

Internal Revenue Service

Number: **200510016**

Release Date: 3/11/05

Index Number: 115.00-00, 170.00-00
3121.00.00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No--.

Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:E02
PLR-137500-04

Date:
November 10, 2004

In Re:

LEGEND

Association =
EIN =
City =
County =
State =

Dear

This is in response to your letter dated July 1, 2004, requesting the following rulings on behalf of the Association: (1) the income of the Association is excludable from gross income under section 115(1) of the Internal Revenue Code ("Code"); (2) a determination that the Association is an instrumentality within the meaning of Code sections 3121(b)(7) and 3306(c)(7); and (3) that the contributions made to the Association will be deductible by the donors as charitable contributions under section 170(c)(1) of the Code.

FACTS

The City is a municipality and political subdivision of the State and is situated in County. The City formed the Association under the State Nonprofit Corporation Code. The Association was formed for the purpose of carrying out the promotion of tourism for the City. By promoting tourism in the City the Association will contribute to the economic development of the City through increased tourism and visitation to the City and will increase the expenditure of tourist dollars at local businesses.

State law authorizes municipalities to levy a hotel/motel tax, and requires such taxes to be expended for the purpose of promoting tourism, conventions, and trade

shows, among other possible purposes. The statute permits the expenditure of these tax revenues through contract with a “private sector nonprofit corporation.” The State law defines the term “private sector nonprofit corporation” in pertinent part as “any other private group organized for similar purposes which is exempt from federal income tax under Section 501(c)(6) of the Internal Revenue Code of 1986.” The Association received a favorable determination letter, from the Internal Revenue Service recognizing it as an organization described in section 501(c)(6).

The Association’s Articles of Incorporation (“Articles”) provide that the Association was organized, and at all times shall be operated, to service the needs and interests of tourism within the City. The stated purposes of the Association include developing the educational, cultural and economic potential of the City, contracting with the City to expend on behalf of the City the tax revenue and other funds it receives to promote tourism, conventions, and trade shows within the City and to stimulate commerce.

The Association has a contract with the City to manage and operate an amphitheater and a tennis center. The amphitheater and the tennis center are owned by the City, and the contract is consistent with the Association’s purposes. The public will continue to have access to theatrical and musical productions at the amphitheater and to the recreational and educational facilities at the tennis center. By performing these functions, the Association seeks to serve the economic development needs of the City and increase tourism, trade, and the economic growth of the City.

The Articles provide that the Association will be managed by a five member Board of Directors (“Board”). After an initial period the makeup of the Board will consist of the City Manager, or a designee who is an employee under the direct supervision of the City Manager, the Chairperson of the Recreation Commission, and a member of the City Council appointed by a majority of the Council. The final two directors are citizens of the City at large, and the articles specify that it is preferable that one is employed in the restaurant or hotel/motel business with a minimum of five years of fiscal experience. The Association’s bylaws provide that the members of the Board are appointed by the City Council. Directors may be removed by the City Council and vacancies are filled by the City Council. The bylaws of the Association provide that the Board has the full power and authority to review and approve in advance both short-term and long-term budgets, capital and operation, of income and expenditures of the Association and to exercise such other supervision and control over the affairs and property of the Association to ensure the 501(c)(6) purposes and functions of the Association are carried out. However, bylaws require that all checks, drafts, or other orders for the payment of money, notes, or other evidences of indebtedness issued in the name of the Association be countersigned by the City Manager or City Director of Finance. No action may be taken with respect to the Articles or bylaws without the prior written approval of the City Council.

Approximately 90 percent of the Association's funding is derived from the hotel/motel tax. Approximately 7 percent is derived from revenues generated by its operation of the amphitheater, and approximately 3 percent is derived from revenues generated by its operation of the tennis center. The Articles provide that the Association shall make an annual budget presentation to the City Council and copies of the Association's meeting minutes shall be submitted for inclusion in the City records.

The Articles provide that the Association is not organized and shall not be operated for pecuniary gain or profit and that no part of the property or net earnings of the Association shall inure to the benefit of or be distributable to its directors, officers, or other private persons. In the event of dissolution of the Association, the Articles provide that the balance of all assets will be distributed to the City or an entity that is an integral part of the City of the City provided that such entity's income is excludable under section 115(1). Membership in Association is limited to entities that are an integral part of the City provided that such entity's income is excludable from gross income under section 115(1).

