MSRB Provides New Resource for EMMA Users Interested in 529 College Savings Plan Information.

The Municipal Securities Rulemaking Board (MSRB) has enhanced its MyEMMA service to allow users to sign up for alerts about 529 college savings plans. The alerts notify users when new information about a 529 plan becomes available on EMMA, such as the posting of a new plan disclosure document. The MSRB provides information on EMMA about the essential terms of 529 plans, including investment options, fees and expenses, and any state tax benefits.

Explore 529 college savings plan information on EMMA: http://emma.msrb.org/Search/Plan529.aspx

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Project Management Agency Requests Guidance on Low-Income Housing Tax Credit.

John Lamey Jr. of the Atlantic County Improvement Authority has written to the IRS and Treasury to express support for guidance that would clarify what happens when an existing low-income housing tax credit property that was previously allocated 9 percent credits is rehabilitated following a natural disaster or casualty loss.

September 19, 2013

Ms. Lee A. Kelley

Deputy Tax Legislative Counsel

Department of the U.S. Treasury

1500 Pennsylvania Avenue, N.W.

Washington, D.C. 20220

lee.kelley@treasury.gov

Mr. Paul F. Handleman

Branch Chief, 5 (CC:PSI:5)

Internal Revenue Service

Room 5111

1111 Constitution Avenue, NW

Washington, DC 20224

paul.f.handleman@irscounsel.treas.gov

RE: Guidance to preserve 9% LIHTC buildings damaged by disasters or casualties

Dear Ms. Kelley and Mr. Handleman,

The Atlantic County Improvement Authority is a body corporate and politic of the State of New Jersey authorized to issue to sell private activity tax-exempt revenue bonds under Internal Revenue Code Section 142 allocated from the State of New Jersey's volume cap. We are enabled under New Jersey law to lend the proceeds of such bond issues to qualified low- and moderate income rental housing projects in conjunction with allocations of 4% LIHTCs equity financing, both for new construction and rehabilitation.

We understand Treasury is considering guidance clarifying what happens in situations where an existing LIHTC property previously allocated 9% credits is rehabilitated following a natural disaster or casualty loss. The rules will clarify that the existing property retains the 9% credit and the rehabilitation can qualify as "New Property" under Internal Revenue Code section 42(e) and be eligible for allocations of tax exempt volume cap bond financing and the 4% credit.

We strongly support the publication of this guidance. It is common sense tax administrative guidance that will be an important tool for state housing agencies, state housing bond issuers, owners and investors in applicable circumstances for maintaining and rehabilitating the stock of low income rental housing in New Jersey and throughout the United States.

The Authority respectfully urges the immediate publication of the requested guidance, which is badly needed now because many months have passed since the impacts of Hurricane Sandy have dealt a serious setback to New Jersey's affordable housing stock, a significant portion of which continues to need restoration. There are projects that could be rehabilitated now by bond and credit financings structured pursuant to the policy and technical parameters of the proposed guidance.

Sincerely.

John C. Lamey, Jr.

Executive Director

Atlantic County Improvement

Authority

Mays Landing, NJ

Mark J. Mazur,

Assistant Secretary (Tax Policy),

U.S. Treasury

Representative Frank LoBiondo,

Congressman

Change to Tax Exemption for Nonprofit Bonds Would Hurt the Economy.

Federal proposals to curb or eliminate tax exemption for bonds used by nonprofits would result in losses in employment, gross domestic product and labor income, according to a report released Wednesday.

IHS Global Inc. prepared the report for the National Association of Health and Educational Facilities Finance Authorities.

The study analyzed the economic impacts of capping the value of the tax exemption for bonds used by nonprofits at 28%, as President Obama proposed in his fiscal year 2014 budget. It also looked at the impacts from completely eliminating the tax-exemption.

The reform proposals would increase borrowing costs, making it harder for nonprofits to fund capital projects. Most nonprofit bonds are used to finance health care and education projects, such as hospital, university and private-school facilities.

“Thousands of hospitals, clinics, colleges, job centers and boys and girls clubs throughout the United States depend on tax-exempt bonds to access capital. Often, particularly in smaller communities, these nonprofits are the largest employers in the area and engines for economic growth.” Pamela Lenane, NAHEFFA president and the Illinois Finance Authority’s vice president and acting general counsel, said in a release. “This study demonstrates in national terms the enormous economic burdens and job loss that will be suffered by charities and hundreds of thousands of others if the tax exemption is curtailed or eliminated.”

The analysis assumes that the 28% cap would result in a decrease in capital spending by nonprofits of $5.8 billion per year. Eliminating tax-exemption would lead to a drop in capital spending of $16.6 billion per year.

These figures are average amounts based on data from the last 10 years.

Capping the value of tax exemption on nonprofit bonds at 28% would cut the GDP by about $8.3 billion, cost the United States about 105,000 jobs and cost the country about $5.5 million in labor income each year, the report found.

Eliminating tax-exemption for nonprofit, also called 501(c)(3), bonds would cut the GDP by about $23.6 billion, cost the country almost 300,000 jobs and cost the U.S. about $15.6 billion in labor income annually, the report said.

The report also looked at how changes to tax-exempt financing for nonprofits would impact employment across economic sectors.

Curbing or eliminating tax exemption would cost the construction sector the most number of jobs, followed by professional and business services, the trade, transportation and utilities sector and manufacturing, according to the paper.

Employment in the construction sector has the largest direct benefits from the current tax-exemption. The professional and business services and manufacturing sectors have the most jobs

associated with indirect benefits of tax exemption. Indirect effects are generated when construction companies make purchases for bond-financed projects from suppliers.

The trade, transportation and utilities sector and the education and health services sector have the most number of jobs associated with the economic stimulus stemming from using the proceeds of tax-exempt bonds to construct facilities.

BY NAOMI JAGODA

IRS Seeking Applications for Vacancies on the Advisory Committee on Tax Exempt and Government Entities.

This is a reminder that the Internal Revenue Service is seeking applications for vacancies on the Advisory Committee on Tax Exempt and Government Entities (ACT).

Applications will be accepted through Nov. 4, 2013.

Apply at: http://www.irs.gov/pub/irs-pdf/f12339c.pdf

A notice published in the Federal Register, dated Oct. 1, 2013, contains more details about the ACT and the application process. http://www.gpo.gov/fdsys/pkg/FR-2013-10-01/html/2013-23993.htm

More information about ACT is available at:

http://www.irs.gov/Government-Entities/Advisory-Committee-on-Tax-Exempt-and-Government-Entities-(ACT)

IRS LTR: Change in Accounting Method Won't Jeopardize Cooperative's Exemption.

The IRS ruled a rural electric cooperative can retire former members' capital credit accounts by offsetting the amounts of their accounts against outstanding debt owed for electric services without adversely impacting its tax-exempt status.

UIL: 501.12-03

Release Date: 10/4/2013

Date: May 30, 2013

Dear * * *

We have considered your ruling request regarding the tax consequences relating to the proposed change of methodology for the retiring all, or portion, of your former members' capital credit accounts, described below.

You were created on Date as a cooperative under the laws of State and have qualified as a cooperative electric company under I.R.C. § 501(c)(12) since that time. Your members elect the

board of directors on a one member, one vote basis.

Pursuant to Article VII, Section 2 of your bylaws, you are obligated to account on a patronage basis to all your members for all amounts received and receivable from electric services in excess of operating costs and expenses properly chargeable against the furnishing of such services. Such excess of revenue over expenses is allocated each year to each member in an equity ownership account which you call a capital credit account in proportion to the amount of the member's electrical usage. The amounts allocated to the capital credit accounts are paid out to the members when the Board determines that you are financially able and in retirement of the capital credit accounts to the extent a payment is made. Payments are only made when it is possible to do so and not violate the requirements of your bylaws to keep reserves for operations and maintenance, debt repayment requirements, working capital, and other specified requirements.

A large number of your former members have outstanding balances due on their accounts for electric services. At this time, and pursuant to Article VII, Section 2 of your bylaws, you offset any outstanding balance with the amount of the former member's capital credit account that is scheduled to be retired in that year. In addition, pursuant to Board policy, a former member's capital credit account is fully retired by offset against any outstanding balance due for non-payment for electric services or by payout (or both) after the member has been a former member for seven years.

You would like to change your current policies so that you do not wait for seven years to fully retire a former member's capital account balance if that former member has an outstanding balance from non-payment for electric services. You would like to use the outstanding balance in the former member's capital credit account to offset any outstanding account balance for non-payment for electric services at the end of fiscal year Year and periodically thereafter.

After the offset occurs, you would retire the former member's capital credit account in accordance with its normal retirement schedule if there is a residual balance in the capital credit account. In addition, you would cease all collection activities with respect to the former member's debt to you. If the former member later pays you amounts in excess of any debt remaining in their account, you will return that payment to the former member. The offset to the former member's outstanding bill would be made at the full amount of the capital credit amount retired. No discount will apply.

You request the following ruling:

The revised method for retiring former members' capital credit accounts by offsetting the amounts of their capital credit accounts against outstanding debt they owe to you for provision of electric services on an accelerated basis will not adversely affect your tax-exempt status as a rural electric cooperative under I.R.C. § 501(c)(12).

LAW

Section 501(c)(12)(A) of the Code provides for the exemption from federal income tax of benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations, but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

Rev. Rul. 72-36, 1972-1 C.B. 151, describes certain basic characteristics an organization must have in order to be a cooperative organization described in § 501(c)(12)(A) of the Code. These characteristics include the following: A cooperative must keep adequate records of each member's rights and interest in the assets of the organization. A cooperative must not retain more funds than it

needs to meet current losses and expenses. The rights and interests of members in the organization's savings must be determined in proportion to their business with the organization. A member's rights and interests may not be forfeited upon the withdrawal or termination of membership. Upon dissolution, gains from the liquidation of assets should be distributed to all current and former members in proportion to the value or quantity of business that each did with the cooperative over the years.

The ruling also addresses a situation involving forfeiture of a former member's rights and interests where the bylaws provide for such action upon withdrawal from the cooperative or termination. It states that even if forfeiture is permitted by the bylaws, the organization has not operated on a cooperative basis and should not be recognized as tax-exempt.

In Puget Sound Plywood, Inc. v. Commissioner, 44 T.C. 305 (1965), acq. 1966-1 C.B. 3, the court stated that an organization must meet certain common law requirements in order to be a cooperative. These common law requirements include: democratic control of the organization by members, the organization operates at cost for the benefit of members, and the contributors of capital to the organization do not control or receive most of the pecuniary benefits of the organization's operations (i.e. subordination of capital).

DISCUSSION

Section 501(c)(12) of the Code provides for the federal tax exemption of cooperative telephone companies or like organizations, including other cooperative organizations not relevant here. While the term "cooperative" is not defined in I.R.C. § 501(c)(12) or the regulations thereunder, a cooperative has been traditionally and historically defined as a voluntary, membership business organization that is organized in response to the economic needs of and to perform services for its members, and not to realize monetary gains as a separate legal entity. A cooperative is organized and operated for the benefit of and is democratically controlled by its members. See Puget Sound Plywood v. Commissioner, 44 T.C. 305 (1965), acq. 1966-1 C.B. 3. Hence, to qualify for exemption under I.R.C. § 501(c)(12), an organization must be a cooperative and organize and operate as such. Puget Sound Plywood v. Commissioner describes the principles that are fundamental to the organization and operation of cooperatives. They are: (1) democratic control by the members, (2) operation at cost, and (3) subordination of capital. These principles apply to organizations described in I.R.C. § 501(c)(12).

Democratic control requires that the cooperative be governed by members and on a one-member, one-vote basis. Each member has a single vote regardless of the amount of business he or she does with the organization. The issue of democratic control is a question of fact.

Operation at cost requires that the cooperative's net earnings or savings derived from furnishing services in excess of costs and expenses be returned to its members in proportion to the amount of business conducted with them. This principle ensures that a cooperative's net savings from members are returned to members in proportion to the amount of business each transacts with the cooperative. A cooperative satisfies this requirement by making annual allocations of patronage to members.

Subordination of capital has two requirements. First, control of the cooperative and ownership of the pecuniary benefits arising from the cooperative's business remains in the hands of the members rather than with non-patron equity investors. Second, the returns on equity investments must be limited. Hence, the net savings that accrue to the cooperative from the business activities it transacts with its members will largely inure to the benefit of those members rather than to its equity investors. The rationale for these limitations is to ensure that the cooperative remains faithful

to its purpose — providing services at the lowest possible prices (or highest possible prices for a marketing cooperative) to its members and not to realize profits for capital. If it were otherwise, the emphasis then would likely be on protection of returns of equity capital rather than services to members, and this would destroy the basic purpose of cooperatives. See Puget Sound Plywood v. Commissioner, Inc., 44T.C. 305 (1965), acq. 1966-1 C.B. 3.

Rev. Rul. 72-36, supra, describes additional fundamental requirements for operation of cooperatives described in IRC. § 501(c)(12). It requires that a member's rights and interest in the assets of a cooperative cannot be forfeited upon termination of membership. It also requires that upon dissolution, a cooperative must distribute any gains from the sales of its assets to those who were members during the period that the assets were owned.

A fundamental tenet of cooperative operation is that the earnings of a cooperative are allocated and ultimately distributed to its members based on the amount of business (patronage) done with those members. The amount a cooperative member pays for the cooperative's services less the cost of providing such services is allocated to the member. Thus, the presumption is that the cooperative's services are provided at cost to the members. But it is impractical for such a cooperative to return immediately all the amounts or earnings to its members because the cooperative needs to have reserves in order to operate, meet unexpected expenses, or to expand. These amounts or earnings are held by the cooperative for a certain period of time as prescribed by cooperative bylaws and are allocated as capital credits to accounts kept for each member. These capital credits are returned to the members or former members when the cooperative redeems them (i.e., sends a check for the amount of the capital credits) at the end of the prescribed time.

The primary issue raised by the change in method for retirement of capital account credits for certain former members is whether it violates any of the cooperative requirements described Puget Sound Plywood, Inc. v. Commissioner, Inc., 44 T.C. 305 (1965), acq. 1966-1 C.B. 3, and Rev. Rul. 72-36. The cooperative principle of democratic control by members is satisfied because the redemption of capital credit accounts of former members by offsetting the amounts in their capital credit accounts against any outstanding balance they owe the cooperative for provision of electric services will not affect member voting rights or governing rights. We also note that the cooperative (and its board of directors and management) has fiduciary duties to former members, and the former members can enforce their rights in the courts. See Lamesa Cooperative Gin v. Commissioner, 78 T.C. 894 (1982). The cooperative principle of operating at cost is satisfied because the members' right to receive the excess (i.e. capital credits) over the cost of electricity service is also not adversely affected since they will receive full credit against a debt owed by them to the cooperative in return for the retirement of the amount in their capital credit account. The debt will be fully extinguished. If they later try to pay the former debt, that money will be returned to them. No collection against the extinguished amount will be attempted once the offset has taken place.

The cooperative principle of subordination of capital is satisfied because the proposed redemption program does not adversely affect the members' control and ownership of the cooperative assets. The cooperative requirement that there is no forfeiture of former members' rights to assets of the cooperative is not violated since the new policy does not impact this aspect of the cooperative's operations.

Accordingly, based on the foregoing facts and circumstances, we rule as follows:

1. The revised method for retiring former members' capital credit accounts by offsetting the amounts of their capital credit accounts against outstanding debt they owe to you for provision of electric services will not adversely affect your tax-exempt status as a rural electric cooperative under I.R.C. § 501(c)(12).

This ruling is conditioned on the understanding that there will be no material changes in the facts upon which it based. Also, we express no opinion as to the tax consequences of the transactions under other provisions of the Code or state laws.

This ruling will be made available for public inspection under I.R.C. § 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions you should follow the instructions in Notice 437.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to your authorized representative. A copy of this letter should be kept in your permanent records.

This ruling is directed only to the organization that requested it. I.R.C. § 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited by others as precedent.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter. You should keep a copy for your permanent records.

Sincerely,

Stephen M. Clarke

Acting Manager,

Exempt Organizations

Guidance Group 1

Citations: LTR 201340017

IRS Lists Factors for Determining if Entity Is an Instrumentality of State or Local Government.

The IRS listed the six factors that it takes into consideration when determining whether an entity is an instrumentality of a state or local government within the meaning of section 3121(b)(7)(F) for employment tax purposes.

UIL: 3121.02-08

Release Date: 9/27/2013

Date: July 30, 2013

Refer Reply To: CC:TEGE:EOEG:ET2 – GENIN-130256-13

Dear * * *:

This is in response to your request for a general information letter dated June 21, 2013, concerning whether a wholly privately owned company can be a political subdivision or an instrumentality of a State or political subdivision within the meaning of Internal Revenue Code (Code) § 3121(b)(7)(F).

Section 3121(b)(7) was added to the Code by the Omnibus Budget Reconciliation Act of 1990. This section generally expands the definition of employment for purposes of the Federal Insurance Contributions Act to include service as an employee for a state or local government entity. Section 3121(b)(7) requires in relevant part that an "instrumentality" be "wholly owned" by the state, or any political subdivision thereof. The fact that employees of an entity are members of a § 3121(b)(7)(F) "retirement system" is not determinative of whether the entity is an instrumentality of a state or political subdivision. An entity that is wholly privately owned cannot qualify as an instrumentality of a state or political subdivision within the meaning of § 3121(b)(7).

In Revenue Ruling 57-128, 1957-1 C.B. 311, the Service provided the following six factors to be taken into consideration when determining whether an entity is an instrumentality of a state or local government within the meaning of § 3121(b)(7): (1) whether it is used for a governmental purpose and performs a governmental function; (2) whether performance of its 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 its operating expenses.

If an entity cannot satisfy the factors of Revenue Ruling 57-128, the entity is not an instrumentality of a state or local government within the meaning of § 3121(b)(7) even if its employees participate in a retirement system maintained by a state or local government.

We hope this general information is helpful. If you have any questions, please contact * * * of my staff. * * * can be reached at * * *.

Sincerely,

Lynne Camillo

Branch Chief, Employment Tax

Branch 2

(Exempt Organizations/

Employment Tax/Government Entities)

(Tax Exempt & Government Entities)

IRS Explains Valuation Process for Charitable Contributions of Property Other Than Money.

The IRS explained that, for charitable contributions made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution, reduced by a set amount; in some cases, taxpayers may claim a higher deduction by using the so-called enhanced deduction.

UIL: 170.00-00

Release Date: 9/27/2013

Date: September 10, 2013

Refer Reply To: CONEX-137437-13

The Honorable Bill Huizenga

Member, U.S. House of Representatives

4555 Wilson Avenue SW, Suite 3

Grandville, MI 49418

Attention: * * *

Dear Congressman Huizenga:

I am responding to your letter dated July 3, 2013, on the behalf of your constituent, * * *, * * *. He requested an exemption from the provisions of section 170(e)(3) of the Internal Revenue Code (the Code) that currently prohibits charging the recipient of the donated food for the food or the cost of its distribution.

A taxpayer may deduct any charitable contribution that is paid within the taxable year under section 170(a) of the Code. For a charitable contribution made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution, reduced by an amount as stated in the Code and accompanying Income Tax Regulations (section 1.170A-1(c)(1)). In general, the deduction is limited to the lesser of the fair market value or the taxpayer's basis in the contributed property.

There is an exception to this general rule: taxpayers can claim a higher deduction amount if they meet certain requirements, including that the donee cannot transfer contributed property in exchange for money, other property, or services (often called the "enhanced deduction," section 170(e)(3)(A) of the Code). Therefore, according to the tax law, the enhanced deduction only applies if the recipient does not transfer the donated food to its clients in exchange for money, other property, or services.

We administer the tax law as enacted. Any change in the law would require legislative action by the Congress.

I hope this information is helpful. If you have any questions, please contact * * *, Identification Number * * *, at * * *.

Sincerely,

Norma C. Rotunno

Acting Branch Chief, Branch 2,

Office of Associate Chief Counsel

(Income Tax and Accounting)

Graev: Conditional Facade Easement.

Wendy C. Gerzog discusses Graev v. Commissioner, in which the Tax Court decided whether the taxpayer's donations of a facade easement and cash contributions were conditional gifts and therefore disallowable as charitable deductions.

In Graev v. Commissioner, the Tax Court decided whether the taxpayers' donations of a facade easement and cash contributions were conditional gifts and therefore disallowable as charitable deductions under the requirements of the regulations.

* * * * *

The Tax Court decided Graev v. Commissioner1 under fully stipulated facts. In 1999, the taxpayers, residents of New York City, purchased property listed in the National Register of Historic Places for $4.3 million, subject to a mortgage.

Pre-2004 case law is replete with disallowed facade easements either for overvaluation or unenforceability issues.2 Under Notice 2004-41,3 the government advised that it would be scrutinizing the substance of transactions involving real property purchases, charitable organizations, and conservation easements. One example mentioned in the notice described a charitable organization that bought property, placed a conservation easement on the property, and sold the property at a substantially reduced price to a buyer who made a cash "charitable donation" to the organization to reimburse the charity for its financial loss. In that instance, the notice stated that the government may treat the cash donation as part of the buyer's purchase price instead of as a charitable gift.

Later, the National Architectural Trust (NAT), a charitable organization with a mission "to preserve historic architecture in metropolitan areas across the United States,"4 approached Mr. Graev to make a facade easement gift. Having qualms about the latest government ruling, Graev, an attorney, sought the advice of his accountant. Graev then e-mailed NAT with his concerns after the accountants urged caution and Graev asked for NAT's "thoughts especially as it relates to the side letter."5

The side letter was NAT's letter to Graev explaining that it was NAT's standard policy to refund the applicable portion of Graev's donation if he couldn't get the promised favorable charitable deduction. Specifically, the letter promised "to join with Graev to immediately remove the façade easement from the property's title."6 Referencing the assurance made by NAT both to Graev and to his neighbor, Graev executed the facade easement agreement on September 20, 2004.

A firm appraised the value of the facade easement at $990,000. At or near the end of 2004, Graev executed a deed that granted a facade easement to NAT and the deed was recorded on February 17, 2005. The conservation deed provided that the easement grant would facilitate preservation, in perpetuity, of the historic structure and of the public open space, but it also stated that the provisions of the deed were not intended to limit the grantee's right "to abandon some or all of its rights hereunder."7 The mortgagee joined in the easement agreement and agreed to subordinate its rights to the enforcement of the conservation easement; however, the mortgagee declared to have claims, superior to the grantee, to all insurance or condemnation proceeds.

In 2004 Graev made a total of $99,000 in cash contributions to NAT, as requested by the trust to subsidize NAT's operating and future monitoring and administrative expenses. In 2005 NAT sent Graev a written acknowledgement of his easement and cash donations, together with the applicable

tax forms to submit with his return. Also in 2005, NAT sent two letters to Graev: the first, apprising him of upcoming reforms, including penalties and fines, applicable to taxpayers, promoters, and appraisers involved in "significantly overvalued" facade easement donations; and the second, informing him that the refund offer "may adversely affect the deductibility of the cash contribution as a charitable gift."8 Graev did not ask NAT to remove the refund feature of his donation.

After those NAT letters, the Graevs filed their income tax returns for 2004 and 2005, taking deductions for both the easement and the cash contribution to NAT.9 In its September 22, 2008, notice of deficiency, the government disallowed the taxpayers' charitable deductions because the donations were made "subject to subsequent events." The taxpayers contended that the side letter agreement was unenforceable under New York law and a nullity under federal tax law.

The court reviewed the facts to determine whether the gifts were conditional donations or whether the condition was allowed under the regulations10 because it was "so remote as to be negligible." Moreover, as the court stated, "Section 170 and the corresponding regulations provide instruction and limitations that, at least in part, ensure that the donor will be able to deduct only what the donee organization actually receives."11 The court reviewed the background of the applicable regulation's language ("so remote as to be negligible") and the identical language in an older estate tax regulation.12

The Supreme Court interpreted the estate tax regulation in Sternberger.13 Concerned that the donation must match what the charity actually received, the court stated that deductible gifts must be unconditional "unless the possibility that the charity will not take is 'negligible' or 'highly improbable.'"14 Applying that standard, the Tax Court held that the deduction was only allowable if the possibility that NAT would lose its easement and cash was so remote that it was a negligible risk.

The legislative history of charitable split interests accords with that emphasis. Section 170(f)(3) was enacted in 1969 and denied a deduction for most partial interests in property, including conservation easements, but also allowed a donation of an open space easement in gross that was donated to a charity in perpetuity. It wasn't until the 1976 Tax Reform Act that Congress amended section 170(f)(3) to create a deduction for a conservation easement. That provision was later revised and expanded in 1980 to include subsection (h), which defines a qualified conservation contribution. The regulations define the perpetuities requirement as ensuring that the potential for the divestment of the easement be so remote as to be negligible.

The court held that at the time of the easement and cash donations, the potential for the IRS to disallow those deductions and for NAT to remove the easement and return the cash to Graev was not so remote as to be negligible. Although Graev argued that case law at the time of the donation allowed for a donation of between 10 and 15 percent of the value of the property, and that he had deducted a value constituting 11 percent of the property's appraised value, the court emphasized that at that date, the potential for IRS disallowance was not negligible and that valuation was a separate issue. Indeed, the court stated that Graev acted (for example, filing returns with the deductions and failing to remove the refund feature) in response both to the IRS notice indicating additional scrutiny applicable to overvalued facade easements and to NAT's second letter warning of the government's disallowance of a deduction for facade easement donations coupled with refund provisions.

Responding to the Graevs' argument that the one example provided in Notice 2004-41 did not apply to their specific transaction, the court found that the notice advised more generally that donations relating to conservation easements would involve greater scrutiny, and that Graev was well aware of this intensified IRS examination, as indicated in his correspondence with his accountants. NAT agreed to return Graev's contributions if the government disallowed deductions for them. Thus the

court held that the risk of the government's disallowing the deduction was "well above 'negligible.'"15 According to the court, Graev required NAT's letter with the refund feature before making his contribution. Also, NAT understood that an IRS disallowance was more than a remote possibility and that was why NAT would routinely issue comfort letters to potential donors.

The court explained that Graev misinterpreted the court's ruling in O'Brien v. Commissioner,16 in which the taxpayers created a charitable remainder trust in 1964, appointing themselves trustees with broad management powers. The issue in the case was whether the donors had retained control sufficient to cause the gift to be incomplete. The return of their contributions was solely in the government's act of disallowance regardless of the correctness of its action, placing "the contingency 'within the control of the Commissioner.'"17 In O'Brien, the court held that the taxpayers had the right to first litigate their position so that the return contingency was not applicable unless the taxpayers lost. The court held that O'Brien did not even address the issue of a tax contingency under the section 170 regulations and "did not hold that a tax-treatment contingency can never be a subsequent event that will defeat a contribution and a deduction."18

The court also rejected Graev's argument that there was no possibility that NAT would return the property. The court analyzed New York's conservation easement law and held that while NAT's letter alone would not satisfy the state's extinguishment requirements, the recorded deed sufficiently reserved NAT's power to abandon the easement in compliance with New York law. Therefore, the court found that this possibility was "more than negligible."19

Likewise, the court was unmoved by Graev's contention that the doctrine of merger extinguished NAT's refund letter. The court cited, as an exception to that principle, a clear intention by the parties to have a particular provision of a contract survive the deed. Graev required NAT's letter before making his donation and thus the letter clearly qualified as an inducement for him to make the contribution. Even when NAT offered to rescind the letter, Graev declined that offer. Therefore, the court found that the parties intended the letter to survive the deed and that the doctrine of merger did not apply.

Finally, Graev argued that the letter was a nullity under Commissioner v. Procter.20 In Procter, a trust provided that a noncharitable gift would revert to the donor if a court later determined that the transfer would be subject to gift tax. The court held that the trust provision was void as contrary to public policy because it (1) discourages the government's tax collection by nullifying the audit of returns; (2) renders the court's decision moot by canceling the gift the court has adjudged; and (3) disturbs a final judgment.

The taxpayer in Procter had asserted that under the terms of the trust, the gift was not to become effective if a court found the transfer to be subject to the gift tax. However, the circuit court held that such a clause in the trust could not prevent the imposition of the gift tax because the clause would discourage the government's tax collection and the gift tax should not be so easily avoided. Furthermore, the court refused to allow that kind of "trifling with the judicial process."

The Tax Court in Graev held that Procter was inapplicable because recognizing that the refund feature in NAT's letter would not prevent Graev from being taxed on his contribution would not undo a judicial decision, would not discourage tax collection, would not render the case moot, and would not undo the judgment in the case. The court concluded that at the time of the donation, the possibility that the IRS would disallow Graev's deduction and that NAT would thereby return both the easement and cash contributions to Graev was not "so remote as to be negligible" in contravention of the regulations. Therefore, the court disallowed both donation deductions.

Analysis and Conclusion

It is ironic that the taxpayers in Graev cited to Procter to sustain their position. If anything, the facts in Graev reflect the very behavior so repugnant to the Procter court.

When a charitable donation is conditional on receiving a tax deduction, it is difficult to accept that the primary goal of the taxpayer is to make a gift to a charity. In United States v. American Bar Endowment,21 donative intent was central to allowing a charitable deduction. That is, while the charitable deduction is often an incentive for making or increasing a charitable gift, no one may contract with a charity to make a donation dependent on getting a tax benefit. If all charitable gifts were conditional on receiving a tax deduction, that limitation would place a heavy burden on charities. They would not know if they were receiving funds and could not rely on using those "donations" until several years in the future. Yet, of course, most donors actually want the charity to be able to apply their funds to the charity's exempt purpose.

It is also difficult to value a conditional gift at its fair market value, because a transfer of property with a refund feature must surely be heavily discounted. Alternatively, if the gift is viewed as a precondition, the completed gift and deduction should not occur until the statute of limitations has run.

As a general policy matter, extending that notion would add extreme complexity to tax administration. What if, for example, payments of expenses were refundable on the condition of a deduction disallowance? What possible positive policy goal would that serve?

This case and others suggest reasons to eliminate the facade easement deduction. The reduction in value because of the easement is often more hypothetical than real. Adding a refund "guarantee" based on the tax benefits to the donor makes the transfer more a commercial transaction than a charitable gift.

FOOTNOTES

1 140 T.C. No. 17 (2013) .

2 Id., slip op. at 6-7, 8-9, n.5.

3 2004-28 IRB 31.

4 Graev, at 5.

5 Id. at 8. The side letter is also referred to as NAT's comfort letter.

6 Id. at 11.

7 Id. at 13.

8 Id. at 15.

9 Their 2004 return was filed on October 10, 2005, wherein they deducted the full $99,000 cash contribution and $544,449 for the easement deduction, as limited by section 170(b)(1)(C). They deducted the remaining $445,551 on their 2005 return. Id. at 16-17.

10 Reg. section 1.170A-1(e), -7(a)(3), and -14(g)(3).

11 Id. at 19.

12 Reg. section 20.2055-2(b).

13 Commissioner v. Estate of Sternberger, 348 U.S. 187, 194 (1955).

14 Id. at 22.

15 Id. at 33.

16 46 T.C. 583 (1966), acq. 1968-1 C.B. 2.

17 Graev, op. at 37, citing O'Brien, at 591 (quoting Surface Combustion Corp. v. Commissioner, 9 T.C. 631, 655 (1947), aff'd, 181 F.2d 444 (6th Cir. 1950)).

18 Id. at 38.

19 Id. at 45.

20 142 F.2d 824 (4th Cir. 1944).

21 477 U.S. 105, 117-118 (1986) ("The sine qua non of a charitable contribution is a transfer of money or property without adequate consideration. The taxpayer, therefore, must at a minimum demonstrate that he purposely contributed money or property in excess of the value of any benefit he received in return." Id.).

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ABA Meeting: IRS Official Listens as Proposed Bond Arbitrage Regs Are Panned.

An official in the IRS Tax-Exempt Bonds Office listened quietly September 20 while tax attorneys criticized proposed regulations (REG-148659-07) on arbitrage restrictions on tax-exempt bonds that his agency and Treasury just published.

Todd Mitchell, group manager for compliance and program management (tax-exempt bonds), IRS Tax-Exempt and Government Entities Division, spoke briefly in San Francisco at the beginning of the meeting of the American Bar Association Section of Taxation's Tax-Exempt Financing Committee, providing an update on various projects his office is working on. But when the discussion turned to the proposed regs and private letter rulings, he took a seat in the audience, explaining that his superiors did not want him to take part in the conversation. He said nothing about the proposed regs except that comments are welcome.

Moderator Stefano Taverna of McCall, Parkhurst & Horton LLP called the proposed regs a "significant departure from what the understanding of the market is." He and other practitioners complained about undefined terms in the proposed regs.

Practitioners seemed particularly concerned about the proposed removal of the definition of "substantial amount" of bonds sold to the public as 10 percent and its replacement by a safe harbor.

The preamble to the regs states that under the safe harbor, an issuer could treat as the issue price the first price at which a minimum of 25 percent of the bonds in an issue (with the same credit and payment terms) is sold to the public, "provided that all orders at this price received from the public during the offering period are filled (to the extent that the public orders at such price do not exceed the amount of bonds sold)."

Taverna and other practitioners appeared unhappy with that approach. "They say that basically they are not redefining what a substantial amount is for purposes of issue price; they're just providing a safe harbor under which issue price is defined," he said. "So now that leaves, obviously, the other question unanswered, which is: What is a substantial amount? It's been taken away from the regulations; nobody really knows what that means."

Taverna said he and other practitioners met with Treasury officials shortly after the proposed regs' September 16 publication and expressed their concerns about the guidance, including the 25 percent threshold, which he said is too high, and the difficulty in trying to ascertain when the mandatory 25 percent safe harbors hit. He said the officials were asked how they arrived at 25 percent.

"There are a lot of undefined terms in the regulations that I think need to be discussed," Taverna said. "I think the Treasury is aware of all that, and they requested comments on every single item that we brought up."

New TEB Director

Before the discussion of the proposed regs, Mitchell provided an update on other things TEB is working on. He said Rebecca Harrigal will be TEB's new director; an IRS spokesman later confirmed that she will start that position October 6. Mitchell said Harrigal has a lot of experience in exempt bonds, including service as the branch chief for the bonds office in the IRS Office of Chief Counsel.

Examinations

Mitchell said TEB will continue its market segment examinations, which cover different types of bond issues. The amount of time spent on a particular segment depends on the characteristics of the segment, the volume of bond issuance in the segment, and the significance of the segment's compliance issues, he explained.

Mitchell also said subject matter experts in each market segment will help examiners during the examination process, although he added that he thinks the first point of contact when an examination begins will continue to be the examiner. The idea behind using subject matter experts is to make the process more efficient, he said.

Nebraska Issuer Pays $350K to Settle BAB Dispute With IRS.

The Nebraska Public Power District has agreed to pay $350,000 to the Internal Revenue Service to settle a tax law dispute regarding $50.36 million of Build America Bonds it issued in 2009.

NPPD disclosed the settlement in an event notice filed on the Municipal Securities Rulemaking Board's EMMA system. The agreement appears to be the first publicly disclosed settlement of a BAB tax dispute.

The IRS concluded that some of the district's 2009 Series A general revenue bonds were sold in its initial public offering at a price greater than the de minimis amount of premium permitted under the tax law. NPPD said in the notice that it disagrees the IRS' finding but decided to resolve the matter in a closing agreement. The resolution allows NPPD to continue getting its full subsidy payment from the U.S. Treasury.

Neither Christine Pillen, NPPD's deputy assistant treasurer, nor lawyers at Fulbright & Jaworski LLP, which was bond counsel for the BABs and represented the NPPD before the IRS, would provide further details about the dispute.

The BABs program allowed state and local governments to issue taxable bonds in 2009 and 2010 and receive subsidy payments equal to 35% of the interest costs. Under the tax law, a bond cannot be treated as a BAB if the issue price has more than a de minimis amount of premium, generally defined as 0.25% of the stated redemption price at maturity multiplied by the number of complete years from the bond's issue date to its maturity date.

Last year, NPPD disclosed that the IRS believed $10 million of these bonds did not qualify for the 35% subsidy, based on the IRS' determination of the bonds' issue price. The loss of the subsidy on the bonds would have been about $260,000 per year or $6.5 million over the term of the bonds, the NPPD said in a notice filed in October.

IRS officials have contended for months that the issue prices stated for some BABS in bond documents were not the actual issue prices because on the day the BABs were issued, they immediately began trading up at higher prices. As a result, the actual issue prices should have higher, exceeding the de minimis amounts, and Treasury's subsidy payments to the issuers should have been lower, according to the IRS officials.

The $50.36 million of bonds were issued along with $100 million of 2009 Series B taxable revenue bonds and $17.89 million of 2009 Series C revenue bonds, according to the official statement. Proceeds from the Series A and C bonds were used to finance about $66.6 million of the costs of generation and other transmission capital additions, as well as to add to a reserve fund and pay for financing costs. Proceeds from the Series B bonds were used to finance about $24.8 million of the costs of additions to the Cooper Nuclear Station in Brownville, Neb., to refund about $69.5 million of taxable series notes, and to add to a reserve fund and pay financing costs, the offering document said.

The bonds were underwritten by a syndicate led by Morgan Stanley. John C. McClure served as the issuer's counsel.

by: NAOMI JAGODA

S. 1523 Would Modify Qualified School Construction and Zone Academy Bonds

S. 1523, the Rebuilding America's Schools Act, introduced by Senate Finance Committee member John D. Rockefeller IV, D-W.Va., would make the qualified school construction and zone academy bonds permanent, treat qualified zone academy bonds as specified tax credit bonds, and modify the treatment of zone academy bonds.

113TH CONGRESS

1ST SESSION

S. 1523

To amend the Internal Revenue Code to make permanent qualified school construction bonds and qualified zone academy bonds, to treat qualified zone academy bonds as specified tax credit bonds, and to modify the private business contribution requirement for qualified zone academy bonds.

IN THE SENATE OF THE UNITED STATES

SEPTEMBER 18, 2013

Mr. ROCKEFELLER (for himself, Mr. BROWN, Mr. HARKIN, and Mr. JOHNSON

of South Dakota) introduced the following bill; which was read twice

and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code to make permanent qualified school construction bonds and qualified zone academy bonds, to treat qualified zone academy bonds as specified tax credit bonds, and to modify the private business contribution requirement for qualified zone academy bonds.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the “Rebuilding America’s Schools Act”.

SEC. 2. QUALIFIED SCHOOL CONSTRUCTION BONDS.

(a) IN GENERAL. — Subsection (c) of section 54F of the Internal Revenue Code of 1986 is amended to read as follows:

“(c) NATIONAL LIMITATION ON AMOUNT OF BONDS DESIGNATED. — There is a national qualified school construction bond limitation for each calendar year after 2013 in the amount of $11,000,000,000.”.

(b) EFFECTIVE DATE. — The amendment made by this section shall apply to obligations issued after December 31, 2013.

SEC. 3. MODIFICATIONS RELATING TO QUALIFIED ZONE ACADEMY BONDS.

(a) LIMITATION MADE PERMANENT. — Paragraph (1) of section 54E(c) of the Internal Revenue Code of 1986 is amended to read as follows:

“(1) NATIONAL LIMITATION. — There is a national zone academy bond limitation for each calendar year after 2013 in the amount of $1,400,000,000.”.

(b) MODIFICATION OF PRIVATE BUSINESS CONTRIBUTION REQUIREMENT. — Subsection (b) of section 54E of such Code is amended —

(1) by striking “if the eligible local education agency” and inserting “if —

“(1) the eligible local education agency”, and

(2) by striking the period at the end and inserting “, or

“(2) the issue will be pooled with other such issues through the acquisition by, or the sponsorship or assistance of, a private, nonprofit corporation established in the District of Columbia and specifically recognized by Congress for the purpose of leveraging resources and stimulating private investment in education technology infrastructure.”.

(c) DIRECT PAYMENT OPTION. — Clause (iii) of section 6431(f)(3)(A) of such Code is amended by striking “54E)” and all that follows and inserting “54E), or”.

(d) EFFECTIVE DATE. — The amendments made by this section shall apply to obligations issued after December 31, 2013.

IRS: Empowerment Zones Designations Continue Through the End of the Year.

WASHINGTON – The IRS today announced that all empowerment zone designations remain in effect through the end of the year. Empowerment Zones are certain urban and rural areas where employers and other taxpayers qualify for special tax incentives.

In May, the IRS issued Notice 2012-38 to address the relevant provision of the American Taxpayer Relief Act of 2012. Notice 2013-38 provided that any nomination for an empowerment zone in effect on Dec. 31, 2009, will have a new termination date of Dec. 31, 2013, unless the governing state or municipality declined the extension in a notification to the IRS. The deadline for notification was July 29, 2013, and no state or municipality contacted the IRS to decline the extension. Therefore, all empowerment zone designations in effect on Dec. 31, 2009, remain in effect through Dec. 31, 2013.

Empowerment Zones were created by legislation enacted in 1993, and most zones had an expiration date of Dec. 31, 2009. Subsequent legislation extended the expiration dates to Dec. 31, 2011, and then Dec. 31, 2013.

The American Taxpayer Relief Act of 2012 did not provide for the extension of the designation for the District of Columbia enterprise zone, and therefore that designation ended on Dec. 31, 2011.

For more information and complete lists of empowerment zone locations, see Form 8844, Empowerment Zone Employment Credit.
http://www.irs.gov/uac/Form-8844,-Empowerment-Zone-and-Renewal-Community-Employment-Credit

IR-2013-78, Sept. 27, 2013

Treasury Responds to Senators' Concerns About Health Plan Fee for Tax-

Exempt, Nonprofit Hospitals.

Treasury Assistant Secretary for Legislative Affairs Alastair Fitzpayne has explained to Sen. Sherrod Brown, D-Ohio, and other Democratic senators that proposed rules (REG-118315-12) on the annual health insurer fee under the Affordable Care Act require nonprofit, tax-exempt hospitals to take into account only a portion of their net premiums when calculating the fee.

September 12, 2013

The Honorable Elizabeth Warren

United States Senate

Washington, DC 20510

Dear Senator Warren:

Thank you for your follow up letter regarding the annual health insurer fee under section 9010 of the Patient Protection and Affordable Care Act. We received several comment letters on the proposed regulations, which were issued on March 1, 2013, from stakeholders regarding the issue raised in your letter. We are carefully considering these comments as we work to finalize the regulations.

As I mentioned in my response to your previous letter on this topic, proposed regulations on the annual health insurer fee reiterate the rule provided in the statute. Under the statute, the fee does not apply to the first $25 million of net premiums written, and it only applies to 50 percent of the net premiums written for amounts between $25 million and $50 million. After application of this rule and in accordance with the statute, the proposed regulations provide that a covered entity exempt from tax under section 501(a) and described in section 501(c)(3) (generally, a charity), 501(c)(4) (generally, a social welfare organization), section 501(c)(26) (generally, a high-risk health insurance pool), or section 501(c)(29) (a consumer operated and oriented plan health insurance issuer) will be required to take into account only 50 percent of its remaining net premiums written that are attributable to its exempt activities.

We appreciate the concerns expressed in your letter regarding the way the fee will be applied, and we look forward to working with you and your staff on these and other important ACA implementation issues.

Sincerely,

Alastair M. Fitzpayne

Assistant Secretary for Legislative

Tax Court Finds Facade Easement Appraisal Was Qualified After Reconsideration.

The Tax Court, in light of a change in law, held that the appraisal of development rights and a facade easement donated by a couple was a qualified appraisal under reg. section 1.170A-13(c)(3), allowing the court to decide later whether the couple was entitled to the charitable contribution deduction for

the facade easement donation.

Citations: Barry S. Friedberg et ux. v. Commissioner; T.C. Memo. 2013-224; No. 9530-09

BARRY S. FRIEDBERG AND CHARLOTTE MOSS,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent*

UNITED STATES TAX COURT

Filed September 23, 2013

Kathleen M. Pakenham, for petitioners.

Robert W. Mopsick, for respondent.

SUPPLEMENTAL MEMORANDUM OPINION

WELLS, Judge: Respondent determined a deficiency of $1,321,250 and a penalty pursuant to section 6662(h)1 of $528,500 with respect to petitioners' 2003 [*2] tax year. In a prior opinion filed September 3, 2011, Friedberg v. Commissioner, T.C. Memo. 2011-238, 2011 WL 4550136 (prior opinion), we granted partial summary judgment on the issue of whether the appraisal report prepared by Michael Ehrmann of Jefferson & Lee Appraisals, Inc., and attached to petitioners' 2003 joint Federal income tax return (Ehrmann appraisal) was a qualified appraisal as defined in section 1.170A-13(c)(3), Income Tax Regs. We held that the Ehrmann appraisal was not a qualified appraisal as it related to petitioners' facade easement. We further held that there remained issues of material fact regarding whether the Ehrmann appraisal was a qualified appraisal as it related to petitioners' transfer of development rights. Petitioners move the Court, pursuant to Rule 161, to reconsider our prior opinion.

BACKGROUND

Many of the underlying facts are set out in detail in our prior opinion and are incorporated herein by reference. We summarize the factual and procedural background briefly here and make additional findings as required for our ruling on petitioners' motion for reconsideration. The facts are based upon examination of [*3] the pleadings, moving papers, responses, and attachments, including numerous affidavits supplied by petitioners. Petitioners are husband and wife who resided in New York at the time they filed their petition.

During 2002, Mr. Friedberg purchased a residential townhouse in New York City on East 71st Street between Park Avenue and Lexington Avenue (subject property) for $9,400,000, and then paid approximately an additional $4 million for extensive renovations. The subject property is in Manhattan's Upper East Side Historic District. On October 15, 2003, the National Park Service determined that the subject property "contributes to the significance of the * * *[Upper East Side Historic District] and is a 'certified historic structure' for a charitable contribution for conservation purposes in accordance with the Tax Treatment Extension Act of 1980."

During 2003, the National Architectural Trust (NAT) contacted Mr. Friedberg to ask him to donate an easement on the subject property. Mr. Friedberg met with Sean Zalka, a representative from NAT, to discuss donating a facade easement and development rights related to the subject property. Mr. Zalka then sent Mr. Friedberg a spreadsheet that provided an estimate of the tax savings available to Mr. Friedberg should he decide to donate to NAT the facade easement [*4] and development rights for the subject property. Mr. Zalka's spreadsheet read as follows:

THE NATIONAL ARCHITECTURAL TRUST

Profile of Estimated Tax Benefit1

134 East 71st Street (Development Rights Extinguished)

Estimated Fair Market Value	$13,000,000
Conservation Easement Value (11% of FMV)2	$ 1,430,000
Estimated Development Rights Value	$ 2,070,000
(See Development Rights Analysis Worksheet)	
Total Estimated Gross Tax Deduction	$ 3,500,000
Tax-Deductible Cash Donations	$ 350,000
(10% of Gross Tax Deduction)	
Appraisal	$ 16,000
Lender Subordination Fee (if applicable)	
Total Estimated Tax-Deductible Costs	$ 366,000
Total Estimated Charitable Contribution	$ 3,866,000
Tax Deduction	
Total Estimated Federal, State and City	$ 1,643,050
Income Tax Savings (42.5% Tax Bracket)	
Total Estimated Cash Savings	$ 1,277,050

FOOTNOTES TO TABLE

1 For illustrative purposes only. Please consult your

tax advisor.

2 Actual figure determined by appraisal, typically 11%

of FMV for comparable properties.

END OF FOOTNOTES TO TABLE

[*5] After reviewing NAT's materials, Mr. Friedberg decided to donate to NAT a facade easement and all of the development rights associated with the subject property.

Mr. Friedberg followed NAT's recommendation and engaged Michael Ehrmann of Jefferson & Lee Appraisals, Inc., based in Pittsburgh, to appraise the subject property. Mr. Ehrmann visited the subject property and conducted an inspection during November 2003 and subsequently prepared the Ehrmann appraisal, which states that it "has been prepared for tax purposes, in order to determine the loss of value due to a facade easement to be donated on the subject property." The Ehrmann appraisal includes a number of pages of background on the economic, social, cultural, environmental, and political forces that influence property values in New York City.

On the basis of the lot's location in an R9X zoning district, permitting a "floor area ratio"2 (FAR) of 9.0 for residential property, Mr. Ehrmann calculated [*6] that the lot had a maximum development potential of 20,786.94 square feet, approximately 13,731 square feet of which was unused.3 Mr. Ehrmann wrote:

Although the underlying zoning would permit expansion of the subject property up to the maximum development potential, I believe that the New York City Landmarks Preservation Commission, which has authority over the Upper East Side Historical [sic] District, would block such an expansion. However, the subject owner clearly has the right to transfer/see [sic] these development rights for use on neighboring blocks within the Historical District. Furthermore, I believe that developments utilizing Transferable Development Rights (TDR) would [be] feasible in this area, particularly along Lexington Avenue.

New York statutes define transfer of development rights (TDR) as "the process by which development rights are transferred from one lot, parcel, or area of land in a sending district to another lot, parcel, or area of land in one or more receiving districts." * * *

In many TDR programs, the zoning provisions applicable to the sending district are amended to reduce the density at which land can be developed. While losing their right to develop their properties at the formerly permitted densities, property owners in the sending district are awarded development rights. These development rights are regarded as severable from the land ownership and transferable by their owners. * * *

[*7] The Ehrmann appraisal then describes different aspects of transferable development rights programs in general, without any reference to the particular program implemented in New York City.

Mr. Ehrmann found that the "sales comparison approach" was the most appropriate valuation method for estimating the market value of the subject property before and after the donation. He wrote: "In the following sections of this report, I have estimated the market value of the subject property both before and after donation of the proposed easement utilizing the Sales Comparison Approach to value." Mr. Ehrmann used the following sales to estimate the before value of the subject property:

Price Histo-

Date	Address	Sale price	Square feet	Adjusted price per square foot	Historic district?
4/15/03	36 East 67th St	$9,750,000	16,235	$1,216.51	$1,655.80	Yes
3/26/03	631 Park Ave	9,650,000	5,143	1,876.34	1,778.20	Yes
1/17/03	151 East 72d St	8,187,500	5,885	1,391.25	1,701.13	No
1/15/03	123 East 73d St	10,250,000	8,625	1,188.41	1,775.24	Yes
8/26/02	54 East 92d St	9,000,000	4,320	2,083.33	2,595.79	No
6/17/02	10 East 87th St	8,200,000	8,791	932.77	1,609.16	No
5/6/02	46 East 69th St	10,250,000	8,500	1,205.88	1,755.77	Yes
2/16/02	20 East 73d St	17,000,000	9,345	1,819.15	2,281.21	Yes
2/14/02	10 East 75th St	8,250,000	8,930	923.85	1,527.13	Yes

Mr. Ehrmann adjusted those sale prices to take into account differences between those properties and the subject property due to the following factors: time of [*8] sale; location; condition of the property; size; and whether the property included a finished basement. Although the properties were subject to different zoning, Mr. Ehrmann did not make any adjustments on that basis because, he wrote: "I do not believe that the varying zones have an impact on subject value." After making all of his adjustments, Mr. Ehrmann averaged the adjusted prices and arrived at $1,853.27 per square foot, which he rounded to $1,855 and used as his estimate for the value of the subject property as of the appraisal date. On the basis of the subject property's gross floor area of 7,056 square feet, Mr. Ehrmann estimated that the subject property's total value was $13,090,000.

In addition to estimating the subject property's fair market value, Mr. Ehrmann sought to appraise the development rights that "could be transferred to a nearby property s [sic] as TDRs." To do so, he identified five transfers involving development rights on the east side of Manhattan. Three of the five transfers involved the sale of development rights by themselves; the other two each involved the sale of an entire tract that included development rights previously acquired. Mr. Ehrmann calculated the price per FAR foot for each of the sales and then averaged those figures to reach an average of $154 per FAR foot. He then considered some general categories of adjustments, including time, location, size, zoning, and historic restrictions. With regard to historic restrictions, he wrote:

[*9] The subject is part of the Upper East Side Historic District, with significant historic restrictions. None of the previous improvements on the comparable sites had a similar status. Furthermore, there do not appear to be historically protected properties in the immediate vicinities of the TDR comparables. As discussed previously, the subject TDRs can only be utilized in a limited geographic area near the site. However, the TDRs transferred to the comparable properties do not appear to have had the same restriction.

I believe that the restrictions on the subject TDRs make these development rights somewhat less valuable than the apparently unrestricted rights purchased in the comparable transactions.

Mr. Ehrmann's comments reflect the fact that none of the other properties he considered was in a historic district. The average price per FAR foot of the comparable properties Mr. Ehrmann reported on was $154. However, Mr. Ehrmann estimated that the value of the unused development rights on the subject property was $170 per FAR foot. He explained his reasoning as follows:

I have identified five adjustment factors applicable to the TDR comparables. Three of the factors — time, location, and size of the TDR — support upward adjustments of a number of the comparable unit prices. The two other factors — zoning and landmark limitations — support downward adjustments of all of the comparable unit prices.

TDR transactions are complex. I have not made specific adjustments of each comparable for each adjustment factor discussed above. However, based on the overall adjustments, I estimate that the value of the TDRs on the subject property as of $170.00 per FAR foot.

[*10] Mr. Ehrmann calculated that the total value of the unused development rights associated with the subject property was $2,335,000. He then added that value to his before estimate of the value of the subject property to arrive at a total value for the subject property of $15,425,000.

The second half of the Ehrmann appraisal provides an estimate of the value of the subject property after the facade easement. In an introduction, Mr. Ehrmann explained that there are several reasons property values are negatively affected by facade easements. One of the factors he listed was "the loss of the right to develop the property up to the maximum density allowed under the subject zone." Other factors included potentially increased maintenance costs, loss of flexibility in changing exterior design, and the inability of future owners to use the tax advantages from an easement contribution. Mr. Ehrmann noted:

The best measure of the impact of these elements on property values is the market place [sic]. I have been able to identify a number of examples of the impact of easements on properties in both New Orleans and Washington, two cities where facade easements have been most actively used.

Mr. Ehrmann provided six examples of sales of eased properties in Washington, D.C., during the mid-1980s and two examples of transactions involving eased properties in New Orleans during the mid-1990s. Mr. Ehrmann constructed the [*11] following table to summarize his research on sales of comparable properties involving facade easements:

Property #	Easement loss
1	27.9%
2	18.3%
3	8.9%
4	18.6%
5	22.5%

6	8%
7	30-40% increase in renovation costs
8	11+%

The average facade "easement loss" of the six sales of eased properties (i.e., properties 1 through 6, the Washington, D.C., sales) was 17.4%. However, Mr. Ehrmann estimated that the facade easement on the subject property decreased its value by 11%. He provided the following analysis to explain his reasoning:

The comparable data shows estimated losses ranging from 8% to 27.9%. The residential properties had losses ranging from 8% to 22.5%. Most of the examples that I have identified took place during the 1980s, when the facade easement programs in both Washington and New Orleans were relatively new. Comparables #7 and #8 are based on recent market developments.

The subject property is a residential dwelling in excellent condition and degree of finish. Based on the comparable data, with particular emphasis on Eased Property #8, I estimate that [the] facade easement will result in a loss of value of 11% of the value of the actual subject improvement before donation of the easement.

[*12] On the basis of his estimate of 11%, Mr. Ehrmann calculated that the facade easement would reduce the value of the subject property by $1,439,000, which he rounded to $1,440,000. He stated that after the easement the unused development rights would have no value. He therefore estimated that the "after" value of the subject property was $11,650,000. Mr. Ehrmann concluded that the loss in value due to the facade easement was $3,775,000.4

Petitioners timely filed their joint 2003 Federal income tax return. They deducted $3,775,000 for the donation of the facade easement and development rights on the subject property. Petitioners appended Form 8283, Noncash Charitable Contributions, signed by Mr. Ehrmann and by the president of NAT. Petitioners also attached to their tax return a copy of the Ehrmann appraisal. On or about January 23, 2009, respondent mailed to petitioners' last known address a statutory notice of deficiency. Petitioners timely filed their petition with this Court on April 20, 2009.

During December 2010, each party filed a motion for partial summary judgment. Petitioners moved that, inter alia, the Court grant summary judgment that the Ehrmann appraisal of the value of the easement was a "qualified [*13] appraisal" within the meaning of section 1.170A-13(c)(3), Income Tax Regs. Respondent moved that the Court grant summary judgment that petitioners are not entitled to a charitable contribution deduction related to their 2003 donation of the facade easement and development rights because, inter alia, "petitioners failed to substantiate their deduction * * * as required by section 155(a) of the Deficit Reduction Act of 1984, Pub. L. 98-369, 98 Stat. 691, ("DEFRA") and Treas. Reg. § 1.170A-13(c)." Specifically, we were asked to determine whether the Ehrmann appraisal included the "method of valuation" and the "specific basis for the valuation" pursuant to section 1.170A-13(c)(3)(ii)(J) and (K), Income Tax Regs.

On October 3, 2011, we issued our prior opinion addressing the parties' cross-motions for partial summary judgment. Relying in part on Scheidelman v. Commissioner, T.C. Memo. 2010-151, 2010 WL 2788205 (Scheidelman I), vacated and remanded, 682 F.3d 189 (2d Cir. 2012), we held that petitioners were not entitled to a deduction for the donation of the facade easement because the Ehrmann appraisal was not a "qualified appraisal" pursuant to section 1.170A-13(c)(3), Income Tax Regs., with respect to its valuation of the facade easement. Accordingly, we granted respondent's motion for partial summary judgment with respect to that issue. However, with respect to the

valuation of the development rights, we concluded that disputed issues of material fact remained as [*14] to whether the Ehrmann appraisal was a qualified appraisal. Accordingly, we denied both parties' motions for partial summary judgment with respect to that issue.

On June 15, 2012, the U.S. Court of Appeals for the Second Circuit vacated our decision in Scheidelman I and remanded the case. Scheidelman v. Commissioner, 682 F.3d 189 (2d Cir. 2012) (Scheidelman II). On July 17, 2012, respondent deposed Mr. Ehrmann in the presence of petitioners' counsel. During the deposition Mr. Ehrmann stated that he had never appraised other transferrable development rights before issuing the Ehrmann appraisal and that Mr. Friedberg knew of this fact.

On August 1, 2012, petitioners moved the Court to reconsider our prior opinion because of the change in law governing the issues noted above. On September 7, 2012, respondent filed a response to petitioners' motion for reconsideration.

DISCUSSION

Reconsideration under Rule 161 is intended to correct substantial errors of fact or law and allow the introduction of newly discovered evidence that the moving party could not have introduced, by the exercise of due diligence, in the [*15] prior proceeding. See Knudsen v. Commissioner, 131 T.C. 185 (2008); Estate of Quick v. Commissioner, 110 T.C. 440, 441-442 (1998). We have broad discretion as to whether to grant a motion for reconsideration, but will not do so unless the moving party can point to unusual circumstances or substantial error. Estate of Quick v. Commissioner, 110 T.C. at 441-442; see also Vaughn v. Commissioner, 87 T.C. 164, 166-167 (1986). "Reconsideration is not the appropriate forum for rehashing previously rejected legal arguments or tendering new legal theories to reach the end result desired by the moving party." Estate of Quick v. Commissioner, 110 T.C. at 441-442.

However, an intervening change of controlling law may warrant our exercising that discretion. See Doe v. N.Y.C. Dep't of Soc. Servs., 709 F.2d 782, 789 (2d Cir. 1983); see also Alioto v. Commissioner, T.C. Memo. 2008-185, 2008 WL 2945349, at *8. We based our prior opinion in part on a similar legal analysis as that contained in Scheidelman I. The U.S. Court of Appeals for the Second Circuit vacated and remanded Scheidelman I, see Scheidelman II, 682 F.3d 189, and, absent stipulation to the contrary, this case is appealable to that court. In accordance with Golsen v. Commissioner, 54 T.C. 742, 757 (1970), aff'd, 445 F.2d 985 (10th Cir. 1971), we conclude that the decision by the Court of Appeals [*16] in Scheidelman II specifically alters the underlying law and, therefore, requires that we reconsider our prior opinion.

Petitioners ask us to reconsider whether the Ehrmann appraisal met the requirements of a "qualified appraisal" pursuant to section 1.170A-13(c)(3)(ii)(J) and (K), Income Tax Regs., with respect to both the facade easement and the development rights. We address each issue in turn.

I. Facade Easement

In our prior opinion we determined that Mr. Ehrmann's approach to valuing the subject property after the facade easement donation diverged significantly from the accepted comparable sales method, which was the method Mr. Ehrmann claimed to apply. We determined that Mr. Ehrmann instead used sale and nonsale transactions of eased properties in locations other than New York City, which is the site of the subject property, to estimate a percentage diminution in value associated with a facade easement. Mr. Ehrmann then multiplied the before value of the subject property, the calculation of which respondent did not contest, by the percentage diminution that he purported to derive from the transactions noted above to estimate the loss in value on account of the facade easement.5 In [*17] Scheidelman I, we held that the mechanical application of a percentage

diminution to the fair market value before donation of a facade easement does not constitute a method of valuation as contemplated under section 1.170A-13(c)(3), Income Tax Regs. Scheidelman I, 2010 WL 2788205, at *9. Accordingly, our prior opinion in this case held, consistent with our decision in Scheidelman I, that the Ehrmann appraisal was not a qualified appraisal with respect to the facade easement because it lacked a method and specific basis for the determined value.

The U.S. Court of Appeals for the Second Circuit vacated this Court's decision in Scheidelman I and remanded the case. See Scheidelman II, 682 F.3d 189. Concerning whether an appraisal includes the method of valuation as required by section 1.170A-13(c)(3)(ii)(J), Income Tax Regs., the Court of Appeals in Scheidelman II stated:

For the purpose of gauging compliance with the reporting requirement, it is irrelevant that the * * * [Commissioner] believes the method employed was sloppy or inaccurate, or haphazardly applied * * *. The regulation requires only that the appraiser identify the valuation method "used"; it does not require that the method adopted be reliable. * * * By providing the information required by the regulation, * * * [the appraiser] enabled the * * * [Commissioner] to evaluate his methodology.

[*18] Id. at 196-197 (fn. ref. omitted). The Court of Appeals held that "the Commissioner's interpretation, that an unreliable method is no method at all, goes beyond the wording of the regulation, which imposes only a reporting requirement." Id. n.6. Concerning whether an appraisal includes the specific basis for the valuation as required by section 1.170A-13(c)(3)(ii)(K), Income Tax Regs., the Court of Appeals stated that the purpose of that reporting regulation was to provide the Commissioner with "sufficient information to evaluate the claimed deduction and 'deal more effectively with the prevalent use of overvaluations.'" Id. at 198 (quoting Hewitt v. Commissioner, 109 T.C. 258, 265 (1997), aff'd, 166 F.3d 332 (4th Cir. 1998)). The Court of Appeals held that the requirement of section 1.170A-13(c)(3)(ii)(K), Income Tax Regs., is fulfilled if the appraiser's analysis is present, even if the Commissioner deems it to be unconvincing. Scheidelman II, 682 F.3d at 198.

In their motion for reconsideration, petitioners contend that the Ehrmann appraisal included a method of valuation because it supplied enough information to enable the Commissioner to evaluate his methodology and showed how he applied the method. Petitioners acknowledge that we previously concluded that Mr. Ehrmann's stated method was improperly applied and unreliable but contend that reliability is not a factor for purposes of determining whether the Ehrmann [*19] appraisal is a qualified appraisal. Respondent opposes petitioners' motion for reconsideration with respect to the facade easement and contends that (1) petitioners misstate the proper standard articulated by the Court of Appeals in Scheidelman II, (2) the Ehrmann appraisal is not a qualified appraisal even if we apply the standard that petitioners advocate, and (3) the Ehrmann appraisal fails to include a specific basis for valuation.6 We disagree with all three of respondent's contentions.

Respondent first contends that petitioners misstate the standard that the Court should apply and that the proper standard is to determine whether the method of valuation stated in the appraisal is the method actually used by the [*20] appraiser. We disagree. In Scheidelman II, 682 F.3d at 197, the Court of Appeals stated that the relevant question is whether the information provided "enabled the * * * [Commissioner] to evaluate * * * [the appraiser's] methodology". See also Rothman v. Commissioner, T.C. Memo. 2012-218, 2012 WL 3101513, at *4. Moreover, the Court of Appeals clarified that "it is irrelevant that the * * * [Commissioner] believes the method employed was sloppy or inaccurate, or haphazardly applied". Scheidelman II, 682 F.3d at 197 (emphasis added). Scheidelman II is clear; the regulations are a reporting requirement. Id. at 197 & n.6. Thus, pursuant to Scheidelman II, any evaluation of accuracy is irrelevant for purposes of deciding whether the appraisal is qualified pursuant to section 1.170A-13(c)(3)(ii)(J), Income Tax Regs.

Respondent also contends that the Ehrmann appraisal fails to enable respondent to evaluate Mr. Ehrmann's methodology. Respondent argues that the Ehrmann appraisal "merely set forth certain disconnected and meaningless steps that Mr. Ehrmann took" and that "the 11% value was arrived at in spite of his research." While we note that we previously determined that "[n]othing in Mr. Ehrmann's report supports his conclusion about the after value of the subject property", Friedberg v. Commissioner, 2011 WL 4550136, at *15, we concede that reaching that determination first required us to evaluate Mr. Ehrmann's [*21] methodology. Although we continue to question whether the Ehrmann appraisal is reliable or properly applied methodology to reach its conclusions, we conclude that it provides sufficient information to enable respondent to evaluate Mr. Ehrmann's underlying methodology. Accordingly, we conclude that the Ehrmann appraisal includes a method of valuation as required by section 1.170A-13(c)(3)(ii)(J), Income Tax Regs., with respect to the facade easement.

Regarding the requirements of section 1.170A-13(c)(3)(ii)(K), Income Tax Regs., respondent contends that the Ehrmann appraisal did not provide a specific basis for the valuation because it lacked reasoned analysis and arrived at the value of the facade easement in spite of Mr. Ehrmann's research, not because of it. The Court of Appeals held that there is a specific basis for the valuation if the appraiser's analysis is present, even if the Commissioner deems it unconvincing. Scheidelman II, 682 F.3d at 198 ("The Commissioner may deem * * * [the appraiser's] 'reasoned analysis' unconvincing, but it is incontestably there."). As we stated in our prior opinion, the Ehrmann appraisal compared eight different properties with facade easements, for which Mr. Ehrmann allegedly considered, inter alia, each property's location, size, local government laws and regulations, use, date of easement, appreciation of value, and improvements. Although we criticized and disagreed with Mr. Ehrmann's analysis, it was "incontestably there". [*22] See id. Indeed, respondent's own argument concedes that the Ehrmann appraisal contained some research and analysis because respondent concludes that value was determined in spite of that research. Accordingly, we conclude that the Ehrmann appraisal includes a specific basis for Mr. Ehrmann's valuation as required by section 1.170A-13(c)(3)(ii)(K), Income Tax Regs., with respect to the facade easement.

Consequently, pursuant to Scheidelman II, we conclude that the Ehrmann appraisal is a qualified appraisal pursuant to section 1.170A-13(c)(3)(ii), Income Tax Regs., with respect to petitioners' facade easement. However, we specifically do not opine on the reliability and accuracy of the methodology and specific basis of valuation in the Ehrmann appraisal, a matter we leave to be decided at trial.

II. Development Rights

In our prior opinion we determined that Mr. Ehrmann's method of using five comparable transactions involving development rights to estimate the value of the subject property's unused development rights was inconsistent and contained mathematical errors and erroneous assumptions. Although we determined that Mr. Ehrmann claimed to be applying the comparable sales method to calculate a price per square foot of the development rights, we were not convinced that the comparable sales transactions were truly comparable. Instead of comparing the [*23] purchase prices per square foot for additional development rights, Mr. Ehrmann compared prices per square foot of properties that included no additional development rights or averaged prices per square foot for both development rights attached to the property and additional development rights. However, we determined that the Ehrmann appraisal nonetheless explained the method and specific basis of valuation with respect to the development rights. Because we questioned the Ehrmann appraisal's accuracy and reliability and whether it adequately evaluated the market demand for and transferability of development rights, we held that issues of material fact remained regarding

whether the Ehrmann appraisal was a qualified appraisal with respect to the development rights.7

In their motion for reconsideration, petitioners contend that our prior opinion concludes that the Ehrmann appraisal included the method of valuation and specific basis for the valuation of the development rights. Petitioners contend that remaining issues of material fact, which caused us to deny petitioners' motion for summary judgment with respect to this issue in our prior opinion, are relevant [*24] only to determining the value of the development rights and not to determining whether the Ehrmann appraisal is qualified under the Scheidelman II analysis. We agree with petitioners. Under Scheidelman II, section 1.170A-13(c)(3)(ii)(J) and (K), Income Tax Regs., "imposes only a reporting requirement" and the taxpayer only needs to include sufficient information to allow the Commissioner to evaluate the methodology and specific basis for valuation. Scheidelman II, 692 F.3d at 196-198, n.6. In our prior opinion, we stated that, despite errors, the Ehrmann appraisal "explained the method of valuation and the specific basis for the valuation" of the development rights. Friedberg v. Commissioner, 2011 WL 4550136, at *22. The remaining issues of material fact (e.g., the effect of the market demand, the transferability of the development rights, and the accuracy and reliability of the Ehrmann appraisal) are relevant to our analysis of valuation but are irrelevant as to whether the Ehrmann appraisal is [*25] qualified pursuant to section 1.170A-13(c)(3), Income Tax Regs.8 See Scheidelman II, 692 F.3d at 196-198.

Respondent does not object to petitioners' motion for reconsideration with respect to whether the Ehrmann appraisal is a qualified appraisal of development rights but contends that we should consider additional factual developments that have arisen since our prior opinion and, in result, grant summary judgment to respondent. Specifically, respondent contends that, at a deposition after our prior opinion, Mr. Ehrmann confirmed that he had never appraised other transferrable development rights before issuing the Ehrmann appraisal and that Mr. Friedberg knew of this fact. Consequently, respondent contends that Mr. Ehrmann was not a qualified appraiser of transferable development rights pursuant to section 1.170A-13(c)(5), [*26] Income Tax Reg., and therefore, the Ehrmann appraisal was not a qualified appraisal.9 We disagree.

Pursuant to section 1.170A-13(c)(5), Income Tax Regs.,10 a qualified appraiser is an individual who includes on the appraisal summary11 a declaration that: (1) the individual either holds himself or herself out to the public as an appraiser or performs appraisals regularly; (2) the appraiser is qualified to make appraisals of the type of property being valued;12 (3) the appraiser is not excluded [*27] from qualifying under section 1.170A-13(c)(5)(iv), Income Tax Regs.;13 and (4) the appraiser understands that an intentionally false or fraudulent overstatement of the value of the property described in the qualified appraisal or appraisal summary may subject the appraiser to a civil penalty under section 6701 for aiding and abetting an understatement of tax liability. According to the plain language of the regulation, an appraiser is a qualified appraiser if he or she makes the requisite declaration that he or she is qualified to appraise the value of the contributed property; the regulation does not direct the Commissioner to analyze the appraiser's qualifications to determine whether he or she has sufficient education, experience, or other characteristics. We conclude that the analysis of the Court of Appeals for the Second Circuit in Scheidelman II regarding the method and specific basis of valuation of a qualified appraisal applies equally to the appraiser's qualification for purposes of section 1.170A-13(c)(5)(i)(B), Income [*28] Tax Regs. Accordingly we conclude that section 1.170A-13(c)(5)(i)(B), Income Tax Regs., is a reporting requirement, i.e., an appraiser is qualified if the declaration is present, regardless of whether it is "unconvincing". See Scheidelman II, 682 F.3d at 198. Accordingly, respondent's contention that Mr. Ehrmann is not a qualified appraiser is without merit.

Respondent has conceded that Mr. Ehrmann signed the appraisal summary that contains the necessary declaration. Consequently, Mr. Ehrmann is a qualified appraiser pursuant to section

1.170A-13(c)(5), Income Tax Regs., and the Ehrmann appraisal is a qualified appraisal of the value of the development rights petitioners contributed.14

III. Conclusion

Upon due consideration of the foregoing, we hold that petitioners are entitled to summary judgment on the issue of whether the Ehrmann appraisal is a qualified appraisal pursuant to section 1.170A-13(c)(3), Income Tax Regs., with respect to both the facade easement and the development rights. Consequently, we reconsider our holding in our prior case that petitioners are not entitled to a [*29] charitable contribution deduction with respect to the facade easement. However, the other holdings of our prior opinion remain.

We have considered all arguments made, and to the extent not specifically addressed herein, conclude they have been previously addressed in our prior opinion in this case or are irrelevant, moot, or without merit.

To reflect the foregoing,

An appropriate order will be issued.

FOOTNOTES

* This opinion supplements Friedberg v. Commissioner, T.C. Memo. 2011-238.

1 Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (Code) and in effect at all relevant times, and Rule references are to the Tax Court Rules of Practice and Procedure. We round all monetary amounts to the nearest dollar.

2 New York, N.Y. Zoning Resolution sec. 12-10 (2011) provides the following definition for "floor area ratio":

"Floor area ratio" is the total floor area on a zoning lot, divided by the lot area of that zoning lot. If two or more buildings are located on the same zoning lot, the floor area ratio is the sum of their floor areas divided by the lot area. (For example, a zoning lot of 10,000 square feet with a building containing 20,000 square feet of floor area has a floor area ratio of 2.0, and a zoning lot of 20,000 square feet with two buildings containing a total of 40,000 square feet of floor area also has a floor area ratio of 2.0).

3 Respondent accepts those numbers as accurate for purposes of the parties' cross motions for partial summary judgment addressed in our prior opinion.

4 That figure reflects the value of both the facade easement and the development rights, but Mr. Ehrmann stated that it represented "the estimated market value of the loss due to the easement."

5 As we noted in our prior opinion in this case, it appears that Mr. Ehrmann arrived at 11%, the percentage of fair market value that NAT had told Mr. Friedberg was typical for facade easements, in spite of his research on comparable sales and not because of it.

6 Respondent also contends that we did not rest our prior opinion entirely on the legal analysis contained in Scheidelman v. Commissioner, T.C. Memo. 2010-151, 2010 WL 2788205 (Scheidelman I), vacated and remanded, 682 F.3d 189 (2d Cir. 2012) (Scheidelman II), pointing to our scarce citations of that case and that we instead relied on Friedman v. Commissioner, T.C. Memo. 2010-45, 2010 WL 845949, and Jacobson v. Commissioner, T.C. Memo. 1999-401, 1999 WL 1127811, which

the Court of Appeals for the Second Circuit approved. Respondent's contention is without merit. The Court of Appeals' opinion in Scheidelman II vacated this Court's decision in Scheidelman I with respect to the same analysis we used in this case in our prior opinion and distinguished both Friedman and Jacobson. See Scheidelman II, 682 F.3d at 197-198 (stating that the appraisals in those cases "failed altogether to 'even indicate the valuation method used or the basis for the appraised values'" (quoting Friedman v. Commissioner, 2010 WL 845949, at *4) and "'provided no methodology or rationale'" (quoting Jacobson v. Commissioner, 1999 WL 1127811, at *2). Pursuant to Golsen v. Commissioner, 54 T.C. at 757, the Court of Appeals' opinion controls our analysis in the instant case.

7 This Court did not discuss qualified appraisals of development rights in Scheidelman I. However, the Court of Appeals for the Second Circuit's analysis of sec. 1.170A-13(c)(3)(ii)(J) and (K), Income Tax Regs., applies as much to a valuation of development rights as it does to a valuation of a facade easement. We do not deem it necessary to restate that analysis, which we discussed above.

8 Respondent contends that the Ehrmann appraisal is not qualified because it assumed a highest and best use for the development rights without adequately assessing the market demand for those rights with a market study. We disagree. We have previously held that, when using the comparable sales method, the before value "is arrived at by first determining the highest and best use of the property in its current condition unrestricted by the easement." Hilborn v. Commissioner, 85 T.C. 677, 689 (1985). However, valuation is not a precise science, and the fair market value of property on a given date is a question of fact to be resolved on the basis of the entire record. Kiva Dunes Conservation, LLC v. Commissioner, T.C. Memo. 2009-145, 2009 WL 1748862, at *3. Like the other questions of fact noted above, respondent's contentions as to the defects of the Ehrmann appraisal are irrelevant as to whether the Ehrmann appraisal is a qualified appraisal pursuant to sec. 1.170A-13(c)(3), Income Tax Regs.

9 Pursuant to sec. 1.170A-13(c)(3)(i)(B), Income Tax Regs., a qualified appraisal must be "prepared, signed, and dated by a qualified appraiser (within the meaning of paragraph (c)(5) of * * * [that] section)."

10 While we recognize that "qualified appraiser" is now defined in sec. 170(f)(11)(E)(ii), that section was not in effect at the time petitioners filed the return for their 2003 tax year. See Pension Protection Act of 2006, Pub. L. No. 109-280, sec. 1219(c)(1), 120 Stat. at 1084 (effective for appraisals prepared with respect to returns filed after August 17, 2006).

11 Pursuant to sec. 1.170A-13(c)(2)(i)(B), Income Tax Regs., a fully completed appraisal summary must be attached to the tax return on which the deduction for contribution is first claimed. The appraisal summary, which differs from a qualified appraisal, must comply with the requirements set forth in sec. 1.170A-13(c)(4), Income Tax Regs.

12 Pursuant to sec. 1.170A-13(c)(3)(ii)(F), Income Tax Regs., the qualified appraisal should include "[t]he qualifications of the qualified appraiser who signs the appraisal, including the appraiser's background, experience, education, and membership, if any, in professional appraisal associations". Respondent makes no claim regarding whether Mr. Ehrmann failed to report his qualifications pursuant to sec. 1.170A-13(c)(3)(ii)(F), Income Tax Regs., so we do not further address that issue.

13 Pursuant to sec. 1.170A-13(c)(5)(iv), Income Tax Regs., an individual is not a qualified appraiser if the individual is, inter alia, the donor, the donee, any person employed by the donor or donee, or an appraiser who is regularly used by the donor or donee and who does not perform most of his or her appraisals for other persons. Respondent makes no claim regarding whether Mr. Ehrmann is excluded from qualifying as a qualified appraiser pursuant to sec. 1.170A-13(c)(5)(iv), Income Tax

Regs., so we do not further address that issue.

14 However, we note that we do not at this time opine on whether Mr. Ehrmann's qualifications are sufficient to qualify as an expert witness to testify in this Court regarding the value of the development rights in this case or whether the Ehrmann appraisal may be admitted as an expert report pursuant to Rule 143(g) for that purpose.

Market Has Concerns, Questions About IRS Issue Price Rules.

Internal Revenue Service's proposed rules on issue price would drastically change market practices and raise major questions and concerns, representatives of issuer and dealer groups said Monday.

"It completely changes industry practices regarding issue price by eliminating reasonable expectations," said Ben Watkins, chair of the Government Finance Officers Association's debt committee and Florida's bond finance director.

Watkins said that, in his view, the rules are unworkable and are "going to create a compliance nightmare."

"They're going to create problems for the entire industry — issuers, bond counsel and underwriters," he said.

Michael Decker, managing director and co-head of municipal securities at the Securities Industry and Financial Markets Association, said, "This is kind of a watershed proposal.

"We're really happy that they're out. We've been waiting a long time for them," he said, adding that SIFMA members are still studying the proposals and determining what they like and don't like.

The proposed rules are "complex" and "raise some questions," he added.

Issue price is important because it is used to determine bond yield and whether an issuer is complying with arbitrage rebate or yield restriction requirements, as well whether issuers are receiving the appropriate amount of federal subsidy payments in the case of direct-pay bonds such as Build America Bonds.

Under current tax rules and market prices, the issuer price is determined at issuance based on reasonable expectations. The issue price for each maturity of bonds publicly offered is the first price at which a substantial amount of the bonds is reasonably expected to be sold to the public, with substantial defined as 10%. Sales to underwriters and wholesalers are not considered to be the public and are excluded from the determination of whether the 10% amount has been reached.

But IRS officials were concerned, based on the Municipal Securities Rulemaking Board's EMMA data, that bonds were being flipped, or almost simultaneously traded up between dealers and other dealers or institutional investors, so that retail investors paid the highest prices for the lowest yields. IRS officials felt the first 10% of sales at the lowest prices did not represent the true issue price, which should have been higher. If that were the case, the interest rate and bond yield should have been lower so the issuer's investments would have to be at a lower yield to avoid arbitrage problems and the Treasury's subsidy payments to BAB issuers should have been lower.

In its proposed rules, the IRS would eliminate the reasonable expectations standard and instead

base issue price on actual sales. It also would expand the percentage of bond sales to be taken into account in determining issue price to 25% from 10%. The IRS would remove any mention of wholesalers. The proposed rules say sales to underwriters could not be counted toward the 25% amount. They would define the term underwriter somewhat broadly in a manner that is subject to interpretation.

Both Watkins and Decker said the proposed rules would mean the issuer and underwriter typically would not know what the issue price was at the time of issuance and without checking the prices on EMMA for several days or possibly even weeks.

Watkins is particularly concerned the proposed rules do not distinguish between negotiated and competitive transactions. In competitive deals, dealers bid to underwrite the bonds. Florida does a lot of competitive deals and typically chooses the underwriter willing to buy the bonds at the highest prices and lowest yields, Watkins said.

“If I take bids on bonds that ought to be prima facie evidence that this is the price and yield of the bonds,” he said. “But I’ve got to go check EMMA? Remember we’re not talking about one bullet maturity. There can be 20 or 30 maturities in any given bond issue. So I’ve got to go find the price at which 25% of each of those maturities was sold to the public? I think that’s wholly unworkable.”

“That’s just an indication of a lack of knowledge on the part of Treasury because these regulations are supposed to clarify the rules and this changes the standards,” he said. Watkins complained IRS officials are trying “to go after some perceived abuse that simply doesn’t exist and in the process of so doing, they are creating a muddled process of what the issue price is.”

“I’m not sure how they can have studied this for over three years and yet gotten it so wrong,” Watkins said. “This will create a lot more problems than it solves.”

“This is so far from what we expected,” he said. Watkins said he thought Treasury might expand the percentage of sales used in the determination of issue price to 15% from 10%, but he never imagined the IRS would take away the reasonable expectations standard.

Decker was also surprised that the IRS did not distinguish between competitive and negotiated sales of bonds, as SIFMA had recommended. He said selling bonds competitively “should on its face establish a market price for the bonds.”

He said the elimination of the reasonable expectations standard would create “a big difference in the market.”

“You now have to wait until 25% of every maturity is sold or committed to investors that meet the criteria. That can take days or, in a worst case scenario, even weeks. And the market moves every day,” he said.

Decker also said the definition of underwriter and language on which sales can and cannot be counted toward the 25% is somewhat ambiguous.

The proposed rules say the issue price of tax-exempt bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public. The proposed rules define public to mean any person other than the underwriter. They define underwriter as “any person that purchases bonds from the issuer for the purpose of effecting the original distribution of the bonds, or otherwise participates directly or indirectly in the original distribution.”

The IRS said an underwriter would include, besides the lead underwriter, an underwriting syndicate

member, and a dealer “that purchases bonds for the purpose of effecting the original distribution.”

Decker pointed out that some dealers buy large portions or all of certain maturities for their inventories and may hold them for a while as an investment. “How are you supposed to sell bonds to a dealer desk and know whether it’s for the purpose of a long-term investment or the purpose of distribution?” he asked. “It raises ambiguity.”

“There are some questions,” he said. Can primary market sales to hedge funds, that don’t typically hold bonds for any length of time, be counted toward the 25%, he asked.

Some underwriters sell the bonds to dealers who specialize in selling bonds to retail investors, he said. A lot of investors want their bonds distributed to retail investors. Some issuers require their underwriters to have retail order periods.

“It’s unclear how the dealers involved in retail distribution are going to be able to adapt to these,” he said.

Decker noted SIFMA members have several months to study the rule and said, “We’re certainly going to suggest some clarifications and changes.”

Comments on the proposed rules are due to be submitted to the IRS by Dec. 16 and a public hearing is to be held Feb. 5, 2014.

Bond Dealers of America also raised concerns about the proposed rules.

Susan Collet, BDA’s senior vice president for government relations, said: “BDA is reviewing the proposed rules and looks forward to the opportunity to comment to the IRS, including to relay concerns that the newly proposed framework on issue price sets up a process that could impede the ability of underwriters to execute transactions efficiently on a day-to-day basis and be detrimental to issuers seeking access to the marketplace.”

by: LYNN HUME and NAOMI JAGODA

Proposed Issue Price Definition Eliminates Reasonable Expectation Standard for Exempt Bonds.

Proposed regulations (REG-148659-07) released September 13 would amend the definition of issue price for tax-exempt bonds, requiring them to be based on the actual sale price as opposed to reasonable expectations. The proposed regs reflect Treasury and IRS concerns that the current regulations do not produce appropriate results.

Issue price is defined under reg. section 1.148-1 as the first price at which a substantial amount of the bonds in an issue are sold to the public. The reg currently allows the price of bonds issued in a public offering to be determined as of the sale date based on reasonable expectations.

The preamble to the proposed regulations suggests that that approach may not produce a representative price, based on market data that show actual sales to the public at significantly different prices than the issue price. As such, the regs propose eliminating the reasonable expectations standard, meaning the issue price would be based on actual sales.

Scott R. Lilienthal of Hogan Lovells described the rule change as a "significant change of direction." Lilienthal, who is president of the National Association of Bond Lawyers, said that the reasonable expectation standard provided certainty for issuers, which would be lost under the proposed amendments. He added that the new rule would disproportionately affect competitive underwritings because it is more likely that the actual price will differ from the expectation of the issuer in those offerings.

Frederic L. Ballard Jr. of Ballard Spahr LLP said that the proposal would probably be criticized as administratively burdensome. "It would require bankers and lawyers to monitor trading activity in a way that is not required under the current regulations," he said.

The proposed regs provide that in the case of a refunding issue when an issuer must estimate the yield before the issue price can be determined, the issuer would be allowed to make curative payments to the IRS to reconcile differences between expected and actual issue prices.

"The regs recognize that the actual yield can be lower than an estimated yield, but they don't address the reverse situation, when the actual yield turns out to be higher," said Ballard.

David J. Cholst of Chapman and Cutler LLP noted that determining yield is not the only use of issue price. Knowing the issue price is also necessary for applying volume caps and limits on the amount of bonds. "Without knowledge of the issue price, you may think you are in compliance when you are not," said Cholst.

"We've gotten a number of comments requesting guidance on issue price over the last couple of years," said Vicky Tsilas, attorney-adviser, Treasury Office of Tax Legislative Counsel. "The proposed regulations are a result of discussions between IRS, Treasury, and industry representatives. We welcome comments and concerns."

The proposed regs also eliminate the mention of wholesaler from the issue price definition, and they define the term "underwriter" to mean any person who purchases bonds from the issuer for the purpose of effecting the original distribution of the bonds or who otherwise participates directly or indirectly in such original distribution. Lilienthal said that because of the broad definition of underwriter, there will continue to be questions about its application in some cases.

The proposed regs would also eliminate the definition of a substantial amount of an issue as 10 percent, citing instances of underwriters selling the first 10 percent at a lower price than the rest of an issue as a reason for changing the rule. Instead, the regs propose a safe harbor under which an issuer can treat the first price at which a minimum of 25 percent of bonds are sold as the issue price.

Working Capital Expenditures Proposals

The proposed regulations also amend the treatment of tax-exempt bond financings for working capital expenditures with the goal of simplifying the rules and providing objective guidelines for longer-term working capital financings.

Lorraine M. Tyson of Pugh, Jones & Johnson PC said that the proposals address many of the issues that have been raised by tax-exempt bond practitioners. "The most significant change is incorporating in the regulations an objective safe harbor against the creation of replacement proceeds for tax-exempt working capital financings with terms longer than 13 months," said Tyson.

Arbitrage restrictions apply to replacement proceeds in order to discourage issuers from issuing tax-exempt bonds with very long maturities or from leaving bonds outstanding longer than necessary. Replacement proceeds arise if the term of an issue is longer than reasonably necessary and amounts

are available for expenditures of the type being financed during the time the bond issue is outstanding beyond the reasonably necessary period.

The proposed safe harbor would require the issuer to determine the first year in which it expects to have funds available for working capital expenditures, monitor for actual available amounts beginning in that year, and apply those amounts to retire or invest in tax-exempt bonds that are not subject to the alternative minimum tax.

Tyson said that the change "recognizes the fiscal challenges many governmental issuers face with their long-term operating deficits and provides more definitive guidance to issuers who need to structure longer-term tax-exempt working capital financings."

by Matthew Dalton

More Standards Coming for Resolving Exempt Bond Violations.

The IRS is preparing to add new resolution standards to its voluntary closing agreement program (VCAP) for issuers of tax-exempt bonds, an official with the agency said September 17.

During a phone forum presented by the IRS Office of Tax-Exempt Bonds (TEB), George Gurrola, a TEB tax law specialist, said the IRS "in the near future" will publish an update to its VCAP for exempt bond issuers. The update will include four new resolution standards, he said.

The first two standards will involve approval violations under the 1982 Tax Equity and Fiscal Responsibility Act. The first will cover instances in which issuers rely on a misinterpretation of the TEFRA approval exception for current refundings under section 147(f)(2)(D), Gurrola said. The standard generally will provide for a closing agreement payment of 7.5 percent of taxpayer exposure from the issue date to the date of the closing agreement.

The second TEFRA-related standard will address violations that take place when an issuer reasonably relies on an individual other than a qualifying, applicable, elected representative to approve an issuance of private activity bonds, Gurrola said. That standard will provide for a closing agreement payment of 5 percent of taxpayer exposure from the issue date to the date of the closing agreement.

The third new standard is intended to resolve violations involving some small-issue bonds issued as draw-down bonds in an amount that exceeds volume cap. The standard was developed after some issuers of small-issue bonds issued as draw-down bonds realized that some draws in calendar years after the calendar year of the issue date resulted in bonds issued above the applicable volume cap limits, Gurrola explained.

The new standard generally will require the closing agreement to include representations from the issuer and a closing agreement payment of $1,000 for each calendar year after the calendar year of the initial draw, Gurrola said.

The final new standard addresses violations that occur when an otherwise satisfactory effort to remediate deliberate actions fails because a Form 8038 series return is not filed. Under the new standard, when the issuer asks to resolve the violation through VCAP within six months of the end of the prescribed period to file the return, the violation will be resolved with a $1,000 closing agreement payment, Gurrola said.

There also will be updates to resolution standards for direct pay bonds. A significant change, Gurrola said, is the separation of the de minimis premium violation standard previously applicable to some direct pay bonds into two resolution standards, with one standard applying to Build America Bonds (BABs) and recovery zone economic development bonds and the other to specified tax credit bonds.

The new standards are designed to resolve violations that occur when direct pay bonds are issued with more than the permitted amount of premium, Gurrola explained. They will provide generally that the violations can be resolved with closing agreement payments representing the amount of the excess direct pay credits attributable to the excess premium, he said. The revised standard for BABs and recovery zone economic development bonds extends the date for submitting VCAP requests to October 1, 2014, but the closing agreement payment will be slightly higher than under the previous standard.

Gurrola said TEB realizes that many VCAP requests will not fit within the resolution standards. He said it often helps if the issuer's proposed resolution terms have some consistency with or similarity to one of the resolution standards or a remedial action in the code or regulations, even if the standard or remedial action does not directly apply to the specific violation or facts and circumstances of the request.

by Fred Stokeld

IRS Publishes Proposed Regs on Arbitrage Rebate Overpayments on Tax-Exempt Bonds.

The IRS has published proposed regulations (REG-148812-11) that provide guidance on the recovery of overpayments of arbitrage rebate on tax-exempt bonds and other tax-advantaged bonds, including the deadline for filing a claim for an arbitrage rebate overpayment.

Comments and discussion topic outlines for the February 5 hearing are due by December 16.

Section 148(f)(1) generally provides that a bond that is part of an issue will be treated as an arbitrage bond unless the issuer pays to the United States the arbitrage rebate amounts described in section 148(f)(2). Reg. section 1.148-3(i) provides that an issuer may recover an overpayment of arbitrage rebate and similar payments on an issue of tax-exempt bonds if the issuer establishes to the satisfaction of the IRS that the overpayment occurred.

Rev. Proc. 2008-37 prescribed procedures for filing claims for a refund of arbitrage rebate and similar payments and imposed a filing deadline. In particular, a claim for a refund must be filed no later than two years after the final arbitrage computation date for the issue from which the claim arose. A transition rule applies to issues with a final computation date before June 24, 2008. The proposed regs include this two-year limitation on filing claims as well as the transition rule.

Under the proposed regs, the IRS may request additional information to support a claim, specify a date for a return of that information, and deny the claim if the information is not returned by the date specified or as extended by the IRS. If the IRS denies a claim because it was filed after the two-year deadline or if the Service doesn't receive requested information by the date specified in the request for additional information, the issuer may appeal the denial to the Office of Appeals. If Appeals determines that the claim was timely filed or that the requested information was timely submitted, the case will be returned for further consideration of the claim's merits.

Prop. reg. section 1.148-3(i)(3)(i) applies to refund claims arising from an issue of bonds to which reg. section 1.148-3(i) applies and for which the final computation date is after June 24, 2008. Issues for which the actual final computation date is on or before June 24, 2008, are deemed to have a final computation date of July 1, 2008. Prop. reg. section 1.148-3(i)(3)(ii) applies to refund claims arising from an issue of bonds to which reg. section 1.148-3(i) applies and for which the final computation date is after the date the proposed regs are published.

Arbitrage Rebate Overpayments on Tax-Exempt Bonds

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-148812-11]

RIN 1545-BK80

AGENCY: Internal Revenue Service (IRS), Treasury.ACTION: Notice of Proposed Rulemaking and Notice of Public Hearing.

SUMMARY: This document contains proposed regulations that provide guidance on the recovery of overpayments of arbitrage rebate on tax-exempt bonds and other tax-advantaged bonds. These proposed regulations provide the deadline for filing a claim for an arbitrage rebate overpayment and certain other rules. These proposed regulations affect issuers of tax-exempt and tax-advantaged bonds. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by December 16, 2013. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for February 5, 2014, at 2 p.m., must be received by December 16, 2013.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-148812-11), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered to: CC:PA:LPD:PR Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR, (REG-148812-11), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-148812-11). The public hearing will be held at the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Timothy Jones at (202) 622-3980; concerning submissions of comments and the hearing, Oluwafunmilayo (Funmi) Taylor at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) on the arbitrage investment restrictions on tax-exempt bonds and other tax-advantaged bonds under section 148 of the Internal Revenue Code (Code) (Proposed Regulations). Section 1.148-3(i) of the

Income Tax Regulations provides that an issuer may recover an overpayment of arbitrage rebate and similar payments on an issue of tax-exempt bonds if the issuer establishes to the satisfaction of the IRS Commissioner that the overpayment occurred. Revenue Procedure 2008-37, 2008-2 CB 137, provides procedures for filing claims for a refund of arbitrage rebate and similar payments and imposes a deadline for filing such claims. In particular, a claim for a refund must be filed no later than 2 years after the final arbitrage computation date for the issue from which the claim arose. A transition rule applies to issues with a final computation date before June 24, 2008. The Proposed Regulations include this 2-year limitation on filing claims as well as the transition rule.

The Proposed Regulations also provide that the Commissioner may request additional information to support a claim, specify a date for a return of that information, and deny the claim if the information is not returned by the date specified or as extended by the Commissioner. Under the Proposed Regulations, if the Commissioner denies a claim because it was filed after the year deadline or requested information is not received by the date specified in the request for such additional information, the issuer may appeal the denial to the Office of Appeals. If Appeals concludes the claim was timely filed or the requested information was timely submitted, as applicable, the case will be returned to the Commissioner for further consideration of the merits of the claim. See 26 CFR 601.601(d)(2).

In accordance with section 7805(b)(1), § 1.148-3(i)(3)(i) of the Proposed Regulations applies to refund claims arising from an issue of bonds to which § 1.148-3(i) applies and for which the final computation date is after June 24, 2008. Issues for which the actual final computation date is on or before June 24, 2008, are deemed to have a final computation date of July 1, 2008. Section 1.148-3(i)(3)(ii) and (iii) of the Proposed Regulations apply to refund claims arising from an issue of bonds to which § 1.148-3(i) applies and for which the final computation date is after the date of publication of the Proposed Regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It is hereby certified that these Proposed Regulations will not have a significant economic impact on a substantial number of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. The proposed changes reaffirm or clarify filing deadlines previously published in other administrative guidance. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these Proposed Regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. The IRS and the Treasury Department request comments on all aspects of the proposed rules. All comments will be available at www.regulations.gov or upon request.

A public hearing has been scheduled for February 5, 2014, at 2 p.m., in the IRS Auditorium, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For more information about having your name placed on the building access list to attend the hearing,

see the “FOR FURTHER INFORMATION CONTACT” section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic by December 16, 2013. Submit a signed paper original and eight (8) copies or an electronic copy. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Timothy Jones, Office of Associate Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for § 1.148-6 and revising the entry for §§ 1.148-0 through 1.148-11 to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Sections 1.148-0 through 1.148-11 also issued under 26 U.S.C. 148(i). * * *

Par. 2. Section 1.148-0 is amended by adding entries to paragraph (c) for §§ 1.148-3(i)(3) and 1.148-11(k) and (l) and revising § 1.148-11 section heading to read as follows:

§ 1.148-0 Scope and table of contents.

(c) * * *

§ 1.148-3 General arbitrage rebate rules.

(i) * * *

(3) Time and manner for requesting refund.

§ 1.148-11 Effective/applicability dates.

(k) [Reserved]

(l) Additional arbitrage guidance updates.

(1) [Reserved]

(2) [Reserved]

(3) [Reserved]

(4) Application.

Par. 3. Section 1.148-3 is amended by adding paragraph (i)(3) to read as follows:

§ 1.148-3 General arbitrage rebate rules.

(i) * * *

(3) Time and manner for requesting refund — (i) An issuer must request a refund of an overpayment no later than the date that is 2 years after the final computation date for the issue to which the overpayment relates (the filing deadline). The request must be made using the form provided by the Commissioner for this purpose.

(ii) The Commissioner may request additional information to support a refund request. The issuer must file the additional information by the date specified in the Commissioner's request which date may be extended by the Commissioner if unusual circumstances warrant.

(iii) A claim described in either paragraph (i)(3)(iii)(A) or (i)(3)(iii)(B) of this section that has been denied by the Commissioner may be appealed to the Office of Appeals under this paragraph (i)(3)(iii). Upon a determination in favor of the issuer, Appeals must return an undeveloped case to the Commissioner for further consideration of the substance of the claim.

(A) A claim is described in this paragraph (i)(3)(iii)(A) if the claim is filed after the filing deadline.

(B) A claim is described in this paragraph (i)(3)(iii)(B) if it is a claim for which additional information satisfactory to the Commissioner is not submitted within the time specified in the request for information or any extension of such specified time period.

Par. 4. Section 1.148-11 is amended by revising the section heading and adding paragraphs (k) and (l) to read as follows:

§ 1.148-11 Effective/applicability dates.

(k) [Reserved]

(l) Additional arbitrage guidance updates. (1) [Reserved]

(2) [Reserved]

(3) [Reserved]

(4) Application. (i) Section 1.148-3(i)(3)(i) applies to refund claims arising from an issue of bonds to which § 1.148-3(i) applies and for which the final computation date is after June 24, 2008. For purposes of this paragraph (l)(4), issues for which the actual final computation date is on or before June 24, 2008, are deemed to have a final computation date of July 1, 2008.

(ii) Section 1.148-3(i)(3)(ii) and (iii) apply to refund claims arising from an issue of bonds to which § 1.148-3(i) applies and for which the final computation date is after September 16, 2013.

Beth Tucker

Deputy Commissioner for Operations

Support

IRS Publishes Proposed Regs on Arbitrage Restrictions on Tax-Exempt Bonds.

The IRS has published proposed regulations (REG-148659-07) on the section 148 arbitrage investment restrictions applicable to tax-exempt bonds and other tax-advantaged bonds to amend the current rules to address market developments, simplify some provisions, explain technical issues, and improve administrability.

In September 2007, the IRS and Treasury published proposed regs (REG-106143-07) to update the rules related to the section 148 arbitrage investment restrictions applicable to some tax-exempt bonds. The new regs propose additional amendments. Comments and discussion topic outlines for the February 5 public hearing are due by December 16.

The issue price definition under the current rules applies a reasonable expectations standard for determining the issue price of bonds that are publicly offered. Treasury and the IRS have expressed concerns that some aspects of the current rules for determining the issue price of tax-exempt bonds are no longer appropriate in light of market developments. One concern is the ability of the reasonable expectations standard to produce a representative issue price. To address all concerns and provide greater certainty, the proposed regs amend the issue price definition used for arbitrage purposes. The regs provide that the issue price of tax-exempt bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public. The regs replace the definition of substantial amount as 10 percent with a safe harbor. The regs provide relief in some cases involving refunding issues, allowing issuers to make curative payments to the IRS to reconcile differences between expected and actual issue prices of the refunding bonds for arbitrage compliance purposes. Under the regs, a person that holds bonds for investment isn’t an underwriter of those bonds. Comments are requested on whether specific identification rules should be provided for determining when a bond is held for investment.

The current rules impose a number of arbitrage investment restrictions to limit arbitrage incentives for excessive use of tax-exempt bond financing for working capital expenditures. The proposed regs amend the treatment of working capital financings to simplify this area and provide objective parameters for longer-term working capital financings. The regs remove a restriction against financing a working capital reserve, retain the general 5 percent test for the size of a permitted reasonable working capital reserve fund, provide that the maturity safe harbor against the creation of replacement proceeds for short-term working capital financings is 13 months, and provide a new objective safe harbor against the creation of replacement proceeds for working capital financings that have terms longer than the proposed 13-month safe harbor. The regs also add extraordinary working capital items to the list of factors that may justify a bond term beyond the maturity safe harbors against the creation of replacement proceeds.

In the 2007 proposed regs, comments were requested on the types of offsetting hedges that are necessary for valid business purposes and suggestions were solicited on how to clarify the current rule on offsetting hedges. In consideration of those comments, the new regs propose rules that provide greater certainty for hedge terminations and clarify and simplify the treatment of modifications and terminations of qualified hedges. The regs provide guidance on the treatment of modifications of qualified hedges while eliminating the concept of offsetting hedges and simplify the

treatment of qualified hedges upon refunding hedged bonds when there is no actual termination of the associated hedge. The regs also provide guidance on the amount of a termination payment for both deemed and actual terminations of qualified hedges.

The preamble to the proposed regs describes other technical changes to the current rules. The regs generally are proposed to apply prospectively to bonds that are sold on or after the date that is 90 days after publication of the final regs in the Federal Register.

Arbitrage Restrictions on Tax-Exempt Bonds

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-148659-07]

RIN 1545-BH38

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of Proposed Rulemaking and Notice of Public Hearing.

SUMMARY: This document contains proposed regulations on the arbitrage restrictions under section 148 of the Internal Revenue Code applicable to tax-exempt bonds and other tax-advantaged bonds. These proposed regulations amend existing regulations to address certain current market developments, simplify certain provisions, address certain technical issues, and make the regulations more administrable. These proposed regulations affect issuers of tax-exempt and other tax-advantaged bonds. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by December 16, 2013. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for February 5, 2014, at 10:00 a.m., must be received by December 16, 2013.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-148659-07), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered to: CC:PA:LPD:PR Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-148659-07), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-148659-07). The public hearing will be held at the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Zoran Stojanovic at (202) 622-3980; concerning submissions of comments and the hearing, Oluwafunmilayo Taylor at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:CAR:MP:T:T:SP, Washington DC 20224. Comments on the collection of information should be received by November 15, 2013.

Comments are sought on whether the proposed collection of information is necessary for the proper performance of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques and other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in § 1.148-4(h)(2)(viii) which contains a requirement that the issuer maintain in its records a certificate provided by the hedge provider. Existing regulations require, among other items, that a hedge must be identified by the actual issuer on its books and records to be a qualified hedge. The identification must specify the hedge provider, the terms of the contract, and the hedged bonds. The proposed regulations require that the identification also include a certificate provided by the hedge provider specifying certain information regarding the hedge. The respondents are issuers of tax-exempt bonds that enter into hedges on their bonds and the hedge providers.

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) on the arbitrage investment restrictions under section 148 of the Internal Revenue Code (Code) and related provisions. On June 18, 1993, the Department of the Treasury (Treasury) and the IRS published comprehensive final regulations in the Federal Register (TD 8476, 58 FR 33510) on the arbitrage investment restrictions and related provisions for tax-exempt bonds under sections 103, 148, 149, and 150, and, since that time, those final regulations have been amended in certain limited respects (the regulations issued in 1993 and the amendments thereto are collectively referred to as the Existing Regulations). A Notice of Proposed Rulemaking was published in the Federal Register (72 FR 54606; REG-106143-07) on September 26, 2007 (2007 Proposed Regulations), which proposes amendments to the Existing Regulations to address market developments, simplify certain provisions, address certain technical issues, and make the regulations more administrable. One notable change in the 2007 Proposed Regulations addresses a municipal market development in which issuers seek to modify interest rate risks by entering into hedging transactions that are based on taxable interest rate indexes (for example, LIBOR-based interest rate swaps). The 2007 Proposed Regulations clarify that these hedges qualify to be taken into account with the hedged bonds on a net basis in determining bond yield for arbitrage purposes. Among the other notable changes in the 2007 Proposed Regulations are (1) a revision to an investment bidding safe harbor to accommodate certain transparent internet-based electronic bidding procedures;(2) removal of the authority in the Existing Regulations to permit issuers of qualified mortgage bonds and qualified student loan bonds to compute a single joint bond yield for purposes of applying the arbitrage restrictions to two or

more issues of these types of tax-exempt bonds; and (3) clarification that the amount an issuer is entitled to receive under a rebate refund claim is the excess of the total amount actually paid over the rebate amount. Among the technical changes in the 2007 Proposed Regulations are changes to the rules that address qualified hedges for arbitrage purposes and additions to the rules on permitted yield reduction payments. This document (the Proposed Regulations) proposes additional amendments to the Existing Regulations.

Explanation of Provisions

I. Definitions and Elections (§ 1.148-1).

A. Issue price definition. Section 148(h) provides that yield on an issue is to be determined on the basis of the issue price (within the meaning of sections 1273 and 1274). The issue price definition under the Existing Regulations generally follows the issue price definition used for computing original issue discount on debt instruments under sections 1273 and 1274 of the Code, with certain modifications. Specifically, the issue price definition under the Existing Regulations applies a reasonable expectations standard (rather than a standard based on actual sales) for determining the issue price of bonds that are publicly offered. Under this standard, the first price at which a substantial amount (defined to mean ten percent) of the bonds is reasonably expected to be sold to the public is treated as the issue price and is used in determining the yield on the issue.

The standard uses reasonable expectations to allow issuers of advance refunding bonds to estimate the yield on the issue before the actual sales prices of the bonds are known so that the issuer can purchase yield-restricted investments for a refunding escrow to defease the prior bonds at the time of the sale of the refunding bonds. The issue prices of bonds with different payment and credit terms are determined separately. Notice 2010-35 (2010-19 IRB 660) provides that the arbitrage definition of issue price also applies to other tax-advantaged bond programs, including Build America Bonds under section 54AA and other Qualified Tax Credit Bonds under section 54A. See 26 CFR 601.601(d)(2).

The Treasury Department and the IRS are concerned that certain aspects of the Existing Regulations for determining the issue price of tax-exempt bonds are no longer appropriate in light of market developments since those regulations were published. In particular, the Treasury Department and the IRS are concerned that the ten-percent test does not always produce a representative price for the bonds. Underwriters of tax-exempt bonds may sell bonds of an issue with the same payment and credit terms in an initial public offering at different prices but execute the first ten percent of the sales of those bonds at the lowest price (and thus the highest yield), causing the issue price of the bonds to be a lower price than is representative of the prices at which the remaining bonds were sold.

In addition, increasing transparency about pricing information in the municipal bond market (for example, publicly-available pricing information from the Municipal Securities Rulemaking Board through its Electronic Municipal Market Access (EMMA) platform) has led to heightened scrutiny of issue price standards. The reported data has shown, in certain instances, actual sales to the public at prices that differed significantly from the issue price used by the issuer. These price differences have raised questions about the ability of the reasonable expectations standard to produce a representative issue price. The reported trade data has also called into question whether sales to underwriters and security dealers have been included as sales to the public in determining issue price in certain instances.

To address these concerns and to provide greater certainty, the Proposed Regulations amend the issue price definition used for arbitrage purposes in certain significant respects. Consistent with

section 148(h), the Proposed Regulations retain the rule that issue price generally will be determined under the rules of sections 1273 and 1274. The Proposed Regulations remove the reference to issue price of bonds that are "publicly offered" because the existing section 1273 regulations do not distinguish between public offering and private placement. The Proposed Regulations parallel the language in the existing section 1273 regulations that refer to debt instruments issued for money.

The Proposed Regulations provide that the issue price of tax-exempt bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public. (As described further below, the Proposed Regulations define the term "public" to mean any person other than an "underwriter" and provide a new definition of the term "underwriter.") The Proposed Regulations, however, remove the definition of substantial amount as ten percent. Instead, the Proposed Regulations provide a safe harbor under which an issuer may treat the first price at which a minimum of 25 percent of the bonds in an issue (with the same credit and payment terms) is sold to the public as the issue price, provided that all orders at this price received from the public during the offering period are filled (to the extent that the public orders at such price do not exceed the amount of bonds sold). Consistent with section 1273, the Proposed Regulations base the determination of issue price on actual sale prices instead of reasonably expected sale prices.

The Treasury Department and the IRS understand that, in the case of a refunding issue, an issuer may need to estimate the yield on the issue before the actual issue price can be determined so that the issuer can purchase yield-restricted investments for a refunding escrow to defease the prior bonds at the time of the sale of the refunding bonds. The Proposed Regulations provide relief in these situations by permitting issuers to make curative payments to the IRS, called "yield reduction payments," to reconcile differences between expected and actual issue prices of the refunding bonds for arbitrage compliance purposes.

The Existing Regulations disregard sales to "underwriters" or "wholesalers" in determining the issue price of tax-exempt bonds that are offered to the public. The Proposed Regulations provide that the issue price of tax-exempt bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public and, for this purpose, define the term "public" to mean any person other than an "underwriter." The Proposed Regulations also define the term "underwriter" to mean any person that purchases bonds from the issuer for the purpose of effecting the original distribution of the bonds, or otherwise participates directly or indirectly in the original distribution. An underwriter includes a lead underwriter and any member of a syndicate that contractually agrees to participate in the underwriting of the bonds for the issuer. A securities dealer (whether or not a member of the issuer's underwriting syndicate) that purchases bonds (whether or not from the issuer) for the purpose of effecting the original distribution of the bonds is also treated as an underwriter for this purpose. An underwriter generally includes a related party to an underwriter.

The Proposed Regulations eliminate the reference to "wholesalers" in the issue price definition, because the revised, more comprehensive definition of underwriter includes those persons who would otherwise be treated as "wholesalers" under the Existing Regulations.

Under the Proposed Regulations, a person that holds bonds for investment is not an underwriter with respect to those bonds. The Treasury Department and the IRS solicit public comment on whether specific identification rules, such as the section 1236(b) identification rules, should be provided for determining when a bond is held for investment.

B. Working capital expenditures and replacement proceeds definition. The Existing Regulations impose a number of arbitrage investment restrictions to limit arbitrage incentives for excessive use of tax-exempt bond financing for "working capital expenditures" (working capital), such as operating

expenses or seasonal cash flow deficits (as distinguished from capital projects). The Proposed Regulations amend the treatment of working capital financings in several respects to simplify this area and to provide objective parameters for longer-term working capital financings.

An issuer is relieved of arbitrage investment restrictions on bond proceeds only after the proceeds are spent. The Existing Regulations impose a strict "bond proceeds-spent-last" accounting assumption for spending proceeds of tax-exempt bonds on working capital. This accounting rule recognizes that sources of funds are fungible and treats bond proceeds as spent for working capital purposes only after the issuer depletes other "available amounts" that the issuer otherwise could use for this purpose. An issuer, however, need not be "broke to borrow" for working capital purposes. Here, the Existing Regulations allow an issuer to maintain a "reasonable working capital reserve" fund that need not be spent before spending bond proceeds on working capital. The Existing Regulations provide a general rule that the permitted size of this reasonable working capital reserve fund is an objective measure equal to five percent of the issuer's actual working capital expenditures in the previous fiscal year from operations. In addition, the Existing Regulations include a broad prohibition against direct or indirect financing of a working capital reserve itself. This prohibition against financing working capital reserves imposes another complex limit on the size of the permitted working capital reserve fund that requires analysis of amounts previously maintained for such purpose.

The Proposed Regulations remove the restriction against financing a working capital reserve. This restriction inappropriately penalizes those State and local governments that have previously maintained the least amount of working capital reserves and that may have the most bona fide need to finance working capital expenditures. Further, this restriction is complex. The Proposed Regulations retain the existing general five percent test for the size of a permitted reasonable working capital reserve fund.

The Existing Regulations also limit working capital financings through the concept of replacement proceeds. The arbitrage rules apply to more than the actual proceeds of the issue; they apply to gross proceeds, which include proceeds and replacement proceeds of an issue. The Existing Regulations provide broadly that replacement proceeds arise if an issuer reasonably expects as of the issue date that (1) the term of an issue will be longer than reasonably necessary for the governmental purposes of the issue, and (2) there will be available amounts for expenditures of the type being financed during the period that the issue remains outstanding longer than necessary. One purpose of the replacement proceeds rules is to discourage issuers from issuing tax-exempt bonds with unduly long maturities or leaving tax-exempt bonds outstanding longer than reasonably necessary. The replacement proceeds rules particularly affect working capital financings.

The Existing Regulations provide a safe harbor against the creation of replacement proceeds for short-term working capital bond financings that are outstanding for no longer than two years. To address concerns about arbitrage incentives associated with certain short-term financing practices, however, Rev. Proc. 2002-31 (2002-1 CB 916) shortened the safe-harbor for these financings from two years to 13 months in most circumstances. Questions have arisen with respect to the interaction between the Existing Regulations and Rev. Proc. 2002-31. See 26 CFR 601.601(d)(2).

The Proposed Regulations provide that the maturity safe harbor against the creation of replacement proceeds for short-term working capital financings is 13 months. This change conforms the regulatory safe harbor to the more recent administrative standard under Rev. Proc. 2002-31 for the traditional short-term working capital financings for seasonal cash flow deficits.

The Existing Regulations, however, provide no safe harbors against the creation of replacement proceeds or other specific guidance regarding appropriate limits for longer-term working capital

financings, such as longer-term deficit financings for issuers experiencing financial distress. State and local governments have sought guidance on appropriate parameters for such financings. The Proposed Regulations provide a new objective safe harbor against the creation of replacement proceeds for working capital financings that have terms longer than the proposed 13-month safe harbor. This new safe harbor requires an issuer to determine the first year in which it expects to have available amounts for working capital expenditures, monitor for actual available amounts in each year beginning with the year it first expects to have such amounts, and apply such available amounts in each year either to retire or to invest in tax-exempt bonds that are not investment property under section 148(b)(3) of the Code (that is, tax-exempt bonds that are not subject to the alternative minimum tax). Consistent with the purpose of the replacement proceeds rules, this new safe harbor aims to control the burden of unnecessary tax-exempt financings on the tax-exempt bond market by requiring issuers to redeem or purchase tax-exempt bonds.

The Existing Regulations have a general arbitrage anti-abuse rule, which provides, in part, that specific factors (particularly bona fide cost under-runs and long-term financial distress) may justify a bond maturity that exceeds the maturity safe harbors against the creation of replacement proceeds. Separately, the Existing Regulations provide more favorable accounting rules for certain extraordinary, non-recurring working capital items, such as casualty losses. The Proposed Regulations add extraordinary working capital items to the factors that may justify a bond term beyond the maturity safe harbors against the creation of replacement proceeds.

II. Qualified Hedge Provisions (§ 1.148-4).

To determine the yield on hedged bonds for purposes of the arbitrage investment restrictions, the Existing Regulations permit issuers to take into account and integrate the net payments on certain qualified hedges entered into to modify the risk of interest rate changes with the payments on the associated hedged tax-exempt bonds. In general, to be a qualified hedge, the terms of the hedge must correspond closely with those of the hedged bonds, the issuer must identify the hedge, and the hedge must contain no significant investment element.

The Existing Regulations provide that a termination of a qualified hedge includes any sale or other disposition of the hedge by the issuer or the acquisition by the issuer of an offsetting hedge. The Existing Regulations further provide that a deemed termination of a qualified hedge occurs when certain material modifications or assignments of a hedge result in a realization event to the issuer under section 1001. Under the Existing Regulations, if a hedge is deemed terminated, the issuer is deemed to have made or received a termination payment and, if applicable (such as when there is a material modification of the hedge), a deemed acquisition payment for a “new” hedge. Because the hedge is integrated with the bond yield, the deemed payments, like actual termination payments, can affect the yield on the bonds.

Issues have arisen in this area as a result of market conditions during the last several years. State and local governments have faced a number of circumstances that have put pressure on issuers to modify or terminate their existing qualified hedges. Treasury and the IRS have also received questions indicating that there is uncertainty about what constitutes an “offsetting hedge” that terminates a qualified hedge.

In the 2007 Proposed Regulations, Treasury and the IRS solicited public comments regarding the types of offsetting hedges that are necessary for valid business purposes and recommendations on how to clarify the rule in the Existing Regulations regarding offsetting hedges. The Proposed Regulations consider those comments and propose rules that provide greater certainty regarding hedge terminations and clarify and simplify the treatment of modifications and terminations of qualified hedges.

A. Modifications of qualified hedges. The Proposed Regulations provide guidance on the treatment of modifications of qualified hedges while eliminating the concept of offsetting hedges. The Proposed Regulations provide that a modification, including an actual modification, an acquisition of another hedge, or an assignment, generally will result in a deemed termination of a hedge if the modification is material and results in a deemed disposition under section 1001.

The Proposed Regulations provide, however, that a material modification of a qualified hedge that otherwise would result in a deemed termination will not result in such a termination if the modified hedge is a qualified hedge. For this purpose, the Proposed Regulations require testing the modified hedge for compliance with the requirements for qualified hedges at the time of the modification.

These proposed changes generally produce results that are economically comparable to the Existing Regulations, but in a simpler manner. The Proposed Regulations reduce complexity associated with the approach under the Existing Regulations by eliminating the need to account for deemed hedge termination and acquisition payments, which deemed payments generally offset each other without substantive effect on the yield on the hedged bonds.

B. Continuations of qualified hedges in refundings. The Existing Regulations generally treat a refunding of hedged bonds as a deemed termination of a qualified hedge and require accounting for the deemed termination payment in the yield on the refunding bonds over the remaining term of the original hedge in accordance with economic substance. The Proposed Regulations simplify the treatment of qualified hedges upon refunding hedged bonds when there is no actual termination of the associated hedge. If the affected hedge meets the requirements for a qualified hedge of the refunding bonds as of the issue date of the refunding bonds, with certain exceptions, the Proposed Regulations treat the affected hedge as continuing as a qualified hedge of the refunding bonds instead of being terminated. Similar to the proposed treatment of hedge modifications, the proposed treatment of these continuations of qualified hedges in refundings under the Proposed Regulations generally produces economically comparable results as the Existing Regulations in a simpler manner.

C. Termination of hedges at fair market value. The 2007 Proposed Regulations clarify that the termination payment for a termination or a deemed termination of a qualified hedge is equal to the fair market value of the hedge on the termination date. In response to comments received on the clarification in the 2007 Proposed Regulation, these Proposed Regulations modify the 2007 proposed rule. For a deemed termination of a qualified hedge, the Proposed Regulations provide that the amount of the termination payment is equal to the fair market value of the qualified hedge on the termination date. For an actual termination of a qualified hedge, the Proposed Regulations provide that the amount of the hedge termination payment treated as made or received on the hedged bonds (i) may not exceed the fair market value of the qualified hedge if paid by the issuer, and (ii) may not be less than the fair market value of the qualified hedge if received by the issuer. Comments on the 2007 Proposed Regulations as well as comments received in response to these Proposed Regulations will be considered in connection with finalizing this rule.

III. Other Technical Changes.

The Proposed Regulations make other technical changes to the Existing Regulations. This section describes the technical changes.

A. Temporary period spending exception to yield restriction (§ 1.148-2). The Existing Regulations provide certain short-term exceptions, called “temporary period” exceptions, which allow investment of proceeds of tax-exempt bonds for fairly short periods without yield restriction. These exceptions reduce administrative burdens and recognize that limited arbitrage potential exists for bond

proceeds that are spent promptly.

The Existing Regulations provide no express exceptions for proceeds used for certain types of working capital expenditures, such as certain extraordinary working capital items. The Proposed Regulations broaden the existing 13-month temporary period exception to yield restriction for restricted working capital expenditures to include all working capital expenditures.

B. Certification of hedge provider (§ 1.148-4). Concerns have been raised about pricing of hedges involving tax-exempt bonds. Existing regulations require, among other items, that a hedge must be identified by the actual issuer on its books and records to be a qualified hedge. The identification must specify the hedge provider, the terms of the contract, and the hedged bonds. To promote greater accountability and transparency about pricing of these hedges, the Proposed Regulations require that the identification also include a certificate provided by the hedge provider specifying certain information regarding the hedge including a statement about the bona fide, arm's-length nature of the pricing and information about payments beyond those properly taken into account as payments to modify the risk of interest rate changes.

C. Yield and valuation of investments (§ 1.148-5). The Existing Regulations provide guidance on how to value investments allocated to an issue. Absent a special rule, the Existing Regulations give issuers the option to choose a valuation method, provided that the chosen method is consistently applied for arbitrage purposes on a valuation date. The special rules in the Existing Regulations leave some ambiguity about when the present value and the fair market value methods of valuation are permitted or required.

The Proposed Regulations clarify that the fair market value method of valuation generally is required for any investment (including a yield-restricted investment) on the date the investment is first allocated to an issue or first ceases to be allocated to an issue as a consequence of a deemed acquisition or a deemed disposition.

The Existing Regulations include only one exception to this mandatory fair market value rule. The issuer has the option to value an investment at present value when proceeds are allocated from one bond issue to another bond issue as transferred proceeds in refundings or universal cap allocations, provided that both affected bond issues consist exclusively of tax-exempt bonds. This exception applies only to transfers between two tax-exempt bond issues to address a concern about allocating excessive value to obligations without arbitrage restrictions. This exception, however, creates a disincentive against retiring tax-exempt bonds with taxable bonds, such as when the fair market value of the investment would cause investment yield to exceed the tax-exempt bond yield. Such a disincentive is inconsistent with the general policies behind the arbitrage rules as stated in § 1.148-0. To provide more appropriate incentives, the Proposed Regulations change this rule to require only that the issue from which the investment is allocated (that is, the first issue in an allocation from one issue to another) consists exclusively of tax-exempt bonds.

D. Authority of Commissioner under anti-abuse rule (§ 1.148-10). The Existing Regulations provide the Commissioner with authority to exercise discretion with respect to any transaction entered into for the principal purpose of obtaining a material financial advantage based on the difference between tax-exempt and taxable interest rates in a manner that is inconsistent with the arbitrage rules. The Proposed Regulations revise the Existing Regulations to clarify that the Commissioner has the authority to depart from the arbitrage rules as necessary to prevent such material financial advantage.

E. Transition provision for certain guarantee funds (§ 1.148-11). Section 1.148-11(d)(1) provides a transition rule that allows certain State perpetual trust funds (for example, certain state permanent

school funds) to pledge funds to guarantee tax-exempt bonds without resulting in arbitrage-restricted replacement proceeds. In Notice 2010-5 (2010-2 IRB 256) the Treasury Department and the IRS proposed to increase the amount of tax-exempt bonds that such funds could guarantee under this special rule and stated their intent to issue proposed regulations to implement this change. The Proposed Regulations include these changes. The Proposed Regulations also extend this rule to cover certain tax-exempt bonds issued to finance public charter schools in response to comments received on the Notice. See 26 CFR 601.601(d)(2).

F. Definitions and special rules (§ 1.150-1).

1. Definition of tax-advantaged bonds. The Proposed Regulations provide a new definition of tax-advantaged bonds as tax-exempt bonds under section 103, taxable bonds that provide Federal tax credits to investors to subsidize the issuer's borrowing costs, and taxable bonds that provide refundable Federal tax credits payable directly to issuers under section 6431, or any future similar bonds that provide a Federal subsidy for any portion of an issuer's borrowing costs.

2. Definition of issue. The Existing Regulations provide that tax-exempt bonds and taxable bonds are not part of the same issue. Questions have arisen regarding the appropriate treatment of taxable tax-advantaged bonds for purposes of this composite issue provision. The Proposed Regulations clarify that taxable tax-advantaged bonds and other taxable bonds are treated as part of different issues. The Proposed Regulations also clarify that different types of tax-advantaged bonds are treated as parts of different issues.

3. Definition and treatment of grants. The Existing Regulations include a definition of a grant. The Existing Regulations also provide a special arbitrage spending rule that treats proceeds used by an issuer to make a grant to an unrelated party as spent for arbitrage investment tracking purposes when the grant is made. A longstanding question is whether an issuer may look at the grantee's use of the grant funds to determine whether the bond issue complies with other arbitrage and general program restrictions on tax-exempt bonds. For example, taking into account the grantee's use may impact whether the issue finances capital projects or working capital expenditures, and accordingly which arbitrage rules apply to that issue. The Proposed Regulations expand the application of the existing definition of grant for arbitrage purposes to apply that definition to other tax-exempt bond provisions. The Proposed Regulations clarify that the character and nature of a grantee's use of proceeds generally is taken into account in determining whether other applicable non-arbitrage requirements of the issue are met.

IV. Effective/Applicability Dates

The Proposed Regulations generally are proposed to apply prospectively to bonds that are sold on or after the date that is 90 days after publication of final regulations in the Federal Register. Section 1.148-4(h)(2)(viii) is proposed to apply to qualified hedges that are entered into on or after the date that is 90 days after the date of publication of the final regulations in the Federal Register. Section 1.148-4(h)(3)(iv)(A) through (H) and (h)(4)(iv) are proposed to apply to hedges that are entered into on or after the date that is 90 days after the date of publication of final regulations in the Federal Register, to qualified hedges that are modified on or after such date with respect to such modifications, and to qualified hedges on bonds that are refunded on or after such date with respect to such refunding.

In addition, except as otherwise provided in the next paragraph, issuers may apply and rely upon the Proposed Regulations, in whole or in part, with respect to bonds that are sold on or after September 16, 2013, and before the date that is 90 days after publication of final regulations in the Federal Register.

Issuers may apply and rely upon § 1.148-4(h)(3)(iv)(A) through (H) and (h)(4)(iv) of the Proposed Regulations in whole to hedges that are entered into on or after September 16, 2013, and before the date that is 90 days after publication of final regulations in the Federal Register; to qualified hedges that are modified on or after September 16, 2013, and before the date that is 90 days after publication of final regulations in the Federal Register with respect to such modifications; and to qualified hedges on bonds that are refunded on or after September 16, 2013, and before the date that is 90 days after publication of final regulations in the Federal Register with respect to such refunding.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Some of the proposed changes clarify or simplify existing regulatory provisions, or otherwise involve simplifying or clarifying changes that will not have a significant economic impact on governmental jurisdictions or other entities of any size. These proposed regulations amend the issue price definition used for arbitrage purposes and provide a new objective safe harbor against the creation for replacement proceeds for long term working capital financings. These proposed changes are not expected to have a significant economic impact because they provide greater certainty to issuers and assist issuers in complying with the arbitrage restrictions on tax-exempt bonds.

Other proposed changes involve the treatment of certain hedging transactions, including requiring a certificate from a hedge provider. Although there is a lack of available data regarding the extent of usage of these hedging transactions by small entities, the IRS and the Treasury Department understand that these hedging transactions are used primarily by larger State and local governments and large counterparties. The IRS and the Treasury Department specifically solicit comment from any party, particularly small entities, on the accuracy of this certification. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these Proposed Regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. The IRS and the Treasury Department request comments on all aspects of the proposed rules. All comments that are submitted by the public will be available for public inspection and copying at www.regulations.gov or upon request.

A public hearing has been scheduled for February 5, 2014, at 10:00 a.m. in the IRS Auditorium, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For more information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be

discussed and the time to be devoted to each topic by December 16, 2013. Submit a signed paper original and eight (8) copies or an electronic copy. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Johanna Som de Cerff, Office of Associate Chief Counsel (Financial Institutions and Products), IRS, and Vicky Tsilas, Office of Tax Policy. However, other personnel from the IRS and Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for § 1.148-6 and revising the entry for §§ 1.148-0 through 1.148-11 to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Sections 1.148-0 through 1.148-11 also issued under 26 U.S.C. 148(i). * * *

Par. 2. Section 1.141-0 is amended by revising the section heading for § 1.141-15 and adding new entries for § 1.141-15(l), (m), and (n) to read as follows:

§ 1.141-0 Table of contents.

§ 1.141-15 Effective/applicability dates.

(l) [Reserved]

(m) [Reserved]

(n) Effective/applicability dates for certain regulations relating to certain definitions.

Par. 3. Section 1.141-1 is amended by revising paragraph (a) to read as follows:

§ 1.141-1 Definitions and rules of general application.

(a) In general. For purposes of §§ 1.141-0 through 1.141-16, the following definitions and rules apply: the definitions in this section, the definitions in § 1.150-1, the definition of placed in service in § 1.150-2(c), the definition of reasonably required reserve or replacement fund in § 1.148-2(f), and the definitions in § 1.148-1 of bond year, commingled fund, fixed yield issue, higher yielding investments, investment, investment proceeds, issue price, issuer, nonpurpose investment, purpose investment, qualified guarantee, qualified hedge, reasonable expectations or reasonableness, rebate amount, replacement proceeds, sale proceeds, variable yield issue and yield.

Par. 4. Section 1.141-15 is amended by revising the section heading and adding paragraphs (l), (m), and (n) to read as follows:

§ 1.141-15 Effective/applicability dates.

(l)[Reserved]

(m)[Reserved]

(n) Effective/applicability dates for certain regulations relating to certain definitions. Revised § 1.141-1(a) applies to bonds that are sold on or after the date that is 90 days after publication of final regulations in the Federal Register.

Par. 5. Section 1.148-0 is amended by adding new entries in paragraph (c) for §§ 1.148-1(f) and 1.148-11(k) and (l); and revising the entries for §§ 1.148-2(e)(3) and 1.148-10(e) and section heading for § 1.148-11 to read as follows:

§ 1.148-0 Scope and table of contents.

(c) Table of contents. * * *

§ 1.148-1 Definitions and elections.

(f) Definition of issue price.

(1) In general.

(2) Tax-exempt bonds issued for money.

(3) Definitions.

(4) Special rules.

§ 1.148-2 General arbitrage yield restriction rules.

(e) * * *

(3) Temporary period for working capital expenditures.

§ 1.148-10 Anti-abuse rules and authority of Commissioner.

(e) Authority of the Commissioner to prevent transactions that are inconsistent with the purpose of the arbitrage rules.

§ 1.148-11 Effective/applicability dates.

(k) [Reserved]

(l) Certain arbitrage guidance updates.

Par. 6. Section 1.148-1 is amended by:

1. Revising the definition of issue price in paragraph (b).

2. Revising paragraphs (c)(4)(i)(B)(1) and (c)(4)(ii).

3. Removing the “or” at the end of paragraph (c)(4)(i)(B)(2).

4. Removing the period at the end of paragraph (c)(4)(i)(B)(3) and adding in its place a semi-colon and the word “or”.

5. Adding a new paragraphs (c)(4)(i)(B)(4) and (f).

The additions and revisions read as follows:

§ 1.148-1 Definitions and elections.

(b) * * *

Issue price means issue price as defined in paragraph (f) of this section.

(c) * * *

(4) * * *

(i) * * *

(B) * * *

(1) For the portion of an issue that is to be used to finance restricted working capital expenditures, if that portion is not outstanding longer than the temporary period under § 1.148-2(e)(3) for which the proceeds qualify;

(4) For the portion of an issue that is to be used to finance working capital expenditures and that is outstanding for a period longer than the temporary period under § 1.148-2(e)(3), if that portion satisfies paragraph (c)(4)(ii) of this section.

(ii) Safe harbor for longer-term working capital financings. A portion of an issue used to finance working capital expenditures satisfies this paragraph (c)(4)(ii) if the issuer meets the requirements of paragraphs (c)(4)(ii)(A) and (c)(4)(ii)(B) of this section.

(A) Determine expected available amounts. An issuer meets the requirements of this paragraph (c)(4)(ii)(A) if —

(1) On the issue date, the issuer determines the first fiscal year following the applicable temporary period (determined under § 1.148-2(e)) in which it reasonably expects to have available amounts for the financed working capital expenditures (first testing year), but in no event can the first testing year be later than five years after the issue date; and

(2) Beginning with the first testing year and for each subsequent fiscal year for which the applicable portion of the issue remains outstanding, the issuer determines its available amounts for the financed working capital expenditures as of the first day of the fiscal year (yearly available amount).

(B) Application of yearly available amount to reduce burden on tax-exempt bond market. An issuer meets the requirements of this paragraph (c)(4)(ii)(B) if, within 90 days after the start of each year in which it determines a yearly available amount, the issuer applies an amount equal to the yearly available amount for such year to redeem or invest in tax-exempt bonds that are excluded from investment property under section 148(b)(3) (that is, tax-exempt bonds that are not subject to the alternative minimum tax)(eligible tax-exempt bonds). The maximum amount required to be applied in such manner shall equal the outstanding principal amount of the applicable portion of the issue

subject to the safe harbor in this paragraph (c)(4)(ii), determined as of the date of such redemption or investment. Any amounts invested in eligible tax-exempt bonds shall be invested or reinvested continuously in such tax-exempt bonds, except during a permitted reinvestment period of no more than 30 days in a fiscal year, for as long as the applicable portion of the issue remains outstanding.

(f) Definition of issue price — (1) In general. Except as otherwise provided in this paragraph (f), issue price is defined in sections 1273 and 1274 and the regulations under those sections. In determining the issue price under section 1274 of a bond that is issued for property, the adjusted applicable Federal rate, as computed for purposes of section 1288, is used in lieu of the applicable Federal rate in determining the issue price.

(2) Tax-exempt bonds issued for money — (i) In general. The issue price of tax-exempt bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public (as defined in paragraph (f)(3)(i) of this section). See paragraph (f)(4)(ii) of this section for an issue including bonds with different payment and credit terms.

(ii) Safe harbor for determining issue price of tax-exempt bonds issued for money. For purposes of paragraph (f)(2)(i) of this section, the issuer may treat the first price at which a minimum of 25 percent of the bonds is sold to the public as the issue price. However the preceding sentence applies only if all orders at this sale price received from the public within the offering period are filled to the extent the public orders at such price do not exceed the amount of bonds sold.

(3) Definitions. For purposes of this paragraph (f), the following definitions apply:

(i) Public. Public means any person (as defined in section 7701(a)(1)) other than an underwriter.

