

## ORGANIZATIONS PROVIDING FUNDS FOR TAX EXEMPT SAVINGS INSTITUTIONS

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Mr. LONG of Louisiana, from the Committee on Finance, submitted  
the following

### REPORT

[To accompany H.R. 327]

The Committee on Finance to which was referred the bill (H.R. 327) to amend section 501(c) of the Internal Revenue Code of 1954 to exempt from taxation certain nonprofit corporations and associations operated to provide reserve funds for domestic building and loan associations, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

#### I. SUMMARY OF BILL

This bill exempts from income taxation mutual, nonprofit organizations organized before September 1, 1957, and operated to provide reserves for building and loan associations, cooperative banks, and mutual savings banks, if at least 85 percent of their income is attributable to providing such reserve funds and to investments. The bill extends this tax-exempt status to organizations which are similar in essential respects to those already exempt. Present provisions, however, exempt such organizations only if they provide both reserves for, and insurance of shares and deposits of, member associations.

The bill also provides that net income derived by such organizations (both that of the organizations exempted by this bill and that of the similar organizations already exempt) which is not related to the provision of reserves or insurance will be taxed as unrelated business income. This latter provision confines the privilege of tax exemption to income derived from the specific services upon which that exemption is based.

The provisions described above are to be effective for taxable years beginning after the date of enactment of this bill.

The treasury Department has indicated that it has no objections to this bill.

## II. GENERAL STATEMENT

Present law exempts from tax certain corporations or associations which provide reserve funds for, and insurance of shares or deposits in, domestic building and loan associations, cooperative banks, and mutual savings banks. To be exempt, the organization must be nonprofit, be organized and operated for mutual purposes, have no capital stock, and have been organized before September 1, 1957.

Prior to September 1, 1951, organizations of this type were exempt from tax under the general exemption provisions then applicable to mutual savings banks, savings associations, and building and loan associations. While the Revenue Act of 1951 imposed the corporate income tax on certain undistributed profits of formerly tax-exempt organizations, provision was made in what is now section 501(c)(14) for continuing the exemption of nonprofit, mutual-deposit guarantee organizations without capital stock organized for the benefit of a group of mutual savings banks or building and loan associations which were organized before September 1, 1951. The law was amended in 1959 to change the required date of organization from September 1, 1951, to September 1, 1957. At that time, it was stated that the law, as amended, would apply to at least four such organizations.

It has come to light that at least one organization, the New York State Savings & Loan Bank, similar in nearly all essential respects to those now exempt is not included within the scope of section 501(c)(14). While the organization is a nonprofit, mutual organization and provides reserve funds for savings and loan associations, it does not insure accounts of its members.

Following the enactment of what is now section 501(c)(14), this organization initially was ruled tax exempt by the Internal Revenue Service. The organization was subsequently notified, however, that its tax-exempt status would be terminated because it was not providing insurance of shares and deposits for its members. Disposition of the matter was delayed for a time while the organization endeavored to obtain an amendment to the banking laws of New York, the State in which it is chartered, but the exemption finally was revoked for 1962 and subsequent years. The law previously authorized the administration of a fund for the insurance of savings accounts only if 100 or more savings and loan associations in the State were included. Recently the State law has been amended to eliminate this requirement, but the organization has not, as yet, found it advisable to establish such an insurance program because so few of its member banks have need for such insurance. Moreover, the law only authorizes the organization to act as a trustee for such an insurance and it is not clear that this would qualify the organization for the present exemption.

Your committee, like the Committee on Ways and Means of the House, has concluded that an organization which meets all the other requirements of section 501(c)(14) should not be precluded from tax-exempt status under Federal income tax law merely because it does not provide insurance of the shares and deposits of its members in addition to reserve funds. As the situation described above illustrates, such an organization may be prevented from providing such services, either by the restrictions imposed by the laws of the State in which it is chartered, or by the lack of need for them.

This bill therefore amends present law with respect to section 501(c)(14) to add a new subparagraph to the existing provision. The new subparagraph provides that certain nonprofit corporations or associations organized before September 1, 1957, and operated for mutual purposes to provide reserve funds for domestic building and loan associations, cooperative banks, or mutual savings banks may be exempt from the tax even if they do not provide insurance of shares and deposits of member associations. The exemption is only available, however, if 85 percent or more of the income of such an organization is attributable to providing reserve funds and to investments. The provision does not apply to organizations which qualify for tax exemption under existing law.

With respect to all organizations described above, including both those previously tax exempt and those newly exempt under the terms of this bill, your committee agrees with the Committee on Ways and Means that only income connected with the provision of reserve funds for, and insurance of shares and deposits in, domestic building and loan associations, cooperative banks, and mutual savings banks should be tax exempt. Therefore the bill taxes as unrelated business income the net income derived by such an organization from activities not substantially related to the purpose or function which constitutes the basis for its exemption. Under this provision, the income derived by such an organization from the provision of data processing services, for example, would be subject to tax as unrelated business income of a tax-exempt organization.

