

PART I

EXEMPT ORGANIZATIONS TECHNICAL TOPICS

A. UPDATE ON STATE INSTITUTIONS - INSTRUMENTALITIES

by

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1. Introduction

Organizations such as state colleges, fire departments, libraries, school districts, hospital districts, soil and water conservation districts, port authorities, and Indian related entities, are some examples of organizations that may be created by, controlled by, or closely affiliated with governments. Many of these organizations file applications for exemption. For the purposes of this article, these government affiliated organizations will be referred to as instrumentalities.

IRM 7664.31(2) has been revised so exemption applications filed by instrumentalities are now being processed by the Key District Offices. Only those applications submitted by instrumentalities where an adverse determination is contemplated are referred to Headquarters.

Specific information on handling instrumentality exemption applications can be found in IRM 7751-34(12), Exempt Organizations Handbook, the 1990 CPE text under the heading of Instrumentalities, and the 1996 CPE text under the heading of State Institutions-Instrumentalities. Basically, if an instrumentality is a separately organized entity, not an integral part of a state or municipal government, and does not possess a disqualifying regulatory or enforcement power, we can recognize it as exempt from federal income tax under IRC 501(a) as an organization described in IRC 501(c)(3).

There have been a few recent developments dealing with instrumentalities that require the referenced materials to be updated. That is the purpose of this article. We are also updating IRM 7751-34(12).

2. Recent Developments

A. Power of Taxation - The 1996 CPE article stated that Headquarters was considering several cases involving the power of taxation, including how to distinguish a power to merely recommend a tax rate from the power to levy, assess or impose taxes, and that additional guidance would be provided in this area.

At issue is whether there is a difference between a power to recommend or certify a tax rate and a power to levy, assess, or impose a tax in terms of the latter powers being disqualifying for purposes of being considered an organization with purposes limited to those within IRC 501(c)(3). Rev. Rul. 74-15, 1974-1 C.B. 126, held that it is okay to certify or determine a tax rate. We have concluded that there is no distinction between the power to recommend or certify a tax rate, the power to determine a tax rate, and the power to levy, assess, or impose a tax, but that the regulatory or enforcement power lies with the power to collect. Thus, if an organization has the power to collect the tax, it will be disqualified from being recognized as exempt.

B. Rev. Proc. 95-48, 1995-47 I.R.B. 13 - One of the requirements for an organization that is recognized as exempt from federal income tax is the requirement to file an annual information return on Form 990, Return of Organization Exempt From Income Tax. Rev. Proc. 95-48, published in November, 1995, relieves most instrumentalities of that filing requirement. This revenue procedure supplements Rev. Proc. 83-23, 1983-1 C.B. 687, and specifies two additional classes of organizations that are not required to file the annual information return. These two classes are (1) governmental units, and (2) affiliates of governmental units that are exempt from federal income tax under IRC 501(a).

The majority of cases under this revenue procedure will involve "affiliates of governmental units." For most of these organizations to be treated as an "affiliate of a governmental unit" and be excepted from filing the annual information return on Form 990, the following two requirements must be satisfied:

First, the organization must be controlled by a governmental unit. This means that a governmental unit (or a public official acting in his official capacity) must appoint the majority of the members of the organization's governing body. A governing body elected by the public also satisfies this requirement. For purposes of this control test, a governmental unit is a state, a possession of the United States, or a political subdivision of one of them; the

United States; the District of Columbia; or a federally recognized Indian tribal government. Indirect control also satisfies this requirement. Thus, an organization controlled by an organization that is itself a qualifying "affiliate of a governmental unit" under the revenue procedure also qualifies.

Second, the organization must satisfy two of the five affiliation factors listed in the revenue procedure indicating actual oversight of its financial affairs and activities by the governmental unit.

At the time it files its application for recognition of exemption under IRC 501(a), an organization may request a determination that it meets the requirements to be excepted from filing Form 990.

An organization that has been recognized as exempt under IRC 501(a) may (but is not required to) request a ruling or determination that it meets the requirements to be excepted from filing Form 990. Requests to be excepted from filing Form 990 that are processed by Headquarters require a \$200.00 user fee. Requests to be excepted from filing Form 990 that are processed by the Key District Offices currently require no fee. See Rev. Proc. 96-8, 1996-1 I.R.B. 187 (or its successor).

3. Closing Remarks

The materials on instrumentalities referred to in this update contain adequate information for handling most instrumentality exemption applications. As stated previously, except for cases where an adverse determination is contemplated, these exemption applications are now being processed by the Key District Offices. For those adverse cases referred to Headquarters that present unique issues, further guidance will be developed as needed.