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Date:
November 24, 2008

Legend

Association =

X =

Y =

States =

Date =

Dear :

This is in response to your letter dated Date, in which you requested rulings on the following three issues:

- 1) Whether the Association qualifies as an instrumentality of the States, and therefore, services performed in the employ of the Association are excepted from

the definition of “employment” under Internal Revenue Code (Code) section 3306(c)(7)?

- 2) If the Association qualifies as an instrumentality of the States, whether contributions made to it are deductible as charitable contributions within the meaning of Code section 170(c)(1)?
- 3) Whether the Association’s income is exempt from federal income tax because it derives its income from the exercise of an essential government function, and the income accrues to one or more States within the meaning of Code section 115(1)?

FACTS

The Association is a nonprofit corporation recently organized under the laws of X. It is intended to be the successor of an unincorporated division of Y. Y is currently exempt from federal income tax under Code section 501(c)(3). The Association’s members consist of the current governors of the States. Members of the Association serve in their capacity as governors. Thus, when an individual ceases to be a governor, he or she also ceases to be a member of the Association. His or her successor as governor becomes a member in the Association.

As stated in its Articles of Incorporation and Bylaws, the Association’s purpose is to provide a medium for the exchange of views and experiences on subjects of general importance to the people of the States; foster interstate cooperation and regional developments; strive for greater efficiency in state administration; share information with the federal government on issues of importance to the States; and facilitate and improve state-federal relationships.

The Association’s members elect an Executive Committee, which serves as its Board of Directors. Each member of the Executive Committee must be a member of the Association. The Bylaws provide the Association will hold member meetings where it will develop a policy document reflecting broad areas of consensus among the members and identifying priority issues to be addressed by the Association.

The Association will receive a significant portion of its funding from annual dues paid by each member. The Association also expects to receive grants and contributions from nonprofit and for-profit entities, and individuals. Upon dissolution, after paying all liabilities and obligations, the Association’s Articles of Incorporation provide that remaining assets will be distributed to the States. No part of the net earnings of the Association shall inure to the benefit of, or be distributable to, any member, director, or officer of the Association or to any other person.

LAW & ANALYSIS

Issue 1:

Section 3306(c)(7) of the Code provides that, for purposes of the Federal Unemployment Tax Act (FUTA), “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. Accordingly, if an organization is a wholly-owned instrumentality of a state or political subdivision thereof, that organization is not required to pay FUTA tax.

Revenue Ruling 57-128, 1957-1 C.B. 311, sets forth the following factors to be taken into account in determining whether an entity is an instrumentality of one or more governmental units: (1) whether the organization 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 states or political subdivisions have the power and interests of an owner; (4) whether control and supervision of the organization is vested in a public authority or authorities; (5) whether express or implied statutory or other authority is necessary for the creation and/or use of the organization, and whether this authority exists; and (6) the degree of financial autonomy of the entity and the source of its operating expenses. Each of these factors must be evaluated in order to determine if the Association is an instrumentality of the States.

The Association satisfies the first factor of Rev. Rul. 57-128, which requires it to have a governmental purpose and perform a governmental function. Association assists its member government officials in the performance of their common official duties. By providing a forum for its members to discuss issues of importance to their constituents and to consider ways to address such issues with representatives of the federal government, the Association allows its members to serve the public more effectively.

The Association satisfies the second factor insofar as it performs functions on behalf of one or more states or political subdivisions. Because the States, through their governors, have control over the performance of the Association’s governmental functions, the Association will therefore perform its functions on behalf of one or more states or political subdivisions.

The Association satisfies the third factor in that there are no private interests involved. The States, through their governors, have the powers and interests of owners in the Association because they have the power to conduct the affairs of the Association. In

addition, pursuant to the Bylaws, upon dissolution, the remaining assets of the Association will be distributed to the members. No part of the net earnings of the Association will inure to the benefit of any member.

The Association satisfies the fourth factor which requires the control and supervision of the organization to be vested in public authorities. The Bylaws provide that the Association's affairs will be conducted by its Executive Committee and its membership, which is limited to the member governors, serving in their official capacity as governors.

The Association satisfies the fifth factor in that express or implied statutory or other authority is necessary for the creation and/or use of the Association, and such authority exists. Membership of the Association consists of current governors of the States who have authority to perform governmental functions. Thus, the governors who are members of the Association have implicit authority to form organizations that facilitate performance of governmental functions.

The Association satisfies the sixth factor which considers the degree of financial autonomy and the source of operating expenses. The Association expects to receive a significant portion of its funding from membership dues paid by the States. In addition, the Bylaws give the Association's members the ability to oversee the use of the Association's funds.

The Association satisfies each of the factors listed in Revenue Ruling 57-128. Accordingly, Association is an instrumentality of the States within the meaning of section 3306(c)(7). Thus, services performed in the employ of Association are excepted from the term "employment" under section 3306(c)(7) for purposes of FUTA.

Issue 2:

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

Section 170(c)(1) defines the term "charitable contribution" as including 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, but only if the contribution or gift is made for exclusively public purposes.

An entity not expressly described in section 170(c)(1) may nevertheless 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 Revenue Ruling 75-359, 1975-2 C.B. 79.

Rev. Rul. 75-359 holds that contributions and gifts to a wholly-owned instrumentality of a political subdivision formed and operated exclusively for public purposes, are deductible contributions “for the use of” political subdivisions, to the extent allowed under section 170. Under Rev. Rul. 75-359, the criteria for identifying wholly-owned instrumentalities of states or political subdivisions are set forth in Revenue Ruling 57-128, 1957-1 C.B. 311.

Since the Association qualifies an instrumentality of the States under Rev. Rul. 57-128’s six-factor test, contributions made to it exclusively for a public purpose may be deductible by donors as charitable contributions under section 170(c)(1) to the extent otherwise provided under section 170.

Issue 3:

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.

Under Revenue Ruling 77-261, 1977-2 C.B. 45, the 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 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 utilities 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 properly to conduct. In addition, pursuant to section 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Revenue Ruling 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(1). In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

The Association was formed for the broad purpose of providing a medium for the exchange of views and experiences on subjects of general importance to the people of the States. As discussed above, by providing a forum for its members to discuss issues

of importance to their constituents and to consider ways to address such issues with representatives of the federal government, the Association allows its members to serve the public more effectively. Thus, the Association exercises an essential government function.

The Association's income and the assets accrue to the benefit of its members. Currently, the Association's membership consists of the governors from the States. The Association's Articles of Incorporation ensure that no part of its income and earnings shall inure to the benefit or profit of any private interest. Therefore, the Association's organizing documents sufficiently provide that the Cooperative's gross income accrues to a state or political subdivision for purposes of section 115(1). Furthermore, the Articles of Incorporation provide that any remaining assets after satisfaction of liabilities shall be distributed only to the States.

Based on the information and representations submitted, we hold that the Association's income is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for the purposes of section 115(1). Accordingly, the Association's income is excludable from gross income under section 115(1).

CONCLUSIONS

- 1) The Association is an instrumentality of the States for purposes of section 3306(c)(7) of the Code, and therefore, all services performed in the employ of the Association are excepted from FUTA.
- 2) Since the Association qualifies as an instrumentality of the States, it is eligible to receive deductible contributions or gifts made for exclusively public purposes to the extent allowed under section 170 of the Code.
- 3) The Association's income is excludible from gross income under section 115(1) of the Code.

These rulings are 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,

Sylvia F. Hunt
Assistant Branch Chief, Exempt Organizations
Branch 2 (Exempt Organizations/Employment
Tax/Government Entities)
(Tax Exempt & Government Entities----)