

EXEMPT STATUS OF VETERANS' ORGANIZATIONS; DISASTER LOSSES

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Mr. BENNETT, from the Committee on Finance;
submitted the following

REPORT

[To accompany H.R. 11185]

The Committee on Finance, to which was referred the bill (H.R. 11185) to amend the Internal Revenue Code of 1954 with regard to the exempt status of veterans' organizations, having considered the same, reports favorably thereon with amendments and recommends that the bill, as amended, do pass.

I. SUMMARY

H.R. 11185, as passed by the House, deals with the tax-exempt status of veterans' organizations and the treatment of their insurance activities under the tax laws. Under present law veterans' organizations have been exempt from tax as social clubs, or as social welfare organizations. The House bill creates a separate exemption category for war veterans' organizations. It also provides that income a war veterans' organization receives from insuring its members and their dependents is not to be subject to the unrelated business income tax, to the extent the income is used or set aside for the insurance benefits or for religious, charitable, educational, etc., purposes.

The committee accepted this House-passed provision with two modifications. First, it extended the new exempt category and the exemption of the organizations' insurance income from the unrelated business income tax to any veterans' organization whose membership consists of at least 75 percent of war veterans as long as substantially all of the other members are veterans (other than war veterans), cadets, or are spouses, widows or widowers of war veterans or such other individuals. In addition, since the unrelated business income tax was extended to these organizations in 1969 by the Tax Reform Act, the committee made the effective date of this bill as of the date of enactment of the Tax Reform Act.

The committee has also added two amendments to the bill with respect to disaster losses. The first amendment allows a taxpayer, at his option, to deduct a disaster loss (in a presidentially declared disaster area) occurring at any time during a taxable year for the immediately preceding year. This extends the recently enacted provision (in P.L. 92-336) which allows this treatment if the disaster occurred within the first six months of the taxable year to cover taxpayers without regard to when during the taxable year the loss occurred. The six months' rule of the recent legislation, for example, denies many fiscal year taxpayers the right to use this provision even for flood losses arising from Hurricane Agnes merely because this storm did not occur in the first six months of their taxable years. The second amendment speeds the processing of refund claims resulting from Hurricane Agnes, other recent disasters and similar future disasters by authorizing the Internal Revenue Service to make credits or refunds in excess of \$100,000 before submitting a report to the Joint Committee on Internal Revenue Taxation. A report will be submitted to the Joint Committee after the refund is made.

This bill has been reported unanimously by the committee and the Treasury Department does not object to the bill's enactment.

II. GENERAL STATEMENT

Exempt status of veterans' organizations

Present law (sec. 501(c)) provides for 18 categories of organizations exempt from income tax. However, there is no category which specifically applies to veterans' organizations. Nevertheless, these organizations generally qualify for exemption from income tax as either social welfare organizations (sec. 501(c)(4)) or social clubs (sec. 501(c)(7)).

In addition to their general activities, some of these veterans' organizations provide one or more types of insurance for their members and the dependents of their members. In some cases the organizations serve as commissioned agents for insurance companies which provide the actual insurance for the organizations' members and their dependents. In such a case, the organization receives portions of the premiums paid by its members for the insurance. In other cases, veterans' organizations receive income from their own provision of insurance benefits for their members and dependents, that is, they are self-insurers.

Before the enactment of the Tax Reform Act of 1969, there was no tax on this insurance activity of the veterans' organizations since the unrelated business income tax did not apply to social welfare organizations and social clubs. However, the 1969 Act extended the application of the unrelated business income tax to virtually all exempt organizations, including social welfare organizations and social clubs. (In the case of social clubs and employees beneficiary associations this tax was also extended to their investment income.) As a result, questions have been raised as to whether the income derived by veterans' organizations from their insurance activities is now subject to the unrelated business income tax.

In the 1969 Act, however, it was also provided (sec. 512(a)(3)) that in the case of employees' beneficiary associations, investment and other nonbusiness income is not to be taxed if it is set aside (1) for

life, sick, accident, or other benefits, or (2) for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. Social clubs also are permitted to set aside income without the payment of tax for the second of these categories of purposes (religious, charitable, educational, etc.). In addition, it was made clear in a 1969 Act committee report that income from insurance activities of fraternal beneficiary associations would be exempt from the unrelated business income tax. The committee agrees with the House that there was no reason not to provide similar treatment for exempt veterans' organizations.

