



Federal Tax Treatment of States, Political Subdivisions and Their Affiliates

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Understanding these categories and treatment of contributions to them provides an important context for SALT workaround debate.

- ▶ We have a crazy quilt of inconsistent rules.
 - ▶ State or Political Subdivisions (and Their Integral Parts)
 - ▶ Section 115(1) Entities
 - ▶ Charitable Contribution Deduction under Section 170(c)(1)
 - ▶ Governmental Charities



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GOVERNMENTS AND GOVERNMENTAL AFFILIATES – BASIC CATEGORIES

TYPE – FILING REQUIREMENTS – CHARITABLE CONTRIBUTION % LIMIT	BASIS FOR EXCLUSION – SOME OF THE KEY AUTHORITIES	CHARACTERISTICS - REQUIREMENTS
<p>State or political subdivision</p> <p>No filing requirement. Rev. Rul. 78-316 50% charity under sec. 170(b)(1)(A)(v)</p>	<p>Implied statutory immunity; no provision taxes such entities (except sec. 511(a)(2)(B)); see reg. sec. 1.103-1(b); Estate of Shamberg, 3 T.C. 131 (1944); Rev. Rul. 71-131; Rev. Rul. 71-132; Rev. Rul. 77-164; Rev. Rul. 87-2; <i>cf.</i> Michigan v. U.S., 40 F.3d 817 (6th Cir. 1994).</p>	<p>Some of the sovereign powers per sec. 103 regulations: taxation, eminent domain, police power.</p>
<p>Integral part of state or political subdivision</p> <p>Generally no filing requirement, Rev. Rul. 78-316. 50% /60% charity under sec. 170(b)(1)(A)(v).</p>	<p>Rev. Rul. 87-2; reg. sec. 301.7701-1(a)(3) and (2)(b)(1) and (6); <i>cf.</i> Maryland Savings-Share Insurance Corp. v. United States, 308 F. Sup. 761 (D. Md. 1970); Michigan v. U.S., <i>supra</i>.</p>	<p>Control or substantial involvement by government officers; financial commitment from state or political subdivision.</p>
<p>Section 115 entities</p> <p>Must file Form 1120. Rev. Rul. 77-261.</p> <p>30% charity under sec. 170(b)(1)(B) as for the use of a governmental unit,</p>	<p>Sec. 115; Rev. Rul. 90-70; Rev. Rul. 90-74; Rev. Rul. 77-261; <i>cf.</i> Omaha Public Power District v. O'Malley, 232 F.2d 805 (8th Cir. 1956); Maryland Savings-Share Insurance Corp, <i>supra</i>.</p>	<p>Must be treated as separately organized from state or political subdivision; save or make money for state or political subdivision; assets must revert to state or political subdivision upon dissolution; no substantial private benefit.</p>
<p>Instrumentality (needed for deductibility of contributions to section 115 entities)</p> <p>Must file Form 1120. Rev. Rul. 77-261.</p> <p>30% charity under sec. 170(b)(1)(B) as for the use of a governmental unit</p>	<p>Sec. 3121(b)(7)(F); sec. 3306(c)(7); sec. 414(d); Rev. Rul. 57- 128.</p> <p>Note: Not itself a basis for exemption from tax.</p>	<p>Factors include whether used for governmental purposes and performs a governmental function; whether it functions on behalf of states or political subdivisions; whether private interests are involved; whether controlled and supervised by public authority; whether express or implied statutory authority to create; degree of financial authority and source of operating expenses.</p>
<p>Section 501 (c)(3) organization</p> <p>Usually 50% charity under sec. 170(b)(1)(A) as publicly supported or as supporting organization of a government unit.</p> <p>Exempt from filing Form 990. Rev. Proc. 95-48, not subject to intermediate sanctions, can voluntarily relinquish exempt status.</p>	<p>Sec. 501(c)(3); Rev. Rul. 74-15; Rev. Rul. 60-384. 4958 regulations, Rev. Proc. 2018-5.</p> <p>Reasons for seeking such exemption: easier to attract donations; easier to obtain preferential mailing rates; eligibility for property tax exemption; eligibility for 403(b) annuities.</p>	<p>Must be treated as separately organized; must be clear counterpart of a charitable, religious or similar organization (i.e. not be political subdivision with sovereign powers).</p>

Tests for Qualifying as State or Political Subdivision

- ▶ Implied statutory immunity (not constitutional intergovernmental immunity)
 - ▶ Applicable GCM and revenue rulings are cryptic at best.
- ▶ Must have sovereign powers per sec. 103
 - ▶ Tax
 - ▶ Eminent Domain
 - ▶ Police power
- ▶ Not need to have all, but these powers cannot be insubstantial.
 - ▶ E.g., revenue rulings where toll road authorities have no power to tax



Tests for Qualifying as Integral Part of State or Political Subdivision

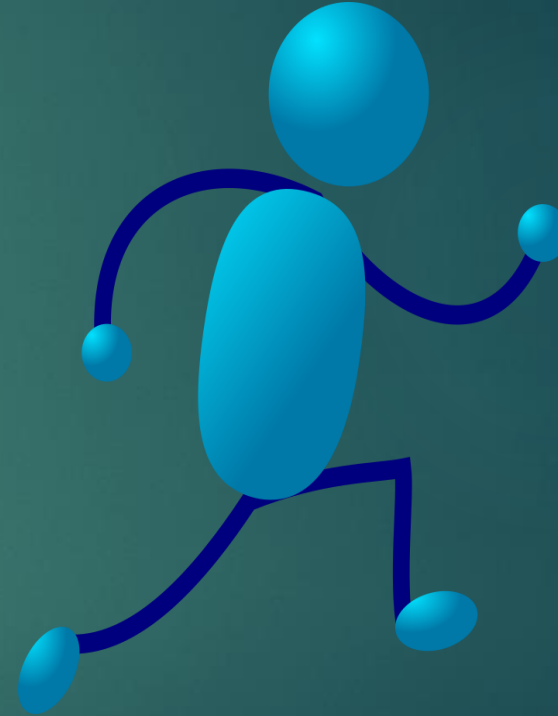
- ▶ Controlled by government officers
 - ▶ Historically most important
- ▶ Not independently organized
- ▶ Degree of financial commitment
 - ▶ Has become quite important
- ▶ Revenue rulings and private rulings inconsistent re all these factors



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Qualification under little known Section 115(1)

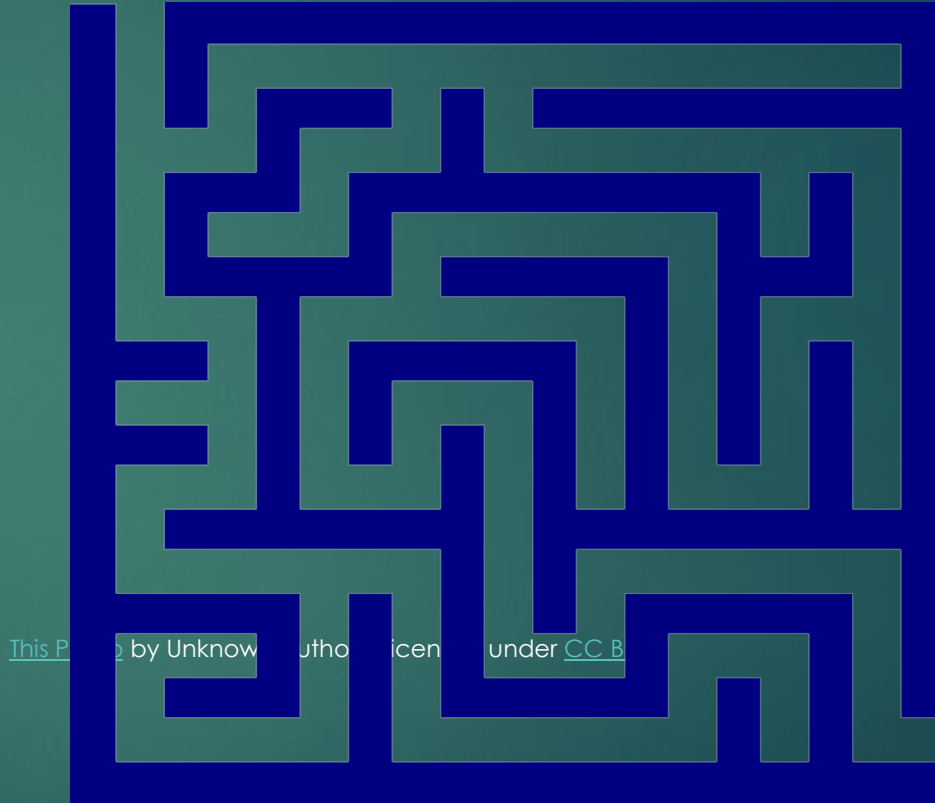
- ▶ Sec. 115(1) excludes income derived from “exercise of any essential governmental function” and
- ▶ “accruing to a State or political subdivision.”
- ▶ Must be entity separate from state or political subdivision.
 - ▶ If not, test as integral part.
 - ▶ Application of this test is inconsistent.
- ▶ Revenue rulings and many private letter rulings involve consortia of liability and investment pools.



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IRS interprets statutory requirements under section 115(1) loosely.

- ▶ Essential function – anything that makes or saves money
- ▶ Accrue – assets upon dissolution go to state or political subdivisions
- ▶ Much more generous than court decisions
- ▶ But IRS has added requirement of no incidental private benefit



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Sec. 170(c)(1): Charitable contribution deduction

- ▶ Applies to contributions to or for the use of states and political subdivisions.
- ▶ As we will see, tests for “to” and “for use of” very different.
- ▶ But only if for “exclusively public purposes.”



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Sec. 170(c)(1) deduction for contributions TO states or their political subdivisions

- ▶ Donations TO states or political subdivisions qualify for 50% or 60% (currently for cash) AGI limit.
- ▶ Revenue Rulings and private letter rulings re such donations
 - ▶ Pay little attention to what is and isn't a public purpose.
 - ▶ Focus on extent of private benefit.



More elaborate sec. 170(c)(1) test applied to section 115(1) entities as FOR USE OF

- ▶ 30% charity because “for use of”
- ▶ PLRs apply Rev. Rul. 57-128 tests for instrumentality
 - ▶ Government purpose and function
 - ▶ Function on behalf of state or political subdivision
 - ▶ Involvement of private interest vs government with power and interest as owner
 - ▶ Control and supervision in public authorities
 - ▶ Express or implied statutory authority
 - ▶ Degree of financial authority, source of operating expenses



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These sec. 115 deductibility tests bear no resemblance to sec. 115 qualification tests.

- ▶ This sec. 170 test requires judgment as to governmental purpose, function.
 - ▶ Supreme Court long ago abandoned this effort
 - ▶ Unlike sec. 115 bizarre qualification test of make or save money
- ▶ State interests as owner more precise than “incidental benefit requirement” for sec. 115 qualification.
- ▶ Deductibility tests for sec. 115 resemble tests for integral part.
- ▶ Note that no precedential authority



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Affiliates of governments can also qualify under section 501(c)(3).

- ▶ If so, contributions deductible under familiar sec. 170(c)(2).
- ▶ Revenue Rulings so recognizing go back to 1950's and 1960's.
- ▶ Applicant must be treated as separate entity.
 - ▶ But IRS both generous and inconsistent re whether separate.
- ▶ Must lack sovereign powers
 - ▶ Substantial sovereign powers disqualify from 501(c)(3) status.
 - ▶ But power of eminent domain OK.
- ▶ Many public universities get c-3 rulings.



Governmental charities get special treatment under section 501 (c) (3).

- ▶ No Annual Information Return on Form 990.
- ▶ No intermediate sanctions under section 4958.
- ▶ Ability to voluntarily relinquish exempt status.
- ▶ A strange hybrid – a platypus of the tax world, with seemingly contradictory features.



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Pre-TCJA, IRS determination letter was key motivation for getting 501(c)(3) status.

- ▶ Donors, especially foundations, want to see IRS determination letter re deductibility under section 170.
- ▶ Once SALT workarounds resolved, I suggest giving determination letters under section 170(c)(1).
- ▶ Such determination letters would avoid current distortion of rules otherwise generally applicable to section 501(c)(3) organizations that results from need for special treatment of governmental charities.



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