

Internal Revenue Service

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Date:

September 26, 2003

LEGEND

Hospital =

City =

year 1 =

State =

Statute A =

day 1 =

Dear

This is in reply to a letter dated March 26, 2003, requesting a ruling that Hospital may be treated as an integral part of City for federal income tax purposes and that charitable contributions made to Hospital for public purposes are deductible under § 170(c)(1).

FACTS

Property was donated to City by a private individual in year 1 for the purpose of establishing a city hospital. The procedure for the donation of property to a city for this purpose is governed by State Statute A. The terms of the deed by which the donation was made included certain restrictions imposed by the donor. Pursuant to Statute A, when property is donated to a city for the purpose of establishing a city hospital the city is directed to immediately name a board of trustees and vest title in the trustees to hold and control according to the terms of the bequest. In a decision dated day 1, the District Court of State modified some of the terms of the deed to bring it into harmony with the statutory guidelines.

Pursuant to Statute A, Hospital is governed by a board of nine trustees. The City Commission has the power to change the number of trustees on the board and has done so twice, changing the number of trustees from five to seven and from seven to nine. All of the members of the board of trustees are appointed by the mayor of City, subject to the approval of the City Commissioners. The board members are considered city officials. Their term of office is described in Statute A. Board meetings are public meetings subject to the state open meeting statute. The hospital facilities and the property on which the facilities are located were donated to City. However, City's control respecting the operation and management of the hospital is vested in the board. The original deed conveying the property to City requires that plans for changes or improvements in the buildings or the real property must be submitted to the Mayor and Commissioners of City for their approval. The annual budget and audit of Hospital are filed with City for review by the City Commission.

All revenue of Hospital derived from hospital operations is applied solely toward offsetting the expenses of its healthcare operations. No part of the net earnings of Hospital inures to the benefit of any private person. Hospital's annual operating income comes primarily from hospital operations and charitable contributions. City can levy taxes for the purpose of equipping, maintaining, operating and improving Hospital. It can also issue bonds for the purpose of hospital construction within and outside of City. Since the hospital was acquired by donation in year 1 several additions and renovations have been made to the hospital facilities and some adjoining real estate has been purchased. City has contributed cash funds for these projects. In addition the City has issued both revenue bonds and general obligation bonds to pay for renovation and construction projects carried out by Hospital.

LAW AND ANALYSIS

Integral Part

Generally, if income is earned by an enterprise that is an integral part of a state or political subdivision of a state, that income is not taxable in the absence of specific

statutory authorization to tax that income. See Rev. Rul. 87-2, 1987-1 C.B. 18, Rev. Rul. 71-131, 1971-1 C.B. 28; Rev. Rul. 71-132, 1971-1 C.B. 29.

In Maryland Savings-Share Ins. Corp. v. United States, 308 F.Supp. 761 (D. Md. 1970), rev'd on other grounds, 400 U.S. 4 (1970) (MSSIC), the State of Maryland formed a corporation to insure the customer accounts of state chartered savings and loan associations. Under MSSIC's charter, the full faith and credit of the state was not pledged for MSSIC's obligations. Only three of eleven directors were selected by state officials. The district court rejected MSSIC's claim of intergovernmental tax immunity because the state made no financial contribution to MSSIC and had no present interest in the income of MSSIC. Thus, the imposition of an income tax on MSSIC would not burden the State of Maryland. Although the Supreme Court reversed the lower court on other grounds it agreed with the lower court's analysis about the treatment of state created enterprises.

In State of Michigan and Michigan Education Trust v. United States, 40 F. 3d 817 (6th Cir. 1994), rev'd 802 F.Supp. 120 (W.D. Mich. 1992), the court held that the investment income of the Michigan Education Trust (MET) was not subject to current taxation under section 11(a). The court's opinion is internally inconsistent because it concludes that MET qualifies as a political subdivision of the State of Michigan (Id. at 825) that MET is "in a broad sense" a municipal corporation (Id. at 826), and that MET is in any event an integral part of the State of Michigan (Id. at 829). Moreover, the court's reliance on the factors listed in Rev. Rul. 57-128, 1957-1 C.B. 311, to reach its conclusion is misplaced. The revenue ruling applies to entities that are separate from the state. The factors in the revenue ruling do not determine whether an enterprise is considered to be a separate entity or an integral part of the state.

Section 301.7701-1 et seq. of the Procedure and Administration Regulations, the co-called "check-the-box" regulations, support the position that an entity that is recognized as separate from a state or political subdivision for local law purposes may still be an integral part of that state political subdivision. Section 301.7701-1(a) provides, in part, that an entity formed under local law is not always recognized as a separate entity for federal tax purposes. For example, an organization wholly owned by a State is not recognized as a separate entity for federal tax purposes if it is an integral part of the state.

In determining whether an enterprise is an integral part of the state, it is necessary to consider all of the facts and circumstances, including the state's degree of control over the enterprise and the state's financial commitment to the enterprise.

City has substantial control over Hospital. The management of a hospital donated to the city for the purpose of establishing a city hospital is governed by state

statute. All of the members of the board of trustees are appointed by the mayor of City, subject to the approval of the City Commissioners. The annual budget and audit are reviewed annually by the City Commission. In addition, City has made a substantial financial commitment to Hospital. City contributed the hospital facilities and the land on which the facilities are located. In addition, City has contributed cash as well as bond proceeds, including the proceeds from general obligation bonds, for the acquisition of additional land and the construction and renovation of the hospital facilities.

Accordingly, we conclude that Hospital is an integral part of City, that Hospital's income is not subject to federal income tax, and that Hospital is not required to file an annual federal income tax return.

Section 170

Section 170(a)(1) of the Code provides, subject to certain limitations, a deduction for contributions or gifts to or for the use of organizations described in § 170(c), payment of which is made within the taxable year.

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

In this case, because Hospital is an integral part of City, contributions or gifts to or for the use of Hospital are to or for the use of an entity described in § 170(c)(1). Accordingly contributions or gifts to or for the use of Hospital are to or for the use of City and, provided they are made for exclusively public purposes, are generally deductible under § 170(c)(1) to the extent otherwise allowed by § 170.

CONCLUSIONS

1. Hospital is an integral part of City.
2. Charitable contributions to Hospital are deductible by the donors to the extent provided by § 170(a) of the Code.

Except as specifically provided otherwise, no opinion is expressed on the federal tax consequences of any particular transaction.

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.

Sincerely,

Barbara Beckman,
Assistant to the Chief, Branch 2
Exempt Organizations
Division Counsel/Associate
Chief Counsel
(Tax Exempt and Government
Entities)

Enclosures;
Copy of this letter
Copy for § 6110 purposes

CC: