

Similar organizations, formed before September 1, 1957, that provide reserve funds for, but not insurance of, shares or deposits in one of the three types of savings institutions previously enumerated may be exempt from tax if 85% or more of the organization's income is attributable to providing reserve funds and to investments.

Not exempt from taxes are building and loan associations, savings and loan associations, mutual savings banks, and cooperative banks.

Application form. The Internal Revenue Service does not provide a printed application form for the use of State chartered credit unions or other organizations included in this chapter. Your application should be made in statement form, including a declaration that is made under the penalties of perjury.

A State chartered credit union must show in its application that it is formed under a State credit union law, the State and date of incorporation, and that the State credit union law with respect to loans, investments, and dividends, if any, is being complied with.

A form of statement furnished to applicants by the Credit Union National Association is acceptable as meeting the application requirements for credit unions, and may be used in lieu of the above statement form of application. Following is a reproduction of that form:

The undersigned ——— (Complete name) Credit Union, Inc., ——— (Complete address, including street and number) a credit union operating under the credit union law of the State of ——— claims exemption from Federal income tax and supplies the following information relative to its operation:

- 1) Date of incorporation ———
- 2) It was incorporated under the credit union law of the State of ———, and is being operated under uniform bylaws adopted by said State.
- 3) In making loans the State credit union law requirements including their purposes, security, and rate of interest charged thereon, are complied with.

4) Its investments are limited to securities which are legal investments for credit unions under the State credit union law.

5) Its dividends on shares, if any, are distributed as prescribed by the State credit union law.

I, the undersigned, a duly authorized officer of the ——— Credit Union, Inc., declare that the above information is a true statement of facts concerning the credit union.

Signature of Officer

Title

Every other organization included in this chapter must show in its application the State in which the organization is incorporated and the date of incorporation; the character of the organization; the purpose for which it was organized; its actual activities; the sources of its income and receipts and the disposition thereof; whether or not any of its income or receipts is credited to surplus or may inure to the benefit of any private shareholder or individual; whether the law relating to loans, investments, and dividends is being complied with; and in general all facts relating to its operations that affect its right to exemption.

The statement must include detailed information showing either that the organization provides both reserve funds for, and insurance of, shares and deposits of its member financial organizations; or the organization provides reserve funds for shares or deposits of its members and 85% or more of the organization's income is attributable to providing reserve funds and to investments. There should be attached a conformed copy of the articles of incorporation or other document setting forth the permitted powers or activities of the organization; the by-laws or other similar code of regulations; and the latest annual financial statement showing the receipts, disbursements, assets, and liabilities of the organization.

13. Title Holding Companies

[Code Sec. 501(c)(2)]

If your organization wishes to obtain recognition of exemption from Federal income tax as a corporation organized to hold title to property, collect income therefrom, and turn over the entire amount less expenses to an organization that is exempt from tax, it should file its application on Form 1024. The information to be submitted upon application is described in this chapter. For a discussion of procedures for obtaining recognition of exemption see Chapter 1.

You must show that your organization is a corporation. If you are in doubt as to whether your organization qualifies as a corporation for this purpose, see your District Director.

The corporate charter that you submit upon application must confine the purposes and powers of your organization to holding title to property, collecting income therefrom, and turning such income over to an exempt organization. If the charter authorizes your organization to engage in activities that go beyond these limitations its exemptions may not be recognized even if its actual operations are so limited. If your organization's original charter does not limit its powers, you may amend the charter to conform to the required limitations and submit evidence with your application that the charter has been so amended.

Remission of income. You must show that your company will be required to turn over the entire income from the property, less expenses, to one or more exempt organizations.

Actual payment of the income must be required. A mere obligation to use the income for the exempt organization's benefit, or the fact that such organization has control over such income does not constitute sufficient payment to comply with this requirement.

Expenses may reduce the amount of income required to be turned over to the tax-exempt organization for which your organization holds property. The term "expenses" (for this purpose) includes not only ordinary and necessary expenses paid or incurred, but also reasonable additions to depreciation reserves and other reserves that would be proper for a business corporation holding title to and maintaining property.

Waiver of remission of income is allowed where the occupant of property held by your title holding company is the exempt organization for which it holds the title.

