AMERICAN FRATERNAL ALLIANCE

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Statement for Senate Finance Committee
Working Group
April 15, 2015

Submitted by Joseph Annotti, President, American Fraternal Alliance

The American Fraternal Alliance represents 70 fraternal benefit societies and their more than nine million members across the United States. On behalf of our member societies and their members, we respectfully submit this statement on the background and benefits of fraternal benefit societies.

Background on Fraternal Benefit Societies

Fraternal benefit societies ("fraternals"), under Section 501(c)(8) of the Internal Revenue Code (IRC), are not-for-profit mutual aid organizations that (1) insure members and their families against death, disease and disability, and (2) operate under a "local lodge" system, a grassroots network of fraternal member-volunteers that meet community and member needs. In general, the term "fraternal" applies to an organization whose members have adopted the same or similar calling, avocation or profession and who have banded together to aid and assist one another and serve their surrounding communities. These member-owned societies have a representative form of government, are chartered and licensed by state laws, and governed by federal and state statutes.

For more than a century, fraternals have been bringing people together with a common purpose to help meet needs in communities that would otherwise go unmet. As required under IRC 501(c)(8), these not-for-profit membership organizations provide financial security to their members through individual insurance products and use revenue generated through the sale of these products to provide a wide variety of benefits to members and to fund community service activities across the country.

Fraternals have a unique mission—they provide life insurance to their members, securing the financial futures of millions of American families; and they operate one of the most cost effective networks of community service volunteers in the nation. These activities are inextricably linked—the provision of insurance to members fuels the community service activities of fraternals, and individuals who have secured their own financial future are much more likely to assist others in need with both charitable giving and volunteerism.

The fraternal model has a positive impact on communities across the country**. In 2013 alone, fraternals and their members provided communities with 83 million volunteer hours and $388.5 million in direct support.** This support is mainly provided through the required fraternal system of local lodges. The fraternal system, now with more than 29,400 lodges nationwide, is one of the largest networks of volunteers and charitable activity in the United States.

A majority of our member-societies were founded more than a century ago to provide a sense of community to new Americans—supporting religious, educational, community and patriotic activities, and offering their members fraternal life insurance to support their families. From these beginnings, they have evolved into a major force for good in the United States. Fraternals have taken on an increasingly vital role in community and charity, at a time when government programs can reach only so fa, yet needs continue to rise. Our members remain dedicated to the roots of fraternalism today as their parents and grandparents were more than a century ago.

The Fraternal Tax Exemption

Under IRC 501(c)(8), fraternal benefit societies are not-for-profit organizations exempt from federal income tax. This exemption dates back to the Tariff Act of 1909,[1] was extended in the Revenue Act of 1913,[2] which exempted non-profit organizations including fraternal benefit societies that operated under a lodge system, and was later codified as Internal Revenue Code Section 501(c)(8).[3] The current 501(c)(8) rules governing fraternal benefit societies make it possible for fraternals to fulfill their community-based missions to serve as a powerful force for good at the grassroots level. According to a report by the U.S. Department of the Treasury, the exemption has remained largely unchanged since inception.[4] It includes three strict requirements for eligible organizations. They must: (1) have a fraternal purpose; (2) provide for the payment of life, sick, accident or other benefits; and (3) operate under a lodge system.[5] All of these requirements are essential to creating the unique fraternal model which delivers extraordinary benefits to society.

Fraternal Purpose

Fraternal benefit societies are mission-driven organizations, contributing greatly to the well-being of the nation—meeting needs that might otherwise go unmet in communities. In order to fulfill their missions, fraternals, unlike many other tax exempt organizations, are required under state statutes to serve specific tax exempt purposes, including charitable, educational, benevolent, fraternal, patriotic or religious purposes carried out through the volunteer activities of fraternal members in their local lodges.[6]

According to an Internal Revenue Service continuing education publication on fraternal benefit societies, for an organization to have a "fraternal purpose" its members need to not only have a common "calling, avocation, or profession," or "pursuit of a common object" or cause, but also need to conduct "fraternal activities." Both must exist in order to demonstrate the fraternal purpose.[7]

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[1] Tariff Act of 1909 § 38, 36 Stat.113 (1909)
[2] Revenue Act of 1913, Pub.L.No.63---6§II(G)(a),38 Stat.172(1913)
[3] 26 U.S.C.§501(c)(8)(2012)
[4] Dept. of the Treas., Report to the Cong. On Fraternal Benefit Societies [Treasury Report] 5 (1993)
[5] Sean M. Barnett and Ward L. Thomas, "IRC 501(c)(8) Fraternal Benefit Societies and IRC 501(c)(10) Domestic Fraternal Societies" in I.R.S., *Exempt Organizations Professional Education Text for FY 2004* at 14.
[6] *See, e.g.* Illinois Insurance Code, Article XVII "Fraternal Benefit Societies" 215 Ill. Comp. State 5/282.1 *et. seq.* (2012).
[7] *See* IRC 501(c)(8) Fraternal Beneficiary Societies *supra* note 5 at 2.

