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PLR-102501-24

Date:
July 30, 2024

Taxpayer =
State =
Statute =
System Manager =

Dear :

This letter responds to a letter from your authorized representative, dated February 1, 2024, and subsequent correspondence requesting a ruling that Taxpayer’s income is excludable from gross income under section 115(1) of the Internal Revenue Code (Code),¹ and that Taxpayer is an instrumentality of State for purposes of section 170(c)(1) to which contributions are deductible to the extent otherwise allowed by section 170.

FACTS

Taxpayer is a corporation created by Statute under the laws of State. Statute provides that Taxpayer’s purpose is to create and manage a system for the public to gain electronic access to information required to be available to the public pursuant to State’s open records law. Accordingly, Taxpayer contracts with State agencies and political subdivisions which are required to provide access to certain public records and information. Statute provides that State considers Taxpayer to be an instrumentality of the state whose activities constitute the performance of an essential governmental function. Taxpayer’s bylaws limit the distribution of Taxpayer’s assets upon dissolution to another organization whose income is excluded from gross income under section

¹ Unless otherwise noted, all references in this letter ruling to “section” refer to the Internal Revenue Code of 1986, as amended.

115(1) for the performance of an essential governmental function or to State or a political subdivision of State.

Statute establishing Taxpayer provides that Taxpayer shall be governed by a nine-member board of directors and how it will be constituted. The directors include a statewide elected official, seven persons appointed directly by the governor of State, and one person, an employee of State selected by the governor, who serves *ex officio*. The majority of the members of the board are government officials representing governmental interests. Pursuant to Taxpayer's bylaws, the board annually elects three officers from among its own members. Taxpayer also has two employees, an Executive Director responsible for the overall management and oversight of Taxpayer's operations, including work performed by the System Manager, and a Chief Administrative Officer, who assists the Executive Director in the day-to-day operations of Taxpayer.

Taxpayer has adopted a conflict of interest policy that imposes a duty on its directors, officers, committee members, and employees. They are required to disclose any financial interest they have, directly or indirectly, such as through a business, investment or family member, in any entity with which Taxpayer has a transaction or arrangement, any compensation arrangement with Taxpayer or an entity or individual with which Taxpayer has a transaction or arrangement, or any potential ownership or investment interest in, or compensation arrangement with, any entity or individual with which Taxpayer is negotiating a transaction or arrangement. Each person subject to the conflict of interest policy must annually sign a statement that he or she has received a copy of the conflict of interest policy, has read and understands the policy, and has agreed to comply with the policy.

Under Statute, Taxpayer is required to hire an individual or entity to direct and supervise the day-to-day operations and expansion of a computer network to conduct Taxpayer's obligations and responsibilities. Taxpayer hired System Manager after soliciting bids for the contract through State's negotiated procurement process dictated by State law. The contract between Taxpayer and System Manager permits Taxpayer to terminate the contract and rebid it at any time with notice to System Manager. System Manager develops, in consultation with Taxpayer's staff, a detailed annual business plan, tracks all projects, and provides monthly reports to Taxpayer. No director, officer, committee member, or employee of Taxpayer is a director, officer, committee member, or employee of, or has a financial interest in or compensation agreement with, System Manager.

System Manager employs a project manager, web developer, designer, systems administrator, software engineers, and developers to implement projects approved by Taxpayer's board of directors and staffs a help desk for Taxpayer's customers. System Manager is also responsible for all aspects of managing the network, including acquisition, installation, operation, maintenance, and testing of all hardware, software,

and enhancements thereto, and the provision of backup, support, and network service to Taxpayer.

Statute requires that Taxpayer fund its operations from revenues and contributions and use its revenues solely in furtherance of Taxpayer's statutory purposes. Taxpayer earns income from fees paid by commercial, professional, and public users that pay fees to access public information supplied by State agencies, elected official offices, counties, the judicial branch, and other State entities. Fees for public records are set by the State legislature and/or the State agency that creates or maintains the public record. Taxpayer pays the State agencies and political subdivisions a portion of each fee as agreed to in the contract with the agency or political subdivision. Taxpayer reimburses itself any processing fee and then pays a portion of the remaining net revenue to System Manager and retains the rest. Taxpayer and System Manager have renegotiated the fee structures several times to address the different risks and costs inherent in the business at different points in time. Taxpayer is permitted to, and does, make grants only to State agencies and political subdivisions of State to enable the recipient to increase access to information and improve the quality of the information delivered.

