

**Internal Revenue Service**

Department of the Treasury

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Trust =

State =

Board =

District =

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Law =

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Dear

This is in reply to a letter dated May 20, 1999, requesting a ruling that the income of Trust is excludable under section 115 of the Internal Revenue Code.

**FACTS**

Trust is a nonprofit corporation incorporated under the Law of State. Trust has been determined to be an organization described in section 501(c)(3) of the Code.

Trust was incorporated as a result of a resolution of Board. The initial incorporator is the manager of District. Trust was established by the official actions of Board and the manager of District.

The purpose of Trust is to establish a model that will serve to protect, nurture, sustain and preserve natural resources within an urban setting while promoting good stewardship of the earth.

Under Trust's bylaws, Board appoints the directors of Trust. Board may declare vacant the office of a director who has been declared of unsound mind by a final order of court, convicted of a felony, or found by a final order or judgment of any court to have breached any duty arising under Sections of Law. Directors' terms are for one year.

The number of directors of Trust is five until changed by bylaw, but may not be less than three or more than nine. Not more than x% of the directors may be "interested persons," defined in Law as any person currently being compensated by Trust for services rendered to it within the previous twelve months, excluding any reasonable compensation paid to a director as director, or any brother, sister, ancestor, descendant, spouse, brother-in-law, sister-in-law, son-in-law, daughter-in-law, mother-in-law, or father-in-law of any such person. Directors select the officers of Trust, who serve at the pleasure of the directors and may be removed at any time with or without cause.

Trust's articles of incorporation currently provide that upon the dissolution or winding up of Trust, its assets remaining after payment or provision for payment of its debts shall be distributed to a nonprofit fund, foundation or corporation that is organized and operated exclusively for charitable purposes and which has established its tax exempt status under section 501(c)(3) of the Code.

Trust proposes to amend its articles (the "proposed action") to provide that upon its dissolution, all assets remaining after provision for satisfaction of its liabilities will be distributed to District.

## LAW

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 governmental function and accruing to a state or any political subdivision of a state.

Rev. Rul. 71-589, 1971-2 C.B. 94, provides that the income from property held in trust by a city that was to be used by the city for certain charitable purposes is not subject to federal income tax. Although Rev. Rul. 71-589 does not explicitly so state, the holding in the revenue ruling means that a determination was made that the income

in question was derived from the exercise of an essential governmental function and accrued to a political subdivision within the meaning of section 115(1) of the Code. Rev. Rul. 71-589 specifically mentions several types of functions that the trust might perform, such as support of a hospital, schools, maintenance of a park, or other purposes ordinarily recognized as municipal functions.

Under Rev. Rul. 77-261, 1977-2 C.B. 45, the income from a fund, established under a written declaration of trust by a state for the temporary investment of cash balances of the state and its political subdivisions, which purchase units of participation and have an unrestricted right of withdrawal, is excludable from gross income. The fund, however, is classified as a corporation and must file a federal income tax return.

Section 170(a)(1) of the Code allows, subject to certain limitations, a deduction for charitable contributions as defined in section 170(c), payment of which is made within the taxable year.

Section 170(c)(1) of the Code includes in the definition of "charitable contribution" a contribution or gift made for exclusively public purposes to or for the use of a state, a possession of the United States, a political subdivision of either a state or possession of the United States, the United States, or the District of Columbia.

Entities eligible to receive tax deductible contributions include not only governmental units described in section 170(c)(1) of the Code but also wholly owned instrumentalities of states and political subdivisions. See Rev. Rul. 75-359, 1975-2 C.B. 79; Rev. Rul. 79-323, 1979-2 C.B. 106.

Under section 170(b)(1)(A) of the Code, the deduction for contributions by individuals to a governmental unit described in section 170(c)(1) is allowed up to 50 percent of the taxpayer's "contribution base" for the taxable year.

Under section 1.170A-8(b) of the Income Tax Regulations, in order to qualify for the 50 percent limitation, contributions must be made "to" and not merely "for the use of" the governmental units described in section 170(c)(1). Under section 170(b)(1)(B), deductions for contributions "for the use of" governmental units described in section 170(c)(1) may not exceed 30 percent of the taxpayer's "contribution base." A contribution to an instrumentality of a governmental unit described in section 170(c)(1) is a contribution "for the use" of such a governmental unit, rather than a contribution "to" such a governmental unit. See Rev. Rul. 75-359, 1975-2 C.B. 79.

Rev. Rul. 57-128, 1957-1 C.B. 311, provides that the following factors are taken into consideration in cases involving the status of an organization as an instrumentality of a state or political subdivision of a state:

1. Whether it is used for a governmental purpose and performs a governmental function;
2. Whether performance of its functions 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 power and interests of an owner;
4. Whether control and supervision of the organization is vested in public authority or authorities;
5. If expressed 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 funds.

Rev. Proc. 95-48, 1995-2 C.B. 418, specifies two classes of organizations that are not required to file annual information returns on Form 990, Return of Organization Exempt From Income Tax. These classes of organizations are governmental units and affiliates of governmental units that are exempt from federal income tax under section 501(a) of the Code. Rev. Proc. 95-48 supplements Rev. Proc. 83-23, 1983-1 C.B. 687.

#### ANALYSIS AND HOLDING

Trust was formed by an official act of Board. Board has de jure and de facto control over the selection of the directors of Trust, who control the actions of Trust and the disposition of its revenues. When the proposed action is completed, upon dissolution of Trust District will receive the net assets of Trust.

Trust will perform a governmental function on behalf of District. Further, (1) Trust was formed by the Board acting in its official capacity, (2) the District will, through its control of Trust's board of trustees, have the power and interests of an owner of Trust and will control and supervise Trust and (3) no private interests will be involved.

Based on the information submitted, Trust is an "affiliate of a governmental unit" within the meaning of section 4 of Rev. Proc. 95-48, 1995-2 C. B. 418.

Accordingly, we conclude that after the proposed action is completed Trust will be (1) an instrumentality of District, and (2) eligible to receive contributions for the use of District that are deductible as charitable contributions under section 170(c)(1) of the

Code, subject to the limitations described in that section.

Accordingly, it is held that:

(1) Provided that District is a political subdivision of State, the income of Trust is excludable under section 115 of the Code.

(2) Contributions to Trust may be deductible under section 170(a) of the Code.

(3) Trust is not required to file federal income tax returns under section 1.6033-2(g)(v) of the Income Tax Regulations. However, no opinion is expressed regarding whether Trust has or will have unrelated business taxable income under section 511 of the Code, and, therefore, must file a Form 990-T return.

Except as specifically provided otherwise, no opinion is expressed on the federal income tax consequences of the transaction described above.

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

In accordance with the terms of a power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Assistant Chief Counsel  
(Financial Institutions & Products)

By: \_\_\_\_\_  
William E. Coppersmith  
Chief, Branch 2