The provisions of the bill will apply to taxable years ending after the date of enactment. They are expected to have a negligible effect on revenue.

### III. CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italic; existing law in which no change is proposed is shown in roman):

#### INTERNAL REVENUE CODE OF 1954

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#### **Sec. 501. Exemption from tax on corporations, certain trusts, etc.**

(a) **EXEMPTION FROM TAXATION.**—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502, 503, or 504.

(b) **TAX ON UNRELATED BUSINESS INCOME.**—An organization exempt from taxation under subsection (a) shall be subject to tax to the extent provided in part II of this subchapter (relating to tax on unrelated income), but, notwithstanding part II, shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

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Source: New.

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a):

(1) 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.

(2) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under this section.

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

(5) Labor, agricultural, or horticultural organizations.

(6) Business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(7) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

(8) Fraternal beneficiary societies, orders, or associations—

(A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and

(B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

(9) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents, if—

(A) no part of their net earnings inures (other than through such payments) to the benefit of any private shareholder or individual, and

(B) 85 percent or more of the income consists of amounts collected from members and amounts contributed to the association by the employer of the members for the sole purpose of making such payments and meeting expenses.

(10) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or their designated beneficiaries, if—

(A) admission to membership in such association is limited to individuals who are officers or employees of the United States Government, and

(B) no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

(11) Teachers' retirement fund associations of a purely local character, if—

(A) no part of their net earnings inures (other than through payment of retirement benefits) to the benefit of any private shareholder or individual, and

(B) the income consists solely of amounts received from public taxation, amounts received from assessments on the teaching salaries of members, and income in respect of investments.

(12) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

(13) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

[(14) Credit unions without capital stock organized and operated for mutual purposes and without profit; and corporations or associations without capital stock organized before September 1, 1957, and operated for mutual purposes and without profit for the purpose of providing reserve funds for, and insurance of, shares or deposits in—

[(A) domestic building and loan associations,

[(B) cooperative banks without capital stock organized and operated for mutual purposes and without profit, or

[(C) mutual savings banks not having capital stock represented by shares.]

(14)(A) *Credit unions without capital stock organized and operated for mutual purposes and without profit.*

(B) *Corporations or associations without capital stock organized before September 1, 1957, and operated for mutual purposes and without profit for the purpose of providing reserve funds for, and insurance of shares or deposits in—*

(i) *domestic building and loan associations,*

(ii) *cooperative banks without capital stock organized and operated for mutual purposes and without profit, or*

(iii) *mutual savings banks not having capital stock represented by shares.*

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(C) Corporations or associations organized before September 1, 1957, and operated for mutual purposes and without profit for the purpose of providing reserve funds for associations or banks described in clause (i), (ii), or (iii) of subparagraph (B); but only if 85 percent or more of the income is attributable to providing such reserve funds and to investments. This subparagraph shall not apply to any corporation or association entitled to exemption under subparagraph (B).

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Sec. 511. Imposition of tax on unrelated business income of charitable, etc., organizations.

(a) CHARITABLE, ETC., ORGANIZATIONS TAXABLE AT CORPORATION RATES.—

(1) IMPOSITION OF TAX.—There is hereby imposed for each taxable year on the unrelated business taxable income (as defined in section 512) of every organization described in paragraph (2) a normal tax and a surtax computed as provided in section 11. In making such computation for purposes of this section, the term "taxable income" as used in section 11 shall be read as "unrelated business taxable income".

(2) ORGANIZATIONS SUBJECT TO TAX.—

(A) ORGANIZATIONS DESCRIBED IN SECTION 501(c)(2), (8), (5), (6), (14)(B) or (C), AND (17), AND SECTION 401(a).—The taxes imposed by paragraph (1) shall apply in the case of any organization (other than a church, a convention or association of churches, or a trust described in subsection (b)) which is exempt, except as provided in this part, from taxation under this subtitle by reason of section 401(a) or of paragraph (3), (5), (6), (14) (B) or (C), or (17) of section 501(c). Such taxes shall also apply in the case of a corporation described in section 501(c)(2) if the income is payable to an organization which, itself is subject to the taxes imposed by paragraph (1) or to a church or to a convention or association of churches.

(B) STATE COLLEGES AND UNIVERSITIES.—The taxes imposed by paragraph (1) shall apply in the case of any college or university which is an agency or instrumentality of any government or any political subdivision thereof, or which is owned or operated by a government or any political subdivision thereof, or by any agency or instrumentality of one or more governments or political subdivisions. Such taxes shall also apply in the case of any corporation wholly owned by one or more such colleges or universities.

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