

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201837011**

Release Date: 9/14/2018

Index Number: 115.00-00, 170.09-01,
6012.05-01

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:EO1
PLR-136857-17

Date:
June 07, 2018

Authority:

Trust:

Act:

County:

City:

Hospital:

Year:

Dear _____ :

This letter responds to a letter from your authorized representative dated December 7, 2017, as supplemented, submitted on behalf of the Trustee, requesting rulings that (1) the Trust's income is excludable from gross income under § 115(1) of the Internal Revenue Code (Code), (2) contributions to the Trust are deductible as charitable contributions under § 170(a) of the Code, and (3) the Trust is not required by § 6012(a)(4) of the Code to file an annual federal income tax return. The Trustee represents the facts as follows.

FACTS

The Authority was formed under the Act as a political subdivision of a state or local government, as defined by § 1.103-1(b) of the Income Tax Regulations. See PLR-

124275-17 (December 21, 2017). The County created the Authority for the general purposes of the Act, including the provision of health care services within the County. The Authority currently owns an acute care general hospital located in the City, which it leases to the Hospital under a long-term lease.

The Authority is governed by a nine-member Board of Trustees (the Board), the members of which are appointed by the County's commissioners. The members may serve an unlimited number of terms. The Board is responsible under the Act for managing the affairs of the Authority, including the appointment of the Authority's officers. The Authority is required by the Act to file an annual report and budget with the County, along with the results of an annual audit.

The Authority intends to sell certain of its assets to a for-profit hospital in the County. As required by the Act, the Authority created the Trust to receive the net proceeds from this sale, to be used exclusively to fund hospital care for the indigent residents of the County. The Trust is administered by the Authority, acting as Trustee. The Trustee represents that no private interests will participate in, or benefit from, the Trust, except in a manner incidental to the public benefit provided by the Trust.

The Trustee has the power under the Trust agreement to invest Trust funds as permitted by applicable law. The Act provides that Trust assets "may be invested in the same way that public moneys may be invested generally pursuant to general law".

The Trust is intended to be perpetual. Should the Trust terminate, however, the assets of the Trust will be distributed to the Authority if it still exists, and if not, then to the County, to be used for the purposes of the Trust. The Trust agreement provides that in no event will Trust assets revert to any entity that is not a state, a political subdivision of a state, or another entity the income of which is excluded from its gross income under § 115 of the Code.

Issue 1 – § 115(1)

LAW AND ANALYSIS

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 government function and accruing to a state or any political subdivision thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, held that the income generated by the subject investment fund, which was established by the state to hold revenues in excess of the amounts needed to meet current expenses, was excludable from gross income under § 115(1) of the Code, because such investment constituted an essential governmental function. The ruling stated 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 an authority engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or political

subdivision of a state. According to the ruling, 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 that are within the ambit of a sovereign to conduct. Pursuant to § 6012(a)(2) of the Code and the underlying regulations, the investment fund, being classified as a corporation subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

Rev. Rul. 90-74, 1990-2 C.B. 34, held that the income of the subject organization, which was formed, funded, and operated by political subdivisions to pool various risks arising from their obligations regarding public liability, workers' compensation, or employees' health, was excludable from gross income under § 115(1) of the Code, because the organization was performing an essential governmental function. The ruling stated that the income of the organization was excludable from gross income as long as private interests did not participate in, or benefit more than incidentally from, the organization. The benefit to the employees of the insurance coverage obtained by the member political subdivisions was deemed incidental to the public benefit.

The Trust will provide hospital care to indigent residents of the County. Such an activity, as required by the Act and within the purposes and powers of the Authority under the Act, constitutes the performance of an essential governmental function. Rev. Rul. 90-74 and Rev. Rul. 77-261.

Providing hospital care for indigents through the Trust satisfies the purposes and powers of the Authority to provide such care. As such, the income of the Trust accrues to the Authority. No private interests participate in, or benefit from, the operation of the Trust other than as providers of goods and services as may be required to carry out the functions of the Trust. Upon termination, any amounts remaining in the Trust after all trust liabilities have been satisfied shall be distributed to the Authority or the County for public purposes. In no event will trust assets be distributed to any entity that is not a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under § 115 of the Code. Rev. Rul. 90-74.

Issue 2 - § 170

LAW & ANALYSIS

Section 170(a)(1) of the Code provides that there shall be allowed as a deduction any charitable contribution (as defined in § 170(c) of the Code) payment of which is made within the tax year.

Section 170(c)(1) of the Code states that, for purposes of § 170 of the Code, the term "charitable contribution" means 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, or

the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

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

- (1) whether the organization is used for a governmental purpose and performs a governmental function;
- (2) whether the organization's function is performed on behalf of a state or political subdivision;
- (3) whether any private interests are involved, or whether a state or political subdivision has the powers and interests of an owner;
- (4) whether the control and supervision of the organization is vested in a public authority;
- (5) whether express or implied statutory or other authority is necessary for the creation or use of the organization, and whether such authority exists; and
- (6) the degree of the organization's financial autonomy and the source of its operating expenses.