1. Section 115

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under section 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under section 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

The promotion of tourism to the City will result in increased trade and economic growth of the City. The promotion of economic development is an essential government function for purposes of section 115(1).

In accordance with its Articles, the Association was formed purely for public benefit. No part of the net earnings of the Association may inure to the benefit of any individual. The members of the Association are limited to entities that are an integral part of the City, provided that such entity's income is excludable from gross income under section 115(1). Upon dissolution, all assets of the Association must be distributed to the City or to an entity that is an integral part of the City, provided that such entity's income is excludable from gross income under section 115(1).

2. Sections 3121(b)(7) and 3306(c)(7)

Code sections 3101 and 3111 impose Federal Insurance Contribution Act (FICA) taxes on the wages paid by an employer to employees with respect to employment. Code section 3301 imposes Federal Unemployment Compensation Act (FUTA) taxes on the wages paid by an employer to employees with respect to employment. Code section 3121(b)(7)(F) provides that, for purposes of the FICA tax, "employment" does not include service in the employ of a State, or any political subdivision thereof, or of any instrumentality of any one or more of the foregoing, by an individual who is a member of a "retirement system" of such State, political subdivision, or instrumentality. Code section 3306(c)(7) provides that, for purposes of the FUTA tax, "employment" does not include service performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned by one or more States or political subdivisions.

A determination of the status of an organization as an instrumentality of one or more states or political subdivisions is made using the criteria of Revenue Ruling 57-128, 1957-1 C.B. 311. Under this revenue ruling, the following six factors are taken into consideration:

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

The Association satisfies the first factor of Rev. Rul. 57-128 insofar as it is used for a governmental purpose and performs a governmental function. State law provides for the expenditure of taxes levied by a municipality by a Code section 501(c)(6) organization for the purpose of promoting tourism, conventions, and trade shows. The Association was formed for this purpose by the City. To further these purposes, the Association also maintains the City owned amphitheater and tennis center on behalf of the City.

The Association also satisfies the second factor which requires performance of its functions on behalf of one or more states or political subdivisions. The Articles provide that the Association was organized to service the needs and interest of tourism within the City. The Association maintains the City owned amphitheater and tennis center on behalf of the City by contract. The Association in accordance with statute contracted with the City to expend on behalf of the City the tax revenue and other funds it receives to promote tourism, conventions, and trade shows within the City.

The third factor is whether there are any private interests involved, or whether the state or political subdivisions involved have the powers and interests of an owner. The Articles provide that the Association is not organized for profit. The Articles provide that no part of the Association's property or net earnings can inure to the benefit of or be distributable to the Association's directors, officers or other private persons, and also provides that no part of the net earnings of the Association can inure to the benefit of any private shareholder or individual within the meaning of Code section 501(c)(6). The City Council retains significant control over the governing instruments of the Association, as well as to the disposition of its funds. Upon dissolution of the Association any remaining assets are to be transferred to the City, or an entity that is in integral part of the City. The Association satisfies this factor.

The Association also satisfies the fourth factor which requires that control and supervision of the organization be vested in public authority or authorities. The Articles provide that the Association will be managed by the Board. Of the five members of the Board, the Articles stipulate that one will be the City Manager, or his designee, who shall be an employee under the City Manager's direct supervision, one will be the Chairperson of the City Recreation Commission, and one will be a member of the City Council. Of the other two directors both shall be citizens of the City at large. Under the articles the majority of the Board is comprised of City officials and officers. The Articles provide that in the event of dissolution, the balance of all assets will be distributed to the City (or an entity that in an integral part of the City). The City Council retains significant control over the governing instruments of the Association and the composition of its Board of Directors.

The fifth factor of Rev. Rul. 57-128 provides that express or implied statutory authority is necessary for the creation and and/or use of such an instrumentality. State law provides that a municipality within a county may contract with a Code section 501(c)(6) organization for the promotion of tourism within the county. The statute also

provides for the municipality's levy of a hotel/motel tax to accomplish the purpose of promoting tourism and provides that a municipality may contract with a Code section 501(c)(6) organization to expend these revenues for the purpose of promoting tourism. The Association was created pursuant to the express terms of the relevant State statute and was determined to be a Code section 501(c)(6) organization by the Internal Revenue Service. The City has contracted with the Association and is funded in significant measure by the hotel/motel tax levied by the City. The Association satisfies the fifth factor.

