

Q. FRATERNITY FOUNDATIONS

by

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1. Introduction

College fraternities serve many objectives in addition to the basic "room and board" function. The fraternity experience is a package of social, recreational, and educational activities and objectives.

To support the educational function, fraternities may wish to provide "educational" areas in their chapter houses that include a library, quiet study rooms and computer rooms. To provide for these spaces, fraternities are either building new houses, or remodeling existing houses.

The cost to provide educational areas is expensive, and many fraternity chapters do not have the funds to undertake these projects. Typically a corporation that owns the chapter house qualifies under IRC 501(c)(7) as a tax-exempt social club. But it may not have the funds to provide for these improvements and seeks other sources of funding for improvements to its houses, such as from a related fraternity foundation. A fraternity foundation can qualify for exemption under IRC 501(c)(3), and be eligible for tax deductible contributions, if it can establish that it is exclusively charitable or educational.

The purpose of this article is to explain why fraternity foundations were formed, how they operate as organizations described in IRC 501(c)(3), and the problems that have arisen with their operation.

2. Formation of Fraternity Foundations

Fraternities serve multiple purposes, such as social and educational purposes. The law is well settled that fraternities serve social purposes and are not described in IRC 501(c)(3). See I.T. 1427, C.B. I-2, 187 (1922), Davison v. Commissioner, 60 F.2d 50 (2d Cir. 1932); and Rev. Rul. 69-573, 1969-2 C.B. 125. In Rev. Rul. 69-573, the Service held that even though a college fraternity does, to some extent contribute to the cultural and educational growth of its members, it held that the organization is primarily a social club and that its major functions are to provide its members with a meeting place, living quarters, meals and a place for entertainment. Since a fraternity is not described in IRC 501(c)(3), contributions would not be deductible under IRC 170.

To support social fraternities in conducting their educational activities, fraternities formed national fraternity foundations under IRC 501(c)(3). The fraternity foundations were formed for charitable and educational purposes, and in particular to provide grants to the local IRC 501(c)(7) fraternities. The making of grants to fraternities raises the

issue of whether a charity may make charitable grants to a noncharitable organization in furtherance of its exempt purposes.

This issue was addressed in Rev. Rul. 68-489, 1968-2 C.B. 210. The Service held that an IRC 501(c)(3) organization can make distributions to organizations that are not within the scope of IRC 501(c)(3), so long as such distributions are in furtherance of its own tax exempt purposes. Thus the grantor must "retain control and discretion as to the use of the funds and maintain records establishing that the funds were used for section 501(c)(3) purposes."

Thus, grants made by a national fraternity foundation exempt under IRC 501(c)(3) to its local fraternity affiliate are subject to and must conform to the standard set forth in Rev. Rul. 68-489.

A. Educational Grants to Fraternities

Fraternity foundations described in IRC 501(c)(3) are permitted to make grants to social fraternities provided that the grants further their own exempt purposes and the foundation maintains control and discretion as described in Rev. Rul. 68-489. Permissible grants that a fraternity foundation could make would consist of awarding scholarships to undergraduate members of a designated fraternity. This situation was addressed in Rev. Rul. 56-403, 1956-2 C.B. 307, which concluded that exemption was not precluded even though scholarships were limited to members of a particular fraternity because there was no specific designation of persons eligible for the scholarships, and the purposes of the foundation were not so personal, private, or selfish as to lack the element of public usefulness.

Foundations are permitted to make grants to a college for the purpose of acquiring or constructing a housing facility for use by a designated fraternity as discussed in Rev. Rul. 60-367, 1960-2 C.B. 73. The contributions made by the donors in this ruling were not made to the social fraternity but were made as a gift to the college for the purpose of improving the housing conditions of fraternity members where the housing would be owned by the college and leased for short-term periods to fraternity members as part of the college's policy of providing housing for all students under comparable terms. Thus the college had the attributes of ownership in respect of the donated property, and its rights as an owner were not, as a condition of the gift, limited by conditions or restrictions, which in effect made a private group the beneficiary of the donated property. The college was not merely used as a conduit through which donors could provide gifts to a fraternity.

B. Noneducational Grants to Fraternities

A grant to a fraternity for the building or general renovation of a fraternity chapter house would not be in furtherance of an IRC 501(c)(3) purpose. Service position has been that an organization whose predominant activity is the acquisition, improvement or maintenance of a fraternity chapter house will not qualify for exemption under IRC 501(c)(3). For example, the organization in Rev. Rul. 64-118, 1964-1 C.B. 182 was not described in IRC 501(c)(3) because providing assistance for the acquisition and maintenance of a chapter house is not an activity that furthers educational purposes. Furthermore, the actual operation of the house was determined to be "for the use and benefit of the members of a local chapter of the fraternity," and not for the benefit of the university.

Under the published positions of the Service, fraternity foundations may make grants for the provision of scholarships, but not for structural improvements to fraternity chapter houses. Nevertheless foundations started to request rulings concerning grants that had an educational flavor, but resulted ultimately in the providing of financial assistance for structural improvements to a local chapter house. The rulings centered on grants earmarked for constructing chapter house libraries and study rooms, and for equipping such libraries, study rooms and students' rooms with desks, tables and bookshelves.

C. Is the Grant Educational or a Structural Improvement

The question of whether earmarked grants to local fraternities are educational or structural improvements was addressed in GCM 39288 (September 20, 1984). The facts concerned numerous grants earmarked by a fraternity foundation to a local chapter for the improvement and maintenance of a fraternity library, and the costs attributable to the educational and charitable uses of study rooms, and equipping students' rooms with desks and bookshelves. The issue concerned whether the grants made by the fraternity foundation furthered its educational purposes or served the private interests of the local fraternity members.

Grants earmarked for a library would ordinarily be considered educational because the maintenance of the library promotes higher scholarship standards among the fraternity members, but the question remains whether it can be viewed as serving a broader public interest. Rev. Rul. 75-196, 1975-1 C.B. 155, is a possible analogy. It concerned the operation of a law library for members of a local bar association. Rev. Rul. 75-196 held that limiting access to the library to a designated class of individuals is not a bar to exemption; however, the class that is benefited needs to be broad enough to warrant a conclusion that the educational facility or activity is serving a broad public interest rather than a private interest. Unlike a law library open to a broad class of persons limited only by the size of the facility, a fraternity chapter house is inextricably intertwined with the fraternity's social and recreational purposes.

In this case, it was held that a fraternity library provides a private benefit to the fraternity members in that the library offers fraternity members easy access to books and study areas specifically suited to their own personal needs, and thus the benefit to the fraternity members outweighs any benefit to the college community. Furthermore, the fraternity members who are benefited from the library are not a broad enough class to warrant a conclusion that the facility serves a broad public interest and any benefit to the university is somewhat marginal and incidental to the private interest received by the fraternity members.

The granting of scholarships to fraternity members as discussed in Rev. Rul. 56-403 was distinguished because the fraternity scholarships help relieve the university of providing additional financial aid to students and the scholarships are not provided to the entire fraternity membership, in comparison to a library which is provided to all fraternity members. In this respect, scholarships solely benefit recipients in accomplishing educational goals based on a fraternity member's demonstrated excellence in scholarship, character, and service to the community.

Grants earmarked for meeting rooms, study rooms, student rooms, and desks and bookshelves in student rooms were also addressed. These types of grants are no more than dollars used for physical improvements to specific portions of local chapter houses and thus similar to the structural improvements disapproved in Rev. Rul. 64-118. These grants are not educational, but if the grants were educational, the private benefit to members is substantial and the benefit to nonmembers is insubstantial.

Basically it was concluded that grants earmarked for educational areas are no more than a device whereby charitable dollars are used for the social purposes of the fraternity membership.

3. Mixed Use Areas

The issue of whether grants made by an IRC 501(c)(3) fraternity foundation to its affiliated IRC 501(c)(7) fraternity foundation to construct, renovate and furnish libraries and study rooms is in furtherance of the foundation's educational and charitable purposes was readdressed in GCM 39612 (March 11, 1987). In GCM 39612, the private benefit analysis was reevaluated and it was decided that an organization may be operating for public purposes even if the access to the educational program is restricted and not available to the general public. The controlling consideration is whether the activity will cause the public to benefit so significantly that any direct benefit accruing to the limited class is incidental.

Additional information was provided representing that the class to be benefited was broad enough to demonstrate that the educational facilities will serve a broad public interest. The information consisted of letters from universities where the fraternities were located representing that the grants contribute to the educational mission of the schools.

The letters stated that the grants will benefit the entire university community by supplementing resources of the university, by alleviating overcrowding in libraries and study areas, and by providing additional computer terminals to the university's mainframe. These types of facilities in fraternity homes were expected to save money for the universities in the long run as they create an additional educational environment which will enhance the scope of the university.

Also, the universities provided information showing that the percentage of students living in fraternity and sorority houses in comparison to the total student body was not insignificant and, thus, would be a large enough group to benefit the universities through having these educational facilities within the chapter houses. Around 10% of the total student body were members of fraternities. It was argued that the building of libraries in fraternities reduces the burden on a university's facilities and the resulting benefit to the college community is significant if the cumulative effect of fraternity libraries and study rooms are considered. Thus, it was concluded that libraries and study rooms in a fraternity would create only incidental private benefit to the fraternity members provided the facilities are used specifically for educational purposes and have little social or personal value to members independent of their educational value.

The issue of how the earmarked grants for the educational areas would further educational purposes rather than be considered improvements to the local chapter house was also addressed. Two requirements were imposed to ensure that the grants would further educational purposes. First, the libraries and study rooms should constitute separate facilities which are segregated from the social facilities of the chapter houses and two, that the grants are monitored to ensure exclusive use for educational purposes. To ensure that the grants are used for educational purposes, fraternities were to sign written agreements and provide progress (and final) reports to the foundations.

GCM 39612 did not totally clarify the difference between a grant that furthers educational purposes and one that provides a structural improvement to a fraternity chapter home. In recent years, it has been argued by the fraternity foundations that the rationale of GCM 39612 should be expanded to cover such areas as exercise facilities and common and individual study or computer use areas. Where there is a commingling of social and educational use, it is difficult, if not impossible, to determine the portion that could be considered educational. Thus, the personal and private benefit to the fraternity members remains at issue.

4. Conclusion/Current Service Position

GCM's are not precedential, and cannot be relied on. Thus, GCM 39612 should not be used as guidance in these situations.