Bond Case Briefs

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IRS: Fraternal Society's Sale of Insurance Policies to Nonmember Spouses Is Unrelated Trade or Business.

In technical advice, the IRS concluded that an entity's sale of life insurance policies to nonmember widows of deceased insured members, under which the widow can name as a beneficiary someone other than a dependent of the member, isn't substantially related to the entity's exempt fraternal purposes.

The parent entity of a fraternal beneficiary society that operates under the lodge system sells individual life insurance contracts to its members. Membership is limited to men. The parent entity and its subordinate chapters have a group exemption under section 501(c)(8). The parent entity was formed to provide aid and assistance to its members and their families and beneficiaries. Within a year following the death of a member who was insured by the parent entity, the nonmember widow could request insurance coverage under which the widow could name someone other than a dependent of the member as a beneficiary.

The parent entity derives income from frequent and regular sales of insurance contracts to the widows of deceased members. Unless those sales are substantially related to the entity's performance of its exempt fraternal functions, the revenue derived from those sales is includable in the entity's unrelated business taxable income. To determine whether the sales constitute an unrelated trade or business, the IRS examined the relationship between the sales and the furtherance of the entity's fraternal purposes.

The IRS determined that the sale of insurance to a widow is no different than an ordinary contractual relationship between a policyholder and an insurance company: The nonmember spouse is ineligible for membership and, thus, lacks any fraternal relationship or mutuality of interest with the entity's members; the insurance coverage that is offered to the widow after the member's death is not a continuation of the member's policy; the widow may apply for different coverage from that held by the member; and the widow isn't guaranteed coverage. Further, section 501(c)(8) requires that a fraternal beneficiary society provide benefits to the society's members and their dependents but a widow may designate a beneficiary other than a dependent of a member.

Thus, the IRS determined that the sale of insurance policies to nonmember widows of deceased insured members doesn't contribute importantly to the society's exempt fraternal purpose and, thus, isn't substantially related to the entity's exempt fraternal purposes. The IRS concluded that the sale of commercial-type insurance to nonmembers constitutes an unrelated trade or business.

Citations: TAM 201320023