(ii) Underwriter — (A) In general. Except as otherwise provided in paragraph (f)(3)(ii)(C) of this section, the term underwriter means any person (as defined in section 7701(a)(1)) that purchases bonds from an issuer for the purpose of effecting the original distribution of the bonds or that otherwise participates directly or indirectly in such original distribution. An underwriter includes a lead underwriter and any member of a syndicate that contractually agrees to participate in the underwriting of the bonds for the issuer. A securities dealer (whether or not a member of an underwriting syndicate for the issuer) that purchases bonds (whether or not from the issuer) for the purpose of effecting the original distribution of the bonds is also treated as an underwriter for purposes of this section

(B) Certain related parties included. Except as otherwise provided in paragraph (f)(3)(ii)(C) of this section, an underwriter includes any related party (as defined in § 1.150-1(b)) to an underwriter.

(C) Holding for investment. A person (as defined in section 7701(a)(1)) that holds bonds for investment is treated as a member of the public with respect to those bonds.

(iii) Securities dealer. Securities dealer means a dealer in securities, as defined in section 475(c)(1).

(4) Special rules. For purposes of this paragraph (f), the following special rules apply:

(i) Subsequent sale at a different price. The issue price as determined under paragraph (f)(1) or (2) of this section does not change if part of the issue is later sold at a different price.

(ii) Separate determinations. The issue price of bonds in an issue that do not have the same credit and payment terms is determined separately.

Par. 7. Section 1.148-2 is amended by revising paragraph (e)(3)(i) to read as follows:

§ 1.148-2 General arbitrage yield restriction rules.

(e) * * *

(3) * * *(i) General rule. The proceeds of an issue that are reasonably expected to be allocated to working capital expenditures within 13 months after the issue date qualify for a temporary period of 13 months beginning on the issue date. Paragraph (e)(2) of this section contains additional temporary period rules for certain working capital expenditures that are treated as part of a capital project.

Par. 8. Section 1.148-4 is amended by:

1. Revising paragraphs (h)(2)(viii) and (h)(3)(iv)(A).

2. Redesignating paragraph (h)(3)(iv)(B) as newly redesignated paragraph (h)(3)(iv)(E) and revising newly redesignated paragraph (h)(3)(iv)(E).

3. Redesignating paragraph (h)(3)(iv)(C) as newly redesignated paragraph (h)(3)(iv)(F) and revising the first sentence in newly redesignated paragraph (h)(3)(iv)(F).

4. Redesignating paragraph (h)(3)(iv)(D) as newly redesignated paragraph (h)(3)(iv)(G) and revising newly redesignated paragraph (h)(3)(iv)(G).

5. Redesignating paragraph (h)(3)(iv)(E) as newly redesignated paragraph (h)(3)(iv)(H) and revising the first sentence in newly redesignated paragraph (h)(3)(iv)(H).

6. Adding new paragraphs (h)(3)(iv)(B), (h)(3)(iv)(C), (h)(3)(iv)(D) and (h)(4)(iv).

The revisions and additions read as follows:

§ 1.148-4 Yield on an issue of bonds.

(h) * * *

(2) * * *

(viii) Identification — (A) In general. The contract must be identified by the actual issuer on its books and records maintained for the hedged bonds not later than 15 calendar days after the date on which the issuer and the hedge provider enter into the hedge contract. The identification must be maintained by the actual issuer and must specify the name of the hedge provider, the terms of the contract, the hedged bonds, and include a hedge provider’s certification as described in paragraph (h)(2)(viii)(B) of this section. The identification must contain sufficient detail to establish that the requirements of this paragraph (h)(2) and, if applicable, paragraph (h)(4) of this section are satisfied. In addition, the existence of the hedge must be noted on the first form relating to the issue of which the hedged bonds are a part that is filed with the Internal Revenue Service on or after the date on which the contract is identified pursuant to this paragraph (h)(2)(viii).

(B) Hedge provider’s certification. The hedge provider’s certification must provide that —

(1) The terms of the hedge were agreed to between a willing buyer and willing seller in a bona fide, arm’s-length transaction;

(2) The rate payable by the issuer under the hedge is comparable to the rate that the hedge provider would have quoted on the trade date to enter into a reasonably comparable hedge with a

counterparty that is similarly situated to the issuer and that involves a hedge on debt obligations other than tax-exempt bonds, taking into account all the terms of the hedge;

(3) The hedge provider has not made, and does not expect to make, any payment to any third party in connection with the hedge, except for any such third-party payment that the hedge provider expressly identifies in documents for the hedge; and

(4) The amounts paid or received pursuant to the hedge do not include any payments other than payments reasonably allocable to the modification of risk of interest rate changes and to the hedge provider's overhead that are properly taken into account under paragraph (h)(3)(i) of this section, unless the hedge provider separately identifies such payments.

(3) * * *

(iv) Accounting for modifications and terminations — (A) Modification defined. A modification of a qualified hedge includes, without limitation, a change in the terms of the hedge, an issuer's acquisition of another hedge with terms that have the effect of modifying an issuer's risks of interest rate changes or other terms of an existing qualified hedge, or an assignment of a hedge provider's remaining rights and obligations under the hedge to a third party. For example, if the issuer enters into a qualified hedge that is an interest rate swap under which it receives payments based on LIBOR, and subsequently enters a second hedge (with the same or different provider) that limits the issuer's exposure under the existing qualified hedge to variations in LIBOR, the new hedge modifies the qualified hedge.

(B) Termination defined. A termination means either an actual or a deemed termination of a qualified hedge. Except as otherwise provided, an actual termination of a qualified hedge occurs to the extent that the issuer sells, disposes of, or otherwise actually terminates all or a portion of the hedge. A deemed termination of a qualified hedge occurs if the hedge ceases to meet the requirements for a qualified hedge of the hedged bonds; the issuer makes a modification (as defined in paragraph (h)(3)(iv)(A) of this section) that results in a deemed exchange of the hedge and a realization event to the issuer under section 1001; or the issuer redeems all or a portion of the hedged bonds.

(C) Special rules for certain modifications when the hedge remains qualified. A modification of a qualified hedge that otherwise would result in a deemed termination under paragraph (h)(3)(iv)(B) of this section does not result in such a termination if the modified hedge meets the requirements for a qualified hedge, determined as of the date of the modification. For purposes of this paragraph (h)(3)(iv)(C), when determining whether the hedge is qualified, the fact that the existing qualified hedge is off-market as of the date of the modification is disregarded and the identification requirement in paragraph (h)(2)(viii) of this section applies by measuring the time period for identification from the date of the modification and without regard to the requirement for a hedge provider's certification.

(D) Continuations of certain qualified hedges in refundings. If hedged bonds are redeemed using proceeds of a refunding issue, the qualified hedge is not actually terminated, and the hedge meets the requirements for a qualified hedge for the refunding bonds as of the issue date of the refunding bonds, then no termination of the hedge occurs and the hedge instead is treated as a qualified hedge for the refunding bonds. For purposes of this paragraph (h)(3)(iv)(D), when determining whether the hedge is a qualified hedge for the refunding bonds, the fact that the hedge is off-market with respect to the refunding bonds as of the issue date of the refunding bonds is disregarded and the identification requirement in paragraph (h)(2)(viii) of this section applies by measuring the time period for identification from the issue date of the refunding bonds and without regard to the

requirement for a hedge provider’s certification.

(E) General allocation rules for hedge termination payments. Except as otherwise provided in paragraphs (h)(3)(iv)(F), (G), and (H) of this section, a payment made or received by an issuer to terminate a qualified hedge, or a payment deemed made or received for a deemed termination, is treated as a payment made or received, as appropriate, on the hedged bonds. Upon an actual termination of a qualified hedge, the amount of the payment that an issuer may treat as a termination payment made or received on the hedged bonds —

(1) May not exceed the fair market value of the qualified hedge on such date if paid by the issuer; and

(2) May not be less than the fair market value of the qualified hedge on such date if received by the issuer.

Upon a deemed termination of a qualified hedge, the amount of the termination payment is equal to the fair market value of the qualified hedge on the termination date. Except as otherwise provided, a termination payment is reasonably allocated to the remaining periods originally covered by the terminated hedge in a manner that reflects the economic substance of the hedge.

(F) Special rule for terminations when bonds are redeemed. Except as otherwise provided in this paragraph (h)(3)(iv)(F) and in paragraph (h)(3)(iv)(G) of this section, when a qualified hedge is deemed terminated because the hedged bonds are redeemed, the termination payment as determined under paragraph (h)(3)(iv)(E) of this section is treated as made or received on that date. * * *

(G) Special rules for refundings. When there is a termination of a qualified hedge because there is a refunding of the hedged bonds, to the extent that the hedged bonds are redeemed using the proceeds of a refunding issue, the termination payment is accounted for under paragraph (h)(3)(iv)(E) of this section by treating it as a payment on the refunding issue, rather than the hedged bonds. In addition, to the extent that the refunding issue is redeemed during the period to which the termination payment has been allocated to that issue, paragraph (h)(3)(iv)(F) of this section applies to the termination payment by treating it as a payment on the redeemed refunding issue.

(H) Safe harbor for allocation of certain termination payments. A payment to terminate a qualified hedge does not result in that hedge failing to satisfy the applicable provisions of paragraph (h)(3)(iv)(E) of this section if that payment is allocated in accordance with this paragraph (h)(3)(iv)(H). * * *

(4) * * *

(iv) Consequences of certain modifications. The special rules under paragraph (h)(4)(iii) of this section regarding the effects of terminations of qualified hedges of fixed yield hedged bonds also applies in the same manner to modifications of a qualified hedge under paragraph (h)(3)(iv)(C) of this section. Thus, for example, a modification may result in a prospective change in the yield on the hedged bonds for arbitrage rebate purposes under § 1.148-3.

Par. 9. Section 1.148-5 is amended by:

1. Revising paragraphs (c)(3), (d)(2) and (d)(3).

2. Revising the last sentence in paragraph (d)(6)(i) and adding a sentence at the end of the

paragraph.

The revisions and additions read as follows:

§ 1.148-5 Yield and valuation of investments.

(c) * * *

(3) Applicability of special yield reduction rule — (i) through (ix) [Reserved].

(x) Investments allocable to gross proceeds of an issue to the extent that the yield reduction payments made with respect to such investments under paragraph (c)(1) of this section relate to any difference between the amount of the actual issue price of the issue and the issuer's reasonable expectations regarding such issue price determined as of the sale date of the issue.

(d) * * *

(2) Mandatory valuation of certain yield restricted investments at present value. Except as otherwise provided in paragraphs (b)(3) and (d)(3) of this section, a yield restricted investment must be valued at present value.

(3) Mandatory valuation of certain investments at fair market value — (i) In general. Except as otherwise provided in paragraphs (d)(3)(ii) and (d)(4) of this section, an investment must be valued at fair market value on the date that it is first allocated to an issue or first ceases to be allocated to an issue as a consequence of a deemed acquisition or deemed disposition. For example, if an issuer deposits existing nonpurpose investments into a sinking fund for an issue, those investments must be valued at fair market value as of the date first deposited into the fund.

(ii) Exception to fair market value requirement for transferred proceeds allocations, universal cap allocations, and commingled funds. Paragraph (d)(3)(i) of this section does not apply if the investment is allocated from one issue to another as a result of the transferred proceeds allocation rule under § 1.148-9(b) or the universal cap rule under § 1.148-6(b)(2), provided that the issue from which the investment is allocated (that is, the first issue in an allocation from one issue to another) consists exclusively of tax-exempt bonds. In addition, paragraph (d)(3)(i) of this section does not apply to investments in a commingled fund (other than a bona fide debt service fund) unless it is an investment being initially deposited in or withdrawn from a commingled fund described in § 1.148-6(e)(5)(ii).

(6) * * *(i) * * *On the purchase date, the fair market value of a United States Treasury obligation that is purchased directly from the United States Treasury, including a State and Local Government Series (SLGS) security, is its purchase price. The fair market value of a SLGS security on any date other than the original purchase date is the redemption price for redemption on that date.

§ 1.148-6 [Amended]

Par. 10. In § 1.148-6, paragraph (d)(4)(iii) is removed.

Par. 11. Section 1.148-10 is amended by revising the last sentence of paragraph (a)(4) and the heading and first sentence of paragraph (e) to read as follows:

§ 1.148-10 Anti-abuse rules and authority of Commissioner.

(a) * * *

(4) * * *These factors may be outweighed by other factors, such as bona fide cost underruns, an issuer's bona fide need to finance extraordinary working capital items, or an issuer's long-term financial distress.

(e) Authority of the Commissioner to prevent transactions that are inconsistent with the purpose of the arbitrage rules. If an issuer enters into a transaction for a principal purpose of obtaining a material financial advantage based on the difference between tax-exempt and taxable interest rates in a manner that is inconsistent with the purposes of section 148, the Commissioner may exercise the Commissioner's discretion to depart from the rules of §§ 1.148-1 through 1.148-11 as necessary to prevent such financial advantage. * * *

Par. 12. Section 1.148-11 is amended by:

1. Revising the section heading.

2. Redesignating paragraph (d)(1) as newly redesignated paragraph (d)(1)(i).

3. Redesignating paragraphs (d)(1)(i), (d)(1)(ii), (d)(1)(iii), (d)(1)(iv), (d)(1)(v), and (d)(1)(vi) as newly redesignated paragraphs (d)(1)(i)(A), (d)(1)(i)(B), (d)(1)(i)(C), (d)(1)(i)(D), (d)(1)(i)(E), and (d)(1)(i)(F), respectively.

4. Revising newly redesignated paragraphs (d)(1)(i)(B), (d)(1)(i)(D), and (d)(1)(i)(F), and adding new paragraphs (d)(1)(ii), (k) and (l).

The revisions and additions read as follows:

§ 1.148-11 Effective/applicability dates.

(d)* * *

(1)* * *

(i) * * *

(B) The corpus of the guarantee fund may be invaded only to support specifically designated essential governmental functions (designated functions) carried on by political subdivisions with general taxing powers or public elementary and public secondary schools;

(D) The issue guaranteed consists of obligations that are not private activity bonds (other than qualified 501(c)(3) bonds) substantially all of the proceeds of which are to be used for designated functions;

(F) As of the sale date of the bonds to be guaranteed, the amount of the bonds to be guaranteed by the fund plus the then-outstanding amount of bonds previously guaranteed by the fund does not exceed a total amount equal to 500 percent of the total costs of the assets held by the fund as of December 16, 2009.

(ii) The Commissioner may, by published guidance, set forth additional circumstances under which guarantees by certain perpetual trust funds will not cause amounts in the fund to be treated as replacement proceeds.

(k) [Reserved]

(l) Additional arbitrage guidance updates — (1) In general. Sections 1.148-1(b); 1.148-

1(c)(4)(i)(B)(1); 1.148-1(c)(4)(i)(B)(4); 1.148-1(c)(4)(ii); 1.148-1(f); 1.148-2(e)(3)(i); 1.148-5(c)(3); 1.148-5(d)(2); 1.148-5(d)(3); 1.148-5(d)(6)(i); 1.148-6(d)(4); 1.148-10(a)(4); 1.148-10(e); 1.148-11(d)(1)(i)(B); 1.148-11(d)(1)(i)(D); 1.148-11(d)(1)(i)(F); and 1.148-11(d)(1)(ii) apply to bonds that are sold on or after the date that is 90 days after the date of publication of final regulations in the Federal Register.

(2) Section 1.148-4(h)(2)(viii) applies to hedges that are entered into on or after the date that is 90 days after the date of publication of the final regulations in the Federal Register.

(3) Section 1.148-4(h)(3)(iv)(A) through (H) and (h)(4)(iv) apply to —

(i) Hedges that are entered into on or after the date that is 90 days after the date of publication of the final regulations in the Federal Register;

(ii) Qualified hedges that are modified on or after the date that is 90 days after the date of publication of the final regulations in the Federal Register with respect to modifications on or after such date; and

(iii) Qualified hedges on bonds that are refunded on or after the date that is 90 days after the date of publication of the final regulations in the Federal Register with respect to the refunding on or after such date.

Par. 13. Section 1.150-1 is amended by:

1. Adding a new paragraph (a)(2)(iii).

2. Adding a definition for tax-advantaged bond in alphabetical order to paragraph (b).

3. Revising paragraph (c)(2).

4. Adding a new paragraph (f).

The revisions and additions read as follows:

§ 1.150-1 Definitions.

(a) * * *

(2) * * *

(iii) Special effective date for definitions of tax-advantaged bond, issue, and grant. The definition of tax-advantaged bond in paragraph (b) of this section, the revisions to the definition of issue in paragraph (c)(2) of this section, and the definition and rules regarding the treatment of grants in paragraph (f) of this section apply to bonds that are sold on or after the date that is 90 days after publication of final regulations in the Federal Register.

(b) * * *

Tax-advantaged bond means a tax-exempt bond, a taxable bond that provides a Federal tax credit to the investor with respect to the issuer’s borrowing costs, a taxable bond that provides a refundable Federal tax credit payable directly to the issuer of the bond for its borrowing costs under section 6431, or any future similar bond that provides a Federal subsidy for any portion of the borrowing costs.

Examples of tax-advantaged bonds include qualified tax credit bonds under section 54A(d)(1) and build America bonds under section 54AA.

(c) * * *

(2) Exceptions for different types of tax-advantaged bonds and taxable bonds. Each type of tax-advantaged bond that has a different structure for delivery of the borrowing subsidy or different program eligibility requirements is treated as part of a different issue under this paragraph (c). Further, tax-advantaged bonds and bonds that are not tax-advantaged bonds are treated as part of different issues under this paragraph (c). The issuance of tax-advantaged bonds in a transaction with other non tax-advantaged bonds must be tested under the arbitrage anti-abuse rules under § 1.148-10(a) and other applicable anti-abuse rules (for example, limitations against window maturity structures or unreasonable allocations of bonds).

(f) Definition and treatment of grants — (1) Definition. Grant means a transfer for a governmental purpose of money or property to a transferee that is not a related party to or an agent of the transferor. The transfer must not impose any obligation or condition to directly or indirectly repay any amount to the transferor or a related party. Obligations or conditions intended solely to assure expenditure of the transferred moneys in accordance with the governmental purpose of the transfer do not prevent a transfer from being a grant.

(2) Treatment. Except as otherwise provided (for example, § 1.148-6(d)(4), which treats proceeds used for grants as spent for arbitrage purposes when the grant is made), the character and nature of a grantee's use of proceeds are taken into account in determining which rules are applicable to the bond issue and whether the applicable requirements for the bond issue are met.

For example, a grantee's use of proceeds generally determines whether the proceeds are used for capital projects or working capital expenditures under section 148 and whether the qualified purposes for the specific type of bond issue are met.

Beth Tucker

Deputy Commissioner for Operations

Support

[FR Doc. 2013-21880 Filed 09/13/2013 at 8:45 am; Publication Date: 09/16/2013]

Law Professor Questions Costs of Tax-Exempt Hospitals.

Tax-exempt hospitals raise prices for consumers and contribute little in charity despite the requirements of their exempt status, Barak D. Richman of Duke University said at a September 19 hearing on healthcare reform held by the House Judiciary Regulatory Reform, Commercial and Antitrust Law Subcommittee.

http://judiciary.house.gov/hearings/113th/09192013_2/Prof%20Richman%20Testimony%20[9-19-13].pdf

IRS Releases Proposed Issue Price Rules, Draws Concerns.

The Treasury Department and Internal Revenue Service have proposed long-awaited rules on arbitrage restrictions for tax-exempt bonds, including issue price, as well as rules on arbitrage rebate overpayments.

The rules, which are to be published in the Federal Register on Monday, are scheduled to be the focus of a public hearing that is to be held on Feb. 5. In addition, public comments are due on the arbitrage rules 60 days after publication in the Federal Register and must be received by Dec. 16 on arbitrage rebate overpayment rules.

The proposed rules on issue price are more stringent than existing rules in an effort to address agency concerns. But market participants say they would represent a major change in the way the market works and question whether they would even be workable.

Issue price is extremely important because it is used to help determine the yield on bonds and whether the issuer is complying with arbitrage rebate or yield restriction requirements, as well as federal subsidy payments in the case of direct-pay bonds such as Build America Bonds. Issue price also plays a role in complying with other rules such as the 2% limit on issuance costs for private activity bonds and the size of debt service reserve funds.

Current tax rules say that the issue price of bonds that are publicly offered is the first price at which a substantial amount of the bonds is reasonably expected to be sold to the public, with substantial defined as 10%.

But in their 56-page proposal on arbitrage restrictions, the agencies say they “are concerned that the 10% test does not always produce a representative price for the bonds.”

The agencies also say they are concerned about flipping. They do not use the term, but describe the behavior.

“Underwriters of tax-exempt bonds may sell bonds of an issue with the same payment and credit terms in an initial public offering at different prices, but execute the first 10% of the sales of those bonds at the lowest prices (and thus the highest yield), causing the issue price of the bonds to be a lower price than is representative of the prices at which the remaining bonds are sold,” they said in the proposed rules.

The agencies said that improvements in price transparency, such as the muni prices reported on the Municipal Securities Rulemaking Board’s EMMA system “has led to heightened scrutiny of issue price standards.”

“The reported data has shown, in certain instances, actual sales to the public at prices that differed significantly from the issue price used by the issuer,” they said. “These price differences have raised questions about the ability of the reasonable expectations standard to produce a representative issue price. The reported trade data has also called into question whether sales to underwriters and security dealers have been included as sales to the public in determining issue price in certain instances.”

In the proposed rules, the agencies remove the reasonable expectations standard and substitute actual sales. They eliminate the reference to “publicly offered” so the rules would clearly cover private placements as well as public offerings.

The new rules would state: “The issue price of tax-exempt bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public,” with substantial meaning 25% instead of 10% of the bonds.

The current rules disregard sales to underwriters or wholesalers when determining issue price.

The proposed rules state “the public” would be any person other than an underwriter. The term underwriter would be defined as “any person that purchases bonds from the issuer for the purpose of effecting the original distribution of the bonds, or otherwise participates directly or indirectly in the original distribution.”

The term would include the lead underwriter, any syndicate member, or “a securities dealer (whether or not a member of the issuer’s underwriting syndicate) that purchases bonds (whether or not from the issuer) for the purpose of effecting the original distribution of the bonds.” Also, “An underwriter generally includes a related party to the underwriter,” the proposed rules say.

Several lawyers have concerns and questions about the proposed rules.

“I think the market will act adversely to the proposed regulations,” said Rick Ballard, a partner at Ballard Spahr. “Financial and legal professionals would like to be able to determine issue price on the initial sale date and not have to worry about what happens later,” he said “You’re going to have to do a lot of post-tracking of sales on EMMA and figure you when you hit the 25%. It’s going to increase the amount of work and make it a lot more complicated.”

Scott Lilienthal, president of the National Bond Lawyers Association and a partner at Hogan Lovells US LLP, agreed, “We’re concerned about his move away from the reasonable expectations standard,” he said. “I’m worried that it’s going to create new problems for issuers.”

Lilienthal said, for example, that issuers trying to structure advance refunding escrows are not going to know what the issue price until later, and while the IRS permits issuers to make yield reduction payments if their estimates are wrong, they won’t be able to gauge the savings they will achieve until they know whether they have to make such payments.

Lilienthal also said the definition of underwriter is still somewhat ambiguous. “There’s a lot of interpretation that has to be done,” he said.

The proposal will create uncertainties for issuers and market participants trying to comply with other rules that rely on issue price such as limits on cost of issuance and the sizing of debt service reserve funds, he added.

The proposed arbitrage rules also codify private-letter ruling guidance on working capital financings, clarify issues related to qualified hedges and cover the valuation of investments.

The other set of proposed rules sets forth procedures for recovering overpayments of arbitrage rebate on tax-exempt bonds and other tax-advantaged bonds.

by: LYNN HUME

IRS Issues Proposed Regs on Arbitrage Rebate Overpayments on Tax-Exempt

Bonds.

The IRS has issued proposed regulations that provide guidance on the recovery of overpayments of arbitrage rebate on tax-exempt bonds and other tax-advantaged bonds, including the deadline for filing a claim for an arbitrage rebate overpayment. (REG-148812-11)

http://www.ofr.gov/(S(cpohw1vx1p4rtqqy5mcjrmz4))/OFRUpload/OFRData/2013-21879_PI.pdf

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IRS Issues Proposed Regs on Arbitrage Restrictions on Tax-Exempt Bonds.

The IRS has issued proposed regulations on the section 148 arbitrage investment restrictions applicable to tax-exempt bonds and other tax-advantaged bonds to amend the current rules to address market developments, to simplify some provisions, to explain technical issues, and to improve administrability. (REG-148659-07)

http://www.ofr.gov/(S(cpohw1vx1p4rtqqy5mcjrmz4))/OFRUpload/OFRData/2013-21880_PI.pdf

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CRS Updates Report on Reauthorizing Compensation to Counties for Tax-Exempt Federal Land.

The reporting of legislation in the Senate and House to temporarily extend the Secure Rural Schools and Community Self-Determination Act of 2000, which compensates counties for the tax-exempt status of federal land, was the subject of a September 5 update to a Congressional Research Service report on reauthorization of the bill.

Reauthorizing the Secure Rural Schools and Community Self-Determination Act of 2000

Katie Hoover

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September 5, 2013

Congressional Research Service

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www.crs.gov

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Summary

Many counties are compensated for the tax-exempt status of federal lands. Counties with national forest lands and with certain Bureau of Land Management (BLM) lands have historically received a percentage of agency revenues, primarily from timber sales. However, timber sales have declined substantially — by more than 90% in some areas. Thus, Congress enacted the Secure Rural Schools and Community Self-Determination Act of 2000 (SRS; P.L. 106-393) as a temporary, optional

program of payments based on historic, rather than current, revenues.

Authorization for SRS payments originally expired at the end of FY2006, but through several reauthorizations the program was extended through FY2012. Congressional debates over reauthorization considered the basis and level of compensation (historical, tax equivalency, etc.); the source of funds (receipts, a new tax or revenue source, etc.); the authorized and required uses of the payments; interaction with other compensation programs (notably Payments in Lieu of Taxes); and the duration of any changes (temporary or permanent). In addition, legislation with mandatory spending, such as SRS reauthorization, raises policy questions about increasing the deficit; current budget rules to restrain deficit spending typically impose a procedural barrier to such legislation, generally requiring offsets by additional receipts or reductions in other mandatory spending.

In 2008, the Emergency Economic Stabilization Act (P.L. 110-343) enacted a four-year extension to SRS authorization through FY2011, with declining payments, a modified formula, and transition payments for certain areas. In 2012, Congress enacted a one-year extension through FY2012, and amended the program by slowing the decline in payment levels and tightening requirements that counties select a payment option promptly (P.L. 112-141).

Section 302 of the Budget Control Act (P.L. 112-25, as amended by P.L. 112-240) requires the President to order a sequester, or cancellation, of budgetary resources for FY2013. The sequester order took effect on March 1, 2013, and affected the SRS payment for FY2012, although BLM and Forest Service implemented the order differently from each other.

With the expiration of SRS at the end of FY2012, county compensation is again the subject of congressional debates. County payments are set to return to a revenue-based system for FY2013, and are likely to be significantly lower than the previous years' payments. However, payments for FY2013 have not yet been made, and Congress may consider extending SRS (with or without modifications and with or without addressing the sequester order), implementing other legislative proposals to address the county payments, or taking no action. No action would continue the revenue-based system that took effect upon the program's expiration. Discussion in the 113th Congress has focused on many of the same issues that were debated in 2006-2008 and again in 2012. On June 18, 2013, the Senate Energy and Natural Resources Committee ordered to be reported S. 783, the Helium Stewardship Act of 2013, which includes a one-year extension of SRS. On July 31, 2013, the House Committee on Natural Resources ordered to be reported H.R. 1526, the Restoring Healthy Forests for Healthy Communities Act, which includes a temporary extension of SRS.

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Acknowledgments

Many counties are compensated for the tax-exempt status of federal lands within those counties. Counties with national forest lands and with certain Bureau of Land Management (BLM) lands have historically received a percentage of agency revenues, primarily from timber sales. However, timber sales have declined substantially since the historic high cut values in 1989 — by more than 90% in some areas. Congress enacted the Secure Rural Schools and Community Self-Determination Act of 2000 (SRS, P.L. 106-393) to provide a temporary, optional system to supplant the revenue-sharing programs for the national forests, managed by the Forest Service (FS) in the Department of Agriculture, and for certain public lands administered by the BLM in the Department of the Interior.

The law authorizing these payments expired at the end of FY2006. The 109th Congress considered the program, but did not enact reauthorizing legislation. The 110th Congress extended the payments for one year through FY2007, then enacted legislation to reauthorize the program for four years with declining payments, and to modify the formula for allocating the payments. The authorization for payments was set to expire again after payments were made for FY2011, but the 112th Congress extended the program for one more year through FY2012, and amended the program by slowing the decline in payments. The authorization expired after payments were made for FY2012. Currently, payments for FY2013 will revert to a percentage of agency revenues, primarily from timber sales and recreation fees. This report explains the changes enacted for the program by the amendments in 2008 and 2012, the effect of the sequester order on the payments, and then describes the issues that Congress has debated and continues to debate in the 113th Congress.

Background

In 1908, the FS began paying 25% of its gross receipts to the states for use on roads and schools in the counties where the national forests are located; receipts come from sales, leases, rentals, or other fees for using national forest lands or resources (e.g., timber sales, recreation fees, and communication site leases).1 This mandatory spending program was enacted to compensate local governments for the tax-exempt status of the national forests, but the compensation rate (10% of gross receipts in 1906 and 1907; 25% of gross receipts since) was not discussed in the 1906-1908 debates. This receipt-sharing program is called FS Payments to States (also referred to as the 1908 payment, or the 25% payment), because each state allocates the funds to road and school programs, although the FS determines the amount to be spent in each county based on the national forest acreage in each county. The states cannot retain any of the funds; they must be passed through to local governmental entities for use at the county level (but not necessarily to county governments) for authorized road and school programs. State law sets forth how the payments are to be allocated between road and school projects.

Congress has also enacted numerous programs to share receipts from BLM lands for various types of resource use and from various classes of land, but one program — the Oregon and California (O&C) payments — accounts for the vast majority (more than 95%) of BLM receipt-sharing.2 The O&C payments are made to the counties in western Oregon containing the revested Oregon and California grant lands returned to federal ownership for failure to fulfill the terms of the grant. The

O&C counties receive 50% of the receipts from these lands. These mandatory payments go directly to the counties for any local governmental purposes. Concerns about, and proposals to alter, FS receipt-sharing payments also typically include the O&C payments, because both are substantial payments derived largely from timber receipts.

At their pre-SRS peaks in FY1989, FS 25% payments totaled $362 million, while O&C payments totaled $110 million. FS and O&C receipts have declined substantially since FY1989, largely because of declines in timber sales (see Figure 1). The decline began in the Pacific Northwest, owing in part to efforts to protect northern spotted owl habitat and other values.3 Provisions in the Omnibus Budget Reconciliation Act of 19934 directed FS payments for 17 national forests in Washington, Oregon, and California and BLM payments to the O&C counties at a declining percentage (beginning at 85% in FY1994 and declining by 3 percentage points annually through FY2003) of the average payments for FY1986-FY1990. Declining federal timber sales in other regions led to the nationwide SRS program replacing these safety net or "owl" payments in 2000.

Figure 1. Forest Service Cut Volume and Cut Value (2012

dollars)

Source: FY1977-FY2012 data: U.S. Forest Service, Forest Cut and Sold Reports, http://www.fs.fed.us/forestmanagement/products/sold-harvest/cut-sold.shtml, accessed November 16, 2012. FY1940-FY1976 data: U.S. Forest Service legislative affairs office.

Similar to the owl payments for the Pacific Northwest, the SRS program was an optional payment counties could elect to receive instead of receiving the 25% receipt-sharing payment. As originally enacted, the SRS payment was calculated as an average of the three highest payments between FY1986 and FY1999. With the extension in FY2007, the SRS payment calculation was modified to also consider county population and per capita income.

Payments under SRS are substantial, and significantly greater than the receipt-sharing payments would be. For example, the average annual total SRS payment for FY2001 through FY2011 was $383 million. In contrast, under the receipt-sharing system prior to the enactment of SRS, the average annual total payment was $273 million from FY1990 through FY2000. Figure 2 shows a comparison of the FS actual payments to estimates of what the payments would have been had SRS not been enacted. FS receipts (for receipt-sharing purposes) in FY2011 totaled $323 million.5 If receipt-sharing had been used rather than SRS payments then the 25% payments would have been less than $80 million. However, FY2011 payments under SRS actually totaled $308 million. Similarly, BLM timber receipts from western Oregon (which includes some non-O&C lands) totaled $22 million in FY2011.6 If 50% payments had been used, then $11 million would have been transferred to the counties, compared to SRS payments of $40 million in FY2011. If SRS is not reauthorized, FY2013 payments will again be based on a percentage of agency receipts, estimated to be $85 million for the Forest Service portion of the payment.7 The BLM estimates the O&C annual payment to be between $5.5 million and $8 million.8

In addition to these receipt-sharing programs, Congress enacted the Payments in Lieu of Taxes (PILT) Program.9 PILT payments to counties are based on "eligible" federal lands, including national forests and O&C lands, in each county (but are restricted in counties with very low populations). PILT payments are reduced (to a minimum payment per acre) by other payment programs — including FS Payments to States and BLM's O&C payments — so changes to these latter programs may also affect a county's payments under PILT. This also explains why FY2012 PILT payments to Colorado were double the PILT payments to Oregon, even though there is more federal land in Oregon (32.6 million acres) than in Colorado (23.8 million acres).

As enacted, PILT requires annual appropriations. If the appropriations are less than the authorized total payments, each county gets its calculated pro rata share of the appropriations. However, the 2008 and 2012 SRS amendments also made PILT payments mandatory spending for FY2008-FY2012. Thus, for those fiscal years, each county received 100% of its authorized PILT payment.

One issue of concern to Congress is the geographic allocation of the FS and PILT payments. Table 1 shows the payments for FY2012. The only O&C payment is made to Oregon, and Oregon also receives the largest FS payment. With the O&C payment of approximately $63 million, Oregon received nearly 35% of the total payments made in FY2012. The next-largest payments are in California, which received just over 10% of the total payments. PILT payments are more evenly distributed, with no state receiving more than 10% of the total payments.

Figure 2. FS Total Payments and Estimated Payments

Source: CRS. FS total payments are from the annual Forest Service report, All Service Receipts: Final Payment Summary Report PNF (ASR-10-01), available from http://www.fs.usda.gov/main/pts/home.

The estimated FS payments if SRS had not been enacted for FY2001-FY2007 are from an unpublished spreadsheet received from Rick Alexander, Secure Rural Schools Act National Program Manager, U.S. Forest Service, on November 30, 2011. The estimated payments for FY2008-FY2011 are from an FS spreadsheet available at http://www.fs.usda.gov/main/pts/home.

Notes: The data presented includes payments under the 25% Payments to States and SRS Title I and Title III programs, but does not include SRS Title II payments and miscellaneous county payments authorized through various other FS payment programs not discussed in this report, such as payments from land utilization projects.

Table 1. FY2012 FS and PILT Payments, by State

(in thousands of dollars)

	FS	PILT
Alabama	$1,844.2	$805.2
Alaska	$13,878.3	$26,894.5
Arizona	$13,080.4	$32,886.6
Arkansas	$6,653.1	$5,277.0
California	$35,777.1	$40,272.0
Colorado	$13,053.1	$27,724.6

Connecticut	$0.0	$29.6
Delaware	$0.0	$18.3
Florida	$2,340.7	$4,891.7
Georgia	$1,549.6	$2,242.6
Hawaii	$0.0	$335.0
Idaho	$26,628.3	$26,560.2
Illinois	$253.9	$1,140.8
Indiana	$269.0	$465.8
Iowa	$0.0	$466.9
Kansas	$0.0	$1,131.4
Kentucky	$1,586.5	$1,835.8
Louisiana	$1,734.5	$610.0
Maine	$71.5	$316.0
Maryland	$0.0	$102.4
Massachusetts	$0.0	$114.4
Michigan	$3,826.0	$4,150.5
Minnesota	$8,477.5	$1,944.1
Mississippi	$5,552.0	$2,736.8
Missouri	$3,352.7	$2,7346.8
Montana	$19,746.9	$26,152.0
Nebraska	$196.8	$1,131.4
Nevada	$3,630.3	$23,917.8
New Hampshire	$546.7	$1,800.9
New Jersey	$0.0	$99.4
New Mexico	$10,264.3	$34,917.8
New York	$18.8	$152.3
North Carolina	$1,902.5	$4,030.5
North Dakota	$0.6	$1,418.4

Ohio	$268.4	$521.9
Oklahoma	$916.7	$2,740.2
Oregon	$63,015.5	$14,005.0
Pennsylvania	$3,330.6	$610.8
Rhode Island	$0.0	$0.0
South Carolina	$1,772.3	$406.0
South Dakota	$1,600.5	$5,363.8
Tennessee	$1,149.6	$1,826.5
Texas	$2,331.1	$4,644.6
Utah	$10,579.8	$36,038.6
Vermont	$334.1	$942.2
Virginia	$1,625.1	$3,113.1
Washington	$20,094.8	$15,340.0
West Virginia	$1,788.6	$2,953.2
Wisconsin	$1,903.0	$1,087.2
Wyoming	$4,309.9	$25,315.3
Othera	$147.2	$63.9
Total	$255,356.3	$381,647.9

Sources: FS: U.S. Dept. of Agriculture, Forest Service, "All Service Receipts (ASR), Final Payment Summary Report PNF (ASR-10-01)," http://www.fs.usda.gov/Internet/FSE_DOCUMENTS/stelprdb5407120.pdf. O&C: U.S. Dept. of the Interior, Bureau of Land Management, FY2012 Secure Rural Schools Act Payments, http://www.blm.gov/or/rac/files/rac-payments.pdf. PILT: U.S. Dept. of the Interior, Payments in Lieu of Taxes (PILT) Payments by State, http://www.doi.gov/pilt/state-payments.cfm?fiscal_yr=2012.

FOOTNOTES TO TABLE 1

a “Other” includes the District of Columbia, Guam,

Puerto Rico, and the Virgin Islands.

END OF FOOTNOTES TO TABLE 1

Receipt-Sharing Program Concerns and Responses

Concerns

The counties and other observers have raised three concerns about FS and O&C receipt-sharing payments.10 The primary focus has been on the decline in FS and O&C receipts due to the decline in timber sales, particularly in Oregon (Figure 1). National forest receipts (subject to sharing) declined from their peak of $1.53 billion in FY1989 to $266 million in FY2003 — a drop of 83% from the FY1989 level. Estimated receipts for FY2012 were $340 million. In some areas, the decline was even greater; for example, payments to the eastern Oregon counties containing the Ochoco National Forest fell from $10 million in FY1991 to $309,000 in FY1998 — a decline of 97% in seven years.

Another concern has been annual fluctuations in the payments. Even in areas with modest declines or increases, the payments varied widely from year to year. From FY1985 to FY2000, the payments from each national forest had fluctuations of an average of nearly 30% annually — that is, on average, a county’s payment in any year was likely to be nearly 30% higher or lower than its payment the preceding year. Such wide annual fluctuations imposed serious budgeting difficulties on the counties.

A third, longer-term concern is referred to as linkage. Some observers have noted that, because the counties receive a portion of receipts, they are rewarded for advocating receipt-generating activities (principally timber sales) and for opposing management that might reduce or constrain such activities (e.g., designating wilderness areas or protecting commercial, tribal, or sport fish harvests). County governments have thus often been allied with the timber industry, and sometimes opposed to environmental and other interest groups, in debates over FS management and budget decisions. This source of funds was deemed appropriate when the FS program was created (albeit, prior to creation of federal income taxes). Some interests support retaining the linkage between county compensation and agency receipts; local support for receipt-generating activities is seen as appropriate by these constituencies, because such activities usually also provide local employment and income, especially in rural areas where unemployment is often high. Others assert that ending the linkage is important so that local government officials can be independent in supporting whatever management decisions benefit their locality, rather than having financial incentives to support particular decisions.

Historical Proposals to Change the Receipt-Sharing System

Concerns about the FS and BLM programs have led to various proposals over the years to alter the compensation system. Most have focused on some form of tax equivalency — compensating the states and counties at roughly the same level as if the lands were privately owned and managed. Many acknowledge the validity of this approach for fairly and consistently compensating state and county governments. However, most also note the difficulty in developing a tax equivalency compensation system, because counties and states use a wide variety of mechanisms to tax individuals and corporations — property taxes, sales taxes, income taxes, excise taxes, severance taxes, and more. Thus, developing a single federal compensation system for the tax-exempt status of

federal lands may be very difficult if not impossible.

In his 1984 budget request, President Reagan proposed replacing the receipt-sharing programs with a tax equivalency system, with a guaranteed minimum payment. The counties argued that the proposal was clearly intended to reduce payments, noting that the budget request projected savings of $40.5 million (12%) under the proposal. The change was not enacted. The FY1986 FS budget request included a proposal to change the payments to 25% of net receipts (after deducting administrative costs). Legislation to effect this change was not offered.

In 1993, President Clinton proposed a 10-year payment program to offset the decline in FS and O&C timber sales, and thus payments, resulting from efforts to protect northern spotted owls and other values in the Pacific Northwest. Congress enacted this program in Section 13982 of the 1993 Omnibus Budget Reconciliation Act (P.L. 103-66). These "spotted owl" payments began in 1994 at 85% of the FY1986-FY1990 average payments, declining by 3 percentage points annually, to 58% in 2003, but with payments after FY1999 at the higher of either this formula or the standard payment.

In his FY1999 budget request, President Clinton announced that he would propose legislation "to stabilize the payments" by extending the spotted owl payments formula to all national forests. The proposal would have directed annual payments from "any funds in the Treasury not otherwise appropriated," at the higher of (1) the FY1997 payment, or (2) 76% of the FY1986-FY1990 average payment. This approach would have increased payments in areas with large payment declines while decreasing payments in other areas, as well as eliminating annual fluctuations in payments and de-linking the payments from receipts. The Administration's proposed legislation was not introduced in Congress. The FY2000 and FY2001 FS budget requests contained similar programs, but no legislative proposals were offered.

The National Association of Counties (NACo) proposed an alternative in 1999.11 The NACo proposal would have provided the counties with the higher of (1) the standard payment, or (2) a replacement payment determined by the three highest consecutive annual payments for each county between FY1986 and FY1995, indexed for inflation. NACo also proposed "a long-term solution . . . to allow for the appropriate, sustainable, and environmentally sensitive removal of timber from the National Forests" by establishing local advisory councils. The NACo approach would have maintained or increased the payments and might have reduced the annual fluctuations, but would likely have retained the linkage between receipts and payments in at least some areas.

Legislative History of the Secure Rural Schools and Community Self-Determination Act of 2000, as Amended

Several bills were introduced in the 106th Congress to alter FS and O&C payments. After extensive debates, Congress enacted the Secure Rural Schools and Community Self-Determination Act of 2000 (SRS, P.L. 106-393). The act established an alternative payment system for FY2001-FY2006. At each county's discretion, the states with FS land and counties with O&C land received either the regular receipt-sharing payments or 100% of the average of the three highest payments between FY1986 and FY1999. Title I of the act directed that counties receiving less than $100,000 under the alternative system could distribute the entire payment to roads and schools in the same manner as the 25% payments. However, counties receiving at least $100,000 under the alternative system were required to spend 15%-20% of the payment on (1) federal land projects proposed by local resource advisory committees and approved by the appropriate Secretary if the projects met specified criteria, including compliance with all applicable laws and regulations and with resource management and other plans (identified in Title II of the act) or (2) certain county programs (specified in Title III of the act). Funds needed to achieve the full payment were permanently appropriated, and came first from agency receipts (excluding deposits to special accounts and trust

funds) and then from “any funds in the Treasury not otherwise appropriated.”

With the enactment of SRS, the FS total payment to counties rose from $194 million in FY2000 (in nominal dollars) to $346 million in FY2001 (Figure 2). For the initial six years SRS was authorized, the average FS payment was $360 million annually, more than $130 million above the average annual FS payment for the six years prior to the enactment of SRS (FY1995-FY2000).

Reauthorization Efforts in the 110th Congress

SRS expired at the end of FY2006, with final payments made at the end of December 2006. Legislation to extend the program was considered in the 110th Congress; various bills would have extended the program for one or seven years, and one specified funding it with a miniscule (0.00086%) rescission of “any [FY2007] non-defense discretionary account.” An amendment to the FY2007 continuing resolution (H.R. 2) to extend the program for one year was offered and then withdrawn.

The debate continued in the Emergency Supplemental Appropriations Act for FY2007 (H.R. 1591, the U.S. Troop Readiness, Veterans’ Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007). The House included a one-year extension of the program. The Senate amended the bill (S.Amdt. 709) to extend the program for five years (FY2008-FY2012) and significantly change the formula for allocating funds to the counties; the change was to address the concentration of payments in certain areas by spreading payments more broadly (as discussed below). The conference agreed to the House-passed version (a one-year extension), but the bill was vetoed by President George W. Bush.

A new version of Emergency Supplemental Appropriations for FY2007 (H.R. 2206) was introduced on May 8, 2007. This bill also included a one-year extension of SRS payments, and it was signed into law as P.L. 110-28 on May 25, 2007. Title V, Chapter 4, Section 5401, authorized payments of $100.0 million from receipts and of $425.0 million from appropriations, to “be made, to the maximum extent practicable, in the same amounts, for the same purposes, and in the same manner as were made to States and counties in 2006 under that Act.” Thus, preliminary FY2007 payments were made at the end of September 2007, with final payments made at the end of December 2007.

Another bill — the Public Land Communities Transition Assistance Act (H.R. 3058) — was introduced in July 2007 to extend, modify, and phase out the SRS payments; it was similar to the 2007 Senate Amendment to H.R. 1591. The House Natural Resources Committee held a subcommittee hearing on the bill on July 26, 2007, and a committee markup on September 26, 2007. The committee ordered the bill reported, amended, by voice vote. The bill was brought up on the House floor under suspension of the rules procedures, but did not garner the two-thirds vote needed to pass under this procedure, and it was not brought up later under other procedures.

Four-Year Extension through FY2011 Enacted in the 110th Congress

On October 1, 2008, the Senate passed H.R. 1424, the Emergency Economic Stabilization Act, with a provision similar to the 2007 Senate Amendment to H.R. 1591 in Section 601 (in Title VI — Other Provisions, Division C — Tax Extenders and Alternative Minimum Tax Relief). The House agreed to the Senate amendments on October 3, 2008, and President George W. Bush signed P.L. 110-343 into law.

Section 601(a) of H.R. 1424 extended the SRS payment program with several changes: “full funding” that declines over four years; the basis for calculating payments; transition payments for certain states; and the use of SRS funds for Title II and Title III activities. In addition, Section 601(b)

modified the original FS 25% payment program (under which counties can get compensation in lieu of SRS payments and for payments after SRS expires). Finally, Section 601(c) provided five years of mandatory spending for the PILT program.

Full Funding

The act defined full funding for SRS in Section 3(11). For FY2008, full funding was $500 million; for FY2009-FY2011, full funding was 90% of the previous year's funding. However, total payments exceeded the full funding amount in the first two years; payments under SRS totaled $572.9 million in FY2008 and $612.8 million in FY2009. This occurred because the calculated payments (discussed below) are based on full funding, as defined in the bill, but the act also authorized transition payments (discussed below) in lieu of the calculated payments in eight states. Since the transition payments exceeded the calculated payments for those states, the total payments were higher than the full funding amount.

Calculated Payments

SRS payments to each state (for FS lands) or county (for O&C lands) differed significantly from the payments made under the original SRS; Table A-1 shows the dollars and share of total SRS payments in each state in FY2006 and FY2009. Payments under Section 102 were based on historic revenue-sharing payments (like SRS), but modified based on each county's share of federal land and relative income level. The payment calculations required a multiple-step process:

- Step 1. Determine the three highest revenue-sharing payments between FY1986 and FY1999 for each eligible county, and calculate the average of the three.12
- Step 2. Calculate the proportion of these payments in each county (divide each county's three-highest average [Step 1] by the total of three-highest average in all eligible counties, with separate calculations for FS lands and O&C lands).
- Step 3. Calculate the proportion of FS and O&C lands in each eligible county (divide each county's FS and O&C acreage by the total FS and O&C acreage in all eligible counties, with separate calculations for FS lands and O&C lands).
- Step 4. Average these two proportions (add the payment proportion [Step 2] and the acreage proportion [Step 3] and divide by 2, with separate calculations for FS lands and O&C lands). This is the base share for counties with FS lands and the 50% base share for counties with O&C lands.
- Step 5. Calculate each county's income adjustment by dividing the per capita personal income in each county by the median per capita personal income in all eligible counties.
- Step 6. Adjust each county's base share [Step 4] by its relative income (divide each county's base share or 50% base share by its income adjustment [Step 5]).
- Step 7. Calculate each county's adjusted share or 50% adjusted share as the county's proportion of its base share adjusted by its relative income [Step 6] from the total adjusted shares in all eligible counties (divide each county's result from Step 6 by the total for all eligible counties [FS and O&C combined]).

In essence, the amendment differed from the original SRS by basing half the payments on historic revenues and half on proportion of FS and O&C land, with an adjustment based on relative county income. This was done because of the concentration of payments under the original SRS to Oregon, Washington, and California (more than 75% of payments in FY2006; see Table A-1). Several counties opted out of the amended SRS system, while others opted in, because of the altered allocation. For example, in FY2006 100% of the payments to Pennsylvania were under SRS, but in FY2009 only 54% of the payments to Pennsylvania were under SRS. Conversely, in FY2006 none of the payments to New Hampshire were under SRS, but in FY2009, 44% of the payments to New Hampshire were under SRS.

In addition, the act set a full payment amount allocated among all counties that chose to participate in the program (eligible counties). Thus, the fewer counties that participated (i.e., the more that opted for the original payment programs), the more each participating county received.

Transition Payments

In lieu of the calculated payments under Section 102, the counties in eight states — California, Louisiana, Oregon, Pennsylvania, South Carolina, South Dakota, Texas, and Washington — received transition payments for three fiscal years, FY2008-FY2010. These counties were included in the calculations, but received payments of a fixed percentage of the FY2006 payments under SRS, instead of their calculated payments. The schedule in the act specified FY2008 payments equaling 90% of FY2006 payments, FY2009 payments at 81% of FY2006 payments, and FY2010 payments at 73% of FY2006 payments. Because the transition payments were higher than the calculated payments (using the multi-step formula, above), total payments have been greater than the "full funding" defined in the act.

Title II and Title III Activities

As with the original SRS, the amended version allowed counties with less than $100,000 in annual payments to use 100% of the payments for roads and schools (or any governmental purpose for O&C counties). However, it modified the requirement that counties with "modest distributions" (annual payments of more than $100,000 but less than $350,000) use 15%-20% of the funds for Title II projects (reinvestment in federal lands). Instead, these counties could use the required 15%-20% either for Title II projects or for Title III projects (county projects). Counties with payments of more than $350,000 were limited to 7% of the payments for Title III programs. The amendment also modified the authorized uses of Title III funds, deleting some authorized uses (e.g., community work centers) while expanding authorized uses related to community wildfire protection.

Income Averaging

The extension also altered the FS 25% Payment to States program. It changed the payment from 25% of current-year gross receipts to 25% of average gross receipts over the past seven years — essentially a seven-year rolling average of receipts. This reduced the annual fluctuation in payments, providing more stability in the annual payments. Thus payments increase more slowly than in the past when and where national forest receipts are rising, but decline more slowly when and where receipts are falling. This change immediately affected counties with FS land that chose not to participate in the SRS payment program, and will affect all counties with FS land in FY2013 (unless SRS is reauthorized or some other alternative is enacted).

Payments in Lieu of Taxes (PILT)

Section 601(c) of the act provided mandatory spending for the PILT program for five years, FY2008-FY2012. This meant that eligible counties received the full calculated PILT payment for those five years — a significant increase in PILT payments, since appropriations averaged less than two-thirds of the calculated payments over the past decade. After FY2012, PILT would again require annual appropriations, unless Congress extends mandatory spending for the program.

Reauthorization Efforts in the 112th Congress

SRS expired at the end of FY2011, with final payments made at the end of December 2011. Legislation to extend the program for five years was considered in the 112th Congress. The County Payments Reauthorization Act of 2011 (S. 1692 and H.R. 3599) would have extended SRS through

2016 and included provisions to slow the decline of the full funding levels to 95% of the preceding fiscal year. Neither the Senate nor the House version was reported out of committee.

One-Year Extension Enacted in the 112th Congress

On April 24, 2012, the Senate passed S. 1813, the Moving Ahead for Progress in the 21st Century Act (MAP-21), with a one-year extension for SRS. The companion legislation in the House did not contain the extension, but the House agreed to the Senate amendments on June 29, 2012. On July 6, 2012, President Obama signed P.L. 112-141 into law.

Section 100101 of P.L. 112-141 extended the SRS program through FY2012 with funding at 95% of the FY2011 level, and included requirements for the counties to select their payment option in a timely manner. The program expired on September 30, 2012, meaning that payments will revert to the original 25% receipt-sharing formula for FY2013 (or the 50% receipt-sharing formula for the O&C lands), absent further action by Congress.

Sequestration Issues

Section 302 of the Budget Control Act (BCA; P.L. 112-25, as amended by P.L. 112-240) required the President to order a sequester, or cancellation, of budgetary resources for FY2013, in the event that Congress did not enact deficit reduction of at least $1.2 trillion by January 15, 2012.13 Congress did not enact such deficit reduction by that date, and on March 1, 2013, the Office of Management and Budget (OMB) determined the amount of the total sequestration for FY2013 to be approximately $85 billion.14

Under the BCA, half of the total reduction calculated pursuant to paragraph (3) for FY2013 is allocated to defense spending, and the other half to non-defense spending.15 Within each half, the reductions are further allocated between discretionary appropriations and direct spending.16 Discretionary appropriations are defined in the BCA as budgetary resources provided in annual appropriations acts.17 In contrast, direct spending is defined to include budget authority provided by law other than appropriations acts.18 The BCA further requires OMB to calculate a uniform percentage reduction that is to be applied to each program, project, or activity within the direct spending category.19 For the direct spending category, OMB has determined this percentage to be 5.1% for FY2013.

Section 102(d)(3)(e) of SRS directs that payments for a fiscal year are to be made to the state as soon as practicable after the end of that fiscal year, meaning that the FY2012 payment is made in FY2013.20 Because the authority to make these payments is not provided in an annual appropriations act, such payments are not discretionary spending for purposes of the BCA. These payments are classified as non-defense, direct spending for purposes of sequestration, as direct spending is defined to include all budget authority provided in law other than annual appropriations acts.21 The BCA exempts a number of programs from sequestration; however, the payments under SRS do not appear to be identified as exempt.22 Consequently, these payments would appear to be subject to sequestration as non-defense, direct spending.

BLM Sequestration of SRS Funds

BLM only issues SRS payments for the O&C lands in Oregon. In February 2013, BLM distributed $36 million to the 18 O&C counties in Oregon for FY2012 SRS payments. However, DOI held back 10% of the scheduled payments across all three titles in anticipation of the possibility of sequestration. The reduction to DOI's SRS program required by sequestration was 5.1% of the total payment, or $2.0 million.23 Since the sequestered amount was less than the amount withheld, DOI-

BLM owed an additional SRS payment for the difference. In May 2013, BLM distributed the remaining 4.9% of the payment, resulting in a total $38 million SRS payment to the O&C counties for FY2012.24

Forest Service Sequestration of SRS Funds

The Forest Service distributed the full FY2012 SRS payments in January and February 2013, without withholding any amount in preparation for the potential sequester order. On March 19, 2013, the Forest Service announced it would seek to recover from the states the 5.1% of the payments that were subject to sequestration.25 In letters sent to each affected governor, the Forest Service outlined two repayment options and asked for the states to respond by April 19, 2013, with how they planned to repay. Invoices for repayment were not included. In addition to repaying the 5.1%, the FS offered the states the option of having the full sequestered amount taken out of Title II funds (for those states with enough Title II money). Three states — Alaska, Washington, and Wyoming — have publicly indicated their intention to not repay the SRS funds.26 In an April 16, 2013, hearing before the Senate Committee on Energy and Natural Resources, the FS indicated that invoices for the repayment would be sent in late April 2013.

On August 5, 2013, the Forest Service sent additional letters which included invoices for the repayment to the governors of the 18 states with insufficient Title II money to cover the sequestered amount.27 The invoices outline three options for the affected states to take within 30 days: pay the debt in full; agree to a payment plan; or petition for administrative review of the debt. The invoices also included a Notice of Indebtedness to the U.S. Forest Service and Intent to Collect by Administrative Offset, which describes the basis of the indebtedness and the Forest Service's intent to offset future payments — without assessing penalties — from future Forest Service and Department of Agriculture state payments.

On August 20, 2013, the Forest Service sent additional letters to the governors of the 22 states that had sufficient Title II money to cover the sequestered amount.28 The letters informed the governors that the Title II allocations are being reduced by the sequestered amount.

On September 4, 2013, House Natural Resources Committee Chairman Doc Hastings issued subpoenas to the Secretary of Agriculture and the Director of OMB seeking documents related to the decision to sequester the SRS payment by September 18, 2013.29

Legislative Issues

Congress may consider extending SRS, with or without modifications, implementing other legislative proposals to address the county payments, or taking no action (thus continuing the revenue-based system that took effect upon the program's expiration). Generally, six issues commonly have been raised about compensating counties for the tax-exempt status of federal lands: the lands covered; the basis for compensation; the source of funds; the authorized and required uses of the payments; interaction with other compensation programs; and the duration of the new system. In addition, any new mandatory spending in excess of the baseline that would result in an increase in the deficit may be subject to budget rules, such as congressional pay-as-you-go (PAYGO) rules, which generally require budgetary offsets.30

Offsets for New Mandatory Spending

One policy issue concerns legislation with mandatory spending that would increase federal expenditures, and whether such spending should be offset so as not to increase the deficit. Congress has enacted a set of budget rules requiring that most legislation that creates new or extends existing

mandatory spending (in excess of the baseline) be balanced — offset — by increases in receipts or decreases in other mandatory spending. The budget rules may be waived or set aside in particular instances, but the increased deficit spending remains a consideration.

Legislation to reauthorize the Secure Rural Schools and Community Self-Determination Act of 2000 (with or without other modifications), or to enact a different alternative, would require an offset — increased revenues or decreased spending from other mandatory spending accounts — or a waiver to the budget rules. In 2000, Congress provided such a waiver by including a specific type of provision, called a reserve fund, in the budget resolution.

In 2006, to fund a six-year reauthorization of SRS, the Bush Administration proposed selling some federal lands. To fund the O&C payments, the BLM would have accelerated its land sales under Section 203 of the Federal Land Policy and Management Act of 1976 (FLPMA; 43 U.S.C. § 1713). For the FS payments, estimated at $800 million, the FS would have sold approximately 300,000 acres of national forest land. This would have required legislation, as the FS currently has only very narrow authority to sell any lands. The Administration offered draft legislation to authorize these land sales, but no bill to authorize that level of national forest land sales was introduced in the 109th Congress. Instead, Congress again included a reserve fund for SRS payments in the budget resolution.

In 2007, the Bush Administration again proposed selling national forest lands to fund a phase-out of SRS payments, with half of the land sale revenues to be used for other programs (including land acquisition and conservation education). Again, no legislation to authorize national forest land sales was introduced.

Lands Covered

SRS includes payments only for national forests and for the O&C lands. Some observers have noted that these compensation programs provide substantial funding for the specified lands, while other federal lands that are exempt from state and local taxation receive little or nothing. The easiest comparison is with the national grasslands. Some have questioned the logic of compensating national forest counties with 25% of gross receipts and protecting these counties from declines in receipts under SRS, while compensating national grassland counties with 25% of net receipts and excluding them from SRS. Both forests and grasslands are part of the National Forest System, although the laws authorizing their establishment differ.

More significantly, many other tax-exempt federal lands provide little compensation to local governments. The BLM has numerous compensation programs, but generally the payments are quite small. (The O&C payments account for about 95% of BLM compensation payments, but O&C lands are only about 1% of BLM lands.) The National Park Service has two small compensation programs related to public schooling of park employees' children at two parks. PILT provides some compensation for most federal lands, but many lands — inactive military bases, Indian trust lands, and certain wildlife refuge lands, for example — are excluded, and the national forests and O&C lands get PILT payments in addition to other compensation. In 1992, the Office of Technology Assessment recommended "fair and consistent compensation for the tax exempt status of national forest lands and activities."31 This concept of fair and consistent compensation could be extended to all tax-exempt federal lands. Others argue that the limited costs imposed on local governments by federal land ownership may lead to overcompensating state and local governments.

Basis for Compensation

The legislative histories of the agriculture appropriations acts establishing the FS payments to states (the last of which, enacted on May 23, 1908, made the payments permanent) indicate that the intent

was to substitute receipt-sharing for local property taxation, but no rationale was discussed for the level chosen (10% in 1906 and 1907; 25% since). Similarly, the rationale was not clearly explained or discussed for the Reagan tax-equivalency proposal, for the spotted owl payments (a declining percent of the historical average), or for the legislation debated and enacted by the 106th Congress (generally the average of the three highest payments during a specified historical period). The proposals' intents were generally to reduce (Reagan Administration) or increase (more recently) the payments.

The geographic basis is also a potential problem for FS payments. FS 25% payments are made to the states, but are calculated for each county with land in each national forest.32 Depending on the formula used — the average of selected historical payments from each national forest or to each county or each state — the calculations could result in different levels of payments in states with multiple national forests.33 (This is not an issue for O&C lands, because the O&C payments are made directly to the counties.)

Source of Funds

As noted above, the FS 25% payments are permanently appropriated from agency receipts, and were established prior to federal income taxes and substantial federal oil and gas royalties. Most of the proposals for change also would establish mandatory payments; lacking a specified funding source, mandatory spending would come from the General Treasury. SRS directed payments first from receipts, then from the General Treasury. Figure 3 shows the breakdown of SRS funding between receipts and the General Treasury. Critics are concerned that retaining the linkage between agency receipts (e.g., from timber sales) and county payments (albeit less directly than for the 25% payments) still encourages counties to support timber sales over other FS uses.

Figure 3. Source and Distribution of FS Payments

Source: CRS. Data from Forest Service, FY2010-FY2013 Budget Justifications, available from http://www.fs.fed.us/aboutus/budget/.

Notes: SRS Title I and Title III payments are passed through the state to the counties to use for specified purposes. SRS Title II payments are retained by the Forest Service for use on approved National Forest projects.

Authorized and Required Uses of the Payments

The FS 25% payments can be spent only on roads and schools in the counties where the national forests are located. State law dictates which road and school programs are financed with the payments, and the state laws differ widely, generally ranging from 30% to 100% for school programs, with a few states providing substantial local discretion on the split. The O&C payments are available for any local governmental purpose.

SRS modified these provisions by requiring (for counties with at least $100,000 in annual payments) that 15%-20% of the payments be used for other specified purposes: certain local governmental costs (in Title III); federal land projects recommended by local advisory committees and approved by the Secretary (under Title II); or federal land projects as determined by the Secretary (under § 402). Use of the funds for federal land projects has been touted as "reinvesting" agency receipts in federal land management, but opponents argue that this "relinks" county benefits with agency receipt-generating activities and reduces funding for local schools and roads. The Forest Counties Payments Committee recommended granting local governments more flexibility in their use of the payments. The committee also recommended that the federal government prohibit the states from adjusting

their education funding allocations because of the FS payments.34

Duration of the Programs

The questions Congress may consider are (1) how often should Congress review the payment systems (these or all county compensation programs, or the lack thereof) to assess whether they still function as intended; and (2) what options are available (e.g., a sunset provision) to induce future Congresses to undertake such a review? The FS 25% payments and the O&C payments are permanently authorized. The FS 25% payments were established in 1908 (after having been enacted as a one-year program in 1906 and again in 1907). The O&C payments were established in 1937. The owl payments were to be a 10-year program, enacted in 1993. SRS was originally enacted as a six-year program that expired on September 30, 2006, but was extended an additional six years through September 30, 2012. The Forest Counties Payments Committee recommended a permanent change based on SRS, with some adjustments.

Legislative Activity in the 113th Congress

The 113th Congress is considering options for reauthorizing or modifying SRS for FY2013. On March 19, 2013, the Senate Energy and Natural Resources committee held a hearing to discuss options for reauthorizing and reforming SRS and PILT.35 On June 18, 2013, the Senate Energy and Natural Resources Committee ordered to be reported S. 783, the Helium Stewardship Act of 2013, which includes a one-year extension of SRS at 95% of the FY2012 SRS payment.

On July 31, 2013, the House Committee on Natural Resources ordered to be reported H.R. 1526, the Restoring Healthy Forests for Healthy Communities Act. In Section 501, H.R. 1526 directs the FS and BLM to distribute, no later than February 2014, a payment to eligible counties in the amount equal to the FY2010 payment. In Section 502, H.R. 1526 changes the calculation formula for the FS 25% Payment to States program. It changes the payment from 25% of average gross receipts over the past seven years to 25% of current-year gross receipts.

The President's FY2014 budget request for the Forest Service and the BLM proposes a five-year reauthorization of SRS, with mandatory funding, starting at $278 million for FY2014 and declining to $106 million by FY2017.36 The President's proposal also includes decreasing the Title I and Title III allocation while increasing the Title II allocation.

The 113th Congress is also conducting oversight on the decision to sequester the SRS FY2012 payment. On September 4, 2013, House Natural Resources Committee Chairman Doc Hastings issued subpoenas to the Secretary of Agriculture and the Director of OMB seeking documents related to the sequester decision by September 18, 2013.37

Appendix. SRS Payments in FY2006 and FY2009

As described in the text, under "Four-Year Extension Enacted in the 110th Congress," the SRS payment formula was modified in the extension to include federal acreage and relative income in each county, as well as transition payments in some states. The result was a change in the payments and the allocation of total payments in the modified formula. These changes are shown in Table 2. Note, however, that the change in the payment formula led some counties that had chosen 25% payments for FY2006 to opt for SRS payments for FY2009, and vice versa. Some of the increase in SRS payments in FY2009 is due to more counties opting for SRS payments in some states, such as Michigan, New Hampshire, Ohio, Puerto Rico, and Wisconsin. In at least one state — Pennsylvania — a portion of the decline is due to some counties opting for 25% payments in FY2009.

Table A-1. FY2006 and FY2009 FS and O&C Payments Under SRS, by State (in thousands of dollars and percent of total SRS funding for all of U.S.)

	FY2006		FY2009	
	Dollars	Percent	Dollars	Percent
AL	2,133.8	0.44%	2,236.2	0.44%
AK	9,377.2	1.92%	18,760.5	3.68%
AZ	7,289.8	1.50%	16,688.2	3.27%
AR	6,568.0	1.35%	8,309.6	1.63%
CA	65,279.3	13.44%	50,125.6	9.83%
CO	6,338.7	1.31%	14,641.3	2.87%
FL	2,504.5	0.52%	2,862.3	0.56%
GA	1,304.6	0.27%	1,864.1	0.37%
ID	21,173.5	4.36%	34,900.0	6.85%
IL	304.2	0.06%	107.6	0.02%
IN	130.2	0.03%	337.4	0.07%
KY	682.1	0.14%	2,596.9	0.51%
LA	3,726.1	0.77%	2,620.1	0.51%
ME	41.4	0.01%	99.3	0.02%
MI	789.8	0.16%	3,397.1	0.67%
MN	1,468.8	0.36%	3,330.1	0.65%

MS	8,287.2	1.71%	7,705.7	1.51%
MO	2,767.2	0.57%	4,681.7	0.92%
MT	12,934.8	2.66%	24,523.6	4.81%
NE	55.6	0.01%	584.4	0.11%
NV	408.8	0.08%	5,174.2	1.02%
NH	0.0	0.00%	275.2	0.05%
NM	2,383.6	0.49%	18,185.9	3.57%
NY	16.9	<0.01%	29.5	0.01%
NC	1,020.9	0.21%	2,326.6	0.46%
ND	0.0	0.00%	0.8	<0.01%
OH	68.8	0.01%	339.7	0.07%
OK	1,238.9	0.26%	1,192.4	0.23%
OR-FS	149,153.3	30.72%	121,316.4	23.80%
OR-O&C	108,852.0	22.42%	87,175.0	17.10%
OR-Total	258,005.3	53.13%	208,491.4	40.91%
PA	6,491.6	1.34%	2,505.6	0.49%
PR	0.0	0.00%	184.7	0.04%
SC	3,288.2	0.68%	2,498.4	0.49%
SD	3,823.4	0.79%	2,931.1	0.58%
TN	560.3	0.12%	1,428.4	0.28%
TX	4,688.8	0.97%	3,655.9	0.72%
UT	1,872.5	0.39%	14,177.0	2.78%
VT	392.3	0.08%	400.7	0.08%
VA	925.2	0.19%	2,093.7	0.41%
WA	42,293.9	8.71%	33,990.9	6.67%

WV	2,006.3	0.41%	2,356.8	0.46%
WI	577.6	0.12%	2,730.1	0.54%
WY	2,387.4	0.49%	4,357.6	0.85%
Total	485,567.7		509,667.8	

Sources: FS: U.S. Dept. of Agriculture, Forest Service, "All Service Receipts (ASR), Final Payment Summary Report PNF (ASR-10-01)," unpublished reports. O&C: U.S. Dept. of the Interior, Bureau of Land Management, FY2011 Budget Justification, p. X-6, http://www.doi.gov/budget/2011/data/greenbook/FY2011_BLM_Greenbook.pdf.

Note: Counties could choose to receive the regular 25% FS payments or 50% O&C payments, rather than the SRS payments, and in many cases opted for the 25% in FY2006 or FY2009, and sometimes in both fiscal years. Thus, a change in the SRS payments in the table might not reflect the total change in FS payments to that state.

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FOOTNOTES

1 16 U.S.C. § 500. For more on these and other county-compensation programs with mandatory spending for federal lands, see CRS Report RL30335, Federal Land Management Agencies' Mandatory Spending Authorities.

2 For more information, see CRS Report R42951, The Oregon & California Railroad Lands (O&C Lands): Issues for Congress.

3 The decline in timber harvests is attributable to a variety of factors, including a combination of

forest management policies and practice, increased planning and procedural requirements, changing public preferences, economic, and industry factors.

4 P.L. 103-66 § 13982-3.

5 Data provided by the Forest Service Legislative Affairs office, February 21, 2013.

6 U.S. Dept. of the Interior, Bureau of Land Management, Public Land Statistics, 2011, Table 3-12, http://www.blm.gov/public_land_statistics/pls11/pls2011.pdf.

7 Forest Service, FY2013 Budget Justification, pp. 12-40, http://www.fs.fed.us/aboutus/budget/.

8 Personal communication with BLM Legislative Affairs office, July 2013.

9 See CRS Report RL31392, PILT (Payments in Lieu of Taxes): Somewhat Simplified.

10 Forest Counties Payments Committee, Recommendations for Making Payments to States and Counties: Report to Congress (Washington, DC: U.S. GPO, 2003). The committee was established in § 320 of the FY2001 Interior and Related Agencies Appropriations Act, P.L. 106-291.

11 National Association of Counties, NACo Resolution in Support of a Forest Counties "Safety Net," Washington, DC, April 21, 1999.

12 Eligible counties are those that choose to receive payments under this program; counties that choose to continue to receive payments under the original revenue-sharing programs are excluded from these calculations.

13 2 U.S.C. § 901A. The sequester was originally supposed to be ordered on January 2, 2013, but was delayed by the American Taxpayer Relief Act of 2012, P.L. 112-240, until March 1, 2013. For more information on sequestration issues, see CRS Report R42972, Sequestration as a Budget Enforcement Process: Frequently Asked Questions.

14 This amount was identified based on a formula set forth in § 302.

15 2 U.S.C. § 901A(4).

16 2 U.S.C. § 901A(6).

17 2 U.S.C. § 900(7).

18 2 U.S.C. § 900(8). Budget authority is further defined as "the authority provided by Federal law to incur financial obligations." 2 U.S.C. § 622.

19 Although not relevant here, additional restrictions are placed on the degree by which Medicare payments in the direct spending category may be reduced. 2 U.S.C. § 901a(8).

20 16 U.S.C. § 7112(e).

21 2 U.S.C. § 900(8).

22 2 U.S.C. § 905.

23 Testimony of DOI Deputy Assistant Secretary Pamela K. Haze, in U.S. Congress, Senate Committee on Energy and Natural Resources, Keeping the Commitment to Rural Communities,

hearing, 113th Cong., 1st sess., March 19, 2013.

24 Personal communication with BLM Legislative Affairs office, June 19, 2013.

25 Testimony of Forest Service Chief Thomas Tidwell, in U.S. Congress, Senate Committee on Energy and Natural Resources, Keeping the Commitment to Rural Communities, hearing, 113th Cong., 1st sess., March 19, 2013. SRS payments are made from the Forest Service to the states, which then distribute the payment to the eligible counties.

26 Phil Taylor, "Hastings probes Forest Service's withholding of timber payments," E&E News, May 21, 2013.

27 The following states did not have sufficient Title II funds to cover the sequester and received invoices: AL, AR, GA, IL, IN, ME, MN, MO, NC, ND, NE, NH, NY, OH, PA, PR, TN, VT, and VA. WA received a letter and invoice to collect money from a special act payment, but the letter also indicated the total SRS Title II reduction.

28 The following states had the sequester withheld entirely from their Title II funds: AK, AZ, CA, CO, FL, ID, KY, LA, MI, MS, MT, NM, NV, OK, OR, SC, SD, TX, UT, WI, WV, and WY.

29 House Natural Resources Committee, Press Release September 4, 2013, http://naturalresources.house.gov/news/documentsingle.aspx?DocumentID=347606.

30 For an overview of federal budget procedures, see CRS Report 98-721, Introduction to the Federal Budget Process. For background on PAYGO rules, see CRS Report RL34300, Pay-As-You-Go Procedures for Budget Enforcement.

31 U.S. Congress, Office of Technology Assessment, Forest Service Planning: Accommodating Uses, Producing Outputs, and Sustaining Ecosystems, OTA-F-505 (Washington: U.S. GPO, Feb. 1992), p. 8.

32 There was no discussion in the legislative history of why the payments were made to the states, and not directly to the counties.

33 The complexity of this situation is shown using Arizona as an example in out-of-print CRS Report RL30480, Forest Service Revenue-Sharing Payments: Legislative Issues (available from the author).

34 Some states include FS payments allocated for education in their calculations allocating state education funds to the counties.

35 U.S. Congress, Senate Energy and Natural Resources, Keeping the Commitment to Rural Communities, 113th Cong., 1 sess., March 19, 2013, pp. http://www.energy.senate.gov/public/index.cfm/2013/3/full-committee-hearing-funding-programs-for-rural-communities.

36 U.S. Forest Service, FY2014 Budget Justification, pp. 12-58, http://www.fs.fed.us/aboutus/budget/.

37 House Natural Resources Committee, Press Release September 4, 2013, http://naturalresources.house.gov/news/documentsingle.aspx?DocumentID=347606.

IRS Releases Publication Containing Guidance on Applying for Tax-Exempt Status.

The IRS has released Publication 4220 (rev. Aug. 2013), Applying for 501(c)(3) Tax-Exempt Status, which provides general guidelines for organizations that seek exemption from federal income tax under section 501(c)(3).

http://www.irs.gov/pub/irs-pdf/p4220.pdf

IRS Releases Publication for Public Charity Compliance.

The IRS has released Publication 4221-PC (rev. Aug. 2013), Compliance Guide for 501(c)(3) Public Charities, which identifies activities that could jeopardize a public charity's tax-exempt status and addresses general compliance requirements on record keeping, reporting, and disclosure for exempt organizations.

http://www.irs.gov/pub/irs-pdf/p4221pc.pdf

IRS Releases Publication on Charitable Contributions.

The IRS has released Publication 1771 (rev. Jul. 2013), Charitable Contributions — Substantiation and Disclosure Requirements, which explains general rules and specifications for documenting charitable deductions and explains new guidelines that allow charities to electronically mail documentation to donors.

http://www.irs.gov/pub/irs-pdf/p1771.pdf

IRS Releases Publication Containing Guidance for Charitable Donations of Vehicles.

The IRS has released Publication 4303 (rev. Aug. 2013), A Donor's Guide to Vehicle Donations, which provides general guidelines for individuals who donate their vehicles to a charity

http://www.irs.gov/pub/irs-pdf/p4303.pdf

IRS Previewing Interactive Exemption Application.

The IRS is previewing an interactive version of Form 1023, "Application for Recognition of Exemption Under Section 501(c)(3)," online and is seeking comments.

The interactive application was posted September 6 and is available until September 20 at www.stayexempt.irs.gov, the IRS announced in an electronic newsletter.

Users cannot now print or submit the interactive version of the application, according to the newsletter. However, when testing is finished later this year, users will be able to print and mail the form and its attachments.

The interactive form should allow users to submit a more complete application and help the agency speed up processing times and provide faster determinations, the newsletter says.

The IRS developed the interactive application from recommendations made in the Advisory Committee on Tax-Exempt and Government Entities report , the newsletter says. The application was also listed in the agency's fiscal 2013 exempt organizations workplan .

The IRS requests that comments on the interactive application be sent to tege.eo.ceo@irs.gov.

Final Regs Remove References to Credit Ratings in Tax Code Rules.

The IRS has issued final regulations that remove any reference to, or requirement of reliance on, credit ratings in various tax code rules and provide substitute standards of creditworthiness where appropriate. (T.D. 9637)

[4830-01-p] DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 48 [TD 9637] RIN 1545-BK27 Modification of Treasury Regulations Pursuant to Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act AGENCY: Internal Revenue Service (IRS), Treasury. ACTION: Final regulations and removal of temporary regulations. SUMMARY: This document contains final regulations that remove any reference to, or requirement of reliance on, "credit ratings" in regulations under the Internal Revenue Code (Code) and provides substitute standards of credit-worthiness where appropriate. This action is required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. These regulations affect persons subject to various provisions of the Code. DATES: Effective Date: These regulations are effective on September 6, 2013.

Applicability Dates: For dates of applicability, see §§1.150-1(a)(4), 1.171-1 (f), 1.197-2(b)(7), 1.249-1(f)(3), 1.475(a)-4(d)(4), 1.860G-2(g)(3), 1.1001-3(d), (e), and (g), and 48.4101-1(l)(5). FOR FURTHER INFORMATION CONTACT: Arturo Estrada, (202) 622-3900 (not a toll- free number). SUPPLEMENTARY INFORMATION: Background

Doc 2013-21135 (17 pgs)

Section 939A(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203 (124 Stat. 1376 (2010)) (the "Dodd-Frank Act"), requires each Federal agency to review its regulations that require the use of an assessment of credit- worthiness of a security or money market instrument, and to review any references or requirements in its regulations regarding credit ratings. Section 939A(b) directs each agency to modify any regulation identified in the review required under section 939A(a) by removing any reference to, or requirement of reliance on, credit ratings and substituting a standard of credit-worthiness that the agency deems appropriate. Numerous provisions under the Internal Revenue Code (Code) are affected.

These regulations amend the Income Tax Regulations (26 CFR part 1) under sections 150, 171, 197, 249, 475, 860G, and 1001 of the Code (the existing regulations). These sections were added to the Code during different years to serve different purposes. These regulations also amend the Manufacturers and Retailers Excise Tax Regulations (26 CFR part 48) under section 4101, which

provides registration requirements related to Federal fuel taxes.

On July 6, 2011, temporary regulations (TD 9533) under sections 150, 171, 197, 249, 475, 860G, and 1001 of the Code were published in the Federal Register (76 FR 39278) that modify or eliminate the reference to credit ratings in the relevant regulations. Additional temporary regulations (26 CFR part 48) under section 4101 were published as part of TD 9533. A notice of proposed rulemaking (REG-118809-11) cross-referencing the temporary regulations was published in the Federal Register the same day (76 FR 39341). No written comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held. The regulations are adopted as proposed without substantive changes. Explanation of Provisions

These regulations remove references to “credit ratings” and “credit agencies” or functionally similar terms in the existing regulations. Some changes involve simple word deletions or substitutions. Others reflect the revision of one or more sentences to remove the credit rating references. Where appropriate, substitute standards of credit- worthiness replace the prior references to credit ratings, credit agencies, or functionally similar terms. Language revisions serve solely to remove the references prohibited by section 939A of the Dodd-Frank Act and no additional changes to the existing regulations are intended. Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. No comments were received.

Drafting Information

These regulations were drafted by personnel in the Office of Associate Chief Counsel (Financial Institutions and Products), the Office of Associate Chief Counsel (Income Tax and Accounting), the Office of the Associate Chief Counsel (International) and the Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in the development of the regulations. List of Subjects 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements. 26 CFR Part 48

Excise taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 48 are amended as follows: PART 1–INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows: Authority: 26 U.S.C. 7805 * * * Par. 2. Section 1.150-1 is amended as follows: 1. Paragraph heading (a)(2) is revised.

2. Paragraph (a)(4) is revised. 3. In paragraph (b), the definition of “Issuance costs” is revised. The revisions read as follows:

§1.150-1 Definitions.

(a) * * *

(2) Effective/applicability date * * * *****

(4) Additional exception to the general applicability date. Section 1.150-1(b), Issuance costs, applies on and after July 6, 2011.

(b) * * *

Issuance costs means costs to the extent incurred in connection with, and allocable to, the issuance of an issue within the meaning of section 147(g). For example, issuance costs include the following costs but only to the extent incurred in connection with, and allocable to, the borrowing: underwriters' spread; counsel fees; financial advisory fees; fees paid to an organization to evaluate the credit quality of an issue; trustee fees; paying agent fees; bond registrar, certification, and authentication fees; accounting fees; printing costs for bonds and offering documents; public approval process costs; engineering and feasibility study costs; guarantee fees, other than for qualified guarantees (as defined in §1.148–4(f)); and similar costs. ***** §1.150-1T [Removed]

Par. 3. Section 1.150-1T is removed.

Par. 4. Section 1.171-1(f) Example 2 is revised to read as follows: §1.171-1 Bond premium.

***** (f) * * *

Example 2. Convertible bond–(i) Facts. On January 1, A purchases for $1,100 B corporation's bond maturing in three years from the purchase date, with a stated principal amount of $1,000, payable at maturity. The bond provides for unconditional payments of interest of $30 on January 1 and July 1 of each year. In addition, the bond is convertible into 15 shares of B corporation stock at the option of the holder. On the purchase date, B corporation's nonconvertible, publicly-traded, three-year debt of comparable credit quality trades at a price that reflects a yield of 6.75 percent, compounded semiannually.

(ii) Determination of basis. A's basis for determining loss on the sale or exchange of the bond is $1,100. As of the purchase date, discounting the remaining payments on the bond at the yield at which B's similar nonconvertible bonds trade (6.75 percent, compounded semiannually) results in a present value of $980. Thus, the value of the conversion option is $120. Under paragraph (e)(1)(iii)(A) of this section, A's basis is $980 ($1,100 – $120) for purposes of this section and §§1.171-2 through 1.171-5. The sum of all amounts payable on the bond other than qualified stated interest is $1,000. Because A's basis (as determined under paragraph (e)(1)(iii)(A) of this section) does not exceed $1,000, A does not acquire the bond at a premium.

(iii) Applicability date. Notwithstanding §1.171-5(a)(1), this Example 2 applies to bonds acquired on or after July 6, 2011. §1.171-1T [Removed]

Par. 5. Section 1.171-1T is removed. Par. 6. Section 1.197-2 is amended by revising paragraph (b)(7) to read as

follows: §1.197-2 Amortization of goodwill and certain other intangibles. *****

(b) * * * (7) Supplier-based intangibles–(i) In general. Section 197 intangibles include any

supplier-based intangible. A supplier-based intangible is the value resulting from the future acquisition, pursuant to contractual or other relationships with suppliers in the ordinary course of business, of goods or services that will be sold or used by the taxpayer. Thus, the amount paid or incurred for supplier-based intangibles includes, for example, any portion of the purchase price of an acquired trade or business attributable to the existence of a favorable relationship with persons providing distribution services (such as favorable shelf or display space at a retail outlet), or the existence of favorable supply contracts. The amount paid or incurred for supplier-based intangibles does not include any amount required to be paid for the goods or services themselves pursuant to the terms of the agreement or other relationship. In addition, see the exceptions in paragraph 2(c) of this section, including the exception in paragraph 2(c)(6) of this section for certain rights to receive tangible property or services from another person.

(ii) Applicability date. This section applies to supplier-based intangibles acquired after July 6, 2011.

*****

§1.197-2T [Removed]

Par. 7. Section 1.197-2T is removed.

Par. 8. Section 1.249-1 is amended by revising paragraphs (e)(2)(ii) and (f)(3) to read as follows:

§1.249-1 Limitation on deduction of bond premium on repurchase. *****

(e) * * * (2) * * * (ii) In determining the amount under paragraph (e)(2)(i) of this section,

appropriate consideration shall be given to all factors affecting the selling price or yields of comparable nonconvertible obligations. Such factors include general changes in prevailing yields of comparable obligations between the dates the convertible obligation was issued and repurchased and the amount (if any) by which the selling price of the nonconvertible obligation was affected by reason of any change in the issuing corporation’s credit quality or the credit quality of the obligation during such period (determined on the basis of widely published financial information or on the basis of other relevant facts and circumstances which reflect the relative credit quality of the corporation or the comparable obligation).

*****

(f) * * * (3) Portion of repurchase premium attributable to cost of borrowing. Paragraph

(e)(2)(ii) of this section applies to any repurchase of a convertible obligation occurring on or after July 6, 2011. ***** §1.249-1T [Removed]

Par. 9. Section 1.249-1T is removed.

Par. 10. Section 1.475(a)-4 is amended by revising paragraph (d)(4) Example 1, Example 2, and Example 3 to read as follows: §1.475(a)-4 Valuation safe harbor. *****

(d) * * * (4) * * *

Example 1. (i) X, a calendar year taxpayer, is a dealer in securities within the meaning of section 475(c)(1). X generally maintains a balanced portfolio of interest rate swaps and other interest rate

derivatives, capturing bid-ask spreads and keeping its market exposure within desired limits (using, if necessary, additional derivatives for this purpose). X uses a mark-to-market method on a statement that it is required to file with the United States Securities and Exchange Commission and that satisfies paragraph (d)(2) of this section with respect to both the contracts with customers and the additional derivatives. When determining the amount of any gain or loss realized on a sale, exchange, or termination of a position, X makes a proper adjustment for amounts taken into account respecting payments or receipts. X and all of its counterparties on the derivatives have the same general credit quality as each other.

(ii) Under X's valuation method, as of each valuation date, X determines a mid- market probability distribution of future cash flows under the derivatives and computes the present values of these cash flows. In computing these present values, X uses an industry standard yield curve that is appropriate for obligations by persons with this same general credit quality. In addition, based on information that includes its own knowledge about the counterparties, X adjusts some of these present values either upward or downward to reflect X's reasonable judgment about the extent to which the true credit status of each counterparty's obligation, taking credit enhancements into account, differs from the general credit quality used in the yield curve to present value the derivatives.

(iii) X's methodology does not violate the requirement in paragraph (d)(3)(iii) of this section that the same cost or risk not be taken into account, directly or indirectly, more than once.

(iv) Applicability date. This Example 1 applies to valuations of securities on or after July 6, 2011.

Example 2. (i) The facts are the same as in Example 1, except that X uses a better credit quality in determining the yield curve to discount the payments to be received under the derivatives. Based on information that includes its own knowledge about the counterparties, X adjusts these present values to reflect X's reasonable judgment about the extent to which the true credit status of each counterparty's obligation, taking credit enhancements into account, differs from this better credit quality obligation.

(ii) X's methodology does not violate the requirement in paragraph (d)(3)(iii) of this section that the same cost or risk not be taken into account, directly or indirectly, more than once.

(iii) Applicability date. This Example 2 applies to valuations of securities on or after July 6, 2011.

Example 3. (i) The facts are the same as in Example 1, except that, after computing present values using the discount rates that are appropriate for obligors with the same general credit quality, and based on information that includes X's own knowledge about the counterparties, X adjusts some of these present values either upward or downward to reflect X's reasonable judgment about the extent to which the true credit status of each counterparty's obligation, taking credit enhancements into account, differs from a better credit quality.

(ii) X's methodology violates the requirement in paragraph (d)(3)(iii) of this section that the same cost or risk not be taken into account, directly or indirectly, more than once. By using the same general credit quality discount rate, X's method takes into account the difference between risk-free obligations and obligations with that lower credit quality. By adjusting values for the difference between a higher credit quality and that lower credit quality, X takes into account risks that it had already accounted for through the discount rates that it used. The same result would occur if X judged some of its counterparties' obligations to be of a higher credit quality but X failed to adjust the values of those obligations to reflect the difference between a higher credit quality and the lower credit quality.

(iii) Applicability date. This Example 3 applies to valuations of securities on or after July 6, 2011.

*****

§1.475(a)-4T [Removed]

Par. 11. Section 1.475(a)-4T is removed.

Par. 12. Section 1.860G-2 is amended by revising paragraphs (g)(3)(ii)(B), (g)(3)(ii)(C) and (g)(3)(ii)(D) to read as follows: §1.860G-2 Other rules. *****

(g) * * * (3) * * * (ii) * * * (B) Presumption that a reserve is reasonably required. The amount of a reserve fund is presumed to be reasonable (and an excessive reserve is presumed to have

been promptly and appropriately reduced) if it does not exceed the amount required by a third party insurer or guarantor, who does not own directly or indirectly (within the meaning of section 267(c)) an interest in the REMIC (as defined in §1.860D-1(b)(1)), as a condition of providing credit enhancement.

(C) Presumption may be rebutted. The presumption in paragraph (g)(3)(ii)(B) of this section may be rebutted if the amounts required by the third party insurer are not commercially reasonable considering the factors described in paragraph (g)(3)(ii)(A) of this section.

(D) Applicability date. Paragraphs (g)(3)(ii)(B) and (g)(3)(ii)(C) of this section apply on and after July 6, 2011. ***** §1.860G-2T [Removed]

Par. 13. Section 1.860G-2T is removed. Par. 14. Section 1.1001-3 is amended as follows: 1. Paragraph (d) Example 9 is revised. 2. Paragraph (e)(4)(iv)(B) is revised. 3. Paragraph (e)(5)(ii)(B)(2) is revised. 4. Paragraph (g) Examples 1, 5 and 8 are revised. The revisions read as follows:

§1.1001-3 Modifications of debt instruments. *****

(d) * * *

Example 9. Holder’s option to increase interest rate. (i) A corporation issues an 8-year note to a bank in exchange for cash. Under the terms of the note, the bank has the option to increase the rate of interest by a specified amount if certain covenants in the note are breached. The bank’s right to increase the interest rate is a unilateral option as described in paragraph (c)(3) of this section.

(ii) A covenant in the note is breached. The bank exercises its option to increase the rate of interest. The increase in the rate of interest occurs by operation of the terms of the note and does not result in a deferral or a reduction in the scheduled payments or any other alteration described in paragraph (c)(2) of this section. Thus, the change in interest rate is not a modification.

(iii) Applicability date. This Example 9 applies to modifications occurring on or after July 6, 2011.

*****

(e) * * * (4) * * * (iv) * * * (B) Nonrecourse debt instruments. (1) A modification that releases, substitutes, adds or otherwise alters a substantial amount of the collateral for, a guarantee on, or other form of credit enhancement for a nonrecourse debt instrument is a significant modification. A substitution of collateral is not a significant modification, however, if the collateral is fungible or otherwise of a type where the particular units pledged are unimportant (for example, government

securities or financial instruments of a particular type and credit quality). In addition, the substitution of a similar commercially available credit enhancement contract is not a significant modification, and an improvement to the property securing a nonrecourse debt instrument does not result in a significant modification.

(2) Applicability date. Paragraph (e)(4)(iv)(B)(1) of this section applies to modifications occurring on or after July 6, 2011. *****

(5) * * * (ii) * * * (B) * * * (2) Original collateral. (i) A modification that changes a recourse debt instrument to a nonrecourse debt instrument is not a significant modification if the instrument continues to be secured only by the original collateral and the modification does not result in a change in payment expectations. For this purpose, if the original collateral is fungible or otherwise of a type where the particular units pledged are unimportant (for example, government securities or financial instruments of a particular type and credit quality), replacement of some or all units of the original collateral with other units of the same or similar type and aggregate value is not considered a change in the original collateral.

(ii) Applicability date. Paragraph (e)(5)(ii)(B)(2)(i) of this section applies to modifications occurring on or after July 6, 2011. *****

(g) * * *

Example 1. Modification of call right. (i) Under the terms of a 30-year, fixed-rate bond, the issuer can call the bond for 102 percent of par at the end of ten years or for 101 percent of par at the end of 20 years. At the end of the eighth year, the holder of the bond pays the issuer to waive the issuer's right to call the bond at the end of the tenth year. On the date of the modification, the issuer's credit quality is approximately the same as when the bond was issued, but market rates of interest have declined from that date.

(ii) The holder's payment to the issuer changes the yield on the bond. Whether the change in yield is a significant modification depends on whether the yield on the modified bond varies from the yield on the original bond by more than the change in yield as described in paragraph (e)(2)(ii) of this section.

(iii) If the change in yield is not a significant modification, the elimination of the issuer's call right must also be tested for significance. Because the specific rules of paragraphs (e)(2) through (e)(6) of this section do not address this modification, the significance of the modification must be determined under the general rule of paragraph (e)(1) of this section.

(iv) Applicability date. This Example 1 applies to modifications occurring on or after July 6, 2011.

Example 5. Assumption of mortgage with increase in interest rate. (i) A recourse debt instrument with a 9 percent annual yield is secured by an office building. Under the terms of the instrument, a purchaser of the building may assume the debt and be substituted for the original obligor if the purchaser is equally or more creditworthy than the original obligor and if the interest rate on the instrument is increased by one-half percent (50 basis points). The building is sold, the purchaser assumes the debt, and the interest rate increases by 50 basis points.

(ii) If the purchaser's acquisition of the building does not satisfy the requirements of paragraph (e)(4)(i)(B) or paragraph (e)(4)(i)(C) of this section, the substitution of the purchaser as the obligor is a significant modification under paragraph (e)(4)(i)(A) of this section.

(iii) If the purchaser acquires substantially all of the assets of the original obligor, the assumption of

the debt instrument will not result in a significant modification if there is not a change in payment expectations and the assumption does not result in a significant alteration.

(iv) The change in the interest rate, if tested under the rules of paragraph (e)(2) of this section, would result in a significant modification. The change in interest rate that results from the transaction is a significant alteration. Thus, the transaction does not meet the requirements of paragraph (e)(4)(i)(C) of this section and is a significant modification under paragraph (e)(4)(i)(A) of this section.

(v) Applicability date. This Example 5 applies to modifications occurring on or after July 6, 2011.

*****

Example 8. Substitution of credit enhancement contract. (i) Under the terms of a recourse debt instrument, the issuer's obligations are secured by a letter of credit from a specified bank. The debt instrument does not contain any provision allowing a substitution of a letter of credit from a different bank. The specified bank, however, encounters financial difficulty. The issuer and holder agree that the issuer will substitute a letter of credit from another bank.

(ii) Under paragraph (e)(4)(iv)(A) of this section, the substitution of a different credit enhancement contract is not a significant modification of a recourse debt instrument unless the substitution results in a change in payment expectations. While the substitution of a new letter of credit by a different bank does not itself result in a change in payment expectations, such a substitution may result in a change in payment expectations under certain circumstances (for example, if the obligor's capacity to meet payment obligations is dependent on the letter of credit and the substitution substantially enhances that capacity from primarily speculative to adequate).

(iii) Applicability date. This Example 8 applies to modifications occurring on or after July 6, 2011.

*****

§1.1001-3T [Removed]

Par. 15. Section 1.1001-3T is removed.

PART 48–MANUFACTURERS AND RETAILERS EXCISE TAXES Par. 16. The authority citation for part 48 continues to read in part as follows: Authority: 26 U.S.C. 7805 * * * Par. 17. Section 48.4101-1 is amended as follows: 1. Paragraph (f)(4)(ii)(B) is revised. 2. Paragraph (l)(5) is revised. The revisions read as follows:

§48.4101-1 Taxable fuel; registration. *****

(f) * * * (4) * * * (ii) * * * (B) Basis for determination. The determination under §48.4101-1(f)(4)(ii) must be based on all information relevant to the applicant's financial status. *****

(5) Applicability date. Paragraph (f)(4)(ii)(B) of this section applies on and after July 6, 2011.

§48.4101-1T [Removed]

Par. 18. Section 48.4101-1T is removed.

Approved: August 14, 2013

Beth Tucker Deputy Commissioner for Operations Support.

Mark J. Mazur Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2013-21752 Filed 09/05/2013 at 8:45 am; Publication Date: 09/06/2013]

IRS Revising Guidelines for Exempt Bond Exams.

The IRS is revising its guidelines on conducting examinations regarding the post-issuance compliance of tax-exempt bonds, officials in the agency's Tax-Exempt Bonds Office (TEB) said August 27.

During a teleconference on monitoring post-issuance compliance, Alma Dripps, a TEB senior tax law specialist, said the IRS is revising the guidelines found in Internal Revenue Manual section 4.82, though she did not say what the revisions will be. The revised guidelines will be released later this year, she said.

During the course of an examination, Dripps explained, examiners may review any records needed to determine tax compliance of the bonds. Evaluation of internal controls, including post-issuance compliance procedures, is critical in determining the reliability of books and records, she said.

"This type of evaluation aids in determining the appropriate audit techniques to be used during the examination," Dripps said.

Lance Fullmer, also a senior tax law specialist in TEB, noted that in June the IRS released Publication 5091, Voluntary Compliance for Tax-Exempt & Tax Credit Bonds. Part I discusses tax-advantaged bond compliance and Part II covers TEB's voluntary closing agreement program, he said.

Earlier this year, TEB released a report, "Avoiding Troubled Tax-Advantaged Bonds," which seeks to help issuers of tax-advantaged bonds by offering items to consider that might help ensure compliance, Fullmer said. He said three IRS compliance guides covering exempt bonds for charities (Publication 4077), private activity bonds (Publication 4078), and governmental bonds (Publication 4079) are being updated and will be released later this year.

TEB Senior Tax Law Specialist Marie Sullivan said the IRS will continue its outreach to the exempt financing community. In September there will be a telephone forum on voluntary compliance, she said.

by Fred Stokeld

EO Update: e-news for Charities and Nonprofits - September 6, 2013.

1. New interactive Form 1023 available for review

In an effort to make applying for tax exemption easier, the IRS Exempt Organizations (EO) office is in the development stage of an alternate version of Form 1023, Application for Recognition of Exemption. The new application is available for preview until September 20, 2013.

The Interactive Form 1023 (i1023) features pop-up information boxes for most lines of the form.

These boxes contain explanations and links to related information on IRS.gov and StayExempt.irs.gov, EO's educational website. When final testing is completed later this year, you'll print and mail the form and its attachments just like the standard Form 1023.

Although viewers are unable to print or submit this "review" version of i1023, EO encourages the public to click through its new features and promote the i1023 to colleagues and business associates. After reviewing the i1023, please send your comments to tege.eo.ceo@irs.gov.

Anticipated i1023 benefits:

- Applicants will be able to submit a more complete form
- IRS processing time is reduced
- Applicants receive a tax-exempt determination more quickly
- The i1023 was developed from recommendations by the IRS' Advisory Committee on Tax-Exempt and Government Entities (ACT).

Interactive Form 1023 is available at: http://www.stayexempt.irs.gov/StartingOut.aspx

2. Register for EO workshops

Register for upcoming workshops for small and medium-sized 501(c)(3) organizations:

Sept. 9 – St. Paul, MN

Hosted by Hamline University

Sept. 10 – Minneapolis, MN

Hosted by University of St. Thomas

Sept. 27 – Albuquerque, NM

Hosted by University of New Mexico

Oct. 16-17 – Lakeland, FL

Hosted by Florida Southern College

Register at:
http://www.irs.gov/Charities-&-Non-Profits/Upcoming-Workshops-for-Small-and-Medium-Sized-501(c)(3)-Organizations

3. Sign up for upcoming phone forums

Exempt Organizations and Employment Taxes (Sept. 10, 2 p.m., EDT)

Even organizations that don't use paid workers on a regular basis should be aware of employment tax issues.
http://ems.intellor.com/index.cgi?p=204698&t=71&do=register&s=&rID=417&edID=305

Stay Exempt: A guide for charitable organizations with changing leadership (Sept. 18, 2 p.m. EDT)

Helps organizations stay tax-exempt – organized and operated exclusively for exempt purposes.

http://ems.intellor.com/index.cgi?p=204707&t=71&do=register&s=&rID=417&edID=305

IRS Publishes Final, Temporary Regs on Excise Tax Return Requirement for Charitable Hospitals.

The IRS has published final and temporary regulations (T.D. 9629) requiring charitable hospital organizations that are liable for an excise tax for failing to meet the community health needs assessment (CHNA) requirements for any tax year to file Form 4720, "Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code."

The Patient Protection and Affordable Care Act enacted sections 501(r) and 4959. A hospital organization seeking to obtain or maintain tax-exempt status as a charitable organization must comply with the requirements of section 501(r), including the requirement to conduct a CHNA under section 501(r)(3). Section 4959 imposes a $50,000 excise tax if a hospital organization to which section 501(r) applies fails to meet the requirements of section 501(r)(3) for any tax year.

In April 2013 the IRS issued proposed regs (REG-106499-12) that provided guidance to charitable hospital organizations on CHNA requirements and related excise tax and reporting obligations. Those regs, however, didn't include amendments to the rules under sections 6011 and 6071 on the return required to accompany a section 4959 excise tax payment and when to file the return.

Accordingly, the temporary regs provide that a charitable hospital organization that is liable for the section 4959 excise tax must file a return on Form 4720 by the 15th day of the fifth month after the end of the organization's tax year during which the liability under section 4959 was incurred. The text of the temporary regs also serves as the text of concurrently issued proposed regs (REG-115300-13). The regs are effective August 15, 2013.

IRS Publishes Proposed Regs on Excise Tax Return Requirement for Charitable Hospitals.

The IRS has published proposed regulations (REG-115300-13) requiring charitable hospital organizations that are liable for an excise tax for failing to meet the community health needs assessment requirements for any tax year to file Form 4720, "Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code."

The text of simultaneously issued temporary regs (T.D. 9629) also serves as the text of the proposed regs. Comments and public hearing requests are due by November 13.

Requirement of a Section 4959 Excise Tax Return

and Time for Filing the Return

[4830-01-p]

DEPARTMENT OF THE TREASURY

26 CFR Part 53

[REG-115300-13]

RIN 1545-BL57

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In the Rules and Regulations section of this issue of the Federal Register, the IRS is issuing regulations requiring hospital organizations liable for the excise tax for failure to meet the community health needs assessment requirements for any taxable year to file Form 4720, "Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code." The regulations also specify the due date for such returns. The text of those temporary regulations also serves as the text of these proposed regulations. DATES: Written or electronic comments and requests for a public hearing must be received by November 13, 2013.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-115300-13), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-115300-13), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at http://www.regulations.gov (IRS REG-115300-13).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Amy F. Giuliano at (202) 622-6070; concerning submission of comments and request for hearing, Oluwafunmilayo Taylor at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in the Rules and Regulations section of this issue of the Federal Register amend the existing regulations under sections 6011 and 6071 to (1) specify the form that must be used to accompany payment of the excise tax imposed by section 4959 for failure to meet the community health needs assessment requirements of section 501(r)(3), and (2) provide the due date for filing the form. Section 501(r) and section 4959 were enacted by section 9007 of the Patient Protection and Affordable Care Act, Public Law 111-148 (124 Stat. 119 (2010)).

The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that this rule will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that this rule merely provides guidance as to the timing and filing of Form 4720 for charitable hospital organizations liable for the section 4959 excise tax, and completing the applicable portion (Schedule M) of the Form 4720 for this purpose imposes little incremental burden in time or expense. The liability for the section 4959 excise tax is imposed by statute, and not these regulations. In addition, a charitable hospital organization may already be

required to file the Form 4720 under the existing final regulations in sections 53.6011-1 and 53.6071-1 if it is liable for another Chapter 41 or 42 excise tax. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. Chapter 6) is not required. Pursuant to section 7805(f) of the Code, these proposed regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business, and no comments were received.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at www.regulations.gov or upon request.

A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the Federal Register.

Drafting Information

The principal author of these regulations is Amy F. Giuliano, Office of Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 53

Excise taxes, Foundations, Investments, Lobbying, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 53 is proposed to be amended as follows:

PART 53 — FOUNDATION AND SIMILAR EXCISE TAXES

Paragraph 1. The authority citation for part 53 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 53.6011-1 is amended by:

1. Redesignating paragraphs (c) through (e) as (d) through (f).

2. Adding new paragraphs (c) and (g).

The addition reads as follows:

§ 53.6011-1 General requirement of return, statement or list.

(c) [The text of paragraph (c) of this section is the same as the text of § 53.6011-1T(c) published elsewhere in this issue of the Federal Register].

(g) [The text of paragraph (g) of this section is the same as the text of § 53.6011-1T(g) published elsewhere in this issue of the Federal Register].

Par. 3. Section 53.6071-1 is amended by:

1. Revising paragraph (h).

2. Adding paragraph (i).

The revision and addition read as follows:

§ 53.6071-1 Time for filing returns.

[The text of paragraphs (h) and (i) of this section is the same as the text of §§ 53.6071-1T(h) and (i)(1) and (2) published elsewhere in this issue of the Federal Register].

Heather C. Maloy

Acting Deputy Commissioner for

Services and Enforcement.

FASB Looks to Improve Nonprofit Reporting of Net Assets.

The Financial Accounting Standards Board on September 4 tentatively decided that it should revise the existing requirements for the presentation, classification, and disclosure of information about the funding and resources of nonprofit organizations.

The Financial Accounting Standards Board on September 4 tentatively decided that it should revise the existing requirements for the presentation, classification, and disclosure of information about the funding and resources of nonprofit organizations.

At a meeting in Norwalk, Conn., FASB members unanimously supported the staff recommendation to replace existing rules that require a nonprofit to present on the face of its statement of financial position the totals for three classes of net assets that are used to fund the entity's operations. Current requirements also dictate that an entity present the changes in each of the classes on the face of its statement of activities.

Based on the staff's recommendation, the board will pursue guidance that instead requires totals for two classes of net assets to be presented on the face of the financial statements: those with donor-imposed restrictions and those without donor-imposed restrictions.

FASB also agreed to replace the definitions of two donor-restricted classes of net assets — temporarily restricted net assets and permanently restricted net assets — with a single definition for net assets with donor-imposed restrictions. The board will retain the substance of the definition of unrestricted net assets but will change its label to "net assets without donor-imposed restrictions."

To further improve disclosures about net asset restrictions, the board tentatively decided that it will require nonprofit entities to provide information in the financial statement footnotes about the composition of net assets at the balance sheet date.

According to FASB, the guidance will require an entity to describe how and when its resources can be used and provide information on the net assets without donor-imposed restrictions that have been "board-designated or otherwise authorized by the board for particular uses."

Ronald Bossio, a senior project manager at FASB, said the net asset composition can be an important part of nonprofit financial reporting if an entity's communications about its liquidity are perceived to be less than adequate. For some financial statement users, such as creditors, the net asset disclosure is a backdoor way of understanding the liquidity of a nonprofit organization, he added.

According to Bossio, the staff recommendations on improving the information that nonprofit entities provide on their liquidity and cash flow will be presented to the board in October.

FASB's latest decisions were made as part of its project on reexamining the standards for nonprofit financial statement presentation. The board previously decided on how intermediate operating measures should be defined in the financial statements of nonprofit entities. (Prior coverage .)

Share-Based Payments

The board also unanimously voted against adding to its technical agenda a new project on how to determine the grant date of share-based payments when the conditions of those awards contain discretionary provisions and clawback arrangements.

Lauren Mottley, a FASB practice fellow, said the request for additional guidance was brought to the board's attention because the Dodd-Frank Wall Street Reform and Consumer Protection Act includes a provision that requires public companies to have a clawback policy on the restatement of their financial statements.

According to Mottley, the staff recommended that the board not pursue a project on the topic because they believed that sufficient guidance was provided in Accounting Standards Codification (ASC) Topic 718, "Compensation — Stock Compensation," and that additional guidance might not be able to resolve the diversity in practice.

FASB member Thomas Linsmeier supported the staff recommendation, adding that the board's guidance on stock-based compensation is converged with the related international financial reporting standards. "I don't see a reason at this point to diverge," he said.

Linsmeier said the board will have another opportunity to reconsider the topic after a post-implementation review of FASB Statement No. 123(R), "Share-Based Payment," is completed by the Financial Accounting Foundation.

by Thomas Jaworski

Tax-Exempt and Government Entities Advisory Committee Announces Meeting.

The IRS's Advisory Committee on Tax Exempt and Government Entities announced it will hold a public meeting on September 12, 2013, at the IRS in Washington to discuss issues regarding employee plans, exempt organizations, and government entities; for more information, contact Mark Kirbabas at (202) 283-9742.

DEPARTMENT OF THE TREASURY Internal Revenue Service

Advisory Group to the Internal Revenue Service Tax Exempt and Government Entities Division

(TE/GE); Meeting

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice.

SUMMARY: The Advisory Committee on Tax Exempt and Government Entities (ACT) will hold a public meeting on Thursday, September 12, 2013.

FOR FURTHER INFORMATION, CONTACT:

Mark Kirbabas, Acting Designated Federal Officer, TE/GE Communications and Liaison; 1111 Constitution Ave. NW.; SE:T:CL—NCA 679; Washington, DC 20224. Telephone: 202–283–9742 (not a toll-free number). Email address: Mark.J.Kirbabas@irs.gov.

SUPPLEMENTARY INFORMATION: By notice herein given, pursuant to section 10(a)(2) of the Federal Advisory Committee Act, 5 U.S.C. App. (1988), a public meeting of the ACT will be held on Thursday, September 12, 2013, from 9:30 a.m. to 11:30 a.m., at the Internal Revenue Service; 1111 Constitution Ave. NW.; Room 3313; Washington, DC. Issues to be discussed relate to Employee Plans, Exempt Organizations, and Government Entities.

Reports from five ACT subgroups cover the following topics:

Employee Plans

• Analysis and Recommendations Regarding the Employee Plans Compliance Resolution System (EPCRS)

Exempt Organizations

• Leveraging Limited IRS Resources in the Tax Administration of Small Tax- Exempt Organizations

Federal, State and Local Governments

• Leveraging Internal Controls of State and Local Governments to Improve Tax Compliance

• Government Levy Processing Improvements

Indian Tribal Governments

• Supplemental Report on the General Welfare Doctrine as Applied to Indian Tribal Governments and Their Members

Tax Exempt Bonds

• A Roadmap To Arbitrage Requirements For Tax-Exempt Governmental Bonds and Qualified Section 501(c)(3) Bonds of Smaller Issuers and Conduit Borrowers

Last minute agenda changes may preclude advance notice. Due to limited seating and security requirements, attendees must call Cynthia Phillips- Grady to confirm their attendance. Ms. Phillips-Grady can be reached at (202) 283–9954.

Attendees are encouraged to arrive at least 30 minutes before the meeting begins to allow sufficient time for security clearance. Photo identification must be presented. Please use the main entrance at

1111 Constitution Ave. NW., to enter the building. Should you wish the ACT to consider a written statement, please call (202) 283–9742, or write to: Internal Revenue Service; 1111 Constitution Ave. NW.; SE:T:CL—NCA– 679; Washington, DC 20224, or email Mark.J.Kirbabas@irs.gov.

Dated: August 22, 2013.

Mark J. Kirbabas,

Acting Designated Federal Officer, Tax Exempt and Government Entities Division.

IRS EO Update - e-news for Charities & Nonprofits - August 30, 2013.

1. IRS describes Code Section 4959 excise tax reporting for charitable hospitals

The IRS has issued temporary and proposed regulations under sections 6011 and 6071 for charitable hospital organizations on how to report any Code Sec.4959 excise tax for failing to meet the community health needs assessment (CHNA) requirements described in Code Sec. 501(r)(3).

The temporary regulations state that a charitable hospital organization liable for the Code Sec. 4959 excise tax must file a return on Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code. The form must be filed by the 15th day of the fifth month after the end of the charitable hospital organization's tax year during which the liability under Code Sec. 4959 was incurred.

The proposed regulations provide that written or electronic comments and requests for a public hearing must be received by November 13, 2013.

The temporary regulations are available at:

http://www.gpo.gov/fdsys/pkg/FR-2013-08-15/pdf/2013-19931.pdf

The proposed regulations are available at:

http://www.gpo.gov/fdsys/pkg/FR-2013-08-15/pdf/2013-19930.pdf

Form 4720 is available at:

http://www.irs.gov/pub/irs-pdf/f4720.pdf

2. EO's latest changes to implement the TIGTA recommendations

Check out the status of improvements at:

http://www.irs.gov/uac/Newsroom/IRS-Charts-a-Path-Forward-with-Immediate-Actions

3. IRS offers alternative solution for political organizations filings made July/August

While Exempt Organizations' political organizations disclosure search and download applications are temporarily unavailable, the IRS has an alternative solution for filings made in July and August 2013.

http://www.irs.gov/Charities-&-Non-Profits/Political-Organizations/Political-Organization-Filing-and-

Disclosure

These filings include copies of Forms 8871, 8872 and 990 filed by 527s. We anticipate the IRS will re-launch its database this fall, at a date to be determined.

The IRS regrets any inconvenience as it continues to work through this complex situation to ensure the public disclosure of these documents while appropriately protecting important personal information.

4. Sign up for upcoming IRS Exempt Organizations phone forums

Exempt Organizations and Employment Taxes (Sept. 10, 2 p.m., EDT)

Even organizations that don't use paid workers on a regular basis should be aware of employment tax issues.

http://ems.intellor.com/index.cgi?p=204698&t=71&do=register&s=&rID=417&edID=305

Stay Exempt: A guide for charitable organizations with changing leadership (Sept. 18, 2 p.m. EDT)

Tax-exempt organizations must be organized and operated exclusively for exempt purposes.

http://ems.intellor.com/index.cgi?p=204707&t=71&do=register&s=&rID=417&edID=305

5. Review the 2013–2014 Priority Guidance Plan

The 2013–2014 Priority Guidance Plan contains 324 projects that are IRS priorities through June 2014, including:

- Updating Revenue Procedure 2011-33 for EO Select Check
- Guidance under section 501(c)(4) relating to measurement of an organization's primary activity and whether it is operated primarily for the promotion of social welfare, including guidance relating to political campaign intervention
- Additional guidance on section 509(a)(3) supporting organizations (SOs)
- Final regulations under §4944 on program-related investments.

http://www.irs.gov/pub/irs-utl/2013-2014_pgp.pdf

6. Register for EO workshops

Register for upcoming workshops for small and medium-sized 501(c)(3) organizations:

Sept. 9 – St. Paul, MN

Hosted by Hamline University

Sept. 10 – Minneapolis, MN

Hosted by University of St. Thomas

Sept. 27 – Albuquerque, NM

Hosted by University of New Mexico

October 16-17 – Lakeland, FL

Hosted by Florida Southern College

http://www.irs.gov/Charities-&-Non-Profits/Upcoming-Workshops-for-Small-and-Medium-Sized-501(c)(3)-Organizations

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Comments Sought on Regs on Standards for State, Local Bond Opinions.

The IRS requested comments on regulations (REG-138367-06) that update the Circular 230 practice standards, adopting one standard for all written tax advice under proposed section 10.37; comments are due by October 21, 2013.

DEPARTMENT OF THE TREASURY Internal Revenue Service

Proposed Collection; Comment Request Regulation Project

AGENCY: Internal Revenue Service (IRS), Treasury. ACTION: Notice and request for comments.

SUMMARY: The Department of the Treasury, as part of its continuing effort to reduce paperwork and respondent burden, invites the general public and other Federal agencies to take this opportunity to comment on proposed and/or continuing information collections, as required by the Paperwork Reduction Act of 1995, Public Law 104–13 (44 U.S.C. 3506(c)(2)(A)). Currently, the IRS is soliciting comments concerning regulations governing practice before the Internal Revenue Service. DATES: Written comments should be received on or before October 21, 2013 to be assured of consideration. ADDRESSES: Direct all written comments to Yvette B. Lawrence, Internal Revenue Service, room 6129, 1111 Constitution Avenue NW., Washington, DC 20224. FOR FURTHER INFORMATION CONTACT: Requests for additional information or copies of the form and instructions should be directed to Gerald J. Shields at Internal Revenue Service, room 6129, 1111 Constitution Avenue NW., Washington, DC 20224, or through the internet at Gerald.J.Shields@irs.gov. SUPPLEMENTARY INFORMATION:

Title: Regulations Governing Practice Before the Internal Revenue Service.

OMB Number: 1545–1916. Form Number: REG–138367–06. Abstract: This collection of

information is necessary to ensure practitioners comply with minimum standards when writing a State or local bond opinion. A practitioner may provide a single opinion or may provide a combination of documents, but only if the documents, taken together, satisfy the requirements of 31 CFR 10.39. In addition, the collection of information will assist the Commissioner, through the Office of Professional Responsibility, to ensure that practitioners properly advise taxpayers regarding state or local bonds. On September 17, 2012, Treasury and the IRS published a notice of proposed rulemaking that would amend the regulations at 31 CFR Part 10. That notice of proposed rulemaking also withdrew the notice of proposed rulemaking (REG–159824–04) that was published in the Federal Register on December 20, 2004 (69 FR 75887). See 77 FR 57055.

Current Actions: There is no change in the paperwork burden previously approved by OMB. This information collection is being submitted for renewal purposes only.

Type of Review: Extension of a currently approved collection.

Affected Public: Individuals and Households.

Estimated Number of Respondents:

1,500. Estimated Time per Respondent: 2

hours.

Estimated Total Annual Burden Hours: 30,000.

The following paragraph applies to all of the collections of information covered by this notice:

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Request for Comments: Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval. All comments will become a matter of public record. Comments are invited on: (a) Whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (b) the accuracy of the agency's estimate of the burden of the collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

Approved: August 15, 2013.

Allan M. Hopkins,

IRS Tax Analyst.

[FR Doc. 2013–20286 Filed 8–20–13; 8:45 am]

BILLING CODE 4830–01–P

IRS Releases Publication on Tax Status of Veterans Organizations.

The IRS has released Publication 3386 (rev. Aug. 2013), Tax Guide — Veterans' Organizations, to explain tax exemptions available to veterans organizations that qualify for tax-exempt status under section 501(c).

http://www.irs.gov/pub/irs-pdf/p3386.pdf

IRS: Community Development District Doesn't Qualify as Political Subdivision.

In technical advice, the IRS concluded that a community development district established under a town ordinance wasn't a political subdivision under reg. section 1.103-1(b) at any time when the district issued bonds to acquire assets from a developer because it was not a division of a state or local governmental unit during that period.

A state corporation owned by an individual and his family developed a retirement community within a town. The developer petitioned the town to create the community development district, which is governed by its own board of supervisors who are elected by a majority vote of landowners in the district. The developer owned enough land to appoint the board throughout the relevant period.

A political subdivision is defined under reg. section 1.103-1(b) as any division of any state or local governmental unit that is a municipal corporation or that has been delegated the right to exercise part of the sovereign power of the unit. The district concedes that it isn't a municipal corporation but claims it has the right to exercise sovereign powers. However, the IRS determined that the district also must demonstrate that it is a division of a state or local governmental unit.

The IRS determined that an entity can't be a political subdivision of a state if it is organized and operated in a manner intended to perpetuate private control and to indefinitely avoid responsibility to a public electorate. Here, the developer was always in a position to select all the board members. It was contemplated that a board would be elected by the qualified electorate when a district acquired a sufficient number of residents. However, that hasn't happened in this case, even after 20 years. And the IRS determined that the facts show that the district was intentionally structured to make sure that it would never happen. The board and its manager controlled the district's daily operations and neither the state nor local government participated in or had authority to overrule the board's decisions. Accordingly, the IRS concluded that the district was organized and operated in a way that ensured continued effective control of the board by the developer, rather than by a general electorate or an existing governmental body.

The district argued that it's a political subdivision because it's sufficiently controlled by the state and because the district and the board are subject to several legal restrictions. Rejecting this argument, the IRS noted that the restrictions don't address the fact that the district was organized and operated to perpetuate private control and indefinitely avoid responsibility to a public electorate. Having concluded that the district isn't a state or political subdivision thereof for purposes of section 103(c)(1), the IRS determined that it need not examine the extent to which the district has been delegated sovereign powers.

ISSUE

Whether the Issuer was a political subdivision within the meaning of section 1.103-1(b) of the Income Tax Regulations during the period of Date 1 through Date 2.

CONCLUSION

The Issuer was not a political subdivision within the meaning of section 1.103-1(b) at any time during the period of Date 1 through Date 2 because it was not a division of a state or local governmental unit during that period. Because we find that the Issuer was not a division, we do not address the delegation of sovereign power.

FACTS

The Developer

The Developer is a State corporation incorporated in Year 1. At all times relevant to the legal issue in this case, Date 1 through Date 2, the Developer was directly or indirectly owned by A and his family.

The Development

In Year 2, the Developer began development of a retirement community within Town and an unincorporated area of County. As part of that development, the Developer constructed, owned and operated various recreation facilities, postal facilities, water management and control systems, fire equipment, and fire stations ("Amenity Facilities"). As the development became profitable, the Developer purchased additional tracts of land for development.

In Year 3, the Developer petitioned the Town to create a community development district in accordance with Act, and, later in Year 3, Town established Issuer as a community development district pursuant to Ordinance. Thereafter, the Developer acquired substantial amounts of additional land and successfully petitioned for the creation of a other separate community development districts, eventually resulting in b community development districts. The b community development districts include c districts that consist of primarily residential areas ("Residential Districts"), the Issuer, which has been solely a commercial area, and d other solely commercial district. The b community development districts, along with certain other areas in County and Town, are known as the Development.

During the relevant years, the Issuer's board of supervisors petitioned the Town for four separate changes to Issuer's geographical boundaries. On Date 3, the Town approved the first change, which reduced Issuer's acreage from e acres to f acres. The removed land was used for g residential dwellings approximately h years after the boundary change. On Date 4, the Town approved the second change, which reduced Issuer's acreage from f acres to i acres and removed j existing (but then unoccupied) dwellings from Issuer boundaries. The remainder of the land removed from the Issuer's acreage was used to construct k residential units approximately l years after the change. On Date 5, the Town approved a third change, which corrected a boundary error and reduced Issuer's acreage from i acres to m acres, and on Date 6, the Town approved the fourth change, increasing Issuer's acreage to o acres consisting of commercial properties.

Lots within the Development are sold subject to deed restrictions ("deed restrictions"), requiring services to be provided by the Developer including an obligation to "perpetually provide the recreational facilities." The deed restrictions require property owners to pay the Developer a monthly fee ("Amenities Fee"). Owners of property within the Residential Districts are required to pay the Amenities Fee even if the recreational facilities are located outside of, and are not owned by, their respective Residential District. The Developer's rights and obligations may be assigned.

Governing Body of Issuer

Each community development district in State is governed by its own board of supervisors. Under the Act, a majority of the board constitutes a quorum and action is taken by majority vote of the members present unless general law or a rule of the district requires a greater number. The board of supervisors is initially elected by landowners, generally based on acreage owned, with a majority of votes controlling. In community development districts such as Issuer, beginning after o years, when there are p or more residents within the district eligible to vote ("Qualified Electors"), the election

process changes and the board is thereafter elected by the Qualified Electors at a general election.

Issuer is governed by a g-member board of supervisors ("Board"). Because the Issuer has never had p or more Qualified Electors, landowners in the Issuer have always elected the Board despite the fact that the Issuer has been in existence for well over 20 years. In fact, Issuer expressed intention was that there would never be p or more Qualified Electors residing within Issuer. The Official Statement for bonds issued on Date 7 states that there will be no residential development within the Issuer, and the Offering Statement for Issuer's Date 8 bond issuance confirmed that, because of the non-residential nature of the development in the Issuer, it was unlikely that there would ever be Qualified Electors in the Issuer. During the relevant years, the q-member Board consisted of A, members of his family, directors, officers, or employees of the Developer, and the chief executive officer of the Bank, a majority of the stock of which was at all times owned by A and his family. For a short period in Year 4, the Board also included an employee of an investment bank not affiliated with A.

The Board appoints a district manager who is accountable to the Board. The district manager has charge and supervision of the works of Issuer, is responsible for preserving and maintaining any improvement or facility constructed or erected pursuant to the provisions of Act, for maintaining and operating equipment owned by Issuer, and for performing such other duties as may be prescribed by the Board.

Landowners

The Board always has been appointed by the landowners in Issuer. The Developer, either alone (from Date 1 through Date 9) or in conjunction with the Partnership, has owned sufficient land to appoint the Board throughout the relevant period.

The Partnership has been controlled at all relevant times directly or indirectly by A, B and C. C is an immediate family member of A, and B at the time was an officer and director or the Developer and served, on at least some occasions, as legal counsel to the Developer. Prior to Date 10, A, B and C served directly as the general partners of the Partnership. On Date 10, the Corporation was formed to serve as the corporate sole general partner, and A, B and C became the owners and directors of the Corporation. The Partnership functioned as an employment incentive for employees of the Developer, and the limited partners in Partnership consisted solely of A, B, A's family members, current or former directors, officers, or employees of the Developer, or trustees or beneficiaries of trusts established by such individuals.

Issuer's Powers and Limitations under the Act

The Act defines a community development district as a local unit of special-purpose government limited to the performance of functions authorized by the Act, the governing body of which is authorized to function to deliver urban community development services, and for which the operation, duration, accountability, disclosure requirements, and termination are determined by general law. The stated primary purpose of community development districts is to provide for specified capital infrastructure, such as that provided by the Issuer.

The Department, which is a department of State, is required by the Act to annually monitor the status of Issuer under the Act. The Issuer must provide financial reports and audits to State, and is required to use a qualified public depository.1 The Issuer must comply with bidding requirements under State law when seeking to construct or improve a public building or structure. Board meetings are open to the public, the Board must keep permanent records of all proceedings, and such records are open to inspection in the same manner as government records in State. Issuer's

properties are exempt from execution and sale by general creditors.

The Board approves the Issuer's annual budget after a hearing. The proposed budget is then submitted to the local general purpose governmental unit for disclosure and information purposes only. The local general purpose governmental unit may review the proposed budget and submit written comments for assistance and information purposes.

The Issuer will remain in existence unless (a) it is merged with another district; (b) all of its facilities and services are transferred to a local general-purpose government unit, subject to the underlying debts being assumed and guaranteed by such unit;2 or (c) it is dissolved due to inactivity. Upon dissolution, assets of the district would be liquidated to pay the district debts and the remainder, if any, would be transferred to an appropriate local government or political subdivision.

Board members are subject to general laws relating to public officers and employees, including ethical standards requiring that public officials be independent and impartial, and that public office not be used for private gain other than the remuneration provided by law. Public officials must discharge their duties in the public interest and must act as agents of the people in holding their positions for the benefit of the public.3 The Act also provides that it shall not be a conflict of interest for a board member, district manager or other employee of the district to be a stockholder, officer, or employee of a landowner.

The Issuer is vested with limited powers. Issuer can exercise the power of condemnation to acquire public easements, dedications to public use, platted reservations for public purposes, or any reservations for those purposes authorized by the Act. The Act allows the Issuer to exercise eminent domain over any property within the state, except municipal, county, state, and federal property. If the property that is the subject of the eminent domain is outside Issuer, Issuer must obtain the prior approval of the governing body of the jurisdiction in which the property is located. The Issuer may exercise eminent domain solely for uses relating to water, sewer, district roads, and water management. Any exercise of eminent domain by the Issuer is in the Issuer's name and results in title to the condemned land being transferred to the Issuer. The Issuer is authorized to impose user charges or fees and special assessments to finance the Issuer's activities authorized by the Act. The Act provides that community districts generally may levy and assess ad valorem taxes, but this power applies only when all Board members are elected by Qualified Electors at a general election and is not available to the Issuer. The Issuer may not exercise any "police power," as that term is used under the Act and must obtain prior consent from the local general-purpose government agencies to provide security services within the Issuer.

Outstanding Bonds

Between Date 1 and Date 2, Issuer issued Bonds in the total principal amount of $r to acquire or refinance the acquisition of assets from Developer and its affiliates, along with the right to collect related Amenities Fees from current residents of the Development. The Issuer asserts that interest on these bonds is exempt from tax under § 103. We do not have information on all of these sales, but in the sales for which we have information, the amount of proceeds paid to the Developer and its affiliates significantly exceeded the Developer's costs for the assets acquired, with the remaining proceeds having been allocated to the right to collect future Amenity Fees from then current residents. Developer retained the right, however, to collect Amenities Fees from future residents of the Development who purchased their property from the Developer. Such future residents would have the right to use the Amenity Facilities owned by the Issuer, despite retention of the Amenity Fees by the Developer.4

The information we have indicates that, on Date 11, Issuer issued $s in bonds to purchase

recreational and utility facilities from the Developer along with related Amenity Fees. The Developer's cost in these facilities was $t, and almost 70% of the purchase price was allocated to future Amenity Fees. On Date 12, Issuer issued $u in bonds to acquire recreational facilities and Amenity Fees from the Developer. The Developer's cost in these facilities was $v, which left almost 67% of the proceeds allocated to future Amenity Fees. Similarly, on Date 13, Issuer used $w to purchase recreational facilities and future Amenity Fees from the Developer. The Developer's cost for these facilities was $x, leaving almost 89% of the proceeds allocated to future Amenity Fees, and on Date 14, the Issuer issued $y in bonds to purchase a utility system from a utility affiliated with Developer; the utility's cost for the system was $z, leaving about 54% of the proceeds allocated to transferred utility fees. Finally, on Date 2, Issuer issued $aa in bonds for recreational facilities for which the Developer's cost was $bb, resulting in 83% of the proceeds being allocated to future Amenity Fees. The monthly Amenities Fees and utility fee payments assigned to the Issuer are pledged to secure the Bonds, along with other sources of Issuer revenue.

LAW AND ANALYSIS

Section 103(a) of the Internal Revenue Code ("Code") provides that gross income does not include interest on any State or local bond. Section 103(c) provides that the term "State or local bond" means an obligation of a State or political subdivision thereof.

The term "political subdivision" is defined in Treasury Regulations § 1.103-1(b) as "any division of any state or local governmental unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the unit." Under this definition, Issuer cannot qualify as a political subdivision whether or not it is a municipal corporation (which Issuer concedes that it is not) or has the right to exercise sovereign powers (which Issuer claims that it has) unless it also can demonstrate that it is a division of a state or local government. See Rev. Rul. 78-276, 1978-2 C.B. 256.

Is Issuer a Division of a State or Local Government?

The phrase "division of a state or local government" must be read in the context of the purpose of § 103, which is to provide subsidized financing for State and local government purposes. The Code permits the benefit of this subsidy to be passed on to private persons under some circumstances, but only if a governmental unit determines that the issuance of such bonds is appropriate. A governmental unit is inherently accountable, directly or indirectly, to a general electorate. In effect, § 103 relies, in large part, on the democratic process to ensure that subsidized bond financing is used for projects which the general electorate considers appropriate State or local government purposes. A process that allows a private entity to determine how the bond subsidy should be used without appropriate government safeguards cannot satisfy § 103.

For these reasons, the mere delegation of sovereign power is not sufficient to create a political subdivision. If it were sufficient, then a clearly private entity with powers of eminent domain, including some railroads and utilities, could issue bonds without any political oversight.

We believe that an entity that is organized and operated in a manner intended to perpetuate private control, and to avoid indefinitely responsibility to a public electorate, cannot be a political subdivision of a State. Cf. Revenue Ruling 83-131, 1983-2 C.B. 184 (concluding that certain corporations did not qualify as political subdivisions, in part because they were "not controlled directly or indirectly by a state or local government," but rather by a board of directors "independent of such authority").

In this case, the Issuer was organized and operated in manner that insured continued effective

control of the Board by A, rather than a general electorate or an existing governmental body. The Board was selected by majority vote of landowners, and, at all times, A was in a position, through entities under his control, to select all members of the Board. During the relevant period, two landowners, the Developer and the Partnership, held a clear majority of the land within the boundaries of the Issuer. The Developer was owned and controlled by A and A's family members. The Partnership was controlled by A, B and C, first as general partners and later as the owners and directors of the sole corporate general partner. The result was that during the relevant years, the Board was composed of individuals who, in all but one limited case, consisted of A, members of his family, directors, officers, or employees of the Developer, and the chief executive officer of Bank owned and controlled by A and his family.

The Act contemplated that a board would be elected by the Qualified Electorate when a district acquired a sufficient number of residents. Even after over 20 years, this has not happened in the Issuer's case. Indeed, the facts indicate that Issuer was intentionally structured to ensure that this never could happen. Bond offering documents indicate that there would be no residential development in the Issuer and that it was unlikely that there ever would be Qualified Electors in the Issuer. Consistent with these statements, on at least two occasions the Board successfully petitioned the Town to change the Issuer's boundaries in such a way that land on which current or future residential development would be located would be removed from within the Issuer's boundaries.

Throughout all relevant years, the Board and its district manager controlled the day-to-day operations of the Issuer. Neither the State nor local government participated in or had authority to overrule decisions of the Board, including decisions to purchase assets from the Developer whose owner controlled the Board. Although a government received the Issuer's financial reports, audits, and budget, this was largely for informational purposes only.

The Issuer argues that it is a political subdivision because it is sufficiently controlled by the State and serves a public purpose, although the Issuer claims that the threshold is too high if it requires that the entity be motivated wholly by a public purpose. See Revenue Ruling 83-131 (indicating entity must be motivated by a wholly public purpose). The Issuer argues that it was created to fulfill the public purpose of managing and financing basic community development services. The Issuer points out that the Act placed a number of legal restrictions on it and the Board. In particular, the Issuer notes that —

1) Issuer had financial and reporting requirements to the State,

2) Issuer was subject to bidding requirements when seeking to construct or improve a public building or structure,

3) Issuer was required to use a qualified public depository,

4) Issuer was subject to open record and open meeting requirements,

5) Issuer was required to submit its budget for disclosure purposes,

6) Issuer was required to comply with the State administrative procedure act,

7) Issuer's property was exempt from sale by general creditors,

8) The local government could adopt and submit a nonemergency plan providing for the transfer of assets or services from a district to the local general-purpose government under certain limited circumstances;

9) On dissolution all of Issuer's assets transferred to public entities,

10) Under State ethics laws, the Board members were required to be independent and impartial; public office could not be used for private gain other than remuneration; board members were required to discharge their duties in the public interest and must act as agents of the people; and financial interests were required to be publicly disclosed, among other requirements.

These restrictions, however, do not address the fact that the Issuer was organized and operated to perpetuate private control and avoid indefinitely responsibility to a public electorate, either directly or through another elected State or local governmental body. That fact is not consistent with qualification as a political subdivision. We need not discuss any other requirements that a division of a State or local governmental unit might need to meet to qualify as an issuer of tax exempt bonds. Issuer is not a "state or political subdivision thereof" for purposes of section 103(c)(1).

Has Issuer been Delegated Sovereign Power?

Having concluded that the Issuer is not a division of a State or local government, we need not examine the extent to which the Issuer has been delegated sovereign powers.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

FOOTNOTES

1 When there was uncertainty about how to interpret the State statutes, including the Act, we generally used the Issuer's interpretations.

2 Act provides that the local general purpose government within the boundaries of which Issuer lies may adopt a nonemergency ordinance providing for a plan for the transfer of a specific community development service to the local general purpose government. The plan must provide for the assumption and guarantee of Issuer's debt that is related to the service by the local general purpose government and must demonstrate the ability of the local general purpose government to provide such service (a) as efficiently as the district, (b) at a level of quality equal to, or higher than, the level of quality actually delivered to the users of the service, and (c) at a charge equal to, or lower than, the actual charge by Issuer to the users of the service.

3 * * *

4 It appears from the submissions that current residents and their grantees and successors who pay Amenities Fees to the Issuer received an easement to use future facilities constructed by the Developer without making payments to the Developer.

Citations: TAM-127670-12

[Editor's Note: The IRS has not formally released this document. Identifying numbers may be updated or changed on its official release date.]

Chevron Step Zero After City of Arlington.

Patrick J. Smith looks at how the Supreme Court in City of Arlington rejected the contention that Chevron does not apply to questions concerning the scope of an agency's jurisdiction, and he notes that the most unsatisfactory aspect of Mead's test for determining when Chevron applies has been eliminated.

City of Arlington was not a tax case, but is still relevant for the tax world because the Supreme Court clarified when the Chevron two-step test for evaluating the validity of some agency interpretations of statutory provisions applies. This issue is generally referred to as "Chevron step zero." The main holding of City of Arlington was that issues of statutory interpretation related to the scope of the agency's jurisdiction or authority to act are subject to the Chevron two-step test. However, the decision also suggests that the most unsatisfactory aspect of the Mead test for answering Chevron step zero may have been eliminated.

Introduction

The Supreme Court's recent decision in City of Arlington, Texas v. FCC1 did not involve a tax issue, so most tax professionals are probably unaware of the decision. However, the case addresses an aspect of the two-part test for evaluating the validity of agency actions that was established in Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.2 Because Mayo Foundation for Medical Education and Research v. United States3 made clear that the Chevron two-part test applies to actions taken by the IRS, just as it does to those taken by all other federal agencies, City of Arlington is relevant to the tax world.4

In City of Arlington, the Court granted certiorari on the question whether the Chevron test applies to issues of statutory interpretation of the scope of a federal agency's jurisdiction or authority to act. The answer, in an opinion written by Justice Antonin Scalia, is an emphatic yes. That holding in and of itself is important enough, but perhaps even more important is what the decision suggests about other aspects of what is now usually referred to as Chevron step zero — namely, determining when the Chevron two-part test applies.5

The decision in which the Court has most comprehensively addressed Chevron step zero is United States v. Mead Corp.6 What is most interesting about the City of Arlington decision is the likelihood that the decision has eliminated the most unsatisfactory aspect of the Chevron step zero test articulated in Mead.

While most of Mead's Chevron step zero test is straightforward, in one respect it is vague, undefined, and open-ended. It is that aspect of the Mead test that seems to have been eliminated by City of Arlington. If that element of the City of Arlington decision holds up, this modification of the Chevron step zero test would be most welcome.

The Chevron Two-Step Test

The Chevron two-step test applies to judicial review of an agency interpretation of a statutory provision the agency is responsible for administering. Chevron describes the first step of the test as follows:

First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.7

In an important elaboration of the step one analysis, the Chevron Court emphasized that the step one inquiry should be based on an application of the "traditional tools of statutory construction":

The judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent. If a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect.8

If the issue of statutory interpretation can be resolved by the reviewing court in step one of the Chevron two-part test, the agency interpretation is given no special weight. If, under step one, the court's interpretation of the statutory provision is different from the agency's interpretation, the agency's interpretation is rejected. If the court's interpretation of the statutory provision coincides with the agency's interpretation, that shared interpretation is the law, not because it is the agency's interpretation, but because the court has concluded that this interpretation is the required interpretation under Chevron step one.

If the issue of statutory interpretation cannot be resolved by the reviewing court in step one of the Chevron two-part test, the court must turn to step two, which Chevron describes as follows:

If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.9

A court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency.10

The court need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding.11

Left open in Chevron was the step zero issue of which agency interpretations are evaluated under the Chevron two-step test.12 The Court did not provide a comprehensive answer to that question until Mead.

Mead's Answer to Step Zero

Mead described its answer to the Chevron step zero issue as follows:

We hold that administrative implementation of a particular statutory provision qualifies for Chevron deference when it appears [1] that Congress delegated authority to the agency generally to make rules carrying the force of law, and [2] that the agency interpretation claiming deference was promulgated in the exercise of that authority.13

Like the Chevron test itself, Mead's answer to the Chevron step zero question has two parts. The first part is that for Chevron to apply, Congress must have "delegated authority to the agency generally to make rules carrying the force of law," usually by notice-and-comment rulemaking but sometimes by case-by-case formal adjudication.14 The second part is that for Chevron to apply, the agency must have promulgated the "interpretation claiming deference . . . in the exercise of that authority" — namely, the authority "to make rules carrying the force of law."15

In almost all cases, the first part of this two-part test will be easily answered and satisfied because

Congress authorizes most federal agencies to issue regulations with the force of law, as long as they issue regulations using the notice-and-comment procedures required by the Administrative Procedure Act.16 Therefore, in most cases, the resolution of the Chevron step zero issue will not turn on the first part of Mead's Chevron step zero test, but instead on whether the second part of this test is satisfied.

Ordinarily, it is also relatively easy to determine whether the second part of this test is satisfied. Agency guidance that is the product of notice-and-comment rulemaking will satisfy the second part of the test, while agency guidance that is not the product of notice-and-comment rulemaking will not, and therefore will not be subject to Chevron.

Thus, in most of Mead's operation, its answer to the Chevron step zero question is straightforward, sensible, and relatively easy to understand and apply. If Mead's answer to the Chevron step zero question had stopped there, step zero would be in good shape.

Unfortunately, Mead's answer went on to suggest that both parts of the test can become more complex than the simple task of asking whether Congress has given the agency at issue rulemaking authority through a statute and whether that agency has adopted the interpretation in question through the use of that authority:

Delegation of such authority [to make rules carrying the force of law] may be shown in a variety of ways, as by an agency's power to engage in adjudication or notice-and-comment rulemaking, or by some other indication of a comparable congressional intent.17

As significant as notice-and-comment is in pointing to Chevron authority, the want of that procedure here does not decide the case, for we have sometimes found reasons for Chevron deference even when no such administrative formality was required and none was afforded.18

Thus, under Mead's test for Chevron step zero, the fact that the agency does not have the authority to issue regulations that have the force of law through notice-and-comment rulemaking, or the fact that an agency that has that authority has not used notice-and-comment rulemaking to adopt the interpretation that is at issue, does not always resolve the Chevron step zero inquiry. Consequently, even though the agency document at issue in Mead was not the product of notice-and-comment rulemaking, the Mead Court did not treat that fact as dispositive in resolving the Chevron step zero inquiry, but instead engaged in the open-ended, multifactor analysis contemplated by the above quotations. The Court analyzed different factors and concluded that the agency document did not satisfy Chevron step zero. However, Mead provided no general guidance for the application of this multifactor analysis aspect of the Chevron step zero test.

The category of agency interpretations in which the Chevron two-step test may apply under the multifactor analysis approach to Chevron step zero, even though notice-and-comment rulemaking is not authorized or the agency did not follow it, is so vague and open-ended that it is almost impossible to predict which interpretations it will apply to. As a result, this part of Mead's answer to the Chevron step zero issue is unsatisfactory.

Mead not only established the test for answering the Chevron step zero issue, but it also clarified that an agency interpretation that does not qualify for the Chevron two-step test under Mead's Chevron step zero analysis is not, as a consequence, given no weight. Mead held that such an agency interpretation is given weight according to its power to persuade.19 Mead derived this power to persuade standard from the Court's 1944 decision in Skidmore v. Swift & Co, in which it said:

The weight [accorded to an administrative] judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.20

As discussed below, the Skidmore standard is relevant to a consideration of the multifactor analysis approach to Chevron step zero because the two inquiries are so similar.

Barnhart v. Walton

The Supreme Court applied the multifactor analysis aspect of Mead's Chevron step zero test in Barnhart v. Walton.21 That case turned not only on the validity of an agency regulation's interpretation of what the Court concluded was an ambiguous statutory provision, but also on the validity of the agency's interpretation of its own regulation. The Court's analysis of the relationship between those two issues was far from clear.

After concluding that the interpretation in the regulation was permissible under step two of Chevron's two-part test, the Court provided the following commentary regarding the Chevron step zero issue in response to the argument that the agency arrived at its interpretation without the benefit of notice-and-comment procedures:

The fact that the Agency previously reached its interpretation through means less formal than "notice and comment" rulemaking, does not automatically deprive that interpretation of the judicial deference otherwise its due. . . .

In this case, the interstitial nature of the legal question, the related expertise of the Agency, the importance of the question to administration of the statute, the complexity of that administration, and the careful consideration the Agency has given the question over a long period of time all indicate that Chevron provides the appropriate legal lens through which to view the legality of the Agency interpretation here at issue.22

That discussion illustrates how difficult it is to predict the outcome of the multifactor analysis aspect of Mead's Chevron step zero test in a given case. Vague concepts such as "the interstitial nature of the legal question," "the importance of the question to administration of the statute," and "the complexity of that administration" provide no useful guidance for predicting what the outcome of an analysis based on those concepts will be in other cases.

That analysis from Barnhart v. Walton also illustrates how hard it is to distinguish that mode of analysis from the Skidmore standard, which applies to determine the weight of an agency interpretation in cases in which the Chevron step zero test is not met. In light of both of those considerations, it is difficult to justify the multifactor analysis aspect of the Chevron step zero test.

Finally, the Barnhart v. Walton commentary illustrates that the multifactor analysis aspect of Mead's Chevron step zero test ordinarily relates to the second part of the test — namely, whether the agency interpretation should be viewed as an exercise of the agency's authority to act with the force of law in a case in which that interpretation is not the product of notice-and-comment rulemaking. The application of the multifactor analysis aspect of Mead's Chevron step zero test in Barnhart v. Walton clearly does not represent the application of the first part of Mead's Chevron step zero test — namely, whether Congress gave the agency the authority to act with the force of law.

In the tax world, the area in which that multifactor analysis aspect of Mead's Chevron step zero test has the most obvious potential significance is in the treatment of temporary regulations, which are

almost always issued without prior notice-and-comment procedures, but which the government nevertheless ordinarily claims satisfy the Chevron step zero test so as to qualify for the Chevron two-step test despite that lack.23 A principal argument the government ordinarily makes in applying the Chevron two-step test to temporary regulations is that temporary regulations come within this vague and undefined multifactor analysis aspect of Mead's Chevron step zero test.

City of Arlington

As noted above, in City of Arlington the Court rejected the proposition that questions of statutory interpretation relating to the scope of an agency's jurisdiction are excluded from the Chevron two-step test. If the Court had instead accepted this proposition, the consequence would have been that for any issue relating to the scope of the agency's jurisdiction that could not be resolved at step one of the Chevron two-part test, the agency's interpretation would not get the benefit of Chevron step two. Thus, the agency interpretation would not be upheld merely because it was reasonable or permissible.

In that instance, the reviewing court would decide the question of statutory interpretation based on the court's best judgment, as is the case under Chevron step one. However, in contrast to the decision the court makes in Chevron step one, the court would make its decision based on what it concluded to be the best reading of the statute, rather than on the basis of determining what was the only permissible interpretation.

In rejecting the proposition that questions of statutory interpretation relating to the scope of an agency's jurisdiction are excluded from the Chevron two-step test, Scalia's majority opinion notes that this proposition was derived from the important distinction between jurisdictional requirements and non-jurisdictional requirements for bringing a case in court that may be imposed by the statutory provisions that apply to the type of case being brought, a distinction that the Court has tried to clarify in recent decisions.24 Scalia noted that while this distinction between jurisdictional requirements and non-jurisdictional requirements for bringing a case in court has significant consequences because it relates to the authority of the Court to hear the case,25 the distinction between jurisdictional issues and non-jurisdictional issues relating to the scope of the authority of agencies has no comparable significance.

Scalia reasons that for issues of statutory interpretation relating to the scope of an agency's authority, the supposed distinction between jurisdictional and non-jurisdictional issues is illusory, because every issue relating to whether the agency's action was consistent with the terms of the relevant statutory provision (and thus every issue to which Chevron could potentially apply) could be reframed as an issue of whether the agency had exceeded its authority:

The label is an empty distraction because every new application of a broad statutory term can be reframed as a questionable extension of the agency's jurisdiction.26

No matter how it is framed, the question a court faces when confronted with an agency's interpretation of a statute it administers is always, simply, whether the agency has stayed within the bounds of its statutory authority.27

The question . . . is always whether the agency has gone beyond what Congress has permitted it to do.28

The question in every case is, simply, whether the statutory text forecloses the agency's assertion of authority, or not.29

Thus, according to Scalia's analysis, limiting Chevron's scope by holding that it does not apply to issues relating to an agency's jurisdiction would essentially eliminate Chevron entirely: "Make no mistake — the ultimate target here is Chevron itself."30 Finally, in response to concerns that Chevron gives agencies too much power, Scalia notes that this concern should be addressed through a robust, rather than permissive, application of Chevron:

The fox-in-the-henhouse syndrome is to be avoided not by establishing an arbitrary and undefinable category of agency decisionmaking that is accorded no deference, but by taking seriously, and applying rigorously, in all cases, statutory limits on agencies' authority. Where Congress has established a clear line, the agency cannot go beyond it; and where Congress has established an ambiguous line, the agency can go no further than the ambiguity will fairly allow. But in rigorously applying the latter rule, a court need not pause to puzzle over whether the interpretive question presented is "jurisdictional."31

Scalia does not cite Mead in his primary discussion of the issue in City of Arlington, even though both cases deal with the Chevron step zero issue of when the Chevron two-step test applies, and even though Mead is clearly the authoritative decision on Chevron step zero. His failure to cite Mead in his primary discussion is not surprising, because he dissented vigorously in Mead, contending that Mead improperly restricted the cases in which the Chevron two-step test applies.32 His dissent in Mead also correctly predicted that the multifactor analysis aspect of Mead's Chevron step zero test would lead to confusion, uncertainty, and unpredictability.33 Moreover, in his dissent in National Cable & Telecommunications Ass'n v. Brand X Internet Services,34 in which the majority held that agencies are permitted to overrule court decisions on issues of statutory construction as long as the court decision did not conclude that its interpretation was the only permissible one, he reiterates his opposition to Mead,35 and in his concurring opinion in United States v. Home Concrete & Supply LLC,36 he reiterated his opposition to Brand X.37

However, in a later section of the City of Arlington opinion in which he responds to the dissent, Scalia seems finally to have accepted Mead:

The dissent is correct that United States v. Mead Corp. requires that, for Chevron deference to apply, the agency must have received congressional authority to determine the particular matter at issue in the particular manner adopted. No one disputes that.38

Nevertheless, having accepted Mead, Scalia proceeds to rewrite it:

But Mead denied Chevron deference to action, by an agency with rulemaking authority, that was not rulemaking. What the dissent needs, and fails to produce, is a single case in which a general conferral of rulemaking or adjudicative authority has been held insufficient to support Chevron deference for an exercise of that authority within the agency's substantive field.39

By describing Mead as having "denied Chevron deference to action, by an agency with rulemaking authority, that was not rulemaking," Scalia makes it appear that the denial of Chevron deference in Mead followed directly from the fact that the agency action at issue in Mead was not rulemaking. That ignores the analysis that Mead went through in explaining why, even though the agency action in Mead was not the product of notice-and-comment rulemaking, that fact alone was not enough to decide that Chevron did not apply: "The fact that the tariff classification here was not a product of such formal process does not alone, therefore, bar the application of Chevron."40

However, while Scalia's characterization of Mead in this respect is inaccurate, he was able to get four other justices to join his opinion without any of them objecting to this inaccuracy in his characterization of Mead. Moreover, the same narrowing of the Mead test for Chevron step zero is

present in his statement that the dissent had cited no case "in which a general conferral of rulemaking or adjudicative authority has been held insufficient to support Chevron deference for an exercise of that authority." This statement leaves no room for the application of the multifactor analysis aspect of Mead's Chevron step zero test, which contemplates that under some circumstances, an agency action that does not represent an exercise of rulemaking authority might nevertheless satisfy Chevron step zero.

Moreover, the majority opinion goes on to describe "the preconditions to deference under Chevron" in the following terms:

It suffices to decide this case that the preconditions to deference under Chevron are satisfied because Congress has unambiguously vested the FCC with general authority to administer the Communications Act through rulemaking and adjudication, and the agency interpretation at issue was promulgated in the exercise of that authority.41

According to this passage, "the preconditions to deference under Chevron" are that "Congress has unambiguously vested the [agency] with general authority to administer the [relevant] Act through rulemaking and adjudication, and the agency interpretation at issue was promulgated in the exercise of that authority." This restatement of "the preconditions to deference under Chevron" (the requirements for satisfying Chevron step zero) makes no reference to the multifactor analysis aspect of Chevron step zero that was identified in Mead and then applied in Barnhart v. Walton, under which an agency interpretation that does not represent an exercise of rulemaking authority might still satisfy Chevron step zero. Once again, although this is a departure from Mead, four other justices joined Scalia in his opinion without objecting to this departure.

Consequently, Scalia's majority opinion suggests that the multifactor analysis aspect of Mead's Chevron step zero test has no vitality. Moreover, additional support for this reading of the decision is presented by Justice Stephen G. Breyer's concurring opinion in the case. Breyer's vote was not necessary to Scalia's five-vote majority, so his concurring opinion represents only his own views. However, Breyer's objection to the majority opinion provides insight into the meaning of that opinion.

Further, in considering Breyer's concurring opinion, it is significant that Breyer was the author of the Court's opinion in Barnhart v. Walton. (Scalia concurred in that case but without joining most of Breyer's analysis.42) It is not surprising that Breyer's concurring opinion in City of Arlington disagrees with the streamlined, simplified version of Chevron step zero articulated in Scalia's majority opinion, in light of Breyer's opinion for the Court in Barnhart v. Walton and his general preference for applying open-ended, multifactor forms of analysis rather than bright-line tests.

However, one notable thing about Breyer's concurring opinion in City of Arlington is that it focuses Breyer's disagreement exclusively on the first part of the two-step Chevron step zero test from Mead and not at all on the second part of that test:

The existence of statutory ambiguity is sometimes not enough to warrant the conclusion that Congress has left a deference-warranting gap for the agency to fill because our cases make clear that other, sometimes context-specific, factors will on occasion prove relevant. . . . In Mead, for example, we looked to several factors other than simple ambiguity to help determine whether Congress left a statutory gap, thus delegating to the agency the authority to fill that gap with an interpretation that would carry "the force of law."43

That passage focuses on whether Congress has given the agency the authority to act with the force of law, rather than on whether the agency interpretation represents an exercise of that authority.

Breyer then quotes the above passage from his opinion in Barnhart v. Walton as supposedly providing an additional example of the use of the multifactor analysis in the first part of Mead's Chevron step zero test, even though that passage actually addressed the second part of Mead's step zero test.

As his discussion continues, however, it clearly focuses on the first part of the step zero test:

The subject matter of the relevant provision — for instance, its distance from the agency's ordinary statutory duties or its falling within the scope of another agency's authority — has also proved relevant.

Moreover, the statute's text, its context, the structure of the statutory scheme, and canons of textual construction are relevant in determining whether the statute is ambiguous and can be equally helpful in determining whether such ambiguity comes accompanied with agency authority to fill a gap with an interpretation that carries the force of law.44

Breyer then acknowledges the view that this type of approach is difficult to apply and makes it virtually impossible to predict the outcome in any particular case, but he dismisses that concern:

Although seemingly complex in abstract description, in practice this framework has proved a workable way to approximate how Congress would likely have meant to allocate interpretive law-determining authority between reviewing court and agency.45

By focusing his attention on the first part of Mead's Chevron step zero test and disagreeing with the streamlining of that part of the test adopted in Scalia's majority opinion, Breyer not only confirms that the majority opinion represents a departure from Mead in abandoning the application of the open-ended, multifactor analysis aspect of the step zero test but also fails to raise any comparable objection to the streamlining effect on the second part of the test. While it might be argued that the focus on the first part of the Mead Chevron step zero test can be explained by the fact that it was this part of the test that was at issue in City of Arlington, the breadth of the language in Scalia's majority opinion cannot be overlooked.

In light of Breyer's concurring opinion, it cannot be claimed that the four other members of the Court who joined Scalia's majority opinion might have overlooked that Scalia's opinion streamlines the step zero test. Thus, by joining the majority opinion, they must be taken to have assented to the streamlining effect.

Chief Justice John G. Roberts Jr. dissented in City of Arlington in an opinion that was joined by justices Anthony Kennedy and Samuel Alito. The main idea of the dissent was similar to that in Breyer's concurring opinion, in that it approached the first part of the Chevron step zero inquiry, which asks whether the agency has the statutory authority to address the particular issue in a way that has the force of law, using a case-by-case approach. The dissent calls for the more open-ended analysis rather than simply asking whether the agency has the general authority to issue rules with the force of law and concluding that if the agency has that general authority, the authority necessarily covers the provision at issue.

In light of this similarity between the dissent and Breyer's concurrence, Scalia's response to the dissent is equally a response to Breyer:

Where we differ from the dissent is in its apparent rejection of the theorem that the whole includes all of its parts — its view that a general conferral of rulemaking authority does not validate rules for all the matters the agency is charged with administering. Rather, the dissent proposes that even

when general rulemaking authority is clear, every agency rule must be subjected to a de novo judicial determination of whether the particular issue was committed to agency discretion. It offers no standards at all to guide this open-ended hunt for congressional intent (that is to say, for evidence of congressional intent more specific than the conferral of general rulemaking authority). It would simply punt that question back to the Court of Appeals, presumably for application of some sort of totality-of-the-circumstances test — which is really, of course, not a test at all but an invitation to make an ad hoc judgment regarding congressional intent. Thirteen Courts of Appeals applying a totality-of-the-circumstances test would render the binding effect of agency rules unpredictable and destroy the whole stabilizing purpose of Chevron. The excessive agency power that the dissent fears would be replaced by chaos.46

This passage leaves no doubt that after City of Arlington, the first part of the Chevron step zero test looks exclusively to whether the agency has general rulemaking authority, and likewise leaves no doubt that the answer to that question is dispositive on this part of the test. Thus, it is clear now that the multifactor analysis aspect of Mead's Chevron step zero test has no application to the first part of the test. Moreover, while this vigorous rejection of the multifactor approach is nominally directed at the first part of the Chevron step zero test, the reasoning based on the need for predictability under the approach that is applied, and the fact that that predictability would be defeated by a requirement to engage in a totality-of-the-circumstances, case-by-case analysis in applying that first part of the Chevron step zero test, is equally applicable to the second part of the Chevron step zero test. That clearly leads to a rejection of the undefined, open-ended, multifactor analysis aspect for both parts of the Chevron step zero test established in Mead.

Conclusion

City of Arlington's negative answer to whether issues of statutory interpretation relating to the scope of an agency's authority are excluded from the Chevron two-step test for evaluating the validity of agency interpretations is clearly important in and of itself. More significant, however, is the decision's streamlining of Mead's Chevron step zero test by eliminating the multifactor analysis approach that had been the most unpredictable aspect of that test.

FOOTNOTES

1 133 S. Ct. 1863 (2013) .

2 467 U.S. 837 (1984).

3 131 S. Ct. 704 (2011) .

4 For prior commentary making this same point, see Kristin E. Hickman, "Don't Overlook City of Arlington, Texas v. FCC," TaxProf Blog (May 22, 2013).

5 The term "Chevron step zero" was first used in Thomas W. Merrill and Hickman, "Chevron's Domain," 89 Geo. L.J. 833, 836 (2001). See also Cass R. Sunstein, "Chevron Step Zero," 92 Va. L. Rev. 187 (2006).

6 533 U.S. 218 (2001). Neither Chevron itself, Mead, nor City of Arlington uses the term "step zero."

7 467 U.S. at 842-843.

8 Id. at 843, n.9 (citations omitted).

9 Id. at 843 (footnotes omitted).

10 Id. at 844.

11 Id. at 843, n.11.

12 Chevron step zero might be described more accurately as Chevron step one and a half, because a reviewing court faced with an issue of statutory interpretation must always undertake the Chevron step one analysis regardless of whether there has been an agency interpretation that might be subject to step two. It is only after the step one analysis has been performed without resolving the question of statutory interpretation that it becomes necessary to ask whether there is an agency interpretation that would be accepted as controlling under step two. Nevertheless, the term "Chevron step zero" is now so widely used that there is no point in quibbling with its accuracy.

13 533 U.S. at 226-227 (numbers added).

14 In the discussion that follows, the focus will be on agency action through rulemaking rather than through adjudication, because the IRS, like most agencies, makes rules that have the force of law through rulemaking rather than through adjudication.

15 For a wide-ranging recent discussion of the force of law concept, see Hickman, "Unpacking the Force of Law," 66 Vand. L. Rev. 465 (2013).

16 See 5 U.S.C. section 553.

17 533 U.S. at 227 (emphasis added).

18 Id. at 230-231 (emphasis added).

19 Id. at 235 (quoting Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944)).

20 533 U.S. at 228 (quoting 323 U.S. at 140) (alteration in original).

21 535 U.S. 212 (2002).

22 Id. at 221-222 (citation omitted).

23 The relevance of Chevron step zero in the tax world is limited to temporary regulations because the IRS and the Justice Department do not claim that the Chevron two-step test applies to any form of IRS guidance other than regulations. See Marie Sapirie, "DOJ Won't Push Chevron Deference for Revenue Rulings," Tax Notes, May 16, 2011, p. 674 .

24 133 S. Ct. at 1868-1869. For a discussion of some of these cases, see Patrick J. Smith, "Is the Anti-Injunction Act Jurisdictional?" Tax Notes, Nov. 28, 2011, p. 1093 .

25 Thus, if a statutory requirement for bringing a case in court is determined to be jurisdictional, the issue may be raised at any stage of the litigation, including by the court itself, and it cannot be waived or forfeited by a party for failing to raise it sooner during the litigation.

26 133 S. Ct. at 1870.

27 Id. at 1868 (emphasis in original).

28 Id. at 1869.

29 Id. at 1871.

30 Id. at 1873.

31 Id. at 1874.

32 533 U.S. at 239-240 (Scalia, J., dissenting).

33 Id. at 245-246.

34 545 U.S. 967 (2005).

35 Id. at 1014-1015 and 1018 (Scalia, J., dissenting).

36 132 S. Ct. 1836 (2012) .

37 Id. at 1848 (Scalia, J., dissenting).

38 133 S. Ct. at 1874 (citation omitted).

39 Id.

40 533 U.S. at 231.

41 133 S. Ct. at 1874.

42 535 U.S. at 226-227 (Scalia, J., concurring).

43 133 S. Ct. at 1875 (Breyer, J., concurring).

44 Id. at 1875-1876 (citations omitted).

45 Id. at 1876 (emphasis added).

46 133 S. Ct. at 1874 (emphasis in original).

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IRS EO Update: e-news for Charities and Nonprofits.

1. IRS website explains tax provisions of the health care law; provides guide to online resources

The IRS has launched a new Affordable Care Act Tax Provisions website at IRS.gov/aca to educate individuals and businesses on how the health care law may affect them. The new home page has three sections, which explain the tax benefits and responsibilities for individuals and families, employers, and other organizations, with links and information for each group. The site provides information about tax provisions that are in effect now and those that will go into effect in 2014 and beyond.

http://www.irs.gov/uac/Affordable-Care-Act-Tax-Provisions-Home

2. Disclosure of return information

On Aug. 13, 2013, the Department of the Treasury and the IRS issued final regulations with rules for disclosure of return information to the Department of Health and Human Services that will be used to carry out eligibility determinations for advance payments of the premium tax credit, Medicaid and other health insurance affordability programs. For additional information on the final regulations, see questions and answers.

http://www.gpo.gov/fdsys/pkg/FR-2013-08-14/pdf/2013-19728.pdf

http://www.irs.gov/uac/Newsroom/IRC-Section-6103(l)(21)-Questions-and-Answers

3. IRS web pages provide information on group exemptions and group returns

These pages explain how to obtain and maintain group exemptions and file group returns.

Group exemptions: http://www.irs.gov/Charities-&-Non-Profits/Group-Exemption-Resources

Group returns:
http://www.irs.gov/Charities-&-Non-Profits/Returns-Filed-by-Organizations-in-Group-Rulings-Resources

4. Register for EO workshops

Register for upcoming workshops for small and medium-sized 501(c)(3) organizations:

August 20-21 – San Francisco, CA

Hosted by Golden Gate University

August 28-29 – Anaheim, CA

Hosted by Trinity Law School

http://www.irs.gov/Charities-%26-Non-Profits/Upcoming-Workshops-for-Small-and-Medium-Sized-501(c)(3)-Organizations

5. IRS open Aug. 30 as cost cutting continues; will reevaluate need for furlough day in September

Read news release:
http://www.irs.gov/uac/Newsroom/IRS-Open-Aug.-30-as-Cost-Cutting-Continues;-Will-Reevaluate-Need-for-Furlough-Day-in-September

6. Six good reasons to become a tax volunteer

If you're looking for a way to help your community, consider becoming a tax volunteer. The IRS is looking for volunteers now who will provide free tax help next year. Read tax tip:
http://www.irs.gov/uac/Newsroom/Six-Good-Reasons-Why-You-Should-Become-a-Tax-Volunteer

7. Ten cool reasons to visit IRS.gov in Espanol this summer

Tax information can be difficult to understand in any language. It can be even more difficult if English is not your first language. The IRS provides a wide range of free products and services on its Spanish language web pages. Visit IRS.gov/espanol to get federal tax help in Spanish. Read all about it: http://www.irs.gov/uac/Newsroom/Ten-Cool-Reasons-to-Visit-IRS.gov-in-Espanol-This-Summer

Nonprofit Housing Organization Requests Guidance on Low-Income Housing Tax Credit.

B. Susan Wilson of Enterprise, responding to a request (Notice 2013-22) for items to include on the 2013-2014 priority guidance list, has asked the IRS to address issues relating to the low-income housing tax credit, including bond issuance costs, casualty losses, over-income tenants, and the applicability of the economic substance doctrine.

Internal Revenue Service

Attn: CC:PA:LPD:PR (Notice 2013-22)

Room 5203

P.O. Box 7604

Ben Franklin Station

Washington, D.C. 20044

Re: Notice 2013-22 Recommendations for 2013-2014 Guidance Priority List

Ladies and Gentlemen:

We are writing in response to Notice 2013-22, in which the Service invited public comment on items that should be included on the 2013-2014 Guidance Priority List.

Enterprise is a national nonprofit organization that creates opportunity for low- and moderate-income people through affordable housing in diverse, thriving communities. For more than 30 years, Enterprise has introduced neighborhood solutions through public-private partnerships with financial institutions, governments, community organizations and others that share our vision. Enterprise has raised and invested more than $13.9 billion in equity, grants and loans to help build or preserve 300,000 affordable rental and for-sale homes to create vital communities. As a key part of our affordable housing finance work, Enterprise is a leading national syndicator of Low-Income Housing Tax Credits (LIHTC).

Below, we have outlined five guidance issues that we believe impact many transactions and propose solutions that we believe would result in the credit working more efficiently and being more effective. Please note that these are the same items that we submitted last year, but we believe that these issues continue to be important and should be considered in the plan.

Inclusion of Bond Issuance Costs in Eligible Basis: We would like the Internal Revenue Service to reconsider the rule that bond issuance costs, including those associated with construction period bonds, cannot be included in basis.

TAM 200043015, issued on October 27, 2000, concludes that Bond Issuance Costs cannot be capitalized and included in eligible basis since they are not subject to depreciation, but are amortizable costs. However, while these costs are amortizable, a portion of the amortization would then be capitalized and depreciable under Internal Revenue Code Section 168. Therefore, to the extent these costs would ultimately be depreciable, they would also be includible in eligible basis.

In many cases, owners use tax-exempt bonds to fund the construction or rehabilitation of the project. In some cases, the bonds are completely paid off at or soon after completion of the project and in other cases, a portion of the bonds are paid off at or near completion of the project, with the balance remaining outstanding for a longer period of time.

Internal Revenue Code Section 42(d)(1) provides that the eligible basis of a building is its adjusted basis at the close of the first taxable year of the credit period.

Generally, costs incurred in obtaining a loan are capitalized and amortized over the life of the loan. Internal Revenue Code Section 263A provides that indirect costs allocable to the production of real or tangible property are to be capitalized into the basis of the produced property.

Such allocable costs would include points and other financing costs associated with a loan used entirely or in part for construction or rehabilitation of the project, as well as interest incurred during the construction or rehabilitation of the project.

To the extent that these costs are amortizable, the amortization associated with the construction or rehabilitation period would be capitalized under Internal Revenue Code Section 263A.

In those cases where the bond is a source of construction financing, the points and other costs of the bonds should be treated as an allocable cost and the portion relating to the construction and rehabilitation of the project should be capitalized into the basis of the building, pursuant to Internal Revenue Code Section 263A.

Loss of Low Income Housing Tax Credits upon a Casualty Loss: We would like the Internal Revenue Service to reconsider its position that credits are not allowed for a year to the extent that the building or units are not available for occupancy on December 31st of that year, due to a casualty loss that is not part of a presidentially declared disaster area, even though the owner is in the process of a timely restoration of the damaged units or building.

Internal Revenue Code Section 42(j)(4) states that there should be no tax credit recapture resulting from a reduction in qualified basis by reason of a casualty loss to the extent that such loss is restored by reconstruction or replacement within a reasonable period established by the Secretary.

In Revenue Procedure 2007-54, which superseded Revenue Procedure 95-28, the IRS stated that the owner of a building that is beyond the first year of the credit period has suffered a reduction in qualified basis that would cause it to be subject to a recapture or loss of credit will not be subject to recapture or loss of credit if the building's qualified basis is restored within a reasonable period. However, the Revenue Procedure addressed this relief to casualties that resulted from a disaster that caused the President to issue a major disaster declaration since that was the general topic of the Revenue Procedure and it did not address casualty losses that did not result from such disasters.

In CCA 200134006 and CCA 200913012, the Chief Counsel to the Internal Revenue Service stated that the ability of the owner to claim credits on units while out of service is limited to those casualties resulting from a presidential declared disaster and is not appropriate for a casualty that resulted form some other cause, such as a fire experienced by a specific project, stating that the exception in Revenue Procedure 95-28 was limited to that.

In the latter case, while recapture does not result if the building or units are restored within a reasonable period of time, if not restored by the end of the year, pursuant to CCA 200134006, no credits are allowed for that year. Although credits would resume for the year in which the project is returned to service, these are credits that the owner would have been entitled to had the casualty

not occurred. Credits would be lost for any year in which the units are not returned to service by the end of the year, regardless of when the casualty occurred, and these credits are not made up later, as in the 11th year, so it is a permanent loss of credits. This result is somewhat punitive to an owner who suffered a loss through no fault of its own, despite acting prudently to restore the unit or building in a reasonable period.

The distinction provided in CCA 200134006 was based on Revenue Procedure 95-28, which only provided relief in the form of the ability to claim credits during the replacement period if the property was in a location being designated as a major disaster area. However, that distinction is inappropriate. The Revenue Procedure was only dealing with such disaster areas, which is why relief was only given to such an area. In addition, in CCA200134006, it states that "Such an event is quite distinct from the general casualty loss situation confronting property owners." While being in a disaster area can make replacements and restoration more challenging, an owner suffering a casualty loss of any sort has similar challenges.

We request that the Service consider revising its policy and provide the same treatment for casualty losses that are not located in a presidentially-declared disaster area. In general, tax law provides a time period for replacements to be completed for casualties, even if not located in a disaster area. If restored within that time period, there should be no loss of tax credit, even if the building is not restored until after the end of the year. This was the treatment accorded to casualty losses that occurred in a disaster area. There is no reason why the rule should be different in a disaster area than outside of it. The rules for casualty losses are the same.

Application of the Economic Substance Doctrine: We would like the Internal Revenue Service to issue official guidance that the Economic Substance Doctrine does not apply to tax credit transactions, including the low income housing credit, new markets credit, rehabilitation credit, and the energy credit.

The Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act codified the common law economic substance doctrine under which federal income tax benefits of a transaction are disallowed if the transaction does not have economic substance or lacks a business purpose, and imposes significant penalties on taxpayers that enter into transactions that lack economic substance.

The Joint Committee on Taxation description of the economic substance doctrine provides that the doctrine is not intended to disallow tax benefits if the realization of those tax benefits is consistent with the Congressional purpose or plan that the tax benefits are designed to effectuate, such as low income housing, new markets, rehabilitation and energy credit transactions.

The Joint Committee on Taxation's description is an interpretation and is not part of the Statute. Without formal guidance of the inapplicability of this statute to the programs named above, potential investors will perceive this to be a risk, which can interfere with the effectiveness of the programs.

We request that the Internal Revenue provide formal guidance that states that the economic substance doctrine provided by The Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act not apply to low income housing, new markets, rehabilitation and energy credit transactions.

Continued qualification of over-income tenants covered by an extended use agreement after a transfer of project: We would like the Internal Revenue Service to issue formal guidance that would state that any household determined to be income qualified at the time of move-in for purpose of the extended use agreement is a qualified household for any subsequent allocation of Internal Revenue

Code Section 42 or allowable through the issuance of tax-exempt bonds pursuant to Internal Revenue Code Section 42(h)(4).

In the Guide for Completing Form 8823 Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition (Revised October 2009), ("The Guide") the Internal Revenue states that "any household determined to be income qualified at the time of move-in for purposes of the extended use agreement is a qualified low-income household for any subsequent allocation of IRC § 42." (p. 4-27)

This is a reasonable position since these tenants may not be evicted without cause and relocation of the tenants will be very costly and inefficient.

Rev. Proc. 2003-82 provides a safe harbor that will allow an owner to treat a unit occupied by a tenant whose income exceeds the maximum qualified income as qualified if "The unit has been a low-income unit under § 42(i)(3)(B), (C), (D), and (E) from either the date the existing building was acquired by the taxpayer or the date the individuals started occupying the unit, whichever is later, to the beginning of the first taxable year of the building's credit period. Further, the safe harbor provided by the Revenue Procedure provides that in order for the unit to be qualified, "The individuals occupying the units have incomes that are at or below the applicable income limitation under 42(d)(4)(B)(i) on either the date the existing building was acquired by the taxpayer or the date the individuals started occupying the unit, whichever is later."

The Revenue Procedure does not state that there would be a different result if an extended use agreement were in effect at the time of the transfer. However, since the purpose of the Rev. Proc. was to provide a safe harbor that would allow tenants to qualify in some situations, it presumably was not intended to cover all situations.

Although The Guide does not have the standing of official guidance from the Office of the Chief Counsel, state agencies and developers rely on it. However, because it is not official guidance, investors and their counsel are reluctant to rely upon it and, in some cases, it forces the owner to relocate tenants that, according to the Service (as stated in The Guide) may not be necessary. This results in additional costs to the owner and displacement of the tenants.

We request that the Internal Revenue Service issue formal guidance that would be consistent with The Guide.

Definition of federally- or state-assisted building for purposes of qualification for exception from ten year rule requirements for the acquisition credit: We would like the Internal Revenue to issue formal guidance on the minimum requirements that a project would need to meet in order to be deemed "a federally- or state-assisted building, which would allow the building to be exempt from the requirement that there be a period of at least ten years between the date the building is being acquired by the taxpayer and the date the building was last placed in service by the previous owner.

The Housing and Economic Recovery Act of 2008 ("HERA") expanded the exceptions from the ten year rule to include federally- or State-Assisted Buildings. HERA defined a federally-assisted building to be "any building which is substantially assisted, financed, or operated under section 8 of the United States Housing Act of 1937, section 221(d)(3), 221(d)(4), or 236 of the National Housing Act, section 515 of the Housing Act of 1949, or any other housing program administered by the Department of Housing and Urban Development or by the Rural Housing Service of the Department of Agriculture." HERA defined a state-assisted building as a building "which is substantially assisted, financed, or operated under any State law similar in purpose to any of the laws" described under the federal definition.

While HERA provided a broad list of the programs that qualified a building for the exception, they did not define “substantially assisted”.

Without a definition or guidance of “substantially assisted”, taxpayers are unsure whether a buiding qualifies and investors are reluctant to invest in these credits due to the uncertainty.

We request that the Internal Revenue Service provide guidance as to what would be deemed substantially federally subsidized. Without such guidance, the purpose of creating this exception to the ten year rule will not be achieved.

We appreciate the opportunity to present our recommendations on items that should be included in the 2012-2013 Priority Guidance Plan. We believe that these changes will improve the use of the tax credits to provide affordable housing that is needed in this country. Thank you in advance for your consideration of these suggestions. If you have any questions about any of the items described above, please feel free to contact Susan Wilson at 410-772-2539 or swilson@enterprisecommunity.com or Peter Lawrence at 202-649-3915 or plawrencet@enterprisecommunity.org.

Very truly yours,

B. Susan Wilson

Vice-President

Enterprise Community Investment,

Inc.

Washington, DC

Affordable Housing Association Requests Guidance on Low-Income Housing Tax Credit.

Kris Cook of the National Affordable Housing Management Association, responding to a request (Notice 2013-22) for items to include on the 2013-2014 priority guidance list, has asked the IRS to address issues relating to the low-income housing tax credit, including the utility allowance submetering rule and the treatment of casualty losses.

May 1, 2013

Internal Revenue Service

Attn: CC:PA:LPD:PR

(Notice 2013-22)

Room 5203

P.O. Box 7604

Ben Franklin Station

Washington, D.C. 20044

Re: Notice 2013-22 Recommendations for 2013-2014 Guidance Priority List

Thank you for this opportunity to submit recommendations for the 2013-2014 Guidance Priority List on behalf of the National Affordable Housing Management Association (NAHMA). NAHMA members manage and provide quality affordable housing to more than two million Americans with very low to moderate incomes. Presidents and executives of property management companies, owners of affordable rental housing, public agencies and national organizations involved in affordable housing, and providers of supplies and services to the affordable housing industry make up the membership of NAHMA. In addition, NAHMA serves as the national voice in Washington for 19 regional, state and local affordable housing management associations (AHMAs) nationwide. NAHMA's comments will focus on two important matters related to the Section 42 Low Income Housing Tax Credit (LIHTC) program, namely the utility allowance submetering rule and treatment of casualty losses.

Utility Allowances (UA) Submetering

On August 7, 2012, the Internal Revenue Service (IRS) — Treasury Department issued the "Utility Allowances Submetering Notice of Proposed Rulemaking and Notice of Public Hearing" [REG-136491-09], RIN 1545-BI91. NAHMA respectfully requests that IRS-Treasury add finalization of this rule, with certain changes, to its 2013-2014 Guidance Priority List.

Before releasing the final rule, NAHMA strongly urges IRS-Treasury to revise its interpretation of State housing agencies' authority to disapprove UA estimation methods permitted under current policies. Under the section, "Summary of Comments on Notice 2009-44 and Explanation of Provisions," the August 7 Notice states:

"A commentator asked whether State housing agencies are allowed to disapprove of certain methods for determining utility allowances listed in § 1.42-10(b)(4)(ii). Existing rules address the role of the State housing agencies in determining utility allowances. Thus, depending on the particular method under § 1.42-10(b)(4)(ii), State housing agencies may require certain information before a method can be used, or they may disapprove of a method."

NAHMA stands by the position articulated by nine national organizations which represent property owners and managers, developers and lenders who participate in the LIHTC program. The joint industry comments, submitted on October 4, 2012, stated:

"We disagree with the general implication of this language that State housing agencies may arbitrarily choose to disapprove any method described in the regulation. . . ."

"As written, the language in the August 7, 2012, proposed rule would give State housing agencies authority to ignore the intent of the existing regulation, which is to recognize accurate estimates that encourage energy efficiency and are based on reliable methods that are easily verifiable. We are concerned that agencies may impose less accurate methods for calculating utility allowances on an arbitrary basis. We recommend that the IRS direct State housing agencies to review the data and information provided by project sponsors and make a determination based on the facts of the individual project submission. Applicants for LIHTC credits should be encouraged to engage with the State housing agency to determine what, if any, issues or concerns the approving agency may have."

NAHMA urges IRS-Treasury to issue a final rule that reaffirms LIHTC property owners' options for selecting an appropriate UA estimation method available under current IRS policies.

Section 42 Low Income Housing Tax Credit Buildings Damaged by Casualty Events

NAHMA respectfully requests that IRS-Treasury include harmonization of casualty loss policies for LIHTC properties on its 2013-2014 Guidance Priority List.

Under current policies, casualties are treated differently depending on whether they are the result of a presidentially declared disaster. As described in Revenue Procedure 2007-54, a taxpayer can continue to claim the credits for casualty events in presidentially declared disaster areas. Low Income Housing Tax Credits will not be subject to recapture or loss of credit if the building's qualified basis is restored within a reasonable restoration period — which may not exceed 24 months after the end of the calendar year in which the president issued a major disaster declaration for the area where the building is located. However, properties that suffer casualty losses outside of these declared disaster areas operate under different terms. Internal Revenue Code 42(j)(4)(E) provides relief from recapture of previously earned credits if the building is restored by reconstruction or replacement within a reasonable time.

However, it does not provide authority for claiming the credit during the time that the building is being restored.

As stated by the IRS, the credit is determined at the close of the taxable year under IRC § 42(c)(1). Credit is determined on a monthly basis only for the first year of the credit period under IRC § 42(f)(2)(A), and for additions to qualified basis under IRC § 42(f)(3)(B). Otherwise, there is no authority to disallowing credits on a monthly basis. Owners of buildings in presidentially declared disaster areas will not lose credits if the building is not placed back in service by the end of the year. However, owners of buildings not in a declared disaster area will lose credits for the year if their units are not back online by December 31. This means an owner could have a unit that was in compliance for the entire year, but have a fire in December that is not restored by December 31, and the owner would not be eligible to take credits for the entire year. If this is not done on December 31, then credits cannot be claimed for the entire year, no matter if the units were in compliance every other day of the calendar year.

NAHMA urges IRS-Treasury to apply the same casualty loss policies across the board. Properties should be able to continue to take the credits during the restoration period, regardless of whether or not the property is in a presidentially declared disaster area. It is reasonable, however, for IRS to establish criteria for owners to demonstrate they took prompt action to begin the restoration process following the casualty event when the loss occurs outside of a presidentially declared disaster area.

Thank you again for the opportunity to offer these recommendations for the Guidance Priority List.

Sincerely,

Kris Cook, CAE

Executive Director

National Affordable Housing

Management Association

Washington, DC

IRS Issues Final, Temporary Regs on Excise Tax Return Requirement for Charitable Hospitals.

The IRS has issued final and temporary regulations requiring charitable hospital organizations that are liable for an excise tax for failing to meet the community health needs assessment requirements for any tax year to file Form 4720, "Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code." (T.D. 9629)

IRS May Make New Jersey Authority's Municipal Bonds Taxable Because of Total Return Swap.

Aug 5 (Reuters) – The Internal Revenue Service has taken a major step toward declaring millions of dollars of revenue bonds issued by the New Jersey Health Care Facilities Financing Authority in violation of U.S. tax law, which could make the interest paid by the debt taxable.

The authority said on Monday it has requested a 90-day extension to evaluate settlement possibilities and to look into seeking advice from the IRS and appealing any determination.

For nearly three years, the tax agency has investigated whether "total return swaps" and other post-issuance transactions associated with bonds sold in 1993 and 1994 led to arbitrage. In a total return swap, an issuer pays a counterparty using the returns on its bonds in exchange for set payments.

At the end of July, the IRS issued notices of "proposed adverse determination" for bonds sold for a loan to the Deborah Heart and Lung Center and a loan to the Jersey Shore Medical Center. It gave the authority 30 days to request a review of the determination.

The IRS contends "that the transactions utilized an abusive arbitrage device, 'creating additional arbitrage investment opportunities for the borrower," Mark Hopkins, the authority's executive director, said in a statement.

The tax exemption for municipal bond interest is considered the chief selling point for the debt and often allows issuers to pay buyers lower interest rates. Most issuers in the $3.7 trillion U.S. municipal bond market work with the IRS to prevent their interest payments from being taxed.

The authority "intends to take whatever steps it deems prudent to prevent the bonds from becoming taxable," said Hopkins. "The NJHCFFA is not aware of any other issues of its bonds that are under similar examination by the IRS."

For the Deborah debt sale, the swaps occurred in 2004, according to a notice posted by the non-profit cardiac organization that was dated August 1. Of the $37.41 million in bonds originally issued, $17.61 million is still outstanding, the notice said.

For the Jersey Shore Medical Center, $87.49 million in bonds were issued, according to a November filing from the Meridian Hospitals Corporation, which includes the center. It said that $16.56 million was outstanding.

Hopkins said lawyers for the authority and hospitals had provided detailed responses to the IRS on two separate occasions, disputing its "purported facts, assumptions and conclusions."

IRS Audits Spell Potential Trouble for Dozens of Jail Bond Deals in Border States.

The Internal Revenue Service is auditing dozens of tax-exempt bond-financed jails, particularly in border states, and suggesting in some cases that, if the jails hold significant amounts of federal inmates, the bonds are no longer tax-exempt and are instead taxable private-activity bonds, sources said Thursday.

Many of these jails were built by state or local governments with tax-exempt bonds or certificates of participation, primarily to hold state and local inmates. But when the jails have additional space or nearby federal facilities are full, the local governments take inmates from U.S. Citizenship and Immigration Service or the U.S. Marshals Service. The federal government typically pays more to house its inmates than state and local governments, the sources said.

Under the federal tax laws and rules that apply to private-activity bonds, state and local governments are considered to be governments but the federal government is a nongovernmental or private entity. Tax-exempt bonds are private-activity bonds if more than 10% of the proceeds are for private use and more than 10% of the payments for debt service are from private parties. But PABs are not tax-exempt unless they are issued for "qualified" purposes and a jail is not considered to be a qualified purpose.

This week, U.S. Bank N.A. filed event notices for two separate issuers that financed jails saying the IRS had indicated the tax-exempt bonds or COPs were not tax-exempt. The bank was trustee for both sets of bonds.

One notice said the Burnet County, Tex., Public Facility Corp. has received four letters from the IRS, the first on Dec. 12, 2011 and the most recent on April 12 of this year, seeking information about $35.38 million of project revenue bonds that were issued in 2008 to build a jail.

The bank said that, in the most recent IRS letter, the issuer was asked to provide information "regarding a preliminary conclusion by the IRS that the … bonds … violate certain Internal Revenue Code rules that cause [them] to be taxable." The notice said the issuer is cooperating with the IRS and that "it is unknown at this time what the outcome of the IRS examination will be."

Bill Neve, president of the Burnet County Public Facility Corp., said the county built the 586-bed jail to hold county prisoners but provided for some extra space so it wouldn't have to expand the jail during the next 20 years or so. The IRS is concerned about the number of federal prisoners in the jail, many of whom were housed for less than 100 days, he said.

The PAB rules contain an exception for short-term private use and define that to be less than 100 days. But Neve and other sources indicated that if the IRS thinks there is a significant number of federal inmates, it does not take that exemption into account.

U.S. Bank, NA also issued an event notice stating that the IRS sent the Village of Epps, La., a Notice of Proposed Issue on July 30 "indicating that [$10.3 million of certificates of participation] may not be qualified or exemption from federal income taxation."

The COPs, part of a total $13.65 million issue, were sold in May 2003 and were used to finance the acquisition and improvement of a 592-bed, 48445 square foot detention facility on 10 acres of land in West Carroll Parish, La., according to the official statement.

Epps essentially purchased the detention facility from the corporation through a lease with an option to buy, but the corporation manages the facility. The lease is put into a trust and COP holders get interest payments from the rental payments. Epps' rental payments under the lease, along with other money held by the trustee, support the debt service payments on the COPs, according to the OS. The detention facility was inspected and approved to house U.S. Marshals Service inmates at the time of issuance, the OS said.

The trustee bank said in the event notice that the IRS "suggests that the COPs may be characterized as 'private-activity bonds' under the Internal Revenue Code" and asked Epps to respond by Aug. 30.

Once the IRS sends a Notice of Proposed Issue, which is a preliminary determination that bonds are taxable, the issuer has 30 days to appeal to the IRS' internal administrative appeals office, sources said.

Treasury Responds to McDermott's Request for Updated Tax-Exempt Bond Guidance.

Treasury Assistant Secretary for Legislative Affairs Alastair Fitzpayne has thanked Rep. Jim McDermott, D-Wash., for suggesting an update of Rev. Proc. 97-13, which describes the conditions under which a management contract does not result in private business use under section 141(b) for tax-exempt bond purposes.

July 31, 2013

The Honorable Jim McDermott

U.S. House of Representatives

Washington, DC 20515

Dear Representative McDermott:

Thank you for your letter regarding the desirability of updating Revenue Procedure 97-13 to recognize new types of arrangements encouraged by the Affordable Care Act (ACA). In your letter, you state that Revenue Procedure 97-13 should be updated because the existing safe harbors it provides may not cover the types of arrangements contemplated by the ACA. This results in uncertainty as to whether these arrangements will result in "private business use" in tax-exempt bond financed facilities.

The Administration shares your interest in advancing coordinated care among hospitals, physicians, and other health care professionals, and in successfully implementing the ACA. Treasury is carefully considering the concerns expressed in your letter as well as all comments we receive on the subject as we develop our plans for future guidance.

Should you have any additional questions, please contact Sandra Salstrom, Office of Legislative Affairs, at (202) 622-1900.

Sincerely

Alastair M. Fitzpayne

Assistant Secretary for

Legislative Affairs

Bond Lawyers Request Guidance on Definition of Issue Price, Other Bond Matters.

Scott Lilienthal of the National Association of Bond Lawyers has asked the IRS to include on its 2013-2014 priority guidance list (Notice 2013-22) guidance on the definition of issue price under section 148, on reissuance, and on the application of the private business use tests to accountable care organizations and some other arrangements.

April 30, 2013

RE: 2013-2014 Guidance Priority List

Ladies and Gentlemen:

The National Association of Bond Lawyers ("NABL") respectfully suggests the following items for inclusion in the 2013-2014 Guidance Priority List. Unless otherwise indicated, section references are to the Internal Revenue Code of 1986.

1. Guidance on the definition of "issue price" under Section 148.

2. Guidance regarding reissuance, including the application of the reissuance rules to multi-modal private placements.

3. Guidance concerning application of the private business use tests to "accountable care organizations" and other arrangements entered into under the Patient Protection and Affordable Care Act.

4. Update to the management and service contract safe harbors in Revenue Procedure 97-13.

5. Reviewing, revising and finalizing proposed regulations concerning (a) public approval under Section 147(f), (b) allocation and accounting of proceeds and projects under Section 141, and (c) yield computation in connection with certain qualified hedges under Section 148 and related matters.

These items are suggested as priority items. These items are not listed in any specific order of priority. Nor by suggesting them do we mean to withdraw any other items we suggested for any prior list.

The list of suggested items was compiled by a NABL task force. If you have any questions concerning them, please contact Michael Larsen (Chair of the NABL Tax Law Committee) at (843) 727-6311 or MikeLarsen@parkerpoe.com.

Sincerely,

Scott R. Lilienthal

National Association of Bond

Lawyers

Washington, DC

State Housing Council Seeks Guidance on Low-Income Housing Tax Credit, Tax-Exempt Bond Issues.

Garth Rieman of the National Council of State Housing Agencies has asked the IRS to include on its 2013-2014 priority guidance list (Notice 2013-22) guidance that the group says is critical to the effective state administration of the low-income housing tax credit and tax-exempt bond programs.

May 1, 2013

Internal Revenue Service

Attn: CC:PA:LPD:PR (Notice 2013-22)

Room 5203

P.O. Box 7604

Ben Franklin Station

Washington, D.C. 20044

RE: Notice 2013-22, Recommendations for 2012-2013 Guidance Plan

To Whom It May Concern:

Thank you for the opportunity to recommend for inclusion on the Department of Treasury/Internal Revenue Service (IRS) 2013-2014 Priority Guidance Plan subjects critical to effective state administration of the Low Income Housing Tax Credit (Housing Credit) and Tax Exempt Bond programs.

As the Washington representative of the agencies that administer the Housing Credit and Bond programs, including the MCC program, in all 50 states, the District of Columbia, New York City, Puerto Rico, and the U.S. Virgin Islands, the National Council of State Housing Agencies (NCSHA) appreciates the Treasury Department's and IRS' expert oversight of these programs, your continued cooperative attitude toward NCSHA and state housing agencies, and your timely provision of program guidance.

To support continued effective state administration of the Housing Credit and tax-exempt Housing Bonds, we urge you to issue the following guidance as quickly as possible.

(1) Guidance concerning the exception under § 42(d)(6) for any federally or State assisted building.

The Housing and Economic Recovery Act of 2008 exempts federally-or state-assisted buildings from the 10-year prior placement in service rule under § 42(d)(2)(B)(ii). The term federally-assisted building means any building which is substantially assisted, financed or operated under section 8 of the United States Housing Act of 1937, section 221(d)(4), or 236 of the National Housing Act, Section 515 of the Housing Act of 1949 or any other housing program administered by the

Department of Housing and Urban Development or by the Rural Housing Service of the Department of Agriculture. The term state-assisted building means any building which is substantially assisted, financed, or operated under any State law similar in purposes to any laws relating to the definition of federally-assisted building. We urge the IRS to promptly issue guidance concerning how it defines "substantially" in this context, keeping in mind the need for as much flexibility as possible.

(2) Regulations concerning utility allowances under § 42(g)(2)(B)(ii) for sub-metered buildings.

NCSHA urges the IRS to issue final guidance concerning utility allowance calculations for Housing Credit developments that sub-meter. In prior comments on proposed utility allowance regulations, NCSHA has expressed its appreciation that regulations generally allow for more accurate utility allowance determinations, provide greater flexibility to make such determinations, and help HFAs promote energy efficiency in Housing Credit properties. We have also maintained that more accurate utility allowances help keep Housing Credit properties financially sustainable. We reiterate these principles and urge the IRS to ensure that any final guidance concerning utility allowances for sub-metered buildings does not impose any unnecessary administrative burdens or complexity on HFAs.

(3) Regulations concerning § 1.42-5 for compliance monitoring

Last year, the IRS issued proposed regulations concerning HFA Housing Credit monitoring procedures, in response to which NCSHA submitted comments suggesting a number of changes to the physical inspection and tenant file review requirements. To ensure that the Section 1.42-5 regulations continue to provide an efficient framework for compliance with Section 42 and provide the information necessary for IRS oversight, while allowing the greatest possible efficiency and effectiveness for the agencies charged with compliance monitoring, we urge IRS to issue final regulations as soon as possible, consistent with NCSHA's comments submitted in response to Notice 2012-18.

(4) Regulations concerning record retention requirements under § 103 for tax-exempt bonds.

NCSHA urges the IRS to issue final guidance concerning the length of time issuers of tax-exempt bonds must maintain loan files. The IRS last requested comments on this issue in Notice 2006-63 but has not since issued final regulations. The current rules, requiring issuers to maintain loan records for the life a bond issue, as well as any refundings of that bond issue plus an additional 6 years, regardless of when the loan is paid off, generate excessive compliance costs, particularly with regard to older loans which are not stored electronically.

(5) Public hearing requirements under § 147(f) for issuance of tax-exempt bonds.

On September 9, 2008, the IRS issued proposed regulations that would simplify the public approval requirements applicable to tax-exempt private activity bonds issued by state and local governments. The proposed regulations would permit the use of electronic notifications if a state's opening meeting laws so allow and cut in half the public notice requirement from 14 to 7 days. The proposed regulations are, however, applicable only after publication of final regulations and may not be applied until such time. NCSHA urges the IRS to issue final regulations consistent with the proposed changes referenced above, allowing HFAs to save time and money while bringing the federal rules in line with current technology and state laws.

NCSHA recommends that the IRS issue guidance on the above referenced items as soon as possible this year, as well as other guidance it believes necessary for the efficient implementation of the Housing Bond and Credit programs.

Thank you for this opportunity to provide input on the Department of Treasury/Internal Revenue Service 2013-2014 Priority Guidance Plan.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Garth Rieman

Director, Housing Advocacy and

Strategic Initiatives

Treasury Will Consider Request on Health Plan Fee for Tax-Exempt, Nonprofit Hospitals.

Treasury Assistant Secretary for Legislative Affairs Alastair Fitzpayne has assured Rep. Tim Walberg, R-Mich., that Treasury will take into consideration his request to classify health plans owned by nonprofit, tax-exempt hospitals or hospital systems in the same category as other nonprofit, tax-exempt health plans.

July 31, 2013

The Honorable Tim Walberg

U.S. House of Representatives

Washington, DC 20515

Dear Representative Walberg:

Thank you for your letter regarding the annual health insurer fee under section 9010 of the Patient Protection and Affordable Care Act.

Proposed regulations on the annual health insurer fee were released through the Federal Register on March 1, 2013. Under the statute, the fee does not apply to the first $25 million of net premiums written, and it only applies to 50 percent of the net premiums written for amounts between $25 million and $50 million. After application of this rule and in accordance with the statute, the proposed regulations provide that a covered entity exempt from tax under section 501(a) and described in section 501(c)(3) (generally, a charity), 501(c)(4) (generally, a social welfare organization), section 501(c)(26) (generally, a high-risk health insurance pool), or section 501(c)(29) (a consumer operated and oriented plan health insurance issuer), will be required to take into account only 50 percent of its remaining net premiums written that are attributable to its exempt activities.

We appreciate the concerns expressed in your letter regarding the way the fee will be applied. We will carefully consider all comments we receive on the proposed regulations, and we intend to continue to work with health insurance providers as the fee is implemented.

If you have any further questions, please contact Sandra Salstrom, Office of Legislative Affairs, at (202) 622-1900.

Sincerely,

Alastair M. Fitzpayne

Assistant Secretary for

Legislative Affairs

IRS LTR: Employee Plan Constitutes Defined Benefit Plan

In technical advice, the IRS concluded that an employee plan for police officers and firefighters, after the adoption of a deferred retirement option plan (DROP) amendment, is a defined benefit plan that provides a benefit derived from employer contributions that is based partly on the balance of the separate account of a participant.

The plan is maintained by a municipality in Michigan and is a governmental plan within the meaning of section 414(d). The plan is also a defined benefit plan under section 414(j).

The IRS determined that allocations of 75 percent of the otherwise payable pension benefits to the DROP accounts are annual additions subject to the limitations of section 415(c)(1). Moreover, the distribution of the DROP account to a retired plan participant is an eligible rollover distribution under section 402(c)(4) and is eligible for the direct rollover provision of section 401(a)(31).

ISSUES

(1) Whether the Plan, after the deferred retirement option plan (DROP) amendment, is a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant.

(2) Whether allocations to the DROP accounts are annual additions subject to the limitations under section 415(c)(1) of the Code.

(3) Whether the distribution of the DROP account to a retired plan participant is an eligible rollover distribution under section 402(c)(4) of the Code and eligible for the direct rollover provision of section 401(a)(31) of the Code.

FACTS

The above-named Plan is maintained by the Taxpayer, a municipality within the State of Michigan, and is a governmental plan within the meaning of section 414(d) of the Code.2 The Plan is also a defined benefit plan under section 414(j) of the Code. Only policemen and firemen employed by the Taxpayer are eligible to participate in the Plan.

The System and Plan were established by the Taxpayer effective July 1, 1941. The most recent determination letter issued to the Plan is dated March 5, 1987. The Taxpayer submitted a request for a determination letter (Form 5300, Application for Determination for Employee Benefit Plan) to the Internal Revenue Service (Service), on January 26, 2004.

During the processing of the determination letter request, the Service determined that the Plan had not been timely amended with respect to TRA ’86, UCA ’92, OBRA ’93, GATT, SBJPA, TRA ’97, and GUST in violation of section 401(a) of the Code. On June 10, 2004, the Service and the System

entered into a closing agreement to resolve these issues.

On February 27, 2002, the System's Board of Trustees adopted a resolution pursuant to the collective bargaining process to adopt the DROP. The provisions of the DROP are effective the later of (1) March 1, 2003, and (2) the date the Service issues a determination that the DROP does not adversely affect the qualified status of the Plan.

Article II of the Plan describes the various definition of terms used in the Plan in determining retirement benefits. Section 2 of this article defines "policemen" as all employees of the Taxpayer's Police Department.

Article II, section 3 defines "firemen" as all employees of the Taxpayer's Fire Department, except those excluded by their classification as civilian employees.

Article II, section 4 defines "member" as any policeman or fireman.

Article II, section 8 defines "service" as service as a policeman or fireman.

Article II, section 10 defines "membership service" as the total service rendered as a policeman or fireman.

Article II, section 14 defines "average final compensation" as:

(a) the average earnable compensation of a member during his last 5 years of service, or total years of service if less than five, for a member described in article IV, section 1(a), (b), or (c); or

(b) the highest average annual compensation received by a member during any 5 consecutive years of credited service selected by the member contained within his 10 years of credited service immediately preceding the date of his employment with the city last terminated, or total years of service if less than five, for a member described in article IV, section 1(d).

Article II, section 15 defines "final compensation" as the annual rate of earnable compensation of a member at the time of termination of employment.

Article II, section 16 defines "earnable compensation" as the compensation fixed by the budget for the rank, grade, or position of member.

Article II, section 17 defines "annuity" as the payments derived from the accumulated contributions of a member.

Article II, section 18 defines "pension" as the payments derived from money provided by the Taxpayer.

Article II, section 19 defines "retirement allowance" as the sum of the annuity and the pension.

Article II, section 20 defines "retirement" as withdrawal from active service with a retirement allowance or pension.

Article IV of the Plan describes membership. Section 1 states that membership of the System generally consists of:

(a) All policemen and firemen, as defined in section 2 and 3 of Article II, who are in service on or after July 1, 1941, but prior to January 1, 1969;

(b) All persons who become policemen and firemen on or after July 1, 1941, but prior to January 1, 1969, and who are confirmed, subject to special provisos for those who are at an attained age of 31 years or more, appointive officials of the Police Department or Fire Department, and any policeman or fireman who is killed or totally incapacitated on active duty prior to being confirmed;

(c) Any member described in (a) or (b) who is transferred to a civilian position in his department;

(d) All persons who become policemen or firemen on or after January 1, 1969, and who are confirmed, subject to special provisos for those who are at an attained age of 31 years or more, appointive officials of the Police Department or Fire Department, any policeman or fireman who is killed or totally incapacitated on active duty prior to being confirmed, any member who under section 1(a), (b), or (c) who separated from service and was subsequently again becomes a member, and any member described in section 1(d) who is transferred to a civilian position in his department.

Article VI, Part A of the Plan describes the service retirement allowance. Section 1 describes the petition for and mandatory age for retirement. Section 1(a) states that any member described in article IV, section 1(a), (b), or (c) in service may file a written application for retirement setting forth a date not less than 15 days nor more than 90 days subsequent thereof, with a total creditable service of 25 years or more. However, firemen with 25 years of creditable service or more may be retired by the Board of Trustees upon recommendation of the Board of Fire Commissioners.

Article VI, Part A, section (1)(b) states that any member described in article IV, section 1(d) in service may file a written application for retirement setting forth a date not less than 15 days nor more than 90 days subsequent thereof, with a total creditable service of 25 years or more and attained age of 55. However, firemen with 25 years of creditable service or more, and who have attained age 55, may be retired by the Board of Trustees upon recommendation of the Board of Fire Commissioners.

Article VI, Part A, section (1)(c) states that any member described in article IV, section 1(a), (b), (c), or (d) who shall reach age 60 shall be retired forthwith. However, such member may continue in service for a maximum of two 2-year terms beyond age 60 with written permission.

Article VI, Part A, section (2) states that upon retirement, a member described in article IV, section 1(a), (b), or (c) shall receive a straight life retirement allowance described in (a) and (b) below:

(a) an annuity which will be the actuarial equivalent of his accumulated contributions standing to his credit in the Annuity Savings Fund at the time of his retirement, and

(b) a pension, which when added to the annuity in (a), will provide a straight life retirement allowance equal to 2% of his average final compensation, multiplied by the number of years, and fraction of a year, of his creditable service, not to exceed 25 years, provided that the pension of a policeman will not exceed 15/22 of the maximum earnable compensation of a patrolman and the pension of a fireman will not exceed 15/22 of the maximum earnable compensation of a firefighter.

Article VI, Part A, section 2.1 states that upon retirement, a member as defined in Article IV, section 1(d) who has at least 25 years of service and who has attained at least age 55 shall receive a straight life retirement allowance descried in (a) and (b) below, and shall have the right to elect an option provided for in part H of Article VI:

(a) an annuity which will be the actuarial equivalent of his accumulated contributions standing to his credit in the Annuity Savings Fund at the time of his retirement, and

(b) a pension, which when added to the annuity in (a), will provide a straight life retirement

allowance equal to 2% of his average final compensation, multiplied by the number of years, and fraction of a year, of his creditable service, not to exceed 35 years.

Article VI, Part H, describes the optional forms of benefit election including a cash refund annuity, a joint and last survivorship retirement allowance, a modified joint and last survivorship retirement allowance, and a single sum distribution of his accumulated contributions to the Annuity Savings Fund.

The DROP applies with respect to those members of the System who are covered by a collective-bargaining agreement with a DROP program.

Section 1 of the DROP states that in lieu of terminating employment and accepting a service retirement allowance under the Plan provisions, any applicable member of the System who is eligible for the DROP program and who is eligible to immediately receive a 25-year service retirement allowance may elect to participate in the DROP and defer receipt of retirement benefits, effective for DROP eligible members retiring on or after the later of March 1, 2002, or after Service approval of the DROP provisions.

Section 2 of the DROP states that no additional service credit will be earned by a participant in the DROP.

Section 3 of the DROP states that there is no limit to the duration of participation in the DROP.

Section 5 of the DROP states that upon the effective date of commencement of participation in the DROP, active membership in the System shall terminate. However, employer contributions shall continue to be paid to the System for the DROP participant as if the DROP participant was not a DROP participant. For purposes of this section, compensation and credit service shall remain as they existed on the effective date of commencement of participation in the DROP. Seventy-five (75%) percent of the monthly retirement benefits (including applicable escalator increases) that would have been payable had the member elected to cease employment and receive a service retirement allowance, shall be paid into the DROP account, a separate account established for each DROP participant. Upon termination of employment, deferred benefits (the DROP account balance) shall be paid as provided in the DROP.

Section 6 of the DROP names the DROP Trust as the initial DROP depositor entity.

Section 7 of the DROP states that the DROP applicable amounts will be invested as directed by the member within the investment choices provide by the DROP Trust.

Section 9 of the DROP states that upon termination of employment, a participant in the DROP shall receive, at his or her option, either a single sum payment from the DROP account equal to the payments to the account plus earnings adjusted for any losses, a true annuity based upon his or her adjusted account, or any other method of payment allowed by the DROP Trust. The participant’s monthly benefits that would have been otherwise paid at retirement prior to participation in the DROP shall be paid to the retiree. Termination of employment includes termination of any kind.

Section 18 of the DROP states that the effective date of the DROP provisions is subject to confirmation from the Service that the DROP does not adversely affect the qualified status of the Plan.

Section 33(N) of the Master Agreements between the Taxpayer and Association 1 (Agreement 1) references the DROP and states the DROP shall be made available July 21, 2000.

Section 33(N)(1) of Agreement 1 states that a member covered by Agreement 1 must have at least 25 years of active service with the Taxpayer as a member of the System, Section 33(N)(2) states that there will be no limit on the number of years that a member may participate in the program.

Section 33(N)(4) of Agreement 1 states that a DROP accumulation account will be established with an outside investment company chosen by the Union.

Section 33(N)(5) of Agreement 1 states that the amount paid into the DROP accumulation account shall be 75% of the member's regular retirement allowance plus the annual escalator (2.25% times the full regular retirement allowance times 75%).

Section 33(N)(6) of Agreement 1 states that once a member has chosen to place his DROP proceeds into the DROP accumulation account, the member shall not be allowed to remove those funds until the member permanently retires.

Section 33(N)(7) of Agreement 1 states that upon permanent retirement, the member shall be given the right to remove funds from the DROP accumulation account.

Section 33(N)(8) of Agreement 1 states that when the member permanently retires, the member will receive a regular retirement allowance calculated as if the member retired on the day that the DROP account started. The member's retirement allowance shall include all annual escalator amounts (2.25%) that would have been added while the member was participating in the DROP.

Section 33(N)(9) of Agreement 1 states that the DROP will not be put into effect unless it is approved by the Service.

Section 42 of the Master Agreement between the Taxpayer and Association 2 (Agreement 2) references the DROP.

Section 42(1) of Agreement 2 states that a member covered by Agreement 2 must have at least 25 years of active service with the Taxpayer as a member of the System. Section 42(2) states that there will be no limit on the number of years that a member may participate in the program.

Section 42(4) of Agreement 2 states that a DROP accumulation account will be established with an outside investment company chosen by the Union.

Section 42(5) of Agreement 2 states that the amount paid into the DROP accumulation account shall be 75% of the member's regular retirement allowance plus the annual escalator (2.25% times the full regular retirement allowance time 75%).

Section 42(6) of the Agreement 2 states that once a member has chosen to place his DROP proceeds into the DROP accumulation account, the member shall not be allowed to remove those funds until the member permanently retires.

Section 42(7) of Agreement 2 states that upon permanent retirement, the member shall be given the right to remove funds from the DROP accumulation account.

Section 42(8) of Agreement 2 states that when the member permanently retires, the member will receive a regular retirement allowance calculated as if the member retired on the day that the DROP account started. The member's retirement allowance shall include all annual escalator amounts (2.25%) that would have been added while the member was participating in the DROP.

Section 42(9) of Agreement 2 states that the DROP will not be put into effect unless it is approved by

the Service.

Section 22(B)(14)(p) of the Master Agreement between the Taxpayer and Association 3 (Agreement 3) references the DROP.

Section 22(B)(14)(p)(1) of Agreement 3 states that a member covered by Agreement 3 must have at least 25 years of active service with the Taxpayer as a member of the System. Section 33(N)(2) states that there will be no limit on the number of years that a member may participate in the program.

Section 22(B)(14)(p)(4) of Agreement 3 states that a DROP accumulation account will be established with an outside investment company chosen by the Union.

Section 22(B)(14)(p)(5) of Agreement 3 states that the amount paid into the DROP accumulation account shall be 75% of the member's regular retirement allowance plus the annual escalator (2.25% times the full regular retirement allowance times 75%).

Section 22(B)(14)(p)(6) of Agreement 3 states that once a member has chosen to place his DROP proceeds into the DROP accumulation account, the member shall not be allowed to remove those funds until the member permanently retires.

Section 22(B)(14)(p)(7) of Agreement 3 states that upon permanent retirement, the member shall be given the right to remove funds from the DROP accumulation account.

Section 22(B)(14)(p)(8) of Agreement 3 states that when the member permanently retires, the member will receive a regular retirement allowance calculated as if the member retired on the day that the DROP account started. The member's retirement allowance shall include all annual escalator amounts (2.25%) that would have been added while the member was participating in the DROP.

Section 22(B)(14)(p)(9) of Agreement 3 states that the DROP will not be put into effect unless it is approved by the Service.

APPLICABLE LAW

Section 401(a) of the Code provides the requirements for a qualified pension plan.

Section 401(a)(25) of the Code provides that a defined benefit pension plan shall not be treated as providing definitely determinable benefits unless, whenever the amount of any benefit is to be determined on the basis of actuarial assumptions, such assumptions are specified in the plan in a way which precludes employer discretion.

Section 401(a)(31)(A) of the Code provides that a trust shall constitute a section 401(a) qualified trust only if the plan of which such trust is a part provides that if the distributee of any eligible rollover distribution (i) elects to have such distribution paid directly to an eligible retirement plan, and (ii) specifies such eligible retirement plan to which such distribution is to be paid (in such form and at such time as the plan administrator may prescribe), such distribution shall be in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

Section 402(c)(4) of the Code provides that the term "eligible rollover distribution" means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified trust except the following distributions: (A) any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made (i) for the life (or life

expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or (ii) for a period of 10 years or more; (B) any distribution to the extent the distribution is required under section 401(a)(9); and (C) any distribution which is made upon hardship of an employee.

Section 414(d) of the Code provides, in part, that the term "governmental plan" means a plan established and maintained for its employees by a State or political subdivision thereof.

Section 414(i) of the Code provides that the term "defined contribution plan" means a plan which provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account.

Section 414(j) of the Code provides that the term "defined benefit plan" is any plan that is not a defined contribution plan.

Section 414(k) provides that a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant shall:

(1) for purposes of section 410 (relating to minimum participation standards), be treated as a defined contribution plan,

(2) for purposes of sections 72(d) (relating to treatment of employee contributions as separate contract), 411(a)(7)(A) (relating to minimum vesting standards), 415 (relating to limitations on benefits and contributions under qualified plans), and 401(m) (relating to nondiscrimination tests for matching requirements and employee contributions), be treated as consisting of a defined contribution plan to the extent benefits are based on the separate account of a participant and as a defined benefit plan with respect to the remaining portion of benefits under the plan, and

(3) for purposes of section 4975 (relating to tax on prohibited transactions), be treated as a defined benefit plan.

Section 415 of the Code provides for certain limitations on contributions and benefits under qualified plans. Section 415(c) of the Code limits the annual additions to which a participant may be entitled under a defined contribution plan during any limitation year.

Section 415(c)(1) provides that, in general, contributions and other additions with respect to a participant exceed the limitation of this subsection if, when expressed as an annual addition (within the meaning of paragraph (2)) to the participant's account, such annual addition is greater than the lesser of (A) $40,000, or (B) 100 percent of the participant's compensation.

Section 415(c)(2) of the Code provides that for purposes of paragraph (1), the term "annual addition" means the sum for any year of (A) employer contributions, (B) the employee contributions, and (C) forfeitures. For the purposes of this paragraph, employee contributions under subparagraph (B) are determined without regard to any rollover contributions (as defined in sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)) without regard to employee contributions to a simplified employee pension which are excludable from gross income under section 408(k)(6). Subparagraph (B) of paragraph (1) shall not apply to any contribution for medical benefits (within the meaning of section 419A(f)(2)) after separation from service which is treated as an annual addition.

Section 415(d) of the Code requires that the Commissioner annually adjust these limits for years after 1987 for cost-of-living increases using procedures similar to procedures used to adjust benefit

amounts under § 215(i)(2)(A) of the Social Security Act. Sections 1.415-5 and 1.415-6 of the regulations provide rules regarding these adjustments.

Section 1.401(a)(31)-1, Q&A-1, of the regulations provides that for purposes of section 401(a)(31) of the Code, eligible rollover distribution has the meaning set forth in section 402(c)(4) of the Code and section 1.402(c)-2 of the regulations.

Section 1.402(c)-2, Q&A-3(a), of the regulations provides that, unless specifically excluded, an eligible rollover distribution means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified plan.

Section 1.402(c)-2, Q&A-3(b), of the regulations provides that an eligible rollover distribution does not include the following:

(1) Any distribution that is one of a series of substantially equal periodic payments made (not less frequently than annually) over any one of the following periods — (i) the life of the employee (or the joint lives of the employee and the employee's designated beneficiary); (ii) the life expectancy of the employee (or the joint life and last survivor expectancy of the employee and the employee's designated beneficiary); or (iii) a specified period often years or more;

(2) Any distribution to the extent the distribution is a required minimum distribution under section 401(a)(9) of the Code; or

(3) The portion of any distribution that is not includible in gross income.

Section 1.402(c)-2, Q&A-4, of the regulations provides that an eligible rollover distribution does not include the following:

(1) Elective deferrals, as defined in section 402(g)(3), that, pursuant to § 1.415-6(b)(6)(iv), are returned as a result of the application of the section 415 limitations, together with the income allocable to these corrective distributions.

(2) Corrective distributions of excess deferrals as described in § 1.402(g)-1(e)(3), together with the income allocable to these corrective distributions.

(3) Corrective distributions of excess contributions under a qualified cash or deferred arrangement described in § 1.401(k)-2(b)(2) and excess aggregate contributions described in § 1.401(m)-2(b)(2), together with the income allocable to these distributions.

(4) Loans that are treated as deemed distributions pursuant to section 72(p).

(5) Dividends paid on employer securities as described in section 404(k).

(6) The costs of life insurance coverage (P.S. 58 costs).

(7) Similar items designated by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin.

Section 1.402(c)-2, Q&A-6(a), of the regulations provides that a payment is treated as independent of the payments in a series of substantially equal payments, and thus not part of the series, if the payment is substantially larger or smaller than the other payments in the series. An independent payment is an eligible rollover distribution if it is not otherwise excepted from the definition of eligible rollover distribution. This is the case regardless of whether the payment is made before,

with, or after payments in the series. For example, if an employee elects a single payment of half of the account balance with the remainder of the account balance paid over the life expectancy of the distributee, the single payment is treated as independent of the payments in the series and is an eligible rollover distribution unless otherwise excepted.

Section 1.415-6(b)(1) of the regulations (as in effect prior to April 5, 2007) provides the definition of annual addition for a defined contribution plan. In general, for limitation years beginning after December 31, 1986, annual addition means the sum credited to a participant's account for any limitation year of (a) employer contributions, (b) employee contributions, and (c) forfeitures.

Section 1.415-6(b)(2)(iv) of the regulations (as in effect prior to April 5, 2007) provides that for purposes of determining the limitation under section 415(c) of the Code, the transfer of funds from one qualified plan to another will not be considered an annual addition for the limitation year for which the transfer occurs.

Section 1.415-6(b)(3) of the regulations provides that the term "annual additions" Includes, to the extent employee contributions would otherwise be taken into account under this section as an annual addition, mandatory employee contributions as well as voluntary employee contributions. The term "annual addition" does not include the direct transfer of employee contributions from one qualified plan to another.

Section 1.415-6(b)(5) of the regulations provides that forfeitures (as well as any income attributable to the forfeiture) will be considered to be an annual addition to the plan if such forfeitures are allocated to the account of the participant.

On April 5, 2007, a new set of final regulations (new regulations) under section 415 of the Code were issued with a general effective date of limitation years beginning on or after July 1, 2007. For governmental plans, the effective date of the new regulations is limitation years that begin more than 90 days after the close of the first regular legislative session of the legislative body with authority to amend the plan that begins on or after July 1, 2007. However, a governmental plan is permitted to apply the provisions of the new regulations to limitation years beginning on or after July 1, 2007.

Section 1.415(c)-1(b)(1) of the new regulations provides the definition of annual addition for a defined contribution plan. In general, annual addition means the sum credited to a participant's account for any limitation year of (a) employer contributions, (b) employee contributions, and (c) forfeitures.

Section 1.415(c)-1(b)(4) of the new regulations provides that the Commissioner may in an appropriate case, considering all of the facts and circumstances, treat transactions between the plan and the employer, transactions between the plan and the employee, or certain allocations to participants' accounts as giving rise to annual additions. Further, where an employee or employer transfers assets to a plan in exchange for consideration that is less than the fair market value of the assets transferred to the plan, there is an annual addition in the amount of the difference between the value of the assets transferred and the consideration. A transaction described in this paragraph may constitute a prohibited transaction.

Rev. Rul. 79-259, 1979-2 C.B. 197, provides that for purposes of section 414(k), the plan provisions regarding a participant's separate account must satisfy the requirements of a defined contribution plan under 414(i).

ANALYSIS

Issue 1

Section 9 of the DROP states that upon termination of employment, a participant in the DROP shall receive, at his or her option, either a single sum payment from the DROP account equal to the payments to the account plus earnings adjusted for any losses, a true annuity based upon his or her adjusted account, or any other method of payment allowed by the DROP Trust. The participants monthly benefits that would have been otherwise paid at retirement prior to participation in the DROP shall be paid to the retiree. Termination of employment includes termination of any kind. Based on this section of the DROP, a member's retirement benefit is the sum of two amounts:

(a) a retirement allowance based on the defined benefit plan formula in the Plan, as of the date the participant elected to participate in the DROP, and

(b) a benefit based on the amount in his DROP account.

In a letter dated January 26, 2007, the System's authorized representative argued that the DROP benefit is merely an internal crediting to the DROP account from within the Plan of 75% of the monthly retirement benefit that would have been paid to the participant had the participant retired and that the benefit under the Plan with the DROP is not based on the balance of a separate account of a participant.3 Furthermore, the representative argues that the amounts allocated to the DROP account are not employer contributions but are based upon the internal transfer within the Plan, and that employer contributions are only made to fund the pension benefits.

Plainly, the retirement allowance part of the benefit is based upon a defined benefit formula, thus causing the Plan to be a defined benefit plan. The focus of our analysis is whether the DROP account is considered a separate account within the meaning of section 414(k) of the Code. Therefore, it must be determined whether the DROP account meets the requirements of section 414(i) of the Code.

While we do not have a copy of the DROP Trust, it is our understanding that the amounts contributed to the DROP are placed in an individual account for each participant, and that the DROP benefit is based solely on the amounts contributed to the participant's DROP account, adjusted for income, expenses, and gains and losses based on the investment choices made by the participant. In other words, after the allocations to the DROP account, the DROP accounts are maintained the same as any defined contribution plan.

Based on the letter dated January 26, 2007, it appears that the Taxpayer's representative does not dispute our understanding of how the DROP accounts operate. Rather, the representative has focused upon the character of the allocations to the DROP accounts. By characterizing the allocations as transfers, the representative seeks to assert that the DROP account is not an individual account with benefits based solely on the amount contributed to the account (and earnings thereon).

Whether the funds are contributed directly by the Taxpayer to the DROP account, or indirectly contributed to the DROP account through the System, does not affect the analysis of the transaction. The pension benefits are funded by employer contributions and earnings thereon. Had an employee continued to work and could not (because there was no DROP account) make the DROP election, or chose not to make the election, the benefits otherwise paid would be lost to the employee. Because these amounts are not paid to the Taxpayer, the Taxpayer has an economic gain,4 which would result in lower future contributions to the System. It is this gain that allows the Taxpayer to create the DROP accounts at no increase over already expected costs in the Plan. The Taxpayer is in the same approximate economic position as if the DROP accounts were funded directly by new employer

contributions while future contributions for pension benefits were reduced because of the economic gain. Furthermore, the original source of the funds allocated to the DROP accounts (the unpaid retirement allowances) are the employer contributions and earnings thereon. The amount of pension benefits otherwise payable is simply a convenient way to measure the amount allocated to the DROP accounts but the source of the funds is employer contributions.

Note that a defined contributions plan does not necessarily have forfeitures reallocated to participants' accounts. Instead, a defined contribution plan can use forfeitures to reduce employer contributions or to pay expenses. Thus, whether or not these are forfeitures (however defined) does not affect the analysis of whether an arrangement is a defined contribution plan. Therefore, we have not addressed the question of whether the unpaid pension benefits, or a portion thereof, are forfeitures when employment continues.

The Plan, after the DROP amendment, is a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant. If the Taxpayer desires to have the DROP accounts not considered as a defined contribution plan, and thus subject to the provisions of section 415(b) of the Code, it is relatively easy to do so. A plan amendment introducing a guarantee feature (such as principal protection) would bring about such a result, because the DROP benefits would not be based solely upon the earnings of the DROP accounts.

Issue 2

Section 414(k) provides in part, that a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant shall be treated as consisting of a defined contribution plan to the extent benefits are based on the separate account of a participant and as a defined benefit plan with respect to the remaining portion of benefits under the plan for purposes of section 415 of the Code (relating to limitations on benefits and contributions under qualified plans).

As discussed in Issue 1 above the Plan, after the DROP amendment, is a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant. Following that analysis, the Plan, after the DROP amendment, will be treated as consisting of a defined contribution plan with respect to the DROP benefits, and will be treated as a defined benefit plan with respect to the retirement allowance under the Plan. The allocations of 75% of the unpaid pension benefits made to the participant's DROP account are considered annual additions under section 415(c)(2) of the Code, and these annual additions are subject to the limitations under section 415(c)(1) of the Code.

The Taxpayer's representative has misread the regulations under section 415 of the Code. On page 3 of the representative's letter dated January 26, 2007, the second sentence in the last paragraph misstates the rule on transfers between plans. The quoted regulation section talks merely about the limitation year for which the transfer occurs. One purpose is not to cause an annual addition simply due to transfers covered by or similar to those described in section 414(l) of the Code. For example, the transfer of accounts and assets from one defined contribution plan to another would not constitute an annual addition. Note that in this case there is no transfer from one plan to another covered by or similar to those described in section 414(l) of the Code, merely an allocation within one plan. The Taxpayer has not even addressed the provisions of section 1.415-6(b)(3) and (5) of the regulations.5

Issue 3

As discussed in Issue 1 above, a participant who elects to participate in the DROP receives a two-tiered retirement benefit upon termination of employment:

(a) a retirement allowance based on the defined benefit plan formula in the Plan, as of the date the participant elected to participate in the DROP, and

(b) a benefit based on the amount in his DROP account.

Essentially, the retirement allowance described in (a) is a benefit that can be considered to be derived from a defined benefit plan, and the benefit in (b) can be considered to be derived from a defined contribution plan. Under section 9 of the DROP, the participant may elect to receive his DROP benefit in the form of a single sum distribution of his DROP account balance.

Section 402(c)(4) of the Code provides that the term "eligible rollover distribution" means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified trust except the following distributions: (A) any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made (i) for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or (ii) for a period of 10 years or more; (B) any distribution to the extent the distribution is required under section 401(a)(9); and (C) any distribution which is made upon hardship of an employee. Because the distribution of the DROP benefit as a single sum does not fall into any of the exceptions under section 402(c)(4), and is a distribution to an employee of all of the balance to the credit of the employee in his DROP account, the distribution is an eligible rollover distribution under section 402(c)(4) of the Code.

The Plan does not currently provide for the direct rollover of the distribution of the DROP account as a single sum. However, because this distribution is an eligible rollover distribution, the distribution would be eligible for the direct rollover provision of section 401(a)(31)(A) of the Code if the Plan is amended accordingly.

CONCLUSIONS

(1) The Plan, after the DROP amendment, is a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant. The Plan is a 414(k) plan after the amendment adding the DROP.

(2) The allocations of 75% of the otherwise payable pension benefits to the DROP accounts are annual additions subject to the limitations under section 415(c)(1) of the Code.

(3) The distribution of the DROP account to a retired plan participant is an eligible rollover distribution under section 402(c)(4) of the Code, and such distribution would be eligible for the direct rollover provision of section 401(a)(31) of the Code if the Plan is amended as described above.

FOOTNOTES

1 For purposes of this memorandum, "System" is generally used to refer to the administration of the Plan, while "Plan" is used to refer to the terms of the Plan. However, either term can be used interchangeably.

2 We are accepting the Taxpayer's representation that it is a governmental plan within the meaning of section 414(d) of the Code. We have neither analyzed this issue, nor are we ruling on this issue.

3 However, the representative states in the same letter that there is a DROP account for each

participant in the DROP, that the participants in the DROP may direct the investment of their account balances, and, upon termination of employment, the DROP account balance is paid in the form of a single-sum distribution or other form of distribution allowed by the Plan.

4 Because the amount going into the DROP account is only 75% of the normal retirement allowance, the other 25% represents a net gain to the System.

5 It should be noted that section 1.415(c)-1(b)(4) of the new regulations allows transactions to give rise to annual additions.

Citations: TAM 053107A

LTR: IRS Addresses Treatment of Deferred Retirement Option Plan With Guarantee Feature.

In technical advice, the IRS concluded that an employee plan for firefighters, which was amended to add a deferred retirement option plan (DROP) with a guarantee feature, is a defined benefit plan that doesn't provide a benefit derived from employer contributions that's based partly on the balance of the separate account of a participant.

The plan, which is maintained by a municipality within a state, is a section 414(d) governmental plan and a section 414(j) defined benefit plan. A DROP participant's DROP pension amount is a normal retirement pension based on a defined benefit formula plus a benefit based on the amount of his DROP account.

The IRS analyzed whether the DROP account is considered a separate account under section 414(k) based on a determination of whether the DROP account meets the requirements of section 414(i). The IRS determined that the plan, after being amended to add the DROP, is a defined benefit plan that provides a benefit derived from employer contributions that is based partly on the balance of the separate account of a participant. The IRS suggested that if the municipality didn't want the DROP accounts to be considered a defined contribution plan it should amend the plan to add a guarantee feature. Accordingly, the plan was amended to provide a guaranteed rate of return on the DROP account. Once that amendment is adopted, the DROP pensions are not solely based on the earnings of the DROP accounts. As a result, the IRS determined that the DROP accounts are no longer considered a separate account of a DROP participant, and the plan is subject only to the provisions of section 415(b).

The IRS also determined that after the adoption of the plan amendment adding the guarantee feature, the allocations to the DROP accounts aren't annual additions subject to the limitations under section 415(c)(1). Thus, the IRS concluded that the plan isn't a plan described under section 414(k), and the benefits paid from the plan, including the DROP benefits, are subject only to the provisions of section 415(b).

ISSUES

(1) Whether the Plan, after the amendment dated December 12, 2002, adding the deferred retirement option plan (DROP), is a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant.

(2) Whether allocations to the DROP accounts are annual additions subject to the limitations under

section 415(c)(1) of the Code.

FACTS

The above-named Plan is maintained by the Taxpayer, a municipality within the State, and is a governmental plan within the meaning of section 414(d) of the Code.1 The Plan is also a defined benefit plan under section 414(j) of the Code. Only firemen employed by the Taxpayer are eligible to participate in the Plan.

The Plan was established by the Taxpayer effective January 1, 1986. The most recent determination letter issued to the Plan is dated May 7, 1997. The Taxpayer submitted a request for a determination letter (Form 5300, Application for Determination for Employee Benefit Plan) to the Internal Revenue Service (Service), on December 31, 2002.

On December 12, 2002, the Plan's Board of Trustees adopted a resolution to adopt the DROP. The provisions of the DROP were effective as of January 1, 2002, and the Plan has been operating accordingly since the amendment was adopted.

Article I of the Plan describes the various definition of terms used in the Plan in determining retirement benefits. Section 1.02 of this article defines "accrued benefit" as a participant's normal retirement pension, deferred vested pension, and DROP pension.

Section 1.09 defines "compensation" as total regular salary and regular hourly wages of the employee concerned as determined by the employer under its current employment policies.

Section 1.12 defines the "DROP pension" as the benefit provided in Article XV.

Section 1.13 defines "effective date" as the plan year and limitation year beginning on or after January 1, 2002.

Section 115 defines "employee" as any person (a) who is employed by the employer on the effective date, (b) whose most recent employment commenced prior to April 8, 1978, (or whose most recent service commenced prior to April 8, 1978, but before January 1, 1980, and who complies with the requirements set forth in the revised statutes of the State), (c) who is paid by the employer on a full-time salary basis, (d) whose duties are directly involved with the provision of fire protection as certified by the employer, and (e) who can normally be expected to be credited with at least 1,600 hours of service each plan year.

Section 1.16 defines "employer" as the Taxpayer.

Section 1.17 defines "employment commencement date" as the date the employee first performs an hour of service for the employer.

Section 1.24 defines "normal retirement pension" as the benefit described in Article V.

Section 1.25 defines "participant" as an employee who is eligible to be and who becomes a participant in accordance with section 2.01.

Section 1.30 defines "service" as any period of time the employee is in the employ of the employer as an employee.

Section 1.35 defines "valuation date" as the accounting date or other date chosen to value the assets in the Plan.

Article II of the Plan describes the eligibility rules for the Plan. Section 2.01 provides that only those employees employed on January 1, 1986, and who were eligible to accrue retirement benefits then provided by the employer under the revised statute of the State, shall be participants in the Plan.

Article III of the Plan describes employer contributions to the Plan. Section 3.01(b) provides that the employer will contribute to the Plan on behalf of each eligible DROP participant who has elected the DROP pension pursuant to Article XV an amount which equals 8% of such participant's plan year compensation each plan year.

Section 3.06(a)(6) defines "year of participation" as a year of service, but only if the Plan was in existence for such year of service.

Article IV of the Plan describes participant contributions to the Plan. Section 4.01(b) provides that any eligible DROP participant who has elected the DROP pension pursuant to Article XV shall be required to contribute an amount which equals 8% of such participant's plan year compensation each plan year.

Article V of the Plan describes the normal retirement pension under the Plan. Section 5.01 provides that the "normal retirement age" is the date the participant attains 50 years of age, and that each participant who retires from service on or after reaching the normal retirement age and after accruing 10 years of service shall receive a normal retirement pension.

Section 5.02 provides that a participant's normal retirement pension shall be computed on a monthly basis as a percentage of the amount of the monthly compensation being paid to such participant as of the date of such participant's actual retirement based on a schedule set forth in this section according to years of participation as of the participant's actual retirement date.

Section 5.03 provides that the participant's normal retirement pension shall be computed in the form of a straight life annuity commencing at the participant's normal retirement age and shall be paid in accordance with the provisions of Article IX.

Article IX of the Plan describes the optional forms of payment available for a participant's accrued benefit.

Article XV of the Plan describes the DROP. Section 15.02 provides that in order to be eligible to elect a DROP pension, a participant must be an eligible DROP participant and comply with the requirements of Article XV.

Section 15.03 defines "eligible DROP participant" as any participant who has attained normal retirement age and who is entitled to a normal retirement pension under section 5.01.

Section 15.04 provides that in order to accrue and receive a DROP pension, an eligible DROP participant must execute a written DROP participant agreement with the employer. Such agreement shall contain an irrevocable election by the eligible DROP participant to (a) elect to participate in the DROP pension and a DROP participation date, (b) to waive all rights to his or her normal retirement pension, (c) to agree to continue employment with the employer after the DROP participation date for a period not to exceed 5 years (the "maximum DROP employment period"), (d) agree to have the employer make the participant DROP contribution required under section 4.01(b) on his or her behalf, (e) to elect and agree to freeze the normal retirement pension determined as of the DROP participation date, (f) to elect payment on a monthly basis, determined as of the DROP participation date, of the normal retirement pension into the DROP account in the form of a straight life annuity or one of the other annuity distribution methods described provided in Article IX.

Section 15.05 describes the DROP account. Section 15.05(a) provides that commencing on the participant's DROP participation date, an individual DROP account will be established for each eligible DROP participant who has elected to participate in the DROP pension. Each DROP account will continue to be an asset of the Plan, but shall be held in an individual investment account in the name of each eligible DROP participant. The investment of each DROP account is subject to participant self-direction pursuant to section 15.09. Each DROP account receives all income it earns and bears all expense or loss it incurs. The Trustees shall be authorized to charge each DROP account for fees associated with the administration of the account.

Section 15.05(b) provides that commencing on the DROP participation date, the following amounts will be allocated and credited to the participant's DROP account: (i) the monthly payment of the DROP participant's normal retirement pension, (ii) the employer DROP contributions as required by section 3.01(b), and (iii) the participant DROP contribution required by section 4.01(b).

Section 15.06 provides that commencing on the participant's DROP participation date, the DROP participant shall remain an active participant of the Plan, but shall earn no additional years of participation, service credit or additional benefits with respect to the normal retirement pension, the normal retirement pension will be frozen, and the participant will only be entitled to the DROP pension.

Section 15.07 provides that the amount of the DROP pension shall be equal to the fair market value of the DROP participant's DROP account as of the valuation date, plus the balance of the participant's normal retirement pension. For purposes of a distribution, the fair market value of the DROP participant's DROP account is its fair market value as of the valuation date immediately preceding the date of the distribution. Upon the actual separation from service of a DROP participant, the portion of the DROP pension attributable to the DROP account shall be paid in accordance with the provisions of Article IX, and the balance of the normal retirement pension elected pursuant to section 15.04(f) shall continue to be payable from and after the DROP participant's actual separation from service in the manner so selected.

Section 15.09 describes participant direction of investment, Section 15.09(a) provides that the DROP participant has the right to direct the investment or reinvestment of the DROP account if the Plan trustees consent in writing to such self direction.

APPLICABLE LAW

Section 401(a) of the Code provides the requirements for a qualified pension plan.

Section 414(d) of the Code provides, in part, that the term "governmental plan" means a plan established and maintained for its employees by a State or political subdivision thereof.

Section 414(i) of the Code provides that the term "defined contribution plan" means a plan which provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account

Section 414(j) of the Code provides that the term "defined benefit plan" is any plan that is not a defined contribution plan.

Section 414(k) provides that a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant shall:

(1) for purposes of section 410 (relating to minimum participation standards), be treated as a

defined contribution plan,

(2) for purposes of sections 72(d) (relating to treatment of employee contributions as separate contract), 411(a)(7)(A) (relating to minimum vesting standards), 415 (relating to limitations on benefits and contributions under qualified plans), and 401(m) (relating to nondiscrimination tests for matching requirements and employee contributions), be treated as consisting of a defined contribution plan to the extent benefits are based on the separate account of a participant and as a defined benefit plan with respect to the remaining portion of benefits under the plan, and

(3) for purposes of section 4975 (relating to tax on prohibited transactions), be treated as a defined benefit plan.

Section 415 of the Code provides for certain limitations on contributions and benefits under qualified plans. Section 415(c) of the Code limits the annual additions to which a participant may be entitled under a defined contribution plan during any limitation year.

Section 415(c)(1) provides that, in general, contributions and other additions with respect to a participant exceed the limitation of this subsection if, when expressed as an annual addition (within the meaning of paragraph (2)) to the participant's account, such annual addition is greater than the lesser of (A) $40,000, or (B) 100 percent of the participant's compensation.

Section 415(c)(2) of the Code provides that for purposes of paragraph (1), the term "annual addition" means the sum for any year of (A) employer contributions, (B) the employee contributions, and (C) forfeitures. For the purposes of this paragraph, employee contributions under subparagraph (B) are determined without regard to any rollover contributions (as defined in sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)) without regard to employee contributions to a simplified employee pension which are excludable from gross income under section 408(k)(6). Subparagraph (B) of paragraph (1) shall not apply to any contribution for medical benefits (within the meaning of section 419A(f)(2)) after separation from service which is treated as an annual addition.

Section 415(d) of the Code requires that the Commissioner annually adjust these limits for years after 1987 for cost-of-living increases using procedures similar to procedures used to adjust benefit amounts under § 215(i)(2)(A) of the Social Security Act. Sections 1.415-5 and 1.415-6 of the regulations provide rules regarding these adjustments.

Section 1.415-6(b)(1) of the regulations (as in effect prior to April 5, 2007) provides the definition of annual addition for a defined contribution plan. In general, for limitation years beginning after December 31, 1986, annual addition means the sum credited to a participant's account for any limitation year of (a) employer contributions, (b) employee contributions, and (c) forfeitures.

Section 1.415-6(b)(2)(iv) of the regulations (as in effect prior to April 5, 2007) provides that for purposes of determining the limitation under section 415(c) of the Code, the transfer of funds from one qualified plan to another will not be considered an annual addition for the limitation year for which the transfer occurs.

Section 1.415-6(b)(3) of the regulations provides that the term "annual additions" includes, to the extent employee contributions would otherwise be taken into account under this section as an annual addition, mandatory employee contributions as well as voluntary employee contributions. The term "annual addition" does not include the direct transfer of employee contributions from one qualified plan to another.

Section 1.415-6(b)(5) of the regulations provides that forfeitures (as well as any income attributable to the forfeiture) will be considered to be an annual addition to the plan if such forfeitures are allocated to the account of the participant.

On April 5, 2007, a new set of final regulations (new regulations) under section 415 of the Code were issued with a general effective date of limitation years beginning on or after July 1, 2007. For governmental plans, the effective date of the new regulations is limitation years that begin more than 90 days after the dose of the first regular legislative session of the legislative body with authority to amend the plan that begins on or after July 1, 2007. However, a governmental plan is permitted to apply the provisions of the new regulations to limitation years beginning on or after July 1, 2007.

Section 1.415(c)-1(b)(1) of the new regulations provides the definition of annual addition for a defined contribution plan. In general, annual addition means the sum credited to a participant's account for any limitation year of (a) employer contributions, (b) employee contributions, and (c) forfeitures.

Section 1.415(c)-1(b)(4) of the new regulations provides that the Commissioner may in an appropriate case, considering all of the facts and circumstances, treat transactions between the plan and the employer, transactions between the plan and the employee, or certain allocations to participants' accounts as giving rise to annual additions. Further, where an employee or employer transfers assets to a plan in exchange for consideration that is less than the fair market value of the assets transferred to the plan, there is an annual addition in the amount of the difference between the value of the assets transferred and the consideration. A transaction described in this paragraph may constitute a prohibited transaction.

Rev. Rul. 79-259, 1979-2 C.B. 197, provides that for purposes of section 414(k), the plan provisions regarding a participant's separate account must satisfy the requirements of a defined contribution plan under 414(i).

ANALYSIS

Issue 1

Section 15,07 of the Plan states that upon separation from service, a participant in the DROP shall receive, at his or her option, the portion of the DROP pension attributable to the DROP account paid in accordance with the provisions of Article IX, and the balance of the normal retirement pension that had been paid in to the DROP account prior to the participant's separation from service. Based on this section of the Plan, a DROP participant's DROP pension is the sum of two amounts:

(a) a normal retirement pension based on the defined benefit plan formula in the Plan, as of the date the participant elected to participate in the DROP, and

(b) a benefit based on the amount in his DROP account.

Under Section 15.05(a) of the Plan, an individual DROP account is established for each eligible DROP participant who has elected to participate in the DROP pension commencing on the participant's DROP participation date. While this section of the Plan states that each DROP account continues to be an asset of the Plan, the DROP account is held in an individual investment account in the name of each DROP participant. The investment of each DROP account is subject to participant self-direction pursuant to section 15.09. Each DROP account receives all income it earns and bears all expense or loss it incurs. The Trustees shall be authorized to charge each DROP account for fees

associated with the administration of the account.

Clearly, the normal retirement pension part of the benefit is based upon a defined benefit formula, thus causing the Plan to be a defined benefit plan. The focus of our analysis is whether the DROP account is considered a separate account within the meaning of section 414(k) of the Code. Therefore, it must be determined whether the DROP account meets the requirements of section 414(i) of the Code.

While we do not have a copy of the Plan Trust, it is our understanding that the amounts contributed to the DROP are placed in an individual account for each participant, and that the DROP benefit is based solely on the amounts contributed to the participant's DROP account, adjusted for income, expenses, and gains and losses based on the investment choices made by the participant. In other words, after the allocations to the DROP account, the DROP accounts are maintained the same as any defined contribution plan.

The Plan, after being amended to add the DROP, is a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant. During the conference of right held on May 9, 2007, we explained to the Taxpayer's authorized representative that if the Taxpayer desired to have the DROP accounts not considered as a defined contribution plan, and thus subject to the provisions of section 415(b) of the Code, it would be is relatively easy to do so. A plan amendment introducing a guarantee feature (such as principal protection) would bring about such a result, because the DROP benefits would not be based solely upon the earnings of the DROP accounts.

In a letter dated May 30, 2007, the Taxpayer's authorized representative provided a copy of an executed amendment to the Plan which was adopted on May 29, 2007, and effective January 1, 2002 (unless expressly set forth to the contrary). This amendment added a new section 15.09(c) to the Plan (effective January 1, 2002) providing a guaranteed rate of return on the DROP account. Under this section, if the trustees of the Plan consent to a DROP participant's self-direction of investment under section 15.09(a), and if the actual net income and earnings of such DROP participant's DROP account do not equal at least 4% on an annualized basis for any plan year, then the Plan shall guaranty any such DROP participant an aggregate guaranteed rate of return on the DROP account of 4% on an annualized basis for such plan year. Hence, after the adoption of this amendment, DROP pensions are not solely based upon the earnings of the DROP accounts. Accordingly, the DROP accounts are no longer considered a separate account of a DROP participant and the Plan is subject solely to the provisions of section 415(b) of the Code.

Issue 2

Section 414(k) provides in part, that a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant shall be treated as consisting of a defined contribution plan to the extent benefits are based on the separate account of a participant and as a defined benefit plan with respect to the remaining portion of benefits under the plan for purposes of section 415 of the Code (relating to limitations on benefits and contributions under qualified plans).

As discussed in Issue 1 above, the Plan, after being amended to add the DROP, is a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant. Following that analysis, the Plan, after being amended to add the DROP, will be treated as consisting of a defined contribution plan with respect to the DROP account, and will be treated as a defined benefit plan with respect to the normal retirement pension under the Plan, The allocations made to the DROP participant's DROP account

would be considered annual additions under section 415(c)(2) of the Code, and these annual additions would be subject to the limitations under section 415(c)(1) of the Code.

However, after the adoption of the May 29, 2007, amendment described above adding guaranteed rate of return in the DROP accounts, the DROP account is no longer considered a separate account of a DROP participant because the DROP benefits are not solely based upon the earnings of the DROP accounts. The allocations made to the DROP participant's DROP account would not be considered annual additions under section 415(c)(2) of the Code, and these annual additions would not be subject to the limitations under section 415(c)(1) of the Code. Hence, the Plan is not a plan described under section 414(k) of the Code, and the benefits paid from the Plan, including the DROP benefits, are subject solely to the provisions of section 415(b) of the Code.

CONCLUSIONS

(1) The Plan, after being amended to add the DROP on December 12, 2002, and after being amended to add the guaranteed rate of return on DROP accounts on May 29, 2007, is a defined benefit plan which does not provide a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant. The Plan is not a 414(k) plan after the amendment adding the DROP.

(2) Allocations to the DROP accounts under the Plan are not annual additions subject to the limitations under section 415(c)(1) of the Code.

FOOTNOTE

1 We are accepting the Taxpayer's representation that it is a governmental plan within the meaning of section 414(d) of the Code. We have neither analyzed this issue, nor are we ruling on this issue.

Citations: TAM 071907

Firm Requests Guidance on Recognizing Nonprofit News Organizations as Exempt From Tax.

Celia Roady of Morgan, Lewis, and Bockius LLP, in response to a request for items to be placed on the IRS 2013-2014 priority guidance plan (Notice 2013-22), has asked for guidance on the standards for recognizing nonprofit news organizations as exempt from tax under section 501(c)(3).

April 29, 2013

Internal Revenue Service

Attn: CC:PA:LPD:PR (Notice 2013-22)

1111 Constitution Avenue, N.W.

Washington, D.C. 20224

Re: 2013-2014 Treasury/IRS Guidance Priority List

Dear Sir or Madam:

The purpose of this letter is to propose guidance for inclusion on the 2013-2014 Treasury/IRS Guidance Priority List. We recommend that the list include guidance about the standards for recognizing organizations engaged in the publication of information that is useful to the individual and beneficial to the community, including general news, as exempt under Section 501(c)(3). In this letter, we refer to such organizations as "nonprofit news organizations."

As background, in 2011 the Federal Communications Commission (the "FCC") issued a report, The Information Needs of Communities: The Changing Media Landscape in a Broadband Age, which documents the substantial decrease in accountability reporting by commercial news organizations. For example, the FCC report points to a study conducted by the Pew Center for Excellence in Journalism which found that in 2009 the Baltimore Sun produced 32 percent fewer investigative stories than it did in 1999 and 73 percent fewer stories than in 1991.1 It explains that financial pressures are forcing commercial news organizations to reduce coverage of investigative pieces involving lengthy documents and records searches or stories requiring a reporter to develop comprehensive knowledge of a particular subject matter. This cut-back affects coverage of issues that Americans care about — such as schools, health care, the environment, and local public affairs — and that offer substantial public benefit and civic value. The FCC report also describes the serious consequences that result from communities losing information that can improve government responsiveness and accountability. It explains that nonprofit news organizations can help to fill the gap in coverage and notes that uncertainty about the standards required for nonprofit news organizations to obtain tax exemption under Section 501(c)(3) is a significant barrier to this evolution.

The FCC report recommended that tax and journalism experts study the tax exemption requirements for nonprofit news organizations more carefully, and the Council on Foundations convened a working group of such experts. The group released its findings in a report issued earlier this year, The IRS and Nonprofit Media: Toward Creating a More Informed Public. The report is available online at http://www.cof.org/files/Bamboo/home/documents/Nonprofit-Media-Full-Report-03Q42013.pdf.

The working group report confirms that many nonprofit news organizations have experienced lengthy delays and even rejections of their applications for exemption. It concludes that the Internal Revenue Service ("IRS") approach for evaluating whether an organization primarily engaged in publishing qualifies for tax exemption under Section 501(c)(3), namely Revenue Ruling 67-4,2 needs to be modernized. The working group report notes that Revenue Ruling 67-4 was issued decades before the advent of the digital era. That ruling establishes four criteria for analyzing the tax-exempt status of nonprofit news organizations, whether; (1) the content of the publication is educational, (2) the preparation of material follows methods generally accepted as "educational" in character, (3) the distribution of the materials is necessary or valuable in achieving the organization's educational and scientific purposes, and (4) the manner in which the distribution is accomplished is distinguishable from ordinary commercial practices. The fourth criterion, in particular, does not reflect dramatic changes in the manner of dissemination of information by all news organizations, nonprofit and for-profit alike.

This request for guidance is consistent with the recommendations of the working group report, and the discussion below explains how such guidance meets the factors that Treasury/IRS considers in choosing to add an item to the priority list.

1. The guidance will resolve significant issues relevant to many taxpayers.

The Section 501(c)(3) status of nonprofit news organizations is of great importance to the millions of Americans who seek information about the events shaping their lives. According to the FCC report,

“communities and citizens are seriously harmed — including financially — if there is not a critical mass of full-time professional journalists watching over the key institutions — such as state and local government, local schools, state and local courts, police, environmental planning, land use, transportation, and public health.”3 Nonprofit news organizations offer an additional source of information on these topics just as the for-profit news sector is cutting back. These stories help Americans gain useful and beneficial information that allows them to make more-informed decisions.

Moreover, investigative reporting benefits residents of communities whether or not they are readers of a particular paper. For example, the working group report points to an in-depth series in the Raleigh News & Observer on the quality of the city’s parole system that helped take criminals off the streets in the Raleigh-Durham area, thereby improving safety for all residents, regardless of whether they were readers of the paper.4 Nonprofit news organizations, often with philanthropic support from foundations, are the hope of the future for this type of reporting.

Section 501(c)(3) status is critical for nonprofit news organizations, in part because their ability to provide or expand accountability coverage on subjects such as local government, schools, and healthcare often hinges on philanthropic support from funders that require such exemption as a prerequisite for providing support. These organizations also want to structure their activities in a manner consistent with the requirements for Section 501(c)(3), but lack guidance about how to do so. In this regard, the working group report notes that the operator of the Oshkosh Community News Network, a Section 501(c)(3) nonprofit news organization, shut down the organization in part because of uncertainty regarding the tax laws.5 Updated guidance will help these organizations gain important information about how to structure their activities in order to ensure continued qualification as a Section 501(c)(3) organization.

Finally, private foundations are investing in nonprofit news organizations, with one report estimating contributions of nearly $128 million to news and information projects since 2005.6 The guidance will facilitate and streamline the grant-making programs of these foundations and help ensure their investments are advancing charitable and educational purposes.

2. The guidance will promote sound tax administration.

As noted above and in the working group report, nonprofit news organizations have experienced substantial delays associated with the processing of their applications for exemption under Section 501(c)(3). Recently, the IRS centralized a group of applications submitted by nonprofit news organizations as it attempted to understand, analyze, and apply the rules for exemption to these organizations and needed to ensure consistent treatment. Providing updated guidance about how nonprofit news organizations advance Section 501(c)(3) purposes will facilitate the IRS’s processing of applications for exemption, as well as nonprofit news organizations’ compliance with the law.

3. The guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance.

The guidance can be drafted in a form such as a revenue procedure that provides background on the rules for evaluating the Section 501(c)(3) status of nonprofit news organizations, outlines the various factors the IRS will consider in evaluating whether a nonprofit news organization is advancing charitable and educational purposes, and identifies the factors that are not relevant in such a determination. The IRS has issued similar types of revenue procedures in the past to help give guidance about how a particular sector or industry advances tax-exempt purposes. For example, Revenue Procedure 96-32 provides a safe harbor for organizations providing low-income housing to qualify as Section 501(c)(3) organizations, and this has proved to be an invaluable tool for low-income housing organizations seeking to apply for exemption, and for IRS agents processing such

applications.

4. The guidance involves regulations that are outmoded, ineffective, insufficient, or excessively burdensome and that should be modified, streamlined, expanded, or repealed.

As noted above and in the working group report, the IRS is relying on outdated standards for evaluating whether nonprofit news organizations are furthering charitable and educational purposes. For example, Revenue Ruling 67-4 evaluates whether an organization's manner of distribution of a publication is distinguishable from ordinary commercial publishing practices. However, since the publication of Revenue Ruling 67-4, advances in the development of technology and devices that facilitate the low-cost dissemination of information have made the distribution of free or low-cost content to the public an ordinary practice by Section 501(c)(3) organizations and commercial publishers alike.

5. The Service can administer the guidance on a uniform basis.

The IRS has faced challenges with applying the rules for tax exemption under Section 501(c)(3) on a uniform basis to nonprofit news organizations, in part because the current outdated guidance does not reflect changes in the manner of dissemination of useful and beneficial public information. Updated guidance will enable the IRS to administer the tax laws on a more uniform basis.

6. The guidance will reduce controversy and lessen the burden on taxpayers and the Service.

As noted above, the guidance will have a substantial positive impact on the American public, nonprofit news organizations, private foundations, and the IRS. It will enable new nonprofit news organizations to move forward to meet the information and accountability needs of their communities. It will provide certainty to philanthropy funders. It will provide clear standards for the IRS to apply. And it will avoid litigation that will inevitably result if the IRS does not address the need for updated guidance in this area.

We appreciate your consideration of this request. We believe the time is right and the time is now for the IRS to issue updated guidance. Every month more commercial newspapers close their doors or reduce new coverage to the detriment of their communities. Nonprofit news organizations can and will emerge to help address this problem, but they need Section 501(c)(3) status to do so. Updated guidance is essential to allow that to happen.

Sincerely,

Celia Roady

Morgan, Lewis & Bockius LLP

Washington, DC

cc:

The Honorable Mark Mazur

Assistant Secretary for Tax Policy

Department of the Treasury

The Honorable William J. Wilkins

Chief Counsel

Internal Revenue Service

FOOTNOTES

1 S. Waldman and the Working Group on Information Needs of Communities, The Information Needs of Communities: the Changing Media Landscape in a Broadband Age, 123 (July 2011).

2 Revenue Ruling 67-4, 1967-1 CB 121.

3 S. Waldman and the Working Group on Information Needs of Communities, The Information Needs of Communities: the Changing Media Landscape in a Broadband Age, 263 (July 2011).

4 See S. Waldman and the Working Group on Information Needs of Communities, The Information Needs of Communities: the Changing Media Landscape in a Broadband Age, 18 (July 2011).

5 Council on Foundations, The IRS and Nonprofit Media: Toward Creating a More Informed Public, 12 (2013).

6 J. Schaffer, New Media Makers: A Toolkit for Innovators in Community Media and Grantmaking 2 (2009).

Nonprofit Association Requests Guidance on Program-Related Investments.

Robert Collier of the Council of Michigan Foundations, in response to a request for items to be placed on the IRS 2013-2014 priority guidance plan (Notice 2013-22), has asked for guidance on program-related investments.

April 30, 2013

Internal Revenue Service

Attn: CC:PA:LPD:PR (Notice 2013-22)

Room 5203

P.O. Box 7604

Ben Franklin Station

Washington, DC 20044

Re: 2013-2014 Guidance Priority List

Sir/Madam:

This letter is in response to Notice 2013-22 and the Department of Treasury and the Internal Revenue Service's invitation for public comment on recommendations for items that should be included on the 2013-2014 Guidance Priority List. We appreciate the opportunity to provide input to formulate a guidance plan that focuses on guidance items that are important to taxpayers and tax

administration.

As a Section 501(c)(3) membership association encompassing more than 350 grantmaking organizations, The Council of Michigan Foundations ("CMF") strongly urges the Department and Service to include in its Guidance Priority List guidance relating to program-related investments ("PRI" or "PRIs"). PRIs are an important, yet underutilized vehicle by which grantmakers may accomplish their charitable purposes. PRIs are underutilized, however, due to minimal guidance regarding qualifying investments and lack of a timely process for approving PRIs.

In 2012, the IRS issued proposed amendments to 26 C.F.R. § 53.4944-3 concerning PRIs. We expressed our comments to the amendments in a letter dated July 16, 2012, a copy of which is attached. We request that the Department and Service consider our letter and recommended course of action for improving the guidance relating to PRIs as part of the 2013-2014 Guidance Priority List.

Additionally, we recommend that further guidance be provided with respect to jeopardizing investments under Section 4944 of the Internal Revenue Code (the "Code"), and offer one other suggestion to allow private foundations to share rulings related to PRIs.

First, we request that the Service issue guidance that a mission-related investment ("MRI") made primarily for charitable purposes is not a jeopardizing investment under Section 4944 of the Code. A "mission-related investment" is a commonly used term among grantmakers and refers to an investment made by a charitable organization to further one or more social objectives. Often, mission-related investments are made primarily for charitable purposes, and as such, are similar to PRIs in that the primary purpose of the investment is to accomplish one or more of the purposes described in Section 170(c)(2)(B). However, MRIs differ from program related investment in that the decision to make the investment is treated primarily as an investment decision rather than a programmatic decision by the foundation. Also, an MRI, whether or not made primarily for charitable reasons, is not treated as a qualifying distribution under Section 4942 of the Code.

Section 4944 of the Code and the regulations thereunder impose taxes on investments made by private foundations which jeopardize charitable purposes. 26 C.F.R. § 53.4944-1 contains care and prudence standards for making a determination as to whether an investment is a jeopardizing one. Guidance is requested to clarify that a mission-related investment made primarily for charitable purposes, or more broadly, any investment, the primary purpose of which is to accomplish one or more of the purposes described in Section 170(c)(2)(B), is not a jeopardizing investment under Section 4944 of the Code.

Finally, as described in the attached letter, we previously requested that the Service amend the regulations to allow rulings relating to PRIs to be relied upon by other parties. While we still urge the Service to give consideration to this suggestion, we offer one other recommendation regarding reliance on PRI rulings.

As you know, currently the Code and revenue procedures indicate that a taxpayer may not rely on a letter ruling issued to another taxpayer or use another taxpayer's written determination as precedent. At least with respect to PRIs, this prohibition on reliance is especially frustrating. Often with economic development projects where a project cannot be financed on traditional commercial terms, multiple foundations may make substantially identical PRIs in the same project. We ask that the Service consider a procedure which would allow a ruling or determination issued to one foundation to be shared among, and relied upon by, foundations investing in the same project so long as the investments are made on substantially similar terms.

For example, assume XYZ Foundation applies for a private letter ruling that its investment in an

urban investment fund will qualify as a PRI. The fund will make loans to growth-oriented businesses in target urban core areas. The target businesses face obstacles to traditional financing by being above the credit risk threshold for commercial bank loans and below the size and return threshold for other mezzanine financing. The fund's principal purpose in making the loans is charitable, and more specifically, is intended to promote economic development, relieve the underprivileged, eliminate prejudice and discrimination and combat community deterioration. The loans significantly further the accomplishment of XYZ Foundation's exempt activities and would not have been made but for such relationship between the loans and XYZ Foundation's exempt activities. The urban investment fund is organized as a limited partnership and governed by a limited partnership agreement. Each private foundation investor will execute the limited partnership agreement of the fund and participate in the investment on substantially identical terms.

Assume that the Service makes a determination that XYZ Foundation's investment in the urban investment fund constitutes a PRI. We request that this ruling be shared and relied upon by other private foundations that invest in the urban investment fund pursuant to the limited partnership agreement. Alternatively, each private foundation may make a loan to the urban investment fund utilizing template loan documents. Assuming that the Service makes a determination that XYZ Foundation's loan to the urban investment fund constitutes a PRI, we request that this ruling be shared and relied upon by other private foundations that loan to the urban investment fund utilizing the template loan documents.

On behalf of CMF, and our 350 member foundations, we thank you for the opportunity to provide recommendations for guidance on PRIs for inclusion on the 2013-2014 Guidance Priority List. We welcome future dialogue regarding our comments and suggested guidance for PRIs. If we can be of additional assistance, please let me know.

Sincerely,

Robert Collier

President and CEO

Council of Michigan Foundations

Grand Haven, MI

IRS Phone Forum: 501(c)(7) Social and Recreational Organizations – How to Stay Tax-Exempt, August 21, 2013 2-3 p.m. ET

Fraternities, country clubs, hobby clubs and sports clubs all are examples of groups organized for social, recreational and similar nonprofit purposes that are tax exempt under Section 501(c)(7) of the Internal Revenue Code.

This instructive phone forum will discuss:

- How they are different from other nonprofits
- Organizational requirements
- Operational requirements
- Required filings
- Unrelated business income

- Non-traditional income

The phone forum is eligible for CPE credits for Enrolled Agents.

Register at:

http://ems.intellor.com/index.cgi?p=204754&t=71&do=register&s=&rID=417&edID=305

TIGTA Finds Potential for Fraudulent Bond Tax Credit Claims.

Changes to tax credit bonds allowing the tax credits to be separated from bonds and sold to investors have increased the risk for improper or fraudulent tax credit claims, and more IRS oversight is required, the Treasury Inspector General for Tax Administration said in a partially redacted June 26 report.

Vulnerabilities Exist for Improper or

Fraudulent Claims for Bond Tax Credits

HIGHLIGHTS

Final Report issued on June 26, 2013

Highlights of Reference Number: 2013-10-060 to the Internal Revenue Service Office of the Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

Nearly $5 billion in tax credit bonds were issued in Calendar Years 2009 and 2010, resulting in millions of dollars of bond tax credits claimed each year. Without effective IRS oversight, improper or fraudulent credits may be claimed, thereby reducing Federal Government revenue.

WHY TIGTA DID THE AUDIT

This review was initiated as part of TIGTA's Fiscal Year 2013 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives. The overall objective of this review was to evaluate the IRS's progress in identifying and addressing bond tax credit noncompliance.

WHAT TIGTA FOUND

TIGTA conducted an analysis of corporate and individual returns and determined that more than $700 million in bond tax credits were claimed in Tax Years 2010 and 2011.

Changes to the law in Calendar Year 2008 allowed bond tax credits to be stripped, or separated, from the bonds and sold to other investors who could use the credits to reduce their tax liability. These changes increased the risk for improper or fraudulent claims for bond tax credits because the population of taxpayers holding the credits became more diverse and there were no requirements for third-party reporting of information on the stripping and transfer of these credits.

In the first quarter of Calendar Year 2013, the IRS began collecting information via the new information return, Form 1097-BTC, Bond Tax Credit, to begin addressing the vulnerabilities in this

area. Research shows that compliance increases when taxpayers know that the IRS receives data from third parties.

WHAT TIGTA RECOMMENDED

In their response, IRS management agreed to the recommendation and plans to analyze the population of bond tax credits and determine whether changes to the compliance strategy are needed to address and prevent the improper or fraudulent claiming of bond tax credits.

June 26, 2013

MEMORANDUM FOR

OFFICE OF THE DEPUTY COMMISSIONER FOR

SERVICES AND ENFORCEMENT

FROM:

Michael E. McKenney

Acting Deputy Inspector General for Audit

SUBJECT:

Final Audit Report — Vulnerabilities Exist for Improper or

Fraudulent Claims for Bond Tax Credits (Audit # 201210032)

This report presents the results of our review to evaluate the Internal Revenue Service’s progress in developing and implementing a process to identify and address bond tax credit noncompliance. This review was conducted as part of the Treasury Inspector General for Tax Administration’s Fiscal Year 2013 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management’s complete response to the draft report is included as Appendix VII.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations).

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Abbreviations

IRS Internal Revenue Service

TCB Tax Credit Bond

TIGTA Treasury Inspector General for Tax Administration

Background

The Taxpayer Relief Act of 19971 introduced a type of tax-preferred bond known as tax credit bonds (TCB). TCBs were first available in 1998 and provide a credit that can be used on the investor's Federal tax return to reduce the tax liability in lieu of receiving interest. Bond tax credits are nonrefundable,2 but credits that are not allowable in the current year can generally be carried forward.3 Although TCBs have not been issued as frequently as tax-exempt bonds, according to the Internal Revenue Service's (IRS) Statistics of Income Division, 378 TCBs totaling $3.7 billion were issued in Calendar Year 2009 and 199 TCBs totaling $1.1 billion were issued in Calendar Year 2010.4 While no additional TCBs have been authorized since February 2009, the tax credits for outstanding TCBs may be claimed on tax returns for more than 20 years.5

Each type of TCB is authorized by Congress and, with the exception of Build America Bonds, is designated for a specific purpose or project. According to a September 2012 Congressional Research Service report,6 issuers have used the proceeds for public school construction and renovation, clean renewable energy projects, refinancing outstanding Government debt in regions affected by natural disasters, conservation of forest land, investment in energy conservation, and economic development purposes. See Appendix IV for a list of TCBs authorized by Congress.

Early issuances of TCBs were privately placed and held as investments primarily by large financial institutions instead of being sold on the open market. However, in May 2008, the Food, Conservation, and Energy Act of 20087 made it possible for bond tax credits to be stripped from the bonds and sold to other investors who could use the credit to reduce their tax liability and allowed Regulated Investment Companies and Real Estate Investment Trusts to pass bond tax credits to investors, such as investors in mutual funds.

Traditionally, taxpayers claimed bond tax credits by entering the amount of the credit, or multiple credits, on Form 8912, Credit to Holders of Tax Credit Bonds. The sum of the credits was then transferred to the taxpayer's income tax return and the Form 8912 was submitted along with the return to the IRS. However, after the credits became more freely transferable, * * * 2 * * *.

Internal Revenue Bulletin Notice 2010-28, issued on March 23, 2010, introduced the proposed third-party information reporting requirements for bond tax credits, including the new Form 1097-BTC, Bond Tax Credit. The Tax Forms and Publications office developed Form 1097-BTC in Calendar Year 2010 for this purpose.8 Beginning the first quarter of Tax Year 2013, bond issuers, entities that sell bond tax credits to other recipients and investors, are required to use the process outlined in Figure 1 to report bond tax credits.

Figure 1: Reporting Bond Tax Credits9

Source: Compilation of information obtained from interviews with IRS management and review of the instructions for Forms 1097-BTC and 8912.

Bondholders that receive a Form 1097-BTC also use this form to report tax credits sold to another recipient. For example, if a Regulated Investment Company receives a Form 1097-BTC from an issuer and transfers it to a mutual fund with 100 holders who are rightful owners of a portion of that credit, the broker would prepare a Form 1097-BTC for each of the 100 mutual fund holders disclosing their portion of the credit and send a copy of the Forms 1097-BTC to the IRS. Similarly, if credits have been stripped from the TCB and resold, the original owner of the credits receives a Form 1097-BTC and must prepare a Form 1097-BTC to provide to the new owner disclosing their portion of the credits and must send a copy to the IRS.

This review was performed at the Wage and Investment Division's Tax Forms and Publications office and the Office of Chief Counsel in Washington, D.C. We also interviewed and received information from the Small Business/Self-Employed Division's Office of Business Modernization and Campus Compliance Services and Examination functions and from the Wage and Investment Division's Reporting Compliance function during the period July 2012 through February 2013. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

* * * 2 * * *.

* * * 2 * * *

* * * 2 * * *. First, the sale of TCBs moved from primarily being privately placed with large financial institutions to being sold on the open market. Additionally, financial institutions purchased bonds to use the credits to reduce their tax liabilities, but with the downturn of the economy, many found they also had reduced taxable income and could not use the bond tax credits to reduce tax liability. Also, mutual funds started investing in TCBs, and the legal changes allowed them to pass the credits on to their investors. Collectively, these changes made the population of owners of these credits more diverse. Because the bond tax credits could be stripped and sold, and because institutional investors, such as mutual funds, could pass the credits on to their investors. * * * 2 * * *.

Because of these weaknesses, the Department of the Treasury expressed concern that multiple taxpayers could improperly or fraudulently claim the same bond tax credit, thereby reducing the amount of taxes paid to the Federal Government. In Calendar Year 2009, the Department of the * * * 2 * * *.

In Calendar Year 2010, the Tax Forms and Publications office developed Form 1097-BTC for this purpose. Beginning the first quarter of Tax Year 2013, Form 1097-BTC, sent from a third party to the IRS, will provide the IRS with information that can be used to verify that a taxpayer is eligible to claim the bond tax credits listed on a tax return if the return is selected for an examination and the bond tax credit amount is identified as a potential examination issue.

Research shows that when taxpayers know that the IRS receives data from third parties, they are more likely to correctly report the income or expenses to the IRS. The IRS estimates that income subject to substantial information reporting, such as pension, dividend, interest, unemployment, and Social Security income, was misreported at an 8 percent rate compared to a 56 percent misreporting rate for income with little or no information reporting, such as sole proprietor, rent, and royalty income.10 Through the use of Form 1097-BTC, the IRS has taken the first step in reducing the risk for improper or fraudulent claims for bond tax credits.

* * * 2 * * *

The IRS Strategic Plan states that, to succeed, the IRS "…must become faster at processing information, identifying areas of noncompliance, and applying the appropriate enforcement tools in a timely manner." * * * 2 * * *

To determine the number and significance of bond tax credits being used to reduce tax liabilities, we quantified the bond tax credits taken on Form 1120 and the Form 1040 series tax returns11 for Tax Years 2010 and 2011. As shown in Figure 2, bond tax credit claims totaled more than $700 million during the two tax years for the types of tax returns we reviewed.12

Figure 2: Bond Tax Credits Claimed on Forms 1120 and Form 1040

Series Tax Returns (Tax Years 2010 and 2011)13

Form 1120 Tax Year	Number of Credits	Form 1040 Returns	Number of Series Credits	Returns
2010	$366,800,000	192	$2,200,000	1,118
2011	$334,900,000	212	$3,100,000	1,153

Source: Treasury Inspector General for Tax Administration (TIGTA)

analysis of Form 1120 data from the Business Return Transaction File

and Form 1040 series data from the Tax Return Database and the

Modernized Tax Return Database.

While the number of tax returns filed claiming bond tax credits is small, the dollar value of bond tax credits claimed per return can be significant and ranged from $1 to approximately $244,000 for individual returns and up to approximately $83 million for corporate returns.

Figure 3 shows that the majority of bond tax credits filed on corporate returns totaled between $10,000 and $1 million each.

Figure 3: Form 1120 Bond Tax Credits

(Tax Years 2010 and 2011)

Source: TIGTA analysis of Form 1120 data from the Business Return Transaction File.

In contrast, Figure 4 shows that individuals filing Form 1040 returns with bond tax credits claimed smaller credits, primarily under $1,000.

Figure 4: Form 1040 Series Bond Tax Credits

(Tax Years 2010 and 2011)

Source: TIGTA analysis of Form 1040 series data from the Tax Return Database and the Modernized Tax Return Database.

* * * 2 * * *. The IRS reported that, of the approximately 148 million individual and corporate income tax returns filed each year, only approximately 1.5 million (1 percent) are examined.14 * * * 2 * * * Moreover, because the amount of some of the claims is large, inappropriate claims for bond tax credits could result in significant loss of revenue for the Federal Government.15

* * * 2 * * *. Bond tax credits can be claimed by different types of taxpayers (individuals, corporations, partnerships, etc.) that for compliance purposes are handled by different IRS operating divisions. In addition, the IRS has not had third-party reporting on Form 1097-BTC in the past.

In April 2012, TIGTA testified that: 1) the IRS does not have reliable third-party data for all categories of taxpayers and for all types of tax returns and 2) the IRS reported that, without these data, it cannot easily detect errors or potential fraud except through expensive and intrusive examinations.16 * * * 2 * * *.

Recommendation

Recommendation 1: * * * 2 * * *.

Management’s Response: IRS management agreed with this recommendation and plans to perform an analysis of the population of bond tax credits. The findings will be considered in determining any changes needed to enhance the compliance strategy for detecting improper or fraudulent claims for bond tax credits.

FOOTNOTES

1 Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of the U.S. Code).

2 See Appendix VI for a glossary of terms.

3 Credits from Qualified Tax Credit Bonds and Build America Bonds can be carried forward. Credits for Clean Renewable Energy Bonds, Midwestern Tax Credit Bonds, or Qualified Zone Academy Bonds cannot be carried forward.

4 The latest year for which statistics are available.

5 The maximum term for TCBs is determined using a discount rate equal to the average annual interest rate of tax-exempt obligations having a term of 10 years or more that are issued during the month. For example, as of February 19, 2013, the term on a qualified TCB was listed as 24 years on www.treasurydirect.gov.

6 Congressional Research Service, Tax Credit Bonds: Overview and Analysis (Sept. 2012).

7 Pub. L. No. 110-234, Stat. 1509.

8 During development of Form 1097-BTC and the related process for reporting bond tax credits, Tax Forms and Publications management coordinated with and considered recommendations from the Information Return Program Advisory Committee on the impact of the reporting process for taxpayers and for the financial community. The Information Return Program Advisory Committee was established in 1991 in response to a recommendation in the Conference Report of the Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239). The Committee has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. Committee members are drawn from, and represent, a broad sample of the payer community, including major professional and trade associations, colleges and universities, and State taxing agencies.

9 See Appendix V for a list of IRS forms used throughout this report.

10 Government Accountability Office, GAO-12-652T, Opportunities to Improve the Taxpayer Experience and Voluntary Compliance (Apr. 2012).

11 Form 1040, Form 1040A, Form 1040-C, Form 1040-ES, Form 1040NR, Form1040-PR, Form 1040-SS, and Form 1040-V were included in this analysis. Bond tax credits can be claimed on various other tax forms, such as Form 1041, Form 1065, Form 990-T, and Form 1120-C.

12 We limited our analysis to Forms 1120 and the 1040 series. The amounts presented in Figure 2 do not include credits claimed on various other tax returns. Therefore, the total bond tax credits claimed on all returns could be greater than what is presented.

13 Dollar amounts have been rounded to the nearest $100,000.

14 Based on an average of IRS Statistics of Income Division examination coverage data, Table 9a, IRS Data Book, Fiscal Years 2009 through 2011.

15 IRS management did inform us that bond tax credits were examined on less than five individual and corporate tax returns from Fiscal Years 2009 through 2012, but none were found to be fraudulent.

16 Problems at the Internal Revenue Service: Closing the Tax Gap and Preventing Identity Theft, 112th Cong. (April 19, 2012) (statement of The Honorable J. Russell George, TIGTA).

END OF FOOTNOTES

* * * * *

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the IRS's progress in developing and implementing a process to identify and address bond tax credit noncompliance. To accomplish this objective, we:

I. Determined IRS requirements for issuer and bondholder reporting of bond tax credits.

A. Obtained and reviewed documentation of the Department of the Treasury's proposal for the new bond tax credit information reporting requirements.

B. Interviewed IRS management and reviewed available documentation to identify issuer requirements for reporting bond tax credits to bondholders and the IRS for bond issuers and pass-through entities.

C. Interviewed IRS management and reviewed available documentation to identify the requirements for bondholders reporting bond tax credits to the IRS.

D. Interviewed IRS management and reviewed available documentation to identify the process for tracking credits that have been stripped from the bonds and sold separately.

II. Evaluated IRS management's plans to identify and address improper or fraudulent claims for bond tax credits on tax returns and determined whether these plans met the Department of the Treasury's intent and purpose for the program.

III. Determined the number and amount of bond tax credits claimed in Tax Years1 2010 and 2011.

A. Interviewed IRS management to determine if the total amount of bond tax credits claimed on the Form 10402 series of returns and Forms 1120 in Tax Years 2010 and 2011 has been quantified to determine the risk of noncompliance.

B. Quantified the total bond tax credits taken on the Form 1040 series of returns and Forms 1120 in Tax Years 2010 and 2011 by analyzing bond tax credits from the Tax Return Database, the Modernized Tax Return Database, and the Business Return Transaction File that were $1 or greater but limited to the amount of total tax on the taxpayers' Federal tax return. Bond tax credits are not separately listed on Form 1040; therefore, we quantified the allowable credit from Form 8912 attached to the Form 1040 series returns. Validation testing of both data sets was completed by reviewing the data for reasonableness and duplicates. Form 1120 data were additionally validated by comparing data from the Business Return Transaction File to the Business Master File data. These data were determined to be reliable for the purposes of this report.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the IRS's controls for reviewing tax returns claiming bond tax credits and Forms 1097-BTC to determine compliance. We evaluated these controls by interviewing IRS and Department of the Treasury officials, reviewing applicable documentation, and quantifying bond tax credit claims.

FOOTNOTES TO APPENDIX II

1 See Appendix VI for a glossary of terms.

2 See Appendix V for a list of IRS forms used throughout this report.

END OF FOOTNOTES TO APPENDIX II

* * * * *

Appendix II

Major Contributors to This Report

Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations)

Troy D. Paterson, Director

Gerald T. Hawkins, Audit Manager

Melinda H. Dowdy, Lead Auditor

Julia Moore, Senior Auditor

David M. Bueter, Auditor

Joseph C. Butler, Information Technology Specialist

Brian W. Hattery, Information Technology Specialist

* * * * *

Appendix III

Report Distribution List

Principal Deputy Commissioner

Office of the Commissioner — Attn: Chief of Staff C

Commissioner, Small Business/Self-Employed Division SE:S

Acting Commissioner, Tax Exempt and Government Entities Division SE:T

Commissioner, Wage and Investment Division SE:W

Director, Office of Legislative Affairs CL:LA

Chief Counsel CC

National Taxpayer Advocate TA

Director, Office of Legislative Affairs CL:LA

Director, Office of Program Evaluation and Risk Analysis RAS:O

Office of Internal Control OS:CFO:CPIC:IC

Audit Liaisons:

Director, CSO Headquarters Operations, Small Business/Self-Employed Division SE:S:CSO:SL:HQ

Director, Communications and Liaison, Tax Exempt and Government Entities Division SE:T:CL

Director, Compliance, Wage and Investment Division SE:W:CP

* * * * *

Appendix IV

Tax Credit Bonds Authorized by Congress

The following table lists all TCBs authorized by Congress as of September 2012. Although the authorized issuance amount is listed in this table, information is not available to determine the actual amounts issued for each of these bonds. The IRS Statistics of Income Division has issuance data available from Fiscal Years1 2007 to 2010; however, data were not available prior to Fiscal Year 2007 due to the lack of information reporting requirements (Form 8038, Information Return for Tax-Exempt Private Activity Bond Issues) and low issuance volume.

Authorized Tax Credit Bond	Issuance Amount	Expired After	Credit Amount	Purpose of Bond
Energy				
Clean Renewable Energy Bonds I	$1.2 billion	2009	100 percent	These bonds were issued to finance renewable energy facilities, such as wind, geothermal, landfill gas, or

				solar energy, and must be owned by a public power provider, State or local government body, or cooperative electric company.
New Clean Renewable Energy Bonds I	$800 million	2010	70 percent	These bonds were issued to finance renewable energy facilities, such as wind, geothermal, landfill gas, or solar energy. Not more than one-third of the new bonds could be allocated to public power providers, government bodies, or cooperative electric companies.
New Clean Renewable Energy Bonds II	$1.6 billion	2010	70 percent	
Qualified	$800 million	No expira-	70 percent	These bonds are

Energy Conservation Bonds I		tion		issued to finance energy conservation efforts such as
Qualified Energy Conservation Bonds II	$2.4 billion	No expiration	70 percent	reducing energy consumption in public buildings and mass transportation or implementing green community programs.

General Government, Economic Development, and Forest Conservation

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Qualified Forestry Conservation Bonds	$500 million	2010	100 percent	These bonds were issued for a qualified forestry conservation purpose for the purchase of at least 40,000 acres of land subject to a native fish habitat conservation plan

approved by the U.S. Fish and Wildlife Service. The land must be adjacent to the U.S. Forest Service Land and at least half of the land must be transferred to the U.S. Forest Service at no net cost to the United States.				
Build America Bonds	No limit	2010	35 percent2	There were two types of Build America Bonds: tax credit and direct payment. o Build America Tax Credit bonds were issued to finance any governmental purpose for which tax-exempt governmental bonds (excluding

private activity bonds) can be issued. o Build America Direct Payment bonds were more limited in their use than the tax credit bond option.				
Midwest Disaster Bonds	$450 million	2009	100 percent	These bonds were designated for areas affected by the severe storms and flooding in the Midwest that occurred in 2008. These bonds could only be issued in Calendar Year 2009 and had a maximum term of two years.
Recovery Zone Economic Development Bonds	$10 billion	2010	45 percent3	These bonds were issued to finance economic development and

activity in areas designated as recovery or empowerment zones.

School Construction

Qualified Academy Bonds I	$4.4 billion	2008	100 percent	These bonds were issued to finance public school programs designed
Qualified Academy Bonds II	$3.2 billion	2011	100 percent	in cooperation with business to enhance the academic curriculum, increase graduation and employment rates, and prepare students for college and the workforce.
Qualified School Construction	$22.4 billion	2010	100 percent	These bonds were issued to finance the construction,

Bonds	rehabilitation, or repair of public school facilities or to acquire the land for such a facility.

Source: Congressional Research Service, Tax Credit Bonds: Overview and Analysis (Sept. 2012).

FOOTNOTES TO APPENDIX IV

1 See Appendix VI for a glossary of terms.

2 The underlying interest rate is market determined, not established by the Secretary of the Treasury as with the other TCBs. The credit is 35 percent of the market-determined interest rate.

3 The credit amount is determined in the same manner as Build America Bonds.

END OF FOOTNOTES TO APPENDIX IV

* * * * *

Appendix V

Internal Revenue Service Forms Used in This Report

Term	Definition
Form 990-T	Exempt Organization Business Income Tax Return
Form 1040	U.S. Individual Income Tax Return
Form 1040A	U.S. Individual Income Tax Return
Form 1040-C	U.S. Departing Alien Income Tax Return
Form 1040-ES	Estimated Tax for Individuals
Form 1040NR	U.S. Nonresident Alien Income Tax Return

Form 1040-PR U.S. Self-Employment Tax Return-Puerto Rico

Form 1040-SS U.S. Self-Employment Tax Return (Including the

Additional Child Tax Credit for Bona Fide

Residents of Puerto Rico)

Form 1040-V Payment Voucher

Form 1041 U.S. Income Tax Return for Estates and Trusts

Form 1065 U.S. Return of Partnership Income

Form 1097-BTC Bond Tax Credit

Form 1120 U.S. Corporation Income Tax Return

Form 1120-C U.S. Income Tax Return for Cooperative

Associations

Form 8038 Information Return for Tax-Exempt Private

Activity Bond Issues

Form 8912 Credit to Holders of Tax Credit Bonds

* * * * *

Appendix VI

Glossary of Terms

Automated Underreporter

The Automated Underreporter function matches information return data received from third parties with the income and deductions reported on tax returns and informs taxpayers when discrepancies are found.

Business Master File

The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

Business Return Transaction File

A computer file of transcribed line items on all business returns and their accompanying forms and schedules.

Calendar Year

The 12-consecutive-month period ending on December 31.

Fiscal Year

A 12-consecutive-month period ending on the last day of any month. The Federal Government's fiscal year begins on October 1 and ends on September 30.

Modernized Tax Return Database

The legal repository for original electronically filed tax returns received by the IRS through the Modernized e-File system.

Nonrefundable Credit

A nonrefundable credit can only reduce the tax liability to zero, whereas a refundable credit can reduce a taxpayer's liability to zero and any credit amount over the tax liability can be refunded to the taxpayer.

Private Placement

A private placement is a nonpublic offering of securities, mostly to a small number of chosen investors.

Strippable Credits

The credits on TCBs are "strippable," meaning the credits can be separated from the underlying bond.

Tax-Exempt Bond

A municipal bond with interest payments that are not subject to Federal income tax.

Tax Return Database

The Tax Return Database contains tax return source information for all electronically filed tax returns.

Tax Year

A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

* * * * *

Appendix VII

Management's Response to the Draft Report

May 29, 2013

MEMORANDUM FOR

MICHAEL E. MCKENNEY

ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:

Peggy Bogadi

Commissioner, Wage and Investment Division

SUBJECT:

Draft Audit Report — Vulnerabilities Exist for Improper

or Fraudulent Claims for Bond Tax Credits (Audit # 201210032)

Thank you for the opportunity to review the subject draft report. As noted in the report, legislative changes and the economic downturn have contributed to the diversification of the population of taxpayers claiming benefits associated with Bond Tax credit (BTC). Consequently, those changes have commensurately increased the complexity associated with the administration of BTC attributes. * * * 2 * * *. We will evaluate the compliance risks associated with BTC and determine strategies that may be implemented to mitigate those risks.

Attached are our comments to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Steve Klingel, Director, Reporting Compliance, Wage and Investment Division, at (404) 338-9085.

Attachment

* * * * *

Attachment

RECOMMENDATION 1

* * * 2 * * *.

CORRECTIVE ACTION 1

An analysis of the population of bond tax credits will be completed and the findings will be considered in determining any changes needed to enhance our compliance strategy for detecting improper or fraudulent claims for bond tax credits.

IMPLEMENTATION DATE:

Bond Tax Credit Analysis — December 15, 2013

Evaluation of Compliance Strategy — June 15, 2015

RESPONSIBLE OFFICIALS

Bond Tax Credit Analysis —

Director, Reporting Compliance, Wage and Investment Division

Evaluation of Compliance Strategy —

Director, Examination Policy, Small Business/Self-Employed Division,

and

Director, Planning, Analysis, Inventory and Research, Large Business

and International Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

Published Volume Cap Limit for Tribal Economic Development Bonds.

In Notice 2012-48, 2012-31 I.R.B. 102 (July 30, 2012), the Treasury Department and the IRS provided guidance regarding applications for allocations of the available amount of national bond volume limitation authority (volume cap) for tribal economic development bonds. The Notice provides that, except as otherwise provided in the Notice, for applications filed with the IRS that meet the requirements detailed in the Notice, the IRS will allocate an amount of available volume cap equal to the amount requested in the application on a first-come, first-served basis by order of submission date (as defined in the Notice).

The Notice also provides that no Indian tribal government will receive an allocation of volume cap that would cause the aggregate amount of volume cap allocated to that Indian tribal government pursuant to the Notice (not including certain amounts forfeited as described in the notice) to exceed the Published Volume Cap Limit in effect for the period that includes the submission date. The Published Volume Cap Limit for any period is the greater of (1) 20% of the amount of available volume cap as of the first day of such period (determined as described in the Notice); or (2) $100 million.

The Published Volume Cap Limit for the period commencing August 1, 2013 is $297,605,846 (20% of the amount of available volume cap of $1,488,029,230 determined as described in the Notice).

For purposes of this limitation, an Indian tribal government includes the Indian tribal government, together with any political subdivisions of the Indian tribal government, and any entities controlled by the Indian tribal government. An application that requests an allocation of volume cap in an amount that would cause the Published Volume Cap Limit in effect on the date of submission to be exceeded will be treated as incomplete until the day the applicant supplements the application in a manner that complies with the requirements of the notice and does not cause such limit to be exceeded.

In accordance with the Notice, the IRS plans to publish updated Published Volume Cap Limits on the IRS website at Information for Tax Exempt Bonds.

The full Volume Cap Limit is available at:

http://www.irs.gov/pub/irs-drop/n-12-48.pdf

IRS: Free Online Presentation: Rehired Annuitants.

Date: August 15, 2013

Time: 2 p.m. Eastern Time

Learn About: The payroll tax treatment of a former government employee that returns to work for the same entity may be different than it was prior to their retirement or separation. This presentation will help government employers understand how to comply with the complicated and often misunderstood tax implications of hiring a former employee.

Topics covered

- Overview of Section 218 Agreements
- The roles the IRS, Social Security Administration and the National Conference of State Social Security Administrators have in determining the employment tax classification of a rehired annuitant
- Guidelines and examples on how to approach different rehired annuitant scenarios.
- How to seek assistance

Click here to register for this event:
https://events.na.collabserv.com/portal/wippages/register.php?id=7f4fdef683&l=en-US

Please register as soon as possible because space is limited.

Group Suggests Bond Project for 2013-2014 Priority Guidance List.

Michael Deane of the National Association of Water Companies has asked Treasury and the IRS to include on the 2013-2014 priority guidance list (Notice 2013-22) guidance on the rules relating to remedial actions for tax-exempt bonds under reg. section 1.141-12, asserting that the defeasance requirement imposes a major burden on issuers seeking to take advantage of public-private partnerships.

July 19, 2013

Internal Revenue Service

Attn: CC:PA:LPD:PR (Notice 2013-22)

Room 5203

P.O. Box 7604

Ben Franklin Station

Washington, DC 20044

Mark J. Mazur

Assistant Secretary (Tax Policy)

Department of the Treasury

1500 Pennsylvania Avenue, N.W.

Washington, D.C. 20220

Subject: Request for priority guidance under Notice 2013-22

Ladies and gentlemen:

This is to request that the Treasury Department and IRS provide guidance as described below on the rules related to remedial actions for tax-exempt bonds under section 1.141-12 of the Treasury Regulations. We also request that you include this issue in the 2013-2014 Guidance Priority List.

The remedial action requirements apply when an issuer of outstanding tax-exempt bonds takes an action that causes the bonds to no longer satisfy the private activity bond restrictions under section 141 of the Code. For example, a city or county may arrange for a private-sector business to assume the ownership or management of public facilities that were financed with tax-exempt bonds and that are used to provide services to residents. Such arrangements — often termed public-private partnerships (PPPs) — let public bodies tap into the expertise, experience, and efficiency of the private sector. Where the public facilities were financed with tax-exempt debt previously issued by the public body, Treasury regulations require that one of three remedial actions be taken in connection with the transfer of the facilities to the private sector to avoid triggering tax on the bond interest for the holders of those bonds.

In a letter last year (attached) to then-Acting Assistant Secretary of the Treasury for Tax Policy Emily McMahon, we outlined reasons why the existing remedial alternatives are inadequate. In particular, we explained that the first alternative — defeasance — is impractical and extremely costly in the current interest-rate environment. To defease bonds bearing an interest rate of, for example, five percent, requires capital outlays far exceeding the face amount of the bonds. A second alternative — a deemed reissuance of the bonds — requires the state to apply its annual volume cap to the reissuance in the case of water and wastewater treatment facilities. This requirement makes the deemed reissuance impractical. The third alternative is for the public body to agree to use the proceeds from the disposition of the public facilities for governmental purposes (i.e., for purposes that do not cause the bonds to be considered private activity bonds). The precise application of this rule to long-term concession arrangements is unclear in the regulations.

We believe the IRS and Treasury have multiple options for modifying one or more of the remedial action rules to reduce hindrances to public-private partnerships due to outstanding tax-exempt bonds. Perhaps the simplest approach would be for the IRS and Treasury to clarify that an issuer’s expenditure of lease payments, or ongoing payments under a concession arrangement, for governmental purposes satisfies the remedial action rules for alternative uses of disposition proceeds. This change would clarify that leases and concession arrangements are eligible for the same remedial action relief as outright sales of facilities. Under the existing regulations, the issuer must reasonably expect to expend the disposition proceeds for governmental purposes within two years of the disposition. Where the issuer receives the proceeds from a lease or concession arrangement over time, rather than up front, the policy behind the existing requirement should logically be considered as satisfied if the issuer were required to expend those proceeds within a time certain following their receipt. We are not aware of a policy basis for a different result.

An alternative approach for the IRS and Treasury to take would be to waive the defeasance requirement where the concessionaire does not receive the benefit of the tax-exempt bonds through an assumption of the debt service. A third approach would be for the IRS and Treasury to waive the requirement that the state allocate volume cap to the bonds at the time of the concession arrangement.

As you know, the President has proposed removing the issuances of tax-exempt bonds for water infrastructure from state private activity bond volume caps. That proposal reflects a policy decision to promote PPPs for development of water infrastructure. The President's budget contains a number of other proposals that would foster PPPs. Any regulatory adjustments by the IRS and Treasury that remove hindrances to the use of such partnerships in cases where there is outstanding tax-exempt debt would be fully consistent with the President's proposals.

Under current economic conditions it is clear that the defeasance requirement imposes a major burden on issuers that desire to take advantage of public-private partnerships. That burden, together with the administration policy favoring expanded use of such partnerships, should satisfy the requirements of Notice 2013-22 for inclusion of this issue on the 2013-2014 Guidance Priority List. We are confident the IRS and Treasury can eliminate or reduce the burden through clarifications in the regulatory requirements for remedial actions.

We appreciate your attention to this matter. Please let us know if you have any questions about this.

Sincerely,

Michael Deane

National Association of Water

Companies

Washington, DC

IRS EO Update.

1. IRS Pub. 5093 provides a list of online ACA health care resources

This electronic flyer provides a list of online Affordable Care Act resources provided by various federal agencies.

http://www.irs.gov/pub/irs-pdf/p5093.pdf

2. Upcoming IRS phone forums cover important topics

Learn about upcoming forums including:

- August 21 – 501(c)(7) Social Clubs: What They Need to Know to Maintain Their Tax-Exempt Status
- September 10 – Exempt Organizations and Employment Taxes
- September 18 – Stay Exempt: A Guide for Charitable Organizations with Changing Leadership

http://www.irs.gov/Charities-&-Non-Profits/Phone-Forums-Exempt-Organizations

3. Register for EO workshops

Register for upcoming workshops for small and medium-sized 501(c)(3) organizations:

August 13 – Highland Heights, KY

Hosted by University of Kentucky

August 15 – Lexington, KY

Hosted by University of Kentucky

August 20-21 – San Francisco, CA

Hosted by Golden Gate University

August 28-29 – Anaheim, CA

Hosted by Trinity Law School

September 9 – St. Paul, MN

Hosted by Hamline University

September 10 – Minneapolis, MN

Hosted by University of St. Thomas

http://www.irs.gov/Charities-&-Non-Profits/Upcoming-Workshops-for-Small-and-Medium-Sized-501(c)(3)-Organizations

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Mortgage, Credit Card, and Utility Payments Were Income to Minister.

The Tax Court, stating that an accuracy-related penalty may apply, held that mortgage, credit card, and utility payments a minister received for services were unreported self-employment income, finding that he failed to show that the mortgage payments were excluded under section 107 or that he was exempt from self-employment income tax.

Citations: Donald L. Rogers et ux. v. Commissioner; T.C. Memo. 2013-177; No. 13138-11

DONALD L. ROGERS AND VYON M. ROGERS,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

UNITED STATES TAX COURT

Filed August 1, 2013

Scott W. Gross, for petitioners.

Frederic J. Fernandez and Mark J. Miller, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

PARIS, Judge: On March 7, 2011, respondent issued to petitioners a notice of deficiency for tax year 2007 determining a deficiency in Federal income tax of [*2] $29,479 and an accuracy-related penalty under section 6662(a)1 of $5,895.80. Petitioners seek redetermination of the deficiency and the penalty.

On November 5, 2012, the parties submitted a joint stipulation of settled issues reflecting the resolution of a number of issues with respect to petitioners' 2007 tax year. The remaining issues for decision are:

(1) whether petitioners failed to report income of $43,2002 related to Mr. Rogers' services as a pastor for tax year 2007; and

(2) whether petitioners are liable for the accuracy-related penalty imposed under section 6662(a) for tax year 2007.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The proposed stipulations deemed admitted under Rule 91(f) on October 26, 2012, the stipulation of facts filed and supplemented on November 6, 2012, and the associated exhibits received in evidence are incorporated herein by this reference. Petitioners resided in Wisconsin when the petition was filed.

[*3] Petitioner Donald Rogers is a pastor at the Pentecostals of Wisconsin (PoW). He was formerly employed in the fields of sales and marketing but has been involved in ministry for over 30 years. Mr. Rogers' duties as a pastor include free home Bible studies, new life classes, men's and women's ministries, marriage outreach, youth outreach, and children's outreach. In return for these services, PoW pays petitioners' personal credit card bills, utility bills, and home mortgage payments.3

Mr. Rogers registered PoW in 1995 as a nonstock corporation in the State of Wisconsin, for which Mr. Rogers was listed as a registered agent. PoW operated in this fashion until 2005, when Mr. Rogers and other members of PoW sought dissolution of the entity in favor of setting up a corporation sole. Mr. Rogers and the other members sought out SACM Management (SACM) to help facilitate the steps necessary to complete the conversion to a corporation sole.

On February 1, 2005, Mr. Rogers signed a document entitled "Vow of Poverty, Statement of Faith" detailing that any donation/honorarium, and/or and endowment given to Mr. Rogers personally will be considered the property of [*4] PoW, and that PoW will in turn provide for Mr. Rogers' needs. The document further states that

[Mr. Rogers] further understands that any honorarium, donation, and/or endowment received by * * * [him] when performing ministerial duties among any other membership of the ecclesiastical church body or among the public that is required by the church is not mine personally, but is actually that of * * * [PoW] and will be turned over to same. * * * Even though * * * [Mr. Rogers] has taken this vow of poverty, * * * [he] further understands that any income/wages * * * [he] would received outside of * * * [PoW] that is not done on behalf of, or is not required by church ministry, is considered a third party and will be considered income to * * * [him] and is taxable.

On February 22, 2005, an entity registered as "The Office of Presding [sic] Pastor Donald L. Rogers and his successors, a Corporation Sole" was created in the State of Nevada. On April 14, 2005, PoW

filed articles of dissolution in the State of Wisconsin. Despite the corporation sole's having been set up as a Nevada entity with a Nevada address, PoW continued to operate in the Milwaukee, Wisconsin, area.

In tax year 2007 various amounts were paid on petitioners' behalf by PoW in return for Mr. Rogers' ministerial services. PoW made $30,612 of home mortgage payments, $8,268 in personal credit card payments, and $4,320 of utility payments on petitioners' behalf for a total of $43,200. Petitioners timely filed a joint Federal income tax return for tax year 2007 by April 15, 2008. On their [*5] return, petitioners reported wage income from Victory Christian Academy of $53,770. Petitioners also reported itemized deductions for home mortgage interest and charitable contributions of $17,965 and $10,820, respectively. Petitioners did not report any income from amounts PoW paid on their behalf, nor did they file a timely certificate of exemption from self-employment tax in accordance with section 1402(e).

On March 7, 2011, respondent issued to petitioners a notice of deficiency for tax year 2007, determining a deficiency of $29,479 and an accuracy-related penalty under section 6662(a) of $5,895.80. This determination reflected, in part, respondent's finding that petitioners failed to report $43,200 of taxable income4 for amounts PoW paid on their behalf for tax year 2007.5 On June 3, 2011, petitioners timely filed a petition in this Court for redetermination.

[*6] OPINION

I. Unreported Income

Section 61(a) defines gross income as "all income from whatever source derived", including compensation for services. This definition includes all accessions to wealth, clearly realized, and over which the taxpayers have complete dominion. Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955).

Section 1401 imposes a tax on an individual's self-employment income, which is defined as the "net earnings from self-employment" derived by an individual during a taxable year. Sec. 1402(b). "Net earnings from self-employment" is the gross income derived by an individual from any trade or business carried on by that individual less the deductions attributable to that trade or business. Sec. 1402(a). Pursuant to section 1402(c)(4), a "duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry" is engaged in carrying on a trade or business unless the minister is exempt from self-employment tax pursuant to section 1402(e). Unless an exemption certificate is timely filed, the minister is liable for self-employment tax on income derived from the ministry.6 Sec. 1402(e)(3). The time limitation imposed by section 1402(e)(3) [*7] is mandatory and is to be complied with strictly. Wingo v. Commissioner, 89 T.C. 922, 930 (1987); Bennett v. Commissioner, T.C. Memo. 2007-355; sec. 1.1402(e)-3A, Income Tax Regs. Petitioners did not file a timely application for exemption from self-employment tax for tax year 2007. Petitioners therefore do not qualify for an exemption from self-employment tax for amounts PoW paid on their behalf.

Section 107 provides that gross income does not include, in the case of a minister of the gospel, "the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home". In order for a minister to be eligible for this exclusion, the following requirements must be met: (1) the home or rental allowance must be provided as remuneration for services which are ordinarily the duties of a minister of the gospel; (2) before the payment of this rental allowance, the employing church or other qualified organization must designate the rental allowance pursuant to official action, which may be evidenced in an employment contract or by any other appropriate instrument; and (3) the designation must be sufficient in that it clearly identifies the portion of the minister's salary that is the rental allowance. Sec. 1.107-1(a) and (b), Income Tax Regs.

[*8] There is no evidence that a rental allowance was designated in an official action between PoW and petitioners. In fact, Mr. Rogers testified at trial that PoW never considered the mortgage payments made on petitioners' behalf to be parsonage allowances. Accordingly, petitioners are not entitled to exclude mortgage payments PoW made on their behalf as a parsonage allowance under section 107.

Petitioners failed to avail themselves of either the exemption from self-employment tax under section 1402(e) or the exclusion for rental allowance under section 107. Instead, petitioners' primary contention at this point is that Mr. Rogers' vow of poverty insulated them from being taxed on the compensation they received for Mr. Rogers' services to PoW.

Petitioners point to several cases and a revenue ruling issued by the Commissioner to illustrate that while members of religious orders who have taken a vow of poverty are subject to tax for income received in their individual capacities, they are not subject to tax on income received by them merely as agents of the orders of which they are members. See Schuster v. Commissioner, 800 F.2d 672, 677 (7th Cir. 1986), aff'g 84 T.C. 764 (1985); Fogarty v. United States, 780 F.2d 1005, 1012 (Fed. Cir. 1986); McEneany v. Commissioner, T.C. Memo. 1986413; Rev. Rul. 77-290, 1977-2 C.B. 26. However, petitioners' reliance on these [*9] authorities is misguided. In each of these cases, the taxpayer was paid a salary by a third party and remitted this salary to the religious order by assignment in accordance with the vow of poverty.

Here, petitioners did not receive a salary from a third party and did not remit any income to PoW by assignment. Mr. Rogers provided services to PoW and received compensation for those services in the form of payments PoW made on petitioners' behalf. The critical difference is that, in this case, there was no income transferred to PoW from petitioners pursuant to their vow of poverty. The mortgage payments PoW made were applied toward a house owned solely by petitioners and titled in petitioners' names. Similarly, the credit card payments and utility payments PoW made on behalf of petitioners served only to benefit petitioners in meeting their basic living expenses. It would be a mischaracterization of the facts to state that petitioners were paid a "salary" as agents of PoW and that this salary was assigned for the benefit of PoW when, in fact, no such salary was paid and all income issued to petitioners was used solely for their benefit. Accordingly, the authorities cited by petitioners are inapplicable in this particular case.

PoW paid $43,200 on petitioners' behalf for tax year 2007, consisting of $30,612 in home mortgage payments, $8,268 in credit card payments, and $4,320 [*10] in utility payments. Petitioners failed to show that they were entitled to an exemption from self-employment tax for these amounts under section 1402(e). Petitioners likewise failed to show that they were entitled to exclude mortgage payments PoW made on their behalf as a parsonage allowance under section 107. Accordingly, respondent's determination that petitioners received $43,200 of unreported self-employment income for tax year 2007 is sustained.

II. Section 6662(a) Accuracy-Related Penalty

Section 6662(a) and (b)(2) imposes an accuracy-related penalty equal to 20% of an underpayment attributable to any substantial understatement of income tax. Under section 7491(c), the Commissioner has the burden of production to show that the imposition of a penalty under section 6662(a) is appropriate. However, this does not mean the Commissioner bears the burden of proof with regard to penalties, only that the Commissioner "must come forward with sufficient evidence indicating that it is appropriate to impose the relevant penalty." Higbee v. Commissioner, 116 T.C. 438, 446-447 (2001). Further, the Commissioner does not have the burden to introduce evidence regarding reasonable cause or substantial authority. Id.

Section 6662(d) defines a "substantial understatement" of income tax as one which exceeds the greater of: (1) 10% of the amount of tax required to be shown [*11] on the return; or (2) $5,000. In a case such as this where the return shows a zero tax liability, the understatement and the amount of tax required to be shown on the return are the same. Accordingly, the understatement of income tax will be "substantial" only if the amount of tax required to be shown on the return exceeds $5,000.

No penalty will be imposed under section 6662(a) if the taxpayer establishes that he acted with reasonable cause and in good faith. Sec. 6664(c)(1). Circumstances that indicate reasonable cause and good faith include reliance on the advice of a tax professional or an honest misunderstanding of the law that is reasonable in light of all the facts and circumstances. Sec. 1.6664-4(b), Income Tax Regs. The taxpayer has the burden of proving that he acted with reasonable cause and in good faith. Rule 142(a); Higbee v. Commissioner, 116 T.C. at 446-447. Regulations promulgated under section 6664(c) further provide that the determination of reasonable cause and good faith "is made on a case-by-case basis, taking into account all pertinent facts and circumstances." Sec. 1.6664-4(b)(1), Income Tax Regs.

It may be argued that petitioners acted with reasonable cause and in good faith when they relied on advice from SACM to set up a corporation sole structure for PoW. However, Mr. Rogers testified at trial that he and the members of PoW [*12] had done the research over a number of years and decided to convert PoW to the corporation sole structure. He further testified that they sought SACM's advice merely to effect the organization of PoW as a corporation sole. It is clear that the members of PoW chose to convert PoW into a corporation sole and that any reliance on SACM was in the execution of that decision. Accordingly, petitioners did not rely on a tax professional such that the reliance would constitute reasonable cause under section 6664(c)(1).

Alternatively, it may be argued that petitioners made a reasonable and honest mistake of law that using the corporation sole structure in conjunction with their vow of poverty would exempt them from tax on amounts PoW paid on their behalf. In actuality, restructuring PoW as a corporation sole on its own did nothing to shield petitioners from tax on the amounts paid on their behalf. Petitioners' understanding of the pertinent law seems to be that the vow of poverty protects them from income tax in all circumstances, particularly when the religious entity is set up as a corporation sole. Petitioners mistook the body of law surrounding the vow of poverty to apply to their circumstances. As explained above, it does not. Petitioners' failure to avail themselves of the established exemption under section 1402(e) in favor of the tenuous corporation sole theory [*13] they espoused was not a reasonable mistake of law given all the facts and circumstances.

Petitioners have failed to present a colorable argument that they acted with reasonable cause and in good faith in filing a tax return reflecting zero income tax due for tax year 2007. Accordingly, if the final computations under Rule 155 reflect an understatement of income tax exceeding $5,000 for tax year 2007, petitioners will be liable for the accuracy-related penalty under section 6662(a).

Respondent alternatively asserts that if the understatement of income tax for tax year 2007 does not exceed $5,000, petitioners should still be liable for the accuracy-related penalty under section 6662(b)(1) because they acted with negligence or disregard of rules or regulations. Negligence is defined as a lack of due care or failure to do what a reasonable and ordinarily prudent person would do under the circumstances. Neely v. Commissioner, 85 T.C. 934, 947 (1985); sec. 1.6662-3(b)(1), Income Tax Regs. While the Court finds that petitioners' mistake of law in this instance was not reasonable for the purposes of establishing reasonable cause, the Court will not go so far as to say that petitioners acted with negligence or disregard of rules and regulations in the preparation of their 2007 return. Accordingly, if petitioners' understatement of income tax for tax year 2007 does not exceed $5,000 (i.e., it is not a "substantial" understatement), [*14] petitioners will not be liable for the accuracy-related penalty for an underpayment of tax attributable to negligence under section

6662(b)(1).

The Court has considered all of the arguments made by the parties and, to the extent they are not addressed herein, they are considered unnecessary, moot, irrelevant, or without merit.

To reflect the foregoing,

Decision will be entered under Rule 155.

FOOTNOTES

1 Unless otherwise indicated, section references are to the Internal Revenue Code in effect for the year in issue, and Rule references are to the Tax Court Rules of Practice and Procedure.

2 This amount consists of $30,612 in home mortgage payments, $8,268 in credit card payments, and $4,320 in utility payments made on behalf of petitioners.

3 The mortgage payments made by PoW on petitioners' behalf were for a house solely owned by petitioners and titled in their names. The house was originally transferred to PoW in 1995 but was transferred back to petitioners in 1997.

4 The notice further determined that this income should be reported as profit or loss from a business and that petitioners were liable for self-employment tax on that income.

5 The remainder of respondent's determinations have been resolved through the stipulation of settled issues lodged by the parties on November 5, 2012, as referenced above.

6 The operative document used to apply for this exemption is Form 4361, Application for Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners.

Comments Requested on Notice for Exempt Organizations.

The IRS has requested comments on Form 990-N, "Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or Form 990-EZ"; comments are due by September 30, 2013.

IRS LTR: Loan Sale Won't Cause State Agency to Be Treated as Taxable Mortgage Pool.

The IRS ruled that a state government agency's proposed sale of certain mortgage loans purchased with tax-exempt bond proceeds won't cause any portion of the agency to be classified as a taxable mortgage pool under section 7701(i).

Citations: LTR 201330008

Index Number: 7701.26-00, 115.03-00

Release Date: 7/26/2013

Date: April 24, 2013

Dear * * *:

This letter responds to a letter dated August 17, 2012, and supplemental correspondence dated September 24, 2012, January 8, 2013, and January 16, 2013, requesting a ruling on behalf of Taxpayer that Taxpayer's proposed sale of certain mortgage loans that it purchased with the proceeds of tax-exempt bonds will not cause any portion of Taxpayer to be classified as a "taxable mortgage pool" (a "TMP") as defined in section 7701(i) of the Internal Revenue Code (the "Code").

FACTS

Taxpayer is a public and official governmental agency of State and a body corporate and politic that was created by State Legislature in Year 1 pursuant to and in accordance with State Law. One of the purposes of Taxpayer is to provide for the housing needs of individuals and families of low and moderate income in State. Taxpayer is governed by a governing board consisting of A public members, appointed by the governor of State. Pursuant to State Law, Taxpayer may issue revenue bonds the debt service of which is payable from, and secured by, the repayments of mortgage loans. Such bonds must be authorized by Taxpayer's governing board and approved by the attorney general of State prior to issuance.

Taxpayer has established its Single Family Mortgage Revenue Bond Program (the "Program") pursuant to State Law for the purpose of assisting in financing the costs of acquisition of residences within the State by first-time homebuyers. Through the Program, Taxpayer finances mortgage loans that meet the requirements imposed by section 143 of the Code, including but not limited to requirements that borrowers be first-time homebuyers and meet specified income limits and that the property financed meet certain purchase price limits.

Funds used by Taxpayer to acquire mortgage loans are derived principally from its sale of bonds that meet all the requirements necessary to be "qualified mortgage bonds" as defined in section 143 and all other requirements for interest on the bonds to be excludable from gross income under section 103. The repayment of the tax-exempt bonds issued by Taxpayer is secured by mortgage loans, cash, and other investments held pursuant to a master indenture structure.

Taxpayer entered into a Single Family Mortgage Revenue Bond Trust Indenture, dated Date 1 (the "Master Indenture"), pursuant to which it issues tax-exempt bonds through a trust (the "Trust"). In connection with each separate "issue" (as defined in section 1.150-1(b) of the Income Tax Regulations) of tax-exempt bonds (each referred to herein as an "Issue"), Taxpayer enters into one or more supplemental indentures (each, a "Supplemental Indenture") that supplements the Master Indenture.

Each Issue is secured by the Trust estate and held by the trustee pursuant to the Master Indenture, as supplemented by any Supplemental Indentures (collectively, the "Indenture"). Taxpayer is the only entity that holds an interest in the Trust estate. The Trust estate generally includes revenues, mortgage loans, investments, and money held in any funds established under the Indenture. However, compliance with the requirements of section 143 and the Code is determined and monitored separately for each Issue. This results in mortgage loans being allocated in whole or in part to the Issue or Issues whose proceeds were used to acquire the mortgage loan. The amount of each separate Issue issued by Taxpayer, as well as the maturities and projected debt-service schedules with respect to debt obligations that comprise each Issue, is determined by reference to

the timing and amount of projected payments on the mortgage loans to be acquired with proceeds of that Issue.

Taxpayer's ownership of mortgage loans held in the Trust estate is most often evidenced by a pass-through certificate representing multiple, identical mortgage loans. Mortgage loans are originated by lenders that have been approved by Taxpayer and have agreed to originate mortgage loans in accordance with the requirements of the Program. The originating lenders are required to sell the mortgage loans made under the Program to the Program's servicer. The servicer purchases qualified mortgage loans on scheduled dates to form loan pools eligible to constitute mortgage backed, pass-through certificates that are guaranteed as to timely payment of principal and interest by the Government National Mortgage Association, Freddie Mac, or Fannie Mae. The trustee for the tax-exempt bonds purchases the mortgage certificates with proceeds of the tax-exempt bonds on behalf of Taxpayer. The mortgage certificates are transferable.

Under the Program, Taxpayer, through its approved lenders, is able to originate mortgage loans to first-time homebuyers with low and moderate incomes that might not otherwise be able to obtain affordable financing. The purposes of the Program, the issuance of the tax-exempt bonds, and the purchase of the mortgage loans, is to address the housing needs of the State's low and moderate income residents. Assuming a continuation of the market conditions on the date of issuance of an Issue of tax-exempt bonds, Taxpayer generally expects that it will retain ownership of the mortgage loans until those loans are fully repaid or prepaid. However, the Indenture does permit Taxpayer to sell mortgage loans without any modification or alteration of the tax-exempt bonds or the Indenture.

Current market conditions have resulted in the fair market value of certain of Taxpayer's mortgage loans exceeding their amortized principal balances by a significant amount. Taxpayer represents that it would benefit Taxpayer to sell certain of its mortgage loans while these market conditions exist and that such sale would permit Taxpayer to use the amounts realized for use in furtherance of the Program and its stated purpose. As such, Taxpayer proposes to sell (the "Proposed Sale") certain mortgage loans with an amortized principal balance, as of Date 2, of approximately B (the "Selected Mortgage Loans"). The majority of each Selected Mortgage Loan is allocated to an Issue of tax-exempt bonds issued by Taxpayer in Year 2 ("Issue 1"), but a portion of each Selected Mortgage Loan is also allocated to an issue of tax-exempt bonds issued by Taxpayer in Year 3 ("Issue 2") and an issue of tax-exempt bonds issued by Taxpayer in year 4 ("Issue 3") (all such bond issues, collectively, "debt obligations").

The tax-exempt bonds comprising Issue 1 have more than one maturity and all of the Issue 1 bonds that remain outstanding are currently callable at the option of Taxpayer. The tax-exempt bonds comprising Issue 2 have more than one maturity and none of those bonds outstanding are subject to optional redemption until Date 3. However, the Supplemental Indenture for Issue 2 does provide that the bonds of such Issue are subject to special redemption from mortgage loan prepayments. The tax-exempt bonds comprising Issue 3 were issued as variable-rate bonds, all of which have a single maturity date and are subject to optional redemption on any business day.

The buyer of the Selected Mortgage Loans in the Proposed Sale will be selected pursuant to a competitive bid process conducted by Taxpayer's financial advisor. Documentation of the transfer of the Selected Mortgage Loans will be accomplished by a transfer of the mortgage certificates evidencing ownership of the Selected Mortgage Loans. Homeowners whose mortgage loans are included among the Selected Mortgage Loans will be unaffected by the Proposed Sale. Additionally, the Proposed Sale will not affect the legal rights of the holders of any tax-exempt bonds issued by Taxpayer related to the Selected Mortgage Loans or such holders' expectation of repayment in full of their tax-exempt bonds; Taxpayer will remain obligated on its debt obligations.

Upon receipt of the proceeds of the Proposed Sale, Taxpayer intends to allocate the proceeds to accounts established under the Supplemental Indenture for each of the three Issues in an amount proportionate to each of the three Issues' participation percentage in the Selected Mortgage Loans. Taxpayer expects to use the proceeds from the Proposed Sale allocated to each of the three Issues as follows:

(1) The mortgage sale proceeds allocated to Issue 1 will be used to retire immediately (subject to any notice requirements) all bonds of Issue 1 that remain outstanding. Any amounts remaining after redemption of Issue 1 will be used to support Taxpayer's programs, including the origination of additional mortgage loans to low and moderate income first-time homebuyers in furtherance of its governmental purpose.

(2) The mortgage sale proceeds allocated to Issue 2 will be invested in nonpurpose investments the yield on which is not materially higher than the yield on Issue 2 and used to (a) effect prepayment redemptions, and (b) to the extent amounts are remaining on Date 3, call a portion of Issue 2 on such date.

(3) The mortgage sale proceeds allocated to Issue 3 will be used to retire immediately (subject to any notice requirements) a portion of Issue 3 and to pay any fees associated with a change in the notional amount of an interest rate swap entered into in connection with Issue 3.

Any amounts not used to redeem bondholders will be held by the Trust. Taxpayer represents that it will use all proceeds from the Proposed Sale in compliance with the rules of sections 143 and 148 and any other relevant section of the Code in order to maintain the tax-exempt status of Issues 1, 2, and 3 under section 103.

LAW AND ANALYSIS

Section 7701(i)(1) provides that a TMP shall be treated as a separate corporation which may not be treated as an includible corporation with any other corporation for purposes of section 1501.

Section 7701(i)(2)(A) provides that in general, a TMP is any entity (other than a REMIC) if (i) substantially all of the assets of such entity consists of debt obligations (or interests therein) and more than 50 percent of such debt obligations (or interests) consists of real estate mortgages (or interests therein), (ii) such entity is the obligor under debt obligations with 2 or more maturities, and (iii) under the terms of the debt obligations referred to in clause (ii) (or underlying arrangement), payments on such debt obligations bear a relationship to payments on the debt obligations (or interests) referred to in clause (i).

Section 7701(i)(2)(B) provides that any portion of an entity which meets the definition of subparagraph (A) shall be treated as a TMP.

Section 301.7701(i)-4(a)(1) of the Procedure and Administration Regulations (the "Regulations") excludes certain governmental bond programs from TMP treatment. It provides that regardless of whether an entity satisfies any of the requirements of section 7701(i)(2)(A), an entity is not classified as a TMP if (i) the entity is a State, territory, a possession of the United States, the District of Columbia, or any political subdivision thereof (within the meaning of section 1.103-1(b) of this chapter), or is empowered to issue obligations on behalf of one of the foregoing; (ii) the entity issues the debt obligations in the performance of a governmental purpose; and (iii) the entity holds the remaining interests in all assets that support those debt obligations until the debt obligations issued by the entity are retired.

Section 301.7701(i)-4(a)(2) provides that the term "governmental purpose" means an essential governmental function within the meaning of section 115 and does not include the mere packaging of debt obligations for resale on the secondary market even if any profits from the sale are used in the performance of an essential governmental function.

Taxpayer is an entity described in section 301.7701(i)-4(a)(1)(i). Thus, in order for the Proposed Sale not to cause any portion of Taxpayer to become treated as a TMP, it must be found that the Proposed Sale is in furtherance of Taxpayer's performance of a governmental purpose and that the Proposed Sale meets the requirements of section 301.7701(i)-4(a)(1)(iii). In order to meet the requirement of "performance of a governmental purpose," the Proposed Sale must satisfy the requirements under section 301.7701(i)-4(a)(2) that the Proposed Sale (1) is in performance of an essential governmental function within the meaning of section 115, and (2) is not the mere packaging of debt obligations for resale in the secondary market. In order to satisfy section 301.7701(i)-(a)(1)(iii), it must be found that the Proposed Sale does not violate the requirement that Taxpayer hold the remaining interests in all assets that support the debt obligations until the debt obligations issued by Taxpayer are retired.

In providing an exclusion from gross income, section 115 requires, among other things, that the income be derived in "the exercise of any essential governmental function."

Rev. Rul. 77-261, 1977-2 C.B. 45, holds, "Income from a fund, established under a written declaration of trust by a State, for the temporary investment of cash balances of the State and its political subdivisions . . . is excludable from gross income. . . ." The ruling reasons that the "investment of positive cash balances . . . in order to receive some yield on the funds until needed to meet expenses is a necessary incident of the power of the State or political subdivision to collect taxes and other revenues for use in meeting governmental expenses." In addressing the meaning of an "essential governmental function" for purposes of section 115, the ruling states, "Congress did not desire in any way to restrict a State's participation in enterprises that might be useful in carrying out those projects desirable from the standpoint of the State government which, on a broad consideration of the question, may be the function of the sovereign to conduct."

In this case, the proceeds of the Proposed Sale will be used by Taxpayer primarily to redeem holders of tax-exempt bonds issued by Taxpayer and to further support Taxpayer's programs, including the origination of additional mortgage loans to low and moderate income first-time homebuyers in furtherance of its governmental purpose. Thus, the Proposed Sale will be in furtherance of Taxpayer's performance of a governmental purpose and satisfies section 301.7701(i)-4(a)(ii).

The Proposed Sale will result in a sale of mortgage loans that currently support Taxpayer's debt obligations; however, the Proposed Sale is a sale of unencumbered mortgage loans and, after the Proposed Sale Taxpayer will remain obligated on its debt obligations. After the Proposed Sale, while the Selected Mortgage Loans will no longer support any of Taxpayer's debt obligations, amounts not used to redeem bonds will be held in the Trust, and Taxpayer will continue to own the entire interest in the pool of mortgages not sold pursuant to the Proposed Sale and other assets that continue to support the debt obligations issued by Taxpayer. Thus, Taxpayer will continue to own the remaining interest in all assets that support Taxpayer's debt obligations, and the Proposed Sale satisfies section 301.7701(i)-4(a)(1)(iii).

CONCLUSION

Based on the information submitted and representations made, we conclude that the Proposed Sale will not cause Taxpayer to fail to satisfy the requirements of section 301.7701(i)-4(a)(1) of the Regulations to be exempt from the TMP rules and, thus, will not cause Taxpayer or any portion of

Taxpayer to be treated as a TMP.

This ruling is limited to the Proposed Sale. This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. No opinion is expressed with regard to whether Taxpayer's Program could meet the requirements of a REMIC under section 860D(a), whether Taxpayer or any portion of Taxpayer would otherwise be a TMP under section 7701(i), whether Taxpayer's Program satisfies either the accrual requirement or the private benefit requirement of section 115, or whether the proposed Sale will cause the bonds financed by the Selected Mortgage Loans to be arbitrage bonds under section 148 or cause the Issue of which such bonds are a part to fail to meet the requirements of section 143(g).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the provisions of a Power of Attorney on file, we are sending a copy of this ruling letter to your authorized representatives.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Diana Imholtz

Branch Chief, Branch 1

(Financial Institutions &

Products)

IRS Grants Extension of Expenditure Period for Qualified School Construction Bond Proceeds.

The IRS granted a state school district an extension of the expenditure period for available project proceeds of qualified school construction bonds on determining that the district's failure to spend its bond proceeds was due to reasonable cause and that the district will spend its remaining proceeds for qualified purposes with due diligence.

Citations: LTR 201330003

Index Number: 54F.00-00

Release Date: 7/26/2013

Date: April 24, 2013

Dear * * *:

This is in response to your request under § 54A(d)(2)(B)(iii) of the Internal Revenue Code for an extension of the expenditure period for the available project proceeds of qualified tax credit bonds.

FACTS AND REPRESENTATIONS

You make the following factual representations. District is a political subdivision of State and provides educational services and facilities for grades kindergarten through 12.

District issued the Bonds on Date 1, and designated the Bonds as qualified school construction bonds within the meaning of § 54F(a)(3). The original three-year expenditure period for the Bonds under § 54A(d)(2)(B)(i) will expire on Date 2 (the "Original Expenditure Period").

All available project proceeds of the Bonds were to be spent on construction costs of the School (the "Project"), and were expected to be spent before Date 2. The Project began on Date 3, or shortly before the Bonds were issued. However, both the subcontractor responsible for the School foundation and the subcontractor responsible for the electrical system defaulted on their contracts and District had to pursue remedies and correct the defective work. As a result of these unexpected delays, District does not expect to complete the School by Date 2. Construction of the School is proceeding, and District expects to spend all available project proceeds not later than Date 4.

District submitted this request for a ruling prior to Date 2.

LAW AND ANALYSIS

Section 54A(d)(1) provides that a qualified school construction bond is treated as a qualified tax credit bond for purposes of Section 54A.

Section 54A(d)(2)(B)(i) provides in part that to the extent that less than 100 percent of the available project proceeds of the issue are expended by the close of the expenditure period for 1 or more qualified purposes, the issuer shall redeem all of the nonqualified bonds within 90 days after the end of such period.

Section 54A(d)(2)(B)(ii) provides that for purposes of this subpart, the term "expenditure period" means, with respect to any issue, the 3-year period beginning on the date of issuance. Such term shall include any extension of such period under clause (iii).

Section 54A(d)(2)(B)(iii) provides that upon submission of a request prior to the expiration of the expenditure period (determined without regard to any extension under this clause), the Secretary may extend such period if the issuer establishes that the failure to expend the proceeds within the original expenditure period is due to reasonable cause and the expenditures for qualified purposes will continue to proceed with due diligence.

Section 54A(d)((2)(C)(iv) provides that for purposes of this paragraph, in the case of a qualified zone academy bond, a "qualified purpose" means a purpose specified in § 54E(a)(1).

Section 54A(e)(4) of the Code defines "available project proceeds" to mean (A) the excess of (i) the proceeds from the sale of an issue, over (ii) the issuance costs financed by the issue (to the extent that such costs do not exceed 2 percent of such proceeds), and (B) the proceeds from any investment of the excess described in subparagraph (A).

The Project was identified prior to the issuance of the Bonds and District reasonably expected to spend all of its allocable available project proceeds within the three-year period. The expected failure to spend all the available project proceeds of the Bonds by the expiration of the three-year

period on Date 2 has been caused by events that were not reasonably expected at the time the Bonds were issued and were beyond the control of District. However, District to the extent possible considering the described unexpected external events that resulted in unforeseen delays, has and will continue to exercise due diligence in spending the remaining available project proceeds on the Project. District expects to spend all available project proceeds not later than Date 4.

CONCLUSION

Under the facts and circumstances of this case, we conclude that District's expected failure to expend the available project proceeds of the Bonds by Date 2 is due to reasonable cause and that District's continued expenditure of the proceeds for qualified purposes will proceed with due diligence. Therefore, City is granted an extension of the Original Expenditure Period with respect to the Bonds until Date 4.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to District's authorized representative.

The ruling contained in this letter is based upon information and representations submitted by District and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the materials submitted in support of the request for a ruling, it is subject to verification upon examination.

Sincerely,

Associate Chief Counsel

(Financial Institutions & Products)

By: Timothy L. Jones

Senior Counsel, Branch 5

Brookings Fellow Recommends Infrastructure Incentives.

To support infrastructure, Congress should expand Build America Bonds to support state and local investments, exempt private activity bonds from the alternative minimum tax, and provide a repatriation holiday to fund a national infrastructure bank, Robert Puentes of the Brookings Institution said at a July 24 Joint Economic Committee hearing.

http://www.jec.senate.gov/republicans/public/?a=Files.Serve&File_id=74829efd-ce22-4e8c-9c03-9d937a52f22a

Tax Policy Center: Quarterly Appraisal of State Economic Conditions.

The inaugural edition of the state economic monitor reviews the health of various aspects of state economies, including employment, housing, state finances, and economic growth. This monitor documents key economic conditions through June 2013 in all 50 states, and also serves as a valuable collection of various state-level economic data. One key finding in this monitor is the remarkable breath of the economic recovery, with all but six states showing gains over the past three months and past year in indices of economic activity.

http://www.taxpolicycenter.org/UploadedPDF/412856-SEM-070913-Q1.pdf

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ABA Members Request Additional Guidance on Accountable Care Organizations.

Rudolph Ramelli of the American Bar Association Section of Taxation and David Douglass of the ABA Health Law Section have responded to a request for comments (Notice 2011-20) on tax-exempt hospitals or other tax-exempt healthcare organizations participating in the Medicare Shared Savings Program (MSSP) through an accountable care organization (ACO).

The tax section and health law section are grateful for the guidance in Notice 2011-20 explaining that a tax-exempt organization that participates in the MSSP through an ACO will not jeopardize its tax-exempt status, will not violate the private inurement or private benefit doctrines, and will not be subject to the unrelated business income tax. However, section members ask that the guidance be formalized in a revenue ruling and have provided an example on which that ruling can be based.

Section members note that Notice 2011-20 focuses primarily on the exempt purpose of lessening the burdens of government, while leaving open the question of whether the promotion of health would qualify as an exempt purpose to support an ACO's tax-exempt status. Members recommend that in general, the promotion of health should be recognized as an exempt purpose for MSSP ACOs as well as non-MSSP ACOs.

Section members also address whether non-MSSP activities will result in private inurement or impermissible private benefit and provide examples of guidelines that can be used to make the determination. Another example is used to illustrate that a tax-exempt organization should not be subject to UBIT when it participates in non-MSSP activities through an ACO joint venture.

Members request guidance confirming that an ACO would qualify for section 501(c)(3) status if it is organized as a nonprofit subsidiary of a tax-exempt organization and is subject to the same safeguards that the IRS has approved for integrated healthcare systems and in other contexts in which ultimate control of an entity resides in the parent's community-controlled board of directors. Lastly, members recommend that a tax-exempt organization that provides services to an ACO in which it participates or which it controls, including project management, actuarial, population management, and clinical care design services, should not be subject to UBIT on payments it receives from the ACO for those services.

IRS Releases Publication on Return Disclosure.

The IRS has released Publication 3373 (rev. Jul. 2013), Disclosure of Information to Federal, State and Local Agencies, outlining the procedures for officers and employees of federal, state, and local agencies to obtain return information from the IRS.

http://www.irs.gov/pub/irs-pdf/p3373.pdf

IRS Spending Bill Would Bar Warrantless E-Mail Searches.

The IRS would be prohibited from accessing private e-mails or other electronic communications without a warrant under a provision added to the agency's annual spending bill July 17.

House Appropriations Committee member Kevin Yoder, R-Kan., added the language as an amendment during the committee's markup of the House's fiscal 2014 financial services and general government spending package . The provision would apply to other departments and agencies under the bill's jurisdiction, including the Treasury Department and the SEC. The amendment was approved by voice vote.

The American Civil Liberties Union in April alleged that the IRS, lacking a definitive policy on taxpayers' e-mail privacy, has permitted its employees to obtain e-mails and other communications stored on Internet service providers' servers without a warrant if the e-mails were more than 180 days old. The ACLU said the IRS's practice was based on "hopelessly outdated" law and could put the agency in violation of the Fourth Amendment.

The spending package would cut IRS funds by 24 percent. A date has not been set for its consideration by the full House.

EO Update: e-news for Charities and Nonprofits - July 19, 2013.

Inside This Issue:

- Upcoming IRS phone forums cover important topics
- Register for EO workshops
- Reminder: Tax credit extension for hiring veterans ends December 31
- Tips for taxpayers who travel for charity work

1. Upcoming IRS phone forums cover important topics

For a list of upcoming phone forums, go to the phone forums section of the Calendar of Events page.
http://www.irs.gov/Charities-&-Non-Profits/Phone-Forums-Exempt-Organizations

"Charities and their Volunteers" – July 24

Go to the registration link to sign up for this encore session.

http://ems.intellor.com/index.cgi?p=204749&t=71&do=register&s=&rID=417&edID=305

“Veterans Organizations – Complying with IRS Rules” — July 30

This phone forum provides information to help veterans organizations stay tax exempt.

Topics include:

- Requirements for exemption
- Recordkeeping
- Filing and reporting
- Unrelated business income tax
- Exempt activities
- Bona fide guests

Click here to register for this event.

http://ems.intellor.com/index.cgi?p=204705&t=71&do=register&s=&rID=417&edID=305

“What’s Special about Schedule K (Form 990)?” – July 31

Topics covered include:

Helpful resources for completion of Schedule K

Detailed discussion of Schedule K information requirements

Helpful compliance monitoring procedures

Space is limited so register quickly.

2. Register for EO workshops

Register for upcoming workshops for small and medium-sized 501(c)(3) organizations:

August 13 – Highland Heights, KY

Hosted by University of Kentucky

August 15 – Lexington, KY

Hosted by University of Kentucky

August 20-21 – San Francisco, CA

Hosted by Golden Gate University

August 28-29 – Anaheim, CA

Hosted by Trinity Law School

September 9 – St. Paul, MN

Hosted by Hamline University

September 10 – Minneapolis, MN

Hosted by University of St. Thomas

http://www.irs.gov/Charities-%26-Non-Profits/Upcoming-Workshops-for-Small-and-Medium-Sized-501(c)(3)-Organizations

3. Reminder: Tax credit extension for hiring veterans ends December 31

Review the following links regarding the Work Opportunity Tax Credit and its extension:

Work Opportunity Tax Credit

http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Work-Opportunity-Tax-Credit-1

Work Opportunity Tax Credit Extended

http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Expanded-Work-Opportunity-Tax-Credit-Available-for-Hiring-Qualified-Veterans

Work Opportunity Tax Credit – frequently asked questions and answers

http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Expanded-Work-Opportunity-Tax-Credit-Available-for-Hiring-Qualified-Veterans

4. Tips for taxpayers who travel for charity work

Do you plan to travel while doing charity work this summer? Some travel expenses may help lower your taxes if you itemize deductions when you file next year. Here are five tax tips the IRS wants you to know about travel while serving a charity.

http://www.irs.gov/uac/Newsroom/Tips-for-Taxpayers-Who-Travel-for-Charity-Work

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IRS Releases FAQ on Governance Section of Exempt Organizations' Annual Return.

The IRS has released a list of frequently asked questions on Part VI of the exempt organization return, which focuses on who is responsible for governing the organization, noting in part that the IRS will use the information to assess noncompliance and the risk of noncompliance for individual organizations and across the broader exempt sector.

Form 990, Part VI — Governance, Management, and Disclosure

Frequently Asked Questions

1. Are all organizations required to complete Part VI and answer all of its questions regarding an organization’s governance structure, policies and practices?

Yes, all organizations that file Form 990 are required to answer all of the questions in Part VI. However, refer to Appendix E of the instructions to the Form 990 for instructions regarding how to complete Part VI in the case of a group return.

2. Are all the policies and practices described in Part VI required by the Internal Revenue Code? If

not, what happens if an organization reports that it does not have such policies in place?

In general, the policies and practices described in Part VI are not required by the Internal Revenue Code. However, organizations are required by the Code to make publicly available some of the items described in Question 18 of Part VI. This includes the Forms 990 of all organizations for their three most recent tax years; the Form 1023 or 1024 of all organizations that filed such forms on or after July 15, 1987, or had a copy on such date; and the Forms 990-T of a section 501(c) (3) organization for its three most recent tax years, if such forms were filed after August 17, 2006. The IRS will use the information reported in Part VI, along with other information reported on the form, to assess noncompliance and the risk of noncompliance with federal tax law for individual organizations and across the broader exempt sector.

3. If an organization adopted a policy or practice after the close of its tax year but before it filed the Form 990 for such year, may it report that it had such policy or practice in place for purposes of answering Part VI?

In most instances, the instructions to the Part VI questions state the specific time or period to be used to answer a particular question. For example, Question 12a asks whether as of the end of the organizations tax year it had a written conflict of interest policy. An organization that did not have a written conflict of interest policy in place on such date must answer no. If that same organization adopted a written policy after the close of the tax year but before it filed its return, it may describe doing so in Schedule O. If the instructions to a particular question do not provide a specific time or period to be used to answer the question, the organization may take into account practices undertaken after the close of the tax year in its response to that question (e.g., Question 12b regarding whether certain persons are required to disclose potential conflicts). Question 10 regarding whether the organization provided a copy of the Form 990 to its governing body before filing the form, and the process (if any) used by the organization to review the form, necessarily involves activity conducted after the close of the tax year.

4. Can our organization answer yes to a question about having a policy if a committee of the board, rather than the board itself, adopted the policy, and was authorized to do so?

Yes. The organization may answer Yes to any question in Section B of Part VI, Form 990, that asks whether the organization has a particular policy if the organization’s governing body (or a committee of the board, if the board delegated authority to that committee to adopt the policy) adopted the policy by the end of its tax year.

5. Part VI asks for information regarding an organization’s members, if any, and any local chapters, branches or affiliates. Why is the IRS concerned about an organization’s members and local units?

Much of Part VI focuses on who is responsible for governing the organization. In most organizations this includes a governing body, such as a board of directors, or trustees. Many organizations, however, also have members, who may be vested with certain governance or financial rights with regard to the organization. Part VI, Questions 6 and 7, ask whether an organization has members, and if so what their governance rights are, in order to provide a more complete and accurate picture about where governance authority is vested and about the organization’s legal structure. Part VI, Question 9 asks about local chapters, branches and affiliates to obtain information about whether and how the organization exercises supervision and control over its chapters, branches, and affiliates to ensure that their activities are consistent with those of the organization. This question is designed to obtain information about the extent to which the filing organization’s policies and practices extend to all of its parts or to affiliated entities.

6. Is an organization required by federal tax law to provide a copy of Form 990 to its board or governing body, or have its board or governing body review the form, before it is filed with the IRS?

No. Nonetheless, it is required to answer Question 10 regarding these matters.

7. Question 1b asks for the number of independent voting members of the governing body. May an organization use its own definition of independence to answer this question?

No, the organization must use the three-part definition contained in the instructions to this question to determine whether a particular voting member of its governing body is independent for purposes of Form 990 reporting. Note that this definition will vary from other meanings of the term independent that may apply to the organization, such as for state law or internal conflict of interest policy purposes.

8. How hard do we have to look for the information requested in Questions 1 and 2 of Form 990, Part VI regarding independent directors and business and family relationships among Board members, officers, and key employees? What if we are unable to obtain and report all the reportable information?

As described in the instructions, the organization need not engage in more than a reasonable effort to obtain the necessary information to answer these questions. An example of a reasonable effort would be for the Form 990 preparer or an officer eligible to sign the Form 990 to distribute a questionnaire annually to each of the organization's officers, directors, trustees and key employees asking for the information that needs to be reported in response to Questions 1 and 2. The questionnaire could include the name, title, date and signature of the person reporting information, and contain the Form 990 Glossary definitions of independent voting member of governing body, family relationship, business relationship and key employee. The organization may rely on information it obtains in response to such a questionnaire in answering Questions 1 and 2.

9. Does the IRS intend to provide model or sample policies (e.g., joint venture policy) that organizations could adopt in order to answer yes to the questions in Part VI regarding such policies or practices?

The IRS does not plan to provide model or sample policies to be used for this purpose. Whether an organization adopts a policy of the type referred to in Part VI of Form 990 is a decision to be made by each individual organization. If an organization decides to adopt such a policy, it should consider its own particular facts and circumstances, including its size, culture, type and structure, in designing and implementing the policy.

10. Must the filing organization provide governance information regarding its related organizations?

In general, no. Part VI is to be completed with respect to the facts and circumstances of the filing organization. Thus, an organization is not required to provide information regarding the composition of the governing body or policies or practices of a related organization, such as a joint venture, for-profit subsidiary, parent, or brother-sister exempt organization.

However, Appendix E provides information regarding how Part VI is to be completed in the case of a group return, Question 1b asks about compensation from transactions with related organizations for purposes of determining a governing board member's independence, and Question 9 asks whether the organization's policies and practices extend to local affiliates.

11. If the filing organization is controlled by an organization with a conflicts of interest policy, whistleblower policy, and document retention and destruction policy, should the filing organization

answer yes or no to Part VI, Questions 12a, 13 and 14?

Because these questions ask whether the filing organization has these policies, answer yes only if the filing organization's governing body has adopted the policies of the controlling organization or other such policies. Otherwise, answer no. The filing organization can explain in Schedule O how it is governed or otherwise affected by the policies of its parent.

12. What are the governance reporting requirements for organizations that file Form 990-EZ?

Form 990-EZ was not revised to include a governance section. However, Question 34 (regarding changes to organizing documents), which was included in the 2007 Form 990-EZ, has been retained.

IRS Releases FAQ on Compensation Section of Exempt Organizations' Annual Return.

The IRS has released a list of frequently asked questions on sections of the exempt organization return that focus on the compensation of officers, directors, trustees, key employees, and independent contractors.

Exempt Organizations Annual Reporting Requirements — Form 990,

Part VII and Schedule J — Compensation Information

The questions below relate to Schedule J (Compensation Information) and Part VII (Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors), Form 990, Return of Organization Exempt From Income Tax.

A. Questions for All Filers

1. Which persons must be listed as officers, directors, trustees, key employees and five highest compensated employees on Part VII of Form 990?

The organization must list all of its current officers, directors and trustees, as those terms are defined in the Glossary in the instructions, regardless of whether any compensation was paid to such individuals. The organization must also list up to 20 current employees who satisfy the definition of key employee (persons with certain responsibilities and reportable compensation greater than $150,000 from the organization and related organizations), and its five current highest compensated employees with reportable compensation greater than $100,000 from the organization and related organizations who are not officers, directors, trustees or key employees of the organization.

Special filing amounts and requirements apply for a former–a person who was an officer, director, trustee, key employee or one of the organization's five highest compensated employees, in one of the five prior reporting years.

TIP: All filing organizations (not just section 501(c)(3) organizations) must list and report compensation paid to the organization's five highest compensated employees with reportable compensation greater than $100,000 from the organization and related organizations, as well as to its five highest compensated independent contractors to which the organization paid more than $100,000 for services. See Part VII and related instructions.

2. Form 990 reporting requirements refer to reportable compensation and other compensation. How does an organization know which types and amounts of compensation are included in each, and where to report these types and amounts on the form?

Reportable compensation generally means compensation reported in Box 5 of the employee's Form W-2, or in Box 7 of a non-employee's Form 1099-MISC. Special rules apply if an employee does not have any amount reported in Box 5 of Form W-2. Other compensation generally means compensation that is not reportable compensation. The instructions to Part VII explain these terms, and also provide a table listing various types of compensation and where to report them in Part VII or in Schedule J. A specific type of other compensation that is less than $10,000 for a given person does not need to be reported in Part VII, except tax-deferred contributions by the employer to a defined contribution retirement plan, the annual increase in the actuarial value of a defined benefit plan, and the value of health benefits not includible in reportable compensation. This $10,000 exception only applies to reporting in Part VII of Form 990; it does not apply to Schedule J.

TIP: As stated above, the $10,000 exclusions for reporting related organization compensation (described in Reporting Compensation Paid by Related Organizations) and certain types of other compensation (described in this Q&A) apply only to Part VII reporting, and are not available for Schedule J reporting. Accordingly, the compensation amounts required to be reported on Schedule J may exceed the amounts required to be reported on Part VII for the same person. Organizations are not required to use the available reporting exclusions for Part VII. Organizations that prefer to report the same total reportable compensation and other compensation amounts in both Part VII and Schedule J for a person listed in Schedule J may do so by reporting otherwise excludible amounts in Part VII.

3. Schedule J, Part VII, contains questions about an organization's executive compensation practices and policies. Are these questions to be answered for all of the persons listed in Form 990, Part VII, or only those persons listed in Schedule J, Part II?

Question 3 of Schedule J, Part I, must be answered with respect to the organization's top management official (e.g., CEO/Executive Director). All other Part I questions are to be answered for all persons listed in the core form Part VII, not just those also required to be listed in Schedule J.

4. The organization uses a fiscal year as its tax year for completing Form 990. May it report executive compensation in Part VII based on its fiscal year, rather than the calendar year amounts reported on Form W-2 or Form 1099?

No. A fiscal year filing organization must report amounts in Form 990, Part VII, as well as any amounts reported in Schedule J, on the calendar year ending with or within the organization's fiscal year. This is the same requirement for organizations filing a Form 990 on a calendar year basis.

TIP: In contrast to the calendar year reporting required in Part VII, an organization filing Form 990 for a fiscal year must report compensation expense amounts in its Statement of Expenses (Part IX of Form 990) based on its fiscal year.

5. How should an organization list in Part VII, Form 990, a person who is a current officer or director for part of the year and a former officer or director for the rest of the year — as a current, former or both? What about persons who are key employees or highest compensated employees for only part of the year?

The filer should list in Part VII, Section A, Form 990, any person who was a current officer or director at any time during the tax year, even if the person is not an officer or director at the end of

the year. All of that person's compensation from the organization should be listed in Part VII, Section A, whether received as a current officer or director, a former officer or director or in another capacity (e.g., independent contractor). A current key employee or highest compensated employee is a person who was a key employee or highest compensated employee for the calendar year ending with or within the organization's tax year, even if he or she is not an employee of the organization at the end of that year. A former officer, director, trustee, key employee or highest compensated employee should be listed in Part VII, Section A, only if such person is not listed in Part VII, Section A, in any other capacity.

6. Under what circumstances must compensation paid by a related organization be reported on Form 990?

For purposes of Form 990, related organization generally means a parent, subsidiary, brother or sister organization under common control, a sponsoring organization of or contributing employer to a voluntary employee beneficiary association (VEBA), or a section 509(a)(3) supporting or supported organization of the filing organization. An organization need not list individuals who are officers, directors, trustees, key employees or the five highest compensated employees of a related organization unless that person also serves in one or more of these capacities with the filing organization. Once a person is required to be listed in Part VII, Section A, however, compensation paid by a related organization to such person generally must be reported in Part VII if it equals or exceeds $10,000 from that organization. The $10,000 exception for amounts paid by a related organization only applies to reporting in Part VII of the core form; it does not apply to Schedule J.

7. The reporting requirements refer to reportable compensation and other compensation. Which types and amounts of compensation are included in each, and where should we report these types and amounts on Form 990?

Reportable compensation generally means compensation reported in Box 5 of the employee's Form W-2, or in Box 7 of a non-employee's Form 1099-MISC. Special rules apply if an employee does not have any amount reported in Box 7 of Form W-2. Other compensation generally means compensation that is not reported on Forms W-2 or 1099. A specific type of other compensation that is less than $10,000 for a given person does not need to be reported in Part VII, except tax-deferred contributions by the employer to a defined contribution retirement plan, the annual increase in the actuarial value of a defined benefit plan, and the value of health benefits not includable in reportable compensation. This $10,000 exception only applies to reporting in Part VII of Form 990; it does not apply to Schedule J.

The instructions to Part VII explain these terms, and also provide a table listing various types of compensation and where to report them in Part VII and in Schedule J.

TIP: As stated above, the $10,000 exclusions for related organization compensation and certain types of other compensation (described above) apply only to Part VII reporting, and are not available for Schedule J reporting. Accordingly, compensation amounts required to be reported on Schedule J may exceed amounts required to be reported on Part VII for the same person. Organizations are not required to use the available reporting exclusions for Part VII. Organizations that prefer to report the same total reportable compensation and other compensation amounts in both Part VII and Schedule J for a person listed in Schedule J may do so by reporting otherwise excludable amounts in Part VII.

8. Form 990, Part VII, Section A instructions say to list persons in a particular order, beginning with trustees or directors, followed by officers, then key employees, then highest compensated employees, then former such persons. Why should these persons be listed in this order?

If a person is a director, trustee or officer of the organization, he or she cannot be listed as a key employee of that organization in Part VII of Form 990. Accordingly, officers, directors or trustees should be listed in Part VII before the organization determines which key employees to list. Likewise, in determining its five highest compensated employees who received more than $100,000 of reportable compensation, the organization is not to consider persons who are already listed in Part VII as officers, directors, trustees or key employees of the organization.

9. Because some of our managers report to the CEO or other executives, they don't have ultimate authority over the organization, so we don't need to report them as key employees on Form 990, right?

The answer depends on whether those employees manage a discrete segment or activity of the organization that represents 10 percent or more of the organization's assets, income, activities or expenses, or whether they have authority to control or determine 10 percent or more of the organization's capital expenditures, operating budget or employee compensation. If so, and if their reportable compensation from the organization and related organizations during the tax year exceeds $150,000, then they must be reported as key employees. If the organization has over 20 employees who meet these tests, then it would only report the top 20 most highly compensated as key employees.

Additional information:

Form 990, Return of Organization Exempt From Income Tax

Form 990 instructions

10. Are all organizations that list individuals in Form 990, Part VII also required to complete Schedule J?

No. An organization is required to complete Schedule J only if it satisfied at least one of three separate requirements:

1. It is required to list any former officer, director, trustee, key employee or highest compensated employee in Part VII, Form 990;

2. The sum of reportable compensation and other compensation paid to any individual listed in Part VII by the filing organization and related organizations exceeds $150,000, or

3. It participated in an arrangement in which compensation was paid by an unrelated organization to at least one of its officers, directors, trustees, key employees or five highest compensated employees for services provided to the filing organization.

The thresholds for completing Schedule J are contained in Questions 3-5 of Part VII, Section A.

TIP: Organizations required to complete Schedule J are not required to list and report compensation for all individuals listed and reported in core form Part VII. They only must list and report in Schedule J, Part II, those individuals who receive compensation for the tax year that exceeds the applicable reporting thresholds described in Questions 3-5 of Part VII, Section A (e.g., $150,000 for current officers, directors, trustees and key employees).

11. Some amounts reported on Form 990 as current year compensation may have also been reported in a prior year's Form 990 or 990-EZ. This could overstate the cumulative compensation reported as paid to the individual. May the organization back out this duplicate amount on the current year's

form?

Part VII core form reporting does not permit amounts to be backed out if they were reported in a prior filing of Form 990; such double reporting may be explained in Schedule O. However, for persons listed in Schedule J, column (F) of that schedule allows for a backing out of duplicate amounts that were included in the current year's reportable compensation amount as well as in a prior year's Form 990 filing. This may occur for compensation deferred in a prior year but paid in the current year. This allows the organization to depict more accurately the cumulative compensation paid to individuals listed on Schedule J.

12. May an organization report base pay at full amount on Form 990, Schedule J, including deferrals to 401(k) and 403(b) plans, rather than separating deferrals from other base pay and reporting them in Schedule J as other reportable compensation?

A table in the core Form 990 Part VII instructions indicates that employee deferrals to 401(k) and 403(b) plans should be reported in other reportable compensation on Schedule J, column (B)(iii). The sum of the amounts reported by the organization for an individual in Schedule J columns (B)(i)-(iii) must equal the total reportable compensation amount (generally the Form W-2 Box 5 amount) for that person. The organization may report the 401(k) or 403(b) employee deferral in either column (B)(i) as base pay, or in column (B)(iii) as other reportable compensation. For instance, if an employee has Box 5 compensation of $200,000, including $5,000 of 401(k) employee deferrals, the organization may report $200,000 in base pay, or $195,000 in base pay and $5,000 in other reportable compensation in Schedule J, column (B).

TIP: Certain pre-tax deductions from Box 5 compensation raise reporting issues not expressly addressed by the instructions. These include pre-tax deductions for certain health insurance premiums, the value of which is not included in Box 5. For example, an employee with base pay of $200,000 before a pre-tax deduction of $5,000 for health insurance premiums might have $195,000 reported in Box 5 of the Form W-2. The organization should report $195,000 in column (B)(i) of Schedule J, and $5,000 in column (D).

13. How do we know whether the compensation we're paying to our officers and key employees is reasonable?

Reasonable compensation is the value that would ordinarily be paid for like services by like enterprises under like circumstances. Reasonableness is determined based on all the facts and circumstances. For more information on reasonable compensation, see Form 990 instructions, Appendix G, Section 4958 Excess Benefit Transactions, and Form 990-EZ instructions, Appendix E, Section 4958 Excess Benefit Transactions.

B. Questions for Political Organizations

1. What does a political organization report in Part VII of Form 990?

Internal Revenue Code section 527 does not require political organizations to be organized with boards of directors, officers and trustees, but if the political organization is organized in this way, it must provide the names, addresses, title, average hours worked and compensation of those officers, directors and trustees, key employees, highest compensated employees and independent contractors.

2. What is a related organization for purposes of reporting compensation paid by related organizations on Form 990?

A related organization is any organization that meets one of the following tests:

Fifty percent or more of the political organization's officers, directors, trustees or key employees are also officers, directors, trustees or key employees of the other organization.

The political organization appoints fifty percent or more of the other organization's officers, directors, trustees or key employees.

Fifty percent or more of the political organization's officers, directors, trustees or key employees are appointed by the other organization.

AICPA Seeks Guidance Limiting Required Disclosure of Exempt Org Returns.

Jeffrey Porter of the American Institute of Certified Public Accountants has suggested that Treasury issue guidance clarifying that the public inspection requirements only apply to items required to be filed under sections 6033 and 6011 to protect sensitive tax information of taxpayers and related parties from tax identity theft and tax fraud.

July 12, 2013

Ms. Emily McMahon

Deputy Assistant Secretary (Tax Policy)

Department of the Treasury

1500 Pennsylvania Avenue, N.W.

3112 MT

Washington, D.C. 20220

Re: Clarification of Public Disclosure Requirements for Exempt Organization Returns

Dear Ms. McMahon:

The American Institute of Certified Public Accountants (AICPA) appreciates the opportunity to provide comments regarding clarification of the public disclosure requirements for returns filed by exempt organizations. These comments were developed by the AICPA Exempt Organizations Taxation Technical Resource Panel, and approved by the AICPA Tax Executive Committee.

The AICPA is the world's largest membership association representing the accounting profession, with nearly 386,000 members in 128 countries and a 125-year heritage of serving the public interest. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We commend the Internal Revenue Service (IRS) and the Department of Treasury ("Treasury") for annually updating forms and instructions of exempt organization returns. However, the AICPA recommends that the IRS and Treasury modify the requirements and add additional instruction

guidance for information to be publicly disclosed on exempt organization returns. Implementation of this recommendation would protect sensitive tax information of the taxpayer and related parties from tax identity theft and tax fraud.

Background

Under Internal Revenue Code (IRC) section 6104(d),1 exempt organizations are required to publicly disclose tax returns filed under sections 6033 and 6011 (in the case of IRC section 501(c)(3) organizations). Section 6033 requires exempt organizations to file the Form 990, Return of Organization Exempt from Income Tax, Form 990EZ, Short Form Return of Organization Exempt From Income Tax, Form 990-N, e-Postcard, or the Form 990PF, Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation. The Form 990-T, Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e)), is required to be filed under section 6011 for certain qualifying exempt organizations. Certain exceptions from public disclosure are provided in section 6104(d)(3), such as the identity of donors.

Exempt organizations are frequently required to file additional tax returns and forms not required by sections 6033 and 6011, and these filings are often transmitted to the IRS when attached to a Form 990 series return or Form 990-T. Examples include the Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations (required under IRC section 6038) and Form 8865, Information Return of U.S. Persons with Respect to Certain Partnerships (required under section 6038B). These additional forms and returns often have sensitive information that is not intended to be included in the public disclosure of the exempt organization tax return filings.

Congress, Treasury, the IRS, and the Treasury Inspector General for Tax Administration have increased their focus on the potential concern for tax identity theft. However, requiring exempt organizations to publicly disclose sensitive information in their additional tax return attachments (e.g., Form 5471 and Form 8865), that are not required by sections 6033 and 6011, creates the potential for tax identity theft and tax fraud as well as potentially placing the employees, officers, and volunteers of an exempt organization at physical risk. We have recommendations, discussed below, to mitigate this risk.

Recommendations

The AICPA recommends that Treasury issue guidance in the form of a Notice or Regulation clarifying the public inspection requirements applicable to Form 990, Return of Organization Exempt from Income Tax, Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation, and Form 990-T, Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e)). Specifically, guidance should be issued clarifying that the public inspection requirements only apply to items required to be filed under Sections 6033 and 6011. This change would reduce the likelihood of incidental release of sensitive information that is included on other additional forms and returns and is not intended to be viewed by the public or potentially abused and misused by third parties.

Additionally, a list of forms that are excluded from the public inspection requirement can be included as part of the instructions to the Form 990 series of returns and Form 990-T. However, merely listing the forms in the instructions (without the Notice or Regulation) is not our preference. We believe the issue is of great importance and a list in the instructions may not be timely updated.

Schedules, attachments, and supporting documents filed with the Form 990-T that are not associated with unrelated business taxable income (UBTI) should not be available for public inspection. The provisions of Notice 2008-49 — Public Inspection of Form 990-T, Exempt

Organization Business Income Tax Return — should be retained, e.g., the requirement to publicly disclose Form 990-T and include any schedules, attachments, and supporting documents that relate to the imposition of tax on the UBTI of the charitable organization.

Both of these recommendations would remediate the risk of tax identity theft, tax fraud, and physical risk to the employees, officers, and volunteers of exempt organizations and other parties, by limiting the disclosure of sensitive information not intended to be publicly disclosed.

Conclusion

We appreciate your consideration of our comments. The AICPA believes that the above recommended revisions limit the disclosure of forms not intended for the public and reduce the risk of misusing sensitive tax information of taxpayers and related parties. If you have any questions regarding this submission, please feel free to contact me at (304) 522-2553 or jporter@portercpa.com; Jeffrey D. Frank, Chair, AICPA Exempt Organizations Taxation Technical Resource Panel, at (317) 656-6921, or jdfrank@deloitte.com; or Amy Wang, AICPA Technical Manager — Taxation, at (202) 434-9264, or awang@aicpa.org.

Respectfully submitted,

Jeffrey A. Porter, CPA

Chair, AICPA Tax Executive

Committee

American Institute of CPAs

Washington, DC

IRS LTR: IRS Denies Tax Exemption to Shareholder Organization.

Citations: LTR 201329024

The IRS denied tax-exempt status to an organization formed to promote shareholders' interests in publicly traded companies, finding that its activities don't improve business conditions along one or more lines of business or of a certain area but rather are services for member convenience.

Person to Contact: * * *

UIL: 501.06-00, 501.36-00

Release Date: 7/19/2013

Date: April 26, 2013

Taxpayer Identification Number: * * *

Tax Period(s) Ended: * * *

Dear * * *:

We considered your appeal of the adverse action proposed by the Director, Exempt Organizations, Rulings and Agreements. This is our final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code (the "Code") section 501(a) as an organization described in section 501(c)(6) of the Code.

Our adverse determination was made for the following reason(s):

You are not described within the purview of section 501(c)(6) of the Code because your purpose, as stated in the Restated Articles of Incorporation, is to restore and then maintain appropriate and effective control of shareholders over the US corporations they own.

Your membership consists of individual investors of equity investment firms who wish to preserve and strengthen their shareholder rights.

You are required to file Federal income tax returns on Forms 1120 for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

Please show your employer identification number on all returns you file and in all correspondence with Internal Revenue Service.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

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

Sincerely Yours,

Karen A. Skinder

Appeals Team Manager

* * * * *

Contact Person: * * *

Identification Number: * * *

Contact Number: * * *

FAX Number: * * *

UIL 501.06-00, 501.36-00

Date: August 2, 2012

Employer Identification Number: * * *

LEGEND:

C = individual

J = business

P = state

u = date

y = year

w = dollar amount

x = dollar amount

y = dollar amount

Dear * * *:

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code ("Code") section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(6). The basis for our conclusion is set forth below.

This letter supersedes our letter dated September 20, 2011

ISSUE

Do you qualify for exemption under section 501(c)(6) of the Code? No, for the reasons stated below.

FACTS

You are a corporation formed on u, and operate pursuant to the laws of the State of P. Your Articles of Incorporation state that your purpose is to restore and then maintain appropriate and effective control of shareholders over the US corporations they own. Your Articles of Incorporation also state that you shall not carry on any activities not permitted to be carried on by a corporation exempt from federal income tax under section 501(c)(6) of the Internal Revenue Code, or the corresponding section of any future federal tax code.

You initially applied for exemption under IRC 501(c)(3), then re-applied under IRC 501(c)(6). You state that you are a chamber of commerce with shareholders of various unrelated corporations as members that seek to improve business conditions for publicly traded US corporations by enhancing the effectiveness with which shareholders contribute to running those corporations. To accomplish this goal, you conduct the following activities:

You organize collective action by shareholders on matters pertinent to effectively running the corporation they own through virtual shareholder meetings, where the organized shareholders pressure public corporations to use remote communications technology in shareholder meetings such as online forums. This work is conducted by your membership — perhaps with leadership by your board or officers — primarily out of their homes. It will consume about * * *% of your time.

You advocate for effective legislation and regulation. Examples of this work include the letters you sent to the SEC in v to comment on proposed regulations on behalf of shareholders. These letters were primarily written by your executive director working out of his office, but many shareholders contributed to and co-signed the letters. This will consume about * * *% of your time.

You organize conferences, media events, rallies or other events that draw attention to critical issues affecting shareholders' ability to effectively run the corporations they own. This work is conducted by your membership — perhaps with leadership by your board or officers — primarily out of their homes. It will consume about * * *% of your time.

You improve shareholders ability to effectively run the corporations they own by helping shareholders engage qualified proxies, agents or board members to represent their interests. While you have facilitated a number of grants of proxies in the past, these efforts will be advanced through implementing social networking software. You have a team of volunteer information technology professionals who will implement that technology. The general membership will also be engaged, with direction from your officers. Work is conducted primarily from members' homes. It will consume about * * *% of your time.

You improve shareholders ability to effectively run the corporations they own by mitigating the risk of frivolous corporate lawsuits against shareholders who exercise their rights or responsibilities as owners of corporations. This work entails securing legal advice for shareholders who are sued by corporations. You have, for example, been assisting shareholder C who was sued by J over a shareholder resolution he submitted for inclusion in that corporation's 2010 proxy materials. You will also form a legal defense trust for shareholders who are victimized by such lawsuits. This work is conducted by your membership — perhaps with leadership by your board or officers — primarily out of their homes. It will consume about * * *% of your time.

Your members are owners of various unrelated publicly traded US corporations who share a common business interest of improving the effectiveness with which the corporations they own are managed. Currently, your members consist solely of your board members. Your membership requirements, duties, and privileges are as follows:

You distinguish members who have not yet reached the age of majority.

You grant full voting rights only to members who have demonstrated commitment to your cause.

You separate classes of membership for shareholders who are natural persons and shareholders that are institutions.

You grant honorary — non-voting — memberships to certain parties, such as academics or service providers who are not shareholders but have knowledge or expertise that could be useful to your organization.

You grant non-honorary membership only to shareholders. Individuals are considered shareholders if they satisfy either the first or both the second and third of the following criteria:

Currently owns at least $* * * in publicly traded US equities, either directly or indirectly, through a mutual fund or other pooled investment vehicle.

Has owned at least $* * * in publicly traded US equities in the past, either directly or indirectly, through a mutual fund or other pooled investment vehicle.

Will very likely own at least $* * * in publicly traded US equities within the next three years, either

directly or indirectly, through a mutual fund or other pooled investment vehicle.

An institution is considered a shareholder if it is an institutional investor that routinely invests * * *% or more of its portfolio in publicly traded US equities, either directly or indirectly, through mutual funds or other pooled investment vehicles.

You have nine classes of members that include:

Nominal individual — an individual of any age who is not a shareholder. This honorary membership provides member benefits but no voting rights.

Junior individual — an individual who is a shareholder but has not yet reached his 18th birthday. This membership provides member benefits but no voting rights.

Associate individual — an adult shareholder who has not been promoted to general member. This membership provides member benefits but limited voting rights on policy issues, as permitted by the board.

General institutional — an associate institutional member can be promoted to general institutional member in recognition of service and commitment to the organization. Provides for full voting rights.

Nominal charitable — Essentially nominal institutional membership but for a 501(c)(3). Membership dues are lower.

Associate charitable — Essentially associate institutional membership but for a 501(c)(3). Membership dues are lower.

General charitable — Essentially general institutional membership but for a 501(c)(3). Membership dues are lower.

Membership dues are:

w dollars a month for all individual memberships

x dollars annually for institutional memberships

y dollars annually for charitable memberships

You have estimated membership to be the following:

Year 1: approximately 20 individual, 2 institutional, 2 charitable

Year 2: approximately 30 individual, 4 institutional, 4 charitable

Year 3: approximately 40 individual, 6 institutional, 6 charitable

LAW

Section 501(c)(6) of the Code provides exemption from federal income tax for “business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.”

Section 1.501(c)(6)-1 of the Income Tax Regulations states, “A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of the kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league.”

In Revenue Ruling. 59-391, 1959-2 C.B. 151, exemption under 501(c)(6) was denied to an organization composed of individuals, firms, associations, and corporations, each representing a different trade, business, occupation, or profession. The organization was created for exchanging information on business prospects and has no common business interest other than a desire to increase sales of members. The revenue ruling found that the members of the instant organization had no common business interest other than a mutual desire to increase their individual sales. It stated that the organization’s activities were not directed to the improvement of business conditions of one or more lines of business, but rather to the promotion of the private interests of its members.

In Revenue Ruling 67-176, 1967-1, CB 140, the organization was formed to advance a given profession, contribute to the welfare and education of students preparing for that profession, to furnish financial aid to that profession in the form of grants and loans and to do other things for the benefit, welfare and security of its members. The ruling found that the emergency loan plan, among other activities served primarily as a convenience and for the economy of the members in providing financial aid, which is found to be the performance of particular services to members as opposed to improving a line of business. Thus, exemption under section 501(c)(6) was not afforded to the organization.

In Revenue Ruling 76-38, 1976-1 C.B. 157, the organization in question was formed to maintain the goodwill and reputation of the credit unions in a particular state. To achieve this goal, they maintained a fund for assistance to credit unions having financial difficulty to keep them solvent so that their members would not lose deposits upon liquidation. They allowed member credit unions to take interest free loans from the fund. The loans were to be repaid only if the borrowers were financially able to do so. The ruling found that the loan activities were not solely calculated to accomplish the objective of improving the industry’s image by protecting depositors. Further, the favorable terms of the loans to members was done in a manner that would provide little or no additional security to depositors and is clearly for the convenience (and economy) of the members in their business and does not constitute an exempt activity under section 501(c)(6).

In MIB, Inc. v. Commissioner, 734 F.2d 71 (1986), an organization whose membership consisted of insurance companies was denied exemption as a business league under section 501(c)(6) of the Internal Revenue Code. The principal activity carried on by MIB was the maintenance and operation of a computerized system for compiling, storing and distributing information about applicants for life insurance. MIB argued that its activities created a deterrent to fraud, which created benefits to the industry through reduced investigation expenses and reduced losses due to misclassification of applicants. The Court held MIB’s activities by their nature consisted of rendering particular services for individual member companies and served to benefit the individual members’ businesses. The Court also stated that even though the services produced various indirect and intangible benefits for the industry as a whole, the fact remained that the rendered services were in form and substance particular services for individual member companies. According to the Court in this case, the ultimate inquiry is whether the association’s activities advance the members’ interests generally, by

virtue of their membership in the industry, or whether they assist members in the pursuit of their individual businesses.

APPLICATION OF THE LAW

You are not described within section 501(c)(6) of the Code as you are not a business league, chamber of commerce, real-estate board, board of trade, or professional football league. You are instead an entity that promotes shareholders' interests in publicly traded corporations.

You are not operated as described in section 1.501(c)(6)-1 of the regulations because your activities are not directed to the improvement of business conditions of one or more lines of business. Rather, your activities provide particular services for individual persons. Additionally, because of the nature of your activities, you do not have a line of business to improve. Your members are individuals and institutions who are in various occupations and business. The only common interest is protecting and improving stockholders' rights. All of your activities consist of promoting the exercise of the rights of shareholders of publicly traded corporations and offering members legal advice. Such programs constitute a particular service to individuals because you vote on behalf of the individuals who delegate their rights to you and provide legal advice to the shareholder who are in litigation with publicly traded corporations.

You state that you are improving the common interest of your member organizations that consist of economic and community development; thus, you qualify for exemption under section 501(c)(6) of the Code. However, there is no common interest since your members own shares of various publicly traded corporations that conduct all kinds of business. There is also no defined geographic area for the improvement of business conditions for a certain area because your members and the stock corporations are all over the world. Like Revenue Ruing 59-391, you are an organization composed of individuals, firms, associations, and corporations, each representing a different trade or business, having no common business interest other than to advocate for shareholder rights. For these reasons you do not meet the qualifications for a 501(c)(6) entity.

The organizations in Revenue Rulings 67-176 and 76-38, above, ran a fund for their members. The rulings conclude that it is the performance of particular services to members as opposed to improving a line of business since it is for the convenience and economy of the members. You are providing a specific service to your members through your programs. You provide direct services to your members for their convenience and economy because your purpose is to maximize members' voice as a shareholder for the company in which the member owns stocks.

In MIB, Inc. v. Commissioner the Court found that even though services produced various indirect and intangible benefits for the industry as a whole, the fact remained that the rendered services were in form and substance particular services for individual member companies. Even if your programs bring some general benefits to the industry under which the companies perform, or benefits to various companies themselves operating under a common line of business, it still holds that programs and services are performed first to benefit your members. In advocating for shareholder rights you are benefitting members specifically, not generally, in pursuing their own interests. Because of this any indirect benefit to the industry does not overcome your main purpose of providing individualized service to members.

PROTEST FROM APPLICANT

You protested our initial adverse ruling in that first, certain facts were not accurate and second, you disagreed with the application of relevant law.

Regarding bullet point five, above, Facts section, you have indicated that you have not and will not provide legal services. Rather, you have petitioned for and prepared amicus curiae briefings, in this instance, regarding the case against C. You were not representing C, but were instead submitting protest to a position you felt could harm you or any U.S. shareholders. Any benefit received on the part of C was incidental and not intentional. You have filed no other briefs, but will do so in the future if the need arises. You have also canceled any attempt at forming any form of legal defense fund.

Regarding our positions stated in the Application of Law section, you disagree with the statement that you do not improve any line of business. The line of business you improve is that of equity finance of corporations and for investment by equity shareholders. You have cited the case of Associated Industries of Cleveland v. Commissioner, 7 TC 1449 (1946) in arguing your members share a common business interest. Petitioner in this case was an association of persons, firms and corporations with offices in Cleveland, OH, meeting to consider labor problems and difficulties confronting industry in that city following the first World War. Petitioner was a business league; members cooperated to employ labor under circumstances deemed advantageous.

You disagree with the position that your activities are not improving business conditions but are instead providing particular services to members. Your efforts are devoted towards communication among shareholders, and facilitating this communication is not a service to members but improves business conditions.

You disagree with the position that you have no defined geographic area in improving business. You focus exclusively on improving business conditions for equity investment in U.S. corporations.

You cited three other entities, all of which are exempt under 501(c)(6), and indicated similar goals and agendas, missions and operations.

SERVICE RESPONSE TO PROTEST FROM APPLICANT

Removing the activity of securing legal advice for shareholders does not change the primary reason for which you are formed, as this made up only * * *% of your total activities. The submission of briefs, which may serve to benefit your position or that of other shareholders, still serves no common business interest nor improves any particular line of business. The changing of this initial fact does not alter the position on our ruling.

You are different from the organization in Associated Industries in that you are advocating for all shareholders across the U.S, rather than employers in a particular city, and your members are individuals who hold stock in any company whereas the members of the organization in Associated Industries were workers and owners of businesses in one geographic area.

While you are improving communication among shareholders, this in and of itself improves no particular business conditions. It serves as a service to your members allowing them to share responsibility in serving proxies, when needed, and acting in place when they are unable to be personally present to protect or represent their interests.

The particular geographic area is not determinate in this particular case. Instead, it is the fact you are composed of individuals, firms, association and corporations, each representing a different trade or business, having no common interest other than to advocate for shareholder rights.

Regarding the entities you referenced currently exempt under 501(c)(6). The qualification of another entity is not a basis for a similar ruling as each application for exemption is determined on its own

merits.

CONCLUSION

Based on the information submitted, your primary purpose is to promote shareholders' interests in publicly traded corporations and provide legal advice to your members. Such activities do not improve business conditions along one or more lines of business or of a certain area but instead are services for the convenience of your members. Therefore, you do not qualify for exemption under IRC 501(c)(6).

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter.

We will consider your statement and decide if that information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, Exempt Organization Appeal Procedures for Unagreed Issues.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. To be represented during the appeal process, you must file a proper power of attorney, Form 2848, Power of Attorney and Declaration of Representative, if you have not already done so. For more information about representation, see Publication 947, Practice Before the IRS and Power of Attorney. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter to you. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service

EO Determinations Quality Assurance

Room 7-008

P.O. Box 2508

Cincinnati, OH 45201

Deliver to:

Internal Revenue Service

EO Determinations Quality Assurance

550 Main Street, Room 7-008

Cincinnati, OH 45202

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Holly O. Paz

Director, Exempt Organizations

Rulings and Agreements

IRS LTR: IRS Revokes Exempt Status of Real Estate Trade Group.

Citations: LTR 201329023

The IRS revoked the tax-exempt status of a trade group that supports the real estate industry, saying it primarily engages in nonexempt activities and performs particular services for members.

Person to Contact/ID Number: * * *

Contact Numbers:

Voice: * * *

Fax: * * *

501-06.00

Release Date: 7/19/2013

Date: January 27, 2012

Taxpayer Identification Number: * * *

Form: * * *

Tax Years Ended: * * *

LEGEND:

ORG = Organization name

XX = Date

Address = address

Dear * * *:

In a determination letter dating from October 19XX, you were held to be exempt from Federal income tax under section 501(c)(6) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(6) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(6) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On September 23, 20XX, you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(6) of the Code.

You are required to file Federal income tax returns for the tax periods shown above. If you have not yet filed these returns, please file them with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted, or unless an examiner’s report for income tax liability was issued to you with other instructions. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

* * *

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Nanette M. Downing

Director, EO Examinations

* * * * *

Person to Contact/ID Number: * * *

Contact Numbers:

Telephone: * * *

Fax: * * *

501-06.00

Date: November 1, 2011

Employer Identification Number: * * *

LEGEND:

ORG = Organization name

XX = Date

Address = address

Dear * * *:

In a determination letter dated March 28, 19XX, you were held to be exempt from Federal income tax under section 501(c)(6) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(6) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(6) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On September 23, 20XX, you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(6) of the Code.

You are therefore required to file Form[s] 1120, U.S. Corporation Tax Return, for the year[s] ended December 31, 20XX, 20XX, and 20XX with the Ogden Service Center. For future periods, you are required to file Form 1120 with the appropriate service center indicated in the instructions for the return.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

* * *

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Nanette M. Downing

Director, EO Examinations

* * * * *

LEGEND:

ORG = Organization name

EIN = ein

XX = Date

State = state

CO-1, CO-2 & CO-3 = 1st, 2nd & 3rd COMPANIES

ISSUES

Whether this exempt organization's (EO) activities permit it to continue to be exempt under § 501(c)(6).

FACTS

ORG (hereinafter, "ORG") was formed with the filing of Articles of Incorporation with the State Corporation Commission on March 28, 19XX.

ORG is a subsidiary of the CO-1 and received its letter of exemption under § 501(c)(6) with an effective date of March 28, 19XX.

The purpose of the organization stated in the original Articles of Incorporation are:

(a) To unite those engaged in the recognized branches of the real estate profession in this community for the purpose of exerting the beneficial influence upon the profession and related interests.

(b) To promote and maintain high standards of conduct in the real estate profession as expressed in the code of Ethics of the CO-2.

(c) To provide a unified medium for real estate owners and those engaged in the real estate profession whereby they may be safe guarded and advanced.

(d) To further the interest of home and other real property ownership.

(e) To unite those engaged in the real estate profession in this community with a CO-1 and the CO-2, thereby furthering their own objectives throughout the state and nation, and obtaining the benefits

and privileges of membership therein.

(f) To designate, for the benefit of the public, those individuals within its jurisdiction authorized to use the term Realtor and Realtor Associates as licensed, prescribed, and controlled by the CO-2.

ORG Articles of incorporation also contains the following:

Article XVIII — Multiple Listing

The CO-3® shall maintain for the use of it Members a Multiple Listing Service which shall be a lawful corporation of the state of STATE, all the stock of which shall be owned by the CO-3®.

Section 2. Purpose. A Multiple Listing Service is a means by which authorized Participants make blanket unilateral offers of compensation to other Participants (acting as subagents, buyer agents, or in other agency or nonagency capacities defined by law); by which disseminated to enable authorized Participants to prepare appraisals, analyses, and other valuations of real property for bona fide clients and customers; by which Participants engaging in real estate appraisal contribute to common databases; and is a facility for the orderly correlation and dissemination of listing information so participants may better serve their clients and the public. Entitlement to compensation is determined by the cooperating broker's performance as a procuring cause of the sale (or lease). Amended 11/XX)

The activity pertinent to this discussion is the level of activities devoted to the multiple listing services (hereinafter, MLS) provided to the members of the Association.

There are six classes of members. Only licensed real estate agents, brokers and realtors can list property for sale on the MLS and see sold information within the database.

ORG maintains a committee on its board that is dedicated to the MLS program. The organization generated more income from the MLS than from it membership dues.

A prior examination of the ORG books and records by the Internal Revenue Service Tax Exempt & Government Entities: Exempt Organization Division in calendar year 20XX resulted in the organization being issued an Advisory Letter. The advisory issued cautioned the organization on the impact of its exempt status with regard to the level of non-exempt activities.

The organization prepared and filed Form 990-T for the tax year ending December 31, 20XX to report all unrelated business income.

The 20XX Form 990-EZ states that the organization's primary purpose is "ORG".

Information from the "EO" 20XX Form 990-EZ:

LAW

In Section 501(c)(6) of the Code, it defines business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

In Section 1.501(c)(6)-1 of the regulations, it provides that a business league is an association of persons having some common business interest the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an

organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization, whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self sustaining, is not a business league.

Section 1.513-1(b) of the regulations provides that the term "trade or business" for purposes of section 513 of the Code has the same meaning it has in section 162 and generally includes any activity carried on for the production of income from the sale of goods or services.

In section 1.513-1(d)(2) of the regulations, in defining unrelated trade or business provides that where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business.

In Rev. Rul. 56-65, it states that a local organization whose principle activity consists of furnishing particular information and specialized individual services to its individual members through publications and other means is performing particular services for individual persons. Such an EO is therefore not entitled to exemption under § 501(c)(6).

Rev. Rul. 68-264 defines a particular service for the purposes of section 501(c)(6) of the Code as an activity that serves as a convenience or economy to the members of the organization in the operation of their own businesses.

In Rev. Rul. 59-234 it states, the purpose of a multiple listing service is:

(a) to assist members of the board in rendering better services to the public by creating a broader and more active market for real estate;

(b) to stimulate and facilitate the transaction of business between members of the board through cooperation and exchange of exclusive listings;

(c) to provide a medium through which real estate may be merchandised more efficiently and expeditiously to the advantage of both buyer and seller and

(d) to encourage realtors to uphold high standards of business practice and to further educate them in adhering to the principles of Realtor's code of Ethics.

Rev Rul. 73-411 states, Trade associations or business leagues under section 501(c)(6) are similar to chambers of commerce, except that they serve only the common business interests of the members of a single line of business or of the members of closely related lines of business within a single industry.

Rev. Rul. 81-175 defines the term "particular services" for the purposes of section 501(c)(6) of the Code, as acting in a manner which provides an economy or a convenience for members in the operation of their own businesses.

In Retailers Credit Ass'n of Alameda County v. Commissioner of Internal Revenue 90 F.2d 47, C.A.9 1937. May 10, 1937, Exemption from petitioner from taxation must be denied on the ground that the purpose to engage in a business of a kind ordinarily carried on for profit is not incidental to a main or principal purpose, but is in fact a principal or main purpose.

In Southern Hardwood Traffic Ass'n v. U.S. 283 F.Supp. 1013 D.C.Tenn. 1968. March 13, 1968, the District Court, Bailey Brown, Chief Judge, held that unincorporated association engaged in regular business of providing, as one of its two main purposes and as substantial part of its total activity, majority of its members with individual services of kind ordinarily carried on for profit was not a 'business league' entitled to tax exempt status.

In Associated Master Barbers and Beauticians of America, Inc., 69 T.C. 53 (1977), the court held that an organization did not qualify as a tax-exempt business league because it both engaged in a regular business of a kind ordinarily carried on for profit and its activities were directed to the performance of particular services for individual members.

In Carolinas Farm & Power Equipment Dealers Ass'n, Inc. v. U.S. 699 F.2d 167, C.A.N.C., 1983. January 24, 1983, we must conclude that the Association's insurance service primarily advances the interests of participating members, and so it is not related to its charitable purpose.

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number of exempt purposes. Better Bus. Bureau v. United States, 326 U. S. 279. 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945); Am. Campaign Acad. v. Commissioner, 92 T.C. 1056, 1065 (19XX).

TAXPAYER'S POSITION

ORG agrees that it is not entitled to exemption under section 501(c)(6) because its primary purpose is the daily operations of the Multiple Listing Services (MLS) in which * * *% of the organization's activities are devoted too.

GOVERNMENT'S POSITION

ORG provides professional development, research, and exchange of information among its members.

ORG's book and records demonstrates the Multiple Listing Services primarily advances the interests of participating members, and so it is not related to its exempt purpose.

In order to qualify for exemption as a business league under Reg. § 1.501(c)(6)-1, an exempt organization must meet all of 6 tests:

(1) Persons having a common business interest

(2) Whose purpose is to promote the common business interest

(3) Not organized for profit

(4) That does not engage in a business ordinarily conducted for profit

(5) Whose activities are directed at improvement of one or more lines of business as distinguished from the performance of particular services

(6) Of the same general class as a chamber of commerce or a board of trade

A review of the ORG books and records indicates the Association fail test 1, 4 and 5 under Reg. § 1.501(c)(6)-1.

ORG fails test (1) — Persons having a common business interest. Rev. Rul. 81-175 defines the term "particular services" for the purposes of section 501(c)(6) of the Code, as acting in a manner which provides an economy or a convenience for members in the operation of their own businesses. A

review of the ORG books and record indicates its primary activity is operating a multiple listing service for its members, which is not a common business interest, but rather providing a convenience to members in the operation of their own businesses and thus performing particular services for members.

ORG fails test (4) — Not being engaged in a business ordinarily carried on for profit. The MLS is a database of homes for sale. Real Estate Agents use the MLS to find homes for buyers that they represent. Listing a home on the MLS notifies all local brokers that the home is for sale. If an agent other than the listing agent sees a listing and brings a buyer, the listing agent must pay the buyer's agent a commission if the buyer accepts the offer. The commission is negotiated on an agent by agent basis. Services to members are an activity ordinarily conducted for profit. These services are of the same character of services provided by Real Estate firms. The membership dues may be construed as being of the same character as that of a professional charging a retainer fee against which future services are applied.

ORG fails test (5) Whose activities are directed at improvement of one or more lines of business as distinguished from the performance of particular services Rev. Rul. 81-175 defines the term "particular services" for the purposes of section 501(c)(6) of the Code, as acting in a manner which provides an economy or a convenience for members in the operation of their own businesses. ORG's primary activity is providing member with a medium through which real estate may be merchandised more efficiently and expeditiously to the advantage of both buyer and seller. Operation of the MLS provides a convenience to members in the operation of their own businesses and thus is performing particular services for the members.

In Better Bus. Bureau v. United States, 326 U. S. 279. 283, 90 L. Ed. 67, 66 S. Ct. 112 (1945) and Am. Campaign Acad. v. Commissioner, 92 T.C. 1056, 1065 (19XX), it is stated that the presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number of exempt purposes. In Associated Master Barbers and Beauticians of America, Inc., 69 T.C. 53 (1977), the court held that an organization did not qualify as a tax-exempt business league because it both engaged in a regular business of a kind ordinarily carried on for profit and its activities were directed to the performance of particular services for individual members.

The primary activity of providing a multiple listing services to members is an activity ordinarily carried on for profit and therefore is nonexempt. The EO's primary activity is one involving providing particular services to individual members in providing member with a medium through which real estate may be merchandised more efficiently and expeditiously to the advantage of both buyer and seller which conflicts with the EO's tax-exempt status.

Rev. Rul. 56-65 states that a local organization whose principle activity consists of furnishing particular information and specialized individual services to its individual members through publications and other means is performing particular services for individual persons. Such an EO is therefore not entitled to exemption under section 501(c)(6). The subject EO's principle activity consists of furnishing particular and specialized individual services to its individual members through response to individual requests for human resource information specific to the individual member; the EO is therefore performing particular services for individual persons.

This organization fails three of the six tests under section 1.501(c)(6)-1 and as a result, is not entitled to remain exempt. The organization engages in primary nonexempt activities involving activities normally conducted for profit and performs particular services for members.

CONCLUSION

Based on the foregoing reasons, ORG does not qualify for exemption under section 501(c)(6) and its tax exempt status should be revoked effective January 1, 20XX.

IRS LTR: Homeowners Association Loses Exemption.

Citations: LTR 201329022

The IRS revoked the tax-exempt status of a homeowners association because its communal property isn't made available to the general public, but the IRS determined that the organization may make an election to be treated as a taxable homeowners association under section 528.

Person to Contact/ID Number: * * *

Contact Numbers:

Phone: * * *

Fax: * * *

501-04.00

Date: July 7, 2012

Taxpayer Identification Number: * * *

Form: * * *

Tax Period(s) Ended: * * *

LEGEND:

ORG = Organization name

XX = Date

Address = address

Dear * * *,

In a determination letter dated June, 19XX, you were held to be exempt from Federal income tax under section 501(c)(4) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(4) of the Code. Accordingly, your exemption from Federal income tax is revoked effective May 1, 20XX. This is a final letter with regard to your exempt status.

We previously provided you a report of examination explaining why we believe revocation of your exempt status was necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On [date] you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(4) of the Code.

You are required to file Federal income tax returns for the tax period(s) shown above. If you have

not yet filed these returns, please file them with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

* * *

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing

Director, EO Examinations

* * * * *

Person to Contact/ID Number: * * *

Contact Numbers:

Telephone: * * *

Fax: * * *

Date: November 15, 2011

Taxpayer Identification Number: * * *

Form: * * *

Tax Period(s) Ended: * * *

LEGEND:

ORG = * * *

ADDRESS = * * *

Dear * * *,

We have enclosed a copy of the preliminary findings of our examination, explaining why we believe revocation of your exempt status under section 501(a) of the Internal Revenue Code (IRC) is necessary. Your organization may instead make an election to be treated as a taxable homeowner’s

association under IRC § 528.

If you accept our findings, please sign and return the enclosed Form 6018-A, Consent to Proposed Action, to the individual listed above. We will then send you a final letter revoking your exempt status. Please also file Federal income tax return Form 1120-H for the tax year ending April 30, 20XX, with the individual listed above.

If you disagree with our findings, please provide in writing any additional information you believe may alter the findings. Your reply should include a statement of the facts, the applicable law, and arguments that support your position. Please also include any corrections to the facts that have been stated, if in dispute.

Upon receipt of your response, we will evaluate any additional information you have provided prior to issuing any final report of examination.

Please respond within 30 days from the date of this letter.

Thank you for your cooperation.

Sincerely,

Anne Jewell

Revenue Agent

Enclosure:

Form 886-A, Explanation of Items

Form 6018-A, Consent to Proposed Action

* * * * *

LEGEND:

ORG = Organization name

XX = Date

EIN = ein

State = state

County = county

POA = poa

Treasurer = treasurer

RA-1 = 1st RA

CO-1, CO-2, CO-3, CO-4 & CO-5 = 1ST, 2ND,

3RD, 4TH & 5TH COMPANIES

ISSUES

1. Does ORG (ORG) qualify as a tax exempt homeowners association under § 501(c)(4) of the Internal Revenue Code (IRC)?

2. Does ORG qualify as a for-profit homeowners association under IRC § 528?

3. What are the exempt and non-exempt function income and expenses as defined in IRC § 528?

4. If so, what are the tax implications of the revocation and reclassification of the organization under IRC § 528?

An alternative position based on if the organization continued to qualify as an organization exempt under IRC § 501(c)(4) is included at the end of the primary position.

FACTS

ORG, * * * (ORG) is currently classified as a tax-exempt organization under § 501(c)(4) of the Internal Revenue Code (IRC). Per the Articles of Incorporation ("Articles"), the organization was originally organized in State on October 3, 19XX. These Articles were later amended on October 3, 20XX to expand the stated purpose. The organization was created to "acquire, maintain and conduct building and property and activities for a community life and center at the ORG as above described, to engage in educational and recreational facilities for members; to acquire other property and construct buildings for such proposes; to foster and promote good citizenship among is members; to promote and foster educational, recreational; physical and social activities of its members and their friends; to engage in such activities as shall raise the standards of civic morality and community welfare." The 19XX Articles were expanded with the following language during the 20XX revision, "ORG's primary purpose is to own, repair, maintain, and improve the roads within the ORG, and to collect and disperse road maintenance fees related to the private roads within the plats of the Assessor's Plat of ORG in Volume 16 of Plats, records of County, State, or in Volumes 17, 18, and 19 of said records, or any additions thereto as platted."

The bylaws were also amended at this time. The current bylaws provide the following definition of a member:

". . . any Property Owner who chooses to pay an annual membership fee established by the Board of Directors to ORG for the rights to enjoy ORG Member Properties and the secondary purposes of ORG as outlined in the Amended Articles of Incorporation."

On October 22, 20XX, a Form 2848, Power of Attorney and Declaration of Representative, was received by the Internal Revenue Service allowing POA authority to discuss income tax for the tax periods ending April 30, 20XX through April 30, 20XX.

On September 20, 20XX, a Letter 3611 and Publication 1, Your Rights as a Taxpayer, and a Form 4564, Information Document Request ('IDR"), were issued to notify the organization of an examination of the Form 990, Return of Organization Exempt from Income Tax, for the year ended April 30, 20XX. The initial appointment was held November 5, 20XX, at POA's office. Treasurer, the Treasurer, and POA, POA, were present on behalf of the organization. The following is a summary of the relevant points of the initial interview (questions asked in bold and response in italics).

To get a full understanding of your organization, please describe the history of your organization and all of its activities.

The organization was started in 19XX as a group of owners who purchased property from the RA-1. The original plan had 1100 lots which were completely undeveloped and were mostly for tents. The mission is to manage and maintain the roads of ORG. The roads were later deeded to ORG. The organization has changed several times over the years based on who has had power over the board of directors. The organization has been involved in 2 major law suits. The first in 20XX was based around additional assessments made to replace a bridge, the organization won the right to make assessments against the owners based on a formula but the formula was not specified. According to the organization, this suit also stated that the organization was not a homeowners association under state law. The formula determined was based on how many of the main and side roads were used when accessing the properties. The second law suit was a class action suit against the owners of the organization who were not paying assessments. This suit validated the formula used before with minor changes to make it more fair. The new formula was * * *% the old formula and * * *% the assessed value of the property. The suit also allowed the organization to place liens or even foreclose on properties. The organization currently has 95 owners in collections. This case also allowed them to collect for administrative and legal costs.

The organization had a road budget of $$* * * and an Admin budget of $* * * ~ $* * * (used for bookkeeping and lawyers as the organization has no employees). The organization is also in the process of selling some of their properties (some gained through foreclosure and some were road accesses). The properties owned by the organization include two beach access points and a stretch of river beach.

What are the rules for non-owners being on the property?

The road is not open to the public except in limited ways. The CO-1 road to the first arch is public access and the organization has an easement across the land from the first arch to the second arch (~1.5 miles). ORG owns the roads while the CO-1 has an easement. Per the CO-1, the only people who should be on the roads after the first gate are owners or those on official CO-1 business. The remainder of the road is marked as being for property owners and guests only. There are signs on both arches which state that the road is private.

The organization requires stickers to be present on cars that enter the property. If the sticker is not present on the car, the organization will place a note on the car. When asked, the treasurer stated that usually if a person is on the property, they are instructed to carry out their business, leave the premises and that they are not to return.

Does the organization have a gate or security guard shack?

The organization does have a guard shack but it has not been used in years.

How commonly does the organization receive income from logging?

This happens once every 100 years or so and was not for the sale of lumber but instead was compensation for use of the roads. The organization was paid $$.00. The lumber company was required to pay repair costs for any damage done to the roads. Per the treasurer, the money was used to pay for flood damage and the class action lawsuit.

For what reason was the organization property logged?

The logging was occurring on the land on the other side of the property and the logging company had an easement across the organization in order to reach their property.

What access is given to the general public to view the waterfalls and the river?

The public are not given access to view the waterfalls and river. The waterfalls are located beyond the area with the CO-1 easement.

What benefit do you provide to the general public?

No benefit is provided to the public.

What are the requirements for being a property owner?

They must own property within the organization's serviced area.

What classes of members or property owners are there and are there any differences in voting rights?

There are no classes of property owners and in order to vote you must be in good standing (have paid all assessments).

What are the dues & initiation fees for the various classes of members?

Assessments are between $$* * * and $$* * * a year based on the formula.

Does the organization own, lease or sublease any real property? If so, is the property encumbered by debt?

The organization owns roads and other properties. None are encumbered by debt.

Per the transcript of the class action law suit posted on the organization's website, the organization is not primarily a membership based organization. The determination was made that the organization may solicit voluntary membership and dues for all purposes besides the maintenance of the roads.

The law suit establishes the validity of the agreement between ORG and the CO-1. This agreement establishes a basis for dues assessments to the ORG members to maintain the .6 of a mile that is owned by the CO-1.

The law suit finds that the administrative costs of the organization, including legal fees from this lawsuit, may be assessed against the owners.

The Class Action finds that the correct assessment formula would be * * *% of the implied easement formula (IE) and * * *% the assessed value of the property. The determination of commercial use of the property is also important as commercial activity increases traffic on the roads. The determination was made that a surcharge of $* * * per lot may be assessed for commercial use.

The minutes for the board meeting held March 7, 20XX, state that there was an issue with guests being on the property and being told that they were not allowed to have access to the property. The organization requires that owners display a sticker on their car to show that they are allowed to park on the property. Guests would receive a hanging tag. These plans were finalized January 9, 20XX with each owner receiving two guest tags with the option to purchase more for $* * * a pair. The minutes for June 6, 20XX state that a sign should be posted at CO-2 to notify non-residents that only residents and their guests may park on CO-3. Money was allocated for this activity.

During the tour of the facility, several posted signs were observed. The signs stated that the roads are private roads for owners only. Signs were observed on both the first and second arches.

The following are the income and expenses as reported by the organization.

Income Statement

Per further discussion, it was noted that the logging company owned property within the organization's boundaries. The logging company paid a total of $$* * * as a "special assessment" for the use of the roads by the logging trucks. The logged area was located behind the land owned by the organization. The logging activity was in process from October 20XX through April 20XX, a total of 26 weeks.

Per the ORG response to an IDR dated January 4, 20XX, the organization noted two expenses which could be directly related to the existence of logging trucks on the roads. These expenses as shown below are for lumber and repairs on a bridge within the organization's boundaries. The expenses were incurred in the next fiscal year, ten months after the end of the logging activity.

Per an ORG IDR response, there are a total of 405 property owners in the organization. Of these, 160 are permanent residents who are likely to drive on the roads an average of twice a day, once as they leave and once when they return.

The remaining 245 property owners are non-residents and more likely to use the roads on a more intermittent basis. On average, they may drive the roads twice per time in residence. Per the ORG IDR response, it is likely that the non-residents used the facility an average of 7 times during the six months that the logging company was using the roads.

Per the ORG IDR response, "A large logging truck does much more damage to a road than a passenger car or pickup truck. For purposes of this analysis, it is assumed that a logging truck does twice as much damage as a passenger car or pickup truck."

ORG spent a total of $$* * * on road maintenance during the year ended April 30, 20XX.

LAW

IRC § 501(c)(4)

IRC § 501(c)(4)(A) holds that civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

It also requires that no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

Revenue Ruling 74-99, 1974-1 C.B. 131, modifies Rev. Rul. 72-102, to make clear that a homeowners' association, oft the kind described in Rev. Rul. 72-102 must, in addition to otherwise qualifying for exemption under section 501(c)(4) of the Code, satisfy the following requirements: (1) It must engage in activities that confer benefit on a community comprising a geographical unit which bears a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof; (2) It must not conduct activities directed to the exterior maintenance of private residences; and (3) It owns and maintains only common areas or facilities such as roadways and parklands, sidewalks and street lights, access to, or the use and enjoyment of which is extended to members of the general public and is not restricted to members of the homeowners' association.

Flat Top Lake Ass'n, Inc v. US holds that an organization will not qualify for tax exempt status under IRC § 501(c)(4) if it restricts its facility and activities only to members. It sites Rev Rul 74-99 which states that a homeowner's association must serve a "community" which bears a reasonably, recognizable relationship to an area ordinarily identified as a governmental subdivision or unit. Second it must not conduct activities directed to the exterior maintenance of any private residence, Third common areas or facilities that the homeowners' association owns and maintains must be for the use and enjoyment of the general public.

IRC § 528

IRC § 528(a) holds that a homeowners association (as defined in subsection (c)) shall be subject to taxation under this subtitle only to the extent provided in this section. A homeowners association shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes. A tax is imposed for each taxable year on the homeowners' association taxable income of every homeowners association. Such tax shall be equal to 30 percent of the homeowners' association taxable income.

IRC § 528(c) defines a homeowners association as an organization which is a condominium management association, a residential real estate management association, or a timeshare association if such organization is organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property, 60 percent or more of the gross income of such organization for the taxable year consists solely of amounts received as membership dues, fees, or assessment's from owners of residences or residential lots in the case of a residential real estate management association, or 90 percent or more of the expenditures of the organization for the taxable year are expenditures for the acquisition, construction, management, maintenance, and care of association property and, in the case of a timeshare association, for activities provided to or on behalf of members of the association, no part of the net earnings of such organization inures (other than by acquiring, constructing, or providing management, maintenance, and care of association property, and other than by a rebate of excess membership dues, fees, or assessments) to the benefit of any private shareholder or individual, and such organization elects (at such time and in such manner as the Secretary by regulations prescribes) to have this section apply for the taxable year.

IRC § 528(c)(3) defines the term "residential real estate management association" as any organization meeting the requirements of subparagraph (A) of paragraph (1) with respect to a subdivision, development, or similar area substantially all the lots or buildings of which may only be used by individuals for residences.

IRC § 528(c)(5) defines "association property" as property held by the organization, property commonly held by the members of the organization, property within the organization privately held by the members of the organization, and property owned by a governmental unit and used for the benefit of residents of such unit.

IRC § 528(d) For purposes of this section, defines homeowners association taxable income as an amount equal to the excess (if any) of the gross income for the taxable year (excluding any exempt function income), over the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income). The section also allows for the following modifications, there shall be allowed a specific deduction of $100, no net operating loss deduction shall be allowed under Link section 172, and no deduction shall be allowed under part VIII of subchapter B (relating to special deductions for corporations).

IRC § 528(d)(3) defines "exempt function income" as any amount received as membership dues, fees,

or assessments from owners of real property in the case of a residential real estate management association.

Federal Tax Regulations (Regulations) § 1.528-1., Homeowners associations

(c) Residential real estate management association. — Residential real estate management associations are normally composed of owners of single-family residential units located in a subdivision, development, or similar area. However, they may also include as members owners of multiple-family dwelling units located in such area. They are commonly formed to administer and enforce covenants relating to the architecture and appearance of the real estate development as well as to perform certain maintenance duties relating to common areas.

TAXPAYER'S POSITION

The taxpayer's position is being solicited at this time.

GOVERNMENT'S POSITION

Issue #1

Does ORG (ORG) qualify as a tax exempt homeowners association under § 501(c)(4) of the IRC?

ORG does not qualify as a tax exempt homeowners association. Per the findings of Revenue Ruling 74-99 and Flat Top Lake Ass'n Inc v. U.S., there are three requirements for a homeowners association to be considered tax exempt under IRC § 501(c)(4). One, the organization must engage in activities that confer benefit on a community comprising a geographical unit which bears a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof. Two, it must not conduct activities directed to the exterior maintenance of private residences. Finally, it must own and maintain only common areas or facilities such as roadways and parklands, sidewalks and street lights, access to, or the use and enjoyment of which is extended to members of the general public and is not restricted to members of the homeowners' association.

The organization satisfies the first and second requirements for exemption but does not satisfy the third requirement The organization, as stated during the initial interview and seen during the tour of the road, does not allow members of the general public access to their road or the common areas maintained by the organization. As noted in the facts above, ORG will ask persons who do not have a parking decal or hanging tag not enter their property again. The organization also posted signs in several locations along the road which state that only members and their guests are allowed access to the road. As such, the communal property of ORG is not made available to the general public and the organization can not qualify under IRC § 501(c)(4).

Issue #2

Does ORG qualify as a for-profit homeowners association under IRC § 528?

Per their bylaws, ORG is organized as a for-profit homeowners association under IRC § 528, as a residential real-estate management association.

IRC § 528 defines a homeowners association as an organization which is organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property. A residential real-estate management association is any organization meeting the requirements of a subdivision, development, or similar area substantially all the lots or buildings of

which may only be used by individuals for residences.

Given the conclusion reached in Issue #1, ORG is operated to manage and maintain the roads of CO-3. Per the current articles of incorporation, the organizations primary purpose “is to own, repair, maintain, and improve the roads within the ORG, and to collect and disperse road maintenance fees related to the private roads within the plats of the Assessor’s Plat of ORG in Volume 16 of Plats, records of County, State, or in Volumes 17, 18, and 19 of said records, or any additions thereto as platted.” This furthers the argument that the organization is organized in such a way as to qualify for exemption under IRC § 528.

Issue #3

What are the exempt and non-exempt function income and expenses as defined in IRC § 528?

Per IRC § 528(d), the taxable income of a homeowners association is the gross income for the taxable year less any exempt function income and any deductions that are directly connected with the production of the gross income. IRC § 528(d)(3) further defines “exempt function income” as any amount received as membership dues, fees, or assessments from owners of real property in the case of a residential real estate management association.

As noted in the initial interview and the books and records of the organization, the organization receives the majority of their money from assessments made for road and administrative fees. These amounts would be considered “exempt function income” to an IRC § 528 organization. The organization’s purpose is to conduct activities which support the community as a whole rather than provide a specific benefit. To support this purpose the organization may impose annual or special assessments for road maintenance.

As noted in the initial interview, the organization also received $$* * * from a logging company for use of the road. This income was classified as a “special assessment.” The fundamental difference between a special assessment for road maintenance and the “special assessment” made against the logging company is in the purpose for which it is assessed. A valid special assessment would be assessed against the entire property owner community or a distinct portion of such community in order to pay for an unusual repair, such as the replacement of a culvert or to fix the damage from a flood. In comparison, the “special assessment” made against the logging company was not made in response to the need for an unusual repair, nor was it an assessment that was paid by any distinct portion of the community. The assessment was instead a payment for use of the road by an outside party to alleviate some of the cost of maintaining the road as well as paying for any additional costs associated with increased traffic. As such, this income would not be considered “exempt function income.”

The total exempt function income is $* * * in the year ended April 30, 20XX and $* * * in the year ended April 30, 20XX. The non-exempt function income includes all investment and other income that is not related to the exempt purpose of an IRC § 528 organization. This is income is as follows.

Non-Exempt Function Income

The Non-exempt function expenses are those expenses which are directly connected to the production of the non-exempt income. In this instance, while the organization may not deduct any portion of expenses from the interest income as it has not directly related expenses, it may deduct any expenses which are directly related to the income from the logging company. These expenditures have been allocated using the method below:

Per IRC § 528(d), the organization may deduct only those expenses which are directly related to the production of the non-exempt function income.

The organization identified the following transactions as directly related to damage caused by the logging trucks.

While these transactions are directly related to the unrelated business activity, they may not be deducted in the year ended April 30, 20XX as they were not incurred until the following year. However, these costs are fully deductable in the following year as valid road maintenance expenses.

The organization may deduct an allocated portion of the years total road maintenance expenses to the unrelated business activity. Using a slightly modified version of the allocation method provided by ORG, the road maintenance costs may be allocated using the estimated road use by logging trucks shown below.

Estimated Road use by Logging Trucks

The estimated number of trips made by logging trucks was calculated using the following calculation method provided by ORG.

Estimated number of Trips by Logging Trucks

The explanation for the damage severity factor per ORG is as follows, “A large logging truck does much more damage to a road than a passenger car or pickup truck. For purposes of this analysis, it is assumed that a logging truck does twice as much damage as a passenger car or pickup truck.” The organization used a damage severity factor of 3 to represent this increased damage.

The estimated number of trips by property owners was calculated using the following calculation method provided by ORG.

Estimated number of Trips by Property Owners

In addition to the allocation factor shown above, the agent also allocated the portion of road maintenance expenses that would have been incurred during the logging assuming that the maintenance expense was incurred evenly over the course of the year. This calculation has been shown below.

Allocated Total Maintenance Expenses

This maintenance cost figure is then multiplied by the estimated use by logging trucks to calculation the total maintenance expense allocable to the logging activity as shown below.

Given the above calculation the organization may deduct a total of $* * * from the income received from the logging trucks using the roads.

As such the total net non-exempt function income is shown in the following table.

Net Non-Exempt Function Income

Issue #4

If so, what are the tax implications of the revocation and reclassification of the organization under IRC § 528?

Given the conclusions reached in Issues #1 through 3, the organization can possibly qualify as an organization exempt under IRC § 528. However, this Code section requires that in any given year the organization have either 60% of the total income of the organization consist of membership dues, fees, or assessments from owners of residences or residential lots, or 90% or more of the expenditures of the organization are for the acquisition, construction, management, and care of association property.

ORG, given the income statement shown above, has the following percentages of income from membership dues, fees and assessments.

Percentage of Exempt Function Income

As noted in the figures above, the organization meets the 60% exempt function income test in only the year ended April 30, 20XX. The year ended April 30, 20XX, did not qualify due to the non-exempt function income received from the logging company.

ORG, given the income statement above, has the following percentages of expenditures made for the acquisition, construction, management, maintenance, and care of association property. This figure includes all expenditures made including those made as a result of the logging trucks using the road.

Percentage of Exempt Function Expenditures

The organization also does not qualify for this Code section under the expenditure test as in nether year do they meet the 90% requirement. As such, the organization may not make the election to be treated as a homeowners association under IRC § 528 for the year ended April 30, 20XX but may for the year ended April 30, 20XX.

IRC § 528(d) defines a homeowners association taxable income as the amount equal to the excess (if any) of the gross income, less the exempt function income, for the taxable year, less any deductions which are directly connected with the production of those non-exempt activities. Exempt function income is defined as any membership dues, fees, or assessments from owners of real property.

The calculation of taxable income for the year ended April 31, 20XX has been shown in the first table below and includes investment income and any additional income that is received by the organization in a given year.

Form 1120-H

U.S. Income Tax Return for Homeowners Associations

For Year Ended April 31, 20XX

The second table calculates the taxable income for the year ended April 31, 20XX as that year does not qualify for the IRC § 528 election. This has been calculated using the corporate tax rate.

Form 1120

U.S. Corporation Income Tax Return

For Year Ended April 31, 20XX

CONCLUSION

As noted in the above analysis, the organization does not qualify for exemption under § 501(c)(4) of

the IRC but does qualify under IRC § 528 as a taxable homeowners association for the year ended April 30, 20XX. As such, the organization may make an election in the year ended April 30, 20XX and all subsequent years when filing the Form 1120, to instead file the Form 1120-H if they continue to qualify. In the year ended April 30, 20XX, the organization would be assessed $* * * in income tax.

In the year ended April 30, 20XX, the organization does not qualify for exemption under either IRC § 501(c)(4) or § 528. As such, they must file Form 1120 for the year in question. The tax to be assessed in the prior year would be $* * *.

Treatment under IRC § 528 is an election made every year upon the filing of the tax return. An organization may qualify for exemption in one year but not the next due to unusual income. As such, the total tax to be assessed against the organization is $* * *.

ALTERNATIVE POSITION

In the alternative, if the organization continues to qualify for exemption under IRC § 501(c)(4), should the income from logging truck using the road received by the organization in the year ended April 30, 20XX be considered unrelated businesses income under IRC § 511.

ISSUES

1. Is the revenue received from the logging company related to the exempt purpose of the organization?

2. If not, what expenses may be allocated to the unrelated business income?

3. What is the total unrelated business income tax due?

FACTS

On September 20, 20XX, a Letter 3611 and Publication 1, Your Rights as a Taxpayer; and a Form 4564, Information Document Request (IDR) were issued to notify the organization of an examination of the Form 990, Return of Organization Exempt From Income Tax, for the year ended April 31, 20XX. The initial appointment was held November 5, 20XX at the Power of Attorney's Office. Treasurer, the Treasurer, and POA, POA, were present on behalf of the organization. The following is a summary of the relevant points of the initial interview in relation to the income from the Logging activity.

How commonly does the organization receive income from logging?

This happens once every 100 years or so and was not for the sale of lumber but instead was compensation for use of the roads. The organization was paid $* * * as well as the lumber company fixing any damage done to the roads. Per the treasurer, the money was used to pay for flood damage and the class action lawsuit.

For what reason was the organization property logged?

The logging was happening on the land on the other side of the property and the logging company had an easement across the organization in order to reach their property.

Per further discussion, it was noted that the logging company owned property within the organization and paid a total of $$* * * as a "special assessment" for the use of the roads by the logging trucks. The area being logged is behind the area owned by the organization. The logging

activity was in process from October 20XX through April 20XX, a total of 26 weeks.

Per the Information Document Request (IDR) response dated January 4, 20XX, the organization noted two expenses which could be directly related to the existence of logging trucks on the roads. These expenses as shown below are for lumber and repairs on a bridge within the organization. The expenses were incurred in the next fiscal year, ten months after the end of the logging activity.

Per IDR response, there are a total of 405 property owners in the organization. Of these 160 are permanent residents who are likely to drive the roads an average of twice a day, once as they leave and once when they return.

The remaining 245 property owners are non residents and more likely to use the roads on a more intermittent basis. On average, they may drive the roads twice per time in residence. Per the ORG, it is likely that the non-residents used the facility an average of 7 times during the six months that the logging company was using the roads.

Per ORG, “A large logging truck does much more damage to a road than a passenger car or pickup truck. For purposes of this analysis, it is assumed that a logging truck does twice as much damage as a passenger car or pickup truck.”

ORG spent a total of $$* * * on road maintenance during the year ended April 30, 20XX. ORG did not file a Form 990-T for the period in question.

LAW

IRC § 512(a)(1) provides that the term “unrelated business taxable income” means the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less the deductions which are directly connected with the carrying on of such trade or business.

Treasury Regulations (Regulations) § 1.512(a)-1(a) defines “unrelated business taxable income” as the gross income derived from any unrelated trade or business regularly carried on, less those deductions allowed by chapter 1 of the Code which are directly connected with the carrying on of such trade or business, subject to certain modifications referred to in § 1.512(b)-1. To be deductible in computing unrelated business taxable income, therefore, expenses, depreciation, and similar items not only must qualify as deductions allowed by chapter 1 of the Code, but also must be directly connected with the carrying on of unrelated trade or business. Except as provided in paragraph (d)(2) of this section, to be “directly connected with” the conduct of unrelated business for purposes of section 512, an item of deduction must have proximate and primary relationship to the carrying on of that business. In the case of an organization which derives gross income from the regular conduct of two or more unrelated business activities, unrelated business taxable income is the aggregate of gross income from all such unrelated business activities less the aggregate of the deductions allowed with respect to all such unrelated business activities. For the treatment of amounts of income or loss of common trust funds, see § 1.584-2(c)(3).

Regulations § 1.512(a)-1(b) defines expenses, depreciation, and other similar items that are attributable solely to the conduct of unrelated business activities as those which are proximately and primarily related to that business activity. Such expenses qualify for deduction to the extent that they meet the requirements of IRC § 162, IRC § 167, or other relevant section of the Internal Revenue Code. Thus, the wages of personnel employed full-time in carrying on unrelated business activates are directly connected with the conduct of said activity and are deductable in computing unrelated business taxable income if they otherwise qualify under the requirements of IRC § 162.

Regulations § 1.512(a)-1(c) provides that when facilities or personnel are used for both exempt activities and the conduct of an unrelated trade or business, expenses, depreciation, and similar items shall be allocated between the two activities on a reasonable basis. The portion of any such item so allocated to the unrelated trade or business is proximately and primarily related to that business activity and shall be allowable as a deduction in computing unrelated business taxable income to the extent provided by IRC § 162, IRC § 167, or other relevant Code section.

TAXPAYER'S POSITION

The taxpayer's position is unknown at this time.

GOVERNMENT'S POSITION

ISSUE # 1

Is the revenue received from the logging company related to the exempt purpose of the organization?

The income received from the logging company is not related to the exempt purpose of the organization.

Per the Bylaws of the organization, the organization is organized "acquire, maintain and conduct building and property and activities for a community life and center at the ORG as above described, to engage in educational and recreational facilities for members; to acquire other property and construct buildings fur such proposes; to foster and promote good citizenship among is members; to promote and foster educational, recreational; physical and social activities of its members and their friends; to engage in such activities as shall fraise the standards of civic morality and community welfare." As such, the organizations purpose is to conduct activities which support the community as a whole rather than provide a specific benefit. To support this purpose the organization may impose annual or special assessments for road maintenance.

The fundamental difference between a special assessment for road maintenance and the "special assessment" made against the logging company is in the purpose for which it is assessed. A valid special assessment would be assessed against the entire property owner community or a distinct portion of such community in order to pay for an unusual repair, such as the replacement of a culvert or to fix the damage from a flood. In comparison, the "special assessment" made against the logging company was not made in response to the need for an unusual repair, nor was it an assessment that was paid by any distinct portion of the community. The assessment was instead a payment for use of the road by an outside party to alleviate some of the cost of maintaining the road as well as paying for any additional costs associated with increased traffic.

As such, the $$* * * paid by the logging company was a payment for use rather than a valid assessment and is therefore unrelated to the exempt purpose of a IRC § 501(c)(4) homeowner's organization.

ISSUE #2

If not, what expenses may be allocated to the unrelated business income?

Per IRC § 512(a)(1), the organization may deduct only those expenses which are directly related to the production of the unrelated business income.

The organization identified the following transactions as directly related to damage caused by the

logging trucks.

While these transactions are directly related to the unrelated business activity, they may not bee deducted in the year ended April 30, 20XX as they were not incurred until the following year. However, these costs are fully deductable in the following year as valid road maintenance expenses.

The organization may take deduction of a portion of the years total road maintenance expenses as allocated to the unrelated business activity. Using a slightly modified version of the allocation method provided by ORG, the road maintenance costs may be allocated using the estimated road use by logging trucks shown below.

Estimated Road use by Logging Trucks

The estimated number of trips made by logging trucks was calculated using the following calculation method provided by ORG.

Estimated number of Trips by Logging Trucks

The explanation for the damage severity factor per ORG is as follows, “A large logging truck does much more damage to a road than a passenger car or pickup truck. For purposes of this analysis, it is assumed that a logging truck does twice as much damage as a passenger car or pickup truck.” The organization used a damage severity factor of 3 to represent this increased damage. The agent disagrees with the damage factor used by the organization as it would represent three times as much damage rather than twice as much damage. As such, the agent has used 2 as the damage factor.

The estimated number of trips by property owners was calculated using the following calculation method provided by ORG.

Estimated number of Trips by Property Owners

In addition to the allocation factor shown above, the agent also allocated the portion of road maintenance expenses that would have been incurred during the logging assuming that the maintenance expense was incurred evenly over the course of the year. This calculation has been shown below.

Allocated Total Maintenance Expenses

This maintenance cost figure is then multiplied by the estimated use by logging trucks to calculation the total maintenance expense allocable to the logging activity as shown below.

Given the above calculation the organization may deduct a total of $* * * from the income received from the logging trucks using the roads.

ISSUE # 3

What is the total unrelated business income tax due?

Per the calculations shown in Issue #1 and 2, the organization owes $* * * in unrelated business income tax. This figure has been calculated as follows: Unrelated business income tax is a * * *% tax on the unrelated income less any directly related expenses.

Allocation of Income and Expenses from the Logging Company

Unrelated Business Income Tax

CONCLUSION

ORG allowed a logging company to use their roads for a fee. As this transaction is not typical of organizations defined under IRC § 501(c)(4) it is considered to be unrelated to the exempt purpose of the organization and is therefore subject to Unrelated Business Income Tax In this case the total tax due was calculated at $* * * for the transaction in question.

IRS LTR: University's Tax-Exempt Status Is Revoked.

Citations: LTR 201329020

The IRS revoked the tax-exempt status of an online university, concluding that the university's net earnings routinely and continuously inured to its president, vice president, and secretary.

Person to Contact: * * *

Employee Identification Number: * * *

Employee Telephone Number:

(Phone): * * *

(Fax): * * *

501-03.00

Release Date: 7/19/2013

Date: January 7, 2013

Taxpayer Identification Number: * * *

LEGEND:

ORG = organization name

xx = Date

Address = address

Officer — 1-3 = 1st, 2nd & 3rd Officer

Dear * * *:

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code. Our favorable determination letter to you dated February 3, 20XX is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 20XX.

The revocation of your exempt status was made for the following reason(s):

Organizations described in IRC 501(c)(3) and exempt under section 501(a) must be both organized and operated exclusively for exempt purposes. You must establish that you are operated exclusively for exempt purposes and that no part of your net earnings inures to the benefit of private shareholders or individuals.

Your earnings have inured to the benefit of three of your officers, Officer-1, Officer-2, and Officer-3. This inurement totaled $* * * during the years 20XX, 20XX, and 20XX. This is a substantial amount of inurement, and violates section 1.501(c)(3)-1(c)(2) of the Treasury Regs. Given the routine and continuous nature of the inurement, this warrants revocation of your 501(c)(3) status effective January 1, 20XX.

Contributions to your organization are no longer deductible under IRC § 170 after January 1, 20XX.

You are required to file income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the tax year ending December 31, 20XX, and for all tax years thereafter in accordance with the instructions of the return.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91st Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to the United States Tax Court at the following address:

* * *

You also have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

* * *

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

Sincerely,

Nanette M. Downing

Director, EO Examinations

* * * * *

Person to contact/ID number: * * *

Contact numbers: * * *

Manager’s name/ID number: * * *

Manager’s contact number: * * *

Response due date: * * *

Date: July 24, 2012

Taxpayer Identification Number: * * *

Form: * * *

Tax year(s) ended: * * *

LEGEND:

ORG = * * *

ADDRESS = * * *

Dear * * *:

WHY YOU ARE RECEIVING THIS LETTER

We propose to revoke your status as an organization described in section 501(c)(3) of the Internal Revenue Code (Code). Enclosed is our report of examination explaining the proposed action.

WHAT YOU NEED TO DO IF YOU AGREE

If you agree with our proposal, please sign the enclosed Form 6018, Consent to Proposed Action — Section 7428, and return it to the contact person at the address listed above (unless you have already provided us a signed Form 6018). We’ll issue a final revocation letter determining that you aren’t an organization described in section 501(c)(3).

After we issue the final revocation letter, we’ll announce that your organization is no longer eligible for contributions deductible under section 170 of the Code.

IF WE DON’T HEAR FROM YOU

If you don’t respond to this proposal within 30 calendar days from the date of this letter, we’ll issue a final revocation letter. Failing to respond to this proposal will adversely impact your legal standing to seek a declaratory judgment because you failed to exhaust your administrative remedies.

EFFECT OF REVOCATION STATUS

If you receive a final revocation letter, you’ll be required to file federal income tax returns for the tax year(s) shown above as well as for subsequent tax years.

WHAT YOU NEED TO DO IF YOU DISAGREE WITH THE PROPOSED REVOCATION

If you disagree with our proposed revocation, you may request a meeting or telephone conference with the supervisor of the IRS contact identified in the heading of this letter. You also may file a protest with the IRS Appeals office by submitting a written request to the contact person at the address listed above within 30 calendar days from the date of this letter. The Appeals office is

independent of the Exempt Organizations division and resolves most disputes informally.

For your protest to be valid, it must contain certain specific information including a statement of the facts, the applicable law, and arguments in support of your position. For specific information needed for a valid protest, please refer to page one of the enclosed Publication 892, How to Appeal an IRS Decision on Tax-Exempt Status, and page six of the enclosed Publication 3498, The Examination Process. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Track Mediation referred to in Publication 3498 generally doesn't apply after we issue this letter.

You also may request that we refer this matter for technical advice as explained in Publication 892. Please contact the individual identified on the first page of this letter if you are considering requesting technical advice. If we issue a determination letter to you based on a technical advice memorandum issued by the Exempt Organizations Rulings and Agreements office, no further IRS administrative appeal will be available to you.

CONTACTING THE TAXPAYER ADVOCATE OFFICE IS A TAXPAYER RIGHT

You have the right to contact the office of the Taxpayer Advocate. Their assistance isn't a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate can't reverse a legally correct tax determination or extend the time you have (fixed by law) to file a petition in a United States court. They can, however, see that a tax matter that hasn't been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate assistance. If you prefer, you may contact your local Taxpayer Advocate at:

Internal Revenue Service

Office of the Taxpayer Advocate

* * *

FOR ADDITIONAL INFORMATION

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing

Director, EO Examinations

Enclosures:

Report of Examination

Form 6018

Publication 892

Publication 3498

* * * * *

LEGEND:

ORG = Organization name

XX = Date

Address = address

City = city

State = state

President = president

Vice-President = vice president

Secretary = secretary

CPA = CPA

Founder = founder

RA-1 = 1st RA

CO-1 through CO-11 = 1st through 11th COMPANIES

ISSUE

Should ORG'S 501(c)(3) status be revoked on the grounds that its net earnings inured to the benefit of its president, vice-president, and secretary?

FACTS

ORG, formerly known as CO-1 ("ORG"), is an online university. Its corporate office is located at Address, City, State. It offers degrees in * * * and * * *. Its enrollment was approximately 200 students during the years under examination. ORG also conducts live training seminars approximately 30 times throughout each school year. These seminars are held in locations throughout the United States and Canada.

During the years under examination, ORG's president and vice-president were President and Vice-President (husband and wife), respectively. ORG's board secretary was Secretary.

ORG filed with the IRS a Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, on May 13, 20XX. On February 3, 20XX, the IRS issued a ruling letter to ORG, recognizing it as a tax-exempt public charity under section 501(c)(3) of the Internal Revenue Code ("Code"), effective April 26, 20XX.

On April 28, 20XX, ORG filed a Plan of Conversion with the State of State to convert back to for-profit status as of June 1, 20XX. The State of State certified this conversion. According to a valuation prepared by CO-2 ORG's value was appraised to be zero. This was primarily due to ORG's

outstanding debt of $$* * * to CO-3 (“CO-3”). President owns * * *% of CO-3’s stock. At conversion, the debt was extinguished in exchange for ORG’s stock. ORG formally changed its name from CO-1 to ORG on December 13, 20XX.

The examining IRS agent contacted ORG president President on December 8, 20XX and advised him of the audit of ORG’s year 20XX Form 990. The agent mailed the audit letter to ORG on December 10, 20XX. The agent conducted the field audit at the City office of ORG’s representative, CPA, CPA on January 10, 20XX. CPA was replaced as representative by CPA, CPA, on March 2, 20XX.

BACKGROUND OF ORG

ORG operated as a for-profit corporation from 19XX until 20XX. ORG was incorporated in City, State on December 13, 19XX. It was a correspondence school organized to train individuals in various self-improvement techniques developed by its founder, Founder. Founder is the father of President.

CO-3 was ORG’s predecessor. It was incorporated November 12, 19XX as a for-profit State corporation. All of the rights, title and interest in programs, training, books, recordings and videos were held either by CO-3 or Founder, personally. Ownership of CO-3 passed from Founder to President in 20XX.

According to ORG’s meeting minutes dated September 18, 20XX, ORG’s board voted unanimously to remove Founder from his position as president of the board of ORG. President was voted to take the position as president.

Following Founder’ termination, he demanded that ORG and CO-3 cease using his registered marks, name and likeness. ORG and CO-3, however, continued to use his marks, name and likeness in their print advertisements and on their web sites. As a result, President brought suit against ORG, CO-3, President, and Vice-President. Founder was granted a Motion for Temporary Restraining Order on March 6, 20XX.

Forms 990 and Payments to Officers

ORG’s Forms 990 for the years under examination reported as follows:

Figure 1: Forms 990

Among the disbursements ORG made during the years under examination were the following:

Figure 2 — Payments 20XX

Figure 3 — Payments 20XX

Figure 4 — Payments 20XX

Secretary’ City Apartment

The payments to CO-4, in 20XX and 20XX, were for ORG board secretary Secretary’ apartment at Address in City, State. ORG did not report these payments as compensation to Secretary on its own Forms 990, or on Secretary’ Forms W2.

The revenue agent asked ORG, in Information Document Request (“IDR”) #3, issued March 16, 20XX, the following question regarding these payments:

Question: What was the reason for not including the value of the City apartment in the W2 of

Secretary as a fringe benefit?

ORG's response to IDR #3, received May 16, 20XX, included the following answer to the above question:

Answer: We did not include the value of the City apartment in the W2 of Secretary due to an oversight. We would be issuing a 1099 for this.

On December 13, 20XX, Secretary sent the agent an email regarding the $$* * * in apartment payments in the year 20XX, which stated as follows:

Unfortunately, I was unable to locate the email correspondence via my old laptop as the PC was non-functional. I had hoped to find the email stating that I was accepting the position with the information included that housing was a condition of employment. As such, for now, I have paid the $$* * * to ORG and have attached evidence of this.

Attached to the email was a scanned check written by Secretary to ORG for $$* * *, and a scanned letter from ORG, signed by President, acknowledging receipt of the check.

On February 8, 20XX, Secretary sent the agent an email regarding the $$* * * in apartment payments in the year 20XX, which stated as follows:

ORG did not report the payment to me of the apartment I resided in as compensation. As I stated in my earlier correspondence with you, as well as, via telephone, provision of housing was offered by the university as part of my original offer of employment. I also indicated to you previously, that the correspondence which references this is unavailable.

There is no discussion in ORG's Board Meeting minutes of paying for Secretary' apartment as part of her compensation or as a condition of her working for ORG.

Payments to President and Vice-President

The agent requested source documents (e.g. invoices or receipts) to support the payments made to President and Vice-President in 20XX via IDRs #2 and #3. ORG did not initially provide any source documents.

With respect to check #* * * for $* * * ORG stated that $* * * of this went to President "for his 20th anniversary gift in 20XX, to be included in his 20XX payroll". ORG stated that the other $* * * went to Vice-President "for her 10th anniversary gift in 20XX, included in her 20XX payroll".

Regarding the $* * * payment to CO-5, ORG's explanation was as follows:

The payment to CO-5 was classified as consulting fee due to the styling, makeup and other tips they were giving us during the big public relations push to increase marketing. Once we understood the styling tips there were (sic) no need for their services anymore. Their services include hair maintenance and make up services. These were for the benefit of President, President and Lead Trainer.

With respect to check #* * * for $* * *, ORG stated that $* * * of it went to two employees' payroll, and the other $* * * went to Vice-President for "personal" purposes. ORG stated that this amount was "to be included in her 20XX payroll".

On October 11, 20XX, the agent sent reports to President and Vice-President, proposing excise taxes

on excess benefit transactions (“EBTs”), as described in Code section 4958, for the year 20XX disbursements shown in Figure 2, above.

On January 17, 20XX, CPA responded to the reports on behalf of the President and Vice-President1. The response had attached to it five “employee expense reports”, none of which are legible. It also had attached about 30 receipts, many of which are also not legible. The response included the following statements:

Taxpayers will agree to reimburse the Company for $* * * for the watch that was purchased for Vice-President.

Taxpayers will agree to reimburse the Company for the $$* * * 20th Anniversary gift to President.

The response argued that the $$* * * payment to CO-5 was justified because, at the time, President was having to make TV appearances to talk about RA-1 (a former ORG student) and the deaths at his State sweat lodge, in an effort to save ORG’s public image. The examining agent later viewed footage of President’ TV appearances, including one on the CO-6 show.

The response argued that the $$* * * of the $$* * * from check ##* * * that went to Vice-President was included in her reported 20XX compensation prior to the examining agent’s January 10, 20XX initial audit appointment, and that it should therefore not be included in EBTs.

Finally, the response went on to state that the President and Vice-President could only produce $$* * * of the requested receipts2. It argued, however, that all of the remaining disbursements to the President and Vice-President were for reimbursements of travel expenses related to conducting ORG’s exempt activities, and that the per diem for the dates and locations of this travel amounts to $$* * * for President and $$* * * for Vice-President. The response argues that these per diem amounts, when added to the receipts, comes to $$* * * ($$* * * + $$* * * + $$* * *) and that, compared to this amount, the disbursements made to the President and Vice-President in the year 20XX were reasonable.

On March 26, 20XX, the agent requested source documents to support the disbursements to the President and Vice-President in 20XX and 20XX (in Figures 3 and 4) via IDRs #6 and #7. On May 10, 20XX, ORG responded by providing a CD with a number of receipts and invoices. Many of these receipts are either illegible or bear no relationship to carrying out ORG’s exempt activities. For example, ORG submitted, in support of checks #* * * and #* * *, two receipts from CO-7, a luxury watch dealer in City, State and City, State. The receipts reflect the purchase of four Rolex watches; two “Oyster” models” one “Yachtmaster”, and one “Submariner”, totaling $$* * *. For check #* * *, ORG submitted $$* * * in receipts from CO-8, CO-9, and the CO-10 boutique in City. In support of check #* * *, ORG produced a receipt for a $$* * * CO-11 men’s bag.

The agent reviewed all legible receipts that could conceivably be related to ORG’s exempt activities, and subtracted them from the corresponding disbursements in Figures 3 and 4. The detailed analysis of valid and invalid receipts is attached as Exhibit A. The results are as follows:

Figure 5 — Unsubstantiated Payments 20XX

Figure 6 — Unsubstantiated Payments 20XX

Figure 7 — Unsubstantiated Payments 20XX

LAW

Internal Revenue Code

Section 501(c)(3) of the Internal Revenue Code provides for exemption from Income Tax for corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 4958(c) defines the term “excess benefit transaction” as any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit. For purposes of the preceding sentence, an economic benefit shall not be treated as consideration for performance of services unless such organization clearly indicated its intent to so treat such benefit.\

Section 4958(e) defines “applicable tax-exempt organization” as an organization described in either section 501(c)(3) or 501(c)(4) of the Internal Revenue Code or an organization which was so described at any time during the five-year period ending on the date of the excess benefit transaction.

Section 4958(f)(1) defines a “disqualified person” as (A) any person who was, at any time during the five-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization, (B) a member of the family of a disqualified person, and (C) a 35% controlled entity.

Section 4958(f)(6) of the Code defines “correction”, with respect to any excess benefit transaction, as the undoing of the excess benefit to the extent possible, and taking any additional measures necessary to place the organization in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.

Treasury Regulations

Section 1.501(c)(3)-1(a)(1) of the Treasury Regulations (“Regs”) provides that, in order to be exempt as an organization described in Section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(2) of the Regs provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(f)(2)(ii) of the Regs provides that, in determining whether to continue to recognize the tax-exempt status of an applicable tax-exempt organization described in section 501(c)(3) that engages in one or more excess benefit transactions that violate the prohibition on inurement under section 501(c)(3), the Commissioner will consider all relevant facts and circumstances, including, but not limited to, the following:

(A) The size and scope of the organization’s regular and ongoing activities that further exempt purposes before and after the excess benefit transaction or transactions occurred;

(B) The size and scope of the excess benefit transaction or transactions (collectively, if more than one) in relation to the size and scope of the organization’s regular and ongoing activities that further

exempt purposes;

(C) Whether the organization has been involved in multiple excess benefit transactions with one or more persons;

(D) Whether the organization has implemented safeguards that are reasonably calculated to prevent excess benefit transactions; and

(E) Whether the excess benefit transaction has been corrected (within the meaning of section 4958(f)(6) and section 53.4958-7), or the organization has made good faith efforts to seek correction from the disqualified person(s) who benefited from the excess benefit transaction.

Section 53.4958-3(c)(2) of the Regs describes individuals having "substantial influence over the affairs of the organization" (per Code section 4958(f)(1)) as including presidents, chief executive officers, chief operating officers, or any person who, regardless of title, has ultimate responsibility for implementing the decisions of the governing body or for supervising the management, administration, or operation of the organization. A person who serves as president, chief executive officer, or chief operating officer has this ultimate responsibility unless the person demonstrates otherwise. If this ultimate responsibility resides with two or more individuals (e.g., co-presidents), who may exercise such responsibility in concert or individually, then each individual is in a position to exercise substantial influence over the affairs of the organization.

Section 53.4958-4(a)(4) provides that certain economic benefits are disregarded for purposes of section 4958, including (i) Nontaxable fringe benefits. An economic benefit that is excluded from income under section 132, except any liability insurance premium, payment, or reimbursement that must be taken into account under paragraph (b)(1)(ii)(B)(2) of this section, and (ii) Expense reimbursement payments pursuant to accountable plans. Amounts paid under reimbursement arrangements that meet the requirements of section 1.62-2(c) of this chapter.

Section 53.4958-4(c)(1) provides that an economic benefit is not treated as consideration for the performance of services unless the organization providing the benefit clearly indicates the intent to treat the benefit as compensation when the benefit is paid. An applicable tax exempt organization is treated as clearly indicating its intent to provide an economic benefit as compensation for services only if the organization provided written substantiation that is contemporaneous with the transfer of the economic benefit at issue. If an organization fails to provide this contemporaneous substantiation, any services provided by the disqualified person will not be treated as provided in consideration for the economic benefit for purposes of determining the reasonableness of the transaction. In no event shall an economic benefit that a disqualified person obtains by theft or fraud be treated as consideration for the performance of services.

Section 53.4958-4(c)(3)(i)(A) provides that an organization's reporting constitutes contemporaneous substantiation to treat a benefit as compensation if the organization reports the benefit as compensation on an original Federal tax information return with respect to the payment (e.g., Form W-2 or 1099); or the recipient disqualified person reports the benefit as income on the person's original Federal tax return (e.g., Form 1040); or there is an approved written employment contract executed on or before the date of the transfer indicating the benefit is compensation; or there is documentation by the organization's authorized body approving the transfer as compensation for services on or before the date of the transfer; or there was written evidence in existence before the due date of the applicable Federal tax return indicating a reasonable belief by the organization that the benefit was a nontaxable benefit as described in Regs section 53.4958-4(c)(2).

Section 53.4958-7(e) provides that when the applicable tax-exempt organization is no longer

described in section 501(c)(3), the disqualified person must make correction to another organization described in sections 501(c)(3) and 170(b)(1)(A) (other than sections 170(b)(1)(A)(vii) or (viii)) which has been so described for at least 60 months ending on the date of correction. It further provides that the disqualified person must not be a disqualified person with respect to the organization which receives the correction, and that the organization receiving the correction amount must not allow the disqualified person to make or recommend any grants or distributions by the organization.

Section 1.62-2(b) provides that for purposes of determining "adjusted gross income," section 62(a)(2)(A) allows an employee a deduction for expenses paid by the employee, in connection with the performance of services as an employee of the employer, under a reimbursement or other expense allowance arrangement with a payor. Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of section 62(a)(2)(A) if —

(1) Such arrangement does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) Such arrangement provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

(c) Reimbursement or other expense allowance arrangement — (1) Defined. For purposes of sections 1.62-1, 1.62-1T, and 1.62-2, the phrase "reimbursement or other expense allowance arrangement" means an arrangement that meets the requirements of paragraphs (d) (business connection), (e) (substantiation), and (f) (returning amounts in excess of expenses) of this section.

(2) Accountable plans — (i) In general. Except as provided in paragraph (c)(2)(ii), if an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, all amounts paid under the arrangement are treated as paid under an "accountable plan."

(ii) Special rule for failure to return excess. If an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, but the employee fails to return, within a reasonable period of time, any amount in excess of the amount of the expenses substantiated in accordance with paragraph (e) of this section, only the amounts paid under the arrangement that are not in excess of the substantiated expenses are treated as paid under an accountable plan.

(3) Nonaccountable plans — (i) In general. If an arrangement does not satisfy one or more of the requirements of paragraphs (d), (e), or (f) of this section, all amounts paid under the arrangement are treated as paid under a "nonaccountable plan." If a payor provides a nonaccountable plan, an employee who receives payments under the plan cannot compel the payor to treat the payments as paid under an accountable plan by voluntarily substantiating the expenses and returning any excess to the payor.

(ii) Special rule for failure to return excess. If an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, but the employee fails to return, within a reasonable period of time, any amount in excess of the amount of the expenses substantiated in accordance with paragraph (e) of this section, the amounts paid under the arrangement that are in excess of the substantiated expenses are treated as paid under a nonaccountable plan.

(4) Treatment of payments under accountable plans. Amounts treated as paid under an accountable plan are excluded from the employee's gross income, are not reported as wages or other compensation on the employee's Form W-2, and are exempt from the withholding and payment of employment taxes.

(5) Treatment of payments under nonaccountable plans. Amounts treated as paid under a nonaccountable plan are included in the employee's gross income, must be reported — as wages or other compensation on the employee's Form W-2, and are subject to withholding and payment of employment taxes (FICA, FUTA, RRTA, RURT, and income tax). See paragraph (h) of this section. Expenses attributable to amounts included in the employee's gross income may be deducted, provided the employee can substantiate the full amount of his or her expenses (i.e., the amount of the expenses, if any, the reimbursement for which is treated as paid under an accountable plan as well as those for which the employee is claiming the deduction) in accordance with sections 1.274-5T and 1.274(d)-1 or section § 1.162-17, but only as a miscellaneous itemized deduction subject to the limitations applicable to such expenses (e.g., the 80-percent limitation on meal and entertainment expenses provided in section 274(n) and the 2-percent floor provided in section 67).

(d) Business connection — (1) In general. Except as provided in paragraphs (d)(2) and (d)(3) of this section, an arrangement meets the requirements of this paragraph (d) if it provides advances, allowances (including per diem allowances, allowances only for meals and incidental expenses, and mileage allowances), or reimbursements only for business expenses that are allowable as deductions by part VI (section 161 and the following), subchapter B, chapter 1 of the Code, and that are paid or incurred by the employee in connection with the performance of services as an employee of the employer. The payment may be actually received from the employer, its agent, or a third party for whom the employee performs a service as an employee of the employer, and may include amounts charged directly or indirectly to the payor through credit card systems or otherwise. In addition, if both wages and the reimbursement or other expense allowance are combined in a single payment, the reimbursement or other expense allowance must be identified either by making a separate payment or by specifically identifying the amount of the reimbursement or other expense allowance.

(3) Reimbursement requirement — (i) In general. If a payor arranges to pay an amount to an employee regardless of whether the employee incurs (or is reasonably expected to incur) business expenses of a type described in paragraph (d)(1) or (d)(2) of this section, the arrangement does not satisfy this paragraph (d) and all amounts paid under the arrangement are treated as paid under a nonaccountable plan. See paragraphs (c)(5) and (h) of this section.

(ii) Per diem allowances. An arrangement providing a per diem allowance for travel expenses of a type described in paragraph (d)(1) or (d)(2) of this section that is computed on a basis similar to that used in computing the employee's wages or other compensation (e.g., the number of hours worked, miles traveled, or pieces produced) meets the requirements of this paragraph (d) only if, on December 12, 1989, the per diem allowance was identified by the payor either by making a separate payment or by specifically identifying the amount of the per diem allowance, or a per diem allowance computed on that basis was commonly used in the industry in which the employee is employed. See section 274(d) and section 1.274(d)-1. A per diem allowance described in this paragraph (d)(3)(ii) may be adjusted in a manner that reasonably reflects actual increases in employee business expenses occurring after December 12, 1989.

(e) Substantiation — (1) In general. An arrangement meets the requirements of this paragraph (e) if it requires each business expense to be substantiated to the payor in accordance with paragraph (e)(2) or (e)(3) of this section, whichever is applicable, within a reasonable period of time. See section 1.274-5T or section 1.162-17.

(2) Expenses governed by section 274(d). An arrangement that reimburses travel, entertainment, use of a passenger automobile or other listed property, or other business expenses governed by section 274(d) meets the requirements of this paragraph (e)(2) if information sufficient to satisfy the substantiation requirements of section 274(d) and the Regs thereunder is submitted to the payor. See section 1.274-5. Under section 274(d), information sufficient to substantiate the requisite

elements of each expenditure or use must be submitted to the payor. For example, with respect to travel away from home, section 1.274-5(b)(2) requires that information sufficient to substantiate the amount, time, place, and business purpose of the expense must be submitted to the payor. Similarly, with respect to use of a passenger automobile or other listed property, section 1.274-5(b)(6) requires that information sufficient to substantiate the amount, time, use, and business purpose of the expense must be submitted to the payor. See section 1.274-5(g) and (j), which grant the Commissioner the authority to establish optional methods of substantiating certain expenses. Substantiation of the amount of a business expense in accordance with rules prescribed pursuant to the authority granted by section 1.274-5(g) or (j) will be treated as substantiation of the amount of such expense for purposes of this section.

(3) Expenses not governed by section 274(d). An arrangement that reimburses business expenses not governed by section 274(d) meets the requirements of this paragraph (e)(3) if information is submitted to the payor sufficient to enable the payor to identify the specific nature of each expense and to conclude that the expense is attributable to the payor's business activities. Therefore, each of the elements of an expenditure or use must be substantiated to the payor. It is not sufficient if an employee merely aggregates expenses into broad categories (such as "travel") or reports individual expenses through the use of vague, nondescriptive terms (such as "miscellaneous business expenses"). See section 1.162-17(b).

(f) Returning amounts in excess of expenses — (1) In general. Except as provided in paragraph (f)(2) of this section, an arrangement meets the requirements of this paragraph (f) if it requires the employee to return to the payor within a reasonable period of time the amount paid under the arrangement in excess of the expenses substantiated in accordance with paragraph (e) of this section. The determination of whether an arrangement requires an employee to return amounts in excess of substantiated expenses will depend on the facts and circumstances. An arrangement whereby money is advanced to an employee to defray expenses will be treated as satisfying the requirements of this paragraph (f) only if the amount of money advanced is reasonably calculated not to exceed the amount of anticipated expenditures, the advance of money is made on a day within a reasonable period of the day that the anticipated expenditures are paid or incurred, and any amounts in excess of the expenses substantiated in accordance with paragraph (e) of this section are required to be returned to the payor within a reasonable period of time after the advance is received.

GOVERNMENT'S POSITION

ORG's 501(c)(3) status should be revoked, effective January 1, 20XX, based on the substantial inurement evidenced by the payments shown in Figures 5, 6, and 7 above. The examining agent has requested documentation and explanations for the above payments. ORG, the President and Vice-President, and Secretary have provided what documentation and explanations they could. The payments to or for these individuals that have either been acknowledged as benefiting them, or that still remain unsubstantiated total $* * * for 20XX, $* * * for 20XX, and $* * * for 20XX. This inurement violates section 501(c)(3) of the Internal Revenue Code and section 1.501(c)(3)-1(c)(2) of the Treasury Regulations.

The payments for Secretary' City apartment constitute inurement and EBTs. They benefited her through the provision of free housing. There was no contemporaneous substantiation that it was ORG'S intent to treat these payments as compensation for services.

The $$* * * from check ##* * * constitutes inurement and an EBT to President. It was not reported as compensation to President on any Form W2 issued to him, nor on any of ORG's Forms 990s filed prior to the December 20XX commencement of the IRS examination. This payment should have been

included in President' year 20XX Form W2, issued in January of 20XX. The President and Vice-President acknowledged in the January 17th response that this $$* * * "gift" should be reimbursed.

The $* * * from check #* * * constitutes inurement and an EBT to Vice-President. The January 17th response acknowledged that this was for the purchase of a watch for Vice-President, and that it should be reimbursed.

The $$* * * from check ##* * * constitutes inurement and an EBT to Vice-President. It was not reported as compensation to Vice-President on any Form W2 issued to her, nor on any of ORG's Forms 990s filed prior to the December 20XX commencement of the IRS examination. This payment should have been included in Vice-President' year 20XX Form W2, issued in January of 20XX. In any event, ORG's issuing of Vice-President' 20XX W2 in January 20XX came after the commencement of the IRS examination. It therefore does not meet the contemporaneous substantiation requirement of Regs section 53.4958-4(c)(3)(i)(A). ORG's inclusion of this amount on President and Vice-President compensation for the year 20XX is not a mitigating factor.

The rest of the unsubstantiated payments to President and Vice-President, shown in Figures 5, 6, and 7 also constitute inurement and EBTs. They benefited the President and Vice-President in the form of outright cash payments, mostly in $* * * denominations. These payments were not part of an accountable plan. They failed, variously, sections (d), (e), and (f) of Regs section 1.62-2. The shopping at CO-11 and other boutiques, and purchases of multiple Rolex watches fail the section 1.62-2(d) business connection requirement. And the rest of the unexplained excess reimbursements fail both the section 1.62-2(e) and (f) substantiation and return of excess requirements.

The argument in the January 17th response to the Code section 4958 reports that the total of receipts should be added to the total of per diem is not logical. Reimbursement arrangements are either "actual" or "per diem". To the extent that ORG had a particular reimbursement arrangement in place, it is clear, from the fact that it used "employee expense reports", that it was not based on per diem. It should be noted that this report only cites the excess of reimbursements over what has been substantiated as having a business connection. An employee would never be entitled to "reimbursement" of both actual and per diem, as was suggested in the response. The unsubstantiated payments in Figures 5, 6, and 7 thus constitute inurement and EBTs.

With respect to section 1.501(c)(3)-1(f)(2)(ii) of the Treasury Regs, the analysis of the five factors set forth therein is as follows:

(A) The size and scope of the organization's regular and ongoing activities that further exempt purposes before and after the excess benefit transaction or transactions

No evidence was gathered during the examination to suggest that there was any fluctuation in ORG's activities. Furthermore, due to the frequency of the payments at issue, being evenly spread throughout each year, no distinction can be made between ORG's activities "before and after" these payments. The qualification of ORG's activities for 501(c)(3) status are not being challenged in this report. Thus, this factor weighs neither in favor of, nor against, revocation.

(B) The size and scope of the excess benefit transaction or transactions in relation to the size and scope of the organization's regular and ongoing exempt activities

ORG does not have any "ongoing" exempt activities. It voluntarily became a for-profit entity on June 1, 20XX. Inasmuch as ORG's revenues reflect its exempt activities, its revenues during the years under examination, while it was still exempt, was $* * *. The inurement and EBTs cited above total $* * *, or about * * *%. This is a significant amount of inurement and EBTs, and weighs in favor of

revocation.

(C) Whether the organization has been involved in multiple excess benefit transactions with one or more persons

ORG engaged in over sixty EBTs during the years under examination. These transactions involved three different officers; President, Vice-President, and Secretary. This weighs in favor of revocation.

(D) Whether the organization has implemented safeguards that are reasonably calculated to prevent excess benefit transactions

ORG forfeited its own 501(c)(3) exemption June 1, 20XX. At issue, then, is whether its exemption should also be revoked for the period of January 1, 20XX to May 31, 20XX. It is evident that no safeguards were put in place to prevent EBTs from 20XX to 20XX, or from 20XX to 20XX. On the contrary, President has even more unfettered control over ORG's assets, now that ORG is owned by his wholly-owned company, CO-3. This factor weighs in favor of revocation.

(E) Whether the excess benefit transaction has been corrected (within the meaning of section 4958(f)(6)), or the organization has made good faith efforts to seek correction from those who benefited from the excess benefit transaction

As of the date of this report, ORG is no longer described in section 501(c)(3) of the Internal Revenue Code. Repayments to ORG would not qualify as "correction" within the meaning of section 4958(f)(6). Therefore, per Regs section 53.4958-7(e), any correction to be made by the President and Vice-President or Secretary would have to go to a different 501(c)(3) organization. As of the date of this report, no correction has been made to such a 501(c)(3) organization. Therefore, applying this factor would weigh in favor of revocation.

TAXPAYER'S POSITION

ORG has not yet taken a position with respect to this report.

CONCLUSION

ORG's earnings have inured to the benefit of three of its officers, President, Vice-President, and Secretary. This inurement totaled $* * * during the years 20XX, 20XX, and 20XX. This is a substantial amount of inurement, and violates section 1.501(c)(3)-1(c)(2) of the Treasury Regs. Given the routine and continuous nature of the inurement, this warrants revocation of ORG's 501(c)(3) status effective January 1, 20XX. ORG should file Form 1120, U.S. Corporation Income Tax Return, for the years 20XX and 20XX, and for the period ended May 31, 20XX. If the proposed revocation becomes final, appropriate State officials will be notified in accordance with Code section 6104(c).

FOOTNOTES

1 CPA also represented the President and Vice-President in their Code section 4958 examinations until March 20XX, when they appointed CPA as their representative.

2 The agent found that the legible receipts only totaled $$* * * which included $$* * * in hotel receipts. The $$* * * CO-5 invoice was discussed separately and so presumably was not included in the $$* * *.

Comments Requested on Information Return for Tax Credit Bonds.

The IRS has requested comments on Form 8038-TC, “Information Return for Tax Credit Bonds”; comments are due by September 6, 2013.

http://services.taxanalysts.com/taxbase/eps_pdf2013.nsf/DocNoLookup/16344/$FILE/2013-16344-1.pdf

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Comments Requested on Regs on Remedial Actions for QZABs.

The IRS has requested comments on regulations (T.D. 9339) on the maximum term and permissible use of proceeds of qualified zone academy bonds and on specified remedial actions for curing some violations of the rules for those bonds; comments are due by September 6, 2013.

http://services.taxanalysts.com/taxbase/eps_pdf2013.nsf/DocNoLookup/16360/$FILE/2013-16360-1.pdf

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IRS: FSLG July 2013 Newsletter.

Inside This Issue

- IRS Guidance on Sick Leave Plans
- Severance Pay and FICA
- Taxpayer Identification Number (TIN) On-Line Matching
- Recorded Webinars for Government Employers
- EHR Reporting
- Directory of FSLG Specialists

http://www.irs.gov/Government-Entities/Federal,-State-&-Local-Governments/Current-Edition-of-the-FSLG-Newsletter

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IRS LTR: Supporting Organization's Ownership Interest in For-Profit Won't Jeopardize Exemption.

The IRS ruled a supporting organization’s ownership interest in a newly formed holding company resulting from a restructuring transaction won’t adversely affect its tax-exempt status.

Employer Identification Number: * * *

LEGEND:

Center = * * *

Group = * * *

Network = * * *

Health = * * *

Dear * * *:

This is in reply to your letter of June 30, 2011, in which you request a ruling on the effect to your tax-exempt status of your proposed ownership (through a wholly-owned disregarded entity) in a for-profit Subchapter S corporation.

FACTS

You are tax-exempt under I.R.C. § 501(c)(3), and a § 509(a) supporting organization of the Center and its School of Medicine. The Center is part of a state-chartered university system. You are a faculty group practice that assists the Center in carrying out its mission, particularly as it relates to the Center's clinical practice function. You consist of the faculty of the clinical departments of the Center. Through you, the Center's faculty is able to enter into contractual relationships with health plans, community providers, and businesses to provide health care services and thereby operate a health care delivery system. The health care delivery system, which you facilitate, promotes the charitable, educational, and research programs of the Center by providing it with the clinical programs and patient populations with which to educate its students and conduct research, while also providing healthcare services to the public regardless of ability to pay.

You are the sole member of the Group, a wholly owned subsidiary that is treated as a disregarded entity for federal tax purposes. The Group provides professional medical services as a participating independent physician association ("IPA") in the Network. The Network is organized as a for-profit corporation, and serves as a third party administrator providing medical necessity review organization services to its clients under state licenses. The Group owns * * * percent of the issued and outstanding common shares of the Network. The Network has six additional IPA shareholders that are unrelated to the Group. The Network is currently a C corporation for federal income tax purposes. These six additional IPA shareholders comprise for-profit corporations and a partnership.

The Network has four wholly owned subsidiaries. Three of the subsidiaries are limited liability companies that are disregarded as separate entities for federal income tax purposes. The fourth subsidiary, Health, is a C corporation and insurance company for federal income tax purposes. All four wholly owned subsidiaries are involved in healthcare or healthcare related services.

In addition to being a participant IPA in, and shareholder of, the Network, the Group has an exclusive management agreement with the Network under which the Network provides certain administrative and contract services to the Group. These services include collecting revenue, paying claims, contracting with healthcare providers, and performing other administrative functions necessary to manage the Group. For its services, the Network collects * * *% of all collected revenues. At the year-end, the Network reconciles its actual management costs incurred on behalf of the Group and remits any overpayments to the Group. The Group remits to you the overpayments it receives from the Network.

Proposed Restructuring Transaction

In order to achieve an ownership structure that is eligible for S corporation status, the following restructuring transaction is proposed:

A new entity, the "Holding Company," will be established, and will make an "S" election as of the date of formation.

The Group and the other shareholders of the Network will contribute their shares of the Network to the capital of the Holding Company, thus making the Network a wholly owned subsidiary of the Holding Company.

The Holding Company will make a qualified subchapter "S" subsidiary ("QSSS") election for the Network.

The Network will distribute its membership interests in its three subsidiaries that are disregarded entities for federal tax purposes to the Holding Company. The Network will continue to own all of the issued and outstanding common shares of Health.

Once the proposed transaction is completed, the Group will hold * * *% of the Holding Company. The remaining * * * % will be owned by the 54 individuals that currently own the six other shareholders of the Network. All of the entities involved in the proposed transaction will continue to operate for the same business purposes as they did prior to the transaction.

The Holding Company will have a board or directors consisting of seven members. The Group will have the right to elect one board member and the other unrelated shareholders will elect the remaining six board members. The Network will have a board of directors consisting of 14 members. The Group will have the right to elect two board members and the other unrelated shareholders will elect the remaining 12 board members.

Health will have a board of directors consisting of six members. Three of the members will be selected by the Network's board of directors from among its members, and the other three members will be selected from the Network's senior management team. The three subsidiaries of the Holding Company that are disregarded entities for federal income tax purposes will be managed by a non-shareholder manager selected by the Holding Company.

The Holding Company and its subsidiaries will each develop, maintain, and manage its own financial systems independent of you and the Group. The Holding Company and its subsidiaries will each by operated by a professional staff with expertise in the relevant business areas, which are independent and unrelated to you. Neither you nor the Group will be involved in the day-to-day management of the Holding Company or any of its subsidiaries.

RULING REQUESTED

You have requested the following ruling:

Your ownership, through your wholly-owned disregarded entity, Group, in a for-profit Subchapter "S" corporation, together with the flow-through allocation of "S" tax items subject to the unrelated business income tax, has no effect on the your tax exempt status.

LAW

I.R.C. § 501(c)(3) provides for the exemption from federal income tax of organizations that are organized and operated exclusively for religious, charitable, scientific, or educational purposes, provided no part of the net earnings inure to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that, in order to qualify as an organization described in § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it does not qualify for exemption.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it is engaged primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

I.R.C. § 511(a) imposes a tax on the unrelated business taxable income of organizations exempt from federal income tax under I.R.C. § 501(c).

I.R.C. § 512(e) provides that if an organization described in § 1361(c)(6) holds stock in a S corporation — (A) such interest shall be treated as an interest in an unrelated trade or business; and, (B) notwithstanding any other provisions of this part — (i) all items of income, loss, or deduction taken into account under § 1366(a), and (ii) any gain or loss on the disposition of the stock in the S corporation shall be taken into account in computing the unrelated business taxable income of such organization.

I.R.C. § 1361(c)(6) provides that, for purposes of subsection (b)(1)(B) (which defines the term "small business corporation"), an organization which is (A) described in § 401(a) or 501(c)(3), and (B) exempt from taxation under § 501(a), may be a shareholder in an S corporation.

In Moline Properties, Inc. v. Comm'r, 319 U.S. 436, 438-39 (1943), the Supreme Court said that "[t]he doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. . . . In general, in matters relating to the revenue, the corporate form maybe disregarded where it is a sham or unreal. In such situations the form is a bald and mischievous fiction." In response to the argument that a corporation is a mere agent of its sole stockholder, the court said that "the mere fact of the existence of a corporation with one or several stockholders, regardless of the corporation's business activities, does not make the corporation the agent of its stockholders. Id. at 440.

In National Carbide Corp. v. Comm'r, 336 U.S. 422, 437 (1949), the Supreme Court said that a finding of a "true agency" relationship turns on several factors. "Whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money received to the principal, and whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal are some of the relevant considerations in determining whether a true agency exists. If the corporation is a true agent, its relations with the principal must not be dependent upon the fact that it is owned by the principal, if such is the case. Its business purposes must be the carrying on of the normal duties of an agent."

In National Investors Corp. v. Hoey, 144 F.2d 466, 468 (2nd Cir. 1944), the court said that "to be a separate jural person for purposes of taxation, a corporation must engage in some industrial, commercial, or other activity besides avoiding taxation; in other words, that the term 'corporation' will be interpreted to mean a corporation which does some 'business' in the ordinary meaning; and that escaping taxation is not 'business' in the ordinary meaning."

In Britt v. U.S., 431 F.2d 227, 237 (5th Cir. 1970), the court said that "business activity is required for recognition of the corporation as a separate taxable entity; the activity may be minimal."

In Krivo Indus. Supply Co. v. Nat'l Distillers & Chem. Corp., 483 F.2d 1098, 1106 (5th Cir. 1973), the Court said that "the control required for liability under the 'instrumentality' rule amounts to total

domination of the subservient corporation, to the extent that the subservient corporation manifests no separate corporate interests of its own and functions solely to achieve the purposes of the dominant corporation."

ANALYSIS

For taxable years beginning before January 1, 1998, tax exempt organizations described in § 501(c)(3) could not be shareholders in an S corporation. In 1996, Congress enacted the Small Business Job Protection Act, Pub. L. No. 104-188, 110 Stat. 1755, authorizing the ownership of S corporation stock by tax-exempt organizations described in § 501(c)(3). The Joint Committee on Taxation's General Explanation of Tax Legislation Enacted in the 104th Congress (JCS-12-96), December 18, 1996, Sec. 1316, p. 130, describes the reason for the change in law as follows —

The Congress believed that the present-law prohibition of certain tax-exempt organizations being S corporation shareholders may have inhibited employee ownership of closely-held businesses, frustrated estate planning, discouraged charitable giving, and restricted sources of capital for closely-held businesses. The Congress sought to lift these barriers by allowing certain tax-exempt organizations to be shareholders in S corporations. However, the provisions of subchapter S were enacted in 1958 and substantially modified in 1982 on the premise that all income of the S corporation (including all gains on the sale of the stock) would be subject to a shareholder-level income tax. This underlying premise allows the rules governing S corporations to be relatively simple . . . because of the lack of concern about "transferring" income to non-taxpaying persons. Consistent with this underlying premise of subchapter S, the provision treats all the income flowing through to a tax-exempt shareholder, and gains and losses from the disposition of the stock, as unrelated business taxable income.

As a result of the legislation, tax-exempt organizations described in § 501(c)(3) are allowed to be shareholders in an S corporation under § 1361(c)(6). Furthermore, under § 512(e), items of income or loss of an S corporation will flow through to tax-exempt shareholders as unrelated business taxable income regardless of the source or nature of such income. In addition, gain or loss on the sale or other disposition of stock of an S corporation will be treated as unrelated business taxable income. These provisions, however, do not cause the for-profit activities of the S corporation to be attributed to the tax-exempt shareholder. See Moline Properties, Inc., 319 U.S. at 440. In determining whether the activities of a for-profit S corporation subsidiary is attributable to its tax-exempt parent, the separate identity principles annunciated in Moline Properties, Inc. v. Comm'r should apply lest the intent of Congress to remove barriers for investment in S corporations by tax-exempt entities be frustrated.

For federal income tax purposes, a parent corporation and its subsidiaries are treated as separate and distinct taxable corporate entities as long as each entity has a valid business purpose and engages in at least a minimal amount of business activity. See Moline Properties, Inc., 319 U.S. at 438; National Investors Corp., 144 F.2d at 468; Britt, 431 F.2d at 234. However, where the parent corporation so controls the affairs of the subsidiary that it is merely an instrumentality of the parent, the corporate identity of the subsidiary may be disregarded. See, Krivo, 483 F.2d at 1106.

Hence, the activities of a for-profit subsidiary will not be attributed to its tax-exempt parent unless (1) the subsidiary lacks a business purpose, or (2) the subsidiary is an arm or agent of the parent.

In your case, your relationship with the Holding Company does not fail the first prong, i.e., that the subsidiary have a business purpose and conduct some amount of business activity. The Holding Company and its four subsidiaries have been, or will be, organized to perform bona fide and substantial business functions. The Holding Company and all of its subsidiaries maintain activities

that are separate, distinct, and independent from you. Therefore, their existence may not be disregarded for tax purposes.

Additionally, your relationship with the Holding Company does not fail the second prong, i.e., that the parent not control the day-to-day operations of the subsidiary. The Holding Company has its own corporate identity and interests, and its own independent board of seven directors, only one of which is chosen by you. The other six directors are chosen by unrelated shareholders. Furthermore, each of the Holding Company's subsidiaries has its own management and employees independent of you. Furthermore, neither your investment in the Holding Company nor your management agreement with the Network exhibits any of the attributes of a "true agency" relationship identified in National Carbide Corp., 336 U.S. at 437. Therefore, neither the Holding Company nor its subsidiaries can be considered a sham or under your "total domination." Consequently, the activities of the Holding Company and its subsidiaries would not be attributable to you.

CONCLUSION

In light of the foregoing, we rule as follows:

Your ownership interest in the Holding Company, a for-profit subchapter S corporation, through Group, together with the flow-through allocation of the Holding Company's "S" tax items subject to the unrelated business income tax, would have no effect on your tax-exempt status as an organization described in § 501(c)(3).

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolved questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Peter A. Holiat

Acting Manager,

Exempt Organizations

Technical Group 1

Citations: LTR 201328035

IRS LTR: Foundation Granted More Time to Dispose of Stock.

The IRS granted a private foundation an additional five years to dispose of excess holdings of corporate stock after concluding the foundation made diligent efforts to dispose of the shares but was unable to do so except at a price substantially below the fair market value.

Employer Identification Number: * * *

LEGEND:

Corporation = * * *

Founder = * * *

Brand = * * *

Date 1 = * * *

Date 2 = * * *

Dear * * *:

This is in response to your ruling request dated November 28, 2012, requesting an extension for an additional five years under I.R.C. § 4943(c)(7) for disposing of certain excess business holdings.

FACTS

You are a private foundation organized as a nonprofit corporation to further the charitable interests of your Founder. You have been recognized as an organization exempt under § 501(c)(3) and are classified as a private foundation within the meaning of § 509(a). You state that you operate exclusively for charitable and educational purposes through the making of grants and contributions to charities. You acquired * * * percent of Corporation stock as a donation from your Founder after his death. You have excess business holdings in Corporation under § 4943(c)(1). Your initial five-year period for disposing of these excess business holdings will end on Date 1.

During the initial five-year period for disposing of excess business holdings under § 4943(c)(6), you have created a more formal management and governance structure for Corporation, and taken steps to unify the Brand with respect to * * *. Your managers have consulted with advisors, valuation specialist and legal counsel to discuss the various disposition options available to you.

You represent that, because of the size, value, nature, and complexity of this business holding, you have, despite your best efforts, been unable to complete the sale of Corporation stock within the prescribed five-year period except at a price substantially below fair market value. You represent that you will be better able to determine and realize the full fair market value of your interest in Corporation after the expiration of the initial five-year period.

Your directors have established a plan of disposition that includes either selling your Corporation stock to an unaffiliated third party or donating Corporation shares to one or more charitable organizations. Your directors expect that they can dispose of the Corporation stock no later than

Date 2. You submitted the plan to your appropriate state Attorney General and are waiting for a response. If and when a response is received from the Attorney General, a copy will be submitted to the Secretary in accordance with § 4943(c)(7)(B)(ii).

Prior to the end of the initial five-year period for disposing of excess business holdings under § 4943(c)(6), you submitted a request to the Internal Revenue Service for an extension of five years to complete the required disposition.

RULING REQUESTED

You requested a ruling extending the five-year period of time for disposing of excess business holdings for an additional five years under § 4943(c)(7).

LAW

I.R.C § 4943(a)(1) imposes excise taxes on the excess business holdings of any private foundation in a business enterprise.

I.R.C. § 4943(c)(1) provides that the term “excess business holdings” means, with respect to the holdings of any private foundation in any business enterprise, the amount of stock or other interest in the enterprise which the foundation would have to dispose of to a person other than a disqualified person in order for the remaining holdings of the foundation in such enterprise to be permitted holdings.

I.R.C. § 4943(c)(2) provides in part that the permitted holdings of any private foundation in an incorporated business enterprise are 20 percent of the voting stock, reduced by the percentage of the voting stock owned by all disqualified persons.

I.R.C. § 4943(c)(6)(A) provides that, if there is a change in the holdings in a business enterprise (other than by purchase by the private foundation or by a disqualified person) which causes the private foundation to have excess business holdings in such enterprise, the interest of the foundation in such enterprise (immediately after such change) shall (while held by the foundation) be treated as held by a disqualified person (rather than by the foundation) during the 5-year period beginning on the date of such change in holdings.

I.R.C. § 4943(c)(7) provides that the Internal Revenue Service may extend for an additional five years the initial five-year period for disposing of excess business holdings in the case of an unusually large gift or bequest of diverse business holdings or holdings with complex corporate structures if:

(A) The foundation establishes that: (i) it made diligent efforts to dispose of such holdings during the initial five-year period, and (ii) disposition within the initial five-year period has not been possible (except at a price substantially below fair market value) by reason of such size and complexity or diversity of holdings;

(B) Before the close of the initial five-year period: (i) the private foundation submits to the Internal Revenue Service a plan for disposing of all of the excess business holdings involved in the extension, and (ii) the private foundation submits the plan to the Attorney General (or other appropriate State official) having administrative or supervisory authority or responsibility with respect to the foundation’s disposition of the excess business holdings involved and submits to the Internal Revenue Service any response the private foundation received during the five-year period; and

(C) The Internal Revenue Service determines that such plan can reasonably be expected to be carried out before the close of the extension period.

ANALYSIS

You are subject to § 4943, which imposes a tax on the excess business holdings of private foundations. Generally, under § 4943(c)(2)(A), a private foundation and its disqualified persons are permitted to hold twenty percent of the voting stock in a business enterprise, with any excess constituting excess business holdings. However, if a private foundation acquires holdings in a business enterprise other than by purchase (e.g., by gift) which causes the foundation to have excess business holdings, then the interest of the foundation in such business enterprise shall be treated as held by a disqualified person (rather than the foundation) for a five-year period beginning on the date such holdings were acquired by the foundation, under § 4943(c)(6)(A).

Under § 4943(c)(7), the Internal Revenue Service may extend the initial five-year period for disposing of excess business holdings for an additional five years if a foundation establishes that: (i) it made diligent efforts to dispose of such holdings during the initial five-year period, and disposition within the initial five-year period has not been possible (except at a price substantially below fair market value) by reason of the size and complexity or diversity of holdings, (ii) before the close of the initial five-year period it submits to the Internal Revenue Service, and to the Attorney General (or other appropriate State official) having administrative or supervisory authority or responsibility with respect to the foundation's disposition of the excess business holdings, a plan for disposing of all of the excess business holdings involved during the extension and (iii) the Internal Revenue Service determines that such plan can reasonably be expected to be carried out before the close of the extension period.

You received a donation of * * *% of the Corporation stock from Founder, a disqualified person under § 4946. You have stated that you consequently have excess business holdings in Corporation under § 4943(c)(1). Therefore, you are required under § 4943(c)(6) to dispose of these holdings during the initial five-year period that will end on Date 1. You have established that during the initial five-year period you have made diligent efforts to dispose of the Corporation stock, but disposition within this period has not been possible (except at a price substantially below fair market value) because of the size and complexity or diversity of your holdings. Before the end of the initial five-year period, you submitted a request to the Internal Revenue Service under § 4943(c)(7) for an additional five-year period within which to dispose of your excess business holdings in Corporation and you described your plan for disposing of these holdings. You also submitted the plan to the Attorney General of your state, who is expected to approve the plan. Based on the information submitted, we have determined that your plan to dispose of your excess business holdings in Corporation within an additional five-year period can reasonably be expected to be carried out. Therefore, we conclude that you do meet the requirements under § 4943(c)(7) for an extension of five years to dispose of your excess business holdings in Corporation.

RULING

Under § 4943(c)(7), the period during which you may dispose of your excess business holdings in Corporation is extended for an additional five years, until Date 2.

We are not ruling on whether your interest in Corporation constitutes excess business holdings.

This ruling will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Ronald Shoemaker

Manager, Exempt Organizations

Technical Group 2

Citations: LTR 201328034

LTR: Issuance of New Bonds Determined to Be Refunding of the Bonds.

The IRS ruled that the issuance of new bonds is a refunding of the bonds within the meaning of reg. section 1.150-1(d)(1), notwithstanding that the technical termination of a partnership that held the principal under reg. section 1.708-1(b)(2) occurred within six months of the date of the refinancing.

Citations: LTR 201326007

LEGEND:

Issuer = * * *

Borrower = * * *

Facility = * * *

Principal = * * *

Partnership = * * *

Holding Company = * * *

Bank A = * * *

Bank B = * * *

Date 1 = * * *

Date 2 = * * *

Date 3 = * * *

Bonds = * * *

New Bonds = * * *

Dear * * *:

This responds to your request for a ruling that notwithstanding the purchases on Date 1 and Date 3 (as described below) and the technical termination of Partnership under § 1.708-1(b)(2) of the Income Tax Regulations, all within six months of the date of the Refinancing (as described below), the issuance of the New Bonds is a refunding of the Bonds within the meaning of Treas. Reg. § 1.150-1(d)(1).

FACTS AND REPRESENTATIONS

You make the following representations. Issuer is a governmental agency constituting a public benefit corporation authorized to issue bonds and responsible for providing low-income housing.

Borrower is a limited-liability company formed for the purpose of constructing and developing Facility, a multi-family rental housing development. For Federal income tax purposes, Borrower is a disregarded entity. Through several single-member limited liability companies that are disregarded for Federal income tax purposes, Principal (or New Principal, as described below) at all relevant times has owned all of the capital and profits interest in Borrower. At all relevant times, Partnership (or New Partnership, as described below) directly has owned * * * percent of Principal.

Immediately prior to Date 1, Bank A and Bank B owned approximately * * * percent of Partnership, and Holding Company owned approximately percent of Partnership. Third parties that include certain Partnership employees and officers unrelated to Bank A, Bank B, or Holding Company (the "Third Parties"), owned the remaining approximate * * * percent of the capital and profits interest in Partnership.

On Date 1, Holding Company exercised an option to acquire half of the capital and profits interests in Partnership that had been owned by Bank A and Bank B (the "Date 1 Purchase"). Thus, after Date 1, Bank A and Bank B owned approximately * * * percent and * * * percent of the capital and profits interests in Partnership, respectively. Holding Company owned approximately * * * percent of the capital and profits interests in Partnership. The Third Parties continued to own the remaining approximate * * * percent of the capital and profits interest in Partnership.

Facility is financed by a mortgage loan (the "Mortgage Loan") from Issuer to Borrower. The Bonds were issued by Issuer to provide a portion of the funding for the Mortgage Loan. Because Borrower is a disregarded entity for Federal income tax purposes, Principal is treated as the obligor on the Bonds. On Date 2, less than four months after Date 1, the Bonds were remarketed such that a reissuance occurred (the "Refinancing"). Borrower is the obligor on the reissued bonds (the "New Bonds") but because Borrower is a disregarded entity, Principal is treated as the obligor on the New Bonds. The proceeds of the New Bonds were used to pay the principal of the Bonds.

On Date 3, less than six months after Date 1, Holding Company acquired from Bank A and Bank B, respectively, their remaining * * * percent and * * * percent of the capital and profits interests in Partnership (the "Date 3 Purchase"). Thus, as of Date 3 Holding Company owned * * * percent of Partnership, and the Third Parties owned the approximate * * * percent of Partnership which

remained. Neither Borrower nor Issuer had any control over the sales by Bank A and Bank B of their interests in Partnership.

Borrower represents that the Refinancing was not related to, or contingent in any way upon, the Date 1 Purchase or the Date 3 Purchase, and that the Date 1 Purchase and the Date 3 Purchase were not related to, or contingent in any way upon, the Refinancing. Borrower represents that the Refinancing would have occurred regardless of whether the Date 1 Purchase or the Date 3 Purchase occurred.

Issuer represents that it is applying Prop. Treas. Reg. § 1.150-1(d)(2)(ii) and (v), 67 Fed Reg 17509 (April 10, 2002), to the New Bonds.

LAW AND ANALYSIS

Treas. Reg. § 1.150-1(a)(1) provides that the definitions of § 1.150-1 apply for all purposes of I.R.C. §§ 103 and 141 through 150. Treas. Reg. § 1.150-1(d)(1) provides, in general, that a refunding issue is an issue of obligations the proceeds of which are used to pay principal, interest, or redemption price on another issue (a prior issue, as more particularly defined in paragraph (d)(5)), including the issuance costs, accrued interest, capitalized interest on the refunding issue, a reserve or replacement fund, or similar costs, if any, properly allocable to that refunding issue.

Treas. Reg. § 1.150-1(b) defines related party in part to mean, with reference to any person that is not a governmental unit or 501(c)(3) organization, a related person (as defined in § 144(a)(3)). Section 144(a)(3) provides in part that a person is a related party to another person if the relationship between such persons would result in a disallowance of losses under §§ 267 or 707(b). Section 707(b)(1)(B) states that no deduction shall be allowed in respect of losses from sales or exchanges of property (other than an interest in the partnership), directly or indirectly, between two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests. Section 707(b)(3) provides that for this purpose, the ownership of a capital or profits interest in a partnership shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) other than paragraph (3) of such section. Section 267(c)(1) provides, in part, that stock owned, directly or indirectly, by or for a partnership shall be considered as being owned proportionately by or for its partners.

Issuers may apply proposed regulations amending Treas. Reg. § 1.150-1(d) published in the Federal Register on April 10, 2002 (67 Fed. Reg. 17509) (the “Proposed Regulations”), in whole, but not in part, to any issue that is sold on or after April 10, 2002, and before the applicability date of the final regulations.

Prop. Treas. Reg. § 1.150-1(d)(2)(ii)(A) provides in part that an issue is not a refunding issue to the extent that the obligor (as defined in paragraph (d)(2)(ii)(B)) of one issue is neither the obligor of the other issue nor a related party with respect to the obligor of the other issue. The determination of whether persons are related for this purpose is generally made immediately before the issuance of the refinancing issue.

Prop. Treas. Reg. § 1.150-1(d)(2)(ii)(B) provides in part that the obligor of an issue means the actual issuer of the issue, except that the obligor of the portion of an issue properly allocable to an investment in a purpose investment means the conduit borrower under that purpose investment.

Prop. Treas. Reg. § 1.150-1(d)(2)(ii)(C) provides in part that if, within six months before or after a person assumes (including taking subject to) obligations of an unrelated party in connection with an acquisition transaction (other than a transaction to which § 381(a) applies), the assumed issue is

refinanced, the refinancing issue is not a refunding issue. An acquisition transaction is a transaction in which a person acquires assets (other than an equity interest in an entity) from an unrelated party.

Section 708(a) provides that, for purposes of subchapter K, an existing partnership shall be considered as continuing, if it is not terminated.

Section 708(b)(1)(B) provides that, for purposes of § 708(a), a partnership shall be considered as terminated only if within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

Treas. Reg. § 1.708-1(a) provides that for purposes of subchapter K, chapter 1 of the Code, an existing partnership shall be considered as continuing if it is not terminated. Section 1.708-1(b)(2) provides, in part, that a partnership shall terminate when 50 percent or more of the total interest in partnership capital and profits is sold or exchanged within a period of 12 consecutive months. Moreover, if the sale or exchange of an interest in a partnership (upper-tier partnership) that holds an interest in another partnership (lower-tier partnership) results in a termination of the upper-tier partnership, the upper-tier partnership is treated as exchanging its entire interest in the capital and profits of the lower-tier partnership. If the sale or exchange of an interest in an upper-tier partnership does not terminate the upper-tier partnership, the sale or exchange of an interest in the upper-tier partnership is not treated as a sale or exchange of a proportionate share of the upper-tier partnership's interest in the capital and profits of the lower-tier partnership.

Treas. Reg. § 1.708-1(b)(4) provides, in part, that if a partnership is terminated by a sale or exchange of an interest, the following is deemed to occur: The partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in a new partnership; and, immediately thereafter, the terminated partnership distributes interests in the new partnership to the purchasing partner and the other remaining partners in proportion to their respective interests in the terminated partnership in liquidation of the terminated partnership, either for the continuation of the business by the new partnership or for its dissolution and winding up.

Issuer is applying the Proposed Regulations to the New Bonds. At the time of the Refinancing on Date 2, the obligor of the Bonds was Borrower/Principal and the obligor of the New Bonds was Borrower/Principal. No change occurred at that time in the ownership of either Principal or Partnership. However, on Date 3, within 6 months of the Refinancing, a termination and transfer of assets and liabilities of Partnership occurred pursuant to § 708(b), when Holding Company acquired Bank A's and Bank B's remaining shares in Partnership. Further, Partnership is treated as exchanging its percent interest in Principal, resulting in a termination and transfer of assets and liabilities of Principal.

Under Prop. Treas. Reg. § 1.150-1(d)(2)(ii)(C), a refinancing issue is not treated as refunding issue if, within six months before or after a person assumes (including taking subject to) obligations of an unrelated party in connection with an asset acquisition from an unrelated party, the assumed obligation is refinanced. That section requires an analysis of whether the debt was assumed by, and the deemed transfer of the assets was to, an unrelated party.

As a result of the technical termination, the assets and liabilities of Partnership were deemed transferred to a new partnership ("New Partnership"), * * * percent of which is owned by Holding Company. Immediately prior to the Date 3 purchase, Holding Company owned * * * of Partnership. Therefore, because Holding Company's ownership interests in Partnership and in New Partnership are both greater than * * * percent, Partnership and New Partnership are related parties for purposes of § 1.150-1(b). Similarly, the assets and liabilities of Principal were deemed transferred to

a new partnership (“New Principal”). Thus, Partnership owned * * * percent of Principal before the Date 3 purchase and New Partnership owned * * * percent of New Principal after the Date 3 purchase. Because of Holding Company’s interests in Partnership and New Partnership, Principal and New Principal also are related parties.

Accordingly, the New Bonds are refunding bonds because the obligors of the Bonds and the New Bonds were the same on Date 2 and the transfers of assets and liabilities of Principal and Partnership on Date 3 were between related parties.

CONCLUSION

Under the facts and circumstances of this case, notwithstanding the technical termination of Partnership under Treas. Reg. § 1.708-1(b)(2) (all within six months of the date of the Refinancing), we conclude that the New Bonds are refunding bonds

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to the authorized representative of Issuer and Borrower.

The ruling contained in this letter is based upon information and representations submitted by Issuer and Borrower and accompanied by penalty of perjury statements executed by the appropriate parties. While this office has not verified any of the materials submitted in support of the request for a ruling, it is subject to verification upon examination.

Sincerely,

Associate Chief Counsel

(Financial Institutions & Products)

By: Timothy L. Jones

Senior Counsel, Branch 5

IRS: Exempt Organization Update.

1. IRS announces Optional Expedited Process for certain 501(c)(4) Exemption Applications
2. IRS Nationwide Tax Forums begin next week
3. Check out this summer’s IRS phone forums
4. Register for EO workshops
5. Section 509(a)(3) Supporting Organizations pages updated
6. IRS accepting applications for Low Income Taxpayer Clinic grants
7. IRS Electronic Tax Administration Advisory Committee delivers report to Congress

1. IRS announces Optional Expedited Process for certain 501(c)(4) Exemption Applications

The IRS announced an optional expedited process for certain Section 501(c)(4) applications. To qualify, organizations must have applied for 501(c)(4) exempt status, their application must be pending for more than 120 days as of May 28, 2013, and their cases must involve possible political campaign intervention or issue advocacy.

http://www.irs.gov/Charities-&-Non-Profits/New-Review-Process-and-Expedited-Self-Certification-Option

2. IRS Nationwide Tax Forums begin next week

The IRS Nationwide Tax Forums, which begin next week in Orlando, Fla., offer three full days of seminars with the latest word from IRS leadership and experts in the fields of tax law, compliance and ethics.

Attendees can:

- Select from more than 40 seminars and workshops
- Earn up to 18 continuing professional education credits
- Explore the expo hall for the latest tax professional products and services

http://www.irs.gov/Tax-Professionals/IRS-Nationwide-Tax-Forum-Information

3. Check out this summer's IRS phone forums

For a list of upcoming phone forums, go to the phone forums section of the Calendar of Events page.

"Charities and their Volunteers" – July 24

We've scheduled an encore session! The registration link on our phone forums page will be live soon.

"Veterans Organizations – Complying with IRS Rules" — July 30

Veterans organizations occupy a special place in the world of exempt organizations. Not only are most veterans organizations exempt from tax, but contributions to them may be deductible, and some are permitted to set aside amounts that are used to provide insurance benefits to members.

This combination — tax-exempt status, deductibility of contributions and the ability to pay benefits to members — is relatively rare and is evidence of Congress's intent to provide special tax treatment for veterans organizations. This phone forum provides information to help them stay tax exempt.

Topics include:

- Requirements for exemption
- Recordkeeping
- Filing and reporting
- Unrelated business income tax
- Exempt activities
- Bona fide guests

"What's Special about Schedule K (Form 990)?" – July 31

Topics covered include:

- Helpful resources for completion of Schedule K
- Detailed discussion of Schedule K information requirements
- Helpful compliance monitoring procedures
- Space is limited so register quickly.

http://www.irs.gov/Charities-&-Non-Profits/Phone-Forums-Exempt-Organizations

4. Register for EO workshops

Register for upcoming workshops for small and medium-sized 501(c)(3) organizations:

August 13 – Highland Heights, KY

Hosted by University of Kentucky

August 15 – Lexington, KY

Hosted by University of Kentucky

August 20-21 – San Francisco, CA

Hosted by Golden Gate University

August 28-29 – Anaheim, CA

Hosted by Trinity Law School

September 9 – St. Paul, MN

Hosted by Hamline University

September 10 – Minneapolis, MN

Hosted by University of St. Thomas

http://www.irs.gov/Charities-&-Non-Profits/Upcoming-Workshops-for-Small-and-Medium-Sized-501(c)(3)-Organizations

5. Section 509(a)(3) Supporting Organizations pages updated

These updated pages illustrate the new rules for certain organizations that carry out their exempt purposes by supporting other public charities. This classification is important because it is one means by which a charity can avoid classification as a private foundation, a status that is subject to a more restrictive regulatory regime.

http://www.irs.gov/Charities-&-Non-Profits/Section-509(a)(3)-Supporting-Organizations

6. IRS accepting applications for Low Income Taxpayer Clinic grants

The IRS recently announced the opening of the 2014 Low Income Taxpayer Clinic grant application process. Read news release.

http://www.irs.gov/uac/Newsroom/IRS-Accepting-Applications-for-Low-Income-Taxpayer-Clinic-Grants-2013

7. IRS Electronic Tax Administration Advisory Committee delivers report to Congress

The Electronic Tax Administration Advisory Committee recently presented its 2013 Annual Report to Congress. The report discusses five groups of recommendations on issues in electronic tax administration.

http://www.irs.gov/pub/irs-pdf/p3415.pdf

IRS Grants Extension of Expenditure Period for Qualified Zone Academy Bond Proceeds.

The IRS granted a city an extension of the expenditure period for available project proceeds of qualified zone academy bonds on determining that the city's failure to spend its bond proceeds was due to reasonable cause and that the city would spend its remaining proceeds for qualified purposes with due diligence.

Citations: LTR 201326001

This is in response to your request under Section 54A(d)(2)(B)(iii) of the Internal Revenue Code for an extension of the expenditure period for the available project proceeds of qualified tax credit bonds.

FACTS AND REPRESENTATIONS

You make the following factual representations. City is a municipal corporation of State and is largely responsible for the financing of local primary and secondary educational expenditures. The Board of Education (the "Board") is the official policy making body of District. Board is composed of members appointed by the Mayor of City, and administers City's school system within District. The school system collectively operates a elementary, middle, and high schools. Board's operations are solely funded through City appropriations, Federal and State aid to education, grants, and locally generated revenues of Board.

The Bonds were issued on Date 1 by City, and were designated by City as qualified zone academy bonds within the meaning of § 54E(a). Pursuant to § 54E (c)(4), State allocated to the Bonds $b of its carryforward allocation of the national zone academy bond limitation from Year 1. In preparing to issue the Bonds, District identified a pool of public school facilities located within District that met the requirements for being treated as qualified zone academies within the meaning of § 54E(d)(1) and were in urgent need of rehabilitation and repair, and equipment. The Bond proceeds were allocated among 17 public school facilities of such previously identified pool of public school facilities located within District (the "Project").

Each of these school facilities was budgeted a specific stated amount of the Bond proceeds. The original three-year expenditure period for the Bonds under § 54A(d)(2)(B)(i) will expire on Date 2. However, several unexpected events have resulted in an unforeseen delay in the expenditure of the available project proceeds of the Bonds. As of Date 3, the date of your request for a ruling, $c of the available project proceeds of the Bonds remains unspent.

With respect to five of the 17 school facilities, although the rehabilitation work has been completed, the State-required "as-built" drawings from electrical contractors installing wiring and electrical equipment at those five schools have not been received by District. District is working with the electrical contractors to receive these drawings. Also, reduced clerical staffing necessitated by budget cutbacks has resulted in unexpected delays in various areas of project administration, including the processing of the documentation for, and payments for, contracts with respect to another five of the 17 school facilities under which the rehabilitation and repair work had already been completed. District expects to expend the allocated available project proceeds with respect to these 10 school facilities by Date 4.

A lengthy review process by State with respect to the rehabilitation and repair design plans of another one of the 17 school facilities has resulted in a delay in the rehabilitation work with respect to that facility. At the time the Bonds were issued, District did not foresee that this review process, which includes delays associated with the project designer's plans and specifications, would take such an extended period of time. District expects the repair and rehabilitation of this school facility and the expenditure of available project proceeds allocated thereto to be completed by Date 5.

The reduced clerical staffing referenced above has also caused an unexpected delay in title transfer and control of the land and thus rehabilitation work with respect to one of the 17 school facilities. District cannot commence the rehabilitation of the school facility without the ownership and possession of the property. District will reallocate the available project proceeds for this project to the "Rehabilitation Project" described below.

The rehabilitation and repair work at another one of the 17 school facilities has been completed. This project, however, is subject to litigation that arose after the work was completed but before the allocable available project proceeds was expended. This expenditure is delayed until the lawsuit is resolved. District will reallocate the available project proceeds for this project to the Rehabilitation Project described below.

At another one of the 17 school facilities, the rehabilitation and repair work was proceeding towards timely completion until it was discovered that the facility was contaminated with polychlorinated biphenyl ("PCB"). The PCB contamination was unexpected and has significantly expanded the scope of the project at this school, and has also significantly increased its cost (collectively referred to herein as the "Rehabilitation Project") to approximately $d from the $e budgeted for the original rehabilitation and repair project. Both the original portion and the expanded portion of the Rehabilitation Project may not be completed, and the allocable available project proceeds may not be expended, prior to Date 2. District expects to completely spend the available project proceeds allocated to the Rehabilitation Project not later than Date 6.

The actual costs of the rehabilitation and repair of several of the 17 schools, some of which are described above, unexpectedly were less than the original budgeted amounts. The available project proceeds that were originally budgeted for those projects but were not expended, will be reallocated to the Rehabilitation Project.

This unexpected series of events has resulted in an unforeseen delay in the spend-down of the available project proceeds.

City submitted this request for a ruling prior to Date 2.

LAW AND ANALYSIS

Section 54A(d)(1) provides that a qualified zone academy bond is treated as a qualified tax credit

bond for purposes of Section 54A.

Section 54A(d)(2)(B)(i) provides in part that to the extent that less than 100 percent of the available project proceeds of the issue are expended by the close of the expenditure period for 1 or more qualified purposes, the issuer shall redeem all of the nonqualified bonds within 90 days after the end of such period.

Section 54A(d)(2)(B)(ii) provides that for purposes of this subpart, the term "expenditure period" means, with respect to any issue, the 3-year period beginning on the date of issuance. Such term shall include any extension of such period under clause (iii).

Section 54A(d)(2)(B)(iii) provides that upon submission of a request prior to the expiration of the expenditure period (determined without regard to any extension under this clause), the Secretary may extend such period if the issuer establishes that the failure to expend the proceeds within the original expenditure period is due to reasonable cause and the expenditures for qualified purposes will continue to proceed with due diligence.

Section 54A(d)((2)(C)(iv) provides that for purposes of this paragraph, in the case of a qualified zone academy bond, a "qualified purpose" means a purpose specified in § 54E(a)(1).

Section 54A(e)(4) of the Code defines "available project proceeds" to mean (A) the excess of (i) the proceeds from the sale of an issue, over (ii) the issuance costs financed by the issue (to the extent that such costs do not exceed 2 percent of such proceeds), and (B) the proceeds from any investment of the excess described in subparagraph (A).

The Project was identified prior to the issuance of the Bonds and District reasonably expected to spend all of its allocable available project proceeds within the three-year period. The failure to spend all the available project proceeds of the Bonds by the expiration of the three-year period on Date 2 was caused by events that were not reasonably expected at the time the Bonds were issued and were beyond the control of either City or District. However, City and District to the extent possible considering all of the described unexpected external events that resulted in unforeseen delays, have and will continue to exercise due diligence in spending the remaining available project proceeds on the Project. City and District expect to spend all available project proceeds not later than Date 6.

CONCLUSION

Under the facts and circumstances of this case, we conclude that District's failure to expend its allocable portion of the available project proceeds of the Bonds was due to reasonable cause and that District's expenditures of the proceeds for qualified purposes will proceed with due diligence. Therefore, City is granted an extension of the expenditure period with respect to the Bonds until Date 6.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to City's authorized representative.

The ruling contained in this letter is based upon information and representations submitted by City and accompanied by a penalty of perjury statement executed by an appropriate party. While this

office has not verified any of the materials submitted in support of the request for a ruling, it is subject to verification upon examination.

Sincerely,

Associate Chief Counsel

(Financial Institutions & Products)

By: Timothy L. Jones

Senior Counsel, Branch 5

ACA Provisions: What You Need to Know Phone Forum Recording Now Available.

If you want to listen to the April 30th ACA Provisions: What you need to know! Phone Forum, click the link below. The 60 minute presentation covers:

What is included in the cost of coverage (i.e. health, dental/vision, FSA benefits).

Additional Medicare Tax: application, calculation, and reporting.

http://www.irsvideos.gov/Governments/Employers/ACAProvisionsWhatYouNeedtoKnow

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TEB Phone Forum: What's Special about Schedule K (Form 990)?

The Office of Tax Exempt Bonds will host a free phone forum on July 31, 2013 at 2:00 p.m. (Eastern Time) to discuss Schedule K (Form 990). To learn more and register, click the following link.

What’s Special about Schedule K (Form 990)?

http://ems.intellor.com/index.cgi?p=204720&t=71&do=register&s=&rID=427&edID=305

McDermott Calls on IRS to Update Safe Harbor Guidelines for Health Care Facilities to Better Implement Affordable Care Act.

In a letter to Assistant Secretary for Tax Policy Mark Mazur, Congressman Jim McDermott (D-WA) today called on the IRS to review outdated “safe harbor” provisions that inhibit the ability of certain new payment models, such as accountable care organizations, to flourish. Updated provisions would help clear obstacles to many of the innovative and more efficient payment models outlined by the Affordable Care Act (ACA), and improve efforts to coordinate care between hospitals and health care professionals.

IRS Revenue Procedure 97-13, which creates safe harbors that protect the tax-exempt status of

certain bonds issued by health care facilities, was issued in 1997. Since then, new compensation models, such as bundled payments, have shown promising results for improving care and reducing costs. Updates to the safe harbors will give providers and bondholders certainty that new payment models are protected under the IRS guidance.

“Stakeholders generally structure arrangements to fit squarely within a safe harbor with respect to their compensation arrangements, as they are aware that the IRS is closely scrutinizing these issues,” wrote McDermott. “As a result, hospitals have some anxiety with entering into new and innovative arrangements encouraged by the ACA.”

As the ACA ramps up to full implementation, any revisions to the relevant tax guidance should be made in time to provide certainty so that the new models can be quickly adopted. “It is imperative that the IRS begin to consider such modifications immediately, since under the Affordable Care Act, models that emerge as successful from [Center for Medicare and Medicaid Innovation] can be rapidly expanded throughout the country,” urged McDermott.

* * * * *

July 1, 2013

Mr. Mark Mazur

Assistant Secretary for Tax Policy

Department of Treasury

1500 Pennsylvania Ave N.W.

Washington, DC 20220

Re: Potential Updates to Rev. Proc. 97-13

Dear Mr. Mazur:

As Ranking Member of the Subcommittee on Health of the Committee on Ways and Means, I am deeply interested in initiatives that advance better coordinated care among hospitals, physicians, and other health care professionals. Such coordinated care is not only good for the patient, it is also good for the economy since coordinated care results in a decrease in the number of duplicative tests performed on patients, and can decrease the potential for medical errors that lead to readmissions and other negative consequences.

Many of the reforms in the Affordable Care Act are intended to promote better care coordination. In fact, the Center for Medicare and Medicaid Innovation (“CMMI”) was tasked with developing new, replicable models where health care professionals and hospitals provide high quality care at a lower cost on a population-wide basis. CMMI is now in the process of testing various permutations of accountable care organizations, as well as various bundled payment initiatives. It is my hope that these programs result in savings to the Medicare program and that patients see demonstrable, measurable improvements in the quality of care that they are provided.

However, I am aware that stakeholders are concerned about the implications that participating in such innovative programs may have on tax-exempt bond financed facilities. As you know, facilities that are financed with tax-exempt bonds attempt to structure their contractual arrangements to fit within the safe harbors of Rev. Proc. 97-13. The safe harbors are narrow and limit the terms of such

arrangements. Also, the safe harbors limit the types of permissible compensation arrangements and may not address innovative payment methods such as payment bundles. Because of the limited nature of the safe harbors, some of the newly emerging innovative methods by which a hospital may want to compensate a physician do not fit squarely within the existing safe harbors. Of course, this does not automatically make the bonds that finance the health care facility taxable. However, stakeholders generally structure arrangements to fit squarely within a safe harbor with respect to their compensation arrangements, as they are aware that the IRS is closely scrutinizing these issues, particularly since it is easier to do so given the Form 990 redesign. As a result, stakeholders may have some anxiety with entering into new and innovative arrangements encouraged by the Affordable Care Act.

While I understand and fully support the intended purpose behind Rev. Proc. 97-13 and believe it should be retained, I believe it should be updated to recognize the newly emerging compensation models between hospitals and physicians. It is imperative that the IRS begin to consider such modifications immediately, since under the Affordable Care Act, models that emerge as successful from CMMI can be rapidly expanded throughout the country. Thus, it is important to update the guidance and allow providers time to gain an understanding of how they can fit squarely within a safe harbor before such programs are expanded on a nationwide basis.

Thank you for your consideration of this important matter. Should you wish to discuss this matter further, please do not hesitate to contact Tiana Korley on my staff at (202) 225-3106 or at tiana.korley@mail.house.gov.

Regards,

Hon. Jim McDermott

Member of Congress

IRS Publication: Voluntary Compliance for Tax-Exempt and Tax-Credit Bonds.

Part one of this publication is a summary of highlighted considerations to help issuers of tax-advantaged bonds comply with related federal tax law requirements. Part two is a summary of Tax-Exempt Bonds Voluntary Closing Agreement Program (TEB VCAP) provisions.

http://www.irs.gov/pub/irs-pdf/p5091.pdf

Guidance Clarifies 'Begins Construction' Standard for Renewable Energy Tax Credit, Treasury Says.

Treasury Assistant Secretary for Legislative Affairs Alastair Fitzpayne has advised Rep. Michael Coffman, R-Colo., that recent guidance (Notice 2013-29) clarifies the new “begins construction” standard for wind investment tax credits and provides “the desired degree of certainty” in the marketplace and allows renewable energy projects to move forward.

June 17, 2013

The Honorable Mike Coffman

U.S. House of Representatives

Washington, DC 20515

Dear Representative Coffman:

Thank you for your letter concerning changes made by the American Taxpayer Relief Act of 2012 (ATRA) to the renewable energy production tax credit (PTC) under section 45 of the Internal Revenue Code and the energy investment tax credit (ITC) under section 48.

As you note, ATRA modified the PTC and ITC to apply to projects that "begin construction" by the end of 2013 instead of projects that are "placed in service" by the end of 2013. On April 15, 2013, Treasury and the Internal Revenue Service issued Notice 2013-29 to clarify this new "begins construction" standard. This notice sets forth two ways that a taxpayer can satisfy the standard in 2013:

(1) beginning physical work of a significant nature,

or (2) paying or incurring 5 percent of the total cost of the project.

These tests are similar to those used for payments under section 1603 of the American Recovery and Reinvestment Act of 2009. A copy of the notice is enclosed. We believe this guidance provides the desired degree of certainty in the marketplace and allows renewable energy projects to move forward.

If you have further questions, please contact Sandra Salstrom, Office of Legislative Affairs, at (202) 622-1900.

Sincerely,

Alastair M. Fitzpayne

Assistant Secretary for

Legislative Affairs

Treasury Informs Oklahoma Governor About Relief From Some Bond and Low-Income Housing Credit Requirements.

Treasury Secretary Jacob Lew has informed Oklahoma Gov. Mary Fallin (R) of Treasury's decision to provide relief (Notice 2013-40) from some low-income housing credit requirements and relief (Notice 2013-39) from some bond requirements due to severe storms and tornadoes in the state.

June 18, 2013

The Honorable Mary Fallin

Governor of Oklahoma

State Capitol Building

2300 N. Lincoln Blvd.

Suite 212

Oklahoma City, OK 73105

Dear Governor Fallin:

Thank you for your letter to me of May 23, 2013, requesting relief from some of the requirements of the low-income housing tax credit program due to the recent tornadoes in Oklahoma.

In response to your letter, the Treasury Department and the Internal Revenue Service (IRS) issued Notice 2013-40, which makes it possible for Low Income Housing Credit projects anywhere in the country to suspend the income limits and provide temporary housing to victims of the Oklahoma tornadoes. At the same time, Treasury and the IRS also issued Notice 2013-39, which makes it possible for qualified residential rental projects financed with exempt facility bonds to provide temporary housing for these victims. These notices, which went into effect on May 20, 2013, are enclosed. Certain filing and payment deadlines have also been extended for affected taxpayers.

We hope that this relief will play a meaningful role in Oklahoma's response to the devastation caused by these terrible disasters. Please contact us again if there are other ways in which we can help.

Sincerely,

Jacob J. Lew

Conditional Donation of Conservation Easement and Cash Precludes Charitable Contribution Deduction.

The Tax Court held that a couple wasn't entitled to charitable contribution deductions for their gift of cash and a conservation easement to an architectural trust, finding that the donation was improperly conditioned on whether the IRS would allow their claimed deductions.

Lawrence Graev agreed to contribute a façade conservation easement on his property to the National Architectural Trust (NAT), a qualified charitable organization. Before the donation, Graev's accountants advised him of Notice 2004-41 and the IRS's increased scrutiny of deductions for conservation easement donations. Graev sought assurances from NAT regarding his donation and his ability to claim deductions. NAT issued Graev a letter in which it agreed to refund any disallowed cash contributions and remove the easement from the property title if the deduction was disallowed.

Graev contributed the easement and made a cash contribution to NAT in 2004. On his 2004 and 2005 joint returns with his wife, Graev claimed charitable contribution deductions for his easement contribution and accompanying cash contribution to NAT. The IRS disallowed the deductions as conditional gifts and imposed accuracy-related penalties against the couple.

The Tax Court, in an opinion by Judge David Gustafson, considered whether the promises made in NAT's letter to Graev made the gift conditional and whether the chance that the condition would

occur was so remote as to be negligible under reg. section 1.170A-1(e). Gustafson wrote that "what is determinative under the section 170 'remote' regulations is the possibility, after considering all the facts and circumstances, that NAT's reception and retention of the easement and cash would be defeated."

The court concluded that the IRS's disallowance of the deductions and NAT's return of the cash and removal of the easement was not so remote as to be negligible at the time of the contribution. The court found that there was a substantial risk of disallowance based on the IRS's announcement of increased scrutiny and that the risk was evident based on Graev's request for assurances from NAT. That NAT had issued "comfort letters" to other donors was further evidence of a non-negligible risk that the IRS would disallow the deduction.

Gustafson rejected the Graevs' argument that the letter from NAT was not enforceable under state law, finding that NAT could abandon the easement under the deed. The court also held that NAT intended to honor its promise if the deduction was disallowed. The court rejected the couple's argument that the doctrine of merger extinguished the terms of the letter once the deed for the easement was recorded. Gustafson wrote, "We find that NAT's promises in the side letter to return to the easement and cash were enforceable because we find a clear intent evidenced by the parties that the side letter would survive the deed."

The Tax Court concluded that there was substantial risk that the IRS would challenge the deductions, that enforcement of the letter wasn't precluded by state or federal law, and that NAT would act as promised in the letter. As a result, the gifts were conditional and the charitable contribution deductions should be disallowed, the court said.

LAWRENCE G. GRAEV AND LORNA GRAEV,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

Citations: Lawrence G. Graev et ux. v. Commissioner; 140 T.C. No. 17; No. 30638-08

UNITED STATES TAX COURT

Filed June 24, 2013

Petitioner husband ("P-H") contributed cash and a conservation easement to N, a charitable organization. Before the contribution, N at P-H's request issued to P-H a side letter which promised that, in the event R disallows Ps' charitable contribution deductions, N "will promptly refund your entire cash endowment contribution and join with you to immediately remove the facade conservation easement from the property's title". Ps claimed charitable contribution deductions for the cash and easement donations. R contends the side letter made those contributions conditional gifts that are not deductible under I.R.C. sec. 170, since the likelihood that N would be divested of the cash and easement was not negligible.

Held: Ps' charitable contribution deductions are not allowed because at the time of P-H's contributions, the possibility that the deductions would be disallowed and, as a result, that N would return the contributions was not "so remote as to be negligible", under 26 C.F.R. secs. 1.170A-1(e),

1.170A-7(a)(3), and 1.170A-14(g)(3), Income Tax Regs.

Frank Agostino, Eduardo S. Chung, Jeremy M. Klausner, and Reuben G. Miller, for petitioners.

Shawna A. Early, for respondent.

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GUSTAFSON, Judge: Pursuant to section 6212(a),1 the Internal Revenue Service ("IRS") determined deficiencies in tax for petitioners, Lawrence and Lorna Graev, in the amounts of $237,481 for 2004 and $412,620 for 2005, resulting from the disallowance of charitable contribution deductions the Graevs claimed for those years. The IRS also determined that Mr. and Mrs. Graev are liable for accuracy-related penalties under section 6662(h) and alternatively under section 6662(a) for 2004 and 2005. Mr. and Mrs. Graev petitioned this Court, pursuant to section 6213(a), for redetermination of these deficiencies and penalties. The issue for decision at present is whether the deductions that the Graevs claimed for charitable contributions of cash and a conservation easement they donated to the National Architectural Trust ("NAT") should be disallowed because they were conditional gifts.2 We hold that the Graevs' contributions were conditional, non-deductible gifts.

FINDINGS OF FACT

The parties submitted this issue fully stipulated pursuant to Rule 122, reflecting their agreement that the relevant facts could be presented without a trial.3 The stipulated facts are incorporated herein by this reference. Mr. and Mrs. Graev resided in the State of New York when they filed the petition.

NAT

The parties have stipulated that, "[f]or purposes of the Court's decision regarding" the conditional gift issue, NAT is a "qualified organization" under section 170(h)(3), to which a charitable contribution can be made that is deductible for tax purposes. NAT's stated mission is to preserve historic architecture in metropolitan areas across the United States. NAT solicits the contribution of facade conservation easements by owners of property with historic significance as determined by the National Park Service. When NAT solicits potential donors, it features the potential charitable deductions that owners may receive by contributing a facade conservation easement and a corresponding cash endowment to NAT. In addition, NAT considered it "standard Trust policy", regarding donors of easements and cash, to return a cash contribution to the extent the IRS disallowed a deduction therefor. In numerous instances NAT issued "comfort letters" assuring donors of this policy.

The property

In 1999 Mr. Graev purchased property in a historic preservation district in New York, New York, for $4.3 million. The property is listed on the National Register of Historic Places. During the years at issue Mr. Graev was the sole fee simple owner of the property, and he held the property subject to a mortgage.

Increased IRS scrutiny of easement contributions

On June 30, 2004, the IRS released IRS Notice 2004-41, 2004-2 C.B. 31, which addressed charitable contributions and conservation easements and stated in part:

The Internal Revenue Service is aware that taxpayers who (1) transfer an easement on real property to a charitable organization, or (2) make payments to a charitable organization in connection with a purchase of real property from the charitable organization, may be improperly claiming charitable contribution deductions under § 170 of the Internal Revenue Code. The purpose of this notice is to advise participants in these transactions that, in appropriate cases, the Service intends to disallow such deductions and may impose penalties and excise taxes. * * *

* * * * * * *

Some taxpayers are claiming inappropriate charitable contribution deductions under § 170 for cash payments or easement transfers to charitable organizations in connection with the taxpayers' purchases of real property.

In some of these questionable cases, the charitable organization purchases the property and places a conservation easement on the property. Then, the charitable organization sells the property subject to the easement to a buyer for a price that is substantially less than the price paid by the charitable organization for the property. As part of the sale, the buyer makes a second payment, designated as a "charitable contribution," to the charitable organization. The total of the payments from the buyer to the charitable organization fully reimburses the charitable organization for the cost of the property.

In appropriate cases, the Service will treat these transactions in accordance with their substance, rather than their form. Thus, the Service may treat the total of the buyer's payments to the charitable organization as the purchase price paid by the buyer for the property.

Thus, the IRS publicly announced its awareness of abuses related to easement contribution deductions, putting potential donors and donees on notice that easement contribution deductions might be examined and challenged. We find that there was at least a non-negligible possibility that the IRS would challenge an easement contribution deduction thereafter claimed by Mr. Graev.

NAT's solicitation

In the summer of 2004, a representative from NAT contacted Mr. Graev regarding a potential easement donation to NAT. Mr. Graev became aware that he had a "neighbor across the street" who had contributed a facade easement to NAT and who had received from NAT a side letter that promised return of contributions if deductions were disallowed. Mr. Graev evidently expressed to NAT an interest in making an easement contribution like his neighbor's, but on September 15, 2004, he sent an email to NAT explaining a concern that had arisen:

My accountants have referred me to Notice 2004-41 * * * issued by the IRS on June 30, 2004, in which the IRS has indicated that it will, in "appropriate cases", disallow charitable deductions to organizations that promote conservation easements and may impose penalties and excise taxes on the taxpayer. They have not advised me to abandon this idea, but they have advised me to be very cautious. What are your thoughts especially as it relates to the side letter, etc.

(The "side letter" to which Mr. Graev referred was NAT's comfort letter assuring that it would refund a contribution in the event that the favorable tax results anticipated from a contribution were not achieved.) Mr. Graev indicated that he had consulted his accountants, and in 2004 those

accountants would surely have been aware of published court decisions issued over the past decade that disallowed deductions claimed for the contribution of facade easements.4 On his tax returns Mr. Graev listed his occupation as "attorney", and we infer that he is an individual of above-average sophistication who, with the help of his accountants, was capable of identifying tax risks. We find that Mr. Graev did in fact identify non-negligible risks regarding the deductibility of facade easements, as evidenced by his September 15 email and subsequent dealings with NAT.

In a response to Mr. Graev's concerns, NAT sent him an email dated September 16, 2004, that stated:

The IRS notices to which you refer were prompted by recently exposed improprieties at the Nature Conservancy, the nation's largest land conservation easement holding organization. The practice the IRS is concerned with here is when a non-profit acquires property, puts an easement on it and sells it for a reduced price plus a tax-deductible contribution. * * *

It is important to distinguish between these activities, which certainly warrant scrutiny, and those engaged in by the National Architectural Trust. * * * We have been in contact with the IRS since the notices were issued and, based upon our discussion with them, have no reasons to expect that we or any of the donations we have received (easement or cash) will be reviewed.

Thus far not a single donation made to the Trust has been disallowed by the IRS (400+ in New York City alone). * * *

With regard to side letters in particular, NAT wrote:

[W]e don't believe they compromise the tax-deductibility of cash donations in the present tax year, as they are simply a confirmation of standard Trust policy. However, we do not believe this would be the case with a legal agreement that explicitly made the cash donation contingent on the survival of the deduction. In such a case, we would recommend that the cash donation be treated as tax-deductible once the contingency period has expired. * * *

That is, it was "standard Trust policy" to refund a cash contribution to the extent the IRS disallowed the donor's deduction for the related easement.

Evidently reassured, Mr. Graev executed a facade conservation easement application to NAT on September 20, 2004. In a cover letter to NAT transmitting the application, Mr. Graev stated: "I will also be looking for the NAT to issue the 'side' letter we discussed (similar to the one being issued to my neighbor across the street)."

The side letter

On September 24, 2004 NAT sent the side letter to Mr. Graev. The side letter read in pertinent part:

1. In the event the IRS challenges the appraisal of your facade conservation easement and the tax deductions derived therefrom are reduced as a result, we will make a proportionate reduction to your cash endowment contribution and promptly refund the difference to you.

2. In the event the IRS disallows the tax deductions in their entirety, we will promptly refund your entire cash endowment contribution and join with you to immediately remove the facade conservation easement from the property's title.

Neither the side letter nor any other evidence in our record suggests that, in the event the IRS disallowed his contribution, Mr. Graev would have to sue NAT in order to induce it to "remove" the

easement. Rather, NAT promised upon disallowance to "join with [him] * * * to immediately remove the facade conservation easement from the property's title". Mr. Graev took NAT at its word, and so do we. That is, we find that there was at least a non-negligible possibility, if the IRS successfully disallowed Mr. Graev's easement contribution deduction, that NAT would do what it said it would do.

Appraisal

Mr. Graev retained the firm of Miller Samuel, Inc. ("MSI"), to prepare an appraisal of the facade easement. In October 2004, MSI issued its appraisal report to Mr. Graev appraising the property at $9 million and concluding that the easement would reduce the value by 11% (or $990,000). Thus, the report appraised the easement at $990,000.

Noncash contribution to NAT

In late 20045 Mr. Graev executed a conservation deed granting a facade easement on the property to NAT. The deed in pertinent part provides:

The Property constitutes an important element in the architectural ensemble of the Treadwell Farms Historic District, and the grant of the Easement as set forth in this instrument will, inter alia, assist in preserving this certified historic structure and in preserving open space for the scenic enjoyment of the general public.

* * * * * * *

The Grantor does hereby grant and convey to the Grantee, TO HAVE AND TO HOLD, an Easement in gross, in perpetuity, in, on and to the Property, the Building and the Facade, being an Open Space and Architectural Facade Conversation Easement on the Property * * *

* * * * * * *

A. * * * This Easement shall survive any termination of Grantor's or the Grantee's existence. The rights of the Grantee under this instrument shall run for the benefit of an may be exercised by its successor and assigns, or by its designees duly authorized in a deed of Easement.

B. Grantee covenants and agrees that it will not transfer, assign or otherwise convey its rights under this Easement except to another "qualified organization" described in Section 170(h)(3) of the Internal Revenue Code of 1986 and controlling Treasury regulations, and Grantee further agrees that it will not transfer this Easement unless the transferee first agrees to continue to carry out the conservation purposes for which this Easement was created, provided, however, that nothing herein contained shall be constructed to limit the Grantee's right to give its consent (e.g., to changes in a Protected Facade(s)) or to abandon some or all of its rights hereunder. [Emphasis added.]

C. In the event this Easement is ever extinguished through a judicial decree, Grantor agrees on behalf of itself, its heirs, successors and assigns, that Grantee, or its successors and assigns, will be entitled to receive upon the subsequent sale, exchange or involuntary conversion of the Property, a portion of the proceeds from such sale, exchange or conversion equal to the same proportion that the value of the initial Easement donation bore to the entire value of the property at the time of donation * * *. Grantee agrees to use any proceeds so realized in a manner consistent with the conservation purposes of the original contribution.

* * * * * * *

Citimortgage Inc. ("Mortgagee/Lender") hereby joins in the execution of this CONSERVATION DEED OF EASEMENT for the sole and limited purpose of subordinating its rights in the Property to the right of the Grantee, its successors or assigns, to enforce the conservation purposes of this Easement in perpetuity under the following conditions and stipulations:

(a) The Mortgagee/Lender and its assignees shall have a prior claim to all insurance proceeds * * * and all proceeds from condemnation, and shall be entitled to same in preference to Grantee until the Mortgage/the Deed of Trust is paid off and discharged, notwithstanding that the Mortgage/the Deed of Trust is subordinate in priority to the Easement.

The deed did not expressly refer to the side letter or incorporate its terms. The City of New York recorded the deed on February 17, 2005.

Cash contribution to NAT

In conjunction with an easement donation, NAT asks a donor to make a cash contribution to NAT equal to 10% of the appraised easement value, in order to pay for NAT's current operating costs and to fund its long-term monitoring and administration needs. In compliance with NAT's request, Mr. Graev made an initial deposit of $1,000 to NAT on September 15, 2004. On December 17, 2004, the same day he delivered the signed deed to NAT, Mr. Graev made a $98,000 cash contribution to NAT, bringing his cash contributions to NAT to a total of $99,000. On January 25, 2005, NAT gave Mr. Graev written acknowledgment of his 2004 cash and non-cash contributions. That correspondence also included a copy of Form 8283, executed by the appraiser, MSI, and NAT.

Subsequent communications from NAT

Also on January 25, 2005, NAT sent a letter to Mr. Graev informing him that the U.S. Senate Committee on Finance had announced in a press release their "intent to implement reforms to the tax laws governing facade easements that will increase and create additional fines and penalties on promoters, taxpayers and appraisers who participate, aid or assist in the donation of facade easements that are found to be significantly overvalued." Several months later, in August 2005, NAT sent Mr. Graev another letter which read:

The purpose of this letter is to bring to your attention a development that may be relevant to the tax deductibility of the cash contributions that you made to the National Architectural Trust * * *

In connection with your donation of a facade conservation easement and cash contribution and per your request, we sent you a letter dated September 24, 2004, stating, among other things, that the cash contribution would be refunded in whole or in part if your tax deduction for the easement were reduced or disallowed by the Internal Revenue Service. It has recently been brought to our attention by our attorney that this offer of a refund may adversely affect the deductibility of the cash contribution as a charitable gift. * * *

We urge you to contact your professional tax advisor to determine the actual impact of the refund offer. Of course, if you determine that you would prefer that we withdraw the refund offer, which according to our attorney should restore the deductibility of your cash contribution, the Trust will promptly do so. * * *

Mr. Graev did not ask NAT to withdraw the refund offer. We find that NAT's formal offer to withdraw the refund offer — made after NAT consulted with its attorney — further indicates that NAT intended to honor its promises in the side letter (even if the promises may not have been legally enforceable), unless Mr. Graev directed otherwise.

2004 and 2005 Federal income tax returns

Mr. and Mrs. Graev filed joint Forms 1040, U.S. Individual Income Tax Return, for taxable years 2004 and 2005. On their 2004 return, which they filed on or around October 10, 2005 (i.e., after the January and August 2005 letters from NAT, discussed above), Mr. and Mrs. Graev reported a charitable contribution of $990,000 for the facade easement contribution and $99,000 for the cash contribution to NAT. Mr. and Mrs. Graev claimed a deduction for the entire cash contribution in 2004, but because of the limitations on charitable contribution deductions in section 170(b)(1)(C), they claimed a charitable contribution deduction with respect to the facade easement of only $544,449 on their 2004 return.

On their 2005 return, filed on or around October 6, 2006, Mr. and Mrs. Graev claimed a carryover charitable contribution deduction of $445,551 relating to the facade easement contribution in 2004.

Notice of deficiency

By a statutory notice of deficiency dated September 22, 2008, the IRS disallowed Mr. and Mrs. Graev's cash and non-cash charitable contribution deductions relating to their contributions to NAT and determined deficiencies in tax for both 2004 and 2005. In the notice of deficiency the IRS stated: "[T]he noncash charitable contribution of a qualified conservation contribution is disallowed because it was made subject to subsequent event(s)". The notice disallowed the Graevs' cash charitable contribution deduction for the same reason. The IRS also determined that Mr. and Mrs. Graev are liable for accuracy-related penalties under section 6662 for 2004 and 2005.

OPINION

The question now before the Court is whether deductions for Mr. Graev's contributions of cash and the easement to NAT should be disallowed because they were conditional gifts. The answer depends on whether NAT's promises in the side letter made the gifts conditional and whether the chance that the condition would occur was "so remote as to be negligible". See 26 C.F.R. secs. 1.170A-1(e), 1.170A-7(a)(3), 1.170A-14(g)(3), Income Tax Regs.

The Graevs argue that under New York law the agreement in the side letter is unenforceable because conditions in the side letter were not included in the recorded deed and that under Federal tax law the side letter was a nullity. We conclude that NAT's promises in the side letter were not a nullity and were not extinguished and that NAT could and would honor its promises both as to the easement and as to the cash contribution.

I. Charitable contributions

A. Generally

Section 170(a)(1) generally allows a deduction for any "charitable contribution" made during the taxable year. Section 170(c)(2) defines a "charitable contribution" for this purpose to include "a contribution or gift to or for the use of" a trust organized and operated exclusively for charitable or educational purposes. The parties agree for purposes of the conditional gift issue that NAT is such an organization.

Application of the general rule in section 170(a)(1) may be complicated — especially with regard to the amount and timing of a charitable contribution deduction — if a donor contributes a property interest to a charity but, at the time of the contribution, there is uncertainty about the amount of property that will actually reach the charity — e.g., when a donor contributes a remainder interest in property to a charity, or (as in this case) the donor contributes property subject to a condition.

Section 170 and the corresponding regulations provide instruction and limitations that, at least in part, ensure that the donor will be able to deduct only what the donee organization actually receives. See, e.g., sec. 170(f)(2), (3), (11). Three such limitations are pertinent in this case: (1) 26 C.F.R. section 1.170A-1(e), which limits deductions for conditional gifts; (2) section 170(f)(3)(A) and the corresponding regulations, which limit deductions for contributions of partial interests in property; and (3) section 170(f)(3)(B)(iii) and corresponding regulations, which provide special rules for conservation easements.

B. Conditional gifts

The general rule of section 170(a)(1) allows a deduction for a charitable contribution only when "payment * * * is made within the taxable year." (Emphasis added.) Regulations corresponding to section 170(a) clarify this rule with a limitation particularly relevant in this case:

If an interest in property passes to, or is vested in, charity on the date of the gift and the interest would be defeated by the subsequent performance of some act or the happening of some event, the possibility of occurrence of which appears on the date of the gift to be so remote as to be negligible, the deduction is allowable. [26 C.F.R. sec. 170A-1(e).]

That is, the deduction may be considered "made" notwithstanding a possibility that the contribution will be defeated by a subsequent event, but only if that possibility is "so remote as to be negligible". Although the parties agree that the side letter recited conditions on Mr. Graev's contributions, the parties disagree about whether this regulation disallows deductions for those contributions.

A brief discussion of the history of 26 C.F.R. section 1.170A-1(e) is helpful in understanding the regulation's application in this case. The Secretary promulgated the first version of this regulation in1959 to correspond to section 170(a) of the 1954 Code.6 The operative language in that 1959 regulation was identical to an older regulation that had limited deductions for estate tax purposes for certain conditional charitable bequests. See 26 C.F.R. sec. 81.46(a), Estate Tax Regs. (1949).7 Given this similarity, we consider interpretations of 26 C.F.R. section 20.2055-2(b), Estate Tax Regs., and its history instructive in construing 26 C.F.R. section 170A-1(e). See Briggs v. Commissioner, 72 T.C. 646, 657 (1979), aff'd without published opinion, 665 F.2d 1051 (9th Cir. 1981).

The Supreme Court in Commissioner v. Estate of Sternberger, 348 U.S. 187, 194 (1955), discussed the estate tax regulations at length, stating:

The predecessor of [26 C.F.R.] s[ec.] 81.46 confined charitable deductions to outright, unconditional bequests to charity. It expressly excluded deductions for charitable bequests that were subject to conditions, either precedent or subsequent. While it encouraged assured bequests to charity, it offered no deductions for bequests that might never reach charity. Subsequent amendments have clarified and not changed that principle. Section 81.46(a) today yields to no condition unless the possibility that charity will not take is "negligible" or "highly improbable." * * *

Similarly, a fundamental principle underlying the charitable contribution deduction is that the charity actually receive and keep the contribution. 26 C.F.R. section 1.170A-1(e) clarifies that principle: no deduction for a charitable contribution that is subject to a condition (regardless of what the condition might be) is allowable, unless on the date of the contribution the possibility that a charity's interest in the contribution "would be defeated" is "negligible".

Accordingly, under section 1.170A-1(e) of the regulations (construing the statutory requirement of section 170(a)(1) that a gift actually "is made"), the Graevs' deductions are not allowable unless the possibility that NAT's interests in the easement and cash would be defeated was "so remote as to be

negligible".

C. Partial interests in general

Logically related to but distinct from the disallowance of deductions for conditional gifts is the limitation in section 170(f)(3) on deductions for contributions of partial interests in property. One is generally allowed a deduction only for the contribution of one's entire interest in property. Congress enacted what is now section 170(f)(3)(A) as part of the Tax Reform Act of 1969, Pub. L. No. 91-172, sec. 201, 83 Stat. at 549. Section 170(f)(3)(A) allows a deduction for a charitable contribution "of an interest in property [not made in trust] which consists of less than the taxpayer's entire interest in such property" only to the extent it would be allowable under section 170 "if such interest had been transferred in trust". This is a narrow allowance, since the rules that allow charitable contribution deductions for partial interests transferred in trust allow deductions only for interests that can be valued using prescribed methods (e.g., actuarial tables promulgated in the regulations) and that have assurances that the charity will receive payments from the trust. See, e.g., sec. 170(e)(2); 26 C.F.R. sec. 1.170A-6, Income Tax Regs.

In this case, since Mr. Graev reserved the right to have NAT return the easement and the cash if certain events occurred, the contributions of both the easement and the cash were less than Mr. Graev's entire interest in the contributed property. Accordingly, Mr. Graev's contributions appear subject to the limitation in section 170(f)(3). However, 26 C.F.R. section 1.170A-7(a)(3) provides the following mitigation of this limitation:

A deduction shall not be disallowed under section 170(f)(3)(A) * * * merely because the interest which passes to, or is vested in, the charity may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible. * * *

Thus, under this regulation, even though the contributions did not consist of Mr. Graev's entire interest in the cash and the easement, the Graevs' deductions for contributions would not be disallowed under section 170(f)(3)(A) if the likelihood that NAT's interests in the cash and the easement would be defeated was "so remote as to be negligible".

D. Conservation easements

An easement is "[a]n interest in land owned by another person, consisting in the right to use or control the land, or an area above or below it, for a specific limited purpose". Black's Law Dictionary 585-586 (9th ed. 2009). Consequently, an easement — whether or not it is subject to any condition — is by definition a partial interest in property, and it would therefore be non-deductible under section 170(f)(3)(A), apart from any further statutory provision. However, further provision is made in subsections (f)(3)(B)(iii) and (h) of section 170, the history of which we briefly survey:

The disallowance of a deduction for partial interests was added to the Code as section 170(f)(3) by the Tax Reform Act of 1969. In that provision's original form, the only exceptions to disallowance of a deduction for contributions of partial interests were for contributions of "a remainder interest in a personal residence or farm" and "an undivided portion of the taxpayer's entire interest in property". That is, no exception was made for a qualified conservation contribution. However, the Staff of Joint Committee on Taxation opined in its General Explanation of the Tax Reform Act of 1969, at 80 (J. Comm. Print 1970), that "a gift of an open space easement in gross is to be considered a gift of an undivided interest in property where the easement is in perpetuity."

Congress made explicit an exception for (i.e., permitted a deduction for) certain easements in the

Tax Reform Act of 1976, Pub. L. No. 94-455, sec. 2124(e), 90 Stat. at 1919, which amended section 170(f)(3)(B) to provide in clause (iii) that a donor may claim a deduction for the contribution of an "easement with respect to real property of not less than 30 years' duration granted to * * * [a charitable organization] exclusively for conservation purposes". The following year Congress revised that exception, eliminating the "30 years' duration" provision and limiting deductibility to an "easement with respect to real property granted in perpetuity". (Emphasis added.) Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, sec. 309(a), 91 Stat. at 154. In the Tax Treatment Extension Act of 1980, Pub. L. No. 96-541, sec. 6(a), 94 Stat. at 3206, Congress amended section 170(f)(3) and added subsection (h), which have remained in effect since then and work in tandem to keep the perpetuity requirement for conservation easement donations.

Section 170(f)(3)(B)(iii) exempts, from the general disallowance of deductions for contributions of partial interests, contributions of "a qualified conservation contribution" — a term defined in section 170(h)(1) as a contribution of a "qualified real property interest," to a "qualified organization", "exclusively for conservation purposes." A "qualified real property interest" must have "a restriction (granted in perpetuity) on the use which may be made of the real property." Sec. 170(h)(2)(C) (emphasis added).8 Regulations describing the perpetuity requirement provide:

A deduction shall not be disallowed under section 170(f)(3)(B)(iii) * * * merely because the interest which passes to, or is vested in, the donee organization may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible. * * * [26 C.F.R. sec. 1.170A-14(g)(3).]

(The "so remote as to be negligible" phrase is the familiar term first used in the 1949 estate tax regulations cited above.) Accordingly, a conservation easement fails to be "in perpetuity" — and is therefore not excepted from the general rule of section 170(f)(3)(A) disallowing deductions for contributions of partial interests — if, on the date of the donation, the possibility that the charity may be divested of its interest in the easement is not so remote as to be negligible.

E. Construing "so remote as to be negligible"

Each of the issues discussed above — i.e., whether a charitable contribution was effectively "made", whether it consisted of an "entire interest", and whether it was a "qualified conservation contribution" — essentially turns on the same question: At the time of Mr. Graev's contributions, was the possibility that NAT's interest in the cash and the easement would be defeated "so remote as to be negligible"? In prior cases, we have defined "so remote as to be negligible" as "'a chance which persons generally would disregard as so highly improbable that it might be ignored with reasonable safety in undertaking a serious business transaction.'" 885 Inv. Co. v. Commissioner, 95 T.C. 156, 161 (1990) (quoting United States v. Dean, 224 F.2d 26, 29 (1st Cir. 1955)). Stated differently, it is "a chance which every dictate of reason would justify an intelligent person in disregarding as so highly improbable and remote as to be lacking in reason and substance." Briggs v. Commissioner, 72 T.C. at 657. What is determinative under the section 170 "remote" regulations is the possibility, after considering all the facts and circumstances, that NAT's reception and retention of the easement and cash would be defeated.

II. Analysis

The side letter provides that the occurrence that would defeat NAT's interest in the easement and cash is the IRS's successful disallowance of the Graevs' charitable contribution deductions and NAT's consequent promised "removal" of the easement and return of the cash. We hold that at the date of the contribution the possibility that the IRS would disallow the deductions and that NAT would return the cash to Mr. Graev and "remove" the easement was not "so remote as to be

negligible".

A. The possibility of disallowance by the IRS

1. The possibility of disallowance as a matter of fact

The Graevs argue that as of December 2004, the caselaw supported an easement valuation of 10% to 15% of Mr. Graev's property and that it was therefore reasonable to conclude that Mr. Graev's easement donation had a value of $990,000 (i.e., 11% of the appraised value of the property). They assert that the possibility the IRS would disallow their deductions was so remote as to be negligible. However, on the undisputed facts of this case, it is self-evident that the risk of IRS disallowance was not negligible.9 A substantial risk obviously arose from the IRS's then-announced intention to scrutinize charitable contribution deductions for facade easement contributions, and that risk is evident from Mr. Graevs' insistence on NAT's issuing the side letter. We need not wonder how a donor or donee would have responded to this risk if he had foreseen it; we know how Mr. Graev did respond when he did foresee it: He did not "disregard" or "ignore[ ]" it, see 885 Inv. Co. v. Commissioner, 95 T.C. at 161; Briggs v. Commissioner, 72 T.C. at 657, but rather went out of his way to address it and hedge against it.

a. Increased IRS scrutiny

The Graevs note that at the time of their contribution in December 2004, no charitable contribution deduction arising from a contribution to NAT had been disallowed (to their knowledge). However, the enforcement landscape regarding deductions for facade easement donations was visibly changing at the time of his contribution. As is discussed above, the IRS released Notice 2004-41, supra, on June 30, 2004. In that notice the IRS stated:

The Internal Revenue Service is aware that taxpayers who (1) transfer an easement on real property to a charitable organization, or (2) make payments to a charitable organization in connection with a purchase of real property from the charitable organization, may be improperly claiming charitable contribution deductions under § 170 of the Internal Revenue Code. The purpose of this notice is to advise participants in these transactions that, in appropriate cases, the Service intends to disallow such deductions and may impose penalties and excise taxes. * * *

Notice 2004-41 goes on to give a specific example of the second instance, i.e., a taxpayer makes a cash contribution to a charitable organization in addition to purchasing (at a discount) from the same organization real property that was subject to a conservation easement, where the total amount of contribution and purchase price equals the charity's initial cost of the real property. The Graevs argue that since Notice 2004-41 specifically described a transaction that did not apply in their case, the notice was not applicable to them.

We disagree. While Notice 2004-41 did list one specific transaction that the Commissioner had determined was inappropriate, the Commissioner's general warning against "improperly claiming charitable contribution deductions" connected with transfers of conservation easements to charities was still very much applicable to the Graevs. Notice 2004-41 made clear before Mr. Graev's transfer that his transaction with NAT would be subject to heightened scrutiny and that if any of the Graevs' positions were susceptible to challenge, the Commissioner would likely enforce a contrary position. Mr. Graev's September 15, 2004, email to NAT reflects his understanding of this possibility, stating that in light of Notice 2004-41 his accountants "have advised [him] to be very cautious."

The Graevs argue that their valuation of the contributed easement was reasonable. Since the valuation issue will be resolved by the parties' stipulation to be bound by the outcome of another

case that is still pending, see note 2 above, we do not decide valuation now but assume that the Graevs' valuation was reasonable. However, the fact that a valuation is reasonable does not mean that it is correct; a reasonable but incorrect valuation may be challenged and disallowed; consequently, someone who assigns a reasonable value to his donation may nonetheless face a non-negligible risk of disallowance.

Moreover, valuation is not the only potential issue faced by a taxpayer claiming a deduction for a contributed easement, and it was not the only issue as to which NAT promised to return Mr. Graev's contributions. The first numbered paragraph of the side letter did address valuation ("In the event the IRS challenges the appraisal"), but the second numbered paragraph made the distinct promise to return the contributions "[i]n the event the IRS disallows the tax deductions in their entirety". There are multiple requirements in section 170 and the corresponding regulations that, if not followed, may lead to disallowance — and valuation is only one of them. For example, an easement contribution may be disallowed where —

The donee fails to be a "qualified organization" described in section 170(h)(3).

The property subject to the easement fails to be of a "historically important land area" or a "certified historic structure." Sec. 170(h)(4)(iv); see Turner v. Commissioner, 126 T.C. 299, 316 (2006).

The taxpayer fails to contribute a "qualified real property interest". Sec. 170(a)(2); see Belk v. Commissioner, 140 T.C. __ (Jan. 28, 2013).

The easement fails to preserve conservation purposes "in perpetuity". Sec. 170(h)(5); see Carpenter v. Commissioner, T.C. Memo. 2012-1; Herman v. Commissioner, T.C. Memo. 2009-205.

The parties fail to subordinate the rights of a mortgagee in the property "to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity." 26 C.F.R. sec. 1.170A-14(g)(2); see Mitchell v. Commissioner, 138 T.C. 324, 331-332 (2012).

The taxpayer fails to "[a]ttach a fully complete appraisal summary * * * to the tax return". 26 C.F.R sec. 1.170A-13(c)(2)(B). But see Kaufman v. Shulman, 687 F.3d 21, 28-30 (1st Cir. 2012), aff'g in part, vacating in part, and remanding in part Kaufman v. Commissioner, 136 T.C. 294 (2011), and 134 T.C. 182 (2010).

The appraisal fails to be a "qualified appraisal". 26 C.F.R. sec. 1.170A-13(c)(3); see Friedberg v. Commissioner, T.C. Memo. 2011-238.

The appraiser fails to be a "qualified appraiser". 26 C.F.R. sec. 1.170A-13(c)(5); see Rothman v. Commissioner, T.C. Memo. 2012-218 (reserving the question on whether an appraiser was "qualified").

The parties fail to record the easement or otherwise fail to effect "legally enforceable restrictions". 26 C.F.R. sec. 1.170A-14(g)(1); see Satullo v. Commissioner, T.C. Memo. 1993-614, aff'd without published opinion, 67 F.3d 314 (11th Cir 1995).

The taxpayer fails to "[m]aintain records" necessary to substantiate the charitable contribution. 26 C.F.R. sec. 1.170A-13(c)(2)(C), Income Tax Regs.

Mr. Graev's September 15, 2004, correspondence with NAT reflects his clear understanding that charitable contribution deductions for contributions "to organizations that promote conservation easements" were going to be the subject of IRS scrutiny and could be disallowed for failing to satisfy any one of the requirements in section 170. Mr. Graev's accountants advised him "to be very

cautious" with such transactions. Clearly, the risk that the IRS might disallow a deduction for the contribution of an easement was well above "negligible".

b. The side letter

Informed by his accountants' warning, Mr. Graev initially asked NAT about the possibility of a side letter from NAT that promised the return of contributions if deductions were disallowed. NAT eventually gave Mr. Graev such a letter on September 24, 2004. The mere fact that he required the side letter is strong evidence that, at the time of Mr. Graev's contribution, the risk that his corresponding deductions might be disallowed could not be (and was not) "ignored with reasonable safety in undertaking a serious business transaction." 885 Inv. Co. v. Commissioner, 95 T.C. at 161.

Mr. Graev was not alone in his assessment of the risk of disallowance. NAT considered it "standard Trust policy" to return a cash contribution to the extent a deduction therefor was disallowed by the IRS. In numerous instances NAT issued "comfort letters" assuring donors of this policy. The very essence of a comfort letter implies a non-negligible risk; and the author uses the letter to induce the recipient to enter into a transaction. In this case the risk was either partial or complete disallowance of Mr. Graev's claimed charitable contribution deductions. NAT's course of dealing confirms that the possibility that the IRS might disallow Mr. Graev's deductions was not "so remote as to be negligible". See 26 C.F.R. secs. 1.170A-1(e), 1.170A-7(a)(3), 1.170A-14(g)(3).

3. Disallowance as a subsequent event

The Graevs argue:

Forty-four years ago, this Court ruled that the [subsequent] events referred to by Treas. Reg. § 1.170A-1(e) do not include contingencies created by Respondent's examination or contingencies within Respondent's control. O'Brien v. Commissioner, 46 T.C. 583, 592 (1966), acq., 1968-1 C.B. 2.[10]

O'Brien v. Commissioner, 46 T.C. 583 (1966), did involve a charitable contribution that was contingent on subsequent favorable tax treatment; but the Graevs' characterization of our ruling in O'Brien is flatly incorrect, and their reliance on it is therefore mistaken.

O'Brien addressed two issues — a charitable remainder trust issue (which we describe here first) and a related but distinct tax-treatment contingency issue. The taxpayers created a charitable remainder trust in June 1964 — of which they made themselves trustees with broad powers to manage the trust — and then made contributions to the trust in December 1964. Id. at 584. The Commissioner argued that the taxpayers were not entitled to charitable contribution deductions derived from the taxpayers' contributions to the trust because the complete management power given to the donor-trustees enabled them to defeat the remainder interests and therefore prevented the deduction. Id. at 591. We rejected that argument and concluded —

that it is highly improbable that the petitioners in their fiduciary capacity will ever perform an act which will defeat the charitable remainders they have created in the trust. All of the conditions and circumstances surrounding the transfers of property interests to the trust persuade us that the named charities, or other qualified ones, will eventually receive the beneficial enjoyment thereof. * * * [Id. at 596; emphasis added.]

We thus decided this remainder trust issue under "[t]he guidelines * * * set forth in section 1.170-1(e), Income Tax Regs."11 Id. at 594.

The Commissioner's tax contingency argument (discussed first in O'Brien) was based on paragraph

16 of the trust instrument, under which contributions to the trust were "subject to the condition that such contribution shall be repaid to the contributor by the Trustees * * * only in the event and to the extent that the Commissioner of Internal Revenue does not allow [it] as a deduction". Id. at 588. In the notice of deficiency issued in September 1965, the Commissioner had disallowed the charitable contribution deductions (for the sole reason that the donor-trustees had power over the trust). We "disposed of [the contingency issue] summarily", id. at 591, so it is not entirely clear what the Commissioner had argued; but it appears that the Commissioner's contention was simply that "the literal meaning of paragraph 16", id., called for return of the contributions upon the mere act of disallowance by the Commissioner, whether or not the Commissioner's position was valid or was upheld. This position would have put the contingency "'within the control * * * of the Commissioner'", O'Brien v. Commissioner, 46 T.C. at 591(quoting Surface Combustion Corp. v. Commissioner, 9 T.C. 631, 655 (1947), aff'd, 181 F.2d 444 (6th Cir. 1950)),12 without regard to the merits of the Commissioner's decision. We held, to the contrary, that despite "the narrow wording of the trust instrument", "[t]he petitioners have a right to litigate respondent's determination", so that the contributions would not be subject to return "unless the petitioners are unsuccessful in this litigation." Id. at 592.

That is, in O'Brien the Commissioner evidently argued that the charitable contribution deductions were improper simply because, under the trust instrument, the charitable contributions were defeated by the IRS's mere disallowance (whether or not that disallowance was upheld in litigation). We held, however, that if the taxpayers successfully challenged that disallowance, then the contributions were not defeated (and the contribution deductions could therefore be allowed). We thus held that a contingency expressed in terms of "disallowance" of a deduction actually looked to the merits of the deduction. Contrary to the Graevs' argument, our O'Brien Opinion did not analyze the tax contingency issue under the section 170 regulations,13 and we did not hold that a tax-treatment contingency can never be a subsequent event that will defeat a contribution and a deduction. We simply did not address that issue.

This case, unlike O'Brien, clearly presents the issue of whether the promised return of a charitable contribution upon the disallowance of the charitable contribution deduction can constitute a subsequent event the possibility of which, if not negligible, renders the deduction not allowable. O'Brien sheds no light on that question.

B. The possibility of return of the contributions

If the risk of IRS disallowance was non-negligible, then so was the prospect that NAT would be called on to honor its side letter and "promptly refund * * * [Mr. Graev's] entire cash endowment contribution and join with * * * [Mr. Graev] to immediately remove the facade conservation easement from the property's title". Given that non-negligible risk, Mr. Graev's contributions fell afoul of the section 170 regulations implementing the statutory requirements that a gift be effectively "made", that it consist of an "entire interest", and that it be a "qualified conservation contribution". The Graevs argue, however, that as a matter of law NAT could not be held to the promises it made in its side letter, so that there was in fact no possibility that the property would be returned.

The Graevs contend that NAT could not be divested of its interest in the easement because the side letter is not enforceable under New York law and that, as a result, the contributions were not really conditional.14 In particular, the Graevs argue that New York's environmental conservation statutes, N.Y. Envtl. Conserv. Law secs. 49-0301 to 49-0311 (McKinney 2008 & Supp. 2013), would prevent the side letter from being enforced, and alternatively, that the common law doctrine of merger extinguished the side letter upon NAT's recording the easement deed. They also contend that under principles of tax law the promises in the side were a nullity. We disagree.

1. Conservation easements under New York law

In general, property interests are determined by State law. United States v. Nat'l Bank of Commerce, 472 U.S. 713, 722 (1985). In 1983 New York enacted the New York Conservation Easement Statute. See N.Y. Envtl. Conserv. Law secs. 49-0301 to 49-0311. For purposes of these statutes a "conservation easement" is defined as:

an easement, covenant, restriction or other interest in real property, created under and subject to the provisions of this title which limits or restricts development, management or use of such real property for the purpose of preserving or maintaining the scenic, open, historic, archaeological, architectural, or natural condition, character, significance or amenities of the real property * * * [Id. sec. 49-0303(1).]

Under these New York statutes, a conservation easement is enforceable even though "[i]t is not appurtenant to an interest in real property" and even though "[i]t can be or has been assigned to another holder".15 N.Y. Envtl. Conserv. Law sec. 49-0305(5). Since an easement with these characteristics would not have been enforceable under New York common law, see Gross v. Cizauskas, 385 N.Y.S.2d 832 (App. Div. 1976), a conservation easement in New York is authorized only by statute and thus is subject to several statutory restrictions. We assume the easement in this case is enforceable only under New York's Environmental Conservation Law and (as the Graevs contend) is subject to the restrictions therein, especially restrictions on how an easement can be extinguished.

The manner and circumstances in which parties can modify or extinguish a conservation easement under New York's Environmental Conservation statutes are clear:

A conservation easement shall be modified or extinguished only pursuant to the provisions of section 49-0307 of this title. Any such modification or extinguishment shall be set forth in an instrument which complies with the requirements of section 5-703 of the general obligations law or in an instrument filed in a manner prescribed for recording a conveyance of real property pursuant to section two hundred ninety-one of the real property law. [N.Y. Envtl. Conserv. Law sec. 49-0305(2).]

The Graevs argue that NAT's promise in the side letter to "remove the facade conservation easement from the property's title" purports to retain for Mr. Graev a right to extinguish the easement that does not comply with the provisions of N.Y. Envtl. Conserv. Law section 49-0307, and as a result, any attempt to remove the easement pursuant to the promise in the side letter would be unlawful.

Pursuant to N.Y. Envtl. Conserv. Law section 49-0307, cross-referenced in the statute quoted above, a conservation easement held by a "not-for-profit conservation organization"16 may be modified or extinguished only: (1) "as provided in the instrument creating the easement"; (2) "in a proceeding pursuant to section nineteen hundred fifty-one of the real property actions and proceedings law"; or (3) "upon the exercise of the power of eminent domain." NAT's promise in the side letter to remove the easement, standing alone, does not appear to comply with any of the three permissible modification or extinguishment methods provided in N.Y. Envtl. Conserv. Law section 49-0307.

The Commissioner argues that the side letter should be considered part of "the instrument creating the easement". That argument fails because the side letter was not "subscribed by the person * * * granting [the deed]", N.Y. Gen. Oblig. Law sec. 5-703 (McKinney 2012), nor was it recorded, which are both required under N.Y. Envtl. Conserv. Law section 49-0305 (cross-referencing N.Y. Gen. Oblig. Law sec. 5-703) in order for a document to be considered an "instrument creating the easement".

However, we hold that NAT had the ability to honor its promises in the side letter because the subscribed and recorded deed — which clearly is "the instrument creating the easement" — reserved for NAT the power to do so. Paragraph IV.B. of the duly recorded deed granting the easement explicitly gives NAT the right to "abandon" the easement, and that deed does comply with one of the three permissible methods — i.e., the first (allowing modification or extinguishment "as provided in the instrument creating the easement"). The recorded deed provides:

Grantee further agrees that it will not transfer this Easement unless the transferee first agrees to continue to carry out the conservation purposes for which this Easement was created, provided, however, that nothing herein contained shall be constructed to limit the Grantee's right to give its consent (e.g., to changes in a Protected Facade(s)) or to abandon some or all of its rights hereunder. [Emphasis added.]

We have found that at the time Mr. Graev made the contribution, NAT intended to honor its promise to "join with * * * [Mr. Graev] to immediately remove the facade conservation easement from the property's title", and we hold that NAT had the ability to honor this promise by exercising its right to abandon the easement as set forth in paragraph IV.B. of the recorded deed.17

Accordingly, we find that the Commissioner has shown that the possibility that NAT would actually abandon its rights was more than negligible.

2. Merger doctrine

Alternatively, the Graevs argue that the entire side letter was extinguished under the common law doctrine of merger. This argument is also without merit. While the doctrine of merger generally extinguishes terms of preliminary contracts or negotiations upon the recording of a deed, so that only the terms in the recorded deed remain, there are exceptions to this general rule. 91 N.Y. Jur. 2d Real Property Sales and Exchanges, sec. 140 (2011). Assuming the doctrine of merger applies to the side letter, the provisions in the side letter would fall within one of these exceptions and survive the deed.

The merger rule does not apply where there is a clear intent evidenced by the parties that a particular provision of the contract shall survive the deed. See Novelty Crystal Corp. v. PSA Institutional Partners, L.P., 850 N.Y.S.2d 497, 500 (App. Div. 2008). "Intention of the parties may be derived from the instruments alone or from the instruments and the surrounding circumstances". Goldsmith v. Knapp, 637 N.Y.S.2d 434, 436 (App. Div. 1996). In Seibros Fin. Corp. v. Kirman, 249 N.Y.S. 497, 499 (App. Div. 1931), a New York court held that because an agreement giving the purchaser a right to reconvey property that was claimed to be the "inducing cause which persuaded the plaintiff to purchase the property * * * [, t]he contract clearly shows that there was no intention on the part of the parties to merge the contract in the deed. A contract for the sale of real estate is merged in the deed only when the latter is intended to be accepted in full performance of the former."

Likewise, we find that the side letter was an inducing cause that persuaded Mr. Grave to contribute the conservation easement and cash to NAT. Before he even filled out his application to NAT, Mr. Graev emailed NAT asking for its thoughts on the side letter; and after receiving NAT's assurances that the side letter would not affect the deductibility of his contribution, he specifically requested the side letter. Moreover, after the donation, when NAT recognized that the side letter might be detrimental to Mr. Graev's tax deductions, NAT offered to rescind the side letter and Mr. Graev did not accept NAT's offer, indicating that the parties understood the side letter had survived the deed. Accordingly, we find that NAT's promises in the side letter to return to the easement and cash were enforceable because we find a clear intent evidenced by the parties that the side letter would

survive the deed.

3. Nullity

The Graevs appear to argue that NAT's side letter is a nullity and should be disregarded for tax purposes because it provides for the donor's potential recovery of the contributions in the event of unwanted tax consequences. In support of this argument the Graevs rely primarily on Commissioner v. Procter, 142 F.2d 824, 827-828 (4th Cir. 1944), rev'g a Memorandum Opinion of this Court. The holding of the Court of Appeals in Procter, however, is inapposite to this case.

In Procter the donors assigned to their children gifts of remainder interests in two trusts, subject to the following clause:

[I]n the event it should be determined by final judgment or order of a competent federal court of last resort that any part of the transfer in trust hereunder is subject to gift tax, it is agreed by all the parties hereto that in that event the excess property hereby transferred which is decreed by such court to be subject to gift tax, shall automatically be deemed not to be included in the conveyance in trust hereunder and shall remain the sole property of * * * [the taxpayer] * * *. [Id. at 827.]

Under that clause, if the gifts were held by the courts to be taxable, then the gifts would be undone, and the donors would then be not liable for the tax for which the courts had held them liable. The clause purported not only to undo the gifts but also to undo the judicial decision.

The Court of Appeals for the Fourth Circuit held that the clause in Procter was "clearly a condition subsequent and void because contrary to public policy", id., for three reasons:

(1) Such a clause "has a tendency to discourage the collection of the tax by the public officials charged with its collection", thereby discouraging efforts to collect the tax. Id.

(2) "[T]he effect of the condition would be to obstruct the administration of justice by requiring the courts to pass upon a moot case". Id.

(3) "[T]he condition is to the effect that the final judgment of a court is to be held for naught because of the provision of an indenture necessarily before the court when the judgment is rendered." Id. That is, a final judgment would cause the condition to be operative, but the condition should not be allowed to operate to undo the judgment, since the instrument containing the condition was before the court, and all matters pertaining thereto merged in the judgment. Id. at 827-828.

None of these three reasons would apply to nullify NAT's side letter:

First, the conditions in NAT's side letter would not discourage the collection of tax. This Opinion decides that the Graevs are not entitled to charitable contribution deductions (and that there are therefore deficiencies in their income tax), and the return of the contributions to the Graevs would not at all undo or contradict that holding but would instead be consistent with that holding. In order for the condition in the side letter to be triggered, the deductions must be disallowed, and income tax will thereafter be owing whether or not the contribution is returned.

Second, the possibility of the subsequent return of the contributions does not render this case moot. The Graevs claimed deductions; the IRS disallowed them and determined deficiencies of tax; the Graevs challenged that determination, and we must decide the matter. If we had upheld the deductions, the condition in the side letter would never have been met, the gift would be complete, the contribution would be deductible (assuming other qualifications are met), and we would enter decision in favor of the Graevs to overturn the IRS's deficiency determination. Because instead we

disallow the deductions and enter decision in the IRS's favor, upholding the deficiency determination, the condition in the side letter is triggered and the gift presumably reverts to the donor. However, in this case, unlike Procter, the reversion to the donor would not be inconsistent with the court's holding — i.e., the tax collector in our case, unlike Proctor, would collect the tax consistent with the judgment even if the condition become operative and the gift were returned to the donor.

Third, although the final judgment in the IRS's favor would cause the side letter to be operative, the return of the contribution pursuant to the side letter would not operate to undo the judgment, as was the case in Procter. The return would have no effect on the Graevs' tax liabilities.

Other cases have similarly distinguished Procter and have held that certain tax contingency provisions are not void as against public policy. See Estate of Christiansen v. Commissioner, 130 T.C. 1, 8 n.7, 17-18 (2008) (a clause that "increases the amount donated to charity should the value of the estate be increased", "would not make us opine on a moot issue [i.e., the value of the estate], and wouldn't in any way upset the finality of our decision in this case"), aff'd, 586 F.3d 1061 (8th Cir. 2009); Estate of Dickinson v. Commissioner, 63 T.C. 771, 777 (1975) (stating that the "agreement makes no attempt to nullify * * * [the Court's] determination" (citing Surface Combustion Corp. v. Commissioner, 9 T.C. 631, and O'Brien v. Commissioner, 46 T.C. 583)); Estate of Petter v. Commissioner, T.C. Memo. 2009-280 ("a judgment adjusting the value of each unit will actually trigger a reallocation of the number of units between the trusts and the foundation under the formula clause. So we are not issuing a merely declaratory judgment"), aff'd, 653 F.3d 1012 (9th Cir. 2011).

4. Voluntary removal of the easement

The event that might defeat the contribution to NAT is the "removal" of the easement and the return of the cash pursuant to NAT's side letter. Even if, as a matter of law, the side letter was not enforceable for any of the reasons the Graevs advance, the question would remain whether, as a matter of fact, in December 2004 there was a non-negligible possibility that the IRS would disallow the Graevs' contribution deduction and NAT would voluntarily remove the easement. We have found that there was. Mr. Graev evidently concluded that NAT's promise should be believed; he took deliberate steps to obtain its promise; and his conclusion is evidence of what was likely. NAT made such promises to Mr. Graev and others precisely because it was soliciting contributions from within a community of potential donors, and the ability of such an organization to obtain solicitations might well be undermined if it got a reputation for failing to keep its promises. To decide that there was no non-negligible possibility that NAT would voluntarily extinguish the easement and return the cash would require us to find that, in order to induce Mr. Graev to make his contribution, NAT made cynical promises that it fully intended to break. Our record will not support such a finding; the stipulated evidence simply shows a non-profit organization going about accomplishing its purpose. If we speculate (without evidence) that NAT might have reneged on its promise, or even if we assume that NAT probably would have reneged on its promise, that still leaves us with at least a non-negligible possibility that NAT would have done what it said it would do. That possibility is fatal to the Graevs' contribution deductions.

III. Conclusion

Thus, on the evidence before us, we find that there was a substantial possibility that the IRS would challenge the Graevs' easement contribution deductions. We hold that neither State nor Federal law would prevent enforcement of the side letter. And we find that apart from any legal enforceability of the side letter, it reflected what NAT was likely to do in the event of IRS disallowance.

For these reasons, we conclude that at the time of Mr. Graev's contributions to NAT, the possibility that the IRS would disallow the Graevs' deductions for the contributions and, as a result, that NAT would "promptly refund * * * [Mr. Grave's] entire cash endowment contribution and join with * * * [Mr. Graev] to immediately remove the facade conservation easement from the property's title" (as it promised) was not "so remote as to be negligible". Accordingly, under 26 C.F.R. sections 1.170A-1(e) and 1.170A-7(a)(3) the deduction relating to the cash contributions is disallowed. Likewise, under 26 C.F.R. sections 1.170A-1(e), 1.170A-7(a)(3), and 1.170A-14(g)(3), the easement contribution deductions are disallowed.

To reflect the foregoing,

An appropriate order will be issued.

FOOTNOTES

1 Unless otherwise indicated, all section references are to the Internal Revenue Code (26 U.S.C.; "the Code"), as amended, and all Rule references are to the Tax Court Rules of Practice and Procedure.

2 In January 2010 the parties entered into a stipulation to be bound, by which they agreed that if in this case the Court decides the conditional gift issue in the Graevs' favor, the outcome of some the other issues in this case (chiefly, the valuation of the contributed easement) will follow the outcome of a then-pending case. That case was decided in favor of respondent in July 2010, appealed to the U.S. Court of Appeals for the Second Circuit, vacated and remanded, and decided again in favor of respondent in January 2013. See Scheidelman v. Commissioner, T.C. Memo. 2010-151, vacated and remanded, 682 F.3d 189 (2d Cir. 2012), remanded to T.C. Memo. 2013-18. Decision in that case was entered April 12, 2013, and the time to appeal has not yet expired; but we are able to resolve the issue addressed herein without awaiting the resolution of the Scheidelman issues. We do not resolve here the issue of the Graevs' liability for the penalties, which will be a subject of future proceedings.

3 The burden of proof is generally on the taxpayer, see Rule 142(a)(1), and the submission of a case under Rule 122 does not alter that burden, see Borchers v. Commissioner, 95 T.C. 82, 91 (1990), aff'd, 943 F.2d 22 (8th Cir. 1991). However, the burden of proof can be shifted when the Commissioner's position implicates "new matter" not in the notice of deficiency, see note 8 below, addressing the Graevs' contention about supposed "new matter" in this case.

4 For pre-2004 cases involving facade easements, see Richmond v. United States, 699 F. Supp. 578 (E.D. La. 1988) (upholding partial disallowance of contribution deduction where the taxpayer's valuation of facade easement was found excessive); Satullo v. Commissioner, T.C. Memo. 1993-614 (upholding disallowance of contribution deduction where the facade easement was unenforceable in the year at issue because it had not been recorded, and where a mortgage had not been subordinated to the donee's interest), aff'd without published opinion, 67 F.3d 314 (11th Cir. 1995); Dorsey v. Commissioner, T.C. Memo. 1990-242 (upholding partial disallowance of contribution deduction where the taxpayer's valuation of facade easement was found excessive); Griffin v. Commissioner, T.C. Memo. 1989-130 (same), aff'd, 911 F.2d 1124 (5th Cir. 1990); Losch v. Commissioner, T.C. Memo. 1988-230 (same); and Hilborn v. Commissioner, 85 T.C. 677 (1985) (same). For pre-2004 cases involving conservation easements generally, see Strasburg v. Commissioner, T.C. Memo. 2000-94 (upholding partial disallowance of contribution deductions where the deductions claimed exceeded the taxpayer's pro rata basis in the property and valuation of the easement was found excessive); Fannon v. Commissioner, T.C. Memo. 1986-572 (upholding partial disallowance of contribution deductions where the taxpayer's valuation of scenic easement was found excessive); Akers v. Commissioner, T.C. Memo. 1984-490, aff'd, 799 F.2d 243 (6th Cir.

1986) (same); and Great N. Nekoosa Corp. v. United States, 38 Fed. Cl. 645, 654 (1997) (holding that conservation easements were not exclusively for conservation purposes when the plaintiffs retained the right to extract sand and gravel).

5 The deed recites that it was executed October 11, 2004, but Mr. Graev's signature on the deed was notarized on December 16, 2004, and he delivered it to NAT one day later. NAT's then president, James Kearns, signed the deed on NAT's behalf on December 28, 2004.

6 26 C.F.R. section 1.170-1(e), Income Tax Regs. (1959), provided:

If as of the date of a gift a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an interest passes to or is vested in charity on the date of the gift and the interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable on the date of the gift, the deduction is allowable. The deduction is not allowed in the case of a transfer in trust conveying a present interest in income if by reason of all the conditions and circumstances surrounding the transfer it appears that the charity may not receive the beneficial enjoyment of the interest. * * *

7 26 C.F.R. sec. 81.46(a), Estate Tax Regs. (1949), provided:

If as of the date of decedent's death the transfer to charity is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that charity will not take is so remote as to be negligible. If an estate or interest has passed to or is vested in charity at the time of decedent's death and such right or interest would be defeated by the performance of some act or the happening of some event which appeared to have been highly improbable at the time of decedent's death, the deduction is allowable.

The current version of this regulation is in 26 C.F.R. sec. 20.2055-2(b)(1), Estate Tax Regs.

8 In his reply brief, Mr. Graev complains that an IRS argument invoking the perpetuity requirement is "new matter" as to which the IRS should bear the burden of proof under Rule 142(a)(1). We do not believe that the burden of proof affects the resolution of this issue, since the material facts are not actually in dispute, and the outcome is the same no matter which party has the burden. See Dagres v. Commissioner, 136 T.C. 263, 279 (2011). More important, however, the argument that the gifts were subject to a subsequent event — an issue plainly stated in the notice of deficiency — is by its nature an argument that the gifts failed to be perpetual. One reason a conservation easement may fail to be a perpetual gift to the donee, and may thus fail to be deductible, is that it is subject to a condition that creates a non-remote possibility that the easement may revert to the donor. See 26 C.F.R. sec. 1.170A-14(g)(3), Income Tax Regs. The issue of perpetuity is not new matter in this case.

9 We do not address the circumstance in which a hyper-cautious donor conditions his gift on non-disallowance where there is no non-negligible possibility of disallowance.

10 The Graevs also cite an IRS private letter ruling. We decline to consider it, in light of section 6110(k)(3), which provides: "(3) Precedential status. — Unless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent." See Abdel-Fattah v. Commissioner, 134 T.C. 190, 202 (2010); Vons Cos., Inc. v. United States, 51 Fed. Cl. 1, 12 (2001).

11 For the remainder trust issue we cited 26 C.F.R. section 1.170-1(e) (1961) (see note 6 above for

the 1959 version which was identical to the 1961 regulation); but the limitations now set forth in 26 C.F.R. sections 1.170A-1(e), 1.170A-7(a)(3), and 1.170A-14(g)(3), Income Tax Regs., are equivalent.

12 In Surface Combustion Corp. v. Commissioner, 9 T.C. 631 (1947), aff'd, 181 F.2d 444 (6th Cir. 1950), we held that a provision in an employee trust allowing an employer to reclaim his contributions to the trust if the contributions were determined to be nondeductible did not prevent the employer from deducting his contributions to the trust since the contingency was in the control of the Commissioner. Surface Combustion did not involve charitable contributions, section 170, nor any regulations with a "so remote as to be negligible" standard.

13 Our Opinion in O'Brien v. Commissioner, 46 T.C. 583, 592 (1966), indicates that the Commissioner also cited — but we distinguished — Jones v. United States, 252 F. Supp. 256 (N.D. Ohio 1966), aff'd in part, rev'd in part, 395 F.2d 938 (6th Cir. 1968), a case not involving a tax-treatment-contingent contribution, in which (as we noted) the District Court held that the possibility that a contribution at issue there would be defeated "was not 'so remote as to be negligible' under section 1.170-1(e), Income Tax Regs." This description of Jones includes our only mention of that regulation in our discussion of this issue in the O'Brien Opinion, and our discussion does not address any relation between the regulation and the tax-treatment-contingent deduction at issue in O'Brien.

14 In this argument the Graevs do not distinguish between the contribution of the easement (which was subject to the statutes that the Graevs cite) and the contribution of the cash (which was not). Reliance on New York real estate principles to argue that the side letter is not enforceable as to the cash contribution is misplaced. Even if the side letter were not enforceable as to the easement, for the reasons the Graevs advance, so that they could not require NAT to "remove" it, the Graevs show no reason that the side letter would not be enforceable so as to require the return of the cash.

15 The legislative history of these provisions suggests that they were included in the statutes so that the conservation easements would satisfy the perpetuity requirement of 26 C.F.R. sec. 170A-14(g). See John C. Partigan, "New York's Conservation Easement Statute: The Property Interest and Its Real Property and Federal Income Tax Consequences", 49 Albany L. Rev. 430, 452 n.87 (1985).

16 The Commissioner does not dispute that NAT is a "not-for-profit conservation organization" for purposes of New York's Environmental Conservation Law.

17 Our holding here is distinguishable from Commissioner v. Simmons, 646 F.3d 6, 10 (D.C. Cir. 2011), aff'g T.C. Memo. 2009-208, which looked at similar abandonment language in an easement deed and concluded "deductions cannot be disallowed based upon the remote possibility * * * [the charity] will abandon the easements." See also Kaufman v. Shulman, 687 F.3d 21, 28 (1st Cir. 2012), aff'g in part, vacating in part, and remanding in part Kaufman v. Commissioner, 136 T.C. 294 (2011), and 134 T.C. 182 (2010). In Commissioner v. Simmons, 646 F.3d at 10, the Court of Appeals for the D.C. Circuit stated that "the Commissioner has not shown the possibility * * * [the charity] will actually abandon its rights is more than negligible. [The charity] * * * has been holding and monitoring easements in the District of Columbia since 1978, yet the Commissioner points to not a single instance of its having abandoned its right to enforce." In the instant case, however, NAT gave Mr. Graev an explicit, written promise that it would abandon its rights in the easement if certain events occurred. We find nothing to indicate that NAT did not intend to comply with its written promises.

Report Outlines Changes for IRS To Ensure Accountability, Chart a Path Forward; Immediate Actions, Next Steps Outlined.

WASHINGTON — Internal Revenue Service Principal Deputy Commissioner Danny Werfel today issued a report outlining new actions and next steps to fix problems uncovered with the IRS' review of tax-exempt applications and improve the wider processes and operations in place at the IRS.

The three-part report covers a wide range of areas Werfel and his leadership team examined during the past month. The report cites actions to hold management accountable and identifies immediate steps to help put the process for approving tax-exempt applications back on track. Werfel also outlines actions needed to protect and improve wider IRS operations, ranging from compliance areas to taxpayer service.

"It is critical that the IRS takes steps to ensure accountability, address the problems uncovered in recent weeks and improve the operations of the IRS to continue to carry out our critical mission on behalf of the public," Werfel said. "We have made a number of changes already, more are in the works and even more will develop as we move forward."

Importantly, the initial IRS review shows no signs of intentional wrongdoing by IRS personnel or involvement by parties outside the IRS in the activities described in the recent TIGTA report. However, the report notes that investigations are ongoing, and that the IRS is committed to a full fact-finding effort to provide the public answers to these and other important questions.

"The IRS is committed to correcting its mistakes, holding people accountable, and establishing control elements that will help us mitigate the risks we face," Werfel said. "This report is a critical first step in the process of restoring trust in this critical institution. We have more work in front of us, but we believe we are on the right track to move forward."

Werfel's report, titled "Charting a Path Forward at the IRS: Initial Assessment and Plan of Action," covers three primary areas:

Accountability. This covers the steps being taken to ensure accountability for the mismanagement described in last month's Treasury Inspector General for Tax Administration (TIGTA) report:

• The report finds that significant management and judgment failures occurred, as outlined in the TIGTA report. These contributed to the inappropriate treatment of taxpayers applying for tax-exempt status.

• To address this, new leadership has been installed across all five executive management levels involved in the chain of command connected to these matters. In addition, the IRS has empaneled an Accountability Review Board to provide recommendations within 60 days (and later as needed) on any additional personnel actions that should be taken.

Fixing the Problems with the Review of Applications for Tax-Exempt Status. This part covers several process improvements underway to ensure that taxpayers are treated appropriately and effectively in the review of applications for tax-exempt status:

The report outlines a new voluntary process to help certain applicants gain fast-track approval to operate as a 501(c)(4) tax-exempt entity if they are being reviewed for advocacy questions and have been in our application backlog for more than 120 days. This self-certification process allows them a streamlined path to tax-exempt status if they certify they will operate within specified limits and thresholds of political and social welfare activities. In addition, the IRS has added new technical and

program staff to assist with reviewing 501(c)(4) applications.

The IRS also suspended the use of any "be-on-the-lookout," or BOLO lists in the application process for tax-exempt status.

Review of IRS Operations and Risks. The report identifies a series of actions to ensure taxpayers that selection criteria across the IRS are appropriate and that taxpayers are aware of how they can seek assistance if they have concerns about the IRS. The report further outlines steps underway to ensure that critical program or operational risks within the IRS are identified early, raised to the right decision-makers and shared timely with key stakeholders.

The report calls for establishing an Enterprise Risk Management Program to provide a common framework for capturing, reporting and addressing risk areas across the IRS. This will improve timeliness in bringing information to the attention of the IRS Commissioner and other IRS leaders as well as key stakeholders to help prevent future instances of inappropriate treatment or mismanagement.

Although there is no current evidence that selection criteria in other IRS organizations is inappropriate, the nature of the problems identified in the tax-exempt application process warrants a review of certain process controls within the IRS. The IRS will initiate a comprehensive, agency-wide review of compliance selection criteria. Results will be shared with the Department of the Treasury, the IRS Oversight Board, and the Chairpersons of the House Ways and Means Committee and the Senate Finance Committee.

The IRS will initiate additional internal and external education and outreach about the role of the National Taxpayer Advocate in assisting taxpayers in resolving problems they encounter with the IRS.

In addition to posting the report on IRS.gov, the IRS will regularly update the progress made on the TIGTA report's recommendations and provide other developments related to this effort.

Adequate Written Procedures Needed for Post-Issuance Compliance With Bond Requirements.

Issuers of tax-exempt bonds should maintain adequate written procedures to ensure continued compliance with the tax rules after the bonds are issued, panelists at a program on post-issuance compliance said June 21.

Christopher Woodin, a senior tax law specialist in the IRS tax-exempt bonds unit, said issuers have a fiduciary responsibility to look after bondholders' best interests. "As an issuer . . . you have to make sure that those bonds remain in compliance with the tax-exempt bond rules," he said at the American Institute of Certified Public Accountants Not-for-Profit Industry Conference in Washington. One way to do that is to adopt and implement written procedures for meeting the requirements "long after the bonds have been issued," he said.

Edward J. Jennings, tax director at the University of Michigan, agreed. "The IRS is looking for a written tax policy as part of due diligence," he said. "They're looking for more information from you." He added that a tax certificate, despite its discussion of arbitrage, private business use, and other areas of concern to the IRS, is not sufficient.

Woodin said the IRS is working on language in the Internal Revenue Manual that will tell revenue agents what to look for when determining whether an issuer's written procedures are adequate. "That's not a safe harbor and won't necessarily ensure that we would consider the procedures that were prepared adequate," he explained. "But at least it gives you some level of guidance to know at least what our examiners are looking at and what they need to see to say that a written procedure is adequate."

It is much easier to resolve a post-issuance compliance problem through the IRS's voluntary closing agreement program (VCAP) than by having a problem uncovered during an examination, which could result in higher penalties and taxability of the bonds, Woodin said. "With the VCAP program we try to work with issuers to come to some resolution that will work for you but does recognize that there is a violation," he said.

Woodin also discussed the IRS's market segment examinations of exempt bonds, explaining that the agency wants to look at the segments every three years through examinations tailored to each segment. Some segments are advance refundings, section 501(c)(3) bonds, exempt facility bonds, student loan bonds, student construction bonds, and Build America Bonds.

Woodin also announced that Clifford Gannett, the longtime director of the tax-exempt bonds unit, is retiring. No replacement has been named.

by Fred Stokeld

Nonlegal Roles of IRS Attorneys May Waive Attorney-Client Privilege.

A federal district court recently held that a senior counsel within the IRS Large Business and International Division was not acting as a legal adviser and that some documentation therefore wasn't protected from discovery by the attorney-client privilege.

A federal district court recently held that a senior counsel within the IRS Large Business and International Division was not acting as a legal adviser and that some documentation therefore wasn't protected from discovery by the attorney-client privilege.

A December 13, 2012, order in Kearney Partners Funds LLC v. United States, No. 153-10, by the U.S. District Court for the Middle District of Florida reviewed documents sent between an LB&I senior counsel and field agents. The taxpayer had asked the court to compel the IRS to produce the documents on the ground that the materials were not subject to the attorney-client privilege because the government attorney was "simply another IRS employee working on the case and not counsel."

Although noting that the IRS attorney was a counsel representative to the LB&I issue management team overseeing the alleged abusive transaction, the court rejected the government's argument that the privilege applied because the attorney was counsel of record in Tax Court cases involving the shelter issue and had worked on other cases involving the same taxpayers. After an in camera review of the documents, the district court held that the government "does not assert that the documents reveal protected mental impressions, trial strategy, or legal advice," and that consequently, it did not "find good cause to support a claim for the attorney client privilege."

A February 4 court order clarifying the previous order reiterated that documents written by the IRS attorney addressed "factual issues" in a case and were "not addressing specific legal advice." The court found that the documents at issue in a discovery challenge were "merely communications" and

"not specified confidential legal advice" subject to the attorney-client privilege.

"Merely because [the senior counsel] is an attorney is not sufficient grounds to impose the attorney-client privilege on her communications," the court said in the additional order.

Robin L. Greenhouse of McDermott Will & Emery said the district court decision points out that the increasing integration of LB&I counsel into the exam process is expected to affect the application of the attorney-client privilege to claims of protection from discovery by the government. "Frequently, IRS attorneys have dual roles, providing both legal advice but also acting as an examiner in drafting information document requests, interviewing witnesses, and preparing the notice of proposed adjustments," she said. "As the court in Kearney Partners found, in those circumstances it is difficult to ascertain whether an attorney was acting as a lawyer or part of an exam team."

The district court's decision is important because LB&I counsel have been increasingly acting in this dual capacity, particularly in transfer pricing cases, said Greenhouse. Consequently, "the court's opinion confirms that LB&I's counsel staffing structure could adversely impact its ability to claim privilege for work they are doing," she said.

The normal presumption is that outside counsel are providing legal advice to a client, but there is no presumption for in-house counsel because in-house frequently has both legal and nonlegal responsibilities, Greenhouse said. "Here the role of IRS LB&I counsel makes it difficult to draw lines, and thus their communications should be closely scrutinized to determine if the attorney-client privilege protection applies," she said.

The litigation in Kearney Partners has covered several court venues and yielded interesting tidbits on how judges continue to evaluate privilege issues arising out of tax shelter transactions. Like in many other cases arising from transactions the IRS viewed as abusive, the government pursued a taxpayer who used partnership forms to artificially generate capital losses to offset significant gains. After the audit, the IRS made proposed adjustments disallowing the taxpayer's claimed loss, which the taxpayer challenged in federal district court. During the litigation, the IRS issued a subpoena to the taxpayer's law firm seeking the production of documents related to the investment structure used in the shelter.

The law firm objected to the production of some of the documents, claiming attorney-client, work product, and section 7525 tax practitioner privileges. In an action brought by the government to compel production, Kearney Partners Funds LLC v. United States, No. 11-4075, a magistrate judge for the U.S. District Court of the District of New Jersey held that the documents were protected by the attorney-client and work product privileges. The magistrate's rationale under the work product doctrine, if it is upheld on appeal, could expand the privilege's scope.

In construing the application of the attorney-client privilege, the magistrate found that the taxpayer's adviser was providing "legal and tax advice pertaining to the transactions undertaken" by the taxpayer, including "the possibility of litigation arising out of the transactions," and therefore that the privilege applied to the communications. The magistrate also held that the adviser hadn't waived the taxpayer's privilege.

Of substantial interest to tax practitioners are the magistrate judge's thoughts on work product. After an in camera review of the contested documents, the magistrate held that the legal evaluation of the taxpayer's proposed investment scheme qualified for work product protection because the documents were prepared in anticipation of possible litigation with the IRS.

"The motivating purpose behind the creation of the Communications was to aid in future litigation,"

the magistrate wrote, adding that "it is clear that the Communications were intended to inform [the taxpayer] about the complexity of the proposed investment that could lead to legal exposure because of its aggressive nature."

The government appealed the magistrate's opinion and order regarding the motion to compel, but only concerning the attorney-client privilege, leaving the work product portion unchallenged. The district court upheld the magistrate's decision.

Other courts have steadfastly resisted the notion of pre-litigation advice receiving work product protection. In Textron Inc. et al. v. United States, No. 09-750, the full First Circuit held that the work product privilege extends only to documents prepared for use in litigation, rather than documents created to comply with financial reporting rules. The en banc opinion reversed an original First Circuit panel that had upheld a federal district court's decision that the workpapers at issue were protected from disclosure because the documents had been prepared in anticipation of litigation.

However, in Regions Financial Corp. et al. v. United States, No. 2:06-CV-00895, the district court held that analyzing a listed transaction is much more closely connected to litigation than preparing a tax return, and thus the work product doctrine applies. The court stated that the "contested documents contain precisely the kind of legal analysis that the work product doctrine exists to protect." While the documents may have had some utility outside litigation, "they would not have been created were Regions not primarily concerned with litigating with the IRS" regarding the listed transaction, the court wrote.

The problem for taxpayers seems to be that while district courts have sometimes accepted the rationale that tax planning documents can be subject to the work product privilege, circuit courts have yet to uphold those conclusions. The Eleventh Circuit dismissed the government's appeal in Regions Financial after the IRS settled with the taxpayer, making the workpaper issue moot.

Most recently, in a May 22 order , the Florida district court addressed the added issue of judicial review of penalty assertions by the government in light of an IRS announcement offering penalty waiver for taxpayer disclosure of participation in the specified tax shelter. The taxpayer sought summary judgment on its claim that accuracy-related penalties should be waived for compliance with Announcement 2002-2, while the IRS argued that the court lacked subject matter jurisdiction on the issue. While the announcement established internal agency rules that lacked the force and effect of law, the court held that the IRS pronouncement was "an agency-wide directive designed to confer important benefits to taxpayers."

Because the announcement set forth a uniform rule of conduct by IRS personnel and was meant to induce taxpayers to disclose their involvement in tax shelters in exchange for the waiver of penalties, the court stated that the IRS "failed to observe self-imposed limits upon the exercise of its discretion which invited reliance upon such limitations." The use of "will" in the announcement's language regarding the waiver of penalties for properly disclosed taxpayer participation "indicates an intent to be bound," the court wrote. Consequently, it was proper under the Administrative Procedure Act for the court to review the taxpayer's disclosure for compliance with the announcement's terms.

However, the court rejected the taxpayer's argument that an LB&I directive on penalty imposition required IRS compliance in order to sustain a penalty. The IRS memo directed agents to obtain approval from the director of field operations in order to impose accuracy-related penalties, but in this case the decision to deny penalty relief to the taxpayer was made by chief counsel. The court held that the strictly internal procedure outlined in the memo was not subject to judicial review, but

rather was a nonbinding rule that did not confer rights on taxpayers. That the IRS deviated from a "benign procedure for administering the disclosure process" did not deprive the taxpayers of a due process, the court wrote.

Thomas D. Sykes of Gould & Ratner LLP said the court's discussion of Announcement 2002-2 was "careful, balanced, and not obviously flawed," noting that public IRS pronouncements like announcements are often relied on by taxpayers.

Sykes said it was understandable that the government would, as a threshold matter, argue that a court lacks the jurisdiction or authority to review an IRS decision not to honor the terms of an IRS announcement. Jurisdictional analysis is highly formalistic, and the executive branch tends to try to protect its prerogatives from the other branches, although the role of the Administrative Procedure Act in the review of IRS actions is still being developed by the courts, he said.

An unanswered question is why the IRS sought to impose penalties despite the timely disclosure it had invited under Announcement 2002-2, Sykes said. It is one thing if there were extraordinary circumstances behind the IRS's refusal to waive penalties, but "if the IRS is backing away from its long-standing policy of honoring resolution arrangements that do not amount to a closing agreement, then that is a worrisome development," he said.

The IRS frequently relies on an agreement procedure to close cases that isn't technically binding upon the government, and yet it has an established policy of honoring those agreements, Sykes said. "For decades, Forms 870-AD have been used far more often than closing agreements to memorialize settlements reached between the IRS and a taxpayer, and yet that form is not technically binding upon the IRS because they are generally executed by IRS officials who lack the settlement authority that is required for a closing agreement — the exclusive means prescribed by the code for settling tax disputes," he said. "Nonetheless, the IRS will seek to enforce the terms of a Form 870-AD against a taxpayer, using an equitable estoppel theory."

Sykes said that when he worked for the Justice Department Tax Division, there was a policy that the government would honor the terms of Forms 870-AD "in the absence of fraud or mutual mistake, even though those forms were not technically binding upon the IRS and even though equitable estoppel is a legal doctrine that only rarely, if at all, can be applied against the government." Now that the government has lost the threshold jurisdictional argument over whether IRS decisions made under an announcement are reviewable, "one hopes that government attorneys will give the policy issues — similar to those involved in the deliberations back in the 1980s over the respect to be given to Forms 870-AD — careful consideration," he said.

Miri Forster, the national leader for tax controversy at Rothstein Kass, said practitioners look to IRS internal guidelines for clarity and that taxpayers expect the IRS to adhere to those guidelines. "While the court makes a distinction between an announcement and an internal directive, the taxpayer's expectation is that IRS communications are in sync and will be followed in the same manner," she said. Although internal guidance is not authority, "why shouldn't the IRS be held responsible when it does not follow its own internal rules? If the IRS isn't going to follow its own guidelines, this may create confusion for those analyzing IRS guidance in connection with future initiatives," she said.

by Jeremiah Coder

S. 952 Would Clarify Treatment of Church Pension Plans.

S. 952, the Church Plan Clarification Act of 2013, introduced by Senate Finance Committee member Benjamin L. Cardin, D-Md., would provide various clarifications regarding the treatment of church plans, including application of controlled group rules, contribution limits, automatic enrollment, transfers and mergers, and investments.

113TH CONGRESS

1ST SESSION

S. 952

To amend the Internal Revenue Code of 1986 to clarify the

treatment of church pension plans, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MAY 14, 2013

Mr. CARDIN (for himself and Mr. PORTMAN) introduced the following

bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1986 to clarify the treatment of church pension plans, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the “Church Plan Clarification Act of 2013”.

SEC. 2. CHURCH PLAN CLARIFICATION.

(a) APPLICATION OF CONTROLLED GROUP RULES TO CHURCH PLANS. —

(1) IN GENERAL. — Section 414(c) of the Internal Revenue Code of 1986 is amended —

(A) by striking “For purposes” and inserting the following:

“(1) IN GENERAL. — For purposes”, and

(B) by adding at the end the following new paragraph:

“(2) CHURCH PLANS. —

“(A) GENERAL RULE. — Except as provided in subparagraphs (B) and (C), for purposes of this subsection and subsection (m), an organization that is otherwise eligible to participate in a church plan as defined in subsection (e) shall not be aggregated with another such organization and treated

as a single employer with such other organization unless —

“(i) one such organization provides directly or indirectly at least 80 percent of the operating funds for the other organization during the preceding tax year of the recipient organization, and

“(ii) there is a degree of common management or supervision between the organizations.

For purposes of this subparagraph, a degree of common management or supervision exists only if the organization providing the operating funds is directly involved in the day-to-day operations of the other organization.

“(B) NONQUALIFIED CHURCH-CONTROLLED ORGANIZATIONS. — Notwithstanding the provisions of subparagraph (A), for purposes of this subsection and subsection (m), an organization that is a nonqualified church-controlled organization shall be aggregated with one or more other nonqualified church-controlled organizations, or with an organization that is not exempt from tax under section 501, and treated as a single employer with such other organizations, if at least 80 percent of the directors or trustees of such organizations are either representatives of, or directly or indirectly controlled by, the first organization. For purposes of this subparagraph, a ‘nonqualified church controlled organization’ shall mean a church-controlled organization described in section 501(c)(3) that is not a qualified church-controlled organization described in section 3121(w)(3)(B).

“(C) PERMISSIVE AGGREGATION AMONG CHURCH-RELATED ORGANIZATIONS. — Organizations described in subparagraph (A) may elect to be treated as under common control for purposes of this subsection. Such election shall be made by the church or convention or association of churches with which such organizations are associated within the meaning of subsection (e)(3)(D), or by an organization determined by such church or convention or association of churches to be the appropriate organization for making such election.

“(D) PERMISSIVE DISAGGREGATION OF CHURCH-RELATED ORGANIZATIONS. — For purposes of subparagraph (A), in the case of a church plan (as defined in subsection (e)), any employer may permissively disaggregate those entities that are not churches (as defined in section 403(b)(12)(B)) separately from those entities that are churches, even if such entities maintain separate church plans.

“(E) ANTI-ABUSE RULE. — For purposes of subparagraphs (A) and (B), the anti-abuse rule in Treasury Regulation section 1.414(c)-5(f) shall apply.”.

(2) EFFECTIVE DATE. — The amendments made by this subsection shall apply to taxable years beginning before, on, or after the date of the enactment of this Act.

(b) APPLICATION OF CONTRIBUTION AND FUNDING LIMITATIONS TO 403(b) GRANDFATHERED DEFINED BENEFIT PLANS. —

(1) IN GENERAL. — Section 251(e)(5) of the Tax Equity and Fiscal Responsibility Act of 1982 (Public Law 97-248), is amended —

(A) by striking “403(b)(2)” and inserting “403(b)”, and

(B) by inserting before the period at the end the following: “, and shall be subject to the applicable limitations of section 415(b) of such Code as if it were a defined benefit plan under section 401(a) of such Code and not the limitations of section 415(c) of such Code (relating to limitation for defined contribution plans).”.

(2) EFFECTIVE DATE. — The amendments made by this subsection shall apply as if included in the enactment of the Tax Equity and Fiscal Responsibility Act of 1982.

(c) AUTOMATIC ENROLLMENT BY CHURCH PLANS. —

(1) IN GENERAL. — This subsection shall supersede any law of a State that relates to wage, salary, or payroll payment, collection, deduction, garnishment, assignment, or withholding which would directly or indirectly prohibit or restrict the inclusion in any church plan (as defined in this subsection) of an automatic contribution arrangement.

(2) DEFINITION OF AUTOMATIC CONTRIBUTION ARRANGEMENT. — For purposes of this subsection, the term “automatic contribution arrangement” means an arrangement —

(A) under which a participant may elect to have the plan sponsor make payments as contributions under the plan on behalf of the participant, or to the participant directly in cash, and

(B) under which a participant is treated as having elected to have the plan sponsor make such contributions in an amount equal to a uniform percentage of compensation provided under the plan until the participant specifically elects not to have such contributions made (or specifically elects to have such contributions made at a different percentage).

(3) NOTICE REQUIREMENTS. —

(A) IN GENERAL. — The plan administrator of an automatic contribution arrangement shall, within a reasonable period before such plan year, provide to each participant to whom the arrangement applies for such plan year notice of the participant’s rights and obligations under the arrangement which —

(i) is sufficiently accurate and comprehensive to apprise the participant of such rights and obligations, and

(ii) is written in a manner calculated to be understood by the average participant to whom the arrangement applies.

(B) ELECTION REQUIREMENTS. — A notice shall not be treated as meeting the requirements of subparagraph (A) with respect to a participant unless —

(i) the notice includes an explanation of the participant’s right under the arrangement not to have elective contributions made on the participant’s behalf (or to elect to have such contributions made at a different percentage),

(ii) the participant has a reasonable period of time, after receipt of the notice described in clause (i) and before the first elective contribution is made, to make such election, and

(iii) the notice explains how contributions made under the arrangement will be invested in the absence of any investment election by the participant.

(4) EFFECTIVE DATE. — This subsection shall take effect on the date of the enactment of this Act.

(d) ALLOW CERTAIN PLAN TRANSFERS AND MERGERS. —

(1) IN GENERAL. — Section 414 of the Internal Revenue Code of 1986 is amended by adding at the end the following new subsection:

“(y) CERTAIN PLAN TRANSFERS AND MERGERS. —

“(1) IN GENERAL. — Under rules prescribed by the Secretary, except as provided in paragraph (2), no amount shall be includible in gross income by reason of —

“(A) a transfer of all or a portion of the account balance of a participant or beneficiary, whether or not vested, from a plan described in section 401(a) or an annuity contract described in section 403(b), which is a church plan described in subsection (e) to an annuity contract described in section 403(b), if such plan and annuity contract are both maintained by the same church or convention or association of churches,

“(B) a transfer of all or a portion of the account balance of a participant or beneficiary, whether or not vested, from an annuity contract described in section 403(b) to a plan described in section 401(a) or an annuity contract described in section 403(b), which is a church plan described in subsection (e), if such plan and annuity contract are both maintained by the same church or convention or association of churches, or

“(C) a merger of a plan described in section 401(a), or an annuity contract described in section 403(b), which is a church plan described in subsection (e) with an annuity contract described in section 403(b), if such plan and annuity contract are both maintained by the same church or convention or association of churches.

“(2) LIMITATION. — Paragraph (1) shall not apply to a transfer or merger unless the participant’s or beneficiary’s benefit immediately after the transfer or merger is equal to or greater than the participant’s or beneficiary’s benefit immediately before the transfer or merger.

“(3) QUALIFICATION. — A plan or annuity contract shall not fail to be considered to be described in sections 401(a) or 403(b) merely because such plan or account engages in a transfer or merger described in this subsection.

“(4) DEFINITIONS. — For purposes of this subsection:

“(A) CHURCH. — The term ‘church’ includes an organization described in subparagraph (A) or (B)(ii) of subsection (e)(3).

“(B) ANNUITY CONTRACT. — The term ‘annuity contract’ includes a custodial account described in section 403(b)(7) and a retirement income account described in section 403(b)(9).”.

(2) EFFECTIVE DATE. — The amendment made by this subsection shall apply to transfers or mergers occurring after the date of the enactment of this Act.

(e) INVESTMENTS BY CHURCH PLANS IN COLLECTIVE TRUSTS. —

(1) IN GENERAL. — In the case of —

(A) a church plan (as defined in section 414(e) of the Internal Revenue Code of 1986), including a plan described in section 401(a) of such Code and a retirement income account described in section 403(b)(9) of such Code, and

(B) an organization described in section 414(e)(3)(A) of such Code the principal purpose or function of which is the administration of such a plan or account,

the assets of such plan, account, or organization (including any assets otherwise permitted to be

commingled for investment purposes with the assets of such a plan, account, or organization) may be invested in a group trust otherwise described in Internal Revenue Service Revenue Ruling 81-100 (as modified by Internal Revenue Service Revenue Rulings 2004-67 and 2011-1), or any subsequent revenue ruling that supersedes or modifies such revenue ruling, without adversely affecting the tax status of the group trust, such plan, account, or organization, or any other plan or trust that invests in the group trust.

(2) EFFECTIVE DATE. — This subsection shall apply to investments made after the date of the enactment of this Act.

LTR: IRS Denies Exempt Status to Jewish Orthodox Synagogue.

The IRS denied tax-exempt status under section 501(c)(3) to a Jewish Orthodox synagogue because it failed to establish that it was organized and operated exclusively for exempt purposes and not for the private benefit of its creators, and because it lacked control and discretion of its funds.

Citations: LTR 201325017

Contact Person: * * *

Identification Number: * * *

Contact Number: * * *

UIL Code: 501.00-00, 501.03-00, 501.03-20, 503.00-00

Release Date: 6/21/2013

Date: March 28, 2013

Employer Identification Number: * * *

Form Required To Be Filed: * * *

Tax Years: * * *

Dear * * *:

This is our final determination that you do not qualify for exemption from federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the

enclosed Notice 437, Notice of Intention to Disclose, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Holly O. Paz

Director, Exempt Organizations

Rulings and Agreements

Enclosure

Notice 437

Redacted Proposed Adverse Determination Letter

Redacted Final Adverse Determination Letter

* * * * *

Contact Person: * * *

Identification Number: * * *

Contact Number: * * *

FAX Number: * * *

UIL Numbers: 501.00-00, 501.03-00, 501.03-20, 503.00-00

Date: January 25, 2013

Employer Identification Number: * * *

LEGEND:

B = individual

C = individual

D = individual

E = couple

F = individual

G = organization

H = business

J = individual

k = dollar amount

L = individual

W = state

X = date

Dear * * *:

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below. This letter supersedes our letter dated July 9, 2012.

ISSUES

1. Do the available facts show you have failed to pass the operational test, therefore disqualifying you from exemption under Section 501(c)(3) of the IRC? Yes, for the reasons described below.

2. Does the fact that you allow a non-board member to have signatory authority on your checking account demonstrate a lack of control and discretion of your funds, causing you to fail the operational test, therefore disqualifying you from exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.

3. Have your transactions resulted in private benefit, therefore precluding you from exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.

4. Do the capital improvements you made constitute a substantial non-exempt purpose, therefore disqualifying you from exemption under Section 501(c)(3) of the Code? Yes, for the reasons described below.

FACTS

You were formed by Articles of Incorporation on X by Trustees B, C and D. Article seven of your Articles states you were formed, in part:

To establish, maintain and conduct services for divine worship and religious observances in accordance with the customs and traditions of the Orthodox Jewish Religion; to establish, maintain and conduct synagogue for religious worship and prayer in accordance with the customs and traditions of the Orthodox Jewish Religion; to establish, maintain and conduct classes in Talmud and religious education; to purchase and lease such property as may be necessary for or incidental to the

conduct and welfare of the corporation and the fulfillment of its religious objectives and purposes; and to solicit contributions form the general public in order to sustain said religious corporation.

Your Bylaws state you were formed to maintain a synagogue to conduct religious worship and services in accordance with the tenants of Jewish Orthodox faith. Article eight of your Bylaws states the following:

The Treasurer shall have the care and custodies of the monies belonging to the Organization and shall be responsible for such monies and securities of the Organization. He shall cause to be deposited in a regular business bank or trust company all sums of the Organization. He or one of the other offices [sic] must be one of the persons who shall sign checks or drafts of the organization. No special fund may be set aside that shall make it unnecessary for the Treasurer to sign the checks issued upon it.

You state in your attachments to Form 1023 that "our organization (you) is controlled by the board of directors. They make all decisions about the organizations (your) activities, and decide how funds are to be spent."

You submitted a Conflict of Interest Policy, which has a purpose of protecting your interest when contemplating entering into a transaction, or arrangement that might benefit the private interest of an officer or director of the organization or might result in a possible excess benefit transaction. However, no one had signed the Conflict of Interest Policy.

You describe your activities as that of a congregation, with services held each weekday morning in accordance with Jewish tradition, as "described in prayer books available at any bookstore." Per your application, you have * * * members. However, you submitted a list of your members of which there were only * * *. Only one of your Trustees was included in your membership listing. You attract new members through "word of mouth, we have no website."

When we asked how you came into existence you said "adherents and former students of B decided to form a congregation to foster community feeling [sic] among former students and appreciative community members."

Your rabbi is B. You said, "We have no written contract with the rabbi. The rabbi does not receive a salary from the congregation. He is otherwise employed." G, a school located within your facility, employs B. B works at least 25 hours per week for them. He works at least 10 hours per week for you, and does not conduct services for any other organization. D and C are the father and father-i--law of B, respectively. You said volunteers conduct all activities. You later revised your board, adding L with B resigning.

You said your schedule is as follows:

Sunday thru Thursday,

9:00AM – 1:00PM — tractate Brachot (blessings)

3:00PM – 6:00PM — tractate Shabbos, and

8:00PM – 9:15PM — code of Jewish law

Friday, 9:30AM – 11:30PM — Brachot (Blessings)

The following is the schedule for G's shared use of your facility:

Sunday thru Thursday, 8:00AM – 9:30PM

Friday, 8:00AM – 1:00PM

Despite your statement that services are held “every day,” it is noted, per your schedule, you do not offer services on the Sabbath (Saturday).

Regarding your membership, you stated you were a membership organization, “a Sabbath-observing Jew who pays dues may become a member of congregation.” Members have the right to vote at annual membership meetings and to elect directors. You further asserted “a member may belong to another Orthodox Jewish congregation.”

We asked for a list of the governing body members of G and you responded by saying “unavailable we do not maintain the records of the” school. However, B is an employee of G. We asked again for this information and you said “most business entities limit the information allowed to employees to the extent necessary to carry out their functions. Accordingly teaching employees are not usually privy to broader organization information since it does not impact on their pedagogical function.”

You are distinguishable from G as “they are a religious school for the religious instruction of young teens. We are a congregation for young and old alike.” The students of the school are not your congregants. You share physical space with the school. Specifically, you share the synagogue space. Although B is a teacher at the school, when we asked approximately how many students attend G, which operates in your physical space, you said “we are not the party to properly address the . . .” school’s enrollment. You conduct religious classes. The instructors for these classes are four men, one of which is B. The other three instructors are Rabbis for other congregations.

You provided a list of your donors. When asked for the Employer Identification Number (EIN) for those donors that were not individuals, you responded, “It is very difficult in our identity theft conscious society to collect specific personal identifying information. This is information not readily shared and just inquiries arouse suspicion and may jeopardize collection efforts especially for a not-for-profit.”

You submitted budgets which showed revenue in the form of gifts, grants and contributions of approximately $* * * annually, with membership fees accounting for approximately $* * * annually, for a three year period. Your expenses consisted of occupancy, professional fees, and other — with other being the majority.

We asked if you had a bank account. You responded you did not yet have a bank account. However, several days after we received correspondence indicating you did not yet have a bank account, you mailed us copies of your bank statements. Regarding this discrepancy you said:

It was erroneously understood to refer to an operating account which we do not have. The Congregation had at one point an active account solely set aside for the purpose of making renovations to the site for use as a congregation. Once the congregation realized their error of their own volition they set the records straight by submitting the statements.

The bank account showed that you had already had tens of thousands of dollars flow through your account before you even submitted your application for exemption, in contradiction to the proposed budgets you provided. B, C, D and F all have signatory authority on your checking account. As evidenced by canceled checks you submitted, F had, in fact, signed checks on your behalf. We asked why F, who is not one of your board members, has signatory authority on your account. You said “in the event board members are not available, and to offer an element of oversight.” However, we

asked if F was related to any of the board members and you responded that she is the daughter of C, daughter-in-law of D and wife of B. You later stated, when asked about payment of expenses from your accounts, that various members pay for out of pocket expenses keeping you afloat.

You occupy a two story, 40 by 100 sq. ft. building. You indicated, “The first floor is a synagogue, furnished with tables, chairs, bookcases, a stand for reading the Torah scroll, an ark for storage of the Torah scroll and prayer books.” On the second floor, “there are classrooms, a dining room and offices for the congregation.” You “occupy the space free of rent” and you “have no lease.” Per our request, as you did not have a lease agreement, you submitted a statement signed by the individuals who own the facility where you conduct your activities. The statement is as follows:

I acknowledge the use of the building at address H by the congregation. I allow it to be used indefinitely (although not contractual) provided the congregation maintains the cleanliness of the building and agrees not to exceed fire department allowable maximum occupancy.

We asked if you had made any improvements to the facility and you responded simply “yes.” We further inquired and you said the “improvements were basically to retrofit the building from a business commercial use to a congregation house of worship use. This involved plastering and installing sheetrock for the walls and installing a drop ceiling, as well as tiles covering a cement floor. It also involved setting up walls to define rooms.” We asked for you to provide the total cost of the project, which you omitted. We again asked and you said the total cost was k dollars. We asked how you are ensured continued use of the facility you have improved, as you have no lease agreement. You responded as follows:

We are assured in a number of ways. Firstly, we have a very good relationship with the owner who is excited about our future growth. Secondly, if our stay is terminated abruptly we would be made whole by the landlord being that at that point he would be the beneficial recipient of the improvements. The cost would be collectable both in a legal proceeding as we’ll [sic] as in a rabbinical tribunal.

G did not pay for any of the renovations. The name of the contractor for the renovation projects is H. We asked for a copy of the contract with the contractor, how the terms were negotiated, the name of the owner of the company, and a description of the renovations planned. To these inquires you responded:

The work was done on a step-by-step project-by-project basis. Each project was priced with various contractors and craftsmen. Work was awarded by project to the one we felt best suited to fill our needs. As we gained confidence in H we felt we are best off using him exclusively. We cannot vouch for ownership, but our contact at H is J. No more renovations planned.”

Regarding our request for copies of the written contracts, you said there is “no overall contract, as construction [sic] done per project basis as opposed to master construction project.” We asked for copies of all of the bids you received for your projects. Rather than provide same, you simply provided a sheet that contained the total of all of the bids received.

You later provided a list of the actual construction costs totaling k dollars and including skeleton and sheet rocking, security, plumbing, air conditioning, electric, carding, furniture and fixtures, floors, ceiling, professional and misc.

You submitted internal and external photographs of your facility. The internal photographs showed two large rooms with numerous desks. One of the rooms had windows at the top of the walls near the ceiling. The other interior photographs include rooms with very large windows. The windows in

both rooms were different in location and size than the windows shown in the exterior photographs of the facility. You said “the room (you use) is not in the basement but on the first floor and the windows are at the top of the walls. It seems that in the older commercial buildings that’s how the architecture was that windows were placed on top of the room. The other pictures are from the interior of the second floor. The exterior pictures are the entrances of the front side of the building and these rooms face the back of the building.” You provided no other photographs to confirm your assertions.

We sent you an internet article which stated F is the director of a religious camp, which has a very similar name to you and to the school with whom you share a facility. We asked if the camp was one of your proposed activities and you said “no.”

We sent you a print from the internet which shows an organization with your exact same name operating a high school out of a different street address, but the same city, as you. You said they are an “unrelated entity which just coincidently has the same name.”

You submitted minutes from your board meetings for each of the three annual meetings you held, and two additional meetings after those. Each indicates a meeting of the trustees was held. The minutes each state that one of your Trustees acted as chairman of the meeting and each year he “. . . nominated three Trustees . . .” and each year he nominated himself and the other two governing body members as Trustees, who are all related (B, C and D). Each year the meeting minutes also document the appointment of B, C and D as Officers. In comparison, the most recent two meetings for which you provided documentation indicate a meeting of the membership was held, not of the trustees, although the same people were present.

LAW

Section 501(c)(3) of the Code describes corporations organized and operated exclusively for charitable purposes no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.

Rev. Proc. 2012-9, superseding Rev. Proc. 90-27, 1990-1 C.B. 514, Section 4.01, provides the Internal Revenue Service will recognize the tax-exempt status of an organization only if its application and supporting documents establish that it meets the particular requirements of the section under which exemption from federal income tax is claimed. Section 4.02 states that a determination letter or ruling on exempt status is issued based solely upon the facts and representations contained in the administrative record. It further states:

(1) The applicant is responsible for the accuracy of any factual representations contained in the application.

(2) Any oral representation of additional facts or modification of facts as represented or alleged in the application must be reduced to writing over the signature of an officer or director of the taxpayer under a penalties of perjury statement.

(3) The failure to disclose a material fact or misrepresentation of a material fact on the application may adversely affect the reliance that would otherwise be obtained through issuance by the Service of a favorable determination letter or ruling.

Section 4.03 states that the organization must fully describe all of the activities in which it expects to engage, including the standards, criteria, procedures or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures.

In United States v. Wells Fargo Bank, 485 U.S. 351, 108 S. Ct. 1179, 99 L. Ed. 2d 368 (1900), the Supreme Court held that an organization must prove unambiguously that it qualifies for a tax exemption.

In American Guidance Foundation v. U.S., 490 F. Supp. 304 (D.D.C. 1980), the court said that, at a minimum, a church must include a body of believers that assemble regularly in order to worship. It must also be reasonably available to the public in the conduct of worship, in its educational instruction, and in its promulgation of doctrine. In addition, it was held that when the assets of an organization are used to pay for the living expenses of an individual(s) denial of exemption is appropriate. Generally, there are fourteen criteria used in determining whether or not an organization qualifies as a church. These criteria are as follows:

a. A distinct legal existence

b. A recognized creed and form of worship

c. A definite and distinct ecclesiastical government

d. A formal code of doctrine and discipline

e. A distinct religious history

f. A membership not associated with any other church or denomination

g. Ordained ministers ministering to its congregation

h. Ordained ministers selected after completing prescribed studies

i. Literature of its own

j. Established place of worship

k. Regular congregation

I. Regular religious services

m. Sunday schools for religious instruction of the young

n. Schools for the preparation of ministers

The court stated that courts in cases where church status has been litigated have more heavily weighted certain criteria. It considered the following factors to be especially important:

A membership not associated with any other church or Denomination

Established places of worship

Regular religious services.

In Bubbling Well Church of Universal Love, Inc. v. Commissioner, 74 T.C. 531 (1980), in an action for declaratory judgment pursuant to section 7428(a), the Tax Court considered an adverse ruling by the IRS on an application for exempt status as a church. The applicant had declined to furnish some information, and made answers to other inquiries that were vague and uninformative. On the basis of the record, the Court held that the applicant had not shown that no part of its net earnings inure to the benefit of the family or that petitioner was not operated for the private benefit.

In Western Catholic Church v. Commissioner, 73 T.C. 196 (1980), the petitioner's only activities were some individual counseling and distribution of a few grants to needy individuals. The petitioner's failure to keep adequate records and its manner of operation made it impossible to trace the money completely, but the court found it clear that money passed back and forth between petitioner and its director and his for-profit businesses. The Court Held that petitioner had not shown it was operated exclusively for exempt purposes or the no part of its earnings inured to the benefit of its officer.

In Basic Unit Ministry of Alma Karl Schurig v. Commissioner, 511 F. Supp. 166 (D.D.C. 1981), aff'd, 670 F.2d 1210 (D.C. Cir. 1982), the court upheld IRS's denial of exempt status as a religious organization in a declaratory judgment action. The court held that in factual situations where there is evident potential for abuse of the exemption provision, a petitioner must openly disclose all facts bearing on the operation and finances of its organization. Here Plaintiff did not proffer sufficiently detailed evidence of its charitable disbursements, or the extent of its support of its members. Rather, plaintiff continually responded that it had already provided the data, or could not furnish anything further. Therefore, the court found that the applicant did not meet its burden to positively demonstrate that it qualifies for the exemption. The Court of Appeals for the District of Columbia Circuit, in affirming that the organization had not met its burden of establishing that no part of its net earnings inured to any private individual, observed:

"taxpayer confuses a criminal prosecution, in which the government carries the burden of establishing the defendant's guilt, with a suit seeking a declaratory judgment that plaintiff is entitled to tax-exempt status, in which the taxpayer, whether a church or an enterprise of another character, bears the burden of establishing that it qualifies for exemption."

In National Association of American Churches v. Commissioner, 82 T.C. 18 (1984), the court denied a petition for declaratory judgment that the organization qualified for exempt status as a church. In addition to evidence of a pattern of tax-avoidance in its operations, the court noted that the organization had failed to respond completely and candidly to IRS during administrative processing of its application for exemption. An organization may not declare what information or questions are relevant in a determination process. It cited a number of declaratory relief actions that upheld adverse rulings by the Service because of the failure of the applicants to provide full and complete information on which the Service could make an informed decision.

In Peoples Prize v. Commissioner, T.C. Memo 2004-12 (2004), the court upheld the Service's determination that an organization failed to establish exemption when the organization failed to provide requested information. The court stated "[Applicant] has, for the most part, provided only generalizations in response to repeated requests by [the Service] for more detail on prospective activities. . . . Such generalizations do not satisfy us that [applicant] qualifies for the exemption."

In New Dynamics Foundation v. United States, 70 Fed. Cl. 782 (2006), the petitioner brought to

challenge the denial of its application for exempt status. The court found that the administrative record supported the Service's denial on the basis that the organization operated for the private benefit of its founder, who had a history of promoting dubious schemes. The organization's petition claimed that the founder had resigned and it had changed. However, there was little evidence of change other than replacement of the founder with an acquaintance who had no apparent qualifications. The court resolved these questions against the petitioner, who had the burden of establishing it was qualified for exemption. If the petitioner had evidence that contradicted these findings, it should have submitted it as part of the administrative process. "It is well-accepted that, in initial qualification cases such as this, gaps in the administrative record are resolved against the applicant".

APPLICATION OF LAW

Section 501(a) of the Internal Revenue Code provides for exemption for organizations operated exclusively for religious, charitable, and educational purposes. Section 1.501(c)(3)-1(a)(1) of the regulations states that if an organization fails to meet either the organizational test or the operational test, it is not exempt. We cannot determine and you are unable to substantiate that your programs are furthering exclusively 501(c)(3) purposes; therefore you are not described in section 501(c)(3) of the Code. Because you are not described in section 501(c)(3) you fail the operational test and are not exempt.

To be exempt an organization must serve public rather than private interests, as described in 1.501(c)(3)-1(d)(1)(ii) of the regulations. Despite having one board member resign, two of the three are still related. Further, the trustee that resigned is still employed in a position of power as your rabbi. You also allow a non-board member, who is related to the other board members, to write checks. You have executed capital improvements on a facility that is privately owned. You have been unable to fully substantiate these improvements, as there was no contract for the work, no documentation on a bid process nor any documentation on your selection process for the contractor. You have only provided that no one on your governing body is related to the contractor. You have been unable to substantiate that the owner of the facility will not benefit from your improvements, as there is no documentation on what would occur in the event you had to vacate the facility, nor is there any documented agreement on the terms of your use of the facility. You have expended most of your revenue for capital improvements for a facility you do not own, and for which do not have a lease agreement. Further, you have provided little details regarding the school, G, that is also sharing this facility. It is unclear if this is a privately owned school, who might own it, or who from that school is benefitting from the improvements you have made to the facility. As you have been unable to document the public benefit of the improvements done to this facility, you have not proven your assets will not inure to insiders or be used to privately benefit certain individuals.

As required by Rev. Proc. 2011-9 you have not established that you are organized and operated exclusively for exempt purposes and not for the private benefit of your creators. Section 4.02(3) of this Rev. Proc. states that the failure to disclose a material fact or misrepresentation of a material fact on the application may adversely affect the reliance that would otherwise be obtained through issuance by the Service of a favorable determination letter or ruling. You indicate control by your board of directors, and that they make all decisions about your activities and how funds are spent. Yet you have stated in correspondence that members are paying expenses out of pocket to keep you afloat, while also stating that members are appraised of issues regarding your finances. It is unclear who has financial control of your operations. We initially asked about bank accounts, to which you replied you had none, only to submit months worth of bank statements indicating much larger actual income than you had submitted as projected budgets. You have a non board member with signatory authority on you account, which was not disclosed, and was discovered only on submission of

cancelled checks. Given the information provided regarding your financial data, it is unclear what your sources of income and expenses will be, or how you intend on maintaining control over your accounts. As a result, we cannot consider the administrative record complete and subsequently your failure to disclose material facts does not demonstrate that your operations further exempt purposes.

As in the above-cited cases of Basic Unit Ministry of Alma Karl Schurig and Peoples Prize, you have the burden of showing you come squarely within the terms of the law conferring the benefit sought, and whether you have satisfied the operational test is a question of fact. You did not respond openly or candidly to our questions as evidenced by the repeat requests for documentation of your facility. In fact, we asked the same questions multiple times and continually received little or no details regarding your operations, or responses contradicted information previously given. You did not provide details regarding your donors or the school with which you share a facility. You were also unable to produce copies of bids for the renovations you performed. An applicant seeking exempt status must provide sufficient information for the Service to make an informed decision, as indicated in National Association of American Churches. You must respond completely and candidly. You have given answers to our inquires that were vague and occasionally contradictory. You have not proven unambiguously that you qualify for a tax exemption, as in United States v. Wells Fargo Bank.

As in the case of Western Catholic Church v. Commissioner, your lack of sufficient records and lack of control over an funds fails to establish an exempt purpose consistent with Section 1.501(c)(3) of the regulations. You permit a non board member, F, to write checks on your behalf, which is in direct contrast with Article Eight of your Bylaws. You delegated your authority, responsibility, and operations to individuals outside of your internal operating control. You allow an unauthorized individual access to your bank account. This, together with your statement that members are paying expenses out of pocket, demonstrates a lack of financial control. Given the contradictory responses provided regarding your financial data it is unclear who may or may not benefit from transactions, what your sources of income and expenses will be, or how you intend on maintaining control over your accounts. Because we cannot determine how you will use or control income or what you may expense we cannot conclude who benefits from these transactions. As it is unclear who will benefit you have not proven your assets will not inure to insiders or be used to privately benefit certain individuals.

As in Bubbling Well Church of Universal Love, you are in a position to perpetuate control of the organization’s operations indefinitely, prepare its budget, have complete control of the organization’s finances and make all decisions on how the funds were spent. The close control held by a few individuals, without a system for public oversight, creates an environment for potential abuse and insider benefit as there are no defined roles or responsibilities for your board or policies setting forth their duties and the handling of your finances. Despite your statements that you are a membership entity, your board meeting minutes confirm the tightly held control of the organization. Therefore, the undue control of the organization by a related board causes the organization to serve private interests and thus fail the operational test.

American Guidance Foundation provides, at a minimum, a church must include a body of believers that assemble regularly in order to worship in an established location, must be reasonably available to the public in the conduct of worship, in its educational instruction, and in its promulgation of doctrine:

It is unclear from your responses if you are conducting regular religious services. While you provided a daily schedule of activities, despite your statement that you act in accordance with traditions, you hold no Sabbath services. G operates from the same facility and you do not conduct service on the Sabbath, although you require your members to observe the Sabbath.

We are unable to conclude you have an established facility for religious services. You are sharing both space and at least one employee with G. You were unable or unwilling to provide any information regarding G. As a result, there is a lack of clarity regarding where you are operating inside of the facility. While you have stated you use the first floor of the building, the pictures you have submitted lend one to think otherwise. The descriptions given in combination with the pictures provided call into question your presence and use of the facility, your establishment in the facility, and your regular use of the facility. It is also unclear how many students G has, making it impossible for us to determine how much space they would occupy in your facility, or to what extent they are using your facility. We are unable to determine who has access to your facility, or when. You have no materials or literature advertising your services to the public, relying instead on word of mouth. It is unclear from your responses that you have an established, regular location for religious services reasonably available to the general public.

We are unable to conclude you have an established congregation that regularly assembles for worship services. You initially stated you have 50 members, but later said you only have 25 members. Only one of your trustees is a congregant. You have provided varied numbers of attendees and have had no increase in attendance in over three years, which calls into question whether you have an established body of believers. Further, it would seem that if you require your congregants to be Sabbath-observing, they must attend services at a different location on the Sabbath as you do not offer services that day. Based on these facts it is unclear that you have an established and regular body of worshipers.

While you meet some of the 14 points as listed in American Guidance, your lack of, or inconsistency of, information has not conclusively demonstrated the existence of the basic tenets required for obtaining status as a church — regular worship services conducted at a regular location with a regular congregation.

An organization that is unable to demonstrate they have now or will have in the future sufficient records to show operations exclusively further exempt purposes will not be found to meet the operational test under Section 501(c)(3) of the Code. You were unable to provide a copy of the contract, or bids, for the construction work on your facility. You have been unable to provide financial data, citing members handling your expenses, despite a grant that was proposed by B. As in the above-cited case of New Dynamics Foundation v. United States, you have not demonstrated that your operations exclusively further exempt purposes and it is your burden to revolve gaps in the administrative record.

APPLICANT'S POSITION

You said it is standard business practice in your state to engage in leasehold improvements, and most properties have to be retro fitted to the specifics of the entity using the property. Leasehold improvements are treated as an asset and depreciate over the life of the asset. It is not considered a benefit to the landlord since the asset is owned and depreciated by the lease holder. You further asserted that the "sum of the total renovations was less than $* * * which is considered a modest sum" by State W standards for construction cost. "Although the written bids were not located the entity maintained the bid tally sheet" which in State W the government agencies consider it sufficient documentation of bids.

Regarding your allowance of a non-board member to write checks, you stated the IRS doesn't mandate any specific management policy. You further stated:

The fact that a small organization which affords the board with tight oversight of fiscal transactions suffices to exercise control of funds. A board is generally not intended to be involved in detail micro

managing of daily operations. Accordingly check signing which is typical of daily management is delegated to persons more readily available outside of the board. This is standard practice in State W to the extent that banks in State W have sample board resolutions designating persons outside the board as signatories."

You also cited some laws from State W as well as a trade manual for non-profits discussing internal controls. These indicate delegating is an effective means of management and supervision is a control activity.

You indicated you are willing to adopt policies we suggest in order to satisfy the operational test. In fact, you submitted board meeting minutes from a recent meeting whereby you nominated an additional, unrelated member of the board. You said the new board member's credential of business acumen and being an unrelated party establishes a well-rounded, totally unrelated board. You said this should aid the approval process. You further asserted the unrelated board mitigates and minimizes the possibility of conflict of interest at the governance level. You said this has public benefit as well as a compliance enhancement and logically should expedite the tax-exempt application process.

Most recently you have requested expedite status of your application for exemption. Your expedite request indicates that an individual with the same surname of B and D (you did not provide the first name) has ". . . committed to our congregation a grant . . ." of a specific amount for the purpose of purchasing a Torah scroll to memorialize his ancestry." This is conditional on our being approved as a 501(c)(3) organization by . . ." a certain date, in time for a specific Jewish holiday. You further stated, "Loss of the grant would severely impact our operations as a Torah Scroll is a necessity."

SERVICE'S RESPONSE TO APPLICANT'S POSITION

You indicated you spent over $* * * for renovations. Based on your documented income, this was * * *% of your revenue to provide renovations to a building not owed by you and for which you do not have a lease. In fact, you said you had a bank account "solely set aside for the purpose of making renovations to the site for use as a congregation." You said the building is an asset owned and depreciated by the leaseholder; however, you do not have a lease. You are operated for the substantial non-exempt purpose of providing renovations to a building, thus providing substantial private benefit to the owner.

Although you state you qualify for exemption under Section 501(c)(3) of the Code as a church under Sections 509(a)(1) and 170(b)(1)(A)(i), you are operating in a manner which contradicts your Bylaws. We are unable to conclude which operational procedures you adhere to and which ones you disregard. You suggest you are willing to adopt policies and procedures in order to satisfy the operational test; however, your written policies and procedures (Bylaws) already in place do not appear to have been followed. Therefore, the adoption of policies to which you may not adhere is insufficient to establish exemption

Your addition of a fourth, unrelated board member does not eliminate the control of the board by the majority-related board. Likewise, the commitment of a grant from a related party does not sufficiently establish qualification of exempt status.

PROTEST

You submitted additional photographs of your facility. You also submitted a lease agreement prepared by the landlord's attorney. Rent was calculated by evenly dividing the amount of capital improvements done to the facility, k dollars, by the lease term, 60 months. You said this satisfies the

private benefit issue. The lease you submitted is back-dated four years and permits your occupancy rent free for one more year. After that time you will have to pay rent.

SERVICE'S RESPONSE TO APPLICANT'S PROTEST

Although you now have a retroactive lease agreement, you did not substantiate how the rent amount was determined and whether it is reasonable. You simply divided the amount of money spent on the renovations over a five year period with you receiving a credit against the amount due. You have not indicated what happens after the five year period expires. The lease also does not alleviate the benefit derived to the other tenants of the building. Although your new lease agreement may reduce some concern over the private benefit to the owners of the facility regarding the renovations you performed, you still have not substantiated the actual improvements made, the process by which they were done and their public benefit.

CONCLUSION

Based on the above facts and law, we conclude that you do not qualify for exemption under section 501(c)(3) of the IRC. More specifically you fail the operational test and lack control and discretion of your funds. Each of these non-exempt purposes causes you to be disqualified from exemption under Section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, Exempt Organization Appeal Procedures for Unagreed Issues.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, Power of Attorney and Declaration of Representative, if you have not already done so. You can find more information about representation in Publication 947, Practice Before the IRS and Power of Attorney. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service

EO Determinations Quality Assurance

Room 7-008

P.O. Box 2508

Cincinnati, OH 45201

Deliver to:

Internal Revenue Service

EO Determinations Quality Assurance

550 Main Street, Room 7-008

Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

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

Sincerely,

Holly O. Paz

Director, Exempt Organizations

Rulings and Agreements

Enclosure:

Publication 892

IRS Phone Forum: "Charities and their Volunteers" – July 17

Many charities use all-volunteer labor to accomplish their work. Even those fortunate enough to have paid staff often rely heavily on volunteers to enhance their efforts.

This phone forum will help charity leaders and tax practitioners understand the tax rules that can come into play with volunteers. We'll discuss what charities and their volunteers need to do to avoid any unintended tax consequences for the organization or the volunteer.

Topics include:

- Out-of-pocket expenses
- Which expenses are deductible
- Travel expenses
- Vehicle expenses
- Recordkeeping
- Reimbursing the volunteer

Click here to register for this event:

http://ems.intellor.com/index.cgi?p=204706&t=71&do=register&s=&rID=417&edID=305

IRS Phone Forum: "Veterans Organizations – Complying with IRS Rules" — July 30.

Veterans organizations occupy a special place in the world of exempt organizations. Not only are most veterans organizations exempt from tax, but contributions to them may be deductible, and some are permitted to set aside amounts that are used to provide insurance benefits to members.

This combination — tax-exempt status, deductibility of contributions and the ability to pay benefits to members — is relatively rare and is evidence of Congress's intent to provide special tax treatment for veterans organizations. This phone forum provides information to help them stay tax exempt.

Topics include:

- Requirements for exemption
- Recordkeeping
- Filing and reporting
- Unrelated business income tax
- Exempt activities
- Bona fide guests

Click here to register for this event:

http://ems.intellor.com/index.cgi?p=204705&t=71&do=register&s=&rID=417&edID=305

FSLG Phone Forum on June 27, 2013 at 2 p.m.(EST) to Discuss Key FICA Replacement Plans Policy Issues.

Phone Forum for FICA Replacement Plans

Date: June 27, 2013

Time: 2 p.m. Eastern Time

What: During this 60 minute presentation we will cover:

- Social Security Coverage laws
- Qualified Employer's Retirement systems

- Defined Benefit and Defined Contribution Plan
- Revenue Procedure 91-40
- FICA replacement plans

Please register as soon as possible because space is limited.

If you have any travel reimbursement or allowance payments questions, please e-mail them to: te.ge.fslg.outreach@irs.gov, and we will try to answer them during the phone forum. Please use the subject line: FICA Replacement Plans.

Register at:

http://apps.irs.gov/app/scripts/exit.jsp?dest=http://ems.intellor.com/index.cgi?p=204717&t=71&do=register&s=&rID=418&edID=305

IRS: Extra Time Granted for Tax-IRS: Exempt Bond Issuers Affected by Severe Storms and Tornados in Oklahoma.

Government entity issuers of tax-exempt bonds affected by the severe storms and tornados occurring in parts of Oklahoma may qualify for additional time to file certain returns related to tax-exempt bonds, qualified tax credit bonds, and specified tax credit bonds.

Following recent disaster declarations for individual assistance issued by the Federal Emergency Management Agency, affected government entities in covered disaster areas in Oklahoma will receive filing and payment relief.

Affected issuers who are required to file a Form 8038 series information return or a Form 8038-T in connection with an arbitrage payment, with a due date between May 18, 2013 and Sept. 29, 2013, may file such returns and make such payments on or before Sept. 30, 2013.

Affected issuers may also file such returns and make such payments on or before Sept. 30, 2013, if the records necessary to make such filing or payment, the conduit borrower, the bond counsel, or other professional upon whom the issuer relies to make such filing or payment are located in a covered disaster area.

The IRS will abate any late-filing penalty that would otherwise apply. The IRS automatically provides this relief to affected issuers located in covered disaster areas. Issuers need not contact the IRS to get this relief. However, affected issuers should clearly indicate on the top of the return that such late filing or payment is the result of devastation caused by the severe storms and tornados in Oklahoma.

In addition, an affected issuer required to file a Form 8038 series information return or a Form 8038-T in connection with an arbitrage payment, due between May 18, 2013 and Sept. 29, 2013, may request authority to file a Form 8038 or Form 8038-T after Sept. 30, 2013, by requesting an extension under Revenue Procedures 2002-48 and 2005-40, which provide guidance on how issuers may request extensions of time to file Form 8038 series information returns and waivers of penalty associated with a late arbitrage payment. Affected issuers should request relief in accordance with these revenue procedures and clearly indicate that such late filing or payment was the result of devastation caused by the severe storms and tornados in Oklahoma.

In addition, a Form 8038-CP authorized to be filed by an affected issuer between May 18, 2013 and Sept. 29, 2013, but filed thereafter, will be immediately processed upon receipt.

At this time, IRS relief for affected issuers applies to the following covered disaster areas in Oklahoma: Cleveland, Lincoln, McClain, Oklahoma and Pottawatomie counties.

Lawmaker Seeks Discounted Health Plan Fee for Tax-Exempt, Nonprofit Hospitals.

Rep. Tim Walberg, R-Mich., has urged Treasury to classify health plans owned by nonprofit, tax-exempt hospitals or hospital systems in the same category as other nonprofit, tax-exempt health plans, which would give the hospital plans a 50 percent discount on the insurance plan fee required under the Affordable Care Act.

May 22, 2013

The Honorable Jacob Lew

Secretary of the Treasury

United States Department of the Treasury

1500 Pennsylvania Avenue, NW, Room 3330

Washington, DC 20220

RE: REG-118315-12: Health Insurance Providers Fee

Dear Secretary Lew:

I write on a matter of concern to a number of federally taxable regional health insurance plans owned by tax-exempt hospitals and health care systems. These hospital-owned health plans (HHPs) are unique because they are entirely owned and controlled by parents that are tax-exempt under section 501(a) of the Internal Revenue Code (IRC) and are further described in section 501(c). Despite paying taxes under the IRC, HHPs function more similarly to nonprofit entities because they must reinvest whatever marginal profits they produce each year into the hospital parent's charitable mission. HHPs were originally created as taxable entities due to the prevailing physician ownership model at the time of their founding. However, as the ownership model moved away from physician ownership, HHPs found it nearly impossible to convert to nonprofit status due to the evolving interpretation of section 501(m) of the IRC. As a result, HHPs will be assessed at unsustainable levels under REG-118315-12: Health Insurance Providers Fee ("the insurer fee") and will likely be forced to significantly limit services or exit the market altogether. Either outcome will negatively affect the communities that HHPs serve by impacting the charitable activities of their parent hospitals.

The recently released rules implementing Section 9010 of the Patient Protection and Affordable Care Act (ACA) failed to curtail the implementation of the insurer fee on this specific group of health plans. In § 57.4(a)(4)(iii) of the insurer fee, the ACA is interpreted as granting partial reductions for certain exempt activities to health insurers that are exempt from Federal income tax and meet section 501(c) requirements. I believe HHPs should be included in this category of health plans that

receive partial reductions because, like other nonprofit health plans, HHP premiums are attributable to the exempt activities of their parent nonprofit, tax-exempt hospitals and health systems. I urge you to provide relief to these plans from the insurer fee, consistent with the treatment of other tax exempt providers.

I am concerned that these taxable health plans owned entirely by nonprofit, tax-exempt hospitals or health systems appear to be included in a group of health plans that receive no exemptions from the insurer fee, while other nonprofit insurance providers receive either a partial or full exemption. I believe HHPs should receive a 50 percent exemption from the insurer fee because they are an essential part of the communities they serve.

HHPs operate differently than traditional for-profit health plans and should be treated accordingly. The parent hospitals and health systems, exempt under Internal Revenue Code Section 501(c)(3) and Section 501(c)(4), are required to hold and use all of their assets and earnings for tax-exempt, charitable purposes. This requirement extends to the equity and earnings of wholly owned/controlled taxable subsidiaries, such as HHPs. Therefore, the cost of the insurer fee that a HHP will be required to pay under the proposed regulation will ultimately reduce the resources of the parent hospital or health system to fulfill their charitable missions. The imposition of the fee on these hospitals and health systems will detract from the organization's mission and the vital community services they provide. To impose the insurer fee on these community-based providers is not sustainable and will have a damaging effect on the communities that these plans serve.

I believe that if no relief is granted to these hospital-owned health plans in the final regulations, these types of health plans will be assessed approximately $200 million in fees in 2014 under the insurer fee. This will make it impossible for these plans to continue to offer quality, locally-based compassionate health care. The imposition of the full insurer fee on these providers may drive HHPs from the marketplace, thus limiting the choices available in these areas.

Classifying these 28 health plans with other non-profit tax-exempt health insurers appears to be in alignment with the federal government's tax exempt policies. These plans share the same charitable mission-driven agendas of their parent nonprofit health systems and should be treated in the same manner as other tax-exempt entities. Adding these plans to the 50 percent tax exempt category would increase the fees of the health plans remaining in the non-exempt category by only about 1.8 percent, resulting in a de minimis impact on the health insurance marketplace.

I greatly appreciate your willingness to continue refining your approach and hope you will grant these hospital-owned health plans a 50 percent exemption from the Health Insurance Providers Fee.

Sincerely,

Tim Walberg

Member of Congress

IRS Rules Against Fla. CDD.

In a precedent-setting decision that could have major ramifications for issuers, the Internal Revenue Service has ruled a Florida Community Development District is not a political subdivision that can issue tax-exempt bonds.

The decision, made in a 12-page technical advice memorandum the IRS' chief counsel's office sent to the Villages CDD on May 30, means that approximately $364 million of its bonds could be declared taxable. It also threatens the tax-exempt status of bonds issued by thousands of organizations with similar structures around the country.

Capping a five-and-a-half year long examination, the IRS said that the Villages CDD board was controlled by the private developer for many years while the bonds were issued and was therefore not a political subdivision under Section 103 of the Internal Revenue Code.

"The mere delegation of sovereign power is not sufficient to create a political subdivision," the IRS said in the TAM. "If it were sufficient, then a clearly private entity with powers of eminent domain, including some railroads and utilities, could issue bonds without any political oversight."

"We believe that an entity that is organized and operated in a manner intended to perpetuate private control, and to avoid indefinitely responsibility to a public electorate, cannot be a political subdivision of a state," the IRS said.

Perry Israel, a lawyer based in Sacramento who is representing the CDD, said the district was disappointed in the TAM's conclusion and is concerned the IRS may be making new rules through the examination process.

Sources said the CDD has several options going forward including, settling with the IRS to preserve the tax-exempt status of the bonds, appealing to the agency's Office of Appeals, allowing the IRS to go after the bondholders who could in turn challenge the ruling in court, or seeking a legislative fix. The issuer does not have the ability to fight the IRS in a court, only taxpayers can do that, they added.

At least two lawmakers form Florida — Sen. Bill Nelson, a Democrat and Rep. Richard Nugent, a Republican — sent separate letters to the IRS ahead of its ruling urging the agency to consider the implications of any federal tax policy that might jeopardize the ability of CDDs to continue to issue tax-exempt municipal bonds in Florida. They worried about the potential harmful impacts on Florida homeowners already saddled by a weak economy.

The district is still considering its options, Israel said.

The IRS noted that the TAM, like other agency rulings for a particular issuer, may not be used or cited as precedent for other issuers. But for months, market participants have been warning that if the agency takes the view that the CDD is not a subdivision, this could potentially hurt scores of other CDDs and special districts.

There are nearly 580 CDDs operating in Florida alone that have been relying on the assumption that they are political subdivisions that can issue tax-exempt bonds.

"The IRS seems to be adding a new requirement for an issuer to be a political subdivision," said Scott Lilienthal, president of the National Association of Bond Lawyers and a partner with Hogan Lovells US LLP. "That new requirement doesn't seem to be based on any existing authority. If the IRS wants to revisit the definition of a political subdivision then it should so through the formal rulemaking process and issue guidance on a prospective basis only."

The Village Center CDD issued $426.2 million of tax-exempt bonds from late November 1993 through June 1, 2004 to finance the acquisition of recreational and other facilities as well as a utility system for the Villages, a retirement community in Florida. The CDD is a commercial district encompasses more than 21,000 acres primarily located in Sumter County, Fla.

CDDs are authorized under Florida law to levy and collect special assessments to pay debt service on bonds and maintenance assessments to fund district operations.

Most recently the Villages CDD urged the IRS to end its audit after a review showed it didn't overpay when purchasing four pieces of property with bond proceeds. The district said the valuations showed it had not been controlled by the developer.

by: JENNIFER DEPAUL

IRS Releases Publication on Managing Taxpayer Clinics.

Citations: Publication 3319

The IRS has released Publication 3319 (rev. May 2013), Low Income Taxpayer Clinic: 2014 Grant Application Package and Guidelines, explaining the requirements for the development, expansion, or continuation of a qualifying IRS low-income taxpayer clinic program and providing instructions on how to apply for a grant.

The publication is available at:

http://www.irs.gov/pub/irs-pdf/p5066.pdf

IRS Accepting Applications for Low Income Taxpayer Clinic Grants.

IR-2013-57, May 30, 2013

The Internal Revenue Service today announced the opening of the 2014 Low Income Taxpayer Clinic (LITC) grant application process.

The LITC grant program is a federal program administered by the Office of the Taxpayer Advocate at the IRS, led by National Taxpayer Advocate Nina E. Olson. The LITC program awards matching grants of up to $100,000 per year to qualifying organizations to develop, expand, or maintain a low income taxpayer clinic. The LITC program funds organizations that serve low income individuals who have a tax dispute with the IRS (*i.e.,* a "controversy clinic") and organizations that provide education and outreach to taxpayers who speak English as a second language (an "ESL clinic"). Applicants may apply as either type of organization, or both. Although LITCs receive partial funding from the IRS, LITCs, their employees, and their volunteers operate independently from the IRS. Examples of qualifying organizations include:

- Clinical programs at accredited law, business or accounting schools whose students represent low income taxpayers in tax disputes with the IRS; and
- Organizations exempt from tax under Internal Revenue Code Section 501(a) that represent low income taxpayers in tax disputes with the IRS or refer those taxpayers to qualified representatives, or that provide outreach and education for ESL taxpayers.

The IRS welcomes all applications and will ensure that each application receives full consideration. The IRS is particularly interested in receiving applications from organizations that will operate in areas that are currently underserved.

Currently underserved areas are as follows:

Identified States for New or Existing Clinics	
CONTROVERSY	ESL
Alaska, Alabama, Kansas, North Dakota, South Dakota	Alabama, Colorado, Connecticut, Georgia, Louisiana, Montana, New Mexico, North Dakota, South Dakota
Identified Metropolitan Areas for New Clinic Applications	
Los Angeles, California, including the following counties:	Los Angeles, Kern, Riverside, Ventura
Sacramento, California, including the following counties:	El Dorado, Placer, Sacramento, San Joaquin, Stanislaus
Philadelphia, Pennsylvania, including the following counties:	Berks, Delaware, Philadelphia
St. Louis, Missouri, including the following counties:	Cape Girardeau, Jefferson, St. Francois, St. Louis

Copies of the 2014 Grant Application Package and Guidelines, IRS Publication 3319, can be downloaded from IRS.gov or ordered by calling 800-TAX-FORM (800-829-3676).

The IRS is authorized to award a multi-year grant not to exceed three years. For a new clinic or a clinic applying for the first year of a three-year grant, the clinic must submit the application electronically at www.grants.gov. For an existing clinic requesting funding for the second or third year of a multi-year grant, the clinic must submit the application electronically at www.grantsolutions.gov. All applicants must use the funding number of TREAS-GRANTS-0520-4-001 and applications must be submitted electronically by July 12, 2013.

Questions about the LITC Program or grant application process can be addressed to the LITC Program Office at 202-622-4711 (not a toll-free call) or by email at LITCProgramOffice@irs.gov.

For more information about the organizations receiving funding in 2013, see Publication 4134, Low Income Taxpayer Clinic List. This publication is also available by calling 800-TAX-FORM (800-82--3676), or can be found at your local IRS office.

IRS: Individual Isn't Entitled to Carryover Deductions From Conservation Easement Contribution.

Citations: Michael S. Mountanos v. Commissioner; T.C. Memo. 2013-138; No. 8158-10

The Tax Court, sustaining a gross valuation misstatement penalty, held that an individual isn’t entitled to carryover deductions from a charitable contribution of a conservation easement on undeveloped and rugged land because the individual didn’t show that the conservation easement had any value.

MICHAEL S. MOUNTANOS,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

UNITED STATES TAX COURT

Filed June 3, 2013

Wendy Abkin and Donald L. Feurzeig, for petitioner.

Christain A. Speck and Matthew D. Carlson, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

KROUPA, Judge: Respondent determined deficiencies exceeding $1.1 million and section 66621 accuracy-related penalties regarding petitioner's Federal [*2] income tax for 2006, 2007 and 2008 (years at issue). We must decide two issues. The first issue is whether petitioner is entitled to carryover deductions from a charitable contribution of a conservation easement for the years at issue. We hold that he is not. The second issue is whether petitioner is liable for an accuracy-related penalty for each year at issue. We hold that he is.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. We incorporate the stipulation of facts, the first supplemental stipulation of facts, the second supplemental stipulation of facts and the accompanying exhibits by this reference. Petitioner resided in California when he filed the petition.

I. Blue Lakes Ranch

Petitioner owned 882 acres of largely undeveloped land in Lake County, California, known as Blue Lakes Ranch (the ranch) through the Michael S. Mountanos Living Trust. Petitioner bought the property for recreational use for his family, such as deer hunting. Except for one small area, Federal land surrounded the ranch. The access roads to the ranch ran through neighboring properties, including Federal land that the Bureau of Land Management (Land Management Bureau) managed. The neighboring property owners granted petitioner easements to pass over their land for purposes of accessing the ranch. [*3] The Land Management Bureau's easement granted limited access to the ranch for single-family use.

The Black Oak Springs Creek traverses the ranch. A permit is required to divert water from the Black Oak Springs Creek for private use. Petitioner did not have the required permit. The ranch also included other springs and two ponds.

The ranch was under a contract (Williamson Act contract) with Lake County that limited the ranch's use and development according to the California Land Conservation Act of 1965 (Williamson Act). Cal. Gov't Code secs. 51200-51297.4 (West 2012). In December 2005, petitioner conveyed a conservation easement on the ranch to Golden State Land Conservancy (Golden State), a California non-profit corporation. The ranch was still subject to the Williamson Act contract when petitioner established the conservation easement on the ranch. Neither the Williamson Act contract nor its terms are part of the record.

II. Tax Returns and Deficiency Notice

Petitioner timely filed an individual Federal income tax return for 2005 claiming a $4,691,500 charitable contribution deduction for the conservation easement he placed on the ranch. Petitioner could use only $1,343,704 of the deduction in 2005 because of the limitations of section 170(b)(1)(B). Petitioner [*4] filed returns and claimed a carryover deduction regarding the unused portion for each year at issue.

Respondent issued petitioner a deficiency notice disallowing the claimed carryover deductions. Petitioner timely filed a petition challenging respondent's determination.

OPINION

We must decide whether petitioner is entitled to any portion of the claimed charitable contribution deduction for placing a conservation easement on the undeveloped and rugged land the ranch encompassed. A taxpayer may generally deduct any charitable contribution only if the contribution is verified under regulations the Secretary prescribed. Sec. 170(a)(1). A deduction for a charitable gift of property consisting of less than the donor's entire interest in that property is not generally allowed. Sec. 170(f)(3). An exception to the general rule is provided in the case of a "qualified conservation contribution." Sec. 170(f)(3)(B)(iii).

Respondent does not challenge that the conservation easement was a "qualified conservation contribution." Instead, respondent contends that the value [*5] of the conservation easement was overstated and therefore challenges the amount of the claimed charitable contribution deduction.2

I. Burden of Proof

We begin with the burden of proof. Deductions are a matter of legislative grace, and a taxpayer bears the burden of proving he or she is entitled to any claimed deductions. INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 84 (1992). Moreover, the Commissioner's determination of value is normally presumed correct, and the taxpayer bears the burden of proving that the determination is incorrect. See Rule 142(a); Welch v. Helvering, 290 U.S. 111, 115 (1933).

The burden of proof, however, on factual issues that affect the taxpayer's tax liability may shift to the Commissioner where the taxpayer complies with all requirements. Sec. 7491(a). Petitioner does not argue section 7491(a) shifts the burden of proof to respondent. Nor do we find that petitioner met the requirements of section 7491(a). Accordingly, petitioner bears the burden of proof.

[*6] II. Value of the Conservation Easement Placed on the

Ranch

We now consider the value of the conservation easement placed on the ranch. The amount of a charitable contribution of a conservation easement is the fair market value of the conservation easement when contributed. Sec. 1.170A-14(h)(3)(i), Income Tax Regs. The fair market value of a conservation easement is ideally based on the sales prices of comparable easements. Sec. 1.170A-14(h)(3), Income Tax Regs. Comparable sales are rarely available, however, because conservation easements are typically granted by deed or gift rather than sold. Symington v. Commissioner, 87 T.C. 892, 895 (1986). As an alternative, the "before-and-after" approach is often used instead. Stanley Works & Subs. v. Commissioner, 87 T.C. 389, 399 (1986). The fair market value of a conservation easement under this approach equals the difference between the fair market value of the easement-encumbered property before it is encumbered by the easement and after the easement is established. Sec. 1.170A-14(h)(3)(i) and (ii), Income Tax Regs. The parties agree that there are no sales of comparable easements and that the before-and-after method is the appropriate method to

use in valuing the conservation easement.

Fair market value is defined as the "price at which the property would change hands between a willing buyer and a willing seller, neither being under any [*7] compulsion to buy or sell and both having reasonable knowledge of relevant facts." See sec. 1.170A-1(c)(2), Income Tax Regs. The fair market value of property must be evaluated in view of the property's highest and best use. Stanley Works & Subs. v. Commissioner, 87 T.C. at 400; sec. 1.170A-14(h)(3)(ii), Income Tax Regs.

A. Highest and Best Use

Accordingly, we now consider the highest and best use of the ranch before and after petitioner established the conservation easement. The highest and best use of the ranch is the highest and most profitable use for which it is adaptable and needed or likely to be needed in the reasonably near future. See Olson v. United States, 292 U.S. 246, 255 (1934); see also Hilborn v. Commissioner, 85 T.C. 677, 689 (1985). The highest and best use of property can be any realistic, objective potential use of the property. Symington v. Commissioner, 87 T.C. at 896. A property's highest and best use is presumed to be the use to which the land is currently being put absent proof to the contrary. See United States v. L.E. Cooke Co., Inc., 991 F.2d 336, 341 (6th Cir. 1993); Symington v. Commissioner, 87 T.C. at 896. A proposed highest and best use different from the property's current use requires the taxpayer to demonstrate "closeness in time" and "reasonable probability" of the proposed use. Hilborn v. Commissioner, 85 T.C. at 689. [*8] Subsequent events are generally not considered in determining fair market value unless they were reasonably foreseeable on the valuation date. Estate of Gilford v. Commissioner, 88 T.C. 38, 52 (1987). We consider existing zoning, historic preservation and other laws and restrictions at the time contributed as well as economic feasibility in evaluating whether a proposed use was reasonably probable and likely in the near future. See, e.g., Losch v. Commissioner, T.C. Memo. 1988-230.

Petitioner presented reports and testimony of three expert witnesses to prove the highest and best use of the ranch before and after he established the conservation easement.3 Petitioner's expert Mark Welch concluded that 287 acres of the ranch were suitable for vineyard use. Petitioner's expert Chris Bell concluded that the highest and best use of the ranch was vineyard use for 287 [*9] acres of it and residential development use for the remaining acreage. Petitioner's expert John Lazaro concluded that the ranch's highest and best use was for vineyard use and "subdivision."4 Both Mr. Bell and Mr. Lazaro determined that recreational use was the highest and best use of the ranch after petitioner established the conservation easement. Respondent did not call any expert witnesses. Respondent relied on cross-examination instead. We agree with petitioner's experts that the ranch's highest and best use was recreation after petitioner established the conservation easement. We find, however, that petitioner failed to show that either residential development and vineyard use, as Mr. Bell contends, or subdivision and vineyard use, as Mr. Lazaro contends, was the highest and best use of the ranch before petitioner established the conservation easement. We explain each reason we so find.

1. Vineyard Use

Petitioner failed to show that vineyard use was a legally permissible, physically possible and economically feasible use of the ranch. See the Appraisal [*10] Foundation, Standards of Professional Practice of the Appraisal Institute 154 (1997). More specifically, petitioner failed to demonstrate that the ranch had the necessary legal access for vineyard use. Access to the ranch required a right-of-way easement over Federal land. The Land Management Bureau granted petitioner a right-of-way easement to access the ranch but restricted the easement to "single-family use." Petitioner failed to present evidence showing that it was likely in the near future that the Land Management Bureau would modify the easement to allow access for vineyard use.

Second, petitioner failed to establish that the ranch possessed an adequate water supply for vineyard use. Mr. Welch's determination that there was sufficient water for vineyard use depended on using water from Black Oak Springs Creek. A permit was required, however, to use or divert the Black Oak Springs Creek water for private use. Petitioner lacked a permit. Respondent contends, and petitioner fails to dispute, that petitioner could not have obtained the required permit. In addition, petitioner failed to establish that he had the legal right to use water from other springs that his expert identified as a potential water source. In any event, petitioner failed to show that water from sources on the ranch other than Black Oak Springs was sufficient to support vineyard use.

[*11] Third, petitioner failed to show there was demand for 287 acres of vineyard-suitable property in Lake County. See, e.g., Hughes v. Commissioner, T.C. Memo. 2009-94. Mr. Welch and Mr. Bell noted in their reports that other vineyards had been developed in the Lake County area. This does not reveal, however, the demand or market conditions in Lake County for vineyard-suitable property when the conservation easement was placed on the ranch. Moreover, petitioner failed to otherwise introduce persuasive evidence, i.e., objective data and analysis, showing demand for 287 acres of vineyard-suitable property.

Finally, petitioner failed to show that vineyard use was economically feasible. See, e.g., Losch v. Commissioner, T.C. Memo. 1988-230. In this regard, the record is devoid of any study supported by data and analysis showing that vineyard use of the ranch would be economically feasible. To be sure, Mr. Welch estimated vineyard development on the ranch would cost $23,500 per acre. He failed, however, to provide any data or analysis showing how he arrived at this number.

In conclusion, we find that petitioner failed to establish that vineyard use was reasonably probable in the near future so as to affect the value of the ranch when the conservation easement was placed on it.

[*12] 2. Residential Development

We now consider Mr. Bell's contention that the ranch's highest and best use was in part residential development. Mr. Bell opined that the ranch could be subdivided into up to 22 parcels for residential development. Mr. Bell failed to take into account, however, various legal restrictions prohibiting the subdivision of the ranch for residential development.

The Williamson Act contract made the ranch subject to the Williamson Act at the time the conservation easement was placed on the ranch. The Williamson Act's purpose is to preserve agricultural and open space land and to discourage premature urban development. Cal. Gov't Code sec. 51220. The Williamson Act accomplishes this by authorizing local governments to establish agricultural preserves and then to enter into long-term land conservation contracts with landowners within the preserves. Id. secs. 51230-51257.5.

These land conservation contracts limit the land to agricultural and compatible uses for 10 or more years and may also include terms and conditions more restrictive than those the Williamson Act requires. Id. secs. 51240, 51243, subd. (a). Each land conservation contract automatically renews for an additional year absent notice of non-renewal by the landowner or local government. Id. secs. 51244-51246. A contract may be cancelled before it lapses on its own terms only [*13] if certain stringent conditions are met. Id. secs. 51281-51285. The landowner receives preferential property tax rates in return for accepting the restrictions on the development and use of the land. Id. secs. 51240-51244.

The record does not reflect that petitioner or Lake County had given notice of non-renewal with

respect to the Williamson Act contract before petitioner established the conservation easement. Additionally, petitioner did not argue or otherwise show that the Williamson Act contract could be cancelled. Accordingly, we consider whether residential development of the ranch would violate the Williamson Act and the Williamson Act contract.

The Williamson Act expressly prohibits the subdivision of land it governs except for transfers to immediate family members and for purposes of agricultural laborer housing. Id. secs. 51230.1, 51230.2. The Williamson Act also prohibits the land it governs from being used as a residential subdivision. Id. sec. 51238.1(a), (c)(4). More generally, the subdivision or use of land the Williamson Act governs for residential development purposes is antithetical to the act's purpose, which is to preserve agricultural and open space land and to prevent its conversion to urban uses. See id. sec. 51220; see also Sierra Club v. City of Hayward, 623 P.2d 180, 186 (Cal. 1981). Thus, residential development of the ranch would have violated the Williamson Act.

[*14] Petitioner also failed to show that residential development would not violate the Williamson Act contract. As previously mentioned, a land conservation contract entered into in accordance with the Williamson Act may restrict the use of a property to a greater extent than that provided in the Williamson Act. Cal. Gov't Code secs. 51240, 51243, subd. (a). The Williamson Act contract was not introduced into evidence. Accordingly, petitioner failed to show that the Williamson Act contract permitted the residential development of the ranch (or vineyard use).5

Subdividing land subject to the Williamson Act for residential development purposes is also prohibited by section 66474.4(a) of the Subdivision Map Act.

[*15] Cal. Gov't Code. sec. 66410 (West 2009).6 That section was amended to require local governments to deny the approval of a tentative map or parcel map for land governed by the Williamson Act in two situations. 1999 Cal. Legis. Serv. ch. 1018 (S.B. 985) (West). The first situation is where parcels following a subdivision of such land would be too small to sustain their agricultural use. Id. The second situation is where the subdivision of land would "result in residential development not incidental to the commercial agricultural use of the land."7 Id. Additionally, legislative history to the amendment states that it was intended to clarify "that a landowner's right to subdivide is subject to the Williamson Act * * * and that, therefore, the subdivision of enrolled lands for residential purposes is prohibited by both the Williamson Act and Section 66474.4 of the [California] Government Code". Id.

[*16] We find that petitioner failed to establish that subdividing the ranch for residential development was a probable use of the ranch in the near future at the time petitioner established the conservation easement.

3. Subdivision

Mr. Lazaro concluded that subdivision was in part the ranch's highest and best use but did not specify a purpose or use for which the ranch would be subdivided. Like Mr. Bell, Mr. Lazaro failed to take into account that the Williamson Act prohibits subdivision of land except for two narrow exceptions requiring stringent conditions be met. Cal. Gov't Code secs. 51230.1, 51230.2. Additionally, it is unclear whether the Williamson Act contract would allow the ranch to be subdivided. As discussed, the Williamson Act contract is not in the record and it could have contained more restrictive terms on subdivision than the Williamson Act.8 Accordingly, petitioner failed to show that "subdivision" was a reasonably probable use of the ranch in the near future and therefore was not, in part, its highest and best use before he established the conservation easement.

We ultimately find that petitioner failed to show that the before and after highest and best use of the

ranch differed.

[*17] B. Before-and-After Analysis

We now consider the fair market value of the ranch. Petitioner contends that the ranch's fair market value after he established the conservation easement was less than its fair market value before he established the conservation easement. Petitioner's contention is predicated on the ranch's losing its potential highest and best uses; i.e., residential development and vineyard use as Mr. Bell contends or subdivision and vineyard use as Mr. Lazaro contends. Because we found that petitioner failed to prove that the ranch's before and after highest and best use differed, it follows that petitioner also failed to show that the conservation easement diminished the ranch's after fair market value. Thus, petitioner failed to show that the conservation easement had any value. We hold therefore that petitioner is not entitled to the claimed charitable contribution carryover deductions for the years at issue.

III. Accuracy-Related Penalty

Respondent determined a 40% gross valuation misstatement penalty for each year at issue. A taxpayer may be liable for a 40% penalty on that portion of an underpayment of tax that is attributable to one or more gross valuation misstatements. Sec. 6662(h). A gross valuation misstatement exists if the value or adjusted basis of any property claimed on a tax return is 400% or more of the [*18] amount determined to be the correct amount of such value or adjusted basis.9 Sec. 6662(h)(2)(A)(i). The value or adjusted basis of any property claimed on a tax return that is determined to have a correct value or adjusted basis of zero is considered to be 400% or more of the correct amount. Sec. 1.6662-5(g), Income Tax Regs.

Respondent bears the burden of production on the applicability of the accuracy-related penalty in that he must come forward with sufficient evidence indicating that it is proper to impose the penalty. See sec. 7491(c); see also Higbee v. Commissioner, 116 T.C. 438, 446 (2001). Petitioner claimed a $4,691,500 charitable contribution deduction on his 2005 tax return for the fair market value of the conservation easement conveyed to Golden State. The actual fair market of value of the conservation easement, as we previously determined, was zero. Petitioner therefore claimed a value that was 400% or more of the correct amount. We conclude that respondent has met his burden of production.

[*19] A taxpayer generally is not liable for an accuracy-related penalty if the taxpayer acted with reasonable cause and in good faith with respect to any portion of the underpayment. Sec. 6664(c)(1); sec. 1.6664-4(a), Income Tax Regs. The reasonable cause exception does not apply, however, in the case of a gross valuation overstatement with respect to property for which a charitable contribution deduction was claimed under section 170. Sec. 6664(c)(3). Accordingly, we find that petitioner is liable for the gross valuation misstatement penalty for the underpayments for the years at issue.

We have considered all the arguments of the parties, and, to the extent we have not addressed them, we find them to be irrelevant, moot or meritless.

To reflect the foregoing,

Decision will be entered for respondent.

FOOTNOTES

1 All section references are to the Internal Revenue Code in effect for the years at issue, and all Rule references are to the Tax Court Rules of Practice and Procedure, unless otherwise indicated.

2 Respondent also asserts that petitioner did not meet certain substantiation requirements. In particular, he asserts that petitioner did not acquire a "contemporaneous written acknowledgment" from the donee organization or a "qualified appraisal" as required. See sec. 170(f)(8)(A); sec. 1.170A-13(c), Income Tax Regs. We need not address these grounds for disallowing the claimed charitable contribution deduction, nor do we, because of our holding below that petitioner failed to establish that the conservation easement had any value.

3 As the trier of fact, the Court must weigh the evidence the experts presented in light of their demonstrated qualifications in addition to all other credible evidence. Estate of Christ v. Commissioner, 480 F.2d 171, 174 (9th Cir. 1973), aff'g 54 T.C. 493 (1970). We are not bound by the opinion of any expert witness, especially when that opinion is contrary to our judgment. Estate of Kreis v. Commissioner, 227 F.2d 753, 755 (6th Cir. 1955), aff'g T.C. Memo. 1954-139; Chiu v. Commissioner, 84 T.C. 722, 734 (1985). Rather, we may accept or reject expert testimony as we find appropriate in our best judgment. Helvering v. Nat'l Grocery Co., 304 U.S. 282, 294-295 (1938); Seagate Tech., Inc. & Consol. Subs. v. Commissioner, 102 T.C. 149, 186 (1994). Moreover, even if we accept the general methodology of an expert witness, we may reject that expert's ultimate conclusion if not supported in the record. Owensby & Kritikos, Inc. v. Commissioner, 819 F.2d 1315, 1331 (5th Cir. 1987), aff'g T.C. Memo. 1985-267.

4 We note that we give little to no weight to Mr. Lazaro's report and testimony because petitioner failed to establish that he was qualified to appraise real estate. Although Mr. Lazaro has been a real estate broker for a number of years, he does not hold an appraisal designation from a recognized professional appraiser organization. Additionally, the record does not reflect that Mr. Lazaro has any formal training or education in appraising real estate or that he regularly performs real estate appraisals.

5 We note that where a party who has the burden of proof fails to introduce evidence within his control and which, if true, would be favorable to him, it gives rise to a presumption that, if produced, the evidence would be unfavorable. Wichita Terminal Elevator Co. v. Commissioner, 6 T.C. 1158, 1165 (1946), aff'd, 162 F.2d 513 (10th Cir. 1947). Wichita Terminal does not apply, however, where the evidence is equally available to both parties. Kean v. Commissioner, 469 F.2d 1183, 1187 (9th Cir. 1972), aff'g on this issue, rev'g on another issue 51 T.C. 337 (1968); Dang v. Commissioner, T.C. Memo. 2002-117. The record reflects that the Williamson Act contract is a public record and thus was equally available to respondent. Accordingly, we do not draw an adverse inference from petitioner's failure to introduce it into evidence. On the other hand, the Court cannot determine that petitioner's proposed residential development use of the ranch complies with the Williamson Act contract.

6 The Subdivision Map Act, Cal. Gov't Code sec. 66410 (West 2009), governs the procedure for subdividing land. A tentative and a final map are required for all subdivisions dividing land into five or more parcels. Id. sec. 66426.

7 Petitioner does not claim nor has he shown that any proposed residential development would be incidental to the commercial or agriculture use of the ranch.

8 See supra note 7.

9 We note that for returns filed after Aug. 17, 2006, the applicable percentage in sec. 6662(h)(2)(A)(i) was changed from 400% to 200%. See Pension Protection Act of 2006, Pub. L. No. 109-280, sec. 1219(a)(2)(A), 120 Stat. at 1083. The change in percentage does not, however, affect our analysis because the penalty for a gross valuation misstatement applies to any portion of an underpayment for the year to which a deduction is carried that is attributable to a gross valuation

misstatement for the year in which the carryover of the deduction arises. Sec. 1.6662-5(c), Income Tax Regs.

IRS LTR: Community Trust, Corporation Treated as Single Entity.

Citations: LTR 201322046

The IRS ruled that a community trust and a state nonprofit corporation that supports the trust's charitable activities will be treated as a single entity and that funds of either organization should be treated as parts of a single-entity community trust.

Contact Person: * * *

Identification Number: * * *

Telephone Number: * * *

Uniform Issue List: 170.19-00

Release Date: 5/31/2013

Date: March 8, 2013

Employer Identification Number: * * *

LEGEND:

Corporation = * * *

Counties = * * *

State = * * *

Foundation = * * *

Date = * * *

Date1 = * * *

Dear * * *:

This letter supersedes our letter dated November 19, 2012, which was in reply to your letter of Date, requesting a ruling that you and Corporation may be treated as a single entity and that funds created within either Foundation or Corporation that otherwise meet the requirements of Treas. Reg. § 1.170A-9(f)(11) (2011) will be treated as component parts of a single entity community trust.

FACTS

You are a community trust created in Date1 to serve the charitable needs of the Counties. You have historically operated as a community trust. You have been recognized as an organization exempt

under I.R.C. § 501(c)(3). You are organized pursuant to a Resolution and Declaration of Trust ("trust document").

According to the trust document, you are organized for the purpose of accepting gifts, grants, bequests or devises to be held in trust, the principal or income available for distribution for any charitable, religious, educational, literary, scientific or public welfare to any charitable organization. Your current trustees are certain banks located in Counties.

You have a distribution committee that is composed of representatives of the Counties. Your distribution committee is the board of directors of the Corporation. The distribution committee and the trustee have determined that reorganizing your organization into a joint corporate/trust structure will allow you to attract more contributions and advance your charitable mission.

Accordingly, your distribution committee and trustees formed Corporation, a State nonprofit corporation. The Corporation is operated exclusively for religious, charitable, scientific, literary and educational purposes and to support your charitable activities.

Corporation's original Articles of Incorporation and Bylaws stated that its purpose is to receive money and other property by gift, administer funds, and make distributions for charitable purposes for the benefit of the residents of the Counties. It has been described to the local community as your affiliate since its inception.

According to your trust document and the bylaws of the Corporation all gifts, devises and bequests of property are made subject to the terms and conditions of these documents.

Your trust document and organizing documents of the Corporation require that both organizations be subject to a common governing body. Specifically, the board of directors of the Corporation serves as the distribution committee of the trust, thus giving the distribution committee control over the Corporation.

Your trust document and Corporation's organizing documents state that all gifts, devises and bequests of property are made subject to the terms and conditions of the resolution. Your distribution committee and board of directors of the Corporation each have the responsibility to ensure that the application and distribution of funds are made exclusively for one or more of your charitable purposes.

Further, your trust document and Corporation's organizing documents each give their boards of directors the power to modify conditions or restrictions concerning the distributions of income and principal for charitable purposes and to remove any trustee that has breached its fiduciary duty or failed to produce a reasonable return of net income.

RULING REQUESTED

You and Corporation may be treated as a single entity; funds of either organization which otherwise meet the requirements of Treas. Reg. § 1.170A-9(f)(11)(ii) should be treated as component parts of a single community trust; that by virtue of the combination of you and Corporation as component parts of a single community trust, the Corporation is included under and takes on all the entitlements of your status as a tax exempt organization under I.R.C. § 501(c)(3); and that you and Corporation as a single community trust, may operate and file a single Form 990 Return of Organization Exempt From Income Tax Return under your E.I.N.

LAW

I.R.C. § 6033 describes the general filing requirements for exempt organizations and in particular specifies certain information required by § 501(c)(3) organizations, in § 6033(b).

Treas. Reg. § 1.170A-9(f)(11)(i) states that any organization that meets the requirements in Treas. Reg. § 1.170A-9(f)(11)(iii) through (vi) will be treated as a single entity, rather than as an aggregation of separate funds. In addition, all funds associated with such organization (whether a trust, not-for-profit corporation, unincorporated association, or a combination thereof), which meet the requirements of Treas. Reg. § 1.170A-9(f)(11)(ii), will be treated as component parts of such organization.

Treas. Reg. 1 170A-9(f)(11)(ii) provides that, to be treated as a component part of a community trust referred to in paragraph (f)(11)(i) of this section, a trust or fund: (A) must be created by gift, bequest, legacy, devise, or other transfer to a community trust which is treated as a single entity under Treas. Reg. § 1.170A-9(f)(11); and (B) may not be directly or indirectly subjected by the transferor to any material restriction or condition with respect to the transferred assets.

Treas. Reg.§ 1.170A-9(f)(11)(iii) provides that the organization must be commonly known as a community trust, fund, foundation or other similar name conveying the concept of a capital or endowment fund to support charitable activities in the community or area it serves.

Treas. Reg. § 1.170A-9(f)(11)(iv) provides that all funds of the organization must be subject to a common governing instrument or a master trust or agency agreement, which may be embodied in a single document or several documents containing common language. In addition, if a community trust adopts a new governing instrument (or creates a corporation) to put into effect new provisions (applying to future transfers to the community trust), the adoption of such new governing instrument (or creation of a corporation with a governing instrument) which contains common language with the existing governing instrument shall not preclude the community trust from meeting the requirements of this paragraph.

Treas. Reg. § 1.170A-9(f)(11)(v) provides: (A) that the organization must have a common governing body or distribution committee, which either directs or monitors the distribution of all the funds exclusively for charitable purposes. In addition, the governing body must have the power in the governing instrument, or other applicable document: (B)(1) to modify any restriction or condition on the distributions of funds for any specified charitable purposes or to specified organizations if in the sole judgment of the governing body, such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served; (B)(2) to replace any participating trustee, custodian, or agent for breach of fiduciary duty under state law; and (B)(3) to replace any participating trustee, custodian, or agent for failure to produce a reasonable return of net income over a reasonable period of time.

Treas. Reg. § 1.170A-9(f)(11)(v)(E) provides that the governing body must commit itself to exercise these powers in the best interests of the community trust.

Treas. Reg. § 1.170A-9(f)(11)(v)(F) provides that the governing body must commit itself to obtain information and take other appropriate steps with the view to seeing that each participating trustee, custodian or agent, with respect to each restricted trust or fund that is, and with respect to the aggregate of the unrestricted trusts or funds that are, a component part of the community trust, administers such trust or fund in accordance with the terms of its governing instrument and accepted standards of fiduciary conduct to produce a reasonable return of net income, with due regard to safety of principal, in furtherance of the exempt purposes of the community trust.

Treas. Reg. § 1.170A-9(f)(11)(vi) provides that the organization must prepare periodic financial

reports treating all of the funds held by the community trust, either directly or in component parts, as funds of the organization.

Treas. Reg. § 1.170A-9(f)(12)(i) indicates, that those entities which fail to qualify as component parts of a community trust will be treated as a separate entity for purposes of Subchapter A of Chapter 61 of Subtitle F . . . I.R.C. § 6033 if the Form 990 filed annually by the community trust included financial information with respect to such fund and treated such fund in the same manner as other component parts. They will be treated as the entity's separate returns and the first such return filed by the community trust will be treated as the notification required of the separate entity for purposes of § 508(a).

ANALYSIS

Treas. Reg. § 1.170A-9(f)(11)(i) states, in part, that any organization that meets the four requirements in Treas. Reg. § 1.170A-9(f)(11)(iii) through (vi) will be treated as a single entity, rather than as an aggregation of separate funds.

You have been established under the name Foundation for nearly a century. You and Corporation are both named for the community they serve and are commonly known in the community as endowment funds that support charitable activity in that community. Therefore, you meet the requirement of Treas. Reg. § 1.170A-9(f)(11)(iii).

Your trust document and the Corporation's organizing documents state that all gifts, devises and bequests of property are made subject to the terms and conditions of these documents. Therefore, all the donor funds will be subject to a common governing instrument or a master trust or agency agreement, which may be embodied in several documents containing common language, within the meaning of Treas. Reg. § 1.170A-9(f)(11)(iv). Accordingly, you meet this requirement.

Your trust document and the organizing documents of the Corporation each state that your distribution committee and Board of Directors of the Corporation, which are required to be the same people, have the responsibility to ensure that the application and distribution of funds are made exclusively for one or more of your charitable purposes. Thus, you satisfy the requirement of Treas. Reg. § 1.170A-9(f)(11)(v) that a common governing body monitor the distribution of all funds for charitable purposes.

Your trust document and the organizing documents of the Corporation each give their boards of directors the power to modify conditions or restrictions concerning the distributions of income and principal for charitable purposes and to remove any trustee that has breached its fiduciary duty or for failure to produce a reasonable return of net income. Therefore, you meet the requirement of Treas. Reg.§ 1.170A-9(f)(11)(v).

Your trust document and the organizing documents of the Corporation require that each organization prepare annual reports. You have continuously prepared such reports in which you treated your component funds as your funds. Similarly, you expect to report the funds and assets of Corporation as part of a single entity. Therefore, both you and Corporation meet this requirement of Treas. Reg. § 1.170A-9(f)(11)(vi).

Although you and Corporation will continue to be legally separate entities, you will be treated as a single entity rather than as an aggregation of separate funds for federal tax law purposes because you meet the requirements described in Treas. Reg. §§ 1.170A-9(f)(11)(iii) through (vi), as required by Treas. Reg. § 1.170A-9(f)(11)(i),

Once a single entity is identified, the component part provisions of the regulations determine whether a particular fund or trust may be considered part of the single entity. All funds associated with an organization (whether a trust, non-for-profit corporation, unincorporated association or a combination) that are treated as a single entity, and which meet the requirements of Treas. Reg. § 1.170A-9(f)(11)(ii), will be treated as component parts of such organization. Treas. Reg. § 1.170A-9(f)(11)(i).

RULING

Based on your facts and representations:

You and Corporation will be treated as a single entity under Treas. Reg. § 1.170A-9(f)(11)(i). In addition, funds of either such organization which otherwise meet the requirements under Treas. Reg. § 1.170A-9(f)(11)(ii), should be treated as a component parts of a single entity community trust; that by virtue of the combination of you and Corporation as component parts of a single entity community trust, Corporation is included under and takes on all the entitlements of your status as a tax exempt organization under I.R.C. § 501(c)(3); and that you and Corporation as a single entity community trust, operate and file returns under your E.I.N. listed in the heading of this letter.

This ruling will be made available for public inspection under I.R.C. § 6110 after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. I.R.C. § 6110(k)(3) provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Ronald Shoemaker

Manager, Exempt Organizations

Technical Group 2

IRS LTR: Multi-Employer Plan With One Non-Church Member Can't Qualify as

Church Plan.

Citations: LTR 201323042

The IRS ruled that a multi-employer plan that included at least one employer that was not a tax-exempt church cannot qualify as a church plan under section 414(e) nor can a subsequent plan, as a continuation of the original plan, qualify as a church plan.

U.I.L 414.08-00

Date: March 12, 2013

Refer Reply To: T:EP:RA:T3

LEGEND:

Organization A = * * *

Church B = * * *

Constitution C = * * *

Board D = * * *

Organization E = * * *

Committee F = * * *

Committee G = * * *

Plan X = * * *

Plan Y = * * *

State S = * * *

Dear * * *:

This is in response to correspondence dated March 11, 2005, as supplemented by correspondence dated October 24, 2005, November 23, 2011, February 3, 2012, February 15, 2012, April 24, 2012, May 11, 2012, and May 24, 2012, submitted by you on behalf of Organization A, concerning whether Plan X qualifies as a church plan under section 414(e) of the Internal Revenue Code ("Code").

The following facts and representations have been submitted under penalty of perjury in support of the rulings requested:

Organization A is a tax-exempt entity under section 501(c)(3) of the Code. Its principal offices are located in State S. Church B is a church for purposes of determining church plan status. Constitution C mandates that Organization A meet Church B's requirements for its affiliate organizations.

Board D consists solely of individuals ratified by State S synods of Church B. Board D has the power to adopt resolutions, appoint and remove Organization A's president, approve Organization A's budget, and designate committees to act on behalf of the board.

Constitution C declares Organization A's affiliation with Church B. Church B plays a significant role in governance of Organization A. In addition to Church B's role in the selection of Board D, Organization A's executive committee includes the bishop of the three State S synods of Church B. These synods of Church B provide financial support to Organization A. Organization A is included in a directory of Church B's ministries. Services provided by Organization A are provided as part of the social ministry of Church B.

Organization A has been recognized as an affiliated organization of Church B by annual filings with the Internal Revenue Service ("Service") and is covered under a group ruling issued to Church B.

Organization A adopted Plan X for the benefit of its eligible employees on January 1, 1966. Plan X is a tax-qualified plan under section 401(a) of the Code. It is represented that Plan X does not benefit any Organization A employees engaged in unrelated trade or businesses. Plan X allows various tax-exempt organizations to sponsor Plan X for the benefit of their employees.

The Preamble of Plan X states that Plan X is for the exclusive benefit of the employees (and their beneficiaries) of the plan sponsor and participating agencies, originally effective as of July 1, 1970.

Section 1.1 of Plan X is the definitions section of Plan X. Section 1.1(r) of Plan X states that an "Employer" means the Lead Sponsor and any health or welfare agency that is exempt from taxation under Section 501(c)(3) or 501(c)(4) of the Code which has adopted the Plan as may be provided under Article XV. Section 1.1(kk) defines the "Lead Sponsor" as Organization E and any successor thereto.

Section 15.1 of Plan X states that any health or welfare agency that is exempt from taxation under section 501(c)(3) or 501(c)(4) of the Code that is not an Employer may, with the consent of the Lead Sponsor, adopt and sponsor the Plan for the benefit of its Employees and become an Employer hereunder by causing an appropriate written instrument evidencing such adoption to be executed in accordance with the requirements of its organizational authority.

Section 16.1 of Plan X states that the Lead Sponsor reserves the right at any time and from time to time, by means of a written instrument executed in the name of the Lead Sponsor by its duly authorized representatives, to amend or modify the Plan and, to the extent provided therein, to amend or modify the funding agreement.

Section 16.2 of Plan X states that if an Employer should disagree with any general amendment made to the Plan by the Lead Sponsor, the Employer shall have 60 days following such amendment in which to notify the Lead Sponsor of its disagreement and its intention either to terminate the Plan with respect to its Employees, as provided in section 16.4, or to withdraw from the Plan and set up its own plan with its own funding arrangement, as provided in section 16.13.

Section 16.3 of Plan X states that the Lead Sponsor reserves the right, by means of a written instrument executed in the name of the Lead Sponsor by its duly authorized representatives, at any time to terminate the Plan. In the event that Lead Sponsor terminates the Plan, each Employer under the Plan must elect either to terminate the Plan with respect to its Employees and proceed as provided in Section 16.4 or to set up its own plan with its own funding arrangement.

Section 16.4 of Plan X states that each employer may, by action of its board of directors or other governing body, elect to terminate the Plan solely with respect to its own Employees and Participants. Except as otherwise provided in section 16.2 or 16.3, such termination may be effectuated only on January 1, or July 1 of any year, and only after the Employer has given the Lead Sponsor at least three months advance notice of its intent to terminate.

On May 11, 2012, your representative sent a letter that included the most recent determination letter for Plan X, the Eighteenth Amendment to the prior plan document, and the current plan document. The Eighteenth Amendment is effective January 1, 1997, and states in relevant part that Plan X is a collection of single employer plans maintained for the exclusive benefit of eligible employers of health or welfare agencies exempt from taxation under section 501(c)(3) or 501(c)(4) of the Code that, with the consent of the Lead Sponsor, adopt and sponsor Plan X for the benefit of their respective employees and their beneficiaries. These employers are set forth on the Schedule of Adopting Employers that immediately precedes Appendix A of Plan X.

The Eighteenth Amendment goes on to state that each adopting employer: (1) maintains a separate single employer plan only with respect to its own respective employees; (2) makes contributions to fund the benefits only of its own employees, which assets are separately accounted for in Pension Fund sub-accounts segregated from any and all other adopting employers' contributions; and (3) has received a separate favorable determination from the Service on the tax-qualified status of its plan.

Prior to March 15, 2005, Board D appointed Committee F to handle functions of Plan X. Committee F consists of members appointed by Board D. Committee F was charged with various tasks related to the funding and administration of Plan X. However, the administration or funding of Plan X was not the principal purpose or function of Committee F.

Effective March 15, 2005, pursuant to a resolution adopted on March 15, 2005 by Board D, Board D appointed Committee G. Committee G consists of three Board D members and two vice-presidents of Organization A. Board D members constitute the majority of Committee G. The principal purpose and function of Committee G is the administration and funding of Plan X. Committee G is responsible for determining which benefits are offered to employees of Organization A, determining how to best provide such benefits, determining the level of benefits provided to the employees of Organization A and establishing funding policies for Plan X.

Effective January 1, 2010, Plan X, as adopted by Organization A, was restated and renamed Plan Y.

On January 12, 2012, Plan Y filed a statement as part of its amended 2007 Form 5500 filing, electing ERISA coverage pursuant to section 410(d) of the Code, effective January 1, 2007.

In accordance with Revenue Procedure 2011-44, Notice to Employees with reference to Plan X was provided on November 22, 2011. This notice adequately explained to participants of Plan X the consequences of church plan status.

Based on the above facts and representations, you request a ruling that Plan X is a church plan within the meaning of section 414(e) of the Code effective March 15, 2005, and for all prior years of the Plan's operation.

Section 414(e) was added to the Code by section 1015 of ERISA. Section 1017(e) of ERISA provided that section 414(e) applied as of the date of ERISA's enactment. However, section 414(e) was subsequently amended by section 407(b) of the Multiemployer Pension Plan Amendments Act of 1980, Pub. Law 96-364, to provide that section 414(e) was effective as of January 1, 1974.

Section 414(e)(1) of the Code generally defines a church plan as a plan established and maintained for its employees (or their beneficiaries) by a church or a convention or association of churches which is exempt from taxation under section 501 of the Code.

Section 414(e)(2) of the Code provides, in part, that the term "church plan" does not include a plan that is established and maintained primarily for the benefit of employees (or their beneficiaries) of

such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513 of the Code); or if less than substantially all of the individuals included in the plan are individuals described in section 414(e)(1) of the Code or section 414(e)(3)(B) of the Code (or their beneficiaries).

Section 414(e)(3)(A) of the Code provides that a plan established and maintained for its employees (or their beneficiaries) by a church or a convention or association of churches includes a plan maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association churches, if such organization is controlled by or associated with a church or a convention or association of churches.

Section 414(e)(3)(B) of the Code generally defines "employee" of a church or a convention or association of churches to include a duly ordained, commissioned, or licensed minister of a church in the exercise of his or her ministry, regardless of the source of his or her compensation, and an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 of the Code, and which is controlled by or associated with a church or a convention or association of churches.

Section 414(e)(3)(C) of the Code provides that a church or a convention or association of churches which is exempt from tax under section 501 of the Code shall be deemed the employer of any individual included as an employee under subparagraph (B).

Section 414(e)(3)(D) of the Code provides that an organization, whether a civil law corporation or otherwise, is associated with a church or a convention or association of churches if it shares common religious bonds and convictions with that church or convention or association of churches.

Section 1.414(e)-1(c) of the Federal Income Tax Regulations ("Regulations") states that the term church plan does not include a plan which, during the plan year, is maintained by two or more employers unless each of the employers is a church that is exempt from tax under section 501(a) of the Code. The Regulations also state that the employees of each employer must not be employed by an unrelated trade or business.

Based on the language of Plan X described above, Plan X was a multiple employer plan when it was established and was a multiple employer plan until January 1, 1997, when the Eighteenth Amendment to Plan X provided that Plan X is a collection of single employer plans. Thus, effective January 1, 1997, Plan X is no longer a multiple employer plan, but it cannot become a church plan, because it was not established as a church plan. In addition the Plan, in its current form, Plan Y, cannot be a church plan, because it is merely a continuation of Plan X.

Since Plan X was a multiple employer plan, not all of whose participating employers were church plans when established, it failed to satisfy section 1.414(e)-1(c) of the Regulations which states that the term church plan does not include a plan which, during the plan year, is maintained by two or more employers unless each of the employers is a church that is exempt from tax under section 501(a).

There is at least one employer that had employees that participated in Plan X that was not a church that is exempt from tax under section 501(a). Therefore, we find that neither Plan X nor Plan Y, as a continuation of Plan X, is or can become a church plan.

This letter expresses no opinion as to whether Plan X satisfies the requirements of section 401(a) of

the Code.

No opinion is expressed as to the tax treatment of the transaction described herein under the provisions of any other section of either the Code or regulations which may be applicable thereto.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter has been sent to your authorized representative in accordance with a power of attorney on file in this office.

If you have any questions regarding this letter, please contact * * *. Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

Laura B. Warshawsky, Manager

Employee Plans Technical Group 3

Enclosures:

Deleted copy of ruling letter

Notice of Intention to Disclose

IRS LTR: IRS Rules on Status of Church Plan, Grantor Trust.

Citations: LTR 201323043

The IRS determined that a plan providing employees and former employees health and life insurance benefits is a church plan, that the trust funding the insurance premium payments is a grantor trust and is not a welfare benefit fund, and that contributions to or premiums paid by the trust are not includable in participants' gross income.

U.I.L: 414.08-00

Date: March 15, 2013

Refer Reply To: T:EP:RA:T2

LEGEND:

Convention B = * * *

Association C = * * *

State A = * * *

Board R = * * *

Denomination D = * * *

Local Denomination D Associations = * * *

Denomination D Associations = * * *

Union W = * * *

Brotherhood P = * * *

Policy J = * * *

Convention G = * * *

Committee O = * * *

Committee N = * * *

Board D = * * *

Plan X = * * *

Resolution H = * * *

Committee U = * * *

Trust T = * * *

Foundation F = * * *

Dear * * *:

This letter is in response to your letter dated December 11, 2003, as supplemented by correspondence dated December 13, 2004, July 8, 2005, August 2, 2005, September 27, 2005, December 1, 2005, November 29, 2006, December 18, 2006, March 1, 2007, and February 23, 2012, submitted on your behalf by your authorized representative regarding the church plan status of Plan X within the meaning of section 414(e) of the Internal Revenue Code (Code). In addition, you have requested rulings under sections 79, 83, 106, 402(b), 419, and 671 of the Code and section 301.7701-4(a) of the Procedure and Administration Regulations (P&A Regulations).

The following facts and representations have been submitted on your behalf:

Convention B was originally incorporated pursuant to State A statutes under the name of Association C in 1852. Association C's name was changed to Convention B on December 20, 19* * * Article I of Convention B's Amended and Restated Articles of Incorporation provides that Convention B constitutes a body corporate and shall have the full power to institute, pursue, adopt, and carry into effect such measures as to them may be thought best for the promotion of morality, benevolence, and religion, not inconsistent with the laws of State A. Convention B is comprised of and offers services to Denomination D churches across State A. The Local Denomination D Associations are comprised of and offer services to most of the same Denomination D churches but in a regional area of State A. Denomination D member churches of Convention B are also typically members of their Local Denomination D Associations.

Both Convention B and the Local Denomination D Associations have the general purpose of assisting Denomination D member churches in carrying out their mission of evangelism, missions, and ministries and work closely together to promote those ends. The Local Denomination D Associations

receive grants and missionary assistance funding from Convention B. Convention B and the Local Denomination D Associations maintain collaborative efforts in training and participation in evangelism/missions and ministries/church development and leadership development and the promotion of the unity and fellowship among and between Denomination D member churches.

Convention B staff often serves as consultants with the local Denomination D associations in helping them with their needs and to develop strategies to meet their perceived needs. As a result of such planning, specific training events are planned and implemented locally, regionally and statewide in which the staff of Convention B and Local Denomination D Associations participate. The consulting work is done on-site, per e-mail, letters or phone calls as needed. The Local Denomination D Association leadership in collaboration with the staff of Convention B negotiate dates, resources, personalities, locations, funding, promotion and other logistics, needed to make such training effective and efficient for mutually desired outcomes in evangelism, missions, ministries and church and leadership development.

Article II of Convention B's Amended and Restated Articles of Incorporation provide that it shall be a medium through which the Denomination D churches, in their sovereign capacity, can work together in promoting all denominational enterprises which they deem necessary in carrying out the Great Commission. Article II further provides that Convention B shall not carry on any activities not permitted to be carried on by a corporation exempt from federal income tax under section 501(c)(3) of the Code.

Convention B receives its funding from the various Denomination D churches throughout State A which are affiliated with and/or working in cooperation with Convention B. It is represented that Denomination D churches that comprise the membership of Convention B are churches as defined in section 414(e)(1) of the Code and are treated as organizations described in section 501(c)(3) of the Code. It is also represented that the Local Denomination D Associations are organizations described in section 501(c)(3) of the Code.

Article III of Convention B's Amended and Restated Articles of Incorporation provides, in general, that Convention B shall have full power to admit, elect, or appoint its members and officers, to select such times and places for its meetings, and the transaction of its business, and to make such bylaws, rules, and ordinances for its own government. Article III further provides that Convention B shall elect a board of directors to be known as the Executive Board (now called Board R), which shall have charge of the work of Convention B between the meetings, and which shall appoint all officers and agencies that may be required in its work.

Article IV of Convention B's Amended and Restated Articles of Incorporation provides that upon dissolution of Convention B, Board R shall, after paying or making provision for the payment of all liabilities of Convention B, dispose of all of the assets of Convention B exclusively for one or more exempt purposes consistent with the purposes of Convention B.

Convention B's Constitution provides that the membership of Convention B shall consist of messengers from cooperating affiliated Denomination D churches.

Article IV of Convention B's Constitution provides that on the occasion of the annual meeting, the messengers of cooperating Denomination D churches of Convention B shall elect by ballot, a president, a first and second vice president, a secretary and one assistant secretary. The President and the Vice President and Secretaries of Convention B shall be the officers of Board R. Board R members must be members of a Denomination D church for at least one year prior to nomination or appointment.

Article VII of Convention B's Constitution provides, in general, that Board R shall consist of members from each cooperating Denomination D District Association, plus eight at-large members from the geographical regions of State A.

The eight at-large members shall be elected from any cooperating affiliated Denomination D church. These members shall be nominated by Committee O of Convention B. Committee O is one of the governing committees of Convention B.

Members of Board R are elected by Convention B. Any vacancies on Board R not filled at the annual meeting of Convention B or which occur during the year shall be filled by Board R upon recommendation of Committee O. The retiring President of Convention B shall be an at-large member of Board R for one year immediately following his term of office. The president of Union W and the president of Brotherhood P shall serve as ex-officio members of Board R.

Article VIII of Convention B's Constitution provides that Board R shall have charge of the work of Convention B between its sessions, and shall appoint all officers and agencies that may be required in its work.

Article IX provides, in part, that no person shall be eligible for election or appointment until he has been a member of a State A Denomination D church for at least one year prior to nomination or appointment.

The messengers from the cooperating Denomination D churches approve the membership on the various governing committees of Convention B.

On May 6, 20* * * Board R approved an employment policy, Policy J, which sets forth a preferential hiring policy for hiring members of Denomination D churches. Policy J provides that it is the policy and intent of Convention B from the effective date of this policy to hire and retain for all full-time and professional contract positions, where possible, persons who are members in good standing of Denomination D churches which are affiliated with and/or working in cooperation with Convention B and Convention G. Convention G is described as a cooperative ministry agency serving Denomination D churches on a world-wide basis. Policy J also states that it is the policy of Convention B to expect all of its employees to conduct themselves in a Christ-like manner both on and off the job so that their lives reflect Christian values, and to assist Denomination D members and State A Denomination D churches in their ministry. Policy J further provides that failure to adhere to this conduct standard may result in disciplinary action up to and including termination of employment.

Plan X was established in 19* * * by Board R to provide health and life insurance coverage to Convention B's retired employees and has always been maintained by Convention B for such employees. All former employees (i.e., retirees) who meet the applicable eligibility criteria established by Convention B can participate in Plan X and are eligible to receive benefits under Plan X. Currently, as premiums become due, Convention B pays all applicable health and life insurance premiums to Board D of Convention G for retirees (including the missionary/pastor employees whose employment was transferred to the Local Denomination D Associations) from its general assets. Retirees may be required to pay a portion of premiums in the future. Convention G is a vehicle through which its affiliated member conventions can purchase insurance coverage such as the coverage provide for under Plan X.

With respect to Plan X membership, it is represented that the majority of the participants are either employees or former employees (i.e., retirees) of Convention B. It is further represented that there is a group of missionary/pastor employees most of whom, if not all, were employed by Convention B in

the 19* * *s. In 19* * * the employment of these missionary/pastor employees was transferred to various Local Denomination D Associations in State A, which share common religious bonds and convictions with Convention B. You state that this group of employees has been grandfathered into Plan X and is a finite group that has not and will not increase in size. There are no other participants in Plan X other than the above described two groups.

You also represent that none of the Plan X participants engage in unrelated trades or businesses within the meaning of section 513 of the Code.

Plan X provides retiree health and life insurance coverage for employees who retire after meeting certain age and service conditions.

Plan X has been historically administered by an informal committee of several employees and officers of Convention B. However, on December * * * 20* * * Board R approved Resolution H that provides that Convention B resolved to amend Plan X to provide that a benefits committee, Committee U shall act as the administrator to maintain and administer Plan X. Committee U shall have the authority to address all administrative issues relating to Plan X including interpreting Plan X provisions. Committee U is comprised of four members who are appointed by Board R and such members may be removed and new members added at any time in the discretion of Board R. All members of Committee U shall share common religious bonds and convictions with Convention B and its related churches. Committee U shall have no activities other than the administration of Plan X and shall meet as often as necessary to administer Plan X.

In connection with Plan X, Convention B has been authorized to establish and fund Trust T. Convention B intends to make a substantial contribution to Trust T to fund future retiree health and life insurance premium payments pursuant to Plan X. Convention B may make future contributions, from time to time, to fund premium costs of Plan X. Convention B, a tax-exempt entity, will not take a deduction for contributions to Trust T. No employee contributions, if made under Plan X, will be held in Trust T. As retiree health and life insurance premiums become due on a monthly basis, Convention B intends to direct the trustee of Trust T to pay the applicable health and life insurance premiums directly to Board D.

Trust T is intended to be a grantor Trust under section 671 of the Code. Trust T will be revocable. However, Trust T may only be revoked on termination of Plan X or dissolution of Convention B. If Trust T is revoked because of termination of Plan X or dissolution of Convention B, the remaining trust assets may be returned to Convention B provided all obligations under Plan X have been satisfied. Convention B may terminate Plan X at any time.

Participants and their dependents have no preferred claim on, or any beneficial ownership interest in, any Trust T assets, and all rights created under Plan X in Trust T are unsecured contractual rights against Convention B. No benefits or assets under Trust T may be assigned, anticipated, or alienated by participants.

Trust T provides that the principal and income of Trust T are subject to the claims of Convention B’s general creditors in the event of insolvency. If Convention B becomes insolvent, the trustee will immediately cease distributions and hold Trust T assets for the benefit of Convention B’s creditors.

Foundation F will serve as the trustee of Trust T.

Specifically, Trust T contains the following provisions:

Paragraph 1(b) of Trust T’s governing document provides that Trust T shall be revocable by

Convention B. However, Convention B may only revoke Trust T upon the termination of Plan X or dissolution of Convention B.

Paragraph 1(c) provides that Trust T is intended to be a grantor trust, of which Convention B is the grantor, within the meaning of subpart E, part I, subchapter J, chapter 1, subtitle A of the Code and shall be construed accordingly.

Paragraph 1(d) provides that the principal of Trust T and any earnings thereon, shall be held separate and apart from other funds of Convention B and shall be used exclusively for the uses and purposes of Plan X participants and general creditors as provided in Trust T's governing document. Plan X participants and their beneficiaries shall have no preferred claim on, or any beneficial ownership interest in, any assets of Trust T. Any rights created under Plan X and Trust T's governing documents shall be mere unsecured contractual rights of the Plan X participants against Convention B.

Paragraph 1(d) also provides that any assets held by Trust T will be subject to the claims of Convention B's general creditors under federal and state law in the event of insolvency of Convention B.

Paragraph 3(a) provides that Convention B will be considered "Insolvent" if (i) Convention B is unable to pay its debts as they become due, or (ii) Convention B is subject to a pending proceeding as a debtor under the United States Bankruptcy Code. This paragraph also provides that the Trustee shall cease payment of insurance benefits on behalf of Plan X participants and their beneficiaries or dependents if Convention B is insolvent.

Paragraph 3(b)(3) provides that if at any time the Trustee has determined that Convention B is insolvent, the Trustee shall discontinue payments under Plan X and shall hold Trust T assets for the benefit of Convention B's general creditors.

Paragraph 4 provides that if Trust T is revoked because of the termination of Plan X or dissolution of Convention B, the remaining Trust T assets may be returned to Convention B provided all of Convention B's obligations under Plan X as of such date have been satisfied.

In its submission for rulings, Convention B has indicated that it plans to request a ruling from the Department of Labor that Plan X is a church plan for purposes of the Employee Retirement Income Security Act (ERISA). Pursuant to ERISA section 4(b)(2), the ERISA Title 1 provisions do not apply to an employee benefit plan that is a church plan with respect to which no election has been made under section 410(d) of the Code.

In a facsimile dated February * * * 20* * * it is represented that the notice required by Revenue Procedure 2011-44 was not issued to participants because Revenue Procedure 2011-44 applies to qualified retirement plans and not to retiree health insurance plans. Plan X is a retiree health and life insurance plan.

Based on the foregoing facts you request the following rulings:

1. That Trust T will be classified as a Trust under section 301.7701-4(a) of the P&A Regulations;

2. That Trust T is a Grantor Trust under section 671 of the Code;

3. That Trust T is not a welfare benefit fund under section 419(e)(1) of the Code;

4. That the contributions to Trust T will not be includible in the Participants' gross income under

either section 83 of the Code or section 402(b) of the Code;

5. That the premiums paid under Plan X from Trust T will be excluded from gross income of retirees under sections 106(a) and 79 of the Code to the same extent as if paid directly by Convention B; and

6. That Plan X as described herein is a church plan under section 414(e) of the Code.

With respect to ruling request number one, section 301.7701-4(a) of the P&A Regulations provides that, generally, an arrangement will be treated as a trust if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of the responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Section 671 of the Code provides that if the grantor or another person is treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account in computing the taxable income or credits against the tax of an individual.

Sections 673 through 677 of the Code specify the circumstances that cause a grantor to be treated as the owner of any portion of a trust.

Section 677(a)(2) of the Code provides that the grantor is treated as the owner of any portion of a trust whose income without the approval or consent of an adverse party is, or in the discretion of the grantor or a non-adverse party, or both, may be distributed or accumulated for future distribution to the grantor.

Section 1.677(a)-1(d) of the Income Tax Regulations (I.T. Regulations) provides that under section 677 of the Code a grantor is treated as the owner of a portion of a trust whose income is, or in the discretion of the grantor or a non-adverse party or both, may be applied in the discharge of the legal obligation of the grantor.

Section 1.671-2(e)(1) of the I.T Regulations provides that for purposes of subchapter J, a grantor includes any person to the extent such person either creates a trust, or directly or indirectly makes a gratuitous transfer of property to a trust.

In this case, Convention B will transfer assets to Foundation F, the trustee, who will have responsibility for the management, protection, conservation, and investment of the assets. Neither the Plan X participants nor their beneficiaries share in this responsibility. Accordingly, with respect to ruling request number one, we conclude that Trust T will be classified as a trust for federal tax purposes under section 301.7701-4(a) of the P&A Regulations.

With respect to ruling request number two, the purpose of Trust T is to provide benefits to Plan X participants and their beneficiaries. However, if Convention B becomes insolvent, Foundation F has an obligation to cease payments from Trust T and hold Trust T’s assets for the benefit of Convention B’s creditors. Convention B is the grantor of Trust T because it creates and funds Trust T. As determined in ruling request number three below, and based solely on the facts described herein, Trust T is not a “welfare benefit fund” within the meaning of section 419(e)(1) of the Code. Accordingly, because the principal and income of Trust T can be applied to discharge legal obligations of Convention B, Convention B will be treated as the owner of Trust T under section 671 of the Code and section 1.677(a)-1(d) of the I.T. Regulations.

With respect to ruling request number three, section 419(a) of the Code provides that employer

contributions to a welfare benefit plan are not deductible under Chapter 1 of the Code, but if they would otherwise be deductible, then they are deductible (subject to the limitation of section 419(b) of the Code) under section 419 of the Code for the taxable year in which paid.

Section 419(e) of the Code defines "welfare benefit fund" to include any fund that is part of a plan of an employer and through which the employer provides welfare benefits to employees. Section 419(e)(2) of the Code defines "welfare benefit" as any benefit other than a benefit with respect to which section 83(h) of the Code applies, section 404 of the Code applies (determined without regard to section 404(b)(2) of the Code), or section 404A of the Code applies. Section 419(e)(3)(A) of the Code provides that the term "fund" includes any organization described in section 501(c)(9) of the Code. Pursuant to section 419(e)(3)(B) of the Code, the term "fund" also includes any trusts not exempt from tax.

In the present case, Trust T is not exempt from tax. Trust T is subject to claims of Convention B's general creditors in the event of the insolvency of Convention B, and so its assets are not irrevocably set aside, apart from the claims of Convention B's creditors, for the provision of welfare benefits under Plan X. Accordingly, we conclude that Trust T is not a welfare benefit fund within the meaning of section 419(e)(1) of the Code. This conclusion is based on the assumption that Plan X is not subject to the provisions of title 1 of ERISA.

With respect to ruling request number four, section 83 of the Code provides, if, in connection with the performance of services, property is transferred to any person other than the service recipient, the excess of the fair market value of the property, on the first day that the rights to property are either transferable or not subject to substantial risk of forfeiture, over the amount paid for the property is included in the service provider's gross income for the first taxable year in which the rights to the property are either transferable or not subject to a substantial risk of forfeiture.

Section 1.83-3(e) of the I.T. Regulations states that the term "property" includes real and personal property, other than money or an unfunded and unsecured promise to pay money or property in the future. Thus, a promise to pay money or property in the future is "property" if it is either funded or secured. The term "property" also includes a beneficial interest in assets (including money) that are transferred or set aside from the claims of creditors of the transferor, such as in a trust or escrow account. In the case of a transfer of a life insurance contract, or other contract providing life insurance protection, only cash surrender value of the contract is considered to be property.

Section 1.83-3(a)(1) of the I.T. Regulations states that a "transfer" of property occurs when a person acquires a beneficial interest in the property, disregarding any lapse restriction as defined in section 1.83-3(i) of the I.T. Regulations.

Section 83(c)(1) of the Code states that the rights of a person in property are subject to a substantial risk of forfeiture if the person's rights to full enjoyment of the property are conditioned on the future performance of services by any individual. Section 1.83-3(c)(1) of the I.T. Regulations further states that whether a risk of forfeiture is substantial or not depends on the facts and circumstances. A substantial risk of forfeiture exists where rights in property that are transferred are conditioned, directly or indirectly, on the future performance (or refraining from performance) of substantial services by any person, or the occurrence of a condition related to the purpose of the transfer, and the possibility of forfeiture is substantial if the condition is not satisfied.

Section 402(b) of the Code generally provides that contributions to an employees' trust that is not exempt under section 501(a) of the Code are included in the gross income of the employee in accordance with section 83 of the Code except that the value of the employee's interest in the trust is substituted for the fair market value of the property for purposes of section 83 of the Code.

In this case, Convention B is providing life and health insurance benefits for participants in Plan X and Trust T contains employer contributions for these benefits. However, Trust T is subject to the claims of the general creditors of Convention B. Further, participants in Plan X have no preferred claim on, or any beneficial ownership interest in, Trust T's assets. Plan X participants may not anticipate, assign, or alienate any of Trust T's assets. Accordingly, the amounts set aside on behalf of participants in Plan X for life and health benefits are not "property" and there is no "transfer of property" to the participants within the meaning of section 83(a) of the Code.

Based solely on the facts presented, we conclude, with respect to your ruling request number four that the contributions to Trust T will not be includible in the Plan X participants' gross income under either section 83 of the Code or section 402(b) of the Code.

As to ruling request number five, section 106(a) of the Code provides that the gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.106-1 of the I.T. Regulations states that the gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by the employee, the employee's spouse, or the employee's dependents as defined in section 152 of the Code. The employer may contribute to an accident or health plan either by paying the premium on a policy of accident or health insurance covering one or more of the employees or by contributing to a separate trust or fund which provides accident or health benefits directly or through insurance to one or more employees. However, if the insurance policy, trust or fund provides other benefits in addition to accident or health, section 106 of the Code applies only to the portion of the contributions allocable to accident or health benefits.

Revenue Ruling 62-199, 1962-2 C.B. 38, provides that the exclusion under section 106 of the Code for employer-provided accident or health plan coverage applies to retired employees as well as active employees.

Section 79(a) of the Code generally provides that an employee must include in gross income an amount equal to the cost of group-term life insurance on the life of the employee under a policy (or policies) carried directly or indirectly by his or her employer, but only to the extent that the cost exceeds: (1) the sum of the cost of $50,000 of insurance; and, (2) the amount, if any, paid by the employee toward the purchase of the insurance.

For purposes of section 79 of the Code, section 79(e) of the Code provides that the term "employee" includes a former employee.

Section 1.79-0 of the I.T. Regulations provides, in part, that a policy of life insurance is "carried directly or indirectly" by an employer if the employer pays any cost of the life insurance directly or through another person.

In this case, Convention B will make contributions to Trust T that will be used by Trust T, in connection with Plan X, to pay premiums for health insurance and life insurance on the lives of Convention B's retired employees. Retirees are employees for purposes of sections 106 and 79 of the Code. Pursuant to section 1.106-1 of the I.T. Regulations, the health insurance coverage will be provided by the employer since Convention B is paying the cost of health insurance through a separate trust. Pursuant to section 1.79-0 of the I.T. Regulations, the life insurance coverage will be carried directly or indirectly by the employer since Convention B is paying the cost of insurance through Trust T. Thus, the fact that the premiums for retiree health insurance and life insurance are paid to the insurance company by Trust T rather than Convention B does not change the taxation to

the retirees under sections 106 and 79 of the Code.

Therefore, based solely on the facts presented, we conclude, with regard to ruling request number five, that the cost of health insurance coverage provided to retired employees of Convention B as a result of premiums paid under Plan X from Trust T will be excluded from gross income of retirees under section 106 of the Code to the same extent as if paid directly by Convention B; and the cost of group term life insurance coverage provided to retired employees of Convention B as a result of premiums paid under Plan X from Trust T will be excluded from the gross income of retirees under section 79 of the Code to the same extent as if paid directly by Convention B.

As to ruling request number six, section 414(e) was added to the Code by section 1015 of ERISA. Section 1017(e) of ERISA provided that section 414(e) of the Code applied as of the date of ERISA's enactment. However, section 414(e) of the Code was subsequently amended by section 407(b) of the Multiemployer Pension Plan Amendment Act of 1980, Pub. Law 96-364, to provide that section 414(e) of the Code was effective as of January 1, 1974.

Section 414(e)(1) of the Code generally defines a church plan as a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches which Is exempt from taxation under section 501 of the Code.

Section 414(e)(2) of the Code provides, in part, that the term "church plan" does not include a plan that is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513 of the Code); or if less than substantially all of the individuals included in the plan are individuals described in section 414(e)(1) of the Code or section 414(e)(3)(B) of the Code (or their beneficiaries).

Section 414(e)(3)(A) of the Code provides that a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches includes a plan maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches.

Section 414(e)(3)(B) of the Code defines "employee" of a church or a convention or association of churches to include a duly ordained, commissioned, or licensed minister of a church in the exercise of his or her ministry, regardless of the source of his or her compensation, and an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 of the Code, and which is controlled by or associated with a church or a convention or association of churches.

Section 414(e)(3)(C) of the Code provides that a church or a convention or association of churches which is exempt from tax under section 501 of the Code shall be deemed the employer of any individual included as an employee under subparagraph (B).

Section 414(e)(3)(D) of the Code provides that an organization, whether a civil law corporation or otherwise, is associated with a church or a convention or association of churches if the organization shares common religious bonds and convictions with that church or convention or association of churches.

Section 414(e)(3)(E) of the Code provides, in general, that if an employee who is included in a

church plan separates from the service of a church or a convention or association of churches or an organization described in clause (ii) of paragraph(3)(B), the church plan shall not fail to meet the requirements of this subsection merely because the plan (i) retains the employee's accrued benefit or account for the payment of benefits to the employee or his beneficiaries pursuant to the terms of the plan, or (ii) receives contributions on the employee's behalf after the employee's separation from service but only for a period of 5 years after such separation, unless the employee is disabled (within the meaning of the disability provisions of the church plan or, if there are no such provisions in the church plan, within the meaning of section 72(m)(7) of the Code) at the time of such separation from service.

In this case, Convention B qualifies as a church or association of churches for purposes of the church plan rules. Additionally, all of the employees that participant in Plan X share the same common bonds and convictions of Denomination D churches, and Convention B is a nonprofit organization described under section 501(c)(3) of the Code which is exempt from tax under section 501(a) of the Code.

Convention B was created to institute, pursue, adopt and carry into effect such measures for the promotion of morality, benevolence and religion consistent with the laws of State A. Convention B receives its funding from various Denomination D churches throughout State A which are affiliated with and/or working in cooperation with Convention B.

To the extent that some participants in Plan X are not employees of Convention B but are employed by Local Denomination D Associations, and in view of the fact that there are common religious bonds between Local Denomination D Associations and Convention B, and that Convention B receives its funding from various Denomination D churches, we conclude that the Local Denomination D Associations are associated with a church or a convention or association of churches within the meaning of section 414(e)(3)(D) of the Code, that the employees of the Local Denomination D Associations meet the definition of employee under section 414(e)(3)(B) of the Code and that they are deemed to be employees of a church or a convention or association of churches by virtue of being employees of an organization which is exempt from tax under section 501 of the Code and which is controlled by or associated with a church or a convention or association of churches.

In addition, the fact that Convention B may make contributions to Trust T and Trust T will then pay premiums directly under Plan X on behalf of retired employees who may have been retired for over five years does not take away the Plan's status as a church plan because benefits under Plan X fully accrued while the retiree was an active employee and no contributions are made with respect to any periods after the employee's separation from service.

Based on the foregoing facts and representations, with respect to ruling request number six, we conclude that Plan X is a church plan within the meaning of section 414(e) of the Code.

No opinion is expressed as to the tax treatment of the transaction described herein under the provisions of any other section of either the Code or regulations, which may be applicable thereto.

This ruling is directed only to the Taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

A copy of this letter ruling is being sent to your authorized representative pursuant to a Power of Attorney on file in this office.

If you have any questions regarding this letter, please contact * * *, I.D. Number * * *, at * * *. Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

Laura B. Warshawsky, Manager

Employee Plans Technical Group 3

IRS LTR: Prep School's Defined Benefit Plan Is Church Plan.

Citations: LTR 201322051

The IRS ruled that a tax-exempt college preparatory school's defined benefit plan is a church plan within the meaning of section 414(e) and has been a church plan since January 1, 1974.

U.I.L 414.08-00

Date: March 8, 2013

Refer Reply To: T:EP:RA:T3

LEGEND:

School S = * * *

State A = * * *

City P = * * *

Society J = * * *

Year B = * * *

Religion C = * * *

Directory C = * * *

Conference C = * * *

Plan X = * * *

Dear * * *

This is in response to your letters dated, December 11, 2007, November 1, 2011, and January 8, 2013, submitted on your behalf by your authorized representative, in which you request a ruling that Plan X is a church plan described in Section 414(e) of the Internal Revenue Code of 1986, as amended (the "Code").

The following facts and representations have been submitted under penalty of perjury in support of the ruling requested.

School S is a private non-profit college preparatory school formed under the non-profit corporation law of State A. School S was founded in Year B in City P as a Society J secondary school for young men. The governing body of School S is a Board of Trustees which consists of no fewer than 18 or

more than 25 members of which no less than one-third plus one shall be members of Society J, which is a religious order of men. The Bylaws of School S provide that the Board of Trustees has the power and authority to (1) appoint or remove the President of School S; (2) approve diplomas, certificates and awards; (3) approve and adopt all major changes or renovations in the educational programs of School S; (4) review and take appropriate action as to the Budget, which shall be submitted to it upon recommendation of the President; (5) institute and promote major fund raising efforts of School S; and (6) authorize any changes in tuition and fees within School S.

The Bylaws of School S provide that the Board of Trustees has the authority to elect the President of School S by a two-thirds majority of the Board of Trustees and by a majority of the members of Society J then on the Board of Trustees, subject to the approval by the Provincial of the Society J Province in which School S is located.

The Bylaws require a vote of a two-thirds majority of the Board of Trustees and a vote of a majority of the members of the Society J then on the Board to approve any action effecting a change in the essential character of School S as a Religion C Society J secondary school.

School S is listed in Directory C and, consequently, is exempt from federal income taxes under section 501 of the Code, pursuant to group rulings issued to Conference C by the Internal Revenue Service (the "IRS").

School S has maintained Plan X, a defined benefit pension plan, since September 15, 19* * *. Plan X covers all employees of School S after their completion of one year of service. None of the eligible participants in Plan X are or can be considered employed in connection with one or more unrelated trades or businesses with the meaning of section 513 of the Code. All the eligible participants are employed by School S. Plan X does not include any employees of for-profit entities.

Prior to May 15, 20* * *, Plan X was administered by School S. By resolutions adopted on May 15, 20* * *, the Board of Trustees of School S established a benefits committee (the "Committee"), the sole purpose of which is to have the exclusive authority to control and manage the operation and administration of Plan X as well as any successor retirement plan that the Board may hereafter establish. The resolutions provide that the Board of Trustees shall appoint the members of the Committee, subject to the requirement that at all times the Committee must consist of not less than three members, the majority of whom must be vowed members of Society J. The resolutions further provide that the members of the Committee will serve at the pleasure of and are subject to removal by the Board of Trustees at any time with or without cause.

In accordance with Revenue Procedure 2011-44, Notice to Employees with reference to Plan X was provided on October * * *, 20* * *. This notice explained to participants of Plan X the consequences of church plan status.

You represent that School S has not made an election under Code Section 410(d) to be subject to the provisions of the Code relating to vesting, funding, participation and other standards applicable to other retirement plans.

Based on your submission and the above facts and representations, you request a ruling that Plan X is a church plan, within the meaning of Section 414(e) of the Code, retroactively effective for all prior years that the Plan has been in effect.

Section 414(e) was added to the Code by section 1015 of ERISA. Section 1017(e) of ERISA provided that section 414(e) applied as of the date of ERISA's enactment. However, section 414(e) was subsequently amended by section 407(b) of the Multiemployer Pension Plan Amendments Act of

1980, Pub. Law 96-364, to provide that section 414(e) was effective as of January 1, 1974.

Section 414(e)(1) of the Code generally defines a church plan as a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from taxation under section 501 of the Code.

Section 414(e)(2) of the Code provides, in part, that the term "church plan" does not include a plan that is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513 of the Code); or if less than substantially all of the individuals included in the plan are individuals described in section 414(e)(1) of the Code or section 414(e)(3)(B) of the Code (or their beneficiaries).

Section 414(e)(3)(A) of the Code provides that a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches includes a plan maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches.

Section 414(e)(3)(B) of the Code defines "employee" of a church or a convention or association of churches to include a duly ordained, commissioned, or licensed minister of a church in the exercise of his or her ministry, regardless of the source of his or her compensation, and an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 of the Code, and which is controlled by or associated with a church or a convention or association of churches.

Section 414(e)(3)(C) of the Code provides that a church or a convention or association of churches which is exempt from tax under section 501 of the Code shall be deemed the employer of any individual included as an employee under subparagraph (B).

Section 414(e)(3)(D) of the Code provides that an organization, whether a civil law corporation or otherwise, is associated with a church or a convention or association of churches if the organization shares common religious bonds and convictions with that church or convention or association of churches.

Revenue Procedure 2011-44, 2011-39 I.R.B. 446, supplements the procedures for requesting a letter ruling under section 414(e) of the Code relating to church plans. The revenue procedure: (1) requires that plan participants and other interested persons receive a notice in connection with a letter ruling request under section 414(e) of the Code for a qualified plan; (2) requires that a copy of the notice be submitted to the IRS as part of the ruling request; and (3) provides procedures for the IRS to receive and consider comments relating to the ruling request from interested persons.

In order for an organization that is not itself a church or a convention or association of churches to have a qualified church plan, it must establish that its employees are employees or deemed employees of a church or convention or association of churches under section 414(e)(3)(B) of the Code by virtue of the organization's control by or affiliation with a church or convention or association of churches. Employees of any organization maintaining a plan are considered to be church employees if the organization: (1) is exempt from tax under section 501 of the Code; and (2) is controlled by or associated with a church or convention or association of churches. In addition in order to be a church plan, the administration or funding (or both) of the plan must be by an

organization described in section 414(e)(3)(A) of the Code. To be described in section 414(e)(3)(A) of the Code, an organization must have as its principal purpose the administration or funding of the plan and must also be controlled by or associated with a church or convention or association of churches.

In view of the common religious bonds between School S and Society J, the inclusion of School S in Directory C, and the indirect control of School S by Society J through the Board of Trustees, we conclude that School S is associated with a church or convention or association of churches within the meaning of section 414(e)(3)(D) of the Code, that the employees of School S meet the definition of employee under section 414(e)(3)(B) of the Code, and that they are deemed to be employees of a church or a convention or association of churches by virtue of being employees of an organization which is exempt from tax under section 501 of the Code and which is controlled by or associated with a church or a convention or association of churches.

The administrative control of Plan X is vested in the Committee. The Committee is controlled by and shares common religious bonds with Society J through its control by the Board of Trustees and the common religious bonds of the members of the Committee with Society J. The sole purpose of the Committee is to have exclusive authority to control and manage the operation and administration of Plan X as well as any successor retirement plan that the Board of Trustees may hereafter establish. Thus, the administration of Plan X satisfies the requirements regarding church plan administration under section 414(e)(3)(A) of the Code.

Accordingly, in regard to your ruling request, we conclude that Plan X is a church plan as defined in section 414(e) of the Code and has been a church plan since January 1, 1974.

This letter expresses no opinion as to whether Plan X, satisfies the requirements for qualification under section 401(a) of Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

No opinion is expressed as to the tax treatment of the transaction described herein under the provisions of any other section of either the Code or regulations which may be applicable thereto.

Pursuant to a power of attorney on file with this office, a copy of this letter ruling is being sent to your authorized representative.

If you have any questions regarding this letter, please contact * * *. Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

Laura B. Warshawsky, Manager

Employee Plans Technical Group 3

Enclosures:

Deleted Copy of Ruling Letter

Notice of Intention to Disclose

FASB Seeks to Improve Reporting of Nonprofit Operations.

The Financial Accounting Standards Board on May 29 took steps to bring more clarity to the ways in which nonprofit entities communicate information about their operations and financial performance.

At a meeting in Norwalk, Conn., Lee Klumpp, a practice fellow at FASB, told the board that the presentation of an intermediate measure of operations could improve a nonprofit entity's ability to "tell its story and promote further comparability among nonprofits." He added that an intermediate operating measure that is based on a "current operating classification scheme" could provide more meaningful information for users of nonprofit financial statements.

The board tentatively decided to define an intermediate operating measure on the basis of a nonprofit entity's mission, which would be based on whether resources are used to carry out an entity's purpose for existence.

Klumpp said the mission of a nonprofit entity is central to how the organization is created, managed, and governed, and how the organization obtains and retains its tax-exempt status with the IRS.

FASB members also agreed that the operating measure should be defined by an availability concept that involves the resources available for the current activities of the nonprofit entity.

Regarding presentation, the board tentatively decided that a nonprofit entity should present in its statement of activities all revenues that are available to support the entity's mission. A board majority favored presenting those revenues on a gross basis before specific amounts are designated for future period operations.

FASB member Lawrence Smith said that presenting operating measures on a gross basis would help to characterize the decisions made by a nonprofit entity's governing board regarding the funding of future operations. "Those decisions are very important to portray on the face of the financial statements," he added.

According to FASB, the proposed presentation approach would report the amounts of previously unavailable funding resources that an entity's governing board would designate for use in the current reporting period.

IRS: Revised Publication 3112 IRS e-file Application and Participation.

This publication provides important information for Tax Professionals and Authorized IRS e-file Providers regarding applying and participating in IRS e-file. All participants should read this publication to become familiar with the requirements for continued participation.

This edition of Publication 3112, IRS e-file Application and Participation, replaces the previous edition last revised in March 2009. The IRS communicated most of the changes on its Web site on IRS.gov as they occurred since the last revision of this publication.

The publication is available at:

http://www.irs.gov/pub/irs-pdf/p3112.pdf

IRS Issues Guidance on Empowerment Zone Designation Extensions.

The IRS has issued guidance on how a state or local government amends the nomination of an empowerment zone to provide for a new termination date of December 31, 2013, as provided for by section 1391, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, and the American Taxpayer Relief Act of 2012. (Notice 2013-38; 2013-25 IRB 1)

The full notice is available at:

http://www.irs.gov/pub/irs-drop/n-13-38.pdf

IRS Issues Median Gross Income Guidance.

Revenue Procedure 2013-27 provides guidance with respect to the United States and area median gross income figures that are to be used by issuers of qualified mortgage bonds, as defined in § 143(a) of the Internal Revenue Code, and issuers of mortgage credit certificates, as defined in § 25(c), in computing the housing cost/income ratio described in § 143(f)(5).

http://www.irs.gov/pub/irs-drop/rp-13-27.pdf

IRS Corrects Errors in Proposed Regs on Community Health Needs Assessment Requirements.

The IRS has corrected errors in the preamble to and in the text of proposed regulations (REG-106499-12) that provide guidance to charitable hospital organizations on the community health needs assessment requirements and related excise tax and reporting obligations.

Community Health Needs Assessments for

Charitable Hospitals; Correction

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 53

[REG-106499-12]

RIN 1545-BL30

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to a notice of proposed rulemaking.

SUMMARY: This document contains corrections to a notice of proposed rulemaking that was

published in the Federal Register on Friday, April 5, 2013. The proposed regulations provide guidance to charitable hospital organizations on the community health needs assessment requirements, and related excise tax and reporting obligations, enacted as part of the Patient Protection and Affordable Care Act of 2010. These proposed regulations also clarify the consequences for failing to meet these and other requirements for charitable hospital organizations.

FOR FURTHER INFORMATION CONTACT: Amy F. Giuliano at (202) 622-6070 (not a toll free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG-106499-12) that is the subject of these corrections provides guidance to charitable hospital organizations under sections 501(r), 4959, 6012, and 6033 of the Internal Revenue Code.

Need for Correction

As published April 5, 2013 (78 FR 20523), the notice of proposed rulemaking (REG-106499-12) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the notice of proposed rulemaking (REG-106499-12), that was the subject of FR Doc. 2013-07959, is corrected as follows:

1. On page 20523, in the preamble, column 3, under the paragraph heading “Paperwork Reduction Act”, line 3 from the top of the paragraph, the language “Return of Organization Exempt from” is corrected to read “Return of Organization Exempt From”

2. On page 20526, in the preamble, column 2, under the paragraph heading “e. Activities Unrelated to the Operation of a Hospital Facility”, lines 11 and 12 of the first full paragraph, the language “organization operates. Similarly, section 1.501(r)-2 of these proposed regulations” is corrected to read “organization operates. Similarly, § 1.501(r)-2 of these proposed regulations”.

3. On page 20537, in the preamble, column 3, under the paragraph heading “Special Analyses”, line 9 from the top of the page, the language “§ 1.501(r)-3 and § 1.6033-2(a)(2)(ii)(l) of” is corrected to read “Effective/Applicability Dates”, line 9 from the top of the page, the language “§ 1.501(r)-3 and § 1.6033-2(a)(2)(ii)(l) of”.

4. On page 20537, in the preamble, column 3, under the paragraph heading “Special Analyses”, line 3 of the second full paragraph, the language “2(a)(2)(ii)(l) of the regulations requires” is corrected to read “2(a)(2)(ii)(l) of the regulations requires”

§ 1.501(r)-1 [Corrected]

5. On Page 20539, column 1, paragraph (c)(3), the last sentence of the paragraph, the language “In addition, a partnership agreement includes provisions of Federal, state, or local law, as in effect before March 23, 2010, that govern the affairs of the partnership or are considered under such law to be part of the agreement.” is corrected to read “In addition, a partnership agreement includes provisions of federal, state, or local law, as in effect before March 23, 2010, that govern the affairs of the partnership or are considered under such law to be part of the agreement.”

§ 1.6012-3 [Corrected]

6. On page 20543, column 3, paragraph (a)(10) in the heading, the language “Hospital organizations organized as trust with noncompliant hospital facilities.” is corrected to read “Hospital organizations organized as trusts with noncompliant hospital facilities.”.

Alvin Hall

Assistant Director

Legal Processing Division

Associate Chief Counsel

(Procedure and Administration)

Corporation Owned by Indian Tribe Not Exempt From Taxes, Tax Court Holds.

Citations: Uniband Inc. v. Commissioner; 140 T.C. No. 13; No. 4718-06

The Tax Court held that a state-chartered corporation owned by an Indian tribe wasn’t exempt from corporate income tax, that consolidated returns it filed with another corporation the tribe owned were invalid, and that the corporation had to reduce its wage and employee expense deductions by the amount of the Indian employment credits it was entitled to claim.

Uniband Inc., a Delaware corporation, was wholly owned by the Turtle Mountain Band of Chippewa Indians for the years at issue. Uniband filed consolidated returns with another corporation, TMMC, which was also owned by the tribe for the 1995-1998 tax years. The consolidated returns offset Uniband’s income with TMMC’s losses. The IRS found that the consolidated returns were invalid and that Uniband’s tax liability should be calculated separately from TMMC’s. The IRS also found that Uniband was entitled to the Indian employment credit under section 45A, which it hadn’t claimed. The IRS applied the credit and reduced Uniband’s deductions for wages by the amount of the credit. The adjustments resulted in Uniband’s liability for tax deficiencies, which it challenged in the Tax Court.

Tax Court Judge David Gustafson rejected Uniband’s argument that it was exempt from income tax as an integral part of an Indian tribe. While agreeing that the tribe itself was exempt from income tax, the court found that Uniband was a separate taxable entity. Gustafson explained that the tribe’s immunity from tax didn’t extend to Uniband, nor was the tribe or Uniband exempt from tax under any treaty, as Uniband had attempted to argue. The court also held that Uniband wasn’t entitled to tribal sovereign immunity.

The Tax Court also rejected Uniband’s claim that it was entitled to tax exemption based on its similarity to corporations established under section 17 of the Indian Reorganization Act of 1934. The court found that Uniband differed in several ways from section 17 corporations, which are exempt from tax. Gustafson explained that as a state-chartered corporation, Uniband lacked the special relation to the tribe that exists with a section 17 corporation.

The court also found that Uniband wasn’t entitled to file a consolidated return with its sister corporation, TMMC, noting that the tribe that owned both corporations was not itself a corporation.

The returns were also invalid because the tribe did not file them, consent to them, or report its items on the purported consolidated returns.

The Tax Court agreed with the IRS that Uniband wasn't entitled to deduct all of its wage and employee business expenses under section 162. The court concluded that Uniband's deductions were reduced according to the amount of the section 45A credit it was entitled to claim. The court noted that section 280C(a) disallows a deduction for wages or salaries paid or incurred for the tax year that equal the sum of the credits determined for that year under section 45A. The court declined to interpret section 280C as limiting the deductions to the extent the credits are currently allowed after applying the general business credit limitation under section 38(c)(1).

LTR: IRS Approves Organization's Set-Aside Program.

Citations: LTR 201321028

The IRS approved an organization's set-aside funding program for restoration of a historic building that will be dedicated entirely to the organization's exempt purposes when the work is finished, saying the project can better be accomplished using a set-aside than by making an immediate payment.

Contact Person – ID Number: * * *

Contact Telephone Number: * * *

UIL LIST: 4942.03-07

Release Date: 5/24/2013

Date: December 27, 2012

Employer Identification Number: * * *

LEGEND:

Q = Name of Facility

R = City, State

u = $ Cost of Project

v = $ Amount of Set Aside

w = $ Set-Aside Year 1

x = $ Set-Aside Year 2

y = $ Set-Aside Year 3

z = $ Set-Aside Year 4

Dear * * *

WHY YOU ARE RECEIVING THIS LETTER

This is our response to your September 18, 2012, and your subsequent amendment thereto, requesting approval of a set-aside under Internal Revenue Code section 4942(g)(2). You've been recognized as tax-exempt under section 501(c)(3) of the Code and have been determined to be a private operating foundation under sections 509(a) and 4942(j)(3).

OUR DETERMINATION

Based on the information furnished, your set-aside program is approved under Internal Revenue Code section 4942(g)(2). As required under section 4942(g)(2), the set aside amount must be paid within the 60-month period after the date of the first set-aside.

DESCRIPTION OF SET-ASIDE REQUEST

You previously acquired a historic property, Q, located in R. You propose to restore Q at an estimated total cost of $u. When you acquired Q, a portion of it was leased out to commercial tenants and the remaining part was vacant. After restoration the building Q, will be dedicated in its entirety to your exempt purposes.

The first floor will be used for orientation space, exhibition space, a gift shop and public space. The second floor will provide office space for various existing functions of your organization, and an exhibition space in the rear. The upper floor will contain exhibition spaces and spaces for organ recitals and receptions. A second exit from Q will also be built to meet a Fire Code requirement.

The project can better be accomplished using a set-aside than by making an immediate payment, because long-term expenditures must be made requiring more than one year's income to assure their continuity. You intend to restore Q using no outside financing. This is a major project demanding the accumulation of funds in earlier years for expenditure in later years. The predesign and design phases of the project will occupy the initial two years of the set-aside period . The final, construction phase of the project will be carried out in the third, fourth and fifth years of the set-aside period. You have requested an initial set-aside of $w for the fiscal year ending March 31, 20* * *, with additions of $x, $y, and $z, for the fiscal years March 31, 20* * *, March 31, 20* * * and March 31, 20* * *, respectively, the total set-aside requested being $v. The set aside requested for each year is expected to be sufficient to ensure that you qualify that year as a private operating foundation under section 4942(j)(3).

You expect that the project will be completed by December 31, 20* * *, and you have affirmed that all the amounts to be set aside will actually be paid within 60 months of the date of the first set-aside.

BASIS FOR OUR DETERMINATION

Internal Revenue Code section 4942(g)(2)(A) states that an amount set aside for a specific project, which includes one or more purposes described in section 170(c)(2)(B), may be treated as a qualifying distribution if it meets the requirements of section 4942(g)(2)(B).

Section 4942(g)(2)(B) of the Code states that an amount set aside for a specific project will meet the requirements of this subparagraph if, at the time of the set-aside, the foundation establishes that the amount will be paid within five years and either clause (i) or (ii) are satisfied.

Section 4942(g)(2)(B)(i) of the Code is satisfied if, at the time of the set-aside, the private foundation establishes that the project can better be accomplished using the set-aside than by making an

immediate payment.

Section 4942(j)(3) of the Code requires that private operating foundations must spend at least 85% of its adjusted net income or its minimum investment return, whichever is less, directly for the active conduct of its exempt activities (the income test) in order to remain a private operating foundation.

Section 53.4942(a)-3(b)(1) of the Foundations and Similar Excise Taxes Regulations provides that a private foundation may establish a project as better accomplished by a set-aside than by immediate payment if the set-aside satisfies the suitability test described in section 53.4942(a)-3(b)(2).

Section 53.4942(a)-3(b)(2) of the Foundations and Similar Excise Taxes Regulations provides that specific projects better accomplished using a set-aside include, but are not limited to, projects where relatively long-term expenditures must be made requiring more than one year's income to assure their continuity.

In Revenue Ruling 74-450, 1974-2 C.B. 388, an operating foundation converted a portion of newly acquired land into a public park under a four-year construction contract. The construction contract payments were to be made mainly during the final two years. This constituted a "specific project." The foundation's set-aside of all its excess earnings for four years was treated as a qualifying distribution under Internal Revenue Code section 4942(g)(2).

WHAT YOU MUST DO

Your approved set-aside(s) will be documented on your records as pledges or obligations to be paid by the date specified. The amounts set aside will be taken into account to determine your minimum investment return under Internal Revenue Code section 4942(e)(1)(A), and the income attributable to your set aside(s) will also be taken into account in computing your adjusted net income under section 4942(f) of the Code.

ADDITIONAL INFORMATION

This determination is directed only to the organization that requested it. Internal Revenue Code section 6110(k)(3) provides that it may not be used or cited as a precedent.

Please keep a copy of this letter in your records.

If you have any questions, please contact the person listed in the heading of this letter.

Sincerely,

Holly O. Paz

Director, Exempt Organizations

Rulings and Agreements

LTR: IRS Rules on Transfer of Assets Between Foundations.

Citations: LTR 201321025

The IRS ruled that the transfer of assets from one private foundation to another will not affect either

foundation’s tax-exempt status, will not give rise to termination taxes or net investment income taxes, will not be an act of self-dealing, and will not constitute a jeopardizing investment

Contact Person: * * *

Identification Number: * * *

Telephone Number: * * *

Uniform Issues List Numbers: 501.03-00, 507.00-00, 507.05-00,

507.06-00, 507.09-00, 512.00-00, 4940.00-00, 4941.04-00, 4942.03-05,

4942.05-00, 4944.00-00, 4945.04-00

Release Date: 5/24/2013

Date: February 27, 2013

Employer Identification Number: * * *

LEGEND:

B = * * *

C = * * *

D = * * *

M = * * *

Dear * * *:

This responds to your letter dated May 31, 2012, in which you requested rulings on the application of Parts I and II of Subchapter F of Chapter 1, I.R.C. §§ 501-509, and Subchapter A of Chapter 42, Subtitle D, §§ 4940-4948, to the transaction described below.

FACTS

M is a trust organized exclusively for charitable purposes, and has been recognized exempt from federal income taxation as an organization described in § 501(c)(3). M is classified as a private non-operating foundation within the meaning of § 509(a). M was created by, and originally funded with a contribution from, B. B and her husband, C, (jointly, the “Founders”), are M’s sole trustees. You stipulate that B is a substantial contributor to M within the meaning of § 507(d)(2)(A), that C is a substantial contributor to M within the meaning of § 507(d)(2)(B)(iii), that B and C are M’s foundation managers within the meaning of § 4946(b), and, consequently, that B and C are disqualified persons with respect to M within the meaning of § 4946(a)(1)(A) and (B).

You are organized as a not-for-profit corporation under state law. You have been recognized exempt from federal income taxation as an organization described in § 501(c)(3), and are classified as a private operating foundation described in § 4942(j)(3). M and you do not share the same tax year. Your officers and directors are B, C, and D. D is an unrelated person who has provided legal services to you, B, C, and M. You stipulate that B is a substantial contributor to you within the meaning of § 507(d)(2)(A), that C is a substantial contributor to you within the meaning of § 507(d)(2)(B)(iii), that

B, C, and D are foundation managers with respect to you within the meaning of § 4946(b), that B and C are disqualified persons with respect to you within the meaning of § 4946(a)(1)(A) and (B), and that D is a disqualified person with respect to you within the meaning of § 4946(a)(1)(B).

You represent that the Founders, as M's sole Trustees and as two of your three directors, effectively control both M and you (collectively, "the Foundations") within the meaning of §§ 1.482-1(a)(3) and 1.507-3(a)(9)(i).

You represent that both of the Foundations have made timely tax filings on their respective Returns of Organizations Exempt from Income Tax, Forms 990-PF, for all applicable years, and that both have complied with all applicable state filing obligations throughout their respective terms of existence. Neither of the Foundations has undertaken any activities that would be inconsistent with tax-exempt status as a § 501(c)(3) organization, nor made any changes to their respective governing documents since the filing of their Applications for Tax-Exempt Status, Form 1023. There have been no willful repeated acts (or failures to act), nor any willful and flagrant act (or failure to act), within the meaning of § 507(a)(2)(A), with respect to either of the Foundations that would give rise to liability for tax under Chapter 42 of the Code, and neither Foundation has received a notification from the Secretary of the Treasury described in § 507(a)(2)(B). Neither Foundation has previously terminated its status as a private foundation. M has made qualifying distributions in sufficient amount to avoid imposition of excise tax under § 4942. You have made qualifying distributions in connection with the conduct of your exempt mission to qualify as a private operating foundation under § 4942(j)(3).

You represent that all grants made, or to be made, by M prior to the transfer of its remaining assets to you, as described below, have been grants to public charities. You have not made grants to other organizations. Neither Foundation has incurred any "taxable expenditure" within the meaning of § 4945(d), and neither Foundation has previously made any grant or other disposition of funds that would require the exercise of expenditure responsibility within the meaning of § 4945(d)(4)(B).

Under the Declaration of Trust that serves as M's governing instrument, M's trustees are empowered to make distributions in their discretion from Trust income and principal to "Qualified Charitable Recipients" ("QCRs"). QCRs are defined as organizations described in § 170(c)(1) or (2) which are exempt from tax under § 501(c)(3). The Trust instrument makes reference to suggested types of QCR donees, but the Trustees are empowered to make distributions to any charitable organization qualifying as a QCR, without regard to its mission or purposes. You, as an organization described in §§ 170(c)(2) and 501(c)(3), are a QCR within the meaning of M's Trust instrument, and, as such, are eligible under the Trust instrument to receive grants from M. Prior to, and except for, the transfer of its remaining assets to you as described below, all of M's grants have been made or will have been made to unrelated grantees that are treated as public charities under the Code.

Your corporate purposes are described in your Articles of Organization as including "the provision of educational, vocational, social, psychological, and financial assistance to homeless individuals and families," as well as making distributions to other § 501(c)(3) organizations. Since you were first organized, you have provided education and practical job-skills training to disadvantaged persons and those who have suffered displacement from recent economic upheavals with the objective of equipping them to survive in the current economy, to enter or re-enter the work-force, and to lead productive and satisfying lives. You have provided free career development services to unemployed and underemployed individuals, and have offered such individuals skill assessment, career planning, computer training, interview and resume help, financial planning, job search planning, and other assistance.

Over the past several years, the Founders have concluded that the services you provide have been

increasingly needed, in part because of the large number of people displaced by recent economic upheaval and recession. The population in need of such services has been underserved by other organizations and the need and demand for the services you provide have increased. At the same time, economic circumstances have made fundraising from third parties more difficult. The Founders have determined that the exempt purposes of both Foundations will be best served by concentrating their efforts and charitable resources on your work and mission, and by eliminating the duplication and administrative burden of operating two separate private foundations.

M's only activities have consisted of grants made to unrelated QCRs, the missions of most of which are unrelated to your mission. The Trustees have determined that the best use of M's remaining charitable funds, in furtherance of its exempt purpose, would be to provide assistance to you in carrying out the activities which form the basis of your exempt purposes. Therefore, the Founders, as Trustees of M and as your Directors, with the concurrence of your third director, have determined that it is in the best interests of both Foundations to contribute all of M's remaining net funds to you, to discontinue any of M's further activities or grants, and to continue to operate you in furtherance of your exempt purposes.

After making some final grants to unrelated public charities, M will transfer all of its remaining assets to you. M's Trustees will reserve a final amount for estimated debts and expenses, including taxes due, if any, under § 4940, and, thereafter, transfer the balance of M's remaining net assets to you (the "Transfer"). The Transfer will involve substantially all of M's net assets, including all accumulated income and undistributed trust principal. Any amounts remaining after the final payment of taxes, expenses, and fees, will also be transferred to you. Following these transfers, M will retain no assets and will cease to operate.

M will file a Form 990-PF for the year of the disposition of its assets. No sooner than at least one day after the Transfer, M's Trustees will provide notice pursuant to § 507(a)(1) to the Manager, Exempt Organizations Determinations, TE/GE, of M's intent to terminate its private foundation status, in the form and manner prescribed by § 1.507-1(b) and other applicable regulations.

Following the Transfer, you will continue to operate as a private operating foundation engaged in the active conduct of activities in furtherance of your exempt purposes. You expect to use the transferred funds as well as your other assets exclusively in furtherance of your exempt purposes. The Founders expect that your qualifying distributions, substantially all in the form of expenditures incurred in carrying out your exempt activities, will continue to exceed your net income and minimum investment returns. You will also take responsibility for all liabilities, if any, under Chapter 42 that may be imposed or in effect with respect to either M or you after the Transfer date.

While you will continue to provide services free of charge, your management has determined that your exempt purposes can be further served by expanding your services to include fee-based training and certification programs in widely-used computer programs. These services have been identified as particularly valuable to your core mission, which is helping displaced and disadvantaged persons acquire the skills needed to obtain meaningful and lasting employment. The fees paid for such services will help you recover the costs of those programs as well as provide a source of revenue to support your ongoing operations and pro bono services.

The legal services with respect to the Transfer will be provided by a law firm in which D is a partner with a profits interest of less than 35%. D, as one of your directors, is a disqualified person with respect to you. You represent that the law firm will charge reasonable fees for the legal services provided in connection with the Transfer, the termination of M and its status as a private foundation, and the application for a private letter ruling. The services provided by the law firm will be limited solely to such services as are reasonably necessary to carrying out the exempt purposes of the

Foundations, and shall not be excessive.

RULINGS REQUESTED

You have requested the following rulings:

1. The transfer of substantially all of M's net assets to you (the "Transfer") will not adversely affect the status of M or you as tax-exempt organizations described in § 501(c)(3).

2. The Transfer will be a transfer described in § 507(b)(2).

3. The Transfer will not terminate M's private foundation status and will not cause M to incur any liability for the § 507(c) termination tax.

4. Following the Transfer, M will be eligible to terminate its private foundation status through the "voluntary termination" procedures of § 507(a)(1).

5. Pursuant to § 1.507-7(b)(1), the date for determining the value of M's assets, for purposes of calculating the termination tax under § 507(c), shall be the date proper notification is given, in the manner prescribed in the regulations, of M's intention voluntarily to terminate its private foundations status (hereinafter, "Notice").

6. Provided that such Notice is given at least one day after the Transfer, and at a time when M's net remaining assets are valued at zero dollars ($0.00), then the amount of termination tax due under § 507(c)(2) upon the termination of M's status as a private foundation shall be zero dollars ($0.00).

7. Pursuant to § 507(b)(2), you will not be treated as a newly created organization as a result of the Transfer.

8. You, as transferee of substantially all of M's net assets, shall be treated as possessing those attributes and characteristics of M described in subparagraphs (2), (3), and (4) of § 1.507-3(a).

9. The Founders, as the only Trustees of M, and as two of your three Directors, and as foundation managers and substantial contributors of both Foundations, effectively control both Foundations within the meaning of §§ 1.482-1(a)(3) and 1.507-3(a)(9), Accordingly, for purposes of Chapter 42, you, the transferee Foundation, will be treated as though you were M, the transferor Foundation.

10. The Transfer will not be a realization event for M, and will not give rise to any gross investment income or capital gain net income, within the meaning of § 4940, with respect to either M or you.

11. You, as transferee, may use any excess § 4940 tax paid by M, the transferor, to offset your § 4940 tax liability.

12. The Transfer will not constitute self-dealing and will not subject either of the Foundations, or any of their respective officers, directors, or Trustees, as the case may be, to tax under § 4941.

13. The providing of reasonable and necessary legal services with respect to the Transfer by a law firm in which D is a partner, and the payment of reasonable compensation for such services by the Foundations, will not be an act of self-dealing within the meaning of § 4941(d), notwithstanding the status of D as a disqualified person with respect to you.

14. M will not be required to meet the qualifying distribution requirements of § 4942 for the taxable year of the Transfer provided that your distributable amount for the year of the Transfer is increased

by M's distributable amount for the year of the Transfer, and M's qualifying distributions made during the taxable year of the Transfer, if any, will be carried over to you, and may be used by you to meet your minimum distribution requirements under § 4942 for the year.

15. The Transfer will not constitute a jeopardizing investment within the meaning of § 4944.

16. The Transfer will not be a taxable expenditure within the meaning of § 4945(d), and there will be no expenditure responsibility requirements that must be exercised under § 4945(d)(4) or (h) with respect to the Transfer.

17. The payment of reasonable legal fees to the attorneys for M and you for services with respect to the Transfer, and the IRS fee for this Private Letter Ruling will not be treated as taxable expenditures within the meaning of § 4945(d)(5).

18. Your operation of state licensed postsecondary career training programs for a fee will not adversely affect your tax-exempt status under § 501(c)(3) or your status as a private operating foundation under § 4942(j)(3).

19. The fees you receive from payments by users for your certification classes will not be considered gross income derived from an unrelated trade or business for purposes of § 512(a)(1).

20. From and after the effective date of the Transfer, you will continue to exist as an organization that is exempt from taxation under § 501(c)(3) and which will qualify as a private operating foundation under § 4942(j)(3).

LAW

I.R.C. § 501(a) exempts from federal income taxation organizations described in § 501(c).

I.R.C. § 501(c)(3) describes organizations organized and operated exclusively for charitable, educational, and other designated exempt purposes.

Treas. Reg. § 1.501(c)(3)-1(d)(3)(i) provides that the term "educational," as used in § 501(c)(3), includes the instruction and training of the individual for the purpose of improving or developing his capabilities.

I.R.C. § 509(a) provides that an organization described in § 501(c)(3) is a private foundation unless it is described in § 509(a)(1), (2), (3), or (4).

I.R.C. § 507(a) provides that, except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if (1) it notifies the Secretary of its intent to accomplish such termination, or (2) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under Chapter 42, and the Secretary notifies such organization that it is liable for the tax imposed by subsection (c), and either such organization pays the tax (or any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

Treas. Reg. § 1.507-1(b)(1) provides that in order for a private foundation to terminate its private foundation status under § 507(a)(1), an organization must submit a statement to the Internal Revenue Service ("Service") of its intent to terminate its private foundation status under § 507(a)(1). Such statement must set forth in detail the computation and amount of tax imposed under § 507(c). Unless the organization requests abatement of such tax pursuant to § 507(g), full payment of such tax must be made at the time the statement is filed under § 507(a)(1).

I.R.C. § 507(c) imposes an excise tax on each terminating private foundation equal to the lower of the aggregate tax benefit resulting from the § 501(c)(3) status of such foundation, or the value of the net assets of such foundation.

I.R.C. § 507(e) and Treas. Reg. § 1.507-7(a) provide that, for purposes of § 507(c), the value of the net assets shall be determined at whichever time such value is higher: (1) the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation, or (2) the date on which it ceases to be a private foundation.

Treas. Reg. § 1.507-7(b)(1) provides that, in the case of a termination under § 507(a)(1), the date for determining the value of the foundation's assets for purposes of calculating the termination tax under § 507(c) shall be the date on which the foundation gives the notification described in § 507(a)(1).

I.R.C. § 507(b)(2) provides that, in the case of a transfer of assets of a private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization.

Treas. Reg. § 1.507-3(c)(1) provides that, for purposes of § 507(b)(2), the terms "other adjustment, organization, or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

Treas. Reg. § 1.507-3(c)(2) provides that the term "significant disposition of assets to one or more private foundations" includes any disposition (or series of related dispositions) by a private foundation to one or more private foundations of 25 percent or more of the fair market value of the net assets of the transferor foundation at the beginning of the taxable year in which the transfers occur.

Treas. Reg. § 1.507-1(b)(6) provides that when a foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in § 507(b)(2) and § 1.507-3(c), such transferor foundation will not have terminated its private foundation status under § 507(a)(1).

Treas. Reg. § 1.507-1(b)(7) provides that neither a transfer of all the assets of a private foundation nor a significant disposition of assets by a private foundation shall be deemed to result in a termination of the transferor private foundation under § 507(a) unless the transferor private foundation elects to terminate pursuant to § 507(a)(1) or § 507(a)(2) is applicable.

Treas. Reg. § 1.507-3(d) provides that unless a private foundation voluntarily gives notice pursuant to § 507(a)(1), a transfer of assets described in § 507(b)(2) will not constitute a termination of the transferor's private foundation status under § 507(a)(1).

Treas. Reg. § 1.507-4(b) provides that private foundations which make transfers described in § 507(b)(2) are not subject to the tax imposed under § 507(c) with respect to such transfers unless the provisions of § 507(a) become applicable.

Treas. Reg. § 1.507-3(a)(1) provides that, in the case of a transfer of assets of a private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, including a significant disposition of assets to one or more private foundations within the meaning of § 1.507-3(c), the transferee organization shall not be treated as a newly created organization. Rather, the transferee organization shall be treated as

possessing those attributes and characteristics of the transferor organization which are described in subparagraphs (2), (3), and (4) of this paragraph.

Treas. Reg. § 1.507-3(a)(2)(i) provides that a transferee organization to which this § 1.507-3(a) applies shall succeed to the aggregate tax benefit of the transferor organization in an amount equal to the amount of such aggregate tax benefit multiplied by a fraction the numerator of which is the fair market vale of the assets (less encumbrances) transferred to such transferee and the denominator of which is the fair market value of the assets of the transferor (less encumbrances) immediately before the transfer. Fair market value shall be determined at the time of the transfer.

Treas. Reg. § 1.507-3(a)(3) provides that, for purposes of § 507(d)(2), in the event of a transfer of assets described in § 507(b)(2), any person who is a "substantial contributor" (within the meaning of § 507(d)(2)) with respect to the transferor foundation shall be treated as a "substantial contributor" with respect to the transferee foundation, regardless of whether such person meets the $5,000-two percent test with respect to the transferee organization at any time.

Treas. Reg. § 1.507-3(a)(4) provides that if a private foundation incurs liability for one or more of the taxes imposed under Chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets described in § 507(b)(2) to one or more private foundations, in any case where transferee liability applies each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the transferor foundation does not satisfy such liability.

Treas. Reg. § 1.507-3(a)(5) provides that, except as provided in subparagraph (9) of this paragraph, a private foundation is required to meet the distribution requirements of § 4942 for any taxable year in which it makes a § 507(b)(2) transfer of all or part of its net assets to another private foundation. Such transfer shall itself be counted toward satisfaction of such requirements to the extent the amount transferred meets the requirements of § 4942(g). However, where the transferor has disposed of all of its assets, the recordkeeping requirements of § 4942(g)(3)(B) shall not apply during any period it which it has no assets. Such requirements are applicable for any taxable year other than a taxable year during which the transferor has no assets.

Treas. Reg. § 1.507-3(a)(9)(i) provides that if a private foundation transfers all of its net assets to one or more private foundations which are effectively controlled (within the meaning of § 1.482-1A(a)(3)), directly or indirectly, by the same person or persons who effectively control the transferor private foundation, for purposes of Chapter 42 (§ 4940 et seq.) and part II of Subchapter F of Chapter 1 of the Code (§§ 507 through 509), such a transferee private foundation shall be treated as if it were the transferor.

I.R.C. § 511(a)(1) imposes a tax for each taxable year on the unrelated business taxable income (as defined in § 512) of organizations described in § 501(c).

I.R.C. § 512(a)(1) provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in § 513) regularly carried on by it less certain deductions and subject to certain modifications.

I.R.C. § 513(a) provides that the term "unrelated trade or business" means, in the case of an organization subject to the tax imposed by § 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or functions constituting the basis for its exemption under § 501.

Treas. Reg. § 1.513-1(d)(2) provides that a trade or business is "related" to exempt purposes, in the relevant sense only where the conduct of the business activities bears a causal relationship to the achievement of exempt purposes (other than through the production of income); and the trade or business is "substantially related," for purposes of § 513, only if the causal relationship is a substantial one. Thus, for the conduct of a trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

I.R.C. § 4940(a) imposes on each private foundation which is exempt from taxation under § 501(a) for the taxable year a tax equal to 2 percent of the net investment income of such foundation for the taxable year.

Rev. Rul. 2002-28, 2002-1 C.B. 941, holds that when a private foundation transfers all of its assets to one or more private foundations in a transfer described in § 507(b)(2) the transfers do not give rise to net investment income and are not subject to tax under § 4940(a). The transferee foundations may use their proportionate share of any excess § 4940 tax paid by the transferor to offset their own § 4940 tax liability.

I.R.C. § 4941(a)(1) imposes a tax on each act of self-dealing between a disqualified person and a private foundation.

I.R.C. § 4946(a)(1) provides that the term "disqualified person," with respect to a private foundation, includes a person who is —

(A) a substantial contributor to the foundation,

(B) a foundation manager (within the meaning of subsection (b)(1)),

(C) an owner of more than 20 percent of —

(i) the total combined voting power of a corporation,

(ii) the profits interest of a partnership, or

(iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation,

(D) a member of the family of any individual described in subparagraph (A), (B), or (C),

(E) a corporation of which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the combined voting power,

(F) a partnership in which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the profits interest, and

(G) a trust or estate in which persons described in subparagraph (A), (B), (C), or (D) hold more than 35 percent of the beneficial interest.

Treas. Reg. § 53.4946-1(a)(8) provides that, for purposes of § 4941, the term "disqualified person"

shall not include any organization described in § 501(c)(3) other than an organization described in § 509(a)(4).

Treas. Reg. § 53.4941(d)-1(b)(4) provides that a transaction between a private foundation and an organization which is not controlled by the foundation (within the meaning of subparagraph (5) of this paragraph) and which is not described in § 4946(a)(1)(E), (F), or (G) because persons described in § 4946(a)(1)(A), (B), (C), or (D) own no more than 35 percent of the total combined voting power or profits or beneficial interest of such organization, shall not be treated as an indirect act of self-dealing between the foundation and such disqualified person solely because of the ownership interest of such persons in such organization.

I.R.C. § 4941(d)(1)(E) provides that the term "self-dealing" includes any direct or indirect payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person.

I.R.C. § 4941(d)(2)(E) and Treas. Reg. § 53.4941(d)-3(c)(1) provide that the payment of compensation (and the payment or reimbursement of expenses) by a private foundation to a disqualified person for personal services which are reasonable and necessary to carrying out the exempt purpose of the private foundation shall not be an act of self-dealing if the compensation (or payment or reimbursement) is not excessive.

Treas. Reg. § 53.4941(d)-3(c)(2) provides examples illustrating the provisions of § 4941(d)(2)(E). In Example (1), M, a partnership, is a firm of 10 lawyers engaged in the practice of law. A and B, partners in M, serve as trustees to private foundation W and, therefore, are disqualified persons. In addition, A and B own more than 35 percent of the profits interest in M, thereby making M a disqualified person. M performs various legal services for W from time to time as such services are requested. It is concluded that the payment of compensation by W to M shall not constitute an act of self-dealing if the services performed are reasonable and necessary for the carrying out of W's exempt purposes and the amount paid by W for such services is not excessive.

I.R.C. § 4942(a) imposes a tax on the undistributed income of a private foundation (other than an operating foundation under § 4942(j)(3)) for any taxable year which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year.

I.R.C. § 4942(c) defines "undistributed income" for any taxable year as the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made out of such distributable amount for such taxable year.

I.R.C. § 4942(d) defines "distributable amount" as the amount equal to the sum of the minimum investment return, plus certain other amounts, reduced by the sum of the taxes imposed on such private foundation for the taxable year under subtitle A and § 4940.

I.R.C. § 4942(g)(1)(A) provides that the term "qualifying distribution" means any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in § 170(c)(2)(B), other than a contribution to (i) an organization controlled directly or indirectly by the foundation or by one or more disqualified persons with respect to the foundation, except as provided in paragraph (3), or (ii) a private foundation which is not an operating foundation under § 4942(j)(3), except as provided in paragraph (3).

I.R.C. § 4942(g)(3) provides that the term "qualifying distribution" includes a contribution to a § 501(c)(3) organization described in paragraph (1)(A)(i) or (ii) if —

(A) not later than the close of the first taxable year after its taxable year in which such contribution is received, such organization makes a distribution equal to the amount of such contribution and such distribution is a qualifying distribution (within the meaning of paragraph (1) or (2), without regard to this paragraph) which is treated under subsection (h) as a distribution out of corpus (or would be so treated if such § 501(c)(3) organization were a private foundation which is not an operating foundation), and

(B) the private foundation making the contribution obtains adequate records or other sufficient evidence from such organization showing that the qualifying distribution described in subparagraph (A) has been made by such organization.

I.R.C. § 4942(i) and Treas. Reg. § 53.4942(a)-3(e) provide for a carry-over of the amount by which qualifying distributions during the five preceding taxable years (other than amounts required to be distributed out of corpus under § 4942(g)(3)) have exceeded the distributable amounts for such years.

I.R.C. § 4942(j)(3) provides that, for purposes of § 4942, the term "operating foundation" means any organization —

A. which makes qualifying distributions (within the meaning of paragraph (1) and (2) of subsection (g)) directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated equal to substantially all of the lesser of —

i. its adjusted net income (as defined in subsection (f), or

ii. its minimum investment return; (the "income test") and

B.

i. substantially more than half of the assets of which are devoted directly to such activities or to functionally related businesses (as defined in paragraph (4)), or to both, or are stock of a corporation which is controlled by the foundation and substantially all of the assets of which are so devoted (the "assets test"),

ii. which normally makes qualifying distributions (within the meaning of paragraph (1) or (2) of subdivision (g)) directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated in an amount not less than two-thirds of its minimum investment return (as defined in subsection (e)) (the "endowment test"), or

iii. substantially all of the support (other than gross investment income as defined in § 509(e)) of which is normally received from the general public and from 5 or more exempt organizations which are not described in § 4946(a)(1)(H) with respect to each other or the recipient foundation, not more than 25 percent of the support (other than gross investment income) of which is normally received from any one such exempt organization and not more than half of the support of which is normally received from gross investment income (the "support test").

Notwithstanding the provisions of subparagraph (A), if the qualifying distributions (within the meaning of paragraph (1) or (2) of subsection (g)) of an organization for the taxable year exceed the minimum investment return for the taxable year, clause (ii) of subparagraph (A) shall not apply unless substantially all of such qualifying distributions are made directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated.

Treas. Reg. § 53.4942(b)-1(b)(1) provides, generally, that qualifying distributions are not made by a foundation "directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose" unless such qualifying distributions are used by the foundation itself, rather than by or through one or more grantee organizations which receive such qualifying distributions directly or indirectly from such foundation. However, administrative expenses (such as staff salaries and traveling expenses) and other operating costs necessary to conduct the foundation's exempt activities (regardless of whether they are "directly for the active conduct" of such activities) shall be treated as qualifying distributions expended directly for the active conduct of such exempt activities if such expenses and costs are reasonable in amount. Conversely, administrative expenses and operating costs which are not attributable to exempt activities, such as expenses in connection with the production of investment income, are not treated as qualifying distributions. Expenses attributable to both exempt and nonexempt activities shall be allocated to each such activity on a reasonable and consistently applied basis.

Treas. Reg. § 53.4942(a)-2(d)(4)(i) provides, in part, that where the deductions with respect to property used for a charitable, educational, or other similar exempt purpose exceed the income derived from such property, such excess shall not be allowed as a deduction, but may be treated as a qualifying distribution.

I.R.C. § 4942(j)(4)(A) provides that the term "functionally related business" includes a trade or business which is not an unrelated trade or business (as defined in § 513).

Rev. Rul. 2002-28, 2002-1 C.B. 941, provides that, when a private foundation transfers all of its assets to one or more private foundations in a transfer described in § 507(b)(2), the transfers do not constitute qualifying distributions for the transferor foundation under § 4942. The transferee foundations assume their proportionate share of the transferor foundation's undistributed income under § 4942 and reduce their own distributable amount for purposes of § 4942 by their proportion share of the transferor's excess qualifying distributions under § 4942(i).

I.R.C. § 4944(a)(1) imposes a tax on any amount invested by a private foundation in a manner that jeopardizes the carrying out of any of the foundation's exempt purposes.

Rev. Rul. 2002-28, 2002-1 C.B. 941, holds that, when a private foundation transfers all of its assets to one or more private foundations in a transfer described in § 507(b)(2), the transfers do not constitute investments jeopardizing the transferor foundation's exempt purposes and are not subject to tax under § 4944(a)(1).

I.R.C. § 4945(a)(1) imposes a tax on any "taxable expenditure" made by a private foundation.

I.R.C. § 4945(d)(4) provides that the term "taxable expenditure" includes any amount paid or incurred as a grant to a private non-operating foundation unless the grantor foundation exercises expenditure responsibility with respect to such grant in accordance with § 4945(h).

I.R.C. § 4945(d)(5) provides that the term "taxable expenditure" includes any amount paid or incurred by a private foundation for any purpose other than one specified in § 170(c)(2)(B).

I.R.C. § 4945(h) provides that the expenditure responsibility referred to in § 4945(d)(4) means that a private foundation is responsible to exert all reasonable efforts and to establish adequate procedures: (1) to see that the grant is spent solely for the purpose for which it was made; (2) to obtain full and complete reports from the grantee on how the funds are spent; and (3) to make full and detailed reports with respect to such expenditures to the Secretary.

Rev. Rul. 2002-28, 2001-1 C.B. 941, provides that, when a private foundation transfers all of its assets to one or more private foundations effectively controlled by the same persons that effectively control the transferor, the transferee foundation is treated as the transferor foundation rather than as the recipient of an expenditure responsibility grant. Therefore, there are no expenditure responsibility requirements that must be exercised under § 4945(d)(4) or (h) with respect to the transfers to the transferee foundation. The transferor foundation is required to exercise expenditure responsibility over the transferor's outstanding grants until it disposes of all of its assets. Thereafter, during any period in which the transferor foundation has no assets, the transferor foundation is not required to exercise expenditure responsibility over any outstanding grants. However, the transferor foundation must still meet the § 4945(h) reporting requirements for the outstanding grants for the year in which the transfer was made.

Treas. Reg. § 53.4945-6(b)(1)(v) provides that any payment which constitutes a qualifying distribution under § 4942(g) ordinarily will not be treated as taxable expenditures under § 4945(d)(5).

Treas. Reg. § 53.4945-6(b)(2) provides that any expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered will ordinarily be taxable expenditures under § 4945(d)(5) unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was consistent with ordinary business care and prudence. The determination whether an expenditure is unreasonable shall depend upon the facts and circumstances of the particular case.

ANALYSIS

Issue 1

Whether the transfer of substantially all of M's net assets to you (the "Transfer") would adversely affect the status of either M or you as tax-exempt organizations described in § 501(c)(3).

Both M and you are currently recognized by the Service as organizations described in § 501(c)(3). Section 501(c)(3) describes organizations organized and operated exclusively for charitable, educational, and other specified exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office.

M's exempt purposes include the making of grants to QCRs, which M's trust instrument defines as organizations described in §§ 170(c)(1) and (2) that are entitled to exemption from tax under § 501(c)(3). Furthermore, Articles I.B and VI of M's trust instrument authorize the Trustees, in their discretion, to distribute up to the entire net income and principal of the Trust to such organizations in furtherance of your exempt purposes. You qualify as an organization described in § 170(c)(2) and are exempt from tax under § 501(c)(3). Therefore, you are a QCR and an eligible recipient of trust distributions under M's trust instrument, and the Transfer of all of M's remaining assets to an organization such as you is expressly permitted thereunder.

You are organized for charitable and educational purposes, including the provision of educational, vocational, social, psychological, and financial assistance to homeless individuals and families, and the making of distributions for such or similar purposes to organizations that qualify as exempt organizations under § 501(c)(3). Article IV, paragraph (a)(ii) of your Articles of Organization permits

you to “receive contributions from any and all sources.” Therefore, the receipt of the transferred funds from M is a permissible action by you under your governing instrument. You intend to utilize these funds in carrying out the activities which constitute the basis of your exempt purposes. No private inurement will result from the receipt of those funds. The founder, B, serves without compensation, and the only persons who will benefit from your activities will be those persons who fall within the charitable class that you were established to serve. Nor will the funds be used for legislative or political activities or for any other purpose that is not in conformity with your exempt purposes.

Since the Transfer is consistent with M’s exempt purposes, and since the transferred funds will be used by you exclusively in furtherance of your exempt purposes, the Transfer will have no adverse effect on the qualification of either M or you as organizations described in § 501(c)(3).

Issue 2

Whether the Transfer would be a transfer described in § 507(b)(2).

I.R.C. § 507(b)(2) applies to the transfer of the assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. Section 1.507-3(c)(1) provides that the terms “other adjustment, organization, or reorganization” shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration. The term “significant disposition of assets to one or more private foundations” is defined by § 1.507-3(c)(2) as any disposition or series of dispositions where the aggregate value transferred is 25 percent or more of the fair market value of the foundation at the beginning of the taxable year.

M will transfer all of its net remaining assets to you after the payment of certain grants to unrelated QCR’s and the payment of final taxes and expenses. After the Transfer is completed, the value of M’s assets would be zero dollars ($0.00). The assets transferred would constitute 100 percent of M’s net assets remaining after the payment of its qualifying distributions, debts, expenses, and taxes, and not less than 93 percent of its total assets as of the beginning of the taxable year. Therefore, the Transfer would constitute a “significant disposition of assets” within the meaning of § 1.507-3(c)(2), and, thus, would qualify as an “other adjustment, organization, or reorganization” within the meaning of § 1.507-3(c)(1). Accordingly, the Transfer would be a transfer described in § 507(b)(2).

Issues 3, 4, 5, and 6

Whether the Transfer would not terminate M’s private foundation status or cause it to incur any liability for the § 507(c) termination tax.

Whether, following the Transfer, M would be eligible to terminate its private foundation status by giving notice to the Service as provided in § 507(a)(1).

Whether, for purposes of calculating the termination tax under § 507(c), the date for determining the value of M’s assets is the date on which it gives the notice described in § 507(a)(1) (“Notice”).

Provided that Notice is given at least one day after the Transfer, and at a time when M’s net remaining assets are valued at Zero Dollars ($0.00), whether the amount of termination tax due under § 507(c)(2) upon termination of M’s status as a private foundation would be Zero Dollars ($0.00).

Section 1.507-1(b)(6) provides that when a foundation transfers all or part of its assets to one or

more other private foundations pursuant to a transfer described in § 507(b)(2), such transferor foundation will not have terminated its private foundation status under § 507(a)(1). In addition, § 1.507-1(b)(7) provides that neither a transfer of all the assets of a private foundation nor a significant disposition of assets by a private foundation shall be deemed to result in a termination of the transferor private foundation under § 507(a) unless the transferor private foundation elects to terminate pursuant to § 507(a)(1). Furthermore § 1.507-3(d) provides that unless a private foundation voluntarily gives notice pursuant to § 507(a)(1), a transfer of assets described in § 507(b)(2) will not constitute termination of the transferor's private foundation status under § 507(a)(1). Finally, § 1.507-4(b) provides that a private foundation that makes a transfer described in § 507(b)(2) is not subject to the tax imposed under § 507(c) with respect to such transfer unless the provisions of § 507(a) become applicable.

As discussed under Issue 2, above, the Transfer will constitute a significant distribution of assets described in § 507(b)(2). Further, you have represented that the Secretary has not notified M of any tax imposed by § 507(c) due to any willful or flagrant acts or failures to act. Consequently, the Transfer would not, of itself, terminate M's private foundation status or subject it to the tax imposed under § 507(c).

Section 507(a)(1) provides that the status of an organization as a private foundation shall be terminated only if such organization notifies the Secretary of its intent to accomplish such termination and such organization pays the tax imposed by § 507(c). Furthermore, § 1.507-1(b)(1) provides that in order for a private foundation to terminate its private foundation status under § 507(a)(1) it must submit a statement to the Internal Revenue Service of its intent to terminate its private foundation status under § 507(a)(1). In M's situation where there have been no willful repeated acts or failures to act, and no flagrant act or failure to act, which would give rise to taxes and penalties under Chapter 42, M may elect to terminate its private foundation status by notifying the Manager, Exempt Organizations Determinations (TE/GE), of its intent to accomplish such termination and paying any termination tax deemed to be due under § 507(c).

Section 507(c) imposes a tax on a terminating private foundation equal to the lesser of the aggregate tax benefit resulting from its § 501(c)(3) status and the value of its net assets. Section 507(e) and § 1.507-7(a) provide that, for purposes of § 507(c), the value of the net assets shall be determined at whichever time such value is greater: (1) the first day on which the organization takes action which culminates in its ceasing to be a private foundation, or (2) the date on which it ceases to be a private foundation. Finally, § 1.507-7(b)(1) provides that in the case of a voluntary termination under § 507(a)(1), the date for determining the value of the foundation's assets for purposes of calculating the termination tax under § 507(c) shall be the date on which the foundation gives the notification described in § 507(a)(1). The date for determining the value of M's assets for purposes of calculating its termination tax is the date it gives Notice. If M gives Notice after the Transfer, the value of its assets on the date of the Notice would be Zero Dollars ($0.00), and, thus, the amount of the § 507(c) termination tax imposed on M would be Zero Dollars ($0.00).

Issues 7, 8, and 9

Whether, for purposes of §§ 507 through 509, you would be treated as a newly created organization as a result of the Transfer, pursuant to § 507(b)(2).

Whether you, as transferee of substantially all of M's net assets, would be treated as possessing those attributes and characteristics of M, the transferor, described in § 1.507-3(a)(2), (3), and (4).

Since M and you are both effectively controlled by the same persons within the meaning of §§ 1.482-1(a)(3) and 1.507-3(a)(9), whether, for purposes of Chapter 42 (§ 4940 et seq.) and §§ 507 through

509, you, the transferee, would be treated as though you were M, the transferor.

Section 1.507-3(a)(1) provides that in the case of a significant distribution of assets to one or more private foundations within the meaning of § 1.507-3(c) the transferee organization shall not be treated as a newly created organization. Rather, it shall be treated as possessing those attributes and characteristics of the transferor organization which are described in § 1.507-3(a)(2), (3), and (4). Since, as discussed under Issue 2, above, the Transfer would qualify as a "significant distribution of assets" within the meaning of § 1.507-3(c)(2), you would not be treated as a newly created organization as a result of the Transfer. Rather, you would be treated as possessing M's attributes and characteristics described in subparagraphs (2), (3), and (4) of § 1.507-3(a).

Treas. Reg. § 1.507-3(a)(9)(i) provides that if a private foundation transfers all of its net assets to one or more private foundations which are effectively controlled by the same persons which effectively controlled the transferor private foundation, for purposes of Chapter 42 (§ 4940 et seq.), the transferee foundation shall be treated as if it were the transferor. Since you have represented that B and C effectively control both M and you, for purposes of Chapter 42, you would be treated as if you were M.

Issues 10 and 11

Whether the Transfer would give rise to any gross investment income with respect to either M or you or will be subject to tax under § 4940(a).

Whether you, as transferee, may use any excess § 4940 tax paid by M to offset your § 4940 tax liability.

Section 4940(a) imposes an excise tax on a private foundation's net investment income for the taxable year. Rev. Rul. 2002-28 holds that when a private foundation transfers all of its assets to one or more private foundations in a transfer described in § 507(b)(2), the transfers do constitute investments of the transferor and, therefore, do not give rise to net investment income subject to tax under § 4940(a). Thus, the Transfer would not give rise to net investment income subject to tax under § 4940.

Furthermore, Rev. Rul. 2002-28 holds that if the transferor foundation transfers all of its assets to private foundations effectively controlled by the same persons that effectively control the transferor, any excess § 4940 tax paid by the transferor may be used by the transferee to offset its § 4940 tax liability. As you represent that the Foundations are effectively controlled by the same persons, any excess § 4940 tax paid by M may be used by you to offset your § 4940 tax liability.

Issues 12 and 13

Whether the Transfer would constitute an act of self-dealing within the meaning of § 4941(d), or would subject any disqualified person or foundation manager with respect to M or you to the tax imposed under § 4941(a).

Whether the provision by a law firm of reasonable and necessary legal services with respect to the Transfer, or the payment of reasonable compensation for such services by M or you, would constitute acts of self-dealing within the meaning of § 4941(d), notwithstanding the status of D, a disqualified person with respect to you, as a partner in that law firm.

Section 4941(a) imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation. Section 4941 and § 1.507-3(a) determine whether the proposed Transfer of all of M's assets to you would constitute an act of self-dealing between a private foundation and its

disqualified persons as defined in § 4946. Under § 53.4946-1(a)(8), a "disqualified person" does not include organizations that are exempt under § 501(c)(3). Therefore, the Transfer of M's assets to you would not be an act of self-dealing because you are recognized by the Service as an organization exempt from tax under § 501(c)(3).

Furthermore, while the payment of compensation, or the payment or reimbursement of expenses by a private foundation to a disqualified person is, generally, an act of self-dealing under § 4941(d)(1)(E), § 4941(d)(2)(E) and § 53.4941(d)-3(c)(1) provide that a payment or reimbursement to a disqualified person for personal services which are reasonable and necessary to carry out the exempt purposes of the private foundation is not an act of self-dealing provided the compensation, payment, or reimbursement is not excessive.

In this case, the law firm is not a disqualified person, so the payment to the law firm for legal services will not be a direct act of self-dealing. Under § 4946(a)(1)(F) a "disqualified person" includes a partnership in which disqualified persons hold more than 35 percent of the profits interests. D is a disqualified person and is a partner of the law firm but holds less than a 35 percent profits interest in the law firm.

The payment will not otherwise be treated as an indirect act of self-dealing benefitting D. Under § 53.4941(d)-1(b)(4) indirect self-dealing will not occur solely as a result of a transaction between a private foundation and an entity in which a disqualified person holds an interest where the entity is not a disqualified person by operation of § 4946(a)(1)(F). Moreover, as Example (1) of § 53.4941(d)-3(c)(2) demonstrates, the payment of compensation by a foundation for legal services does not constitute an act of self-dealing if the services performed are reasonable and necessary for carrying out of the foundation's exempt purposes and the amount paid for such services is not excessive, and you have represented that these requirements will be met.

Issue 14

Whether the Transfer will be a qualifying distribution by M under § 4942.

Whether you will assume M's "undistributed income" (if any) or succeed to M's excess distributions (if any).

Section 4942(a) generally imposes a tax on the undistributed income of a private foundation (other than an operating foundation under § 4942(j)(3)) for any taxable year which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year. Section 4942(c) defines "undistributed income" for any taxable year as the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made out of such distributable amount for such taxable year. Section 4942(g)(1)(A) defines "qualifying distribution" generally as any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in § 170(c)(2)(B), but a qualifying distribution does not include a contribution to an organization controlled directly or indirectly by the foundation or by one or more disqualified persons with respect to the foundation

Section 1.507-3(a)(5) provides that, except as provided in section 1.507-3(a)(9), a private foundation making a transfer described in § 507(b)(2) must satisfy its distribution requirements under § 4942 for the taxable year in which the transfer is made. Section 1.507-3(a)(5) further provides that the transfer will count as a distribution in satisfaction of the transferor foundation's distribution requirement under § 4942 subject to the provisions of § 4942(g). Section 4942(g) provides that a distribution from one private foundation to another private foundation, where both foundations are effectively controlled by the same persons, will not be treated as a qualifying distribution by the

transferor foundation for the purposes of § 4942 except to the extent that the transferee foundation makes one or more distributions that would be qualifying distributions under § 4942(g) (other than a distribution to a controlled foundation) prior to the close of the transferee's first tax year following the tax year in which it received the transfer and the distributions are treated as being made out of corpus (as if the transferee foundation were not an operating foundation).

Rev. Rul. 2002-28 holds that where, by reason of § 1.507-3(a)(9)(i), a transferee private foundation is treated as though it were the transferor for purposes of § 4942, a transfer to the transferee foundation is not treated as a qualifying distribution of the transferor foundation. Rather, the transferee foundation assumes all obligations with respect to the transferor's "undistributed income" within the meaning of § 4942(c), if any, and reduces its own distributable amount under § 4942 by the transferor foundation's excess qualifying distributions under § 4942(i). None of the three situations in Rev. Rul. 2002-28, however, involved an operating foundation.

As discussed under Issues 7, 8, and 9, above, by reason of § 1.507-3(a)(9)(i), you would be treated as if you were M for purposes of Chapter 42, including § 4942. Accordingly, the Transfer to you would not be treated as a qualifying distribution of M. Rather, you would assume M's obligations with respect to its undistributed income within the meaning of § 4942(c), if any (after taking into account any excess qualifying distribution carryovers that M may have), and M would not be required to meet its qualifying distribution requirements under § 4942 for the taxable year of the Transfer prior to the Transfer. M must file a final Form 990-PF return for the short tax year of its termination. If M has undistributed income for such tax year, you will owe § 4942 tax if you fail, by the end of your tax year following the tax year in which you receive the Transfer, to make qualifying distributions of such amount that would be treated as out of corpus if you were a non-operating foundation. You should provide an attachment to your Form 990-PF showing how you have met this requirement.

If M has excess qualifying distributions that carry over to you, they will be forfeited if you are an operating foundation in the year of the Transfer. Section 53.4942(a)-3(e)(4) (Example (3)) explains that excess qualifying distributions carried forward lapse in their entirety in any year that the private foundation is treated as an operating foundation. Accordingly, if M has any unused excess qualifying distributions that it could have carried forward to a taxable year after the Transfer, and if you are an operating foundation in that year, M's unused excess qualifying distributions will lapse and will not be available for your use in any taxable year after the year of the Transfer if you were to cease to be an operating foundation.

Issue 15

Whether the Transfer would constitute a investment jeopardizing M's exempt purposes, or would be subject to tax under § 4944(a)(1).

Section 4944 imposes a tax on any investment that jeopardizes an exempt organization's charitable purposes. Rev. Rul, 2002-28 holds that where a private foundation transfers all of its assets and liabilities to another private foundation, the transfer does not constitute an investment for purposes of § 4944 and, therefore, the transfer does not constitute an investment jeopardizing the transferor foundation's exempt purposes and is not subject to tax under § 4944(a)(1), Therefore, the Transfer would not constitute a jeopardizing investment or subject M to tax under § 4944(a)(1).

Issues 16 and 17

Whether the Transfer would be a taxable expenditure within the meaning of § 4945(d) or would require the exercise of expenditure responsibility under § 4945(d)(4) or (h).

Whether the payment of the IRS fee for this private letter ruling would be treated as a taxable expenditure within the meaning of § 4945(d), or whether payment of reasonable legal fees to the attorneys for M and you to obtain this private letter ruling with respect to the Transfer would be treated a taxable expenditures within the meaning of § 4945(d)(5).

Section 4945 imposes a tax on any "taxable expenditure" made by a private foundation. Section 4945(d)(4) provides that the term "taxable expenditure" includes any amount paid or incurred as a grant to a private non-operating foundation unless the grantor foundation exercises expenditure responsibility with respect to such grant in accordance with § 4945(h).

Rev. Rul. 2002-28 holds that where, by reason of § 1.507-3(a)(9)(i), a transferee foundation is treated as though it were the transferor foundation for purposes of § 4945, the transferee foundation is not treated as the recipient of an expenditure responsibility grant, and no expenditure responsibility requirements must be exercise under § 4945(d)(4) or (h) with respect to the transfer to the transferee foundation.

As discussed under Issues 7, 8, and 9, above, by reason of § 1.507-3(a)(9)(i), you would be treated as if you were M for purposes of Chapter 42, including § 4945. Consequently, the Transfer would not be considered a taxable expenditure under § 4945, and there would be no expenditure responsibility requirements to be exercised under § 4945(d)(4) or (h) with respect to the Transfer.

Section 53.4945-6(b)(1)(v) provides that any payment which constitutes a qualifying distribution under § 4942(g) will not be treated as a taxable expenditure under § 4945(d)(5). Section 4942(g)(1)(A) and § 53.4942(a)-3(a)(2)(i) provide that a qualifying distribution under § 4942(g) includes reasonable and necessary administrative expenses paid to accomplish one or more purposes described in § 170(c)(1) or (2)(B). Administrative expenses incurred in obtaining a ruling from the Service or for legal fees relating to a foundation's exempt purposes are qualifying distributions. On the other hand, § 53.4945-6(b)(2) provides that expenditures for unreasonable administrative expenses, including consultant fees and other fees for services rendered, will ordinarily be taxable expenditures under § 4945(d)(5). The payment of legal fees to the attorneys for M or you and the payment of the IRS fee for this private letter ruling are administrative expenses necessary to the accomplishment of the Foundations' exempt purposes. So long as such payments are reasonable, the legal fees paid to the attorneys for M and you to obtain a private letter ruling with respect to the Transfer, and the IRS fee paid for this private letter ruling, would not be treated as taxable expenditures within the meaning of § 4945(d)(5).

Issues 18 and 19

Whether the operation by you of state licensed postsecondary career training programs for a fee would adversely affect your tax exempt status under § 501(c)(3) or your status as an operating foundation under § 4942(j)(3).

Whether the fees received by you from the operation of the state licensed postsecondary career training programs would be considered gross income derived from an unrelated trade or business for purposes of § 512(a)(1).

Your exempt purposes, as described in your Articles of Organization, include "the provision of educational, vocational, social, psychological, and financial assistance to homeless individuals and families." From your beginning, you have provided education and practical job-skills training to disadvantaged persons and those who have suffered displacement from economic upheavals so that they may be better equipped to obtain employment and to lead productive and satisfying lives. You now wish to provide training in software programs widely used by the business community to help

displaced persons whose existing skills do not correspond to the current needs of the marketplace.

Providing such training is educational within the meaning of § 1.501(c)(3)-1(d)(3)(a), and contributes importantly to the accomplishment of your exempt purposes of providing educational and vocational assistance to homeless and displaced persons. Thus, such activities amount to a trade or business that is substantially related to the accomplishment of your exempt purposes within the meaning of § 1.513-1(d)(2), and are, therefore, not unrelated trade or business within the meaning of § 513(a). Insofar as the term "functionally related business" under § 4942(j)(4)(A) includes a trade or business which is not an unrelated trade or business, as defined in § 513, the providing of such state-licensed postsecondary career training programs by you would constitute a "functionally related business," and deductible expenses related thereto in excess of the income from such business would constitute qualifying distributions made directly for the active conduct of activities constituting your exempt function for purposes of qualifying as a private operating foundation under § 4942(j)(3), as provided in § 53.4942(a)-2(d)(4) and § 53.4942(b)-1(b)(1). The operation of state licensed postsecondary career training programs for a fee will not adversely affect your status as an organization described in § 501(c)(3) or your status as a private operating foundation under § 4942(j)(3). Furthermore, since the income derived from such activities would constitute income from a related trade or business, such income would not constitute gross income derived from an unrelated trade or business for purposes of § 512(a)(1).

Issue 20

Whether, following the Transfer, if your qualifying distributions (within the meaning of § 4942(g)(1) or (2)) made directly for the active conduct of the activities constituting your exempt purpose or function were to exceed both your net investment income and your minimum investment return, you will continue to qualify as a private operating foundation within the meaning of § 4942(j)(3).

To qualify as a private operating foundation under § 4942(j)(3), an organization must meet the income test under § 4942(j)(3)(A) and any one of three alternative tests — the assets test under § 4942(j)(3)(B)(i), the endowment test under § 4942(j)(3)(B)(ii), or the support test under § 4942(j)(3)(B)(iii). The income test requires that the organization make qualifying distributions directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated equal to substantially all of the lesser of (i) its adjusted net income or (ii) its minimum investment return. The endowment test requires qualifying direct distributions of at least two-thirds of the foundation's minimum investment return.

You anticipate, and represent, that, notwithstanding an increase in your assets and income as a result of the Transfer, you will continue to make qualifying direct distributions in excess of both your minimum investment return and your adjusted net income. So long as your qualifying direct distributions continue to exceed both your net investment income and your minimum investment return, you would continue to qualify as a private operating foundation under § 4942(j)(3).

CONCLUSION

In light of the foregoing, we rule as follows:

1. The transfer of substantially all of M's net assets to you (the "Transfer") would not adversely affect the status of either M or you as organizations described in § 501(c)(3).

2. The Transfer would be a transfer described in § 507(b)(2).

3. The Transfer would not terminate M's private foundation status or cause M to incur any liability

for the § 507(c) termination tax.

4. Following the Transfer, M would be eligible to terminate its private foundation status by giving notice to the Service as provided in § 507(a)(1).

5. For purposes of calculating the termination tax under § 507(c), the date for determining the value of M's assets would be the date on which it gives the notice described in § 507(a)(1) ("Notice").

6. Provided that Notice is given at least one day after the Transfer, and at a time when M's net remaining assets are valued at Zero Dollars ($0.00), the amount of termination tax due under § 507(c)(2) upon termination of M's status as a private foundation would be Zero Dollars ($0.00).

7. For purposes of §§ 507 through 509, you would be treated as a newly created organization as a result of the Transfer, pursuant to § 507(b)(2).

8. You, as transferee of substantially all of M's net assets, would be treated as possessing those attributes and characteristics of M described in § 1.507-3(a)(2), (3), and (4).

9. Since M and you are both effectively controlled by the same persons within the meaning of §§ 1.482-1(a)(3) and 1.507-3(a)(9), for purposes of Chapter 42 (§ 4940 et seq.) and §§ 507 through 509, you, the transferee, would be treated as though you were M, the transferor.

10. The Transfer would not give rise to net investment income and would not be subject to tax under § 4940(a).

11. You, as transferee, may use any excess § 4940 tax paid by M, the transferor, to offset your § 4940 tax liability.

12. The Transfer would not constitute an act of self-dealing within the meaning of § 4941(d), and would not subject any disqualified person or foundation manager with respect to M or you to the tax imposed under § 4941(a).

13. The provision by a law firm of reasonable and necessary legal services with respect to the Transfer, and the payment of reasonable compensation for such services by M or you, would not constitute acts of self-dealing within the meaning of § 4941(d), notwithstanding the status of D, a disqualified person with respect to you, as a partner in that law firm.

14. The Transfer would not constitute a qualifying distribution by M under § 4942. You would assume M's undistributed income under § 4942 (if any) and be required to make qualifying distributions of such amount treated as distributed out of corpus by the end of your tax year after the tax year in which you receive the Transfer, but excess distributions by M (if any) will not carry over to you, but will lapse in the first year after the Transfer that you qualify as an operating foundation

15. The Transfer would not constitute an investment jeopardizing M's exempt purposes, and would not be subject to tax under § 4944(a)(1).

16. The Transfer would not be a taxable expenditure within the meaning of § 4945(d); consequently there would be no expenditure responsibility requirements to be exercised under § 4945(d)(4) or (h).

17. The payment of the IRS fee for this private letter ruling would not be treated as a taxable expenditure within the meaning of § 4945(d), and payments of reasonable legal fees to the attorneys for M and you to obtain this private letter ruling with respect to the Transfer would not be treated as

taxable expenditures within the meaning of § 4945(d) so long as such payments were reasonable.

18. The operation by you of state licensed postsecondary career training programs for a fee would not adversely affect your tax-exempt status under § 501(c)(3) or your status as an operating foundation under § 4942(j)(3).

19. The fees received by you from the operation of state licensed postsecondary career training programs would not be considered gross income derived from an unrelated trade or business for purposes of § 512(a)(1).

20. Following the Transfer, if your qualifying distributions (within the meaning of § 4942(g)(1) or (2)) made directly for the active conduct of the activities constituting your exempt purpose or function were to exceed both your net investment income and your minimum investment return, you would continue to qualify as a private operating foundation under § 4942(j)(3).

This ruling will be made available for public inspection under § 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. I.R.C. § 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Peter A. Holiat

Acting Manager,

Exempt Organizations

Technical Group 1

LTR: Scholarship Awards Won't Be Taxable Expenditures.

Citations: LTR 201321029

The IRS ruled that awards made through a private foundation’s employer-related scholarship

program will not constitute taxable expenditures and will be excludable from the gross income of the recipients if the funds are used for qualified tuition and related expenses.

Contact person – ID number: * * *

Contact telephone number: * * *

UIL: 4945.04-04

Release Date: 5/24/2013

Date: February 27, 2013

Employer Identification Number: * * *

LEGEND:

B = Name

C = Company

D = Location

E = Location

F = Location

p = grade level

v = Number

w = Number range

x = Number

$y = Dollar amount

Dear * * *:

You asked for advance approval of your employer-related scholarship grant procedures under Internal Revenue Code section 4945(g). This approval is required because you are a private foundation that is exempt from federal income tax. You requested approval of your scholarship program to fund the education of certain qualifying students.

OUR DETERMINATION

We approved your procedures for awarding employer-related scholarships. Based on the information you submitted, and assuming you will conduct your program as proposed, we determined that your procedures for awarding employer-related scholarships meet the requirements of Code section 4945(g)(1). As a result, expenditures you make under these procedures won’t be taxable.

Also, awards made under these procedures are scholarship or fellowship grants and are not taxable to the recipients if they use them for qualified tuition and related expenses (subject to the limitations provided in Code section 117(b)).

DESCRIPTION OF YOUR REQUEST

Your letter indicates you will operate an employer-related scholarship program called B. The purpose of B is to provide scholarships for post-secondary education of undergraduate studies to students who are interested in obtaining an education focused on health and wellness related fields. Approximately v children will be eligible to apply and roughly w actual applications are to be received. You will award x non-renewable scholarships annually for $y each to children of C employees and their subsidiaries. Scholarships will be offered for full-time study at an accredited college or vocational institution of the student's choice.

You will advertise your program by posting application information on your intranet and make annual announcements via company newsletters, e-mail, postings in employee cafeterias or on other bulletin boards to inform employees of the program and timing for the annual application process.

To be eligible, applicants must be graduating high school students or existing college students with a minimum GPA of 3.0 on a 4.0 scale, aged 25 and under and a dependent child of eligible full time employees with one year of employment who intends to attend a qualified post-secondary school. Students outside the United States must be in their final year of upper or higher secondary school or be current technical or university level students.

You define dependent children as biological, step, or legally adopted children living in the employee's household or primarily supported by the employee. Children of a) employees at or above a vice president or p level and above of C or subsidiaries, b) Directors of C, or c) Trustees of your foundation are not eligible to apply.

Interested students must complete the application in English, Spanish or French and mail it along with a copy of current and complete transcripts of grades and any other required documents to the qualified independent third party hired to manage your program. Online transcripts must display the student's name, school name, grade and credit hours earned for each course, and term in which each course was taken. Applicants will receive acknowledgement of receipt of their application. If an acknowledgement is not received within four weeks, applicants may contact the independent third party to verify that the application has been received.

Non-U.S. applicants currently or previously enrolled in an institute of higher education (university) must include their academic record (transcripts of grades) for all higher education course work completed and secondary school credential/diploma/certificate. Current secondary school students and students who have completed less than one year of higher education (university) must include their academic record (transcript of grades) for all secondary education course work completed during the past three years, and results of college entrance academic examinations.

All applicants are responsible for gathering and submitting all necessary information. Applications will be evaluated on the information supplied; therefore, answer all questions as completely as possible. Incomplete applications will not be evaluated. All information received will be considered confidential and is reviewed only by the independent third party management service hired.

Scholarship recipients are selected on the following basis: academic performance, demonstrated leadership and participation in school and community activities, work experience, a statement of career and educational goals and objectives, unusual school and community activities, work experience, unusual personal and family circumstances that have affected school or work achievements, and the applicant appraisal found on page two of the application. Academic evaluation of global applicants will include review of the grade/mark average based on the grading system used in the applicant's country and a review of the results of academic examinations.

Financial need is not considered. However, because sources of funding for higher education vary across the globe, you request applicants from countries outside the United States submit school cost and government subsidy information.

Provided there are qualified applicants, recipients will be selected in proportion to the number of employees in three primary C regions — D, E, and F. The goal is to grant at least one award per region.

The selection committee will be chosen from a qualified independent third party. No relatives of the independent selection committee, or children of C employees that are at a senior level position (Vice President, or equivalent, or above) are eligible to participate in the program. No children of C's board members or your foundation's trustees or disqualified persons will be eligible to participate. In no instance does any officer or employee of C or your foundation play a part in the selection. All applicants agree to accept the selection decisions as final. Applicants will be notified of selection decisions. Not all applicants to the program will be selected as recipients.

The independent third party will process scholarship payments on your behalf. Checks will be mailed to each recipient's home address and will be made payable to the student's school. The award checks will be issued in U.S. currency. If requested, award payments for recipients outside the United States and Canada may be made via wire transfer.

Recipients will have no obligation to you. They are, however, required to notify the independent third party of any changes in address, school enrollment, or other relevant information and to send complete official transcripts when requested. You reserve the right to review the conditions and procedures of this scholarship program and to make a change at any time including termination of the program.

You will (1) arrange to receive and review grantee reports annually and upon completion of the purpose for which the grant was awarded, (2) investigate diversion of funds from their intended purposes, and (3) take all reasonable and appropriate steps to recover the diverted funds, ensure other grant funds held by a grantee are used for their intended purposes, and withhold further payments to grantees until you obtain grantees' assurances that future diversions will not occur and that grantees will take extraordinary precautions to prevent future diversion from occurring.

You will maintain all records relating to individual grants including information obtained to evaluate grantees, identify a grantee as a disqualified person, establish the amount and purpose of each grant, and establish that you undertook the supervision and investigation of grants described above.

BASIS FOR OUR DETERMINATION

The law imposes certain excise taxes on the taxable expenditures of private foundations (Code section 4945). A taxable expenditure is any amount a private foundation pays as a grant to an individual for travel, study, or other similar purposes. However, a grant that meets all of the following requirements of Code section 4945(g) is not a taxable expenditure.

The foundation awards the grant on an objective and nondiscriminatory basis.

The IRS approves in advance the procedure for awarding the grant.

The grant is a scholarship or fellowship subject to Code section 117(a).

The grant is to be used for study at an educational organization described in Code section 170(b)(1)(A)(ii).

Revenue Procedure 76-47, 1976-2 C.B. 670, provides guidelines to determine whether grants a private foundation makes under an employer-related program to employees or children of employees are scholarship or fellowship grants subject to the provisions of Code section 117(a). If the program satisfies the seven conditions in sections 4.01 through 4.07 of Revenue Procedure 76-47 and meets the applicable percentage tests described in section 4.08 of Revenue Procedure 76-47, we will assume the grants are subject to the provisions of Code section 117(a).

You represented that your grant program will meet the requirements of either the 25 percent or 10 percent percentage test in Revenue Procedure 76-47. These tests require that:

The number of grants awarded to employees' children in any year won't exceed 25 percent of the number of employees' children who were eligible for grants, were applicants for grants, and were considered by the selection committee for grants, or

The number of grants awarded to employees' children in any year won't exceed 10 percent of the number of employees' children who were eligible for grants (whether or not they submitted an application), or

The number of grants awarded to employees in any year won't exceed 10 percent of the number of employees who were eligible for grants, were applicants for grants, and were considered by the selection committee for grants.

You further represented that you will include only children who meet the eligibility standards described in Revenue Procedure 85-51, 1985-2 C.B. 717, when applying the 10 percent test applicable to employees' children.

In determining how many employee children are eligible for a scholarship under the 10 percent test, a private foundation may include only those children who submit a written statement or who meet the foundation's eligibility requirements. They must also satisfy certain enrollment conditions.

You represented that your procedures for awarding grants under this program will meet the requirements of Revenue Procedure 76-47. In particular:

An independent selection committee whose members are separate from you, your creator, and the employer will select individual grant recipients.

You will not use grants to recruit employees nor will you end a grant if the employee leaves the employer.

You will not limit the recipient to a course of study that would particularly benefit you or the employer.

OTHER CONDITIONS THAT APPLY TO THIS DETERMINATION

This determination only covers the grant program described above. This approval will apply to succeeding grant programs only if their standards and procedures don't differ significantly from those described in your original request.

This determination is in effect as long as your procedures comply with sections 4.01 through 4.07 of Revenue Procedure 76-47 and with either of the percentage tests of section 4.08. If you establish another program covering the same individuals, that program must also meet the percentage test.

This determination applies only to you. It may not be cited as a precedent.

You cannot rely on the conclusions in this letter if the facts you provided have changed substantially. You must report any significant changes to your program to the Cincinnati Office of Exempt Organizations at::

Internal Revenue Service

Exempt Organizations Determinations

P.O. Box 2508

Cincinnati, OH 45201

You cannot award grants to your creators, officers, directors, trustees, foundation managers, or members of selection committees or their relatives.

All funds distributed to individuals must be made on a charitable basis and further the purposes of your organization. You cannot award grants for a purpose that is inconsistent with Code section 170(c)(2)(B).

You should keep adequate records and case histories so that you can substantiate your grant distributions with the IRS if necessary.

Please keep a copy of this letter in your records.

If you have questions, please contact the person listed at the top of this letter.

Sincerely,

Holly O. Paz

Director, Exempt Organizations

Rulings and Agreements

LTR: IRS Rules on Transfer of Assets Between Foundations.

Citations: LTR 201321024

The IRS ruled that the transfer of assets from one private foundation to another will not affect either foundation’s tax-exempt status, will not give rise to termination taxes or net investment income taxes, will not be an act of self-dealing, and will not constitute a jeopardizing investment.

Contact Person: * * *

Identification Number: * * *

Telephone Number: * * *

Uniform Issues List Numbers: 501.03-00, 507.00-00, 507.05-00,

507.06-00, 507.09-00, 512.00-00, 4940.00-00, 4941.04-00, 4942.03-05,

4942.05-00, 4944.00-00, 4945.04-00

Release Date: 5/24/2013

Date: February 27, 2013

Employer Identification Number: * * *

LEGEND:

B = * * *

C = * * *

D = * * *

P = * * *

Dear * * *:

This responds to your letter dated May 31, 2012, in which you requested rulings on the application of Parts I and II of Subchapter F of Chapter 1, I.R.C. §§ 501-509, and Subchapter A of Chapter 42, Subtitle D, §§ 4940-4948, to the transaction described below.

FACTS

You are a trust organized exclusively for charitable purposes, and you have been recognized exempt from federal income taxation as an organization described in § 501(c)(3). You are classified as a private non-operating foundation within the meaning of § 509(a). You were created by, and originally funded with a contribution from, B. B and her husband, C, (jointly, the "Founders"), are your sole trustees. You stipulate that B is a substantial contributor to you within the meaning of § 507(d)(2)(A), that C is a substantial contributor to you within the meaning of § 507(d)(2)(B)(iii), that B and C are your foundation managers within the meaning of § 4946(b), and, consequently, that B and C are disqualified persons with respect to you within the meaning of § 4946(a)(1)(A) and (B).

P is organized as a not-for-profit corporation under state law. P has been recognized exempt from federal income taxation as an organization described in § 501(c)(3), and is classified as a private operating foundation described in § 4942(j)(3). You and P do not share the same tax year. The officers and directors of P are B, C, and D. D is an unrelated person who has provided legal services to you, B, C, and P. You stipulate that B is a substantial contributor to P within the meaning of § 507(d)(2)(A), that C is a substantial contributor to P within the meaning of § 507(d)(2)(B)(iii), that B, C, and D are foundation managers of P within the meaning of § 4946(b), that B and C are disqualified persons with respect to P within the meaning of § 4946(a)(1)(A) and (B), and that D is a disqualified person with respect to P within the meaning of § 4946(a)(1)(B).

You represent that the Founders, as your sole Trustees and as two of the three directors of P, effectively control both you and P (collectively, "the Foundations") within the meaning of §§ 1.482-1(a)(3) and 1.507-3(a)(9)(i).

You represent that both of the Foundations have made timely tax filings on their respective Returns of Organizations Exempt from Income Tax, Forms 990-PF, for all applicable years, and that both have complied with all applicable state filing obligations throughout their respective terms of existence.

Neither of the Foundations has undertaken any activities that would be inconsistent with tax-exempt status as a § 501(c)(3) organization, nor made any changes to their respective governing documents since the filing of their Applications for Tax-Exempt Status, Form 1023. There have been no willful repeated acts (or failures to act), nor any willful and flagrant act (or failure to act), within the meaning of § 507(a)(2)(A), with respect to either of the Foundations that would give rise to liability for tax under Chapter 42 of the Code, and neither Foundation has received a notification from the Secretary of the Treasury described in § 507(a)(2)(B). Neither Foundation has previously terminated its status as a private foundation. You have made qualifying distributions in sufficient amount to avoid imposition of excise tax under § 4942. P has made qualifying distributions in connection with the conduct of its exempt mission to qualify as a private operating foundation under § 4942(j)(3).

You represent that all grants made, or to be made, by you prior to the transfer of your remaining assets to P, as described below, have been grants to public charities. P has not made grants to other organizations. Neither Foundation has incurred any "taxable expenditure" within the meaning of § 4945(d), and neither Foundation has previously made any grant or other disposition of funds that would require the exercise of expenditure responsibility within the meaning of § 4945(d)(4)(B).

Under the Declaration of Trust that serves as your governing instrument, your trustees are empowered to make distributions in their discretion from Trust income and principal to "Qualified Charitable Recipients" ("QCRs"). QCRs are defined as organizations described in § 170(c)(1) or (2) which are exempt from tax under § 501(c)(3). The Trust instrument makes reference to suggested types of QCR donees, but the Trustees are empowered to make distributions to any charitable organization qualifying as a QCR, without regard to its mission or purposes. P, as an organization described in §§ 170(c)(2) and 501(c)(3), is a QCR within the meaning of the Trust instrument, and, as such, is eligible under the Trust instrument to receive grants from you. Prior to, and except for, the transfer of its remaining assets to P as described below, all of your grants have been made or will have been made to unrelated grantees that are treated as public charities under the Code.

The corporate purposes of P are described in its Articles of Organization as including "the provision of educational, vocational, social, psychological, and financial assistance to homeless individuals and families," as well as making distributions to other § 501(c)(3) organizations. Since P was first organized, it has provided education and practical job-skills training to disadvantaged persons and those who have suffered displacement from recent economic upheavals with the objective of equipping them to survive in the current economy, to enter or re-enter the work-force, and to lead productive and satisfying lives. P has provided free career development services to unemployed and underemployed individuals, and has offered such individuals skill assessment, career planning, computer training, interview and resume help, financial planning, job search planning, and other assistance.

Over the past several years, the Founders have concluded that the services provided by P have been increasingly needed, in part because of the large number of people displaced by recent economic upheaval and recession. The population in need of such services has been underserved by other organizations and the need and demand for the services provided by P have increased. At the same time, economic circumstances have made fundraising from third parties more difficult. The Founders have determined that the exempt purposes of both Foundations will be best served by concentrating their efforts and charitable resources on the work and mission of P, and by eliminating the duplication and administrative burden of operating two separate private foundations.

Your only activities have consisted of grants made to unrelated QCRs, the missions of most of which are unrelated to P's mission. The Trustees have determined that the best use of your remaining charitable funds, in furtherance of your exempt purpose, would be to provide assistance to P in carrying out the activities which form the basis of P's exempt purposes. Therefore, the Founders, as

your Trustees and as Directors of P, with the concurrence of P's third director, have determined that it is in the best interests of both Foundations to contribute all of your remaining net funds to P, to discontinue any of your further activities or grants, and to continue to operate P in furtherance of its exempt purposes.

After making some final grants to unrelated public charities you will transfer all of your remaining assets to P. Your Trustees will reserve a final amount for estimated debts and expenses, including taxes due, if any, under § 4940, and, thereafter, transfer the balance of your remaining net assets to P (the "Transfer"). The Transfer will involve substantially all of your net assets, including all accumulated income and undistributed trust principal. Any amounts remaining after the final payment of taxes, expenses, and fees, will also be transferred to P. Following these transfers, you will retain no assets and will cease to operate.

You will file a Form 990-PF for the year of the disposition of your assets. No sooner than at least one day after the Transfer, your Trustees will provide notice pursuant to § 507(a)(1) to the Manager, Exempt Organizations Determinations, TE/GE, of your intent to terminate your private foundation status, in the form and manner prescribed by § 1.507-1(b) and other applicable regulations.

Following the Transfer, P will continue to operate as a private operating foundation engaged in the active conduct of activities in furtherance of its exempt purposes. It expects to use the transferred funds as well as its other assets exclusively in furtherance of its exempt purposes. The Founders expect that P's qualifying distributions, substantially all in the form of expenditures incurred in carrying out its exempt activities, will continue to exceed its net income and minimum investment returns. P will also take responsibility for all liabilities, if any, under Chapter 42 that may be imposed or in effect with respect to either you or P after the Transfer date.

While P will continue to provide services free of charge, its management has determined that P's exempt purposes can be further served by expanding its services to include fee-based training and certification programs in widely-used computer programs. These services have been identified as particularly valuable to the core mission of P, which is helping displaced and disadvantaged persons acquire the skills needed to obtain meaningful and lasting employment. The fees paid for such services will help P recover the costs of those programs as well as provide a source of revenue to support P's ongoing operations and pro bono services.

The legal services with respect to the Transfer will be provided by a law firm in which D is a partner with a profits interest of less than 35%. D, as a director of P, is a disqualified person with respect to P. You represent that the law firm will charge reasonable fees for the legal services provided in connection with the Transfer, the termination of you and your status as a private foundation, and the application for a private letter ruling. The services provided by the law firm will be limited solely to such services as are reasonably necessary to carrying out the exempt purposes of the Foundations, and shall not be excessive.

RULINGS REQUESTED

You have requested the following rulings:

1. The transfer of substantially all of your net assets to P (the "Transfer") will not adversely affect the status of you or P as tax-exempt organizations described in § 501(c)(3).

2. The Transfer will be a transfer described in § 507(b)(2).

3. The Transfer will not terminate your private foundation status and will not cause you to incur any

liability for the § 507(c) termination tax.

4. Following the Transfer, you will be eligible to terminate your private foundation status through the "voluntary termination" procedures of § 507(a)(1).

5. Pursuant to § 1.507-7(b)(1), the date for determining the value of your assets, for purposes of calculating the termination tax under § 507(c), shall be the date proper notification is given, in the manner prescribed in the regulations, of your intention voluntarily to terminate your private foundations status (hereinafter, "Notice").

6. Provided that such Notice is given at least one day after the Transfer, and at a time when your net remaining assets are valued at zero dollars ($0.00), then the amount of termination tax due under § 507(c)(2) upon the termination of your status as a private foundation shall be zero dollars ($0.00).

7. Pursuant to § 507(b)(2), P will not be treated as a newly created organization as a result of the Transfer.

8. P, as transferee of substantially all of your net assets, shall be treated as possessing those attributes and characteristics of yours described in subparagraphs (2), (3), and (4) of § 1.507-3(a).

9. The Founders, as the only Trustees of you, and as two of the three Directors of P, and as foundation managers and substantial contributors of both Foundations, effectively control both Foundations within the meaning of §§ 1.482-1(a)(3) and 1.507-3(a)(9), Accordingly, for purposes of Chapter 42, the transferee Foundation, P, will be treated as though it were you, the transferor Foundation.

10. The Transfer will not be a realization event for you, and will not give rise to any gross investment income or capital gain net income, within the meaning of § 4940, with respect to either you or P.

11. P, as transferee, may use any excess § 4940 tax paid by you, the transferor, to offset P's § 4940 tax liability.

12. The Transfer will not constitute self-dealing and will not subject either of the Foundations, or any of their respective officers, directors, or Trustees, as the case may be, to tax under § 4941.

13. The providing of reasonable and necessary legal services with respect to the Transfer by a law firm in which D is a partner, and the payment of reasonable compensation for such services by the Foundations, will not be an act of self-dealing within the meaning of § 4941(d), notwithstanding the status of D as a disqualified person with respect to P.

14. You will not be required to meet the qualifying distribution requirements of § 4942 for the taxable year of the Transfer provided that P's distributable amount for the year of the Transfer is increased by your distributable amount for the year of the Transfer, and your qualifying distributions made during the taxable year of the Transfer, if any, will be carried over to P, and may be used by P to meet its minimum distribution requirements under § 4942 for the year.

15. The Transfer will not constitute a jeopardizing investment within the meaning of § 4944.

16. The Transfer will not be a taxable expenditure within the meaning of § 4945(d), and there will be no expenditure responsibility requirements that must be exercised under § 4945(d)(4) or (h) with respect to the Transfer.

17. The payment of reasonable legal fees to the attorneys for you and P for services with respect to

the Transfer, and the IRS fee for this Private Letter Ruling will not be treated as taxable expenditures within the meaning of § 4945(d)(5).

18. The operation by P of state licensed postsecondary career training programs for a fee will not adversely affect P's tax-exempt status under § 501(c)(3) or its status as a private operating foundation under § 4942(j)(3).

19. The fees received by P from payments by users for its certification classes will not be considered gross income derived from an unrelated trade or business for purposes of § 512(a)(1).

20. From and after the effective date of the Transfer, P will continue to exist as an organization that is exempt from taxation under § 501(c)(3) and which will qualify as a private operating foundation under § 4942(j)(3).

LAW

I.R.C. § 501(a) exempts from federal income taxation organizations described in § 501(c).

I.R.C. § 501(c)(3) describes organizations organized and operated exclusively for charitable, educational, and other designated exempt purposes.

Treas. Reg. § 1.501(c)(3)-1(d)(3)(i) provides that the term "educational," as used in § 501(c)(3), includes the instruction and training of the individual for the purpose of improving or developing his capabilities.

I.R.C. § 509(a) provides that an organization described in § 501(c)(3) is a private foundation unless it is described in § 509(a)(1), (2), (3), or (4).

I.R.C. § 507(a) provides that, except as provided in subsection (b), the status of any organization as a private foundation shall be terminated only if (1) it notifies the Secretary of its intent to accomplish such termination, or (2) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under Chapter 42, and the Secretary notifies such organization that it is liable for the tax imposed by subsection (c), and either such organization pays the tax (or any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

Treas. Reg. § 1.507-1(b)(1) provides that in order for a private foundation to terminate its private foundation status under § 507(a)(1), an organization must submit a statement to the Internal Revenue Service ("Service") of its intent to terminate its private foundation status under § 507(a)(1). Such statement must set forth in detail the computation and amount of tax imposed under § 507(c). Unless the organization requests abatement of such tax pursuant to § 507(g), full payment of such tax must be made at the time the statement is filed under § 507(a)(1).

I.R.C. § 507(c) imposes an excise tax on each terminating private foundation equal to the lower of the aggregate tax benefit resulting from the § 501(c)(3) status of such foundation, or the value of the net assets of such foundation.

I.R.C. § 507(e) and Treas. Reg. § 1.507-7(a) provide that, for purposes of § 507(c), the value of the net assets shall be determined at whichever time such value is higher: (1) the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation, or (2) the date on which it ceases to be a private foundation.

Treas. Reg. § 1.507-7(b)(1) provides that, in the case of a termination under § 507(a)(1), the date for

determining the value of the foundation's assets for purposes of calculating the termination tax under § 507(c) shall be the date on which the foundation gives the notification described in § 507(a)(1).

I.R.C. § 507(b)(2) provides that, in the case of a transfer of assets of a private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, the transferee foundation shall not be treated as a newly created organization.

Treas. Reg. § 1.507-3(c)(1) provides that, for purposes of § 507(b)(2), the terms "other adjustment, organization, or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

Treas. Reg. § 1.507-3(c)(2) provides that the term "significant disposition of assets to one or more private foundations" includes any disposition (or series of related dispositions) by a private foundation to one or more private foundations of 25 percent or more of the fair market value of the net assets of the transferor foundation at the beginning of the taxable year in which the transfers occur.

Treas. Reg. § 1.507-1(b)(6) provides that when a foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in § 507(b)(2) and § 1.507-3(c), such transferor foundation will not have terminated its private foundation status under § 507(a)(1).

Treas. Reg. § 1.507-1(b)(7) provides that neither a transfer of all the assets of a private foundation nor a significant disposition of assets by a private foundation shall be deemed to result in a termination of the transferor private foundation under § 507(a) unless the transferor private foundation elects to terminate pursuant to § 507(a)(1) or § 507(a)(2) is applicable.

Treas. Reg. § 1.507-3(d) provides that unless a private foundation voluntarily gives notice pursuant to § 507(a)(1), a transfer of assets described in § 507(b)(2) will not constitute a termination of the transferor's private foundation status under § 507(a)(1).

Treas. Reg. § 1.507-4(b) provides that private foundations which make transfers described in § 507(b)(2) are not subject to the tax imposed under § 507(c) with respect to such transfers unless the provisions of § 507(a) become applicable.

Treas. Reg. § 1.507-3(a)(1) provides that, in the case of a transfer of assets of a private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization, including a significant disposition of assets to one or more private foundations within the meaning of § 1.507-3(c), the transferee organization shall not be treated as a newly created organization. Rather, the transferee organization shall be treated as possessing those attributes and characteristics of the transferor organization which are described in subparagraphs (2), (3), and (4) of this paragraph.

Treas. Reg. § 1.507-3(a)(2)(i) provides that a transferee organization to which this § 1.507-3(a) applies shall succeed to the aggregate tax benefit of the transferor organization in an amount equal to the amount of such aggregate tax benefit multiplied by a fraction the numerator of which is the fair market vale of the assets (less encumbrances) transferred to such transferee and the denominator of which is the fair market value of the assets of the transferor (less encumbrances) immediately before the transfer. Fair market value shall be determined at the time of the transfer.

Treas. Reg. § 1.507-3(a)(3) provides that, for purposes of § 507(d)(2), in the event of a transfer of assets described in § 507(b)(2), any person who is a "substantial contributor" (within the meaning of § 507(d)(2)) with respect to the transferor foundation shall be treated as a "substantial contributor" with respect to the transferee foundation, regardless of whether such person meets the $5,000-two percent test with respect to the transferee organization at any time.

Treas. Reg. § 1.507-3(a)(4) provides that if a private foundation incurs liability for one or more of the taxes imposed under Chapter 42 (or any penalty resulting therefrom) prior to, or as a result of, making a transfer of assets described in § 507(b)(2) to one or more private foundations, in any case where transferee liability applies each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the transferor foundation does not satisfy such liability.

Treas. Reg. § 1.507-3(a)(5) provides that, except as provided in subparagraph (9) of this paragraph, a private foundation is required to meet the distribution requirements of § 4942 for any taxable year in which it makes a § 507(b)(2) transfer of all or part of its net assets to another private foundation. Such transfer shall itself be counted toward satisfaction of such requirements to the extent the amount transferred meets the requirements of § 4942(g). However, where the transferor has disposed of all of its assets, the recordkeeping requirements of § 4942(g)(3)(B) shall not apply during any period it which it has no assets. Such requirements are applicable for any taxable year other than a taxable year during which the transferor has no assets.

Treas. Reg. § 1.507-3(a)(9)(i) provides that if a private foundation transfers all of its net assets to one or more private foundations which are effectively controlled (within the meaning of § 1.482-1A(a)(3)), directly or indirectly, by the same person or persons who effectively control the transferor private foundation, for purposes of Chapter 42 (§ 4940 et seq.) and part II of Subchapter F of Chapter 1 of the Code (§§ 507 through 509), such a transferee private foundation shall be treated as if it were the transferor.

I.R.C. § 511(a)(1) imposes a tax for each taxable year on the unrelated business taxable income (as defined in § 512) of organizations described in § 501(c).

I.R.C. § 512(a)(1) provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in § 513) regularly carried on by it less certain deductions and subject to certain modifications.

I.R.C. § 513(a) provides that the term "unrelated trade or business" means, in the case of an organization subject to the tax imposed by § 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or functions constituting the basis for its exemption under § 501.

Treas. Reg. § 1.513-1(d)(2) provides that a trade or business is "related" to exempt purposes, in the relevant sense only where the conduct of the business activities bears a causal relationship to the achievement of exempt purposes (other than through the production of income); and the trade or business is "substantially related," for purposes of § 513, only if the causal relationship is a substantial one. Thus, for the conduct of a trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and

circumstances involved.

I.R.C. § 4940(a) imposes on each private foundation which is exempt from taxation under § 501(a) for the taxable year a tax equal to 2 percent of the net investment income of such foundation for the taxable year.

Rev. Rul. 2002-28, 2002-1 C.B. 941, holds that when a private foundation transfers all of its assets to one or more private foundations in a transfer described in § 507(b)(2) the transfers do not give rise to net investment income and are not subject to tax under § 4940(a). The transferee foundations may use their proportionate share of any excess § 4940 tax paid by the transferor to offset their own § 4940 tax liability.

I.R.C. § 4941(a)(1) imposes a tax on each act of self-dealing between a disqualified person and a private foundation.

I.R.C. § 4946(a)(1) provides that the term "disqualified person," with respect to a private foundation, includes a person who is —

(A) a substantial contributor to the foundation,

(B) a foundation manager (within the meaning of subsection (b)(1)),

(C) an owner of more than 20 percent of —

(i) the total combined voting power of a corporation,

(ii) the profits interest of a partnership, or

(iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation,

(D) a member of the family of any individual described in subparagraph (A), (B), or (C),

(E) a corporation of which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the combined voting power,

(F) a partnership in which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the profits interest, and

(G) a trust or estate in which persons described in subparagraph (A), (B), (C), or (D) hold more than 35 percent of the beneficial interest.

Treas. Reg. § 53.4946-1(a)(8) provides that, for purposes of § 4941, the term "disqualified person" shall not include any organization described in § 501(c)(3) other than an organization described in § 509(a)(4).

Treas. Reg. § 53.4941(d)-1(b)(4) provides that a transaction between a private foundation and an organization which is not controlled by the foundation (within the meaning of subparagraph (5) of this paragraph) and which is not described in § 4946(a)(1)(E), (F), or (G) because persons described in § 4946(a)(1)(A), (B), (C), or (D) own no more than 35 percent of the total combined voting power or profits or beneficial interest of such organization, shall not be treated as an indirect act of self-dealing between the foundation and such disqualified person solely because of the ownership interest of such persons in such organization.

I.R.C. § 4941(d)(1)(E) provides that the term "self-dealing" includes any direct or indirect payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person.

I.R.C. § 4941(d)(2)(E) and Treas. Reg. § 53.4941(d)-3(c)(1) provide that the payment of compensation (and the payment or reimbursement of expenses) by a private foundation to a disqualified person for personal services which are reasonable and necessary to carrying out the exempt purpose of the private foundation shall not be an act of self-dealing if the compensation (or payment or reimbursement) is not excessive.

Treas. Reg. § 53.4941(d)-3(c)(2) provides examples illustrating the provisions of § 4941(d)(2)(E). In Example (1), M, a partnership, is a firm of 10 lawyers engaged in the practice of law. A and B, partners in M, serve as trustees to private foundation W and, therefore, are disqualified persons. In addition, A and B own more than 35 percent of the profits interest in M, thereby making M a disqualified person. M performs various legal services for W from time to time as such services are requested. It is concluded that the payment of compensation by W to M shall not constitute an act of self-dealing if the services performed are reasonable and necessary for the carrying out of W's exempt purposes and the amount paid by W for such services is not excessive.

I.R.C. § 4942(a) imposes a tax on the undistributed income of a private foundation (other than an operating foundation under § 4942(j)(3)) for any taxable year which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year.

I.R.C. § 4942(c) defines "undistributed income" for any taxable year as the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made out of such distributable amount for such taxable year.

I.R.C. § 4942(d) defines "distributable amount" as the amount equal to the sum of the minimum investment return, plus certain other amounts, reduced by the sum of the taxes imposed on such private foundation for the taxable year under subtitle A and § 4940.

I.R.C. § 4942(g)(1)(A) provides that the term "qualifying distribution" means any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in § 170(c)(2)(B), other than a contribution to (i) an organization controlled directly or indirectly by the foundation or by one or more disqualified persons with respect to the foundation, except as provided in paragraph (3), or (ii) a private foundation which is not an operating foundation under § 4942(j)(3), except as provided in paragraph (3).

I.R.C. § 4942(g)(3) provides that the term "qualifying distribution" includes a contribution to a § 501(c)(3) organization described in paragraph (1)(A)(i) or (ii) if —

(A) not later than the close of the first taxable year after its taxable year in which such contribution is received, such organization makes a distribution equal to the amount of such contribution and such distribution is a qualifying distribution (within the meaning of paragraph (1) or (2), without regard to this paragraph) which is treated under subsection (h) as a distribution out of corpus (or would be so treated if such § 501(c)(3) organization were a private foundation which is not an operating foundation), and

(B) the private foundation making the contribution obtains adequate records or other sufficient evidence from such organization showing that the qualifying distribution described in subparagraph (A) has been made by such organization.

I.R.C. § 4942(i) and Treas. Reg. § 53.4942(a)-3(e) provide for a carry-over of the amount by which qualifying distributions during the five preceding taxable years (other than amounts required to be distributed out of corpus under § 4942(g)(3)) have exceeded the distributable amounts for such years.

I.R.C. § 4942(j)(3) provides that, for purposes of § 4942, the term "operating foundation" means any organization —

A. which makes qualifying distributions (within the meaning of paragraph (1) and (2) of subsection (g)) directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated equal to substantially all of the lesser of —

i. its adjusted net income (as defined in subsection (f), or

ii. its minimum investment return; (the "income test") and

B.

i. substantially more than half of the assets of which are devoted directly to such activities or to functionally related businesses (as defined in paragraph (4)), or to both, or are stock of a corporation which is controlled by the foundation and substantially all of the assets of which are so devoted (the "assets test"),

ii. which normally makes qualifying distributions (within the meaning of paragraph (1) or (2) of subdivision (g)) directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated in an amount not less than two-thirds of its minimum investment return (as defined in subsection (e)) (the "endowment test"), or

iii. substantially all of the support (other than gross investment income as defined in § 509(e)) of which is normally received from the general public and from 5 or more exempt organizations which are not described in § 4946(a)(1)(H) with respect to each other or the recipient foundation, not more than 25 percent of the support (other than gross investment income) of which is normally received from any one such exempt organization and not more than half of the support of which is normally received from gross investment income (the "support test").

Notwithstanding the provisions of subparagraph (A), if the qualifying distributions (within the meaning of paragraph (1) or (2) of subsection (g)) of an organization for the taxable year exceed the minimum investment return for the taxable year, clause (ii) of subparagraph (A) shall not apply unless substantially all of such qualifying distributions are made directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated.

Treas. Reg. § 53.4942(b)-1(b)(1) provides, generally, that qualifying distributions are not made by a foundation "directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose" unless such qualifying distributions are used by the foundation itself, rather than by or through one or more grantee organizations which receive such qualifying distributions directly or indirectly from such foundation. However, administrative expenses (such as staff salaries and traveling expenses) and other operating costs necessary to conduct the foundation's exempt activities (regardless of whether they are "directly for the active conduct" of such activities) shall be treated as qualifying distributions expended directly for the active conduct of such exempt activities if such expenses and costs are reasonable in amount. Conversely, administrative expenses and operating costs which are not attributable to exempt activities, such as expenses in connection with the production of investment income, are not treated as qualifying

distributions. Expenses attributable to both exempt and nonexempt activities shall be allocated to each such activity on a reasonable and consistently applied basis.

Treas. Reg. § 53.4942(a)-2(d)(4)(i) provides, in part, that where the deductions with respect to property used for a charitable, educational, or other similar exempt purpose exceed the income derived from such property, such excess shall not be allowed as a deduction, but may be treated as a qualifying distribution.

I.R.C. § 4942(j)(4)(A) provides that the term "functionally related business" includes a trade or business which is not an unrelated trade or business (as defined in § 513).

Rev. Rul. 2002-28, 2002-1 C.B. 941, provides that, when a private foundation transfers all of its assets to one or more private foundations in a transfer described in § 507(b)(2), the transfers do not constitute qualifying distributions for the transferor foundation under § 4942. The transferee foundations assume their proportionate share of the transferor foundation's undistributed income under § 4942 and reduce their own distributable amount for purposes of § 4942 by their proportion share of the transferor's excess qualifying distributions under § 4942(i).

I.R.C. § 4944(a)(1) imposes a tax on any amount invested by a private foundation in a manner that jeopardizes the carrying out of any of the foundation's exempt purposes.

Rev. Rul. 2002-28, 2002-1 C.B. 941, holds that, when a private foundation transfers all of its assets to one or more private foundations in a transfer described in § 507(b)(2), the transfers do not constitute investments jeopardizing the transferor foundation's exempt purposes and are not subject to tax under § 4944(a)(1).

I.R.C. § 4945(a)(1) imposes a tax on any "taxable expenditure" made by a private foundation.

I.R.C. § 4945(d)(4) provides that the term "taxable expenditure" includes any amount paid or incurred as a grant to a private non-operating foundation unless the grantor foundation exercises expenditure responsibility with respect to such grant in accordance with § 4945(h).

I.R.C. § 4945(d)(5) provides that the term "taxable expenditure" includes any amount paid or incurred by a private foundation for any purpose other than one specified in § 170(c)(2)(B).

I.R.C. § 4945(h) provides that the expenditure responsibility referred to in § 4945(d)(4) means that a private foundation is responsible to exert all reasonable efforts and to establish adequate procedures: (1) to see that the grant is spent solely for the purpose for which it was made; (2) to obtain full and complete reports from the grantee on how the funds are spent; and (3) to make full and detailed reports with respect to such expenditures to the Secretary.

Rev. Rul. 2002-28, 2001-1 C.B. 941, provides that, when a private foundation transfers all of its assets to one or more private foundations effectively controlled by the same persons that effectively control the transferor, the transferee foundation is treated as the transferor foundation rather than as the recipient of an expenditure responsibility grant. Therefore, there are no expenditure responsibility requirements that must be exercised under § 4945(d)(4) or (h) with respect to the transfers to the transferee foundation. The transferor foundation is required to exercise expenditure responsibility over the transferor's outstanding grants until it disposes of all of its assets. Thereafter, during any period in which the transferor foundation has no assets, the transferor foundation is not required to exercise expenditure responsibility over any outstanding grants. However, the transferor foundation must still meet the § 4945(h) reporting requirements for the outstanding grants for the year in which the transfer was made.

Treas. Reg. § 53.4945-6(b)(1)(v) provides that any payment which constitutes a qualifying distribution under § 4942(g) ordinarily will not be treated as taxable expenditures under § 4945(d)(5).

Treas. Reg. § 53.4945-6(b)(2) provides that any expenditures for unreasonable administrative expenses, including compensation, consultant fees, and other fees for services rendered will ordinarily be taxable expenditures under § 4945(d)(5) unless the foundation can demonstrate that such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was consistent with ordinary business care and prudence.

The determination whether an expenditure is unreasonable shall depend upon the facts and circumstances of the particular case.

ANALYSIS

Issue 1

Whether the transfer of substantially all of your net assets to P (the "Transfer") would adversely affect the status of either you or P as tax-exempt organizations described in § 501(c)(3).

Both you and P are currently recognized by the Service as organizations described in § 501(c)(3). Section 501(c)(3) describes organizations organized and operated exclusively for charitable, educational, and other specified exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which does not participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for public office.

Your exempt purposes include the making of grants to QCRs, which your trust instrument defines as organizations described in §§ 170(c)(1) and (2) that are entitled to exemption from tax under § 501(c)(3). Furthermore, Articles I.B and VI of your trust instrument authorize the Trustees, in their discretion, to distribute up to the entire net income and principal of the Trust to such organizations in furtherance of your exempt purposes. P qualifies as an organization described in § 170(c)(2) and is exempt from tax under § 501(c)(3). Therefore, P is a QCR and an eligible recipient of trust distributions under your trust instrument, and the Transfer of all your remaining assets to such an organization is expressly permitted thereunder.

P is organized for charitable and educational purposes, including the provision of educational, vocational, social, psychological, and financial assistance to homeless individuals and families, and the making of distributions for such or similar purposes to organizations that qualify as exempt organizations under § 501(c)(3). Article IV, paragraph (a)(ii) of P's Articles of Organization permits P to "receive contributions from any and all sources." Therefore, the receipt of the transferred funds from you is a permissible action by P under its governing instrument. P's intention is to utilize these funds in carrying out the activities which constitute the basis of its exempt purposes. No private inurement will result from the receipt of those funds. The founder, B, serves without compensation, and the only persons who will benefit from P's activities will be those persons who fall within the charitable class that P was established to serve. Nor will the funds be used for legislative or political activities or for any other purpose that is not in conformity with P's exempt purposes.

Since the Transfer is consistent with your exempt purposes, and since the transferred funds will be used by P exclusively in furtherance of its exempt purposes, the Transfer will have no adverse effect

on the qualification of either you or P as organizations described in § 501(c)(3).

Issue 2

Whether the Transfer would be a transfer described in § 507(b)(2).

I.R.C. § 507(b)(2) applies to the transfer of the assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. Section 1.507-3(c)(1) provides that the terms "other adjustment, organization, or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration. The term "significant disposition of assets to one or more private foundations" is defined by § 1.507-3(c)(2) as any disposition or series of dispositions where the aggregate value transferred is 25 percent or more of the fair market value of the foundation at the beginning of the taxable year.

You will transfer all of your net remaining assets to P after the payment of certain grants to unrelated QCR's and the payment of final taxes and expenses. After the Transfer is completed, the value of your assets would be zero dollars ($0.00). The assets transferred would constitute 100 percent of your net assets remaining after the payment of your qualifying distributions, debts, expenses, and taxes, and not less than 93 percent of your total assets as of the beginning of the taxable year. Therefore, the Transfer would constitute a "significant disposition of assets" within the meaning of § 1.507-3(c)(2), and, thus, would qualify as an "other adjustment, organization, or reorganization" within the meaning of § 1.507-3(c)(1). Accordingly, the Transfer would be a transfer described in § 507(b)(2).

Issues 3, 4, 5, and 6

Whether the Transfer would not terminate your private foundation status or cause you to incur any liability for the § 507(c) termination tax.

Whether, following the Transfer, you would be eligible to terminate your private foundation status by giving notice to the Service as provided in § 507(a)(1).

Whether, for purposes of calculating the termination tax under § 507(c), the date for determining the value of your assets is the date on which you give the notice described in § 507(a)(1) ("Notice").

Provided that Notice is given at least one day after the Transfer, and at a time when your net remaining assets are valued at Zero Dollars ($0.00), whether the amount of termination tax due under § 507(c)(2) upon termination of your status as a private foundation would be Zero Dollars ($0.00).

Section 1.507-1(b)(6) provides that when a foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in § 507(b)(2), such transferor foundation will not have terminated its private foundation status under § 507(a)(1). In addition, § 1.507-1(b)(7) provides that neither a transfer of all the assets of a private foundation nor a significant disposition of assets by a private foundation shall be deemed to result in a termination of the transferor private foundation under § 507(a) unless the transferor private foundation elects to terminate pursuant to § 507(a)(1). Furthermore § 1.507-3(d) provides that unless a private foundation voluntarily gives notice pursuant to § 507(a)(1), a transfer of assets described in § 507(b)(2) will not constitute termination of the transferor's private foundation status under § 507(a)(1). Finally, § 1.507-4(b) provides that a private foundation that makes a transfer described in

§ 507(b)(2) is not subject to the tax imposed under § 507(c) with respect to such transfer unless the provisions of § 507(a) become applicable.

As discussed under Issue 2, above, the Transfer will constitute a significant distribution of assets described in § 507(b)(2). Further, you have represented that the Secretary has not notified you of any tax imposed by § 507(c) due to any willful or flagrant acts or failures to act. Consequently, the Transfer would not, of itself, terminate your private foundation status or subject you to the tax imposed under § 507(c).

Section 507(a)(1) provides that the status of an organization as a private foundation shall be terminated only if such organization notifies the Secretary of its intent to accomplish such termination and such organization pays the tax imposed by § 507(c). Furthermore, § 1.507-1(b)(1) provides that in order for a private foundation to terminate its private foundation status under § 507(a)(1) it must submit a statement to the Internal Revenue Service of its intent to terminate its private foundation status under § 507(a)(1). In your situation where there have been no willful repeated acts or failures to act, and no flagrant act or failure to act, which would give rise to taxes and penalties under Chapter 42, you may elect to terminate your private foundation status by notifying the Manager, Exempt Organizations Determinations (TE/GE), of your intent to accomplish such termination and paying any termination tax deemed to be due under § 507(c).

Section 507(c) imposes a tax on a terminating private foundation equal to the lesser of the aggregate tax benefit resulting from its § 501(c)(3) status and the value of its net assets. Section 507(e) and § 1.507-7(a) provide that, for purposes of § 507(c), the value of the net assets shall be determined at whichever time such value is greater: (1) the first day on which the organization takes action which culminates in its ceasing to be a private foundation, or (2) the date on which it ceases to be a private foundation. Finally, § 1.507-7(b)(1) provides that in the case of a voluntary termination under § 507(a)(1), the date for determining the value of the foundation's assets for purposes of calculating the termination tax under § 507(c) shall be the date on which the foundation gives the notification described in § 507(a)(1). The date for determining the value of your assets for purposes of calculating your termination tax is the date you give Notice. If you give Notice after the Transfer, the value of you assets on the date of the Notice would be Zero Dollars ($0.00), and, thus, the amount of the § 507(c) termination tax imposed on you would be Zero Dollars ($0.00).

Issues 7, 8, and 9

Whether, for purposes of §§ 507 through 509, P would be treated as a newly created organization as a result of the Transfer, pursuant to § 507(b)(2).

Whether P, as transferee of substantially all of your net assets, would be treated as possessing those attributes and characteristics of you, the transferor, described in § 1.507-3(a)(2), (3), and (4).

Since you and P are both effectively controlled by the same persons within the meaning of §§ 1.482-1(a)(3) and 1.507-3(a)(9), whether, for purposes of Chapter 42 (§ 4940 et seq.) and §§ 507 through 509, P, the transferee, would be treated as though it were you, the transferor.

Section 1.507-3(a)(1) provides that in the case of a significant distribution of assets to one or more private foundations within the meaning of § 1.507-3(c) the transferee organization shall not be treated as a newly created organization. Rather, it shall be treated as possessing those attributes and characteristics of the transferor organization which are described in § 1.507-3(a)(2), (3), and (4). Since, as discussed under Issue 2, above, the Transfer would qualify as a "significant distribution of assets" within the meaning of § 1.507-3(c)(2), P would not be treated as a newly created organization as a result of the Transfer. Rather, P would be treated as possessing your attributes and

characteristics described in subparagraphs (2), (3), and (4) of § 1.507-3(a).

Treas. Reg. § 1.507-3(a)(9)(i) provides that if a private foundation transfers all of its net assets to one or more private foundations which are effectively controlled by the same persons which effectively controlled the transferor private foundation, for purposes of Chapter 42 (§ 4940 et seq.), the transferee foundation shall be treated as if it were the transferor. Since you have represented that B and C effectively control both you and P, for purposes of Chapter 42, P would be treated as if it were you.

Issues 10 and 11

Whether the Transfer would give rise to any gross investment income with respect to either you or P or will be subject to tax under § 4940(a).

Whether P, as transferee, may use any excess § 4940 tax paid by you to offset P's § 4940 tax liability.

Section 4940(a) imposes an excise tax on a private foundation's net investment income for the taxable year. Rev. Rul. 2002-28 holds that when a private foundation transfers all of its assets to one or more private foundations in a transfer described in § 507(b)(2), the transfers do constitute investments of the transferor and, therefore, do not give rise to net investment income subject to tax under § 4940(a). Thus, the Transfer would not give rise to net investment income subject to tax under § 4940.

Furthermore, Rev. Rul. 2002-28 holds that if the transferor foundation transfers all of its assets to private foundations effectively controlled by the same persons that effectively control the transferor, any excess § 4940 tax paid by the transferor may be used by the transferee to offset its § 4940 tax liability. As you represent that the Foundations are effectively controlled by the same persons, any excess § 4940 tax paid by you may be used by P to offset P's § 4940 tax liability.

Issues 12 and 13

Whether the Transfer would constitute an act of self-dealing within the meaning of § 4941(d), or would subject any disqualified person or foundation manager with respect to you or P to the tax imposed under § 4941(a).

Whether the provision by a law firm of reasonable and necessary legal services with respect to the Transfer, or the payment of reasonable compensation for such services by you or P, would constitute acts of self-dealing within the meaning of § 4941(d), notwithstanding the status of D, a disqualified person with respect to P, as a partner in that law firm.

Section 4941(a) imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation. Section 4941 and § 1.507-3(a) determine whether the proposed Transfer of all of your assets to P would constitute an act of self-dealing between a private foundation and its disqualified persons as defined in § 4946. Under § 53.4946-1(a)(8), a "disqualified person" does not include organizations that are exempt under § 501(c)(3). Therefore, the Transfer of your assets to P would not be an act of self-dealing because P is recognized by the Service as an organization exempt from tax under § 501(c)(3).

Furthermore, while the payment of compensation, or the payment or reimbursement of expenses by a private foundation to a disqualified person is, generally, an act of self-dealing under § 4941(d)(1)(E), § 4941(d)(2)(E) and § 53.4941(d)-3(c)(1) provide that a payment or reimbursement to a disqualified person for personal services which are reasonable and necessary to carry out the exempt purposes of the private foundation is not an act of self-dealing provided the compensation,

payment, or reimbursement is not excessive.

In this case, the law firm is not a disqualified person, so the payment to the law firm for legal services will not be a direct act of self-dealing. Under § 4946(a)(1)(F) a "disqualified person" includes a partnership in which disqualified persons hold more than 35 percent of the profits interests. D is a disqualified person and is a partner of the law firm but holds less than a 35 percent profits interest in the law firm.

The payment will not otherwise be treated as an indirect act of self-dealing benefitting D. Under § 53.4941(d)-1(b)(4) indirect self-dealing will not occur solely as a result of a transaction between a private foundation and an entity in which a disqualified person holds an interest where the entity is not a disqualified person by operation of § 4946(a)(1)(F). Moreover, as Example (1) of § 53.4941(d)-3(c)(2) demonstrates, the payment of compensation by a foundation for legal services does not constitute an act of self-dealing if the services performed are reasonable and necessary for carrying out of the foundation's exempt purposes and the amount paid for such services is not excessive, and you have represented that these requirements will be met.

Issue 14

Whether the Transfer will be a qualifying distribution by you under § 4942.

Whether P will assume your "undistributed income" (if any) or succeed to your excess distributions (if any).

Section 4942(a) generally imposes a tax on the undistributed income of a private foundation (other than an operating foundation under § 4942(j)(3)) for any taxable year which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year. Section 4942(c) defines "undistributed income" for any taxable year as the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made out of such distributable amount for such taxable year. Section 4942(g)(1)(A) defines "qualifying distribution" generally as any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in § 170(c)(2)(B), but a qualifying distribution does not include a contribution to an organization controlled directly or indirectly by the foundation or by one or more disqualified persons with respect to the foundation

Section 1.507-3(a)(5) provides that, except as provided in section 1.507-3(a)(9), a private foundation making a transfer described in § 507(b)(2) must satisfy its distribution requirements under § 4942 for the taxable year in which the transfer is made. Section 1.507-3(a)(5) further provides that the transfer will count as a distribution in satisfaction of the transferor foundation's distribution requirement under § 4942 subject to the provisions of § 4942(g). Section 4942(g) provides that a distribution from one private foundation to another private foundation, where both foundations are effectively controlled by the same persons, will not be treated as a qualifying distribution by the transferor foundation for the purposes of § 4942 except to the extent that the transferee foundation makes one or more distributions that would be qualifying distributions under § 4942(g) (other than a distribution to a controlled foundation) prior to the close of the transferee's first tax year following the tax year in which it received the transfer and the distributions are treated as being made out of corpus (as if the transferee foundation were not an operating foundation).

Rev. Rul. 2002-28 holds that where, by reason of § 1.507-3(a)(9)(i), a transferee private foundation is treated as though it were the transferor for purposes of § 4942, a transfer to the transferee

foundation is not treated as a qualifying distribution of the transferor foundation. Rather, the transferee foundation assumes all obligations with respect to the transferor's "undistributed income" within the meaning of § 4942(c), if any, and reduces its own distributable amount under § 4942 by the transferor foundation's excess qualifying distributions under § 4942(i). None of the three situations in Rev. Rul. 2002-28, however, involved an operating foundation.

As discussed under Issues 7, 8, and 9, above, by reason of § 1.507-3(a)(9)(i), P would be treated as if it were you for purposes of Chapter 42, including § 4942. Accordingly, the Transfer to P would not be treated as a qualifying distribution of yours. Rather, P would assume your obligations with respect to your undistributed income within the meaning of § 4942(c), if any (after taking into account any excess qualifying distribution carryovers that you may have), and you would not be required to meet your qualifying distribution requirements under § 4942 for the taxable year of the Transfer prior to the Transfer. You must file a final Form 990-PF return for the short tax year of your termination. If you have undistributed income for such tax year, P will owe § 4942 tax if P fails, by the end of P's tax year following the tax year in which P receives the Transfer, to make qualifying distributions of such amount that would be treated as out of corpus if P were a non-operating foundation. P should provide an attachment to its Form 990-PF showing how it has met this requirement.

If you have excess qualifying distributions that carry over to P, they will be forfeited if P is an operating foundation in the year of the Transfer. Section 53.4942(a)-3(e)(4) (Example (3)) explains that excess qualifying distributions carried forward lapse in their entirety in any year that the private foundation is treated as an operating foundation. Accordingly, if you have any unused excess qualifying distributions that you could have carried forward to a taxable year after the Transfer, and if P is an operating foundation in that year, your unused excess qualifying distributions will lapse and will not be available for P's use in any taxable year after the year of the Transfer if P were to cease to be an operating foundation.

Issue 15

Whether the Transfer would constitute a investment jeopardizing your exempt purposes, or would be subject to tax under § 4944(a)(1).

Section 4944 imposes a tax on any investment that jeopardizes an exempt organization's charitable purposes. Rev. Rul, 2002-28 holds that where a private foundation transfers all of its assets and liabilities to another private foundation, the transfer does not constitute an investment for purposes of § 4944 and, therefore, the transfer does not constitute an investment jeopardizing the transferor foundation's exempt purposes and is not subject to tax under § 4944(a)(1), Therefore, the Transfer would not constitute a jeopardizing investment or subject you to tax under § 4944(a)(1).

Issues 16 and 17

Whether the Transfer would be a taxable expenditure within the meaning of § 4945(d) or would

require the exercise of expenditure responsibility under § 4945(d)(4) or(h).

Whether the payment of the IRS fee for this private letter ruling would be treated as a taxable expenditure within the meaning of § 4945(d), or whether payment of reasonable legal fees to the attorneys for you and P to obtain this private letter ruling with respect to the Transfer would be treated a taxable expenditures within the meaning of § 4945(d)(5).

Section 4945 imposes a tax on any "taxable expenditure" made by a private foundation. Section 4945(d)(4) provides that the term "taxable expenditure" includes any amount paid or incurred as a grant to a private non-operating foundation unless the grantor foundation exercises expenditure responsibility with respect to such grant in accordance with § 4945(h).

Rev. Rul. 2002-28 holds that where, by reason of § 1.507-3(a)(9)(i), a transferee foundation is treated as though it were the transferor foundation for purposes of § 4945, the transferee foundation is not treated as the recipient of an expenditure responsibility grant, and no expenditure responsibility requirements must be exercise under § 4945(d)(4) or (h) with respect to the transfer to the transferee foundation.

As discussed under Issues 7, 8, and 9, above, by reason of § 1.507-3(a)(9)(i), P would be treated as if it were you for purposes of Chapter 42, including § 4945. Consequently, the Transfer would not be considered a taxable expenditure under § 4945, and there would be no expenditure responsibility requirements to be exercised under § 4945(d)(4) or (h) with respect to the Transfer.

Section 53.4945-6(b)(1)(v) provides that any payment which constitutes a qualifying distribution under § 4942(g) will not be treated as a taxable expenditure under § 4945(d)(5). Section 4942(g)(1)(A) and § 53.4942(a)-3(a)(2)(i) provide that a qualifying distribution under § 4942(g) includes reasonable and necessary administrative expenses paid to accomplish one or more purposes described in § 170(c)(1) or (2)(B). Administrative expenses incurred in obtaining a ruling from the Service or for legal fees relating to a foundation's exempt purposes are qualifying distributions. On the other hand, § 53.4945-6(b)(2) provides that expenditures for unreasonable administrative expenses, including consultant fees and other fees for services rendered, will ordinarily be taxable expenditures under § 4945(d)(5). The payment of legal fees to the attorneys for you or P and the payment of the IRS fee for this private letter ruling are administrative expenses necessary to the accomplishment of the Foundations' exempt purposes. So long as such payments are reasonable, the legal fees paid to the attorneys for you and P to obtain a private letter ruling with respect to the Transfer, and the IRS fee paid for this private letter ruling, would not be treated as taxable expenditures within the meaning of § 4945(d)(5).

Issues 18 and 19

Whether the operation by P of state licensed postsecondary career training programs for a fee would adversely affect P's tax exempt status under § 501(c)(3) or its status as an operating foundation under § 4942(j)(3).

Whether the fees received by P from the operation of the state licensed postsecondary career training programs would be considered gross income derived from an unrelated trade or business for purposes of § 512(a)(1).

The exempt purposes of P, as described in its Articles of Organization, include "the provision of educational, vocational, social, psychological, and financial assistance to homeless individuals and families." From its beginning, P has provided education and practical job-skills training to disadvantaged persons and those who have suffered displacement from economic upheavals so that

they may be better equipped to obtain employment and to lead productive and satisfying lives. P now wishes to provide training in software programs widely used by the business community to help displaced persons whose existing skills do not correspond to the current needs of the marketplace.

Providing such training is educational within the meaning of § 1.501(c)(3)-1(d)(3)(a), and contributes importantly to the accomplishment of P's exempt purposes of providing educational and vocational assistance to homeless and displaced persons. Thus, such activities amount to a trade or business that is substantially related to the accomplishment of P's exempt purposes within the meaning of § 1.513-1(d)(2), and are, therefore, not unrelated trade or business within the meaning of § 513(a). Insofar as the term "functionally related business" under § 4942(j)(4)(A) includes a trade or business which is not an unrelated trade or business, as defined in § 513, the providing of such state-licensed postsecondary career training programs by P would constitute a "functionally related business," and deductible expenses related thereto in excess of the income from such business would constitute qualifying distributions made directly for the active conduct of activities constituting P's exempt function for purposes of qualifying as a private operating foundation under § 4942(j)(3), as provided in § 53.4942(a)-2(d)(4) and § 53.4942(b)-1(b)(1). The operation of state licensed postsecondary career training programs for a fee will not adversely affect P's status as an organization described in § 501(c)(3) or its status as a private operating foundation under § 4942(j)(3). Furthermore, since the income derived from such activities would constitute income from a related trade or business, such income would not constitute gross income derived from an unrelated trade or business for purposes of § 512(a)(1).

Issue 20

Whether, following the Transfer, if P's qualifying distributions (within the meaning of § 4942(g)(1) or (2)) made directly for the active conduct of the activities constituting its exempt purpose or function were to exceed both its net investment income and its minimum investment return, P will continue to qualify as a private operating foundation within the meaning of § 4942(j)(3).

To qualify as a private operating foundation under § 4942(j)(3), an organization must meet the income test under § 4942(j)(3)(A) and any one of three alternative tests — the assets test under § 4942(j)(3)(B)(i), the endowment test under § 4942(j)(3)(B)(ii), or the support test under § 4942(j)(3)(B)(iii). The income test requires that the organization make qualifying distributions directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated equal to substantially all of the lesser of (i) its adjusted net income or (ii) its minimum investment return. The endowment test requires qualifying direct distributions of at least two-thirds of the foundation's minimum investment return.

P anticipates, and represents, that, notwithstanding an increase in its assets and income as a result of the Transfer, P will continue to make qualifying direct distributions in excess of both its minimum investment return and its adjusted net income. So long as P's qualifying direct distributions continue to exceed both its net investment income and its minimum investment return, P would continue to qualify as a private operating foundation under § 4942(j)(3).

CONCLUSION

In light of the foregoing, we rule as follows:

1. The transfer of substantially all of your net assets to P (the "Transfer") would not adversely affect the status of either you or P as organizations described in § 501(c)(3).

2. The Transfer would be a transfer described in § 507(b)(2).

3. The Transfer would not terminate your private foundation status or cause you to incur any liability for the § 507(c) termination tax.

4. Following the Transfer, you would be eligible to terminate your private foundation status by giving notice to the Service as provided in § 507(a)(1).

5. For purposes of calculating the termination tax under § 507(c), the date for determining the value of your assets would be the date on which you give the notice described in § 507(a)(1) ("Notice").

6. Provided that Notice is given at least one day after the Transfer, and at a time when your net remaining assets are valued at Zero Dollars ($0.00), the amount of termination tax due under § 507(c)(2) upon termination of your status as a private foundation would be Zero Dollars ($0.00).

7. For purposes of §§ 507 through 509, P would be treated as a newly created organization as a result of the Transfer, pursuant to § 507(b)(2).

8. P, as transferee of substantially all of your net assets, would be treated as possessing those attributes and characteristics of yours described in § 1.507-3(a)(2), (3), and (4).

9. Since you and P are both effectively controlled by the same persons within the meaning of §§ 1.482-1(a)(3) and 1.507-3(a)(9), for purposes of Chapter 42 (§ 4940 et seq.) and §§ 507 through 509, P, the transferee, would be treated as though it were you, the transferor.

10. The Transfer would not give rise to net investment income and would not be subject to tax under § 4940(a).

11. P, as transferee, may use any excess § 4940 tax paid by you, the transferor, to offset P's § 4940 tax liability.

12. The Transfer would not constitute an act of self-dealing within the meaning of § 4941(d), and would not subject any disqualified person or foundation manager with respect to you or P to the tax imposed under § 4941(a).

13. The provision by a law firm of reasonable and necessary legal services with respect to the Transfer, and the payment of reasonable compensation for such services by you or P, would not constitute acts of self-dealing within the meaning of § 4941(d), notwithstanding the status of D, a disqualified person with respect to P, as a partner in that law firm.

14. The Transfer would not constitute a qualifying distribution by you under § 4942. P would assume your undistributed income under § 4942 (if any) and be required to make qualifying distributions of such amount treated as distributed out of corpus by the end of P's tax year after the tax year in which P receives the Transfer, but excess distributions by you (if any) will not carry over to P, but will lapse in the first year after the Transfer that P qualifies as an operating foundation

15. The Transfer would not constitute an investment jeopardizing your exempt purposes, and would not be subject to tax under § 4944(a)(1).

16. The Transfer would not be a taxable expenditure within the meaning of § 4945(d); consequently there would be no expenditure responsibility requirements to be exercised under § 4945(d)(4) or (h).

17. The payment of the IRS fee for this private letter ruling would not be treated as a taxable expenditure within the meaning of § 4945(d), and payments of reasonable legal fees to the attorneys for you and P to obtain this private letter ruling with respect to the Transfer would not be treated as

taxable expenditures within the meaning of § 4945(d) so long as such payments were reasonable.

18. The operation by P of state licensed postsecondary career training programs for a fee would not adversely affect P's tax-exempt status under § 501(c)(3) or its status as an operating foundation under § 4942(j)(3).

19. The fees received by P from the operation of state licensed postsecondary career training programs would not be considered gross income derived from an unrelated trade or business for purposes of § 512(a)(1).

20. Following the Transfer, if P's qualifying distributions (within the meaning of § 4942(g)(1) or (2)) made directly for the active conduct of the activities constituting its exempt purpose or function were to exceed both its net investment income and its minimum investment return, P would continue to qualify as a private operating foundation under § 4942(j)(3).

This ruling will be made available for public inspection under § 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. I.R.C. § 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Peter A. Holiat

Acting Manager,

Exempt Organizations

Technical Group 1

Insurance Company Seeks Discounted Health Plan Fee for Tax-Exempt, Nonprofit Hospitals.

James Fritz of Bluegrass Family Health has urged Treasury to classify health plans owned by

nonprofit, tax-exempt hospitals or hospital systems in the same category as other nonprofit, tax-exempt health plans, which would give the hospital plans a 50 percent discount on the insurance plan fee required under the Affordable Care Act.

May 16, 2013

The Honorable Jacob Lew

Secretary of the Treasury

United States Department of the Treasury

1500 Pennsylvania Avenue, NW, Room 3330

Washington, DC 20220

RE: REG-118315-12: Health Insurance Providers Fee

Dear Secretary Lew:

We write on a matter of concern to a number of federally taxable regional health insurance plans owned by tax-exempt hospitals and health care systems. These hospital-owned health plans (HHPs) are unique because they are entirely owned and controlled by parents that are tax-exempt under section 501(a) of the Internal Revenue Code (IRC) and are further described in section 501(c). Despite paying taxes under the IRC, HHPs function more similarly to nonprofit entities because they must reinvest whatever marginal profits they produce each year into the hospital parent's charitable mission. HHPs were originally created as taxable entities due to the prevailing physician ownership model at the time of their founding. However, as the ownership model moved away from physician ownership, HHPs found it nearly impossible to convert to nonprofit status due to the evolving interpretation of section 501(m) of the IRC. As a result, HHPs will be assessed at unsustainable levels under REG-118315-12: Health Insurance Providers Fee ("the insurer fee") and will likely be forced to significantly limit services or exit the market altogether. Either outcome will negatively affect the communities that HHPs serve by impacting the charitable activities of their parent hospitals.

The recently released rules implementing Section 9010 of the Patient Protection and Affordable Care Act (ACA) failed to curtail the implementation of the insurer fee on this specific group of health plans. In § 57.4(a)(4)(iii) of the insurer fee, the ACA is interpreted as granting partial reductions for certain exempt activities to health insurers that are exempt from Federal income tax and meet section 501(c) requirements. We believe HHPs should be included in this category of health plans that receive partial reductions because, like other nonprofit health plans, HHP premiums are attributable to the exempt activities of their parent nonprofit, tax-exempt hospitals and health systems. We urge you to provide relief to these plans from the insurer fee, consistent with the treatment of other tax exempt providers.

We are concerned that these taxable health plans owned entirely by nonprofit, tax-exempt hospitals or health systems appear to be included in a group of health plans that receive no exemptions from the insurer fee, while other nonprofit insurance providers receive either a partial or full exemption. We believe HHPs should receive a 50 percent exemption from the insurer fee because they are an essential part of the communities they serve.

HHPs operate differently than traditional for-profit health plans and should be treated accordingly. The parent hospitals and health systems, exempt under Internal Revenue Code Section 501(c)(3) and

Section 501(c)(4), are required to hold and use all of their assets and earnings for tax-exempt, charitable purposes. This requirement extends to the equity and earnings of wholly owned/controlled taxable subsidiaries, such as HHPs. Therefore, the cost of the insurer fee that a HHP will be required to pay under the proposed regulation will ultimately reduce the resources of the parent hospital or health system to fulfill their charitable missions. The imposition of the fee on these hospitals and health systems will detract from the organization's mission and the vital community services they provide. To impose the insurer fee on these community-based providers is not sustainable and will have a damaging effect on the communities that these plans serve.

We believe that if no relief is granted to these hospital-owned health plans in the final regulations, these types of health plans will be assessed approximately $200 million in fees in 2014 under the insurer fee. This will make it impossible for these plans to continue to offer quality, locally-based compassionate health care. The imposition of the full insurer fee on these providers may drive HHPs from the marketplace, thus limiting the choices available in these areas.

Classifying these 28 health plans with other non-profit tax-exempt health insurers appears to be in alignment with the federal government's tax exempt policies. These plans share the same charitable mission-driven agendas of their parent nonprofit health systems and should be treated in the same manner as other tax-exempt entities. Adding these plans to the 50 percent tax exempt category would increase the fees of the health plans remaining in the non-exempt category by only about 1.8 percent, resulting in a de minimis impact on the health insurance marketplace.

We greatly appreciate your willingness to continue refining your approach and hope you will grant these hospital-owned health plans a 50 percent exemption from the Health Insurance Providers Fee.

Sincerely,

James S. Fritz

President & CEO

Bluegrass Family Health

Lexington, KY

Minnesota Lawmaker Requests Guidance on Historic Rehabilitation Tax Credit.

Rep. Betty McCollum, D-Minn., has written to Treasury to request guidance on the future of the historic rehabilitation tax credit program, which she says has been disrupted by a recent court ruling and subsequent IRS memorandum that have created uncertainty and effectively halted investment in rehabilitation projects.

May 10th, 2013

The Honorable Jack Lew

Secretary

U.S. Department of the Treasury

1500 Pennsylvania Avenue N.W.

Washington, D.C. 20220

Dear Mr. Secretary:

I recently met with local nonprofit and development leaders in my Congressional District who have participated in many successful projects to rehabilitate historic properties during the past forty years, due in large part to the Historic Rehabilitation Tax Credit program (HTC). These leaders voiced concerns about the result of a recent court ruling and subsequent Internal Revenue Service (IRS) memorandum and uncertainty that has effectively halted investment in these projects, and which they believe could jeopardize the future of the HTC program. Therefore, I respectfully request your assistance in providing clear guidance from the IRS that allows the HTC to be utilized again within the next 60 days.

Nationally and in Minnesota, the HTC enjoys strong bipartisan support. HTC is a critical tool for urban renewal, facilitating the creation of jobs through the rehabilitation of historic buildings. Since its creation in the 1970s, it has helped to create 2.3 million jobs, rehabilitated more than 38,000 buildings, and spurred more than $106 billion in private investment. This record of success and the litany of examples of community revitalization in every state in the nation have made this a popular and effective tool for economic resurgence.

Through my conversations with Minnesota leaders in urban revitalization and historic preservation, I have learned that several recent or current local projects likely would not have been possible or will not be possible without the HTC. The successful redevelopment of the landmark Saint Paul Pioneer and Endicott buildings into mixed use and residential units is helping to spur energy investment in the heart of the city's downtown, and could not have occurred without the HTC according the project's developer. More urgently, a nonprofit partnership to save rapidly deteriorating buildings at the former frontier military outpost Fort Snelling and convert them for use as housing for homeless veterans is in jeopardy. Similarly, a project to rehabilitate the former Saint Paul Post Office Building for mixed use and residential development is at risk, due to the current impasse with the HTC.

In communities like mine with a large urban core and many historic and endangered properties, HTC is a catalyst and lynchpin for redevelopment and renewal as our economy recovers from the great recession. This story is similar across the country. By one national estimate, loss of the HTC for a year would mean that 55,000 jobs will not be created, 1,000 structures will not be rehabilitated, and more than $3 billion in private funding will not be invested in strategic historic property rehabilitation. Given the pressing need to have businesses grow and create more jobs in the economy, an immediate resolution of this matter would allow this investment to continue.

It is my understanding that within the last week, senior IRS officials have indicated that more clarity will be provided to the public within the coming days or weeks. This is a welcome development, and I respectfully request your assistance to make sure this commitment is kept.

Residents of my Congressional District are proud of our success at protecting and investing in our historic properties by utilizing the HTC. It would be an honor to host you for a tour of some of these dynamic projects should your schedule allow it in the coming months.

Thank you for your support in finding an expeditious path forward that assures that the HTC is functioning again and the economic benefits it makes available to communities across the nation are once again flowing.

Sincerely,

Betty McCollum

Member of Congress

Udall Announces Bill to Lower Excise Tax on Beer.

The Brewers Excise and Economic Relief (BEER) Act of 2013 would reduce the per-barrel federal excise tax on beer and eliminate excise taxes for most small brewers, Sen. Mark Udall, D-Colo., said in a May 15 release announcing the bill's introduction.

IRS Official Explains Approach in Power Generation Revenue Procedure.

The IRS chose to use a definitional safe harbor in the long-awaited power generation revenue procedure (Rev. Proc. 2013-24, 2013-21 IRB 1) because of the difficulties raised by a percentage safe harbor, Douglas E. Toney, utilities technical specialist, IRS Large Business and International Division, said during a May 16 webcast.

Issued April 30, the Service's latest industry issue resolution guidance provides safe harbor definitions for unit of property and major component that taxpayers may use when applying the disposition rules in the repair regulations (T.D. 9564) to power generation property, according to Carol Conjura of KPMG LLP, whose firm sponsored the webcast.

Conjura noted that the revenue procedure for electric transmission and distribution property (Rev. Proc. 2011-43, 2011-37 IRB 1) uses a percentage safe harbor for expensing.

"A percentage approach would have presented more challenges to implement. These are very different assets than electric and transmission distribution assets," Toney said. "The approach of defining units of property and major components is more administrable and easier to follow than a percentage approach would have been."

Conjura suggested that anticipated guidance on gas transmission property may be more likely to use a percentage safe harbor, given that gas transmission property, unlike power generation property but like electric transmission property, is considered network property.

Toney said the definitions in Rev. Proc. 2013-24 were intended to "reflect the application of the concepts in the regs to these particular and specific types of plant assets used in the generation of steam or electricity." He added that although that approach "wasn't driven by the accounting records . . . it will be easier for the power generation companies to identify these major components and units of property because of their accounting records."

Practitioner Questions

Conjura asked why the guidance didn't allow for a four-year adjustment period for a positive section 481 adjustment. According to the revenue procedure, "A taxpayer must take the entire net section 481(a) adjustment into account (whether positive or negative) in computing taxable income in the year of change."

By pushing all of the effects of section 481 into one tax year, all taxpayers will receive the same treatment, regardless of their initial positions, Toney replied.

Peter Baltmanis of KPMG LLP asked whether in the context of the guidance the definitions of different service levels contained in a taxpayer's long-term service agreement would help determine whether an expense should be capitalized or deducted. Taxpayers in the power generation industry enter into long-term service agreements that may cover the costs connected with the replacement of a major component in connection with an outage.

Although broad generalizations are difficult to make, "the long-term service agreements most likely would be one step removed from a determination of the actual work done. I don't know that they'd be helpful," Toney said. "The scope of the work done is probably more clearly reflected in the individual work orders." He added that an analysis would depend on the facts and circumstances.

Acceptable extrapolation methods are contained in appendix B of the revenue procedure. Baltmanis asked about statistical sampling and whether the procedures in Rev. Proc. 2013-24 differ from those in Rev. Proc. 2011-43.

The basic principles are the same, Toney said, but "the formula was tweaked a little bit to eliminate some unintended results." The most significant difference is that the initial calculation under Rev. Proc. 2013-24 is performed on a gross basis, not a net basis, he said.

IRS Publishes Proposed Regs on Community Health Needs Assessment Requirement for Tax-Exempt Hospitals.

The IRS has published proposed regulations (REG-106499-12) that provide guidance to charitable hospital organizations on the community health needs assessment (CHNA) requirements and related excise tax and reporting obligations. The regs also clarify the consequences for failing to meet these and other requirements for charitable hospital organizations.

Comments and requests for a public hearing must be received by July 5. The regs are proposed to be effective for returns filed on or after the date they are published in the Federal Register as final or temporary regulations.

Section 501(r)(1) imposes four additional requirements that organizations described as hospital organizations must satisfy to be tax exempt under section 501(c)(3), one of which is to conduct a CHNA every three years. In July 2011 Treasury and the IRS issued guidance (Notice 2011-52) on the anticipated regulatory provisions.

As a general rule, the proposed regs provide that a hospital organization operates a hospital facility if it is a partner in a joint venture, limited liability company, or other entity treated as a partnership for federal income tax purposes that operates the hospital facility. A hospital organization also operates a hospital facility under the proposed regs if it does so through a wholly owned entity that is disregarded as separate from the hospital organization for federal tax purposes. A hospital organization is not required, however, to meet the requirements of section 501(r) for any activities unrelated to the operation of a hospital facility.

The proposed regs provide that a hospital organization meets the requirements of section 501(r)(3) in any tax year for a hospital facility it operates only if the hospital facility has conducted a CHNA in that tax year or in either of the two immediately preceding tax years. Also, an authorized body of the

hospital facility is required to have adopted an implementation strategy to meet the community health needs identified through the CHNA by the end of the tax year in which the hospital facility conducts the CHNA. The regs include extensive rules for conducting a CHNA and developing implementation strategies.

Under the proposed regs, a hospital facility's omission of required information from a policy or report described in reg. section 1.501(r)-3 or 1.501(r)-4 or error regarding the implementation or operational requirements described in reg. section 1.501(r)-3 through 1.501(r)-6 will not be considered a failure to meet a requirement of section 501(r) if the omission or error was minor, inadvertent, and due to reasonable cause and the hospital facility corrects the omission or error as promptly after discovery as is reasonable given the nature of the omission or error. Also, the IRS will consider for purposes of determining whether revocation of section 501(c)(3) status is warranted the relative size, scope, nature, and significance of any failures to meet the section 501(r) requirements as well as the reasons for the failures and whether the same type of failures have previously occurred. The proposed regs include rules that apply if one hospital facility within a hospital organization fails to meet a section 501(r) requirement during a tax year, even though the hospital organization as a whole continues to be recognized as a section 501(c)(3) organization.

Citations: REG-106499-12; 2013-21 IRB 1111; 78 F.R. 20523-20544

IRS: Fraternal Society's Sale of Insurance Policies to Nonmember Spouses Is Unrelated Trade or Business.

In technical advice, the IRS concluded that an entity's sale of life insurance policies to nonmember widows of deceased insured members, under which the widow can name as a beneficiary someone other than a dependent of the member, isn't substantially related to the entity's exempt fraternal purposes.

The parent entity of a fraternal beneficiary society that operates under the lodge system sells individual life insurance contracts to its members. Membership is limited to men. The parent entity and its subordinate chapters have a group exemption under section 501(c)(8). The parent entity was formed to provide aid and assistance to its members and their families and beneficiaries. Within a year following the death of a member who was insured by the parent entity, the nonmember widow could request insurance coverage under which the widow could name someone other than a dependent of the member as a beneficiary.

The parent entity derives income from frequent and regular sales of insurance contracts to the widows of deceased members. Unless those sales are substantially related to the entity's performance of its exempt fraternal functions, the revenue derived from those sales is includable in the entity's unrelated business taxable income. To determine whether the sales constitute an unrelated trade or business, the IRS examined the relationship between the sales and the furtherance of the entity's fraternal purposes.

The IRS determined that the sale of insurance to a widow is no different than an ordinary contractual relationship between a policyholder and an insurance company: The nonmember spouse is ineligible for membership and, thus, lacks any fraternal relationship or mutuality of interest with the entity's members; the insurance coverage that is offered to the widow after the member's death is not a continuation of the member's policy; the widow may apply for different coverage from that held by the member; and the widow isn't guaranteed coverage. Further, section 501(c)(8) requires

that a fraternal beneficiary society provide benefits to the society's members and their dependents but a widow may designate a beneficiary other than a dependent of a member.

Thus, the IRS determined that the sale of insurance policies to nonmember widows of deceased insured members doesn't contribute importantly to the society's exempt fraternal purpose and, thus, isn't substantially related to the entity's exempt fraternal purposes. The IRS concluded that the sale of commercial-type insurance to nonmembers constitutes an unrelated trade or business.

Citations: TAM 201320023

Rules Governing Nonprofits and Political Activity: A Brief Overview.

If you've read the news at all this week, you've likely read about the escalating controversy regarding the IRS' seemingly selective scrutiny of certain organizations, including Tea Party organizations. Without delving into the motivations behind the IRS' actions, the central question they were attempting to answer is whether the groups were operating in a manner consistent with the rules governing the activity of 501(c)(4) nonprofit organizations, the tax status for which they had applied (and were all ultimately granted, to the best of our knowledge). Given the increased attention on the topic, below is a brief overview of the permissible activities and characteristics of nonprofits that engage in political activities.

This is meant to be a basic overview, and there is a tremendous amount of nuance and detail not included here. If you need more detailed information, please see the references at the end and/or consult a specialist in nonprofit or political law. That said, there are three basic types of organizations that engage with the political system:

501(c)(3) Organizations – Public Charities

There are two types of 501(c)(3) organizations: Public Charities and Private Foundations. This section focuses exclusively on Public Charities, which are allowed to participate in the civic sphere in ways that are in line with their charitable mission.

Permitted activities: Voter education, voter registration, policy analysis, issue education, and related nonpartisan activities. Allowed to conduct limited lobbying (defined as "insubstantial") activities.

Organizations have the option to choose an official test (501H election) that sets a concrete limit on lobbying expenditures.

Advantages: Greater fundraising capacity through charity status. Can accept contributions of any size from individuals, corporations, and other nonprofits. Not required to disclose donors to the public, although the information is shared with the IRS on Forms 990.

Disadvantages: Restrictions on allowable political activities. Cannot directly engage in elections. Cannot be involved in lobbying as a primary organization activity.

Examples: League of Women Voters, The Urban Institute

501(c)(4) – Social Welfare Organizations; 501(c)(5) – Labor Unions; 501(c)(6) – Business Leagues

While many, if not most, 501(c)(4) organizations do not engage heavily in lobbying or political

activity, the ones that do are supposed to exist in order to “promote the social welfare.” 501(c)(5) and 501(c)(6) organizations are membership-based associations capturing labor/agricultural entities and business entities, respectively.

Permitted activities: Nonpartisan issue and legislative advocacy, lobbying, endorsement of specific legislation.

Advantages: Not required to disclose donors to the public, although shared with the IRS on Forms 990. Can accept contributions of any size; the Citizens United decision allowed for unlimited corporate contributions. Can engage in nonpartisan election campaign-related activity, but that must not be the primary purpose of organization. Can endorse candidates in communication with members, although not with public.

Disadvantages: Must be nonpartisan. Cannot publicly (outside of membership) endorse or overtly support or oppose political candidates. No contributions to 501(c)(4) organizations for lobbying or political activity are tax-deductible, by individuals or businesses. In 501(c)(6) organizations, the portion of membership dues used for lobbying and political expenditures cannot be claimed by members as a business expense and deducted from tax liability.

Examples: AARP (c4), Crossroads GPS (c4), Tea Party Patriots (c4), SEIU (c5), Chamber of Commerce (c6)

527 Organizations – Political Action Committees

Section 527 of the tax code encompasses all forms of organizations engaged directly in electoral politics, including candidate and political party committees. This section focuses on independent Political Action Committees that are predominantly–though not exclusively–organized under Section 527, both “traditional” PACs and the newer SuperPACs that emerged following the 2010 Citizens United decision. There is another notable type of independent spending committee known informally as the “527” that can raise and spend money on elections in unlimited amounts without endorsing specific candidates, but these organizations are now significantly less prevalent and influential than they were around a decade ago.

Permitted activities: Partisan-oriented activities to influence elections. Explicit support of or opposition to individual candidates.

Advantages: “Traditional” PACs can engage in direct political activity and endorse candidates. SuperPACs can raise money in unlimited amounts from individuals or corporate/organizational donors.

Disadvantages: Required to disclose donors to the public through the Federal Election Commission. “Traditional” PACs have $5000 contribution limits. SuperPACs are not allowed to coordinate with candidate committees. Lobbying activities are not necessarily tax-exempt.

Examples: EMILY’s List (PAC), American Crossroads (SuperPAC)

Each structure serves a specific function within the political sphere, but reviewing applications of all politically oriented organizations to ascertain whether the proposed activities fit into the allowable activities of the organization type they have chosen seems prudent. However, many of the lines between these organizational types are blurry. Of particular relevance to the current controversy, 501(c)(4) social welfare organizations in practice run issue-based attack ads that look a lot like attempts to influence the outcome of an election. With little guidance from Congress, the IRS is left with the unenviable task of sorting out whether organizations engaged in such activities are merely

toeing that blurry line or outright crossing it in some objective way.

If you want to learn more, here are some resources:

Chapter 10 of the 2006 book Nonprofits and Government: Collaboration and Conflict, published by Urban Institute Press, is devoted to permissible activities for politically active nonprofits.

The Alliance for Justice offers details about the permissible political activities of 501(c)(4) organizations.

The National Center for Charitable Statistics website has more general information about 501(c)(4), c5, and c6 organizations.

The IRS offered detailed guidance on the "Political Campaign and Lobbying Activities of IRC 501(c)(4), (c)(5), and (c)(6) Organizations" in 2003.

The Congressional Research Service released a more recent study looking at the role of SuperPACs in federal elections and their relation to other types of political organizations.

The IRS 2012 Data Book has details on the number of 501c organizations by type, including those applying for tax exemption and how many were reviewed more closely and ultimately rejected. See the tables on pages 55 and 56.

Author: Jeremy Koulish

Comments Sought on Exempt Organization E-File Form.

The IRS, as part of a paperwork reduction effort, has asked for public comment on Form 8453-EO, "Exempt Organization Declaration and Signature for Electronic Filing"; comments are due by July 15, 2013.

Tea Party Flap Highlights the Road to Exemption.

The uproar surrounding the revelation that the IRS gave extra scrutiny to the exemption applications of conservative groups, resulting in delays in the applications' processing, may have people wondering how the process is supposed to work.

The uproar surrounding the revelation that the IRS gave extra scrutiny to the exemption applications of conservative groups, resulting in delays in the applications' processing, may have people wondering how the process is supposed to work.

That possibility may have been on the minds of IRS officials on May 15 when they released a Q&A explaining the exemption application process, including how the IRS handles applications of organizations that may engage in political or advocacy activities. Detailed information is also available at http://www.irs.gov/eo.

Numerous Tea Party groups and other conservative entities sought to qualify as tax-exempt organizations described in section 501(c)(4). To qualify, an organization must operate primarily to

further the common good and general welfare of the people of the community, according to the IRS. Civic leagues, homeowners associations, and volunteer fire companies can qualify as social welfare organizations.

An organization that believes it meets the qualifications for exemption must decide whether to declare itself exempt or apply to the IRS for exemption. Rosemary E. Fei of Adler & Colvin said most of her firm's clients apply for exemption because they want the IRS to bless their proposed activities in writing and because potential donors may want to see a favorable determination letter. (Contributions to a section 501(c)(4) organization are not deductible, however.) A favorable determination letter also grants the organization advantageous postage rates and exemption from some state taxes.

To apply for exemption under section 501(c)(4), an organization must file a Form 1024, "Application for Recognition of Exemption Under Section 501(a)," which is more than 25 pages and asks about the organization's activities, revenues and expenses, assets and liabilities, and other issues. Organizations seeking exemption as a charity under section 501(c)(3) instead file a Form 1023, "Application for Recognition of Exemption Under Section 501(c)(3)."

Using Form 1024 requires a user fee of $400 for organizations with annual gross receipts of $10,000 or less during the preceding four years, or of $850 for organizations with annual gross receipts exceeding $10,000 for the preceding four years.

An organization also must have an employer identification number, even if it has no employees. The EIN can be obtained by filing Form SS-4, "Application for Employer Identification Number."

Exemption applications are sent to the IRS determinations center in Cincinnati. If the application is complete, the IRS will send the organization a letter of acknowledgement; incomplete applications will be returned. If the IRS needs more information to determine whether the organization qualifies for exemption, it will ask the applicant for the information by a specified date.

Applicants will be informed if their applications are forwarded to IRS headquarters for review. In its Q&A, the IRS said the Cincinnati office may consult with tax law specialists in Washington on how the law applies to a particular case.

Fei said that if an application is in a category singled out for special attention, it will be assigned to a dedicated group of agents. In that case, the applicant can expect a significantly longer wait for one of those few agents to become available, she said. The applicant may also be asked questions that do not seem directly relevant to the application or that have already been answered, she added.

The applicant will normally receive a determination letter after the IRS gets all the information it needs, Fei said. An organization whose application is denied will receive a letter explaining why the IRS believes it does not qualify for exempt status, and it has 30 days to protest. If the IRS does not receive a protest within that time frame, the proposed denial becomes final. Organizations seeking exemption under section 501(c)(3) may petition the Tax Court, the Court of Federal Claims, or the D.C. district court for declaratory judgment that they qualify, but the IRS's determination is final for section 501(c)(4).

The Tea Party controversy may have arisen because the IRS decided to form a dedicated group to handle the applications of social welfare organizations with possible political or advocacy agendas, "since they certainly would present legal issues that would require more knowledge to review than typical applications," Fei said. The group would have had to identify indications that applications needed specialized review, and it may have occurred to someone in the group that having "Tea

Party" in an organization's name might point to a political focus that warranted careful scrutiny, she said.

"It was stupid because of the appearance of bias, but in terms of efficient use of limited IRS resources, not unreasonable," Fei said.

by Fred Stokeld

Guidance Planned for Intermediate Violations of Community Needs Assessment Rules.

The IRS is developing guidance on correction and disclosure of section 501(r) violations that are more than minor or inadvertent but less than egregious or willful, a Treasury Department official said May 15.

The guidance is likely to take the form of a revenue procedure and will provide hospitals with more details on remedying failures to comply with section 501(r) requirements, of which community health needs assessments (CHNAs) are one, and a way to keep those details fresh, Ruth Madrigal, attorney-adviser in the Treasury Office of Tax Legislative Counsel, said during a luncheon program sponsored by the District of Columbia Bar Taxation Section's Exempt Organizations Committee.

The intermediate violations comprise "a large range, but I think we gave the outlines of it in the proposed regs that there would be a mechanism for disclosure and correction," Madrigal said after the luncheon, referring to REG-106499-12 . "And so I think we need to put some meat on those bones," she said, adding that officials hope to release the new guidance before the final regs.

The proposed regs say Treasury and the IRS plan to publish guidance to help hospital facilities correct failures to meet CHNA requirements and other rules under section 501(r) and to inform them how to disclose the corrections.

Revocation of a hospital's exemption is possible but won't be a knee-jerk response, Madrigal said. The proposed regs lay out several factors the IRS will consider when deciding whether to revoke exempt status, including the size and scope of the failures. Madrigal said she believes the factors would be applied when the failure was known, which would typically be during an audit. But she said hospitals she's spoken with and those who regularly counsel hospitals are working hard to avoid all failures, so a willful or egregious failure would be rare.

Minor and inadvertent failures won't be considered failures if corrected reasonably promptly after they're found, Madrigal said, giving the example of a hospital failing to widely publicize its policy for a few days because its posted financial assistance policy fell under a sofa and the website hosting the policy crashed due to malware.

"The things that are truly minor, foot faults, they don't need to be discussed," Madrigal said.

Schedule H

Alexander L. Reid of Morgan, Lewis & Bockius LLP said there are discrepancies between the instructions on Schedule H of the Form 990, "Return of Organization Exempt from Income Tax," and the proposed regs under section 501(r). For example, the definition of a hospital is broader in the instructions than in the proposed regs, raising the question of which should be relied on, Reid said.

Typically after a statutory change makes an IRS form obsolete, the IRS has attached a cover sheet with instructions on how to proceed, but that hasn't happened yet, he said.

"It would be premature to change the form until we do have final regulations in place," said Amy Giuliano, attorney-adviser in the IRS Office of Associate Chief Counsel (Tax-Exempt and Government Entities). "We're planning to change [Schedule] H when the regulations are finalized."

by David van den Berg

Cardin Bill Would Clarify Church Pension Plan Treatment.

The Church Plan Clarification Act of 2013 (S. 952), introduced by Senate Finance Committee member Benjamin L. Cardin, D-Md., would make code changes for religious institution pension plans to provide clarity and to bring them more in line with other qualified plans.

Citations: S. 952; Church Plan Clarification Act of 2013

Travel Reimbursement Policies: What you need to know!

In keeping with the IRS mission of providing America's taxpayers with top-quality service by helping you understand and meet your tax responsibilities, the office of Federal, State and Local Governments will host a phone forum on May 28th to assist you in determining the proper tax treatment of various allowances and reimbursement payments.

To learn more, we cordially invite you to attend the "Travel Reimbursement Policies: What you need to know!" Phone Forum. This forum is tailored for federal, state and local government board members and employers, payroll and benefits administrators.

- During this 60-minute presentation we will cover:
- Accountable plan rules
- Payment not covered under an accountable plan
- Board member payments or stipends
- Car allowance payment policy
- Meal allowances
- Fringes benefits

You can register at Travel Reimbursement Policies Phone Forum. Please register as soon as possible because space is limited.

If you have any travel reimbursement or allowance payments questions, please e-mail them to: te.ge.fslg.outreach@irs.gov by May 21, 2013, and we will try to answer them during the phone forum. Please use the subject line: Travel Reimbursement Policies.

We look forward to the opportunity to serve you on May 28th.

Register at:

http://apps.irs.gov/app/scripts/exit.jsp?dest=http://ems.intellor.com/index.cgi?p=204699&t=71&do=

register&s=&rID=418&edID=305

IRS: Many Tax-Exempt Organizations Must File with IRS By May 15 to Preserve Tax-Exempt Status.

A key deadline of May 15 is facing many tax-exempt organizations that are required by law to file annual reports with the Internal Revenue Service. Organizations will see their federal tax exemptions automatically revoked if they have not filed reports for three consecutive years.

The Pension Protection Act of 2006 mandates that most tax-exempt organizations file annual Form 990-series informational returns or notices with the IRS. Under this law, organizations that fail to file reports for three consecutive years automatically lose their federal tax-exempt status. The law, which went into effect at the beginning of 2007, also imposed a new annual filing requirement on small organizations. Churches and church-related organizations are not required to file annual reports.

Form 990-series information returns and notices are due on the 15th day of the fifth month after an organization's fiscal year ends. Organizations that need additional time to file may obtain an extension.

Many organizations use the calendar year as their fiscal year, which makes May 15 the deadline for them. Organizations that fail to file annual reports for three consecutive years will see their tax exemptions automatically revoked as of the due date of the third required filing.

Small tax-exempt organizations with average annual receipts of $50,000 or less may file an electronic notice called a Form 990-N (e-Postcard), which asks organizations for a few basic pieces of information. Tax-exempt organizations with average annual receipts above $50,000 must file a Form 990 or 990-EZ, depending on their receipts and assets. Private foundations file a Form 990-PF.

The IRS began to publish the names of organizations identified as having automatically lost their tax-exempt status for failing to file annual reports for three consecutive years. Organizations that have had their exemptions automatically revoked and wish to have that status reinstated must file an application for exemption and pay the appropriate user fee.

The IRS offers an online search tool, Exempt Organizations Select Check, to help users more easily find key information about the federal tax status and filings of certain tax-exempt organizations, including whether organizations have had their federal tax exemptions automatically revoked.

JCT Releases Tax Reform Working Group Report.

A May 6 report by the Joint Committee on Taxation prepared for the House Ways and Means Committee summarizes current tax law, selected tax reform proposals, and suggestions submitted to the committee's tax reform working groups.

http://services.taxanalysts.com/taxbase/eps_pdf2013.nsf/DocNoLookup/11003/$FILE/2013-11003-1.pdf

IRS Spells Out Policy on E-Mail Searches During Investigations.

The IRS will obtain a search warrant in all cases when seeking the content of stored e-mail communications from internet service providers, the IRS announced in a May 3, 2013, policy statement, adding that it will not seek e-mails from an ISP in civil administrative proceedings.

http://services.taxanalysts.com/taxbase/eps_pdf2013.nsf/DocNoLookup/11183/$FILE/2013-11183-1.pdf

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IRS: Many Tax-Exempt Organizations Must File with IRS By May 15 to Preserve Tax-Exempt Status.

A key deadline of May 15 is facing many tax-exempt organizations that are required by law to file annual reports with the Internal Revenue Service. Organizations will see their federal tax exemptions automatically revoked if they have not filed reports for three consecutive years.

The Pension Protection Act of 2006 mandates that most tax-exempt organizations file annual Form 990-series informational returns or notices with the IRS. Under this law, organizations that fail to file reports for three consecutive years automatically lose their federal tax-exempt status. The law, which went into effect at the beginning of 2007, also imposed a new annual filing requirement on small organizations. Churches and church-related organizations are not required to file annual reports.

Form 990-series information returns and notices are due on the 15th day of the fifth month after an organization's fiscal year ends. Organizations that need additional time to file may obtain an extension.

Many organizations use the calendar year as their fiscal year, which makes May 15 the deadline for them. Organizations that fail to file annual reports for three consecutive years will see their tax exemptions automatically revoked as of the due date of the third required filing.

Small tax-exempt organizations with average annual receipts of $50,000 or less may file an electronic notice called a Form 990-N (e-Postcard), which asks organizations for a few basic pieces of information. Tax-exempt organizations with average annual receipts above $50,000 must file a Form 990 or 990-EZ, depending on their receipts and assets. Private foundations file a Form 990-PF.

The IRS began to publish the names of organizations identified as having automatically lost their tax-exempt status for failing to file annual reports for three consecutive years. Organizations that have had their exemptions automatically revoked and wish to have that status reinstated must file an application for exemption and pay the appropriate user fee.

The IRS offers an online search tool, Exempt Organizations Select Check, to help users more easily find key information about the federal tax status and filings of certain tax-exempt organizations, including whether organizations have had their federal tax exemptions automatically revoked.

Urban Institute Reviews Charitable Contributions Deduction.

This paper attempts to better understand rhetoric over the charitable contributions deduction, arguing that debate surrounding the deduction is ultimately a projection of more fundamental debates relating to the theme of government versus charity. The phrase “government versus charity” can mean government as opposed to charity or government in opposition to charity. The first sense contemplates the need to choose which of government versus charity should supply a given good or service. The second sense contemplates the ideal regulatory posture of government in relation to charity. Competing views over the charitable contributions deduction often reduce to competing views over these two issues.

The full paper is available at:

http://www.urban.org/UploadedPDF/412818-The-Charitable-Contributions-Deduction.pdf

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IRS: Restriction on Use of Property Affects Its Fair Market Value.

In a legal memorandum, the IRS concluded that a restriction on the use of donated property within the boundaries of a national park affects the fair market value of the property under section 170.

A taxpayer claimed a charitable deduction for a donation to the National Park Service of land and mineral rights located in a national park. Before the donation, mining was phased out in the park after Congress passed the Mining in the National Parks Act of 1976. Mining was then resumed on a limited basis for years until the last of the mines in the park was closed.

Under section 170, the fair market value of a property determines the amount of the contribution and is calculated as the price at which the property would change hands between a buyer and a seller.

The IRS said examiners should determine if the donated property’s highest and best use is for mining and whether existing legal restrictions on mining are likely to be removed for a potential owner. The IRS also said examiners should consider whether the property became worthless in the year that mining operations in the park were closed.

Citations: ILM 201319010

IRS Looks to Build on College and University Project.

After releasing the almost complete results of more than 30 examinations of colleges and universities on their compensation and unrelated business income last month, the IRS plans to gather more information from across the exempt sector, an agency official told a congressional subcommittee May 8.

Speaking at a hearing of the House Ways and Means Oversight Subcommittee, Lois Lerner, exempt organizations director in the IRS Tax-Exempt and Government Entities Division, said the agency has “already started a second unrelated business income project.”

“We are looking at organizations that are reporting unrelated business activity on their 990s but they’re not filing a [Form] 990-T,” Lerner said. “We think that’s problematic.”

That project started in the current fiscal year, Lerner said, adding that she couldn’t predict when the examinations would be completed.

In response to a question from Ways and Means member Diane Black, R-Tenn., Lerner said plans are in the works to review multiple types of exempt organizations. “I think that it is very important to broaden this out and see what kind of activities are going on in other tax-exempt organizations, because this was a homogeneous group,” she said. “We want to look farther, and we are developing a project for our next year’s workplan that will do just that.”

Other colleges and universities may be included in the larger study, Lerner said.

Lerner was the lone witness at the hearing about the IRS’s colleges and universities compliance project final report released in April. The report provided findings of more than 30 examinations of colleges and universities on compensation and unrelated business income. With more than 90 percent of the exams finished, the IRS said they resulted in more than 180 adjustments to unrelated business taxable income amounts. The report also revealed that about 20 percent of the private colleges and universities examined failed to meet the rebuttable presumption standard for compensation. (Prior coverage .)

Subcommittee Chair Charles W. Boustany Jr., R-La., asked about the report, noting that colleges and universities and their advisers were frequently wrong about the classification of activities and allocation of expenses related to activities.

“What we did not see was organizations that didn’t seem to have a thought out reason for classifying things the way they classified them,” Lerner said. “But it is very factual related and there were disagreements between the IRS and the organizations, and I think by putting this report out and doing some other work around the issue that we can probably benefit the college and university sector as well as the exempt sector in general.”

“This investigation is notable for what you uncovered,” said Ways and Means member Joseph Crowley, D-N.Y. “And I think we’re all disturbed by what you have discovered in terms of abuse within college and university systems.”

Boustany noted that discussions about tax reform are taking place and said the report contains some troubling details about tax-exempt organizations and how they report unrelated business income and determine executive compensation. He asked Lerner if the report suggested the presence of structural problems within the tax-exempt sector, or if more targeted changes were needed.

“I think that it’s really important for us to get more information than [on] just these 34 organizations, because they were selected because of potential noncompliant activity,” Lerner responded. “I would like to gather more information more broadly to see where the real issues are that could be addressed before changes were made.”

Lerner, in response to questioning from Oversight Subcommittee ranking minority member John Lewis, D-Ga., said that the examinations do not represent a statistically valid sample and that the results apply only to the 34 examined organizations. Four hundred questionnaires that were sent to randomly selected colleges and universities and were completed before the examinations, however, do represent a statistically valid sample and can be considered generally representative of how colleges and universities act, she said.

Lewis also asked whether anything was learned from the examinations that could be useful in investigating other areas of the exempt sector. Lerner said there was.

“This is the first time that we’ve actually looked beyond the fact that the organizations were using comparables to see whether the comparables were really in fact comparable,” she said. “And when I speak to groups about this, what I caution the board members and the executive directors about is, don’t just accept the report from a compensation consultant — you need to ask them questions about this. Because it can be done correctly, and obviously the organizations are trying to do it correctly.”

Boustany Cites High Noncompliance by Colleges on UBIT.

An IRS review of exempt colleges found “almost universal noncompliance by some of the most sophisticated organizations in the tax-exempt sector,” particularly in their calculation of unrelated business income taxes, House Ways and Means Oversight Subcommittee Chair Charles W. Boustany Jr., R-La., said at a May 8 hearing.

http://services.taxanalysts.com/taxbase/eps_pdf2013.nsf/DocNoLookup/11266/$FILE/2013-11266-1.pdf

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Elected Constables Are Employees for Tax Purposes; County Is Employer.

In partially redacted field attorney advice, the IRS concluded that a state’s elected constables aren’t subject to self-employment tax, are employees for FICA and income tax withholding purposes, and that the county is the statutory employer for employment tax purposes because it controls payment to the constables.

This memorandum responds to your request for advice dated June 13, 2012, regarding the above taxpayer. This advice may not be used or cited as precedent in other cases. This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

ISSUES

1. Are the elected constables serving * * * (“constables”) covered under a section 218 agreement?

2. Are the constables considered fee-based public officials for purposes of I.R.C. § 1402(c)(1) and therefore subject to self-employment tax?

3. Are the constables employees for the purposes of the Federal Insurance Contributions Act (“FICA”)?

4. Are the constables employees for the purposes of federal income tax withholding (“ITW”) requirements?

5. If constables are employees, who is the employer for federal employment tax purposes?

SUMMARY CONCLUSIONS

1. The constables are covered by a section 218 agreement, as established by the letter you received from the Social Security Administration. * * *

2. The constables are not solely fee-based as required by section 1402(c)(1), and therefore they are not fee-based public officials. The constables are not subject to self-employment tax.

3. The constables are employees based on the common law employee analysis and are therefore employees for purposes of FICA.

4. The constables are employees for the purposes of ITW pursuant to I.R.C. § 3401(c) because they are elected officials.

5. The employer of the constables for employment tax purposes is the County. The County controls the payment to the constables and is therefore the statutory employer under I.R.C. § 3401(d)(1).

FACTS

Background

Both the State and the County have section 218 agreements1. In order to determine whether the constables are covered under the State or County 218 agreements, you requested a determination from the Social Security Administration ("SSA") regarding whether the constables were covered under either 218 agreement. * * *, you received a letter from SSA which stated that the constable position is covered under the State 218 agreement. * * *

The County made payments to approximately * * * constables totaling approximately $* * * during the years at issue. The constables perform various services such as prisoner transport, service of summonses and warrants, court protection within the Magisterial Courts of Pennsylvania, and services relating to landlord/tenant disputes and resolutions.

Constables are elected officials within a local government in the State. The constables are required to take an oath of office and undergo a background check. They must also receive State-provided training and certification prior to performing services as a constable. Constables must provide proof to the clerk of courts that they hold professional liability insurance in amounts set by statute in order to maintain certification. Once constables are certified by the State, they have statewide authority and jurisdiction enabling him to perform services throughout the state, not just in the local area in which they were elected. Therefore, the constables may perform services for and receive payment from multiple counties. In some counties, constables serve as the primary means of law enforcement.

Constables are covered by quasi-judicial immunity. See e.g. Berg v. Allegheny County, 219 F.3d 261 (3d Cir. 2000). However, upon election, a constable must post a bond between $500 and $3000 as directed by the court to be held in trust for the use and benefit of persons who may sustain injury by reason of neglect of duty. 44 Pa C.S.A. § 7114(c).

Enacted in October of 2009, Part IV of Title 44 of the Pennsylvania Code, titled "Other Officers," sets out the provisions of State statute relating to constables. Part IV contains one chapter, Chapter 71 titled "Constables." Chapter 71 includes subchapters outlining election, appointment, conflicts, training, powers and duties, compensation, and penalties and remedies.2 A constable is elected for a term of six years. 44 Pa. C.S.A. § 7111 (2009). Constables can be re-elected for an unlimited number of terms. Per your interviews, many constables have a continuing and ongoing relationship with the County. Some of the constables in the County have held office for between 20 and 30 years. When a constable vacancy occurs, the court of common pleas for the county where there is a vacancy must

appoint an individual to serve as a constable for the remainder of the term. Id. § 7121. The constable has sole power to appoint deputy constables, subject to approval of the court of common pleas. Id. § 7122.

State statute provides "[w]hile a constable or deputy constable is performing duties other than judicial duties, regardless of whether or not he is certified under this subchapter, he shall not in any manner hold himself out to be active as an agent, employee, or representative of any court, magisterial district judge or judge." Id. § 7142(f) (emphasis added). Prior to 2009, State statute provided that a constable was an independent contractor and not an employee of the Commonwealth, the judiciary, the township, or the county in which he works. This provision appears to follow a ruling of the Supreme Court of Pennsylvania which held unconstitutional as a violation of separation of powers a provision attempting to make constables employees of the State judiciary because constables perform functions of the executive branch. In re Act 147 of 1990, 528 A.2d 985, 990. (Pa. 1991).

Constable Training and Certification

State statute provides for the establishment of a board responsible for establishing, implementing and administering a constable education and training program. 44 Pa. C.S.A. § 7144 (2009). The board also certifies constables and deputy constables who have completed training requirements. Id. The constables must complete a total of 80 hours of initial training and comply with a mandatory continuing education program which may include no more than 40 required hours per year. Id. §§ 7145, 7146. Constables interviewed stated they must also attend an additional 40 hours of training for required firearms certification. The mandatory curriculum for the training consists of topics including: role of the constable in the justice system; professional development; civil law process; criminal law process; mechanics of arrest; prisoner transport and custody; and court security. State statute establishes an account to provide funds for the constable training program; the account is funded by a surcharge collected by constables as a court cost and turned over to the Department of Revenue. Id. § 7149.

Constable Powers and Duties

State statute also sets out the powers and duties of the constables. Constables are required to serve at all elections by preserving the peace at polling places. Id. § 7152. The statute directs constables to arrest individuals without a warrant for various offenses. Id. § 7158. Constables may serve as coroner; collect taxes under a warrant issued by the tax collector; and arrest a person trespassing upon any forest. Id. §§ 7154-7156.

Constables must impound trespassing livestock and notify owner to collect livestock and pay the constable for the cost of damage, care and fee for the constable. Id. § 7159. If the owner fails to pay, the livestock shall be sold at a public sale and the all money realized from the sale will be turned over to the magisterial district judge. Id. § 7159.1. The magisterial district judge then distributes payment to the landowner for damages and the constable for his services. Id.

Some other duties which constables may perform include, but are not limited to, the following: transporting defendants to arraignments and hearings; carrying out sales and ejectments in landlord-tenant disputes; serving complaints, summonses and notices; providing courtroom security; executing warrants of arrest; serving notice of election to township or borough officers; seizing registration plates and drivers' licenses. Id. §§ 7161, 7165. Criminal subpoenas can be served by police officers or constables. Sheriff's deputies are also permitted to transport prisoners.

Constables generally set their own hours of work. The magisterial district judges assign work to the

constables. The constables interviewed indicated that they can turn down work but do so at the risk of not getting future assignments from that judge. The constables interviewed stated that the judges are the bosses and make the rules. A constable must be present in the courtroom when a magisterial district judge is present in court. Therefore the magisterial district courts cannot function without the services of the constable. The constables view themselves as "officers of the court." Police officers in the county do not provide courtroom or courthouse security. Sheriff's deputies perform courtroom security for the "major" courts.

Constables must provide some of the supplies necessary for the performance of their duties. For example, they must provide their own vehicles for prisoner transport, clothing, guns, ammunition and handcuffs. Some judges require a constable to be in uniform when providing courtroom security, while others simply require the constables dress professionally. There is no state-mandated uniform for constables. The court provides metal detectors and wands. Some courts also provide constables with desk space or an office. The State issues the constables ID badges with the title "PA State Constable."

* * *. Constables are not prohibited from performing services for private entities, * * *. Constables must carry an additional liability insurance policy if he performs private work.

Constable Guidelines and Discipline

* * *. * * *. A State constable handbook is in the process of being drafted * * *. During the required constable training, the constables must abide by a State-issued classroom code of conduct. The constables you interviewed stated that the State regulates how they do their job.

State statute provides for discipline of constables through Subchapter H, Penalties and Remedies. A court of common pleas may inquire into the official conduct of the constable and remove the constable from office if it determines the constable is incompetent. Id. § 7172. A constable's compensation may be withheld if he defaults on remittance of collected tax. Id. § 7173. A constable may also be subject to fines and criminal penalties for neglecting or refusing to perform duties. Id. §§ 7175, 7178. As public officials, constables are required to file Statements of Financial Interests annually with the State Ethics Commission.

Constable Payment

Constables are paid according to schedules set by statute. Where the constable is performing a service on behalf of a litigant, for example, the litigant is required to pay the constable fees in advance to the court for services desired to be performed. Id. § 7161(d). According to State statute, the court is to turn the fees over to the constable as soon as possible. Id. § 7161(e). In criminal cases, the constable fees are charged to the defendant; however, if the defendant is discharged or indigent, the fee is assessed to the county. Id. § 7161(g)(16). * * *.

Constables are reimbursed for actual mileage traveled. Id. § 7161. In certain cases when transporting prisoners, the constable may, at his discretion, be accompanied by a second constable or deputy constable; in these cases each constable shall receive payment for the transportation. Id. For services performed relating to elections, constable compensation is paid by the county. Id. § 7163. The Department of Motor Vehicles pays the constables for seizing registrations and drivers' licenses. Id. § 7165.

Constables are permitted by statute to collect monies from the public for certain items, including outstanding fines and constable fees and surcharges. Amounts collected by the constable must be turned over entirely to the court within time frames set by statute. The court then distributes

payment to the constables. * * *.

* * *. Payments for election day services are paid from a separate fund by the Board of Elections.

LAW AND ANALYSIS

1. Coverage Under a Section 218 Agreement

The SSA determines whether the workers are employees within the meaning of section 210(j) of the Social Security Act, which applies the common law rules. If the SSA determines that an individual worker is covered under the section 218 agreement, the Service then has jurisdiction over the liability for FICA taxes with respect to wages paid to such individual. See I.R.C. section 3121(d)(4).

The determination of who is covered under the terms of a section 218 agreement is under the jurisdiction of the SSA. See Sec 3 (page 3) of the attached 2002 IRS-SSA MOU. The final determination of federal tax liability is under the jurisdiction of the Service. The enforcement mechanism with respect to section 218 agreements is also with the Service because the payments under the agreements are treated as FICA taxes.

The SSA (Regional Office III, Philadelphia) has determined that the constables are covered under the State 218 agreement. * * *.

2. Fee-Based Public Officials Subject to Self-Employment Tax

Before we apply the common law employee analysis, we must determine whether the constables are fee-based public officials for the purposes of the Self-Employment Contributions Act ("SECA"). If the constables are fee-based public officials, they are subject to SECA rather than FICA ("fee-based public official exception"). SECA is imposed on the self-employment income derived by an individual from any trade or business carried on by such individual. I.R.C. §§ 1401, 1402(a).

The general rule is that the performance of the functions of a public office does not constitute a trade or business. I.R.C. § 1402(c)(1), Treas. Reg. § 1.1402(c)-2(a). However, when those functions are compensated solely on a fee basis, the performance of those functions does constitute a trade or business. I.R.C. § 1402(c)(1).

The statute provides that a trade or business does not include "the performance of the functions of a public office, other than the functions of a public office or of a State or political subdivision thereof with respect to fees received in any period in which the functions are performed in a position compensated solely on a fee basis". I.R.C. § 1402(c)(1). Treas. Reg. § 1.1402(c)-2(a)(2) provides:

If an individual receives fees after 1967 for the performance of the functions of a public office of a State or a political subdivision thereof for which he is compensated solely on a fee basis, and if the service performed in such office is eligible for (but is not made the subject of) an agreement between the State and the Secretary of Health, Education, and Welfare pursuant to section 218 of the Social Security Act to extend social security coverage thereto, the service for which such fees are received constitutes a trade or business within the meaning of section 1402(c) and § 1.1402(c)-1. If an individual performs service for a State or a political subdivision thereof in any period in more than one position, each position is treated separately for purposes of the preceding sentence.

Therefore, "fee-based public officials" are public officials — (1) who receive fees; (2) whose positions are compensated solely on a fee basis; and (3) who are not subject to a 218 agreement. Fee-based public officials are subject to SECA rather than FICA. A public office includes any elective or appointive office of a State or its political subdivision. Treas. Reg. § 1.1402(c)-2(b). Examples include

a county commissioner, a judge, a marshal, a sheriff, a constable or a notary public. Id. The constables in the County are elected and are therefore public officials.

Next we must determine whether the constables are compensated solely on a fee basis. The IRS position on what constitutes a fee is clarified in Revenue Ruling 74-608. In Rev. Rul. 74-608, State statute required an elected tax collector to account for and turn over all tax collections to the treasurer of each taxing authority. State statute also authorized the taxing authority to set a salary, wage, or commission, not to exceed 5% of the tax collected, as remuneration for the tax collector. His remuneration for his term in office was a fixed percentage of the amounts collected and turned over for each taxing authority; specifically, 3 percent from the county, 4 percent from the township and 2.8 percent from the school district. The revenue ruling finds that the tax collector is not a fee-based public official because his remuneration was a salary from a government fund rather than fees collected directly from the public. Rev. Rul. 74-608 provides.

When a public official receives his remuneration in the form of fees directly from the members of the public with whom he does business, such remuneration is 'fees' within the meaning of section 1402(c)(1) of the Act. When, however, a public official receives his remuneration or salary from a government fund and no portion of the monies collected by him belongs to or can be retained by him as compensation, the remuneration is not 'fees' under section 1402(c)(1).

In Rev. Rul. 74-608, not only was the tax collector turning over what he collected from the public to the taxing authority, but also the taxing authority had the authority to determine what his remuneration would be and paid with general government funds.

For some of their duties, the constables serving this County collect monies from the public and turn them over to the County. The County then pays then constables an amount set by statute. Often the amount collected is equal to the amount due to the constable by statute. The constables also receive other payments for their services that do not come directly from the public. For example, they receive payments directly from the County for their services on Election Day. In addition, they receive a payment directly from the judge for the sale of livestock. Therefore, the constables are not solely fee-based for the purposes of SECA, as required by the clear statutory language of section 1402(c)(1).

In addition, as noted above, according to SSA, the constables are covered under the State 218 agreement. Coverage under a 218 agreement also removes the constables from the provisions of SECA pursuant to section 1402(c)(1). Therefore, the constables do not qualify for the fee-based public official exception.

3. Employees for the Purposes of FICA

The definition of employee for purposes of FICA includes "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee" and "any individual who performs services that are included in an agreement entered into pursuant to section 218 of the Social Security Act." I.R.C. § 3121(d). Since SSA has determined that constables are included in the State's section 218 agreement, they must be treated as employees for purposes of FICA. * * *.Whether an employer-employee relationship exists in a particular situation is a factual question to which common law principles apply. See Weber v. Commissioner, 103 T.C. 378, 386, aff'd. 60 F.3d 1104 (4th Cir. 1995); Nationwide Mutual Ins. Co. v. Darden, 503 U.S. 318, 323 (1992). Factors which are considered include: (1) the degree of control exercised by the principal; (2) which party invests in work facilities used by the individual; (3) the opportunity of the individual for profit or loss; (4) whether the principal can discharge the individual; (5) whether the work is part of the principal's regular business; (6) the permanency of the

relationship; and (7) the relationship the parties believed they are creating. Weber v. Commissioner at 387. See also, Avis Rent A Car System v. United States, 503 F.2d 423 (2d Cir. 1974); Ewens & Miller, Inc. v. Commissioner, 117 T.C. 263, 270 (2001).

The Treasury Regulations also offer guidance in making a determination as to whether workers are employees or independent contractors:

Generally such relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work, to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is an independent contractor. An individual performing services as an independent contractor is not as to such services an employee under the usual common law rules. Individuals such as physicians, lawyers, dentists, veterinarians, construction contractors, public stenographers, and auctioneers, engaged in the pursuit of an independent trade, business, or profession, in which they offer their services to the public, are independent contractors and not employees.

Treas. Reg. § 31.3121(d)-1(c)(2).

Additionally, Rev. Rul. 87-41 identifies twenty factors, based on an examination of cases and rulings, which indicate whether sufficient control is present to establish an employer-employee relationship. These twenty factors are to be used as a guide in determining employment status; however, special scrutiny may be required to ensure that formalistic aspects of an arrangement do not obscure its substance. The factors are (1) instructions, (2) training, (3) integration (whether the worker's services are so integrated into business operations that success of continuation of business depend upon those services, (4) services rendered personally, (5) hiring, supervising and paying assistants, (6) continuing relationship, (7) set hours of work, (8) full time required, (9) doing work on employer's premises, (10) order or sequence set (worker must perform services in the order or sequence determined by the person for whom services are performed), (11) oral or written reports, (12) payment by hour, week, month, (13) payment of business and/or travel expenses, (14) furnishing of tools and materials, (15) significant investment (if worker invests in facilities, this is an indication of independent contractor status; however, if there is a lack of investment on the part of the worker, it indicates a status of employee), (16) realization of profit or loss (if worker can realize a profit or loss, it indicates independent contractor status), (17) working for more than one firm at a time, (18) making service available to the general public, (19) right to discharge, and (20) right to terminate.

More recently the Service considers the issue under three primary categories of evidence — behavioral control, financial control, and relationship of the parties. Refer to IRM 4.23.5-1 and Independent Contractor or Employee? Training Materials, Training 3320-102 (10-96). Facts that illustrate behavioral control, or whether there is a right to direct or control how the worker performs the specific task for which he or she is hired, are (1) instructions and (2) training. Facts that illustrate financial control, or whether there is a right to direct or control how the business aspects of the worker's activities are conducted, are (1) significant investment, (2) unreimbursed expenses,

(3) services available to the public, (4) method of payment, and (5) opportunity for profit or loss. Facts that illustrate the relationship of the parties are (1) employee benefits, (2) intent of parties/written contracts, (3) permanency, (4) discharge/termination, and (5) regular business activity.

The facts regarding behavioral control indicate that the constables are employees. The constables must undergo 80 hours of initial training plus up to 80 hours of additional training each year. * * *. These facts indicate that the State and/or the County have control over how the constables perform their duties.

The facts regarding financial control are mixed. The constables must turn over all monies collected to the County and then only receive payment if they properly submit forms according to the County's procedures and a judge signs off on those forms. This indicates control over the finances at the County and State level. The constables are reimbursed for their mileage and are provided some tools (metal detectors, desk). However, the constables must provide some of the tools needed themselves (cars, guns, ammunition, etc.). The constables also make an investment by posting a bond upon election. However, the constables have a minimized financial loss because in some cases they are able to collect payment regardless of whether they are successful in their services or not. While it is legally possible for constables to provide services for the public, according to your interviews, it is rare.

The facts regarding the relationship of the parties are also mixed. The County has been treating the constables as independent contractors and reporting payments made to them on Forms 1099. In addition, they do not provide any employee benefits to the constables. However, the constables have an ongoing relationship with the County as some of them have served for more than 20 years. In addition, the constables are completely integrated into the County business; the magisterial district court cannot function without them and the County relies on them to serve notices and execute warrants because they do not have enough police officers or sheriffs to do so. The constables can be terminated by a judge for failure to perform their duties pursuant to the statute.

As in most worker classification cases, the facts are not all indicative of an employee or an independent contractor. However, on balance, it appears that the constables are employees. The State's ability to control how the constables perform their services through state statute, required training and the * * * constable handbook is an especially strong factor that indicates they are employees subject to the control of an employer.

The County maintains that the constables are not its employees. It relies, in part, on State case law which holds that the constables are independent contractors and not employees. For example, the Supreme Court of Pennsylvania held that legislation designed to bring constables within the control and direction of the judiciary was in violation of the State's constitution because it attempted to place constables, whose central functions and activities consist of exercising executive powers, within the supervisory authority of the judicial branch, thereby violating the doctrine of separation of powers. In re Act 147 of 1990, 528 A.2d 985, 990. (Pa. 1991). The court cited an earlier case that held a constable is not an employee of the Commonwealth, the judiciary, the township, or the county in which he works. Id. at 986, citing Rosenwald v. Barbieri, 462 A.2d 644 (Pa. 1983). State case law is not binding for federal income tax purposes. In addition, the court in these cases did not apply the common law employee analysis used to determine coverage under FICA. Finally, there do not appear to be any cases classifying the constables as independent contractors since the enactment of Chapter 71 to the Pennsylvania Code in 2009, discussed above. These amendments and consolidation appear to make significant changes to the law regarding constables and may change the analysis under state law. Thus, the County's reliance on state case law is unfounded.

4. Employees for the Purposes of Income Tax Withholding

I.R.C. § 3402 obligates any employer making a payment of wages to deduct and withhold tax as prescribed by the Secretary. I.R.C. § 3401(a) defines wages as all remuneration (other than fees paid to a public official) for services performed by an employee for his employer. I.R.C. § 3401(c) provides that for the purposes of income tax withholding ("ITW") requirements, an employee includes "an officer, employee, or elected official of the United States, a State or any political subdivision thereof . . ." Because the constables are elected officials of the County, they are employees for the purpose of ITW.

5. Who is the Employer?

Section 3401(d)(1) provides, that for purposes of income tax withholding, the term employer means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" (except for purposes of the definition of wages) means the person having control of the payment of such wages. Neither FICA nor FUTA contains a definition of employer similar to the definition contained in section 3401(d)(1), relating to income tax withholding. However, Otte v. U.S., 419 U.S. 43 (1974), holds that a person who is an employer under section 3401(d)(1), relating to income tax withholding, is also an employer for purposes of FICA withholding under section 3102. Otte involved a trustee in bankruptcy who was an employer under section 3401(d)(1) by virtue of having control over the payment of wages owed by the bankrupt. The Court stated, "The fact that the FICA withholding provisions of the Code do not define 'employer' is of no significance, for that term is not to be given a narrower construction for FICA withholding than for income tax withholding." Otte, 419 U.S. at 51. The Otte decision has been extended to provide that the person having control of the payment of wages is also an employer for purposes of section 3111, which imposes the FICA tax on employers, and for purposes of section 3301, which imposes the FUTA tax on employers.3 In re Armadillo Corp., 410 F. Supp. 407 (D. Col. 1976), aff'd, 561 F.2d 1382 (10th Cir. 1977), In re Laub Baking Co., 642 F.2d 196 (6th Cir. 1981), and STA of Baltimore — ILA Container Royalty Fund v. U.S., 621 F. Supp. 1567 (D.C. Md. 1985), aff'd, 804 F.2d 296 (4th Cir. 1986) reached similar conclusions.

The constables primarily perform services for the courts, which are part of the State judiciary system. They also perform various services the County by serving on election day, executing warrants, and impounding livestock. They also perform services for private litigants, including carrying out ejectments in landlord-tenant disputes. However, the constables' payment for all of these services is controlled by the County, as the funds come from County checking accounts and the County Manager of Constable Services verifies all submissions for payments. Even if the County is not the common law employer, the County is the employer for purposes of ITW and FICA because it controls the payments.

CONCLUSION

Based on the facts you have gathered, we agree that the constables are employees under the common law standard. Further, SSA has determined that the constables are covered under the State's 218 agreement. Finally, we believe the County is liable for employment taxes for the constables.

Please call * * * if you have any further questions.

Joseph W. Spires

Area Counsel

(Tax Exempt & Government Entities)

IRS Reminder: Calendar Year Form 990 Series Returns Due by May 15.

May 15 is the filing deadline for exempt organizations whose tax year ends on December 31, unless the organization submitted Form 8868, Application for Extension of Time To File an Exempt Organization Return. Remember an organization that fails to file for three consecutive years automatically loses its federal tax-exempt status.

Foundation's Grantmaking Expenditures Not Taxable.

The IRS ruled that expenditures made through a private foundation’s grantmaking program through which American art will be brought to international audiences will not be taxable.

Dear * * *

You asked for advance approval of your educational grant procedures under Internal Revenue Code section 4945(g)(3). This approval is required because you are a private foundation that is exempt from federal income tax.

OUR DETERMINATION

We approved your procedures for awarding educational grants. Based on the information you submitted, and assuming you will conduct your program as proposed, we determined that your procedures for awarding educational grants meet the requirements of Code section 4945(g)(3). As a result, expenditures you make under these procedures won’t be taxable.

DESCRIPTION OF YOUR REQUEST

You are dedicated to fostering exploration, understanding, and enjoyment of the visual arts of the United States for national and international audiences. You are committed to supporting projects designed to engage audiences around the globe in an enriched dialogue on American art. Through grants and initiatives, you have made it a priority to bring American art, interpretation, and research resources to international audiences, and have a particular interest in fostering multi-national perspectives.

In furtherance of this international perspective, you will initiate a grant making program called B. The B will further your mission of internationalizing the field of American art by supporting scholars worldwide who share your goals of excellence and originality. In addition to encouraging international scholarship, B will enrich the field through the introduction of new approaches to American art research and will enable scholars outside the United States greater access to American art scholarship. It also will allow them to publish on this topic in their home countries.

Awards under B generally will be made to qualified publishers of selected works. Such grants will be treated as grants to organizations. In limited circumstances described below, however, certain grants will be made directly to individual authors and volume editors and/or contributors. The grants

to individuals is the reason you are requesting advance approval under section 4945(g)(3).

B will support scholarly publications that (1) offer translations of key texts on American art, (2) encourage international scholarship on American art, or (3) present focused theses exploring American art in an international context. B is designed to determine the nature of the proposed publication, the professional qualifications of the publisher, the professional qualifications of the author, the commitment and capacity of the author and his or her publisher, and the expected outcomes of publication.

You initially intend to operate B with a three-year budget of x dollars. Grants to support the publication of a book generally will not exceed y dollars, and grants to support the publication of an article generally will not exceed z dollars, although you may vary the size of the grants based on the quality of the applications received and the amount requested. Funds awarded under B will be used for direct costs of publishing the particular work, including translation costs and image rights of black-and-white or full-color illustrations.

You will promote the grants through an extensive list of academic and museum contacts. Grant announcements will be posted on your website and distributed to various relevant associations worldwide. Additionally, information about the grants will be disseminated to individuals through your general e-newsletter, as well as international curators, publishers, and scholars through targeted e-blasts. Posters and postcards are also distributed to major universities and museums to increase the visibility of your grant program.

Each application must be for a scholarly book or article in print or digital format that focuses on historical American art (circa 1500 to 1980), that has an international dimension, and that is under contract for publication. You will strongly encourage applications for:

Translations of books and articles originally written or published in English.

English-language translations of books and articles originally written or published in another language.

Books and articles for publication outside the United States.

Internationally collaborative projects.

Books and articles examining American art in an international context.

Neither new exhibition catalogues nor collection catalogues are eligible for grants under your program; however, translations or reprints of exhibition catalogues that were originally published prior to 2005 may be considered if they contain substantial scholarship.

In reviewing applications, your review committees will consider objective criteria regarding each application. The criteria you will consider include:

The publication’s significant contribution to the field of American art as well as its place in the current literature on the topic.

The publisher’s history, mission, and art list.

The distribution and marketing plan for the publication.

The author’s curriculum vitae.

A partial (in the case of a book) or full (in the case of an article) manuscript, including sample book chapters in both languages if the project involves translation or a detailed English abstract if the article is in a language other than English.

Two or more recent peer reviews of the full manuscript.

The publisher's endorsement of the manuscript.

Your organization will review applications using internal and external review committees. The external review committee will be comprised of three or more international scholars in the field of American art, each with extensive subject matter knowledge and experience. All external review committee members will be asked to provide a list of potential personal and/or financial conflicts, and will be asked to recuse themselves should any conflicts arise. External review committee members shall remain anonymous to the public and to applicants during their term on the committee. No external review committee member may benefit personally or professionally from the selection of any particular application for the grant.

The internal review committee will consist of your staff including scholars of American art. Your staff will process and review applications received, with a focus on accomplishing your goal of international exposure for American art. Your internal review committee will collect the recommendations of the external review committee and combine these results with your internal review committee. The internal review committee will make the final decision regarding the recipients. No internal review committee member may benefit personally or professionally from the selection of any particular application for a grant.

B awards generally will be paid to the qualified publisher to be used only for the approved publication; however, grants will be made directly to authors in certain circumstances.

Each grant will be made pursuant to a written grant agreement with the publisher or author. The grant agreement will limit the use of the funds to those enumerated in the approved application. Grant recipients will be required to submit periodic reports to you, and a schedule of deadlines for these reports will be outlined in the grant agreement. If required reports are delinquent or there are other indications of a possible diversion of funds, follow-up requests will be submitted. If satisfactory reports are not received after a reasonable time, you will attempt to recover the funds. While conducting an investigation, you will withhold future payments (if any) until the delinquent reports have been submitted. If a diversion is determined to have occurred, no future payments will be made to the recipient and appropriate steps will be taken to recover the grant funds. You will maintain appropriate records regarding the amount of the grant, grant recipient, information sufficient to insure that the recipient was not a "disqualified person" under Code Section 4946 with respect to you for the purposes of the self-dealing rules set forth in Code Section 4941, the purpose of the grant, the grant agreement and final report, and all follow-up information regarding progress reports, any suspension of grants, and any investigations of possible diversion of grant funds.

BASIS FOR OUR DETERMINATION

The law imposes certain excise taxes on the taxable expenditures of private foundations (Code section 4945). A taxable expenditure is any amount a private foundation pays as a grant to an individual for travel, study, or other similar purposes. However, a grant that meets all of the following requirements of Code section 4945(g) is not a taxable expenditure.

The foundation awards the grant on an objective and nondiscriminatory basis.

The IRS approves in advance the procedure for awarding the grant.

The grant is:

A scholarship or fellowship subject to section 117(a) and is to be used for study at an educational organization described in section 170(b)(1)(A)(ii); or

A prize or award subject to the provisions of section 74(b), if the recipient of the prize or award is selected from the general public; or

To achieve a specific objective; produce a report or similar product; or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar skill or talent of the recipient.

To receive approval of its educational grant procedures, Treasury Regulations section 53.4945-4(c)(1) requires that a private foundation show:

The grant procedure includes an objective and nondiscriminatory selection process.

The grant procedure results in the recipients performing the activities the grants were intended to finance.

The foundation plans to obtain reports to determine whether the recipients have performed the activities that the grants were intended to finance.

OTHER CONDITIONS THAT APPLY TO THIS DETERMINATION

This determination covers only the grant program described above. This approval will apply to succeeding grant programs only if their standards and procedures don’t differ significantly from those described in your original request.

This determination applies only to you. It may not be cited as precedent.

You cannot rely on the conclusions in this letter if the facts you provided have changed substantially. You must report any significant changes in your program to the Cincinnati Office of Exempt Organizations at:

* * *

You cannot make grants to your creators, officers, directors, trustees, foundation managers, or members of selection committees or their relatives.

All funds distributed to individuals must be made on a charitable basis and must further the purposes of your organization. You cannot award grants for a purpose that is inconsistent with Code section 170(c)(2)(B).

You should keep adequate records and case histories so that you can substantiate your grant distributions with the IRS if necessary.

We’ve sent a copy of this letter to your representative as indicated in your power of attorney.

Please keep a copy of this letter in your records.

If you have any questions, please contact the person listed at the top of this letter.

Sincerely,

Holly O. Paz

Director, Exempt Organizations

Rulings and Agreements

Citations: LTR 201318008

IRS: Religious Organization's Benefits Plans Are Church Plans.

The IRS ruled that a tax-exempt religious organization's defined benefit pension plans are church plans within the meaning of section 414(e), retroactive to specified dates.

Date: February 6, 2013

Dear * * *

This letter is in response to your request dated May 13, 2005, as supplemented by correspondence dated March 5, 2012, submitted on your behalf by your authorized representative regarding the church plan status of Plan X, Plan Y and Plan Z within the meaning of section 414(e) of the Internal Revenue Code (Code).

The following facts and representations have been submitted under penalties of perjury on your behalf:

Taxpayer A was established in 19* * * by Order B, a Church C religious order based in Country G, which operates hospitals and health care facilities in three locations in the United States. Taxpayer A is a not-for-profit corporation organized under the laws of State E. Taxpayer A is listed in Directory S, and accordingly, is exempt from Federal income tax under section 501(c) of the Code. Order B is listed in Directory S as being represented in Entity I by virtue of its presence at Taxpayer A. The current president and chief executive officer of Taxpayer A is a member of Order B.

Taxpayer A's by-laws contain the stated purpose to establish and operate a Church C hospital for the purposes of providing hospitalization and care of the sick and injured, necessary facilities for the treatment of disease, and for scientific purposes; and to establish and operate schools and educational institutions in the hospital, nursing and related fields. Any applicant for appointment to Taxpayer A's medical staff must, as part of the application, agree to be bound by the Ethical and Religious Directives of Church C Healthcare Services as promulgated by Entity J.

Under Article III of Taxpayer's by-laws, the sole member of Taxpayer A's corporation is Network D. Also under the by-laws, Network D has the right to ensure that Taxpayer A is conducting its business and affairs consistently with and in furtherance of the objectives and philosophy of Order B.

Network D is a corporation organized under the Statute N. Among its corporate purposes is to conduct the business affairs of the corporation in a manner consistent with the objectives and philosophy of Order B. Prior to September * * *, 20* * *, members of Network D were from the Provincial Council of Order B, and those members of Entity F Executive were appointed by the Provincial Council. The Provincial Council of Order B is comprised of the local Provincial Superior of

Order B and the local Provincial Superior of Order B's councilors. The Entity F Executive is comprised of Order B members who have been appointed by the Provincial Council to serve on the Entity F Executive.

Effective September * * *, 20* * *, Network D's by-laws were amended to provide that Network D's members shall be comprised of seven members appointed by the General Council of Order B, at least four of whom must at all times be members of Order B. As a result, you represent that Taxpayer A is under the control of Network D, a majority of whose members must be members of Order B. If at any time Network D ceases to exist, Taxpayer A's by-laws provide that the Provincial Council may elect a new corporate member.

Prior to the adoption of Taxpayer A's current by-laws on October * * *, 20* * *, Taxpayer A's members were members of Order B's Provincial Council and members of the Entity F Executive. Since its founding in 19* * *, Taxpayer A has been controlled either directly, or through Network D, by Order B.

Taxpayer A's board of trustees is responsible for the oversight of Taxpayer A, the appointment of its officers and medical staff, the assessment of its programs, the preparation and recommendation to Network D of Taxpayer A's capital and operating budget, and certain additional oversight responsibilities set forth in Taxpayer A's by-laws. The board of trustees is comprised of not less than 12, nor more than 18 members, including three members of Order B or their representatives, appointed by Entity F, at least five members appointed by Network D, two members of Taxpayer A's medical staff, and any additional trustees (up to 18) appointed by Network D.

Entity F is a corporation which is incorporated under the laws of Country G. Under its by-laws, its membership is limited to members of Order B. The members of Entity F consist of the members of the Provincial Council of Order B and selected members of the Entity F Executive. Any member of the board of trustees of Taxpayer A may be removed by Network D with or without cause. As a result, through its power to appoint Taxpayer A's trustees, either through Entity F or through Network D, and its power through Network D to remove the trustees with or without cause, you represent that Order B controls the board of trustees..

In 19* * *, Taxpayer A adopted Plan X for the benefit of the employees of Taxpayer A. Plan X is a defined benefit pension plan. Plan X is a new plan, not a successor plan, and meets the requirements of section 401(a) of the Code. Effective September * * *, 19* * *, Plan X's benefit formula was incorporated into the plan document for Plan Y. Accruals under Plan X were frozen by an amendment to Plan X effective November * * *, 19* * *, which is incorporated into the current plan by an individually designed amendment.

Plan Y is a defined contribution money purchase pension plan adopted by Taxpayer A on September * * *, 19* * *, solely for the benefit of its employees. Plan Y is intended to be qualified under section 401(a) of the Code.

The combined plan document for Plan X and Plan Y was amended and restated periodically, and the most recent favorable determination letter for the combined plan document is dated April * * *, 20* * *. Participation in Plan X and Plan Y has been limited to employees of Taxpayer A at all times.

Plan Z was originally adopted by Taxpayer A effective January * * *, 19* * *, solely for the benefit of its employees. Plan Z is intended by Taxpayer A to be a tax deferred annuity arrangement under section 403(b) of the Code. Participation in Plan Z has been limited to employees of Taxpayer A at all times.

None of the eligible participants in Plan X, Plan Y or Plan Z are, were, or can be considered to be employed in connection with one or more unrelated trades or businesses within the meaning of section 513 of the Code. The plans do not include as participants employees of for-profit entities.

By resolutions dated December * * *, 20* * *, Taxpayer A established Committee H. Committee H's sole purpose and function is to administer Plan X, Plan Y and Plan Z. Under the resolutions, the initial members of Committee H were the president and chief executive officer of Taxpayer A, and the executive vice president of Taxpayer A. If Taxpayer A's president is a member of Order B, the president is an ex officio member of Committee H and has the authority to appoint and discharge up to six Committee H members at any time. Under Taxpayer A's by-laws, the President of Taxpayer A is appointed (and can be removed) by Network D.

You represent that the establishing resolutions for Committee H provide that if the president is not or ceases to be a member of Order B, Network D shall assume the authority to appoint and discharge up to seven Committee H members, so that Committee H continues to constitute an organization that is controlled by or associated with Order B. As established by Taxpayer A, Committee H has all such powers as may be necessary or helpful to discharge its duties as administrator of the plans.

By resolutions dated December * * *, 20* * *, Taxpayer A amended Plan X, Plan Y and Plan Z to name Committee H as the administrator under each of the Plans.

Taxpayer A has not made the election under section 410(d) of the Code with respect to Plan X, Plan Y, or Plan Z. However, it has in the past voluntarily operated Plan Y in compliance with the standards of the Employee Retirement Security Act of 1974 (ERISA) to include filing Form 5500, and paying premiums to the Pension Benefit Guaranty Corporation.

In accordance with Revenue Procedure 2011-44, Notice to Employees with reference to Plan X was provided on March * * *, 20* * *. This notice explained to participants of Plan X, Plan Y and Plan Z the consequences of church plan status.

Based on the foregoing, you request a ruling that Plan X and Plan Y are church plans within the meaning of section 414(e) of the Code effective as of January 1, 1974; and that Plan Z is a church plan within the meaning of section 414(e) of the Code effective as of January 1, 1987.

Section 414(e) was added to the Code by section 1015 of ERISA. Section 1017(e) of ERISA provided that section 414(e) of the Code applied as of the date of ERISA's enactment. However, section 414(e) of the Code was subsequently amended by section 407(b) of the Multiemployer Pension Plan Amendments Act of 1980, Pub. Law 96-364, to provide that section 414(e) of the Code was effective as of January 1, 1974.

Section 414(e)(1) of the Code generally defines a church plan as a plan established and maintained for its employees (or their beneficiaries) by a church or a convention or association of churches which is exempt from taxation under section 501 of the Code.

Section 414(e)(2) of the Code provides, in part, that the term "church plan" does not include a plan that is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513 of the Code); or if less than substantially all of the individuals included in the plan are individuals described in section 414(e)(1) of the Code or section 414(e)(3)(B) of the Code (or their beneficiaries).

Section 414(e)(3)(A) of the Code provides that a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches includes a plan maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches.

Section 414(e)(3)(B) of the Code defines "employee" of a church or a convention or association of churches to include a duly ordained, commissioned, or licensed minister of a church in the exercise of his or her ministry, regardless of the source of his or her compensation, and an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 of the Code, and which is controlled by or associated with a church or a convention or association of churches.

Section 414(e)(3)(C) of the Code provides that a church or a convention or association of churches which is exempt from tax under section 501 of the Code shall be deemed the employer of any individual included as an employee under subparagraph (B).

Section 414(e)(3)(D) of the Code provides that an organization, whether a civil law corporation or otherwise, is associated with a church or a convention or association of churches if the organization shares common religious bonds and convictions with that church or convention or association of churches.

Section 414(e)(4)(A) of the Code provides that if a plan, intended to be a church plan, fails to meet one or more of the church plan requirements and corrects its failure within the correction period, then that plan shall be deemed to meet the requirements of this subsection for the year in which the correction was made and for all prior years. Section 414(e)(4)(C)(i) of the Code provides, in pertinent part, that the term "correction period" means the period ending 270 days after the date of mailing by the Secretary of a notice of default with respect to the plan's failure to meet one or more of the church plan requirements.

Revenue Procedure 2011-44, 2011-39 I.R.B. 446, supplements the procedures for requesting a letter ruling under section 414(e) of the Code relating to church plans. The revenue procedure: (1) requires that plan participants and other interested persons receive a notice in connection with a letter ruling request under section 414(e) of the Code for a qualified plan; (2) requires that a copy of the notice be submitted to the Internal Revenue Service (IRS) as part of the ruling request; and (3) provides procedures for the IRS to receive and consider comments relating to the ruling request from interested persons.

In order for an organization that is not itself a church or convention or association of churches to have a qualified church plan, it must establish that its employees are employees or deemed employees of a church or convention or association of churches under section 414(e)(3)(B) of the Code by virtue of the organization's control by or affiliation with a church or convention or association of churches. Employees of any organization maintaining a plan are considered to be church employees if the organization: 1) is exempt from tax under section 501 of the Code; and, 2) is controlled by or associated with a church or convention or association of churches. In addition, in order to be a church plan, the plan must be administered or funded (or both) by an organization described in section 414(e)(3)(A) of the Code. To be described in section 414(e)(3)(A) of the Code, an organization must have as its principal purpose the administration or funding of the plan and must also be controlled by or associated with a church or convention or association of churches.

In this case, Taxpayer A is a not-for-profit corporation which is exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3) of the Code. In view of the common religious bonds between Church C and Taxpayer A, the inclusion of Order B in Directory S, and the indirect control of Taxpayer A by Church C through Order B, we conclude that Taxpayer A is associated with a church or a convention or association of churches within the meaning of section 414(e)(3)(D) of the Code, that the employees of Taxpayer A meet the definition of employee under section 414(e)(3)(B) of the Code and that they are deemed to be employees of a church or a convention or association of churches by virtue of being employees of an organization which is exempt from tax under section 501 of the Code and which is controlled by or associated with a church or a convention or association of churches.

Effective December * * *, 20* * *, with Taxpayer A's establishment of Committee H and Committee H becoming administrator of Plan X, Plan Y and Plan Z, the plans are each maintained by an organization whose sole purpose and function is the administration of the plans. Under the establishing resolutions for Committee H, if Taxpayer A's president is a member of Order B, the president is an ex officio member of Committee H, and has the authority to appoint and discharge up to seven additional Committee H members. The establishing resolutions for Committee H provide that if the president is not or ceases to be a member of Order B, Network D has the authority to appoint and discharge Committee H members. Accordingly, Committee H is an organization that is controlled by or associated with Order B which is a Church C religious order. As a result, the plans are administered by an organization that is controlled by or associated with a church or an association of churches within the meaning of section 414(e)(3)(A) of the Code.

Also, as provided under section 414(e)(4)(A) of the Code, where a plan fails to meet one or more of the church plan requirements and corrects its failure within the correction period, then that plan shall be deemed to meet the requirements of section 414(e) for the year in which the correction is made and for all prior years. Committee H was established to administer Plan X, Plan Y and Plan Z on December 1* * *, 20* * *, which is within the correction period for Plan X, Plan Y and Plan Z.

Based on the foregoing facts and representations, we conclude that Plan X and Plan Y are church plans within the meaning of section 414(e) of the Code, and have been church plans within the meaning of section 414(e) of the Code retroactive to January * * *, 19* * *. We conclude that Plan Z is a church plan within the meaning of section 414(e) of the Code, and has been a church plan within the meaning of section 414(e) of the Code retroactive to January * * *, 19* * *.

This letter expresses no opinion as to whether Plan X and Plan Y satisfy the requirements for qualification under section 401(a) or whether Plan Z satisfies the requirements of section 403(b) of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

A copy of this letter is being sent to your authorized representative pursuant to a Power of Attorney on file in this office.

If you have any questions regarding this letter, please contact * * * at * * *. Please refer all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

Laura B. Warshawsky, Manager

Employee Plans Technical Group 3

Citations: LTR 201318030

IRS Rules on Donation of Depreciated Property.

The IRS ruled that if a taxpayer donates fully depreciated property to one or more charities, the resulting charitable deduction will not be reduced by 20 percent of the accumulated depreciation of the property.

Re: Request for Private Letter Ruling under

Sections 170, 291, and 1250

Dear * * *:

This letter responds to a letter dated July 27, 2012, and supplemental correspondence, submitted by Taxpayer requesting a letter ruling that, if certain section 1250 property is contributed to one or more tax-exempt organizations, the charitable deduction attributable to the value of that contribution will not be reduced by twenty percent of the accumulated depreciation of this section 1250 property under section 291(a)(1) of the Internal Revenue Code.

FACTS

Taxpayer represents that the facts are as follows:

Taxpayer is a State1 corporation with a principal place of business in City1, State1. Taxpayer is a wholly-owned subsidiary of A and joins in the consolidated Federal income tax return filed for the affiliated group headed by A. A files its consolidated Federal income tax return on a calendar year basis.

Taxpayer owns certain improved real property located at Taxpayer's B plant in City1, State1 (the "B property"). The B property contains certain depreciable real property that is section 1250 property. Most of this section 1250 property has been fully depreciated. Hereinafter, the fully depreciated B property that is section 1250 property will be referred to as "the Property."

Taxpayer intends to contribute some or all of the Property to one or more organizations that are exempt from Federal income tax under section 501(c)(3) as a charitable contribution under section 170. Moreover, Taxpayer intends to claim a charitable deduction under section 170 with respect to its contribution of the Property to one or more section 501(c)(3) tax-exempt organizations.

Taxpayer represents that these section 501(c)(3) tax-exempt organizations will have the same basis in the Property as Taxpayer will have at the time of the transfer pursuant to section 1015(a).

RULING REQUESTED

Taxpayer requests the following ruling:

If the Property is contributed to one or more section 501(c)(3) tax-exempt organizations, the charitable deduction attributable to the value of the contribution will not be reduced by twenty percent of the accumulated depreciation of the Property pursuant to section 291(a)(1).

LAW AND ANALYSIS

Section 170 generally allows a deduction, subject to certain limitations, for charitable contributions made during the taxable year to or for the use of organizations described in section 170(c), including section 501(c)(3) organizations.

Section 170A-1(c)(1) of the Income Tax Regulations provides that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution, reduced as provided in section 170(e)(1) and section 1.170A-4(a), or section 170(e)(3) and section 1.170A-4A(c).

Section 170(e)(1) provides that the amount of any charitable contribution of property otherwise taken into account under section 170 shall be reduced by, among other amounts, the amount of gain that would not have been long-term capital gain (determined without regard to section 1221(b)(3)) if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution).

Section 1.170A-4(a)(1) provides that in the case of a contribution by an individual or by a corporation of ordinary income property, as defined in section 1.170A-4(b)(1), the amount of the charitable contribution that would be taken into account under section 170(a) without regard to section 170(e) shall be reduced before applying the percentage limitations under section 170(b) by the amount of gain that would have been recognized as gain that is not long-term capital gain if the property had been sold by the donor at its fair market value at the time of its contribution to the charitable organization.

Section 1.170A-4(b)(1) defines the term “ordinary income property” as meaning property any portion of the gain on which would not have been long-term capital gain if the property had been sold by the donor at its fair market value at the time of its contribution to the charitable organization.

Section 291(a)(1) provides that in a case where a corporation disposes of section 1250 property, an amount equal to twenty percent of the excess, if any, of (A) the amount that would be treated as ordinary income if such property was section 1245 property, over (B) the amount treated as ordinary income under section 1250 (determined without regard to section 291(a)(1)), shall be treated as gain which is ordinary income under section 1250 and shall be recognized notwithstanding any other provision of Subtitle A of the Code. Section 291(a)(1) further provides that under regulations prescribed by the Secretary, the provisions of section 291(a)(1) will not apply to the disposition of any property to the extent that section 1250(a) does not apply to such disposition by reason of section 1250(d).

If section 1245 property is disposed of, section 1245(a)(1) generally provides that the amount by which the lower of (A) the recomputed basis of the property, or (B) the amount realized (in the case of a sale, exchange, or involuntary conversion) or the fair market value of such property (in the case of any other disposition), exceeds the adjusted basis of such property is treated as ordinary income. Such gain is recognized notwithstanding any other provision of Subtitle A of the Code.

Section 1245(a)(2) defines the term “recomputed basis” with respect to any property as meaning, generally, its adjusted basis recomputed by adding thereto all adjustments reflected in such adjusted basis on account of deductions (whether in respect of the same or other property) allowed or allowable to the taxpayer or to any other person for depreciation or amortization.

If section 1250 property is disposed of after December 31, 1975, section 1250(a)(1)(A) generally provides that 100 percent of the lower of (i) that portion of the additional depreciation attributable

to periods after December 31, 1975, in respect of such property, or (ii) the excess of the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value of such property (in the case of any other disposition), over the adjusted basis of such property, is treated as gain that is ordinary income. Such gain is recognized notwithstanding any other provision of Subtitle A of the Code.

Section 1250(b)(1) defines the term "additional depreciation" as meaning, in the case of any property, the depreciation adjustments in respect of such property; except that, in the case of property held more than one year, it means such adjustments only to the extent that they exceed the amount of the depreciation adjustments that would have resulted if such adjustments had been determined for each taxable year under the straight-line method of depreciation.

Section 1250(d)(1) provides that section 1250(a) shall not apply to a disposition by gift.

Section 1.1250-3(a)(1) provides that, for purposes of section 1250(d)(1), the term "gift" shall have the same meaning as in section 1.1245-4(a).

Section 1.1245-4(a) provides that the term "gift" means, generally, a transfer of property which, in the hands of the transferee, has a basis determined under the provisions of section 1015(a) or (d) (relating to basis of property acquired by gifts).

If section 1250 property is disposed of by gift (as defined in sections 1.1250-3(a)(1) and 1.1245-4(a)), section 1250(d)(1) provides that section 1250(a) does not apply to such disposition. Consequently, section 291(a)(1) would not apply to a gift (as defined in sections 1.1250-3(a)(1) and 1.1245-4(a)) of section 1250 property.

In this case, Taxpayer represents that it intends to contribute the Property to one or more organizations that are section 501(c)(3) tax-exempt organizations, that this intended contribution will be a valid charitable contribution that meets the requirements of section 170, and that these section 501(c)(3) tax-exempt organizations will have a basis in the Property equal to Taxpayer's basis in the Property at the time of transfer pursuant to section 1015(a). These are material representations. Because the basis of the Property in the hands of the section 501(c)(3) tax-exempt organizations will be the same as Taxpayer's basis in the Property at the time of the transfer pursuant to section 1015(a), the contribution of the Property by Taxpayer to the section 501(c)(3) organizations is a gift for purposes of sections 1250(d)(1) and 1.1250-3(a)(1). Accordingly, the provisions of section 291(a)(1) will not apply to Taxpayer's disposition of the Property to the section 501(c)(3) tax-exempt organizations.

CONCLUSION

Based solely on Taxpayer's representations and the relevant law and analysis set forth above, we conclude that if the Property is contributed to one or more section 501(c)(3) tax-exempt organizations, the charitable deduction attributable to the value of the contribution will not be reduced by twenty percent of the accumulated depreciation of the Property pursuant to section 291(a)(1).

Except as specifically set forth above, no opinion is expressed or implied concerning the tax consequences of the facts described above under any other provisions of the Code. Specifically, this letter ruling is based upon Taxpayer's description of the proposed contribution of property to certain section 501(c)(3) organizations. This letter ruling does not address whether the proposed contribution is a valid charitable contribution that meets the requirements of section 170. Further, the amount of the deduction for the proposed contribution is outside the scope of this letter ruling,

and no approval of the amount should be inferred from this letter ruling. Moreover, no opinion is expressed or implied on (i) whether any of the property located at B is section 1250 property, and (ii) the propriety of Taxpayer's methods of depreciating the property located at B.

This letter ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney, we are sending a copy of this letter to Taxpayer's authorized representatives. We are also sending a copy of this letter to the appropriate operating division director.

Sincerely,

Kathleen Reed

Chief, Branch 7

Office of Associate Chief Counsel

(Income Tax and Accounting)

Citations: LTR 201318003

IRS: Colleges and Universities Compliance Project Final Report – Revised.

The IRS has released a revised version of its Colleges and Universities Compliance Project Final Report.

The revised report can be found at:

http://www.irs.gov/pub/irs-tege/CUCP_FinalRpt_042513.pdf

IRS Declines to Limit Retroactive Effect of Organization's Revocation.

In technical advice, the IRS declined to limit the retroactive effect of its revocation of a credit counseling organization's tax-exempt status.

The IRS initially denied the organization's exemption application partly because of the organization's close connection to a for-profit company owned by the president of the organization. After the organization said it would educate the public on money management and provide credit counseling, the IRS granted exemption. But a subsequent IRS examination showed the organization, six years after obtaining exemption, had contracted with the same for-profit entity and was operating as a trade or business. The IRS also discovered that the organization was primarily engaged in enrolling people in debt management plans instead of providing counseling. Further, the organization had not told the IRS about its change in operations.

The IRS concluded that the revocation may be retroactive to the year under examination, when the IRS determined the organization had made material changes in its operations.

IRS: Foundation's Expenditures for Mentorship Program Aren't Taxable.

The IRS ruled that expenditures made through a private foundation's mentorship program for disadvantaged youth will not be taxable.

Dear * * *:

You asked for advance approval of your educational grant procedures under Internal Revenue Code section 4945(g)(3). This approval is required because you are a private foundation that is exempt from federal income tax.

OUR DETERMINATION

We approved your procedures for awarding educational grants. Based on the information you submitted, and assuming you will conduct your program as proposed, we determined that your procedures for awarding educational grants meet the requirements of Code section 4945(g)(3). As a result, expenditures you make under these procedures won't be taxable.

DESCRIPTION OF YOUR REQUEST

Your letter indicates that you will operate a mentorship program.

The program will provide greater opportunities for disadvantaged youth around the world to realize their full potential and attain mentorships by introducing young adults to leading entrepreneurs, artists, and academics, by sponsoring visa applications, and by covering expenses related to the pursuit of their goals whether in the fields of science, arts, sports, academia, or otherwise.

You intend to both publicize your program on your website, and through foreign and international websites that have the potential of drawing a wide audience from around the world.

You will have application forms completed by both a nominating organization and the potential protégé. In the future you intend to allow applicants to self-nominate.

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Specific criteria for selection will be based on the following factors:

Age: Applicants should be between the ages of 18 and 30.

Talent: Applicants must demonstrate talent, potential, and perseverance in their chosen fields.

Need: Applicants must demonstrate that they have faced significant adversity, as defined by each applicant's individual circumstances.

Professional Development Potential: Applicants should demonstrate that the foundation can significantly impact his or her ability to realize his or her full potential.

Leadership Potential: Applicants must demonstrate a genuine desire to give back to their communities in a meaningful and realistic way. Specifically, in accordance with W, protégés must work to bring about positive change in one of the following categories: alleviation of poverty and hunger, improvement of education for all, elimination of discrimination, environmental sustainability, improvement of global health, improvement of global economy, or attainment of world peace.

Substantial contributors, foundation managers, officers, directors, and employees of the foundation, as well as their family members, are ineligible to participate in the mentorship program.

You currently plan to run between two and six mentorships each year. You hope to scale up to ten to twelve mentorships in the future depending on the availability of funding, the particular needs of each recipient, and the overall success of your programs.

You envision providing support to protégés of up to $z per recipient over the course of a year or, some cases, more than a year. The support will be used to cover the expenses of travel, conference participation, art exhibits, supplies, courses, and other expenses related to each protégés particular field of interest, as well as in some cases a cash stipend.

You have adopted the following mandatory procedure in order to ensure continuing compliance with the post-9/11 Executive Orders and with Office of Foreign Assets Control, OFAC, requirements:

You will operate in compliance with all statutes, Executive Orders, and regulations restricting or prohibiting U.S. persons from engaging in transactions and dealings with countries, entities, or individuals subject to economic sanctions administered by OFAC.

You will check the OFAC List of Specially Designated Nationals, SDN, and Blocked Persons before dealing with persons including individuals, organizations and entities and specifically avoid dealing with any persons on the list.

You will not enter into a relationship with a grantee where doubts exist about the grantees' ability to ensure safe delivery of charitable resources independent of influence by or association with any terrorist organization.

You will not engage in trade or transaction activities that violate the regulation behind OFAC's country-based sanctions programs or engage in trade or transaction activities with sanctions targets named on OFAC's SDN list.

You will acquire from OFAC the appropriate license and registration where necessary.

The selection committee varies per protégé. The President and Executive Director, together field applications to select the most promising candidates. The candidates will then be presented to an individualized selection committee made up of experts and luminaries in the applicant's field, in order to assess the relevance of the stated goals and the potential of the applicant. Once a protégé has been selected, the Board of Directors of the foundation will approve the chosen recipients.

The following are criteria you use for grant renewal.

Recipients must:

Participate actively in their fields, including maintaining frequent contact with you and with their mentors, and participate in conferences, exhibits, or roundtables, as pertinent.

Provide receipts and other documentation showing the use of all grant monies awarded.

Spend the majority of their time in the communities from which they came, and seek to improve the conditions of their particular communities beyond the length of the program. The goal of each protégé should be to one day mentor other youths in his or her chosen field and to bring about positive change in his or her own community.

You will maintain records of your mentorship participants, including the names and addresses of its protégés and mentors, as well as accounts of their activities and any expenses paid to facilitate the mentorship. Records will also include information obtained to evaluate protégés, confirmation that the protégé is not a disqualified person to the foundation, the amount and purpose of any assets spent, how the mentorship was supervised and how any possible diversion of funds was investigated and addressed.

You closely monitor and evaluate the expenditure of funds and the progress made by each recipient. A representative from the foundation will attend conferences and exhibitions at which protégés are participating, and will also continue to maintain frequent contact with all of the participants of the program, including the mentors. Much of the support is provided in the form of in-kind support (such as hotel rooms), or in the reimbursement of specific expenses documented by the protégé. While mentors provide guidance, support, and networking opportunities, the foundation acts as a kind of sub-mentor by monitoring the protégés' progress, finding adequate housing and other necessary facilities, recording all expenses, and sponsoring foreign individuals for visa or other purposes. To the extent the support is distributed in the form of a stipend/grant to a protégé, the protégé will be required to sign a letter or agreement committing to how the funds will be used, and agreeing to oversight by the foundation and to fulfilling any reporting requirements. Upon completion of each mentorship, the foundation and the protégé will work together to produce a summary report describing the goals achieved, the work produced, and the protégé's use of resources. If the mentorship goes beyond one year in duration, the foundation will require annual interim reports.

Any possible diversion of grant funds will be promptly investigated. If the foundation discovers that funds have been misused, it will take all reasonable and appropriate steps to recover diverted funds, and will make no further distributions to that recipient, unless it is able to obtain assurances that future diversion will not occur and protégé will take extraordinary precautions to prevent future diversion from occurring.

BASIS FOR OUR DETERMINATION

The law imposes certain excise taxes on the taxable expenditures of private foundations (Code section 4945). A taxable expenditure is any amount a private foundation pays as a grant to an individual for travel, study, or other similar purposes.

However, a grant that meets all of the following requirements of Code section 4945(g) is not a taxable expenditure.

The foundation awards the grant on an objective and nondiscriminatory basis.

The IRS approves in advance the procedure for awarding the grant.

The grant is:

A scholarship or fellowship subject to section 117(a) and is to be used for study at an educational organization described in section 170(b)(1)(A)(ii); or

A prize or award subject to the provisions of section 74(b), if the recipient of the prize or award is selected from the general public; or

To achieve a specific objective; produce a report or similar product; or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar skill or talent of the recipient.

To receive approval of its grant procedures, Treasury Regulations section 53.4945-4(c)(1) requires that a private foundation demonstrate that:

The grant procedure includes an objective and nondiscriminatory selection process.

The grant procedure results in the recipients performing the activities the grants were intended to finance.

The foundation plans to obtain reports to determine whether the recipients have performed the activities that the grants were intended to finance.

OTHER CONDITIONS THAT APPLY TO THIS DETERMINATION

This determination covers only the grant program described above. This approval will apply to succeeding grant programs only if their standards and procedures don’t differ significantly from those described in your original request.

This determination applies only to you. It may not be cited as precedent.

You cannot rely on the conclusions in this letter if the facts you provided have changed substantially.

You must report any significant changes in your program to the Cincinnati Office of Exempt Organizations at:

Internal Revenue Service

Exempt Organizations Determinations

P.O. Box 2508

Cincinnati, OH 45201

You cannot make grants to your creators, officers, directors, trustees, foundation managers, or members of selection committees or their relatives.

All funds distributed to individuals must be made on a charitable basis and must further the purposes of your organization. You cannot award grants for a purpose that is inconsistent with Code section 170(c)(2)(B).

You should keep adequate records and case histories so that you can substantiate your grant distributions with the IRS if necessary.

We’ve sent a copy of this letter to your representative as indicated in your power of attorney.

Please keep a copy of this letter in your records.

If you have any questions, please contact the person listed at the top of this letter.

Sincerely,

Holly O. Paz

Director, Exempt Organizations

Rulings and Agreements

Comments Sought on Exempt Organization Return.

The IRS asked for public comment on Form 990, "Return of Organization Exempt From Income Tax Under Section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except black lung benefit trust or private foundation)," and related schedules. Comments are due by June 25, 2013.

Send comments regarding the burden estimate, or any other aspect of the information collection, including suggestion for reducing the burden, to (1) Office of Information and Regulatory Affairs, Office of Management and Budget, Attention: Desk Officer for Treasury, New Executive Office Building, Room 10235, Washington, DC 20503, or email at OIRA_Submission@OMB.EOP.GOV and (2) Treasury PRA Clearance Officer, 1750 Pennsylvania Ave. NW., Suite 8140, Washington, DC 20220, or email at PRA@treasury.gov.

IRS Releases Final Report on Tax-Exempt Colleges and Universities Compliance Project.

The Internal Revenue Service today released its final report summarizing audit results from the IRS' colleges and universities study, which began in 2008. This final report describes the agency's multi-year project on a major segment of tax-exempt organizations.

"The audits identified some significant compliance issues at the colleges and universities examined," said Lois Lerner, Director, Exempt Organizations division. "Because these issues may well be present elsewhere across the tax-exempt sector, all exempt organizations need to be aware of the importance of accurately reporting unrelated business income and providing appropriate executive compensation."

The attached final report focuses on two primary areas within the examinations: reporting of unrelated business taxable income, and compensation, including, employment tax and retirement plan issues.

The full report is available at:

http://www.irs.gov/pub/irs-tege/CUCP_FinalRpt_042513.pdf

IRS: Attend the Exempt Organizations Workshop at the 2013 Tax Forums.

This two-hour workshop will include a review of recent changes to the Form 990, Return of Organization Exempt from Income Tax. In addition, the workshop will present several topics that are of interest to tax professionals who work with exempt organizations.

Exempt Organizations will participate in the IRS Nationwide Tax Forums in six cities starting in July. The forums are a major outreach event providing three packed days of seminars, workshops, focus groups and an exhibit hall for the tax practitioner community. In addition to getting the latest tax information, tax professionals can earn continuing professional education credits for their attendance.

For more information, go to:

http://www.irs.gov/Tax-Professionals/IRS-Nationwide-Tax-Forum-Information

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FASB: Update No. 2013-06—Not-for-Profit Entities (Topic 958): Services Received from Personnel of an Affiliate (a consensus of the FASB Emerging Issues Task Force)

The amendments in this Update require a recipient not-for-profit entity to recognize all services received from personnel of an affiliate that directly benefit the recipient not-for-profit entity. Those services should be measured at the cost recognized by the affiliate for the personnel providing those services. However, if measuring a service received from personnel of an affiliate at cost will significantly overstate or understate the value of the service received, the recipient not-for-profit entity may elect to recognize that service received at either (1) the cost recognized by the affiliate for the personnel providing that service or (2) the fair value of that service.

The full Update is available at:

http://www.fasb.org/cs/BlobServer?blobkey=id&blobwhere=1175826718911&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs

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IRS: Foundation's Expenditures for Mentorship Program Aren't Taxable.

The IRS ruled that expenditures made through a private foundation’s mentorship program for disadvantaged youth will not be taxable.

Dear * * *:

You asked for advance approval of your educational grant procedures under Internal Revenue Code section 4945(g)(3). This approval is required because you are a private foundation that is exempt from federal income tax.

OUR DETERMINATION

We approved your procedures for awarding educational grants. Based on the information you

submitted, and assuming you will conduct your program as proposed, we determined that your procedures for awarding educational grants meet the requirements of Code section 4945(g)(3). As a result, expenditures you make under these procedures won't be taxable.

DESCRIPTION OF YOUR REQUEST

Your letter indicates that you will operate a mentorship program.

The program will provide greater opportunities for disadvantaged youth around the world to realize their full potential and attain mentorships by introducing young adults to leading entrepreneurs, artists, and academics, by sponsoring visa applications, and by covering expenses related to the pursuit of their goals whether in the fields of science, arts, sports, academia, or otherwise.

You intend to both publicize your program on your website, and through foreign and international websites that have the potential of drawing a wide audience from around the world.

You will have application forms completed by both a nominating organization and the potential protégé. In the future you intend to allow applicants to self-nominate.

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You have adopted the following mandatory procedure in order to ensure continuing compliance with the post-9/11 Executive Orders and with Office of Foreign Assets Control, OFAC, requirements:

You will operate in compliance with all statutes, Executive Orders, and regulations restricting or prohibiting U.S. persons from engaging in transactions and dealings with countries, entities, or individuals subject to economic sanctions administered by OFAC.

You will check the OFAC List of Specially Designated Nationals, SDN, and Blocked Persons before dealing with persons including individuals, organizations and entities and specifically avoid dealing with any persons on the list.

You will not enter into a relationship with a grantee where doubts exist about the grantees' ability to ensure safe delivery of charitable resources independent of influence by or association with any terrorist organization.

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You will acquire from OFAC the appropriate license and registration where necessary.

The selection committee varies per protégé. The President and Executive Director, together field applications to select the most promising candidates. The candidates will then be presented to an individualized selection committee made up of experts and luminaries in the applicant's field, in order to assess the relevance of the stated goals and the potential of the applicant. Once a protégé has been selected, the Board of Directors of the foundation will approve the chosen recipients.

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To receive approval of its grant procedures, Treasury Regulations section 53.4945-4(c)(1) requires that a private foundation demonstrate that:

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Sincerely,

Holly O. Paz

Director, Exempt Organizations

Rulings and Agreements

IRS: Foundation's Expenditures for Mentorship Program Aren't Taxable.

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You aim to support young adults, ages 18 to 30, who have faced, or are facing, significant adversity in life. You do not define what specifically constitutes adversity. It is up to the applicants to demonstrate how their ability to develop in their chosen fields has been stifled by individual circumstances. You will consider individuals who have not had the economic means to pursue their goals, as well as individuals living under oppressive regimes, or in repressive communities. These are just a few examples of the kind of adversity that might qualify a candidate for the mentorship program.

Specific criteria for selection will be based on the following factors:

Age: Applicants should be between the ages of 18 and 30.

Talent: Applicants must demonstrate talent, potential, and perseverance in their chosen fields.

Need: Applicants must demonstrate that they have faced significant adversity, as defined by each applicant's individual circumstances.

Professional Development Potential: Applicants should demonstrate that the foundation can significantly impact his or her ability to realize his or her full potential.

Leadership Potential: Applicants must demonstrate a genuine desire to give back to their communities in a meaningful and realistic way. Specifically, in accordance with W, protégés must work to bring about positive change in one of the following categories: alleviation of poverty and hunger, improvement of education for all, elimination of discrimination, environmental sustainability, improvement of global health, improvement of global economy, or attainment of world

peace.

Substantial contributors, foundation managers, officers, directors, and employees of the foundation, as well as their family members, are ineligible to participate in the mentorship program.

You currently plan to run between two and six mentorships each year. You hope to scale up to ten to twelve mentorships in the future depending on the availability of funding, the particular needs of each recipient, and the overall success of your programs.

You envision providing support to protégés of up to $z per recipient over the course of a year or, some cases, more than a year. The support will be used to cover the expenses of travel, conference participation, art exhibits, supplies, courses, and other expenses related to each protégés particular field of interest, as well as in some cases a cash stipend.

You have adopted the following mandatory procedure in order to ensure continuing compliance with the post-9/11 Executive Orders and with Office of Foreign Assets Control, OFAC, requirements:

You will operate in compliance with all statutes, Executive Orders, and regulations restricting or prohibiting U.S. persons from engaging in transactions and dealings with countries, entities, or individuals subject to economic sanctions administered by OFAC.

You will check the OFAC List of Specially Designated Nationals, SDN, and Blocked Persons before dealing with persons including individuals, organizations and entities and specifically avoid dealing with any persons on the list.

You will not enter into a relationship with a grantee where doubts exist about the grantees' ability to ensure safe delivery of charitable resources independent of influence by or association with any terrorist organization.

You will not engage in trade or transaction activities that violate the regulation behind OFAC's country-based sanctions programs or engage in trade or transaction activities with sanctions targets named on OFAC's SDN list.

You will acquire from OFAC the appropriate license and registration where necessary.

The selection committee varies per protégé. The President and Executive Director, together field applications to select the most promising candidates. The candidates will then be presented to an individualized selection committee made up of experts and luminaries in the applicant's field, in order to assess the relevance of the stated goals and the potential of the applicant. Once a protégé has been selected, the Board of Directors of the foundation will approve the chosen recipients.

The following are criteria you use for grant renewal.

Recipients must:

Participate actively in their fields, including maintaining frequent contact with you and with their mentors, and participate in conferences, exhibits, or roundtables, as pertinent.

Provide receipts and other documentation showing the use of all grant monies awarded.

Spend the majority of their time in the communities from which they came, and seek to improve the conditions of their particular communities beyond the length of the program. The goal of each protégé should be to one day mentor other youths in his or her chosen field and to bring about

positive change in his or her own community.

You will maintain records of your mentorship participants, including the names and addresses of its protégés and mentors, as well as accounts of their activities and any expenses paid to facilitate the mentorship. Records will also include information obtained to evaluate protégés