Although the House bill only deals with war veterans' organizations, the committee's bill extends the bill's treatment to all other veterans' organizations if at least 75 percent of its membership consists of war veterans and substantially all of the other members are veterans (other than war veterans—that is, they served during peacetime), cadets, or are spouses, widows or widowers of war veterans or such individuals. The committee has been informed that there are several veterans' organizations whose membership consist of mostly war veterans but also includes those individuals who served in the Armed Forces only during peacetime as well as a few cadet members who are eligible to join by virtue of their participating in the ROTC programs or as cadets in the Armed Forces academies. The committee has also been informed that some of these veterans' organizations also accept as members those who are currently on active duty, but that this group is considered by the Internal Revenue Service to be war veterans. In addition, some of these organizations include in their membership a small percentage of other individuals, such as spouses, widows or widowers of war veterans.

The committee was also concerned about the effective date of the House bill with respect to the application of the unrelated business income tax to the insurance income of these veterans' organizations. As indicated above, prior to 1969 there was no tax on this insurance activity of these organizations. When the Tax Reform Act extended the application of the unrelated business income tax to the exempt categories including these veterans' organizations, it became effective in 1970. Since the committee believes that there was no specific intent to tax the insurance income of veterans' organizations by the 1969 Act, it, therefore, believes it is appropriate to make the exemption of their insurance income from the unrelated business income tax effective as of the effective date of the Tax Reform Act.

Disaster losses

On June 30, 1972, Congress amended section 165(h) of the code (in P.L. 92-336) to provide that if a disaster occurred within the first 6 months of the taxable year in an area designated by the President for relief under the Disaster Relief Act of 1970, the taxpayer could elect to deduct the loss in the preceding taxable year. Prior to this amendment, section 165(h) applied only to disaster losses which occurred on or before the time prescribed for filing the income tax return for the taxable year (in the first 3½ months in the case of individuals or 2½ months in the case of corporations), and for most taxpayers did not cover the major flood disasters which occurred in June of 1972. Under section 165(h) as amended, a calendar year taxpayer who sustained a disaster loss in June of 1972 may, at his

option, deduct the loss on his 1971 return and receive an immediate tax benefit to help restore his lost home or business. However, this does not cover any losses of a fiscal year taxpayer whose taxable year ended in the latter part of calendar year 1971 for flood losses arising from Hurricane Agnes merely because this storm did not occur in the first six months of his taxable year. Thus, he would not be able to deduct a loss attributable to the recent flood disaster which occurred in June of 1972 on his return for his taxable year ended in 1971. He must wait to deduct the loss on his 1972 return, thus postponing the time he receives a tax benefit from deduction of the loss. In effect, the committee's amendment allows the same treatment with respect to disaster losses for all taxpayers without regard to when during the taxable year the loss occurs. This means that both calendar and fiscal year taxpayers who suffer a disaster loss at any time during the taxable year may deduct that loss in the immediately preceding year.

The committee was also concerned about the speed in which disaster loss refunds may be made to taxpayers. Section 6405(a) of the Internal Revenue Code presently provides that refund or credit of any income tax in excess of \$100,000 shall not be made by the Internal Revenue Service until after the expiration of 30 days from the date when a report on the matter is filed with the Joint Committee on Internal Revenue Taxation. The purpose of this provision is to insure that large refund claims may be reviewed by the Joint Committee and its staff. However, in the case of the returns involving the recent flood disasters, this provision has the effect of delaying badly needed tax relief to individuals and businesses entitled to refunds in excess of \$100,000. To prevent this hardship, the committee's amendment allows large refunds attributable to disaster losses to be made immediately, subject to a later report and review by the Joint Committee. This will provide an adequate review of large disaster loss refund claims, but without delaying the payment of such claims.

III. EXPLANATION OF PROVISION

Exempt status of veterans organizations

The bill adds a new category—veterans' organizations—to the list of organizations exempt from tax under the Internal Revenue Code (sec. 501(c)). Under the House bill, the new provision (sec. 501(c)(19)) defines a veterans' organization as an organization (or post) of war veterans (or an auxiliary unit or society of, or trust or foundation for any such organization) which is organized in the United States (or any of its possessions) and no part of the net earnings of which inures to the benefit of any private shareholder or individual. The committee amends this provision, however, to cover any veterans organization if at least 75 percent of its membership are war veterans and substantially all of the other members are veterans (other than war veterans), cadets or are spouses, widows or widowers of war veterans or of such other individuals. The committee intends that any individual who is in the active service of the Armed Forces of the United States is to be considered a veteran. (As indicated above, the committee understands that the Internal Revenue Service already treats individuals in active service as veterans.) The committee also intends that individuals who served in the Armed Forces during the

Korean and Vietnam conflicts are to be treated as war veterans. In addition, the committee intends that cadets are to include those individuals who are in the Armed Forces' academies or are in ROTC programs in their colleges or universities.