Application for recognition of exemption. In addition to the information required by Form 1024, the organization must furnish evidence that the organization for which title is held has obtained recognition of exempt status. If that organization has not been specifically notified in writing by the Internal Revenue Service that it is exempt, the applicant organization must submit the necessary application and supporting documents to enable the Internal Revenue Service to determine whether the organization for which title is held qualifies for exemption. A copy of a ruling or determination letter issued to the organization for which title is held will be proof that it qualifies for exemption. However, until the organization for which title is held obtains recognition of exempt status, or proof is submitted to show that it qualifies, the applicant organization cannot obtain recognition of exemption.

Donations to an exempt title holding company are generally not deductible as charitable contributions on the donor's Federal income tax return.

Reference Chart *

Section of 1954 Code	Description of organization	General nature of activities	Form No. for application for exemption from income tax	Annual return required to be filed	Contributions deductible
501(c)(1)	Corporations Organized Under Act of Congress (including Federal Credit Unions)	Instrumentalities of the United States	No Form	None	Yes, if made for exclusively public purposes
501(c)(2)	Title Holding Corporation For Exempt Organization	Holding title to property of an exempt organization	1024	990 ²	No ¹
501(c)(3)	Religious, Educational and Charitable Organizations	Activities of nature implied by description of class of organization	1023	990 or 990-PF ²	Generally, Yes
501(c)(4)	(a) Civic Leagues, Social Welfare Organizations, and (b) Local Associations of Employees	(a) Promotion of community welfare; (b) Charitable, educational or recreational	1024	990 ²	Generally, No ^{1,2}
501(c)(5)	Labor, Agricultural and Horticultural Organizations	Educational or instructive, the purpose being to improve conditions of work, and to improve products and efficiency	1024	990 ²	No ¹
501(c)(6)	Business Leagues, Chambers of Commerce, Real Estate Boards, Etc.	Improvement of business conditions of one or more lines of business	1024	990 ²	No ¹
501(c)(7)	Social and Recreation Clubs	Pleasure, recreation, social activities	1024	990 ²	No ¹
501(c)(8)	Fraternal Beneficiary Societies and Associations	Lodge providing for payment of life, sickness, accident, or other benefits to members	1024	990 ²	Yes, if used for Sec. 501(c)(3) purposes
501(c)(9)	Voluntary Employees' Beneficiary Associations (including Federal Employees' Voluntary Beneficiary Associations formerly covered by section 501(c)(10))	Providing for payment of life, sickness, accident or other benefits to members	1024	990 ²	No ¹
501(c)(10)	Domestic Fraternal Societies and Associations	Lodge devoting its net earnings to charitable, fraternal, and other specified purposes. No life, sickness, or accident benefits to members	1024	990 ²	Yes, if used for Sec. 501(c)(3) purposes
501(c)(11)	Teachers' Retirement Fund Associations	Teachers' association for payment of retirement benefits	No Form	990 ²	No ¹
501(c)(12)	Benevolent Life Insurance Associations, Mutual Dish or Irrigation Companies, Mutual or Cooperative Telephone Companies, Etc.	Activities of a mutually beneficial nature similar to those implied by the description of class of organization	1024	990 ²	No ¹
501(c)(13)	Cemetery Companies	Burials and incidental activities	1024	990 ²	Generally, Yes
501(c)(14)	State Chartered Credit Unions, Mutual Reserve Funds	Lends to members. Exemption as to building and loan associations and cooperative banks repealed by Revenue Act of 1951, affecting all years after 1951	No Form	990 ²	No ¹
501(c)(15)	Mutual Insurance Companies or Associations	Providing insurance to members substantially at cost	1024	990 ²	No ¹
501(c)(16)	Cooperative Organizations to Finance Crop Operations	Financing crop operations in conjunction with activities of a marketing or purchasing association	No Form	990 ²	No ¹
501(c)(17)	Supplemental Unemployment Benefit Trusts	Provides for payment of supplemental unemployment compensation benefits	1024	990 ²	No ¹
501(c)(18)	Employee Funded Pension Trust (created before June 25, 1958)	Payment of benefits under a pension plan funded by employees	No Form	990 ²	No ¹
501(c)(19)	Pool or Organization of War Veterans	Activities implied by nature of organization	1024	990 ²	Yes
501(a)	Religious and Apostolic Associations	Regular business activities. Communal religious community	No Form	1085	No ¹
501(e)	Cooperative Hospital Service Organizations	Performs cooperative services for hospitals	1023	990 ²	Yes
501(f)	Cooperative Service Organizations of Operating Educational Organizations	Performs collective investment services for educational organizations	1023	990 ²	Yes
521(a)	Farmers' Cooperative Associations	Cooperative marketing and purchasing for agricultural producers. Exemption as to farm cooperatives repealed by Revenue Act of 1951 affecting all years after 1951	1028	990-C	No

*An organization exempt under a Subsection of Code Sec. 501 other than (c)(3), may establish a charitable fund, contributions to which are deductible if such a fund must itself meet the requirements of section 501(c)(3) and the related notice requirements of section 509(a).

