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Person To Contact:

, ID No.

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CC:TEGE:EOEG:ET2

PLR-154139-04

Date:

February 18, 2005

Legend

The Association =

The City =

Date X =

Date Y =

Year Z =

State A =

Dear :

This is in reply to your August 30, 2004, request for a ruling that the Association is not an instrumentality of the City, for purposes of Section 3121(b)(7) of the Internal Revenue Code (the Code). Section 3121(b)(7) of the Code excepts from "employment" service performed in the employ of, inter alia, any wholly owned instrumentality of any one or more States or political subdivisions thereof, with exceptions not applicable here.

Facts:

According to the information submitted, the Association is responsible for the administration of several museums located in the City. In a Date Y letter ruling the Association was deemed to be an instrumentality of the City. In its present request for a ruling that it is not an instrumentality of the City, the Association has drawn our attention to changes that have been made with respect to the Association's operations and functions since the Date Y letter was issued. Prior to Date X, the Association was responsible for the administration both of the museums mentioned previously as well as of all the public libraries in the City. As of Date X, however, the City has assumed control and administration of all of the libraries formerly administered by the Association, while the Association now operates museums only. The Association has received a

letter from the Internal Revenue Service indicating that it is exempt from income tax under Section 501(c)(3) of the Code.

Law:

Code section 3101(a) imposes a tax on employees for Old Age, Survivors, and Disability Insurance (i.e., the social security tax) on the income of every individual received by such individual with respect to employment. Code section 3111(a) imposes the social security tax on employers calculated as a percentage of wages with respect to employment. Subject to certain exceptions not applicable in this case, Code section 3121(b)(7)(F) provides that the definition of “employment” includes service in the employ of a state, or any political subdivision thereof, or of any instrumentality of the foregoing, by an individual who is not a member of a retirement system of such state.

The following six factors are applied to the relevant facts and circumstances in order to determine whether an organization is a wholly owned instrumentality of a political subdivision or a state:

- (1) Whether the organization is used for a governmental purpose and performs a governmental function;
- (2) Whether the performance of the organization’s function is on behalf of one or more states or political subdivisions;
- (3) Whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner;
- (4) Whether control or supervision of the organization is vested in public authority or authorities;
- (5) Whether express or implied statutory or other authority is necessary or exists for the creation or use of the organization; and
- (6) The organization’s degree of financial autonomy and the source of its operating expenses.

Revenue Ruling 57-128, 1957-1 C.B. 311.

Analysis:

In light of the foregoing factors, we conclude that the Association is not a wholly owned instrumentality of the City. This conclusion is based on the following analysis of the facts as submitted by the Association.

(1) Whether the organization is used for a governmental purpose and performs a governmental function

The Association’s only business is the operation of several museums in the City. The Association was originally created by statute in Year Z “for the purpose of establishing and maintaining a social Library and a Museum of Natural History and Art, and for the

diffusion of knowledge and the promotion of intellectual improvement in the City....” Factor (1) is indeterminate in the present case, since the operation of museums has traditionally been performed by both governmental organizations and private entities, and is not necessarily characteristic of either one or the other.

(2) Whether the performance of the organization’s function is on behalf of one or more states or political subdivisions

The Association has entered into a Museum Services Agreement with the City. Under this agreement the Association promises to provide museum services on certain terms to the City’s residents and visitors in exchange for the City’s providing a certain amount of funding to the Association. This agreement requires the Association to maintain certain hours of operation at its museums. It also obligates the Association to meet certain requirements of furnishing and paying utilities, maintenance and insurance. The existence of the Agreement tends to support a finding that the Association is performing its function on behalf of the City. The context of the transaction, however, suggests otherwise. The Association has separated from the City due to the City’s budget shortfalls. The Agreement is necessary to provide structure for the new arrangement. Most of the Association’s obligations under the Agreement reflect the Association’s assumption of responsibilities that have arisen as a consequence of its operating independently of the City. Thus, the Agreement supports a finding that the Association is not an instrumentality of the City.

The Association’s function—the operation of museums—is performed by a professional museum administrator on behalf of its Board of Trustees. The Museum Administrator answers to the Chairman of the Board of Trustees. The Board of Trustees is self-perpetuating and made up of private citizens. Under the Association’s bylaws the Board of Trustees is obligated “to uphold the broad scope of the purpose of the Association as stated in the Association’s Act of Incorporation, as amended.” The Association’s original Act of Incorporation states that the Association holds its property “in trust, for all the uses and purposes proper and appropriate for a public and social Library and Museum, the same to be used and enjoyed by the inhabitants of [the City]....” On balance it seems the Association’s function is not performed on behalf of the City, but rather for the benefit of the residents and visitors of the City. The fact that the City does not have the power to appoint a member to the Association’s board further suggests that the Association does not perform services “on behalf of” the City.

(3) Whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner

The City does not have the powers and interests of an owner. The Association operates as a State A non-stock corporation. The owners of a non-stock corporation are its members. The Association’s members are known as “Corporators” and are responsible for electing members of the Board of Trustees. The Corporators are

elected at the Annual Meeting of the Corporation, upon recommendation to the Nominating Committee and election by Corporators. The Corporators are not City officials, and the City has no proprietary interest in the Association.

As discussed above, the Association holds its property in trust for the use and enjoyment of the residents of the City. If the Association's operations were terminated, the City would have no claim to its assets. Upon dissolution the Corporators and Board of Trustees would direct the Association's assets to another organization.

(4) Whether control or supervision of the organization is vested in public authority or authorities

No public authority is charged with the supervision of the museum functions. The Association is controlled by the Board of Trustees, the Museum Director and its various individual directors. The Museum Administrator is responsible for the museum operations and answers to the Chairman of the Board of Trustees. The Board of Trustees does not include any municipal officers acting as agents of the City. The Association is governed by individuals who are independent of the City.

The Agreement does impose a series of obligations on the Association. However, these obligations are the ordinary responsibilities of an independent organization and reflect the Association's change in status from an instrumentality of the City to an independent organization. Thus, the terms of the Agreement do not provide the City with control or supervision of the Association.

(5) Whether express or implied statutory or other authority is necessary or exists for the creation or use of the organization

The Association was created by statute in Year Z and its charter has been modified by acts of the legislature since its incorporation. These legislative actions have been for the purpose of facilitating the Association's operations and not for the purpose of governing those operations. The statutory authority contemplated by factor five of Rev. Rul. 57-128, *supra*, is not present in the instant case. Thus, factor five suggests that the Association is not an instrumentality of the City.

(6) The organization's degree of financial autonomy and the source of its operating expenses

The Association is relatively financially autonomous. The Association estimates that, for this year, twenty percent of its budget comes from the City. While this represents a significant amount of the Association's budget, a governmental unit's providing support to a private organization does not render that organization an instrumentality.

For the foregoing reasons, we conclude that the Association is not an instrumentality for purposes of exempting it from social security tax under Section 3121(b)(7). The above

analysis is based on the assumption that the Association's employees are not covered by a section 218 agreement.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Lynne A. Camillo
Chief, Employment Tax Branch 2
Associate Chief Counsel/ Division Counsel
(Tax Exempt/Government Entities)