The sixth factor of Rev. Rul. 57-128 which considers the degree of financial autonomy and the source of its operating expenses is also satisfied. State law provides that the Association may be funded by a hotel/motel tax collected for the purposes of promoting tourism. Over 90 percent of the Association's operating expenses are derived from the hotel/motel tax imposed by the City. In addition to this source of funding, the Association also receives a percentage of its operating expense from the operation of the amphitheater and tennis center on behalf of the City.

The Association satisfies each of the above six factors. Therefore, the Association is an instrumentality of the City, a political subdivision of the State, for purposes of Code sections 3121(b)(7)(F) and 3306(c)(7).

3. Section 170

Section 170(a)(1) of the Code provides, subject to certain limitations, that there shall be allowed as a deduction any charitable contribution payment of which is made within the taxable year.

Under section 170(c)(1), the term "charitable contribution" means a contribution or gift to or for the use of a State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States, or the District of Columbia, but only if the contribution is made for exclusively public purposes.

The term political subdivision is not defined in the Code. However, Treas. Reg. § 1.103-1(b) provides that "political subdivision" means any division of any state or local government unit that is a municipal corporation or that has been delegated the right to exercise part of the sovereign power of the unit. Rev. Rul. 78-356, 1978-2 C.B. 256, states that the term "political subdivision" has been defined consistently for all federal tax purposes as denoting either (1) a division of a state or local government that is a municipal corporation, or (2) a division of such state or local government that has been delegated the right to exercise sovereign power.

The three generally acknowledged sovereign powers of states are the power to tax, the power of eminent domain, and the police power. Estate of Shamburg v. Commissioner, 3 T.C. 131 (1944), aff'd 144 F.2d 998 (2nd Cir. 1944). It is not necessary that all three of these powers be delegated in order to treat an entity as a political

subdivision for purposes of the Code. However, possession of only an insubstantial amount of any or all of the sovereign powers is not sufficient. All of the facts and circumstances must be taken into consideration, including the public purposes of the entity and its control by a government. Rev. Rul. 77-164. 1977-1 C.B. 20.

City has not granted Association the power to tax, the power of eminent domain, or the police power. Although Association is permitted to spend hotel/motel tax revenues, the hotel/motel tax is levied by the City and not the Association. Because Association has not been delegated the right to exercise any sovereign power, the Association is not a political subdivision under Treas. Reg. § 1.103-1(b).

Nevertheless, an entity not expressly described in section 170(c)(1) may qualify to receive deductible charitable contributions if it is an instrumentality of a state or an instrumentality of a political subdivision of a state, and if the contributions are made for exclusively public purposes. See Rev. Rul. 75-359, 1975-2 C.B. 79.

Rev. Rul 75-359 provides that the criteria for identifying wholly owned instrumentalities of states or political subdivisions are set forth in Rev. Rul. 57-128. These criteria are discussed above in the analysis of ruling request number 2. Therefore, the Association constitutes an instrumentality of City for purposes of section 170(c)(1).

Section 170(b)(1)(A)(v) provides in relevant part that in the case of an individual, the deduction provided in section 170(a) shall be allowed for any charitable contribution to a governmental unit referred to in section 170(c)(1) to the extent that the aggregate of such contributions does not exceed 50 percent of the taxpayer's contribution base for the taxable year. Section 170(b)(1)(F) generally provides that the term contribution base means adjusted gross income.

In view of the foregoing, we conclude that the Association is an instrumentality of a political subdivision of a state and operates for exclusively public purposes. We further conclude that contributions made to Association will be deductible by the donors as charitable contributions under section 170(c)(1) to the extent otherwise provided under section 170.

CONCLUSIONS

1. The income of Association is excludible from gross income under section 115 of the Code.
2. The Association is an instrumentality of the City, a political subdivision of the State, for purposes of Code sections 3121(b)(7)(F) and 3306(c)(7).
3. Charitable contributions to Authority are deductible by the donors to the extent provided by section 170 of the Code.

This ruling does not determine the existence of a retirement system within the meaning of Code section 3121(b)(7)(F) nor does it determine the applicability of a section 218 agreement within the meaning of Code section 3121(b)(7)(E).

Except as specifically provided herein, no opinion is expressed or implied on the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

In accordance with a Power of Attorney on file, we are sending a copy of this letter to the Association.

Sincerely,

David L. Marshall
Chief, Exempt Organizations Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures:

Copy of this letter
Copy for § 6110 purposes