RULINGS REQUESTED

1. Taxpayer's income is excludable from gross income under section 115(1) because all of Taxpayer's income is derived from its performance of an essential governmental function and accrues to a state or other political subdivision thereof.
2. Contributions to Taxpayer are deductible to the extent otherwise allowed by section 170, because Taxpayer is an instrumentality for purposes of section 170(c)(1).

LAW

Section 115(1) 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 thereof.

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

Section 170(c)(1) states that, for purposes of section 170, 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.

Revenue Ruling 57-128, 1957-1 C.B. 311, provides six factors to consider when determining whether an organization is a wholly owned instrumentality of one or more states or political subdivisions. The revenue ruling's factors are: (1) whether the organization is used for a governmental purpose and performs a governmental function; (2) whether performance of the organization's 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 involved have the powers and interests of an owner; (4) whether control and supervision of the organization is vested in public authority or authorities; (5) if express 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 the organization's operating expenses. Not all factors need be present to be an instrumentality within the purview of Revenue Ruling 57-128.

Revenue Ruling 75-359, 1975-2 C.B. 79, provides that a voluntary association of counties is separate from its member counties and qualifies as a wholly owned instrumentality of those counties, which are political subdivisions, and is formed and operated exclusively for the public purposes of the member counties. Therefore, the revenue ruling holds that contributions to the association are deductible as contributions for the use of political subdivisions, subject to the limitation of section 170(b)(1)(B).

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income generated by an investment fund that is established by a state to hold revenues in excess of the amounts needed to meet current expenses is excludable from gross income under section 115(1) because such investment constitutes an essential governmental function. The ruling states that the statutory exclusion is 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 entity engaged in the operation of a public utility or the performance of some governmental function that accrues to either a state or political subdivision of a state. The ruling explains 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 that are within the ambit of a sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds 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) because the organization is performing an essential governmental function. The revenue ruling states that the income of such an organization is excludable from gross income so long as private interests do not participate in the organization 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.

ANALYSIS

Ruling Request 1

Taxpayer was created under State law to facilitate public access to State public records required by State law to be made available to the public. Providing access to State public records is an essential governmental function. See Rev. Rul. 90-74 and Rev. Rul. 77-261.

Taxpayer's income accrues to political subdivisions of State. Taxpayer benefits private interests only incidentally. See Rev. Rul. 90-74. In no event will Taxpayer's assets be distributed or revert to any entity that is not a state, a political subdivision of a state, or another entity the income of which is excludable from its gross income by application of section 115(1). Upon dissolution, Taxpayer's bylaws provide that all assets are required to be distributed, or shall revert to, State, a political subdivision of State, or another entity the income of which is excludable from its gross income by application of section 115(1) that performs an essential governmental function.

Ruling Request 2

Section 170(c)(1) generally defines the term "charitable contribution," for purposes of section 170(a)(1), to include a contribution or gift to or for the use of a state or any political subdivision of a state, provided the contribution or gift is made for exclusively public purposes. Contributions to Taxpayer cannot constitute charitable contributions to a state or political subdivision of a state for purposes of section 170(c)(1), because Taxpayer is neither a state nor a political subdivision of a state. However, pursuant to Revenue Ruling 75-359, contributions to Taxpayer may constitute charitable contributions for the use of a state or political subdivisions of a state, if Taxpayer qualifies as a separate, wholly owned instrumentality of one or more political subdivisions of State. In that event, contributions to Taxpayer are deductible under section 170(a), subject to the limitation of section 170(b)(1)(B). A determination of whether Taxpayer is a wholly owned instrumentality of one or more political subdivisions of State is made by considering the factors set forth in Revenue Ruling 57-128.

Governmental Purpose and Function

The first factor under Revenue Ruling 57-128 is whether Taxpayer is used for a governmental purpose and performs a governmental function. Taxpayer was established by State to facilitate public access to State public records as required by State law.

Performance on Behalf of Political Subdivisions

The second factor under Revenue Ruling 57-128 is whether the performance of Taxpayer's function is on behalf of one or more states or political subdivisions.

Taxpayer was established pursuant to State Statute to facilitate public access to State public records. Taxpayer's board consists of nine members. One member is a statewide elected official. The remaining eight are appointed by the governor. The majority of the members represent governmental interests in operating Taxpayer. The statute governing Taxpayer requires it to carry out the services it provides to the State and its political subdivisions. Taxpayer is subject to State's open meetings and records laws.

Private Interests Involved.

The third factor under Revenue Ruling 57-128 is whether there are any private interests involved, or whether the state or political subdivisions involved have the powers and interests of an owner. Taxpayer's revenues accrue to State and may be deposited in the State treasury or may be maintained in a State bank or savings and loan association until expended pursuant to Statute. Taxpayer pays System Manager a fee for providing management and operating services for Taxpayer. These fees are paid pursuant to a contract that was negotiated under State's public bidding laws. Taxpayer and System Manager have renegotiated the fee structures several times to address the different risks and costs inherent in the business at different points in time. Moreover, System Manager is required to provide monthly reports to Taxpayer's board of directors regarding all planned and existing projects. Additionally, Taxpayer maintains a conflict of interest policy and requires its directors to file an annual statement stating that they understand and agree to comply with Taxpayer's conflict of interest policy. Upon dissolution, Taxpayer's bylaws provide that all assets are required to be distributed, or shall revert to, State, a political subdivision of State, or another entity the income of which is excludable from its gross income by application of section 115(1) that performs an essential governmental function.

Control and Supervision

The fourth factor under Revenue Ruling 57-128 is whether control and supervision of Taxpayer is vested in public authority or authorities. Pursuant to State law, Taxpayer's board of directors consists of nine members. One director is a statewide elected official. The remaining eight members are appointed by the governor. The majority of the members represent governmental interests and will always have control of Taxpayer's board of directors. Moreover, as an entity established by the State legislature, the Taxpayer inherently is accountable to the State legislature.

Statutory Authority

The fifth factor under Revenue Ruling 57-128 is whether express or implied statutory or other authority is necessary for the creation and use of Taxpayer and whether such authority exists. Taxpayer was established by State statute.

Financial Authority and Source of Operating Funds

The sixth factor under Revenue Ruling 57-128 is the degree of Taxpayer's financial autonomy and the source of its operating expenses. Taxpayer derives its funding from the fees it generates by providing access to State governmental records and information required to be available to the public pursuant to State's open records law. Although Taxpayer has its own source of revenue, State law directs that Taxpayer must use revenue from its activities solely in furtherance of its statutory purposes.

Taxpayer substantially satisfies the factors of Revenue Ruling 57-128. Consequently, we conclude that Taxpayer is an instrumentality of State.

RULINGS

Based on the information and representations submitted on behalf of Taxpayer, we rule that:

1. Taxpayer derives its income from the exercise of an essential governmental function, and because Taxpayer's income accrues to a state or a political subdivision of a state, Taxpayer's income is excludable from gross income under section 115(1).
2. Taxpayer is an instrumentality for purposes of section 170(c)(1). Thus, contributions to Taxpayer are deductible to the extent otherwise allowed by section 170.

The rulings contained in this letter are based on information and representations submitted by or on behalf of Taxpayer and accompanied by penalties of perjury statements executed by an appropriate party, and on the understanding that there will be no material changes in the facts described above. While this office has not verified any of the material submitted in support of the request for a ruling, the material is subject to verification upon 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. 2024-1, section 11.05.

This letter does not address the applicability of any section of the Code or 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 aspect of any transaction or item of income discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that this ruling 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.

A copy of this letter must be attached to any income tax return to which it is relevant. Taxpayer may satisfy this requirement by attaching a statement to its return that provides the date and control number of this letter ruling.

If you have any questions about this letter ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Matthew Giuliano
Branch Chief
Exempt Organizations Branch 1
(Employee Benefits, Exempt Organizations,
and Employment Taxes)

cc: