

A wholly-owned state or municipal instrumentality which is a separate entity and which is organized and operated exclusively for purposes described in section 501(c)(3) of the Internal Revenue Code of 1954 may qualify for exemption from Federal income tax under section 501(a) as an organization described in section 501(c)(3) of the Code.

Rev. Rul. 55-319, C.B. 1955-1, 119, amplified.

The Internal Revenue Service has given further consideration to the position expressed in Revenue Ruling 55-319, C.B. 1955-1, 119, that a wholly-owned state instrumentality may in some circumstances qualify for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

As indicated in Revenue Ruling 55-319, an organization which is a wholly-owned state or municipal instrumentality may seek exemption as a section 501(c)(3) organization so that the benefit of a particular feature may be extended to its employees, as for example, the exception provided by section 403 of the Code which depends on exemption under section 501(a) of an employer described in section 501(c)(3).

Section 403 of the Code reads, in part, as follows:

\*% \*% \*

(b) TAXABILITY OF BENEFICIARY UNDER ANNUITY PURCHASED BY SECTION 501(c)(3) ORGANIZATION.-

(1) GENERAL RULE.-If-

(A) an annuity contract is purchased for an employee by an employer described in section 501(c)(3) which is exempt from tax under section 501(a),

(B) such annuity contract is not subject to subsection (a), and

(C) the employee's rights under the contract are nonforfeitable, except for failure to pay future premiums,

then amounts contributed by such employer for such annuity contract on or after such rights become nonforfeitable shall be excluded from the gross income of the employee for the taxable year to the extent that the aggregate of such amounts does not exceed the exclusion allowance for such taxable year. The employee shall include in his gross income the amounts received under such contract for the year received as provided in section 72 (relating to annuities) except that section 72(e)(3) shall not apply.

(2) EXCLUSION ALLOWANCE.-For purposes of this subsection, the exclusion allowance for any employee for the taxable year is an amount equal to the excess, if any, of-

(A) the amount determined by multiplying (i) 20 percent of his includible compensation by (ii) the number of years of service, over

(B) the aggregate of the amounts contributed by the employer for annuity contracts and excludable from the gross income of the employee for any prior taxable year.

Section 501(c) of the Code describes certain organizations exempt from income tax under section 501(a) and reads, in part, as follows:

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Revenue Ruling 55-319 holds, in part, that where an organization desires to have the benefit of a particular tax feature extended to its employees, such as the exemption provided by section 403 of the Code, which depends on exemption under section 501(a) of an employer described in section 501(c)(3), and the particular organization meets the statutory requirements for exemption under section 501(c)(3) of the Code, it may be granted exemption thereunder, regardless of the fact that it also qualifies as a wholly-owned state instrumentality and, as such, would not be subject to Federal income tax.

Thus, such an organization may be exempt under section 501(c)(3) of the Code if it is organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

A state or municipality itself, however, would not qualify as an organization described in section 501(c)(3) since its purposes are clearly not exclusively those described in section 501(c)(3) of the Code. See for example, Estate of John C. F. Slayton v. Commissioner, 3 B.T.A. 1343. It follows, therefore, that where the particular branch or department under whose jurisdiction the activity in question is being conducted is an integral part of a state or municipal government the provisions of section 501(c)(3)

would not be applicable. For example, where a public school, college, university or hospital is an integral part of a local government, it could not meet the requirements for exemption under section 501(c)(3) of the Code.

On the other hand a wholly-owned state or municipal instrumentality which is a counterpart of an organization described in section 501(c)(3) of the Code such as a separately organized school, college, university, or hospital may qualify for exemption under section 501(c)(3) of the Code. If the organization conducting the activity, although a separate entity, is clothed with powers other than those described in section 501(c)(3) it would not be a clear counterpart of a section 501(c)(3) organization. For example, where a wholly-owned state or municipal instrumentality exercises enforcement or regulatory powers in the public interest such as health, welfare, or safety, it would not be a clear counterpart of an organization described in section 501(c)(3) of the Code even though separately organized since it has purposes or powers which are beyond those described in section 501(c)(3).

In order for a wholly-owned instrumentality to establish an exemption under section 501(c)(3) of the Code, it is necessary to file an application on Form 1023, Application for Exemption, with the District Director of Internal Revenue for the internal revenue district in which is located the principal place of business or principal office of the organization. See section 1.501(a)-1 of the Income Tax Regulations.

Revenue Ruling 55-319, C.B. 1955-1, 119, is hereby amplified.