The committee intends this provision to cover any veterans organization whose membership is composed almost exclusively of military associated individuals. Although these veterans organizations include mostly war veterans (including, in some cases, individuals who are currently in active service), the new exempt category will apply to a veterans' organization whose membership includes some nonwar veterans if they do not comprise more than 25 percent of the organization's members. For these purposes, the new exempt category provides that substantially all (which is intended to mean 90 percent) of these nonwar veterans, as indicated above, are to be individuals who served in the Armed Forces during peace time (or who serve in the Armed Forces during a peace time period in the future), cadets, or spouses, widows or widowers of war veterans or of the above-mentioned groups. Since substantially all is intended to mean 90 percent, this means that 10 percent of the nonwar veterans (that is the 25-percent group)—thus, 2½ percent of a veterans' organization's entire membership—may include individuals outside of the above-mentioned nonwar veteran groups.

Both versions of the bill also provide a special rule for these veterans' organizations for the income they receive from providing insurance benefits for their members or the dependents of their members. This special rule excludes from the unrelated business income tax any amounts attributable to payments for life, sick, accident, or health insurance with respect to members of such organizations or their dependents to the extent these amounts are set aside for the purpose of either providing for the payment of insurance benefits or for religious, charitable, scientific, literary, educational, etc., purposes (the purposes specified in sec. 170(c)(4)). In this regard it is intended that any income which is spent by a veterans' organization for religious, charitable, etc., purposes (which the committee intends are to include programs involving Americanism, youth activities, community activities, and information and educational programs relative to national security and foreign affairs for purposes of this provision) is first to be deemed to represent funds derived by the organization from its insurance activities (to the extent this income is not used in connection with the insurance activities). The committee does not intend for any expenditures for lobbying purposes to come under this exemption.

As is the case with regard to set-asides for charitable, etc., or for insurance purposes by other organizations (see sec. 512(a)(3)(B)), if in any year, an amount is taken out of the set-aside and used for any other purposes, this amount is then to be subject to the unrelated business income tax. Also, the committee intends that income will be treated as set aside for the specified benefits where it is used for the reasonable cost of administration directly connected with the benefit programs (as well as the payment of the benefits themselves), or the reasonable cost of administration directly connected with the organization's religious, educational, charitable, etc., activities.

The House bill makes these changes effective for taxable years ending after the date of enactment. The committee's bill, however,

makes the changes effective for taxable years beginning after December 31, 1969, the effective date of the extension of the unrelated business income tax by the Tax Reform Act of 1969.

Disaster losses

As indicated above, the committee has added two amendments to the bill relating to disaster losses. The first provision amends section 165(h) of the Internal Revenue Code to permit a taxpayer who sustains a loss attributable to a disaster at any time during a taxable year to deduct the loss on the return for the immediately preceding taxable year if the disaster occurs in an area determined by the President to warrant assistance under the Disaster Relief Act of 1970. The amount of any reimbursement to which the taxpayer is entitled or has a reasonable prospect of receipt with respect to the disaster will be determined as of the date on which he files an amended return or claim for refund deducting the disaster loss in the preceding taxable year. Any subsequent additional reimbursement would be includable in the taxpayer's gross income under the "tax-benefit rule," in the year in which it was received or accrued. This amendment applies to disasters occurring after December 31, 1971.

The second amendment (to section 6405 of the Internal Revenue Code) provides that in the case of a credit or refund in excess of \$100,000, which is attributable to a taxpayer's election under section 165(h) to deduct a disaster loss in the taxable year immediately preceding the occurrence of the disaster, the Internal Revenue Service is permitted, in its discretion, to make the refund or credit without previously submitting a report on the matter to the Joint Committee on Internal Revenue Taxation. However, in such cases, the report shall be made as soon as the Service has determined the correct amount of tax for the year with respect to which the refund is made. This provision shall apply to credits or refunds made after July 1, 1972.

IV. EFFECT ON THE REVENUES OF THE BILL

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statement is made relative to the effect on the revenues of the bill. The committee estimates that this bill will have no effect, or at most a negligible effect, on the revenues. The Treasury Department agrees with this statement.

V. CHANGES IN EXISTING LAW

In the opinion of the committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, as reported).

