

If an entity is “governmental,” how does it get tax exemption under IRC 115(1)?

An IRS letter ruling is generally used to get a determination that an organization is exempt under I.R.C. 115.

When organizing as a nonprofit corporation, an organization seeking exemption under I.R.C. 115 should have dissolution provisions in the articles of incorporation that reference I.R.C. 115. See this example from the I.R.S.

.03 Organization C is exempt from federal income tax under §501(a) as an organization described in §501(c)(3). Upon dissolution, Organization C's remaining assets will be distributed by operation of the law of Organization C's state of incorporation to a political subdivision of the state for a public purpose. Organization C requests a letter ruling that its income is excluded from gross income under §115(1). Although state law provides a dissolution distribution scheme that meets the organizational test of Treas. Reg. §1.501(c)(3)-1(b)(4), the state's dissolution provision fails to satisfy the accrual test of §115(1) for purposes of obtaining a §115(1) letter ruling. In these circumstances, a favorable ruling on §115(1) would not be issued. To receive a favorable §115(1) letter ruling, Organization C must have articles of organization that contain a provision satisfying the distribution of assets upon dissolution requirement for the §115(1) accrual test. Rev. Proc. 2003-12, 2003-4 I.R.B. 316

Helpful Sources

Guthry, Peter. Dealing with government related entities—A brave new world. ALI-ABA CLE (1991)

Aprill, Ellen P. The Integral, the essential and the instrumental: Federal Income tax treatment of governmental affiliates, 23 J. Corp. L. 803 (1998)

McCray, Richard A. Sr. and Marvin Fridlander, “Organizations closely affiliated with state or Indian tribal governments reference guide”, IRS Exempt Organizations CPE TIP FY 2004

Internal Revenue Service Exempt Organizations Continuing Professional Education (CPE) Technical Instruction Program FY 2004

Organizations Closely Affiliated with State or Indian Tribal Governments Reference Guide

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Guide sheet for section 501(c)(3) organizations closely affiliated with state or Indian tribal governments.

Instructions—This guide sheet is designed to assist in the processing of an IRC 501(c)(3) exemption application submitted by an organization that is closely affiliated with state government (including federally recognized Indian tribal governments). See the Reference Guide for assistance in completing this guide sheet. Contact EO Technical for additional help.

Yes/ No

1. Is the applicant a corporation, association, or trust? (A Yes response is favorable. A No response indicates that a problem exists.)
2. Does the organization meet the organizational test? (A Yes response is favorable. A No response indicates that a problem exists.)
3. Is the organization a wholly owned integral part of a State or local government? (A Yes response indicates that a problem exists. A No response is favorable.)
4. Is the organization a federally recognized Indian tribal government or a political subdivision of a federally recognized Indian tribal government? (A Yes response indicates that a problem exists. A No response is favorable.)
5. Does the organization have substantial regulatory or enforcement powers (sovereign powers)? (A Yes response indicates that a problem exists. A "No" response is favorable.)
If Yes, are they regulatory or enforcement powers that are specifically excepted from disqualifying an organization under IRC 501(c)(3)?
 - Determining a tax rate (Rev. Rul. 74-15)
 - Conducting campus policing (Rev. Rul. 177-165)(A Yes response is favorable. A No response indicates that a problem exists.)
6. Has the organization requested an exception from the Form 990 filing requirement under Rev. Proc. 98-45? If Yes, continue.

7. Has the organization requested an exception from filing Form 990 because it is a governmental unit under Section 4.01 of Rev. Proc. 95-48 or because it is an affiliate of a governmental unit under either Section 4.02(a) or Section 4.02(b) of Rev. Proc. 95-48? (If Yes, must meet a, b, or c below.)
 - a. Does the organization meet Section 4.01 because it is a governmental unit (1) as defined in Reg. 1.103-1(b), (2) an organization described in IRC 170(c)(1), or (3) an Indian tribal government or a political subdivision of an Indian tribal government under IRC 7701(a)(40) and 7871?
 - b. Does the organization meet Section 4.02(a) because it possesses a ruling or determination from the Service that (1) its income is excluded from gross income under IRC 115, (2) it is entitled to receive deductible contributions under IRC 170(c)(1), or (3) it is a wholly owned instrumentality of a state or political subdivision of a state for employment tax purposes under sections 3121(b)(7) and 3306(c)(7)?
 - c. Does the organization meet Section 4.02(b) because (1) the organization is controlled by a governmental unit, (2) it satisfies at least two of the five affiliation factors listed in Section 4.03, and (3) its filing of Form 990 is not otherwise necessary for efficient tax administration.