¹For exceptions to the filing requirement, see Chapter 1 and the instructions for Forms 990 and 990-AF.

²Contributions to volunteer companies and similar organizations are deductible, but only if made for exclusively public purposes.

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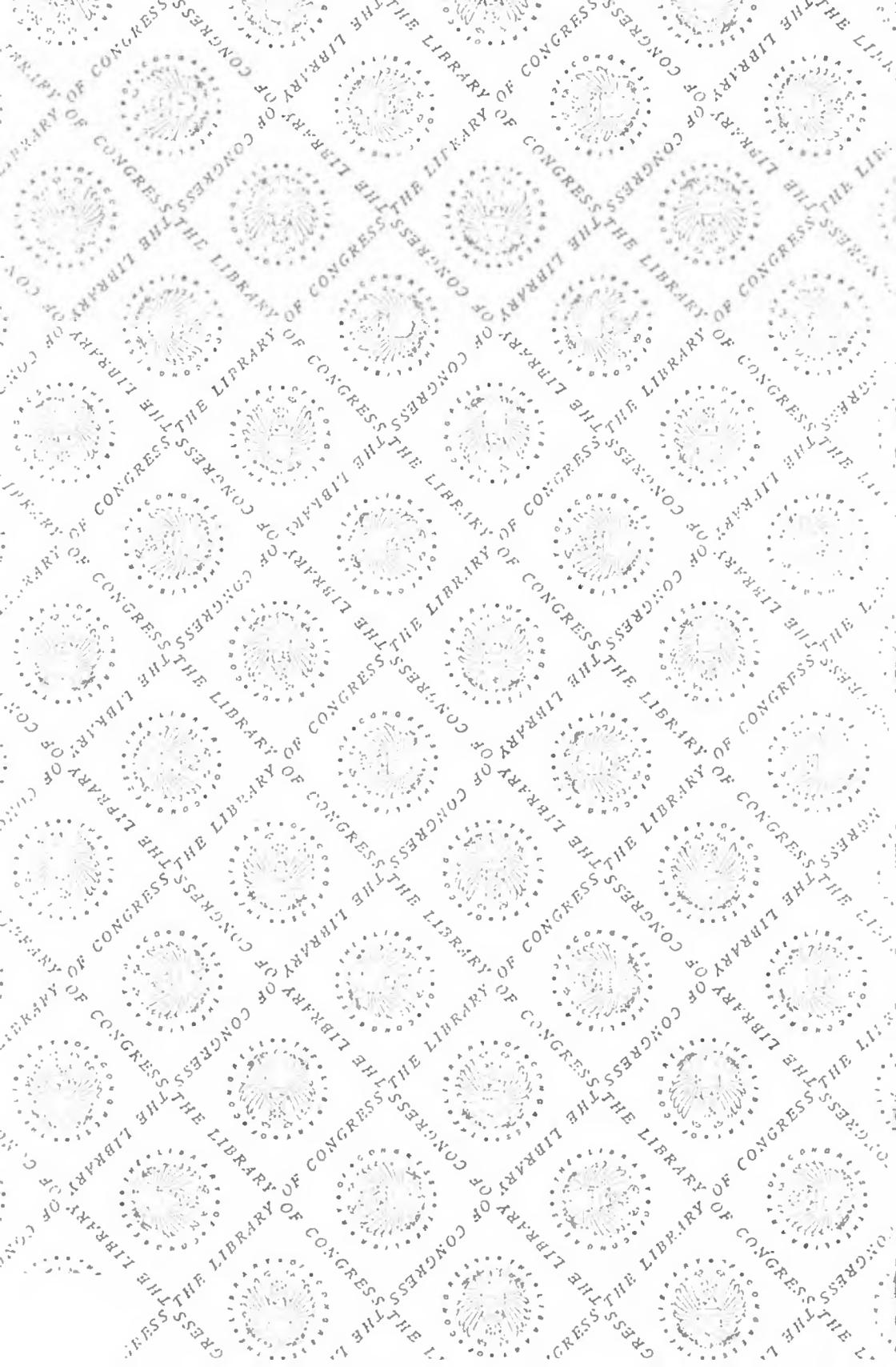
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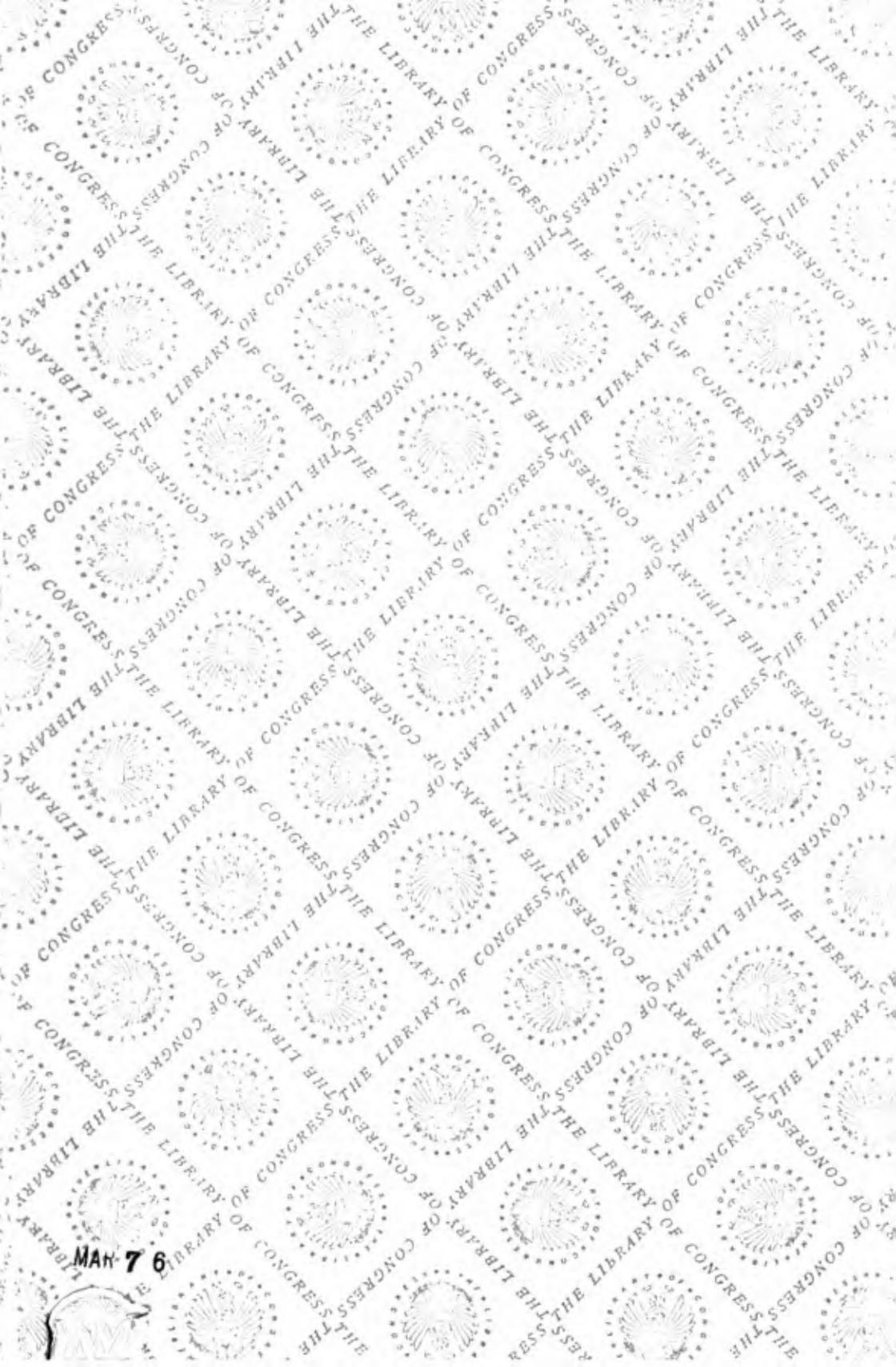
Send all applications for recognition of exemption to the District Director, Internal Revenue Service, for your State.

- Alabama—Birmingham, Ala. 35203
 Alaska—Anchorage, Alaska 99510
 Arizona—Phoenix, Ariz. 85025
 Arkansas—Little Rock, Ark. 72203
 California—Los Angeles, Calif. 90012
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