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LEGEND:

Marketing Act =

State =

Official A =

Committee =

Commodity =

State University =

X =
Y =

This is in response to a letter dated December 23, 1996, requesting rulings concerning the status of the Committee for federal income tax purposes. Specifically, the Committee requests rulings on five issues: (1) whether the income of the Committee is excludable from gross income under § 115 of the Internal Revenue Code, (2) whether the Committee is required to file annual Federal income tax returns, (3) whether contributions to or for the use of the Committee are deductible by the donor under § 170 of the Code, (4) whether bequests, legacies, devises, transfers, or gifts to or for the use of the Committee are deductible for federal estate and gift tax purposes under §§ 2055, 2106, and 2522 of the Code, and (5) whether the Committee is required to withhold income tax from wages paid to any employees and make remittances of withheld amounts to the Internal Revenue Service.

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FACTS

The Federal program of marketing orders, described in 7 U.S.C. 608c, provides that Federal marketing orders may be implemented to regulate various aspects of the production and marketing of certain agricultural products. The most commonly known form of regulation involves establishing controls over pricing, quality, and production volume. However, the Federal marketing order statute also permits other activities. In particular, a marketing order may establish production research, marketing research, and development projects designed to improve or promote the marketing, distribution, and consumption or efficient production of a covered commodity and require that the expenses of any projects are to be paid from monies collected pursuant to the marketing order. Projects may also provide for any form of marketing promotion including paid advertising. 7 U.S.C. 608c(6)(I).

The Marketing Act was enacted by the State legislature to promote efficient and equitable methods of production and marketing of the State's agricultural resources, thereby promoting the State's overall economy. The Marketing Act was closely modeled after the Federal program.

The Marketing Act permits Official A to regulate production of agricultural commodities, including production quantities, timing of marketing, grading, labeling, inspection, unfair competition, and other related matters. Official A may prescribe rules governing the processing, distribution, sale, or handling of the Commodity through a marketing order.

Although the Marketing Act permits a marketing order to cover activities such as grading, labeling, inspection, and pricing, State has chosen to regulate these activities through other avenues. The marketing order at issue only governs activities related to increasing consumption of the Commodity, including research efforts and general promotional activities.

A marketing order may be issued only after there has been due notice of and opportunity for a public hearing on the matter. Notice of the opportunity for a hearing will be given to all persons who may be directly affected by the marketing order and whose names are upon a list filed by the Commodity industry. The hearing shall be open to the public. All testimony at the hearing will be made under oath, and a full and complete record of all proceedings will be maintained by Official A's office.

If, following the hearing, Official A determines that it is appropriate to issue a marketing order, the marketing order will not go into effect unless a simple majority of the producers of the Commodity vote to participate in the marketing order. The

marketing order applies to all Commodity producers within the covered counties in State. Any county not originally included in the marketing order may petition to join the marketing order if two-thirds or more of the Commodity producers in that county agree to be subject to the marketing order.

Official A is legally responsible for implementing all aspects of any marketing order issued under the Marketing Act. However, realizing that Official A could be responsible for numerous marketing orders as well as many other duties, the State legislature provided in the Marketing Act that each marketing order must provide for a board of control to administer that marketing order on behalf of Official A.

Official A has appointed the Committee to administer the marketing order for the Commodity. Committee members are nominated by the producers of the Commodity and are appointed by Official A. If no nominations are received, Official A may select the members of the Committee and their alternates. Official A may remove any Committee member for cause at any time. In addition, Official A has the right at any time to nullify any regulation, decision, determination, or other action taken by the Committee. However, any such nullification will not adversely impact any actions taken in reliance upon a Committee action that has been nullified.

The Committee presents an annual budget to Official A for approval. All expenditures are approved by Official A via his review and approval of the annual budget. The Committee will be audited at least annually and will file a copy of the audit report with Official A.

Each producer covered by the marketing order is liable for its pro rata share of the Committee's expenses. In order to pay for the expenses, Official A levies an assessment upon each producer at a rate proposed by the Committee. Under the Marketing Act, assessments are payable to Official A. Official A has delegated the duty to collect the assessments to the Committee but retains general oversight over Committee operations. All monies must be deposited in an institution approved by the State Treasurer. The Committee will keep records of the amounts paid by its producers. Any amounts unspent at the end of a year may be returned pro rata to the producers if Official A deems appropriate. Otherwise, the amounts will be carried over to the next year. To date, the amounts have been carried over rather than returned.

Assessments are collected at the time the Commodity is first sold to either a middleman or an end user. In practice, most Commodity producers sell their crops to a middleman, who subtracts the assessments from the amounts paid to producers.

The middleman is responsible for remitting assessments to the Committee and providing paperwork indicating the producers on whose behalf the remittances are made. If a producer sells directly to an end user, the producer is responsible for sending the assessments to the Committee. Assessments are due to the Committee after a sale has occurred; thus, monies are received throughout the year.

Assessments upon the Commodity are partially refundable if a written request for refund is made within x days after payment of an assessment. After the refund period has passed, producers have no further legal claim on the monies.