Rev. Rul. 75-359, 1975-2 C.B. 79, found that a voluntary association of counties was separate from its member counties and qualified as a wholly-owned instrumentality of those counties, which were political subdivisions, and that it was formed and operated exclusively for the public purposes of the member counties. Therefore, the ruling held that contributions to the association were deductible as contributions for the use of political subdivisions, subject to the limitation of § 170(b)(1)(B) of the Code.

Rev. Rul. 69-453, 1969-2 C.B. 182, applied the six factors of Rev. Rul. 57-128 to hold that a soil and water conservation district formed as a private non-stock corporation by private individuals was not an instrumentality of the state. The ruling found that the state had no authority or control over the district's expenditures, that it had no authority to remove any member of the district's board, and that the district funded its operations through fees that it charged landowners for work done for the purpose of soil conservation. The ruling noted that the state had no claim to the district's assets after the district's dissolution.

Rev. Rul. 65-196, 1965-2 C.B. 388, held that a sports area commission formed pursuant to an agreement (which was authorized by the enactment of a state law legalizing such agreements) among a city and two villages to erect and operate an athletic stadium was an instrumentality of political subdivisions of the state. The commission was composed of members appointed by the councils of the city and the villages as their representatives. Each member was required to be a citizen and resident of the state and could not be a member of the governing body of the city or the villages. The sole source of financing for the commission came from bonds issued by the city; the city was

authorized to issue bonds upon the request of the commission to fund the athletic stadium. The ruling found that the commission was an instrumentality of the city and the two villages by whose agreement it was formed, because it met substantially all of the Rev. Rul. 57-128 factors: the commission was created by the city and the villages as their instrumentality, and validated by state law; the commission members were delegated certain authority under the terms of the agreement among the city and the villages; control and supervision of the assets of the commission were in the hands of the city and the villages; there were no private interests involved; and the city, upon the commission's direction, was responsible for the project's finances.

Section 170(c)(1) of the Code generally defines the term "charitable contribution," for purposes of § 170(a)(1) of the Code, to include a contribution or gift to or for the use of a state or any political subdivision of the state, provided the contribution or gift is made for exclusively public purposes

The Trust is not itself a political subdivision of the State. Therefore, contributions to the Trust cannot constitute charitable contributions to a political subdivision of the State for purposes of § 170(c)(1) of the Code. However, pursuant to Rev. Rul. 75-359, contributions to the Trust may constitute charitable contributions for the use of a political subdivision of the State, which are deductible under § 170(a) of the Code, subject to the limitation of § 170(b)(1)(B) of the Code, if the Trust qualifies as a separate, wholly-owned instrumentality of one or more political subdivisions of the State. Whether the Trust is a wholly-owned instrumentality of a state or political subdivision of a state is determined by applying the six factors of Rev. Rul. 57-128.

The first factor under Rev. Rul. 57-128 is whether the Trust is used for a governmental purpose and performs a governmental function. The Authority was created by the County as a political subdivision of the State, pursuant to the Act, to provide health care to indigents in the County. The Trust, in turn, was created by the Authority pursuant to the Act, which requires that Trust assets be used exclusively to fund hospital care for the indigent residents of the County. Thus, the State, through its legislature, has identified the setting aside of assets, in trust, for the provision of hospital care for the indigent, as a legitimate function of the counties and their hospital authorities in the State. Accordingly, we conclude that the Trust is used for a governmental purpose and performs a governmental function.

The second factor under Rev. Rul. 57-128 is whether the performance of the Trust's function is on behalf of a state or political subdivision. The Trust is administered by the Authority, acting as Trustee, for the purpose of funding the provision of hospital care for the indigent residents of the County. The Board of the Authority is appointed by the County's commissioners pursuant to the Act to manage the Authority for the general purpose of providing health care within the County. Therefore, the Trust's function is on behalf of the County, acting through the Authority, which is also governed by the Board, to provide health care to individuals living in the County. Consequently, we find that the

Trust's function is performed on behalf of the County, which is a political subdivision of the State.

The third factor under Rev. Rul. 57-128 is whether any private interests are involved, or whether a state or political subdivision has the powers and interests of an owner. The Act requires that assets held in the Trust be used exclusively to fund hospital care for indigent County residents. The Trust represents that no private interests will participate in, or benefit from, the Trust, except in a manner incidental to the public benefit provided by the Trust.

The Act provides that Trust assets may be invested in the same way that public funds may be invested pursuant to general law. Moreover, the Trust instrument provides that if the Trust ever terminates, the Board must distribute all property remaining in the Trust to the Authority, if the Authority still exists, and if not, then to the County, to be used in a manner consistent with the purposes of the Trust.

Consequently, we conclude that no private interests are involved in the Trust. Rather, we find a political subdivision of the State has the powers and interests of an owner with respect to the Trust.