Whether fraternal members are bound by faith (as is the case, for example, of the Catholic Financial Life, Everence Association, and Thrivent Financial), or ethnicity (in the case of the Croatian Fraternal Union of America, the Polish National Alliance, and the Slovene National Benefit Society), or profession (in the case of the United Transportation Union Insurance Association, and Police and Firemen's Insurance Association), or a civic-minded spirit that drives them to give back (in the case of the Modern Woodmen of America), or groups dedicated to empowering women such as Royal Neighbors of America and Woman's Life Insurance Society, fraternal benefit societies come together to help others.

Meeting local needs big and small daily, fraternals have continued to serve out their purpose in communities for more than a century – creating a real impact in the lives of individuals and families across the country. As stated in the bipartisan resolution, H.Con.Res. 19, recently re-introduced by Reps. Erik Paulsen (R-MN) and Ron Kind (D-WI)

> Congress recognizes that fraternal benefit societies have served their original purpose for over a century, helping countless individuals, families, and communities through their fraternal member activities….The section 501(c)(8) tax exemption of fraternal benefit societies continues to generate significant, outsized returns to United States society and the work of fraternals should continue to be promoted.[8]

Insurance Protection

Under IRC 501(c)(8), fraternals must provide insurance protection to their members – generally interpreted as life, annuity and health products.[9] The provision relating to insurance benefits is necessary to support the charitable and fraternal activities of the volunteer lodges within communities. Fraternals cannot and do not use their tax exemption to offset the price of their products. Rather, the tax exemption allows fraternals to conduct benevolent, educational, patriotic, charitable, and volunteer activities. Though fraternals only account for approximately two percent of the life insurance market,[10] a 1993 study by the Department of Treasury on fraternal benefit societies found that:

> Analysis of the cost of comparable insurance policies indicates that fraternal benefit societies charge prices similar to those charged by large mutual life insurance companies. These prices are sufficient to cover costs (including taxes paid by the commercial companies) and suggest that the tax exemption is generally not being passed onto policyholders in the form of lower prices for insurance. Fraternal benefit societies do not appear to compete unfairly with taxable insurance companies.[11]

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[8] H. Con. Res. 19, 114th Congress. §4 and preamble (2015).
[9] Rev. Rul. 76-457, 1976-2 C.B. 155
[10] *See* A.M. Best., "U.S. Fraternal Life Societies- Admitted Assets 2008-2011" Best's Statistical Study. BestWeek U.S./Canada (2012). Market share derived by analyzing admitted assets of Fraternal Life Societies for 2008 through 3Q 2011 (latest data available).
[11] Treasury Report at 2.

Further, Professor Phillip Swagel, Ph.D. of the University of Maryland School of Public Policy found as part of his 2014 study, which is an update on a similar 2010 study,on the economic impact of fraternal benefit societies in communities:

> That is, the tax-exempt status of fraternal benefit societies does not appear to provide any "unfair advantage" for the issuance of their insurance products such as life insurance. And, as required by law, fraternals use that benefit to fulfill their charitable, educational, social, and religious purposes in communities across the country.[12]

Behavioral research suggests that individuals are more likely to "give back" with their time and treasure if they have a strong sense of financial security. According to the Independent Sector's *Giving and Volunteering in the US*, "In 2001, the majority of contributing households reported being worried about their financial future and gave a little more than half the amount to charitable causes as did the 42.5% of contributing households who said they were not worried about their financial security."[13] Fraternals uniquely promote financial security through insurance protection and offer their members the opportunity to give back through various programs and the local lodge system.

Lodge System

Fraternals must be organized through a system of lodges according to IRC 501(c)(8). Each fraternal has a local lodge system that creates a binding tie with a community and allows the fraternal benefit society to meet local needs. U.S. Treasury regulations describe operating a lodge system as "…carrying on its activities under a form of organization that comprises of local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like."[14]

These lodges serve as the backbone of fraternal organizations and allow fraternal members to meet local community needs in a unique way. Through their nearly 30,000 lodges nationwide, fraternals have created a network that could not be easily replicated. Millions of fraternal members are on-the-ground in communities where they can identify local needs as they arise, and then work together to meet those needs.

The local lodges use support from the parent fraternal organization to seed their community activities and those funds are leveraged many times over with additional charitable giving, volunteerism, and valuable social capital that is generated by bringing fraternal members together to pursue the common good.

Without the current 501(c)(8) tax rules, fraternals could no longer support this grassroots network of lodges spread throughout the country. From providing disaster relief to assisting families struggling with

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[12] Phillip L Swagel, Economic Contributions of Fraternal Benefit Societies: A Five Year Perspective [Swagel Study] 21 (2014).

[13] Mary A. O'Herlihy, John J. Havens, & Paul G. Schervish, Charitable Giving: How Much, By Whom, To What, and How? *In* The Non-Profit Sector: A Research Handbook 30 (2002) *available at* http://www.bc.edu/content/dam/research_sites/cwp/pdf/Charitable.pdf (citing independent Sector, Giving and Volunteering in the U.S.: Findings From a National Survey (2002)).

[14] Treas. Reg. § 1.501(c)(8)-1.

medical bills or veterans coming home from war, from stocking food pantries to building community parks—fraternals, through the local lodge system, are helping their communities. The 2014 Swagel Study found that:

> It would be exceedingly difficult for government or a for-profit corporation to duplicate or replace the activities and contributions made by fraternal benefit societies. Whereas a government agency may send its employees into a community, a fraternal benefit society *is* the community. In responding to emergencies and natural disasters, government relief agencies often rely on the local knowledge and infrastructure of fraternal benefit societies.[15]

The Impact of Fraternals

For more than a century, fraternals have been serving the financial and social needs of U.S. communities. Bringing together people with shared interests and a common purpose builds social capital that strengthens communities – the value of the fraternal common bond. Social capital refers to the socioeconomic benefits that result when people form community bonds and act together for the greater good. In his groundbreaking study of the decline of the American community, *Bowling Alone*, Harvard University sociologist Robert D. Putnam described social capital as "the connections among individuals – social networks and the norms of reciprocity and trustworthiness that arise from them."[16] The decline in social capital in the United States, Dr. Putnam explained, has led to a more isolated and less empathetic population of fellow citizens. Fraternal members counteract this trend, and through their collective activities the fraternal bond is reinforced and more societal benefits are generated. The 2010 Swagel study found:

> ***In an era in which there are widespread concerns about declining social and civic engagement by Americans, fraternal benefit societies remain bulwarks of social and civic engagement for the common good.*** The fraternal model has a unique leveraging power of the resources made available through the 501(c)(8) tax status and the issuance of insurance products to their members to allow members the opportunity to give back and think bigger as they respond to their communities' needs. By national societies providing seed money, along with an extensive grassroots network and organizational resources, fraternal lodge members are able to magnify their local charitable and volunteer efforts many times over to have a more consistent, positive impact nationwide. The activities by fraternal members then build valuable social capital by serving as a powerful catalyst for stronger community bonds, increased trust, and a wider awareness and interest in working to meet even more local needs, to give even more back. No government or corporate program can offer this benefit to society.[17]

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[15] Swagel Study at 22.
[16] Robert D. Putnam, *Bowling Alone* 19 (2001).
[17] Swagel Study at 23.

In fact, the 2014 Swagel study finds that fraternal benefit societies and their extensive network of member-volunteers generate a $3.8 billion annual benefit to society. This is a 76-fold return on the federal government's investment and includes direct charitable contributions, volunteer hours, as well as the value of the social capital created through the fraternal members' collective activities.[18]

Simply put, the fraternal model provides its members the opportunities and resources to help those in need. Complementing these daily, individual service activities of fraternal lodge members, many societies maintain large-scale partnerships that provide the lodges and members with additional local volunteer opportunities. For example, Thrivent Financial for Lutherans is the largest nongovernmental partner for Habitat for Humanity. Thrivent members build hundreds of Habitat homes around the country each year, not only with funding support but hands-on volunteer labor and support. The Knights of Columbus has a national partnership with Special Olympics, providing thousands of volunteers and much needed financial assistance. Foresters works closely with both Children's Miracle Network and KaBoom, two organizations dedicated to improving the lives of young people. Catholic Financial Life partners with the St. Vincent DePaul Society to help the neediest individuals in communities across the country. And the list goes on and on.

Without the current 501(c)(8) tax rules in place, the extensive impact of the fraternal community support network would be impossible to continue. According to the 1993 Treasury Report:

Fraternal benefit societies perform valuable social, commercial, and charitable functions. The charitable services provided by fraternal benefit societies benefit society as a whole. Fewer of these charitable goods and services are likely to be provided unless current tax treatment continues.[19]And, the local needs currently being met by fraternal benefit societies would likely go unmet, increasing pressure on already strapped local, state and federal government budgets and programs. As Swagel suggested in the 2014 study, Government could not afford the costs of filling the needs currently met by the fraternal benefit system. Thus, it is important now, more than ever, to ensure fraternal benefit societies exist to help address these growing gaps.[20]

Through the fraternal lodge structure, fraternal members marshal resources and fill the gaps in community services right in their own back yard. Whether it is supplying food and shelter in the wake of a disaster, covering the cost of medical care for underprivileged children, or providing a domestic abuse center with much needed supplies **– totaling 83 million volunteer hours and $388.5 million in direct support in2013 alone – fraternals occupy a unique and irreplaceable position in America's social fabric.**

While the statute providing the tax exemption for not-for-profit fraternal benefit societies is more than a century old, the work of fraternals today is precisely what was intended when Congress saw fit to

[18] Swagel Study at 23.
[19] Treasury Study at 3.
[20] Swagel Study at 22.

ensure that these organizations could exist, thrive and make a difference in serving America's needs one community at a time.

We have attached the 2014 Swagel study which discusses in greater detail the benefits that fraternals bring to communities and to the nation.