In the event that the marketing order is terminated, Official A must return any remaining funds pro-rata to the Commodity producers. However, if the amounts to be returned are so small that it would not be practical to actually pay them out, Official A may retain the money to be used for the implementation of any future marketing order regulating the Commodity.

In the event that a producer refuses to pay an assessment, the Marketing Act authorizes Official A to pursue the non-paying producer, including suing for payment in state court. In addition to payment of the assessment, possible sanctions include monetary penalties, imprisonment in a county jail, an injunction against participation in the Commodity industry until the assessment is paid, and attorney fees. In addition to enforcement by Official A, after investigating the facts, any State district attorney may bring a criminal suit in the name of the people of State if the district attorney believes there has been a violation of either the Marketing Act or any marketing order. If any monetary penalties are assessed, the penalties are turned over to the State general fund. The Committee represents that there have been no problems with collection of assessments to date.

Generally, the Committee is responsible for research, promotion, and education with respect to the production and marketing of the Commodity. The Committee provides administrative functions only; it does not buy or sell the Commodity.

The Committee spends a small portion of the annual budget on advertising, such as print ads in newspapers for the general promotion of the Commodity and not on behalf of a particular producer, distributor, or any other person. The Committee also publishes a regular report to the Commodity industry, including State and national information on the Commodity. The Committee also participates in trade missions that promote the Commodity. For example, if business people from another country visit, they may be given a tour of some Commodity producers, where they might

be given information about how to evaluate the quality of the Commodity.

The Committee uses a majority, currently approximately y percent, of its annual budget to support market development and research exploring different aspects of the Commodity. The Committee currently provides funding for this research by providing support to a large non-profit organization interested in Commodity-related research, the State University, and several other programs.

LAW AND ANALYSIS

Issues 1 and 2

In general, if income is earned by an enterprise that is an integral part of a state or a 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; Section 511(a)(2)(B) of the Code; GCM 14407, C.B. XIV-1, 103 (1935), superseded by Rev. Rul. 71-131, 1971-1 C.B. 28. When a state conducts an enterprise through a separate entity, however, the income of the entity may be excluded from gross income under section 115.

In Maryland Savings-Share Insurance Corp.("MSSIC") v. United States. 308 F. Supp. 761, rev'd on other grounds, 400 U.S. 4 (1970), 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. Although the district court was reversed on other grounds, the Supreme Court agreed with the lower court's analysis of the instrumentality and section 115 issues. The Supreme Court rejected MSSIC's position that "it is an instrumentality of the State and hence entitled to exemption from federal taxation under the doctrine of intergovernmental immunity and under section 115 of the Code." MSSIC, 400 U.S. at 7, n.2.

In State of Michigan and Michigan Education Trust v. United States, 40 F.3d 817 (6th Cir. 1994), rev'g 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) of the Code. 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 C.B. 311, to reach its conclusion is misplaced. The revenue ruling applies to entities that are separate from a 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.

Nevertheless, 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.

Under the Marketing Act, Official A is legally responsible for all aspects of the marketing order. Official A has delegated his administrative responsibilities for the marketing order to the Committee. However, Official A exercises significant control over the Committee. Official A appoints members to the Committee from a list of nominees selected by Commodity producers. Official A may select and appoint Committee members if no nominations are received. In addition, Official A has the power to nullify all acts of the Committee at any time, subject only to the limitation that actions taken in reliance upon a nullified act are not themselves voided. Official A also reviews and approves the annual budget filed by the Committee and receives a copy of the annual audit.

Further, State has made a significant financial contribution to the Committee. Under a state analog to the federal agricultural marketing order program, the State legislature empowered Official A to enter into the marketing order. Under the Marketing order, Official A charges an assessment on Commodity producers that is partially refundable for only a short period of time after payments are made. Under the Marketing Act, the assessments are payable directly to Official A. Official A has delegated the collection of the assessments to the Committee. Although assessments are refundable for a short period of time after collection, over the last few years, a significant majority of the total assessments have been retained by State for use by the Committee to achieve the goals established by State in the marketing order. The monies are used to support research, education, and general promotional activities of State.

Based upon all of the above factors, the Committee is an integral part of State.

Because the Committee is an integral part of State, it is treated the same as State for the purposes of federal income tax filing requirements. Thus, the Committee is not required to file annual federal income tax returns.

Issue 3

Section 170(a) of the Internal Revenue Code provides 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 defines a "charitable contribution" to include 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 United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

Because the Committee is an integral part of State, we conclude that contributions to the Committee for exclusively public purposes are contributions to or for the use of a state and, therefore, are charitable contributions deductible by the donor under § 170(c)(1), subject to the limitations set forth in § 170.

Issue 4

Section 2055(a) provides that for the purposes of the tax imposed by § 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises or transfers to or for the use of the United States or any political subdivision thereof, or the District of Columbia, for exclusively public purposes.

Section 2522(a) provides that in computing the taxable gifts for the calendar year, there shall be allowed as a deduction in the case of a citizen or resident of the United States the amount of all gifts made during such year to or for the use of the United States, any state or subdivision thereof, or the District of Columbia, for exclusively public purposes.

Section 2106 provides that for the purposes of the tax imposed by § 2101, the value of the taxable estate of every decedent non resident not a citizen of the United States shall be determined by deducting from the value of that part of his gross estate which at the time of his death is situated in the United States, the amount of all bequests, legacies, devises, or transfers to or for the use of the United States, any state, any political subdivision thereof, or the District of Columbia, for exclusively public purposes.

The Service does not issue blanket estate and gift tax rulings to organizations since organizations are not the taxpayers for estate and gift tax purposes. For estate tax purposes, the estate is the taxpayer; for gift tax purposes, the

donor is the taxpayer. However, to the extent that taxpayers otherwise meet the requirements of §§ 2055, 2522, and 2106, contributions to the Committee will be deductible for estate and gift tax purposes.

Issue 5

Section 3401(d) of the Internal Revenue Code provides that the term "employer" means the person for whom an individual performs or performed any service, of whatever nature, as an employee of such person. "Wages" are defined in § 3401(a) of the Code as all remuneration for services performed by an employee for his employer with certain exceptions not applicable here. Under § 3402(a), every employer making payment of wages is required to deduct and withhold federal income tax from such wages. Accordingly, the Committee is required to withhold income tax from wages paid to any employees it may have and to make remittances to the Internal Revenue Service.

The Committee has cited Rev. Rul. 57-120, 1957-1 C.B. 310 and Rev. Rul. 57-128, 1957-1 C.B. 311 in their ruling requests. Both rulings concluded that the workers in question were employees of a political subdivision or wholly owned instrumentality thereof and, as such, the services performed were exempt from employment for the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) purposes. Section 3306(c)(7) remains unchanged and excludes the services performed in the employ of a State, political subdivision, or wholly owned instrumentality thereof from the definition of "employment" for FUTA purposes. However, § 3121(b)(7) has been amended since 1957.

Section 3121(b)(7) of the Code excludes from the term "employment," service performed in the employ of a State, political subdivision or wholly owned instrumentality thereof. However, under § 3121(b)(7)(E), the exception from employment does not apply to services included under an agreement entered into pursuant to section 218 of the Social Security Act.

In the event that the services performed by the employees are not included under a section 218 agreement, § 3121(b)(7)(F) provides that the exception from employment shall not apply to services performed by an employee of a State, political subdivision or wholly owned instrumentality thereof by an individual who is not a member of the retirement system of such State, political subdivision or wholly owned instrumentality. See § 31.3121(b)(7)-2 of the Employment Tax Regulations.

If the employees are qualified participants in a retirement system of the employer within the meaning of the regulations and, therefore, exempt under § 3121(b)(7)(F) from the taxes imposed

under the FICA, they may nevertheless be subject to the Medicare portion of the FICA taxes. Under § 3121(u)(2)(C) of the Code, all State or local government employees hired after March 31, 1986 are subject to the Medicare portion of the FICA taxes regardless of membership in a retirement system provided by the employer.

CONCLUSION

Based on the information and representations submitted by the Committee and Official A, we hold as follows:

1. The Committee is an integral part of Official A's office and therefore an integral part of State.

2. Because the Committee is deemed to be an integral part of State, the Committee is not required to file federal income tax returns.

3. Contributions to the Committee for exclusively public purposes are contributions to or for the use of a state and, therefore, are charitable contributions deductible by the donor under § 170(c)(1), subject to the limitations set forth in § 170.

4. To the extent that taxpayers otherwise meet the requirements of §§ 2055, 2522, and 2106, contributions to the Committee will be deductible for estate and gift tax purposes.

5. Assuming that the individuals who perform services for the Committee are employees, the Committee is required to withhold income tax from wages paid to any employees it may have and to make remittances to the Internal Revenue Service.

   If the Committee has entered into agreements pursuant to section 218 of the Social Security Act, it will be responsible for withholding and paying the taxes imposed under FICA and FUTA. Information concerning section 218 agreements can be obtained by contacting the State Social Security Administrator.

   If they have not entered into section 218 agreements, the Committee may nevertheless be responsible for withholding and paying the taxes imposed under FICA and FUTA if the individuals performing services for the Committee are not participants in the retirement system of State or the Committee.

   If the Committee has not entered into section 218 agreements and their employees are qualified participants in a

retirement system of State or the Committee, the Committee is not required to withhold and remit the majority of the taxes imposed under the FICA. However, it will be responsible for withholding and remitting the Medicare portion of the FICA taxes for any employees hired after March 31, 1986.

The Committee has not provided sufficient information to rule on the workers' classification. If the Committee is interested in obtaining rulings regarding the proper classification of their workers, it may do so by filing Form SS-8, Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding, with the appropriate District Director's office.

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

Sincerely,

Assistant Chief Counsel
(Financial Institutions and Products)

By: Alice M. Bennett
Alice M. Bennett
Chief, Branch 3

enclosures: copy of this letter
section 6110 copy