The fourth factor under Rev. Rul. 57-128 is whether the control and supervision of the Trust is vested in a public authority. The County created the Authority, which in turn created the Trust. The Authority administers the Trust as Trustee. The Authority is governed by the Board, the members of which are appointed by the County. The Authority is required by the Act to provide the County with an annual report and budget, along with the results of an annual audit. The Authority is accountable to the County for using the Trust's assets in accordance with the purposes of the Trust under the Act. Therefore, we conclude that the control and supervision of the Trust is vested in a public authority.

The fifth factor under Rev. Rul. 57-128 is whether express or implied statutory or other authority is required to create or use the Trust, and whether such authority exists. Pursuant to the Act, the proceeds from any sale or lease of a hospital authority or political subdivision of the State generally must be held by the authority or political subdivision in an irrevocable trust fund, such as the Trust. The Authority created the Trust to receive the proceeds from the Authority's sale of certain of its assets to a for-profit hospital operating within the County. The Act requires that assets held in the Trust be used exclusively to fund hospital care for indigent County residents. Consequently, we conclude that express statutory authority is necessary for the creation and use of the Trust and that such authority does exist.

The sixth factor under Rev. Rul. 57-128 is the degree of the Trust's financial autonomy and the source of its operating expenses. The financial affairs of the Trust are managed by the Authority, through the Board, which is appointed by the County. The

assets of the Trust are treated as public funds and, under the Act, must be used exclusively for the public purposes of the Trust. Therefore, we find the Trust is not financially autonomous from any political subdivision of the State. Rather, the Trust's assets consist entirely of public funds.

Thus, similar to the organization described in Rev. Rul. 65-196, and unlike the one in Rev. Rul. 69-453, the Trust is used for a governmental purpose and performs a governmental function; the Trust's function is on behalf of the County, which is a political subdivision of the State; there are no private interests involved with the Trust, and a political subdivision of the State has the powers and interests of an owner of the Trust; the control and supervision of the Trust is vested in a public authority; express statutory authority is necessary for the creation and use of the Trust, and such authority exists; the Trust is not financially autonomous from one or more political subdivisions of the State, but rather the Trust's assets consist entirely of public funds.

Issue 3 – § 6012(a)(4)

LAW & ANALYSIS

Section 301.7701-1(b) of the Procedure and Administration Regulations (the regulations) provides that the classification of organizations that are recognized as separate entities is determined under §§ 301.7701-2 through -4 of the regulations, unless a provision of the Code provides for special treatment of that organization.

Section 301.7701-4(a) of the regulations provides, in general, that an arrangement will be treated as a trust under the Code if it can be shown that the purpose of the arrangement is to vest in Trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

The Trust enables the Authority to use funds from the sale of the Authority assets to provide hospital care for indigents in the County. The Authority, acting as Trustee, is responsible for protecting and conserving the Trust's assets for trust beneficiaries. The beneficiaries of the Trust cannot share in the discharge of the Trustee's responsibility and, therefore, are not associates in a joint enterprise for the conduct of a business for profit. Thus, assuming that it is recognized as a separate entity under § 301.7701-1 of the regulations, the Trust is treated as an ordinary trust under § 301.7701-4(a) of the regulations.

Section 6012(a)(4) of the Code provides that every trust having taxable income for the tax year, or having gross income of \$600 or more for that year regardless of the amount of taxable income, must file a return with respect to income taxes under subtitle A.

RULINGS

Based solely on the facts and representations submitted by the Trustee:

1. We conclude that the income of the Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1) of the Code. Consequently, we rule that the Trust's income is excludable from gross income under § 115(1) of the Code.
2. We conclude that the Trust is a wholly-owned instrumentality of a political subdivision of the State. Therefore, in accordance with Rev. Rul. 75-359, we rule that contributions to the Trust constitute charitable contributions (within the meaning of § 170(c)(1) of the Code) for the use of a political subdivision of the State, that are deductible under § 170(a) of the Code, subject to the limitation of § 170(b)(1)(B) of the Code.
3. Assuming that the Trust is a separate entity under § 301.7701-1 of the regulations, we conclude that the Trust is classified as an ordinary trust under § 301.7701-4(a) of the regulations. Because all of the Trust's income is excludable from gross income under § 115(1) of the Code, we rule that the Trust is not required by § 6012(a)(4) of the Code to file an annual income tax return.

The rulings contained in this letter are based upon information and representations submitted by or on behalf of the Trust and accompanied by a penalty of perjury statement executed by an individual with authority to bind the Trust and upon the understanding that there will be no material changes in the facts. 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. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2018-1, § 11.05.

This letter does not address the applicability of any section of the Code or its regulations to the facts submitted other than with respect to the sections specifically described, and, except as expressly provided in this letter, no opinion is expressed or implied concerning the tax consequences of any aspects of any transaction or item of income discussed or referenced in this letter.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3) of the Code, this ruling may not be used or cited as precedent.

Sincerely,

Mary J. Salins
Branch Chief
Exempt Organizations Branch 1
Office of Associate Chief Counsel
(Tax Exempt & Government Entities)

cc: