



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

OFFICE OF  
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE ADVICE

MEMORANDUM FOR  
DISTRICT COUNSEL

FROM: DEBORAH A. BUTLER  
ASSISTANT CHIEF COUNSEL (FIELD SERVICE)  
CC:DOM:FS

SUBJECT: Applicability of Section 131(b)(2)(A)

This advice responds to your memorandum dated December 9, 1998, and is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

ISSUES:

Whether operators of foster family homes may exclude from income payments for adult foster care recipients who are placed in the home by a private nonprofit "regional center." More specifically:

1. Whether a "regional center" funded pursuant to California state statutes is "an agency of a State or political subdivision thereof" for purposes of the definition of a "qualified foster individual" in I.R.C. § 131(b)(2)(A).
2. Whether adults placed in foster homes by a regional center are "qualified foster individuals" within the meaning of § 131(b)(2).

CONCLUSION:

The regional centers in question are private entities and not agencies of the State or a political subdivision of the State. Therefore, adults placed by regional centers in the homes of foster care providers are not “qualified foster individuals” within the meaning of I.R.C. § 131(b)(2). Accordingly, foster care providers may not exclude from income payments received for the foster care of these adults.

FACTS:

In 1969, the California legislature enacted the Lanterman Developmental Disabilities Act, Cal. Welf. & Inst. Code §§ 4500-4846 [“Lanterman Act,” or “the Act ”]. The legislature drafted the Lanterman Act to meet the lifetime needs of certain disabled persons, to prevent or minimize their institutionalization, and to enable them to live in a manner approximating that of non-disabled persons.

The California Department of Developmental Services [“DDS”] is responsible for executing the laws relating to the care, custody, and treatment of disabled persons covered by the California Code, including the provisions of the Lanterman Act. Cal. Welf. & Inst. Code § 4416. The Act provides that DDS “shall contract with appropriate agencies to provide fixed points of contact in the community for persons with developmental disabilities .... It is the further intent of the legislature that the design and activities of regional centers reflect a strong commitment to the delivery of direct service coordination ....” Lanterman Act, § 4620(a). The Act further provides expressly:

(b) The Legislature finds that the service provided to individuals and their families by the regional centers is of such a special and unique nature that it cannot be satisfactorily provided by state agencies. Therefore, private nonprofit community agencies shall be utilized by the state for the purpose of operating regional centers.

Lanterman Act, § 4620(b). [Emphasis added.]

Regional centers are State-licensed nonprofit corporations qualifying under § 501(c)(3) as exempt from tax under § 501(a). Cato v. Commissioner, 99 T.C. 633, 635 (1992). Although regional centers receive some funds from third parties, they receive their operating budgets from the State and operate under the supervision of the State. Id. at 635-36. As part of their services, the regional centers place developmentally disabled individuals in State-licensed foster care

facilities and pay the operators of foster care facilities a nonnegotiable, legislatively-mandated sum for caring for the foster individuals. Id.<sup>1</sup>

Operators of licensed foster care facilities contract with regional centers to provide foster care for developmentally disabled adults placed in their homes by the regional center. Questions have arisen whether amounts received from the regional centers are excludable from foster care providers' income under §131(a).

## LAW AND ANALYSIS

Issue 1: Whether a regional center is “an agency of a State or political subdivision thereof” for purposes of defining a “qualified foster individual.”

It appears that the California Legislature did not intend that regional centers be agencies of the State. The Lanterman Act expressly states that the Legislature “finds” that the work to be done regarding developmentally disabled persons cannot be done by state agencies, and thus “private non-profit community agencies” shall be used to operate the regional centers. Lanterman Act § 4620(b). Further, a California Attorney General’s opinion states that DDS has no authority to control the operations of regional centers. 62 Ops. Atty. Gen. 229 (Cal. May 5, 1979). Also, if a regional center is not operating effectively, DDS has the right to terminate the relationship and contract with a different regional center. Lanterman Act §§ 4635(c), (d). Therefore, regional centers are not agencies of a State.

Although the term “political subdivision” is not defined in the Code, it is cited in several Code sections, including § 131. In regulations covering state and local bond interest issued under I.R.C. § 103, the Secretary defines a political subdivision as “any division of any State or local government unit which is a municipal corporation or has been delegated the right to exercise part of the sovereign power of the unit.” Treas. Reg. § 1.103-1(b). [Emphasis added.]

Sovereign powers are generally recognized to be the police power, the power to tax, and the power of eminent domain. Texas Learning Technology Group v. Commissioner, 958 F.2d 122, 124 (5<sup>th</sup> Cir. 1992), aff’g 96 T.C. 686 (1991). Although the test is not a rigid one, an entity must have some sovereign power to be a political subdivision. Id. at 125. It is not sufficient that an entity performs a public service; the entity is not a subdivision of the state unless there have been

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<sup>1</sup>In Cato, the parties stipulated to both the legal status of regional centers and the placement/reimbursement mechanism. Lacking independent verification of the legal status of regional centers, we assume the stipulation in Cato to be factually accurate.

delegated to it some functions of local government. Seagrave Corporation v. Commissioner, 38 T.C. 247 (1962). See also Philadelphia National Bank v. United States, 666 F.2d 834, 839 (3d Cir. 1981), cert. denied, 457 U.S. 1105 (1982) (university was not a political subdivision because sovereign power had not been delegated); Old Colony Trust Co. v. United States, 438 F.2d 684 (1<sup>st</sup> Cir. 1971) (hospital was not a political subdivision because, inter alia, it did not exercise any sovereign power).

Regional centers lack the powers of police, taxation, and eminent domain. In actuality, although DDS has oversight responsibility over the regional centers and issues regulations, manuals, and procedural guidelines for them to follow, DDS contracts at arm's length with them. Furthermore, the regional centers receive nearly all their funding from DDS. Thus, the regional centers neither belong to the State nor have the ability to obtain funding through taxation.

In addition, the California Supreme Court has circumscribed the rights and duties of the State regarding the regional centers. Fearing a budget shortfall, DDS ordered the regional centers to make sweeping reductions in services without regard to the previously determined needs of individual clients. The court found that under California statutes, the regional centers, not DDS, had authority to determine the services needed for each client and that, under the Lanterman Act, DDS had no authority to make determinations regarding the manner in which regional centers provide services. Association of Retarded Citizens v. Department of Developmental Services, 38 Cal. 3d 384, 696 P.2d 150 (Cal. 1985). This case further proves that the regional centers are neither agencies of the State nor political subdivisions thereof.

The Tax Court already has adjudicated a case involving contractual placement of adult foster individuals by a § 501(c)(3) entity. Micorescu v. Commissioner, T.C. Memo. 1998-398. In Micorescu, a § 501(c)(3) agency, ElderPlace, contracted with the State of Oregon to provide services to certain adult individuals. ElderPlace then contracted with foster care providers to provide the actual care of those adults. The Tax Court concluded that adults enrolled in the ElderPlace program were not placed by an agency of a State or political subdivision thereof. We believe that a court will arrive at the same finding in cases involving California's regional centers.

Issue 2: Whether adults placed in foster homes by regional centers are “qualified foster individuals” within the meaning of § 131(b)(2).

The Internal Revenue Code provides that gross income shall not include amounts received during the year as “qualified foster care payments.” I.R.C. § 131(a). Qualified foster care payments are defined in pertinent part by the statute as:

... any amount—

- (A) which is paid by a State or political subdivision thereof or by a placement agency which is described in section 501(c)(3) and exempt from tax under section 501(a), and
- (B) which is–
  - (i) paid to the foster care provider for caring for a qualified foster individual in the foster care provider’s home ....

I.R.C. § 131(b)(1). [Emphasis added.]

The statute further defines a “qualified foster individual” as:

- ... any individual who is living in a foster family home in which such individual was placed by–
- (A) an agency of a state or political subdivision thereof, or
  - (B) in the case of an individual who has not attained age 19, an organization which is licensed by a State (or political subdivision thereof) as a placement agency and which is described in section 501(c)(3) as exempt from tax under section 501(a).

I.R.C. § 131(b)(2). [Emphasis added.]

The language of § 131(b)(2)(B) clearly limits placement of qualified foster individuals by a section 501(c)(3) organization to children under the age of 19. Thus, while a child may be a qualified foster individual if the child is placed in a home by either (1) a State or local government agency or (2) a section 501(c)(3) agency, an adult cannot be a qualified foster individual unless the adult is placed by an agency of the State or a political subdivision thereof. Therefore, qualified foster payments do not include payments for adults placed in foster homes by section 501(c)(3) organizations. Micorescu, T.C. Memo. 1998-398.

In the situations in question, adults are placed in the foster homes by the regional centers. Because these foster care individuals are adults, they must be placed in the foster care providers’ homes by an agency of the State or its political subdivision thereof in order to be qualified foster individuals under § 131(b)(2). The regional centers are not agencies of the State or one of its political subdivisions. Therefore, the foster individuals in the foster care providers’ homes are not qualified foster individuals, and the payments for their care are not qualified foster care payments under § 131(b)(1). Accordingly, foster care providers in these instances may not exclude from income payments received for providing foster care for adults placed in their homes by the regional centers.

Please call if you have any further questions.

By: \_\_\_\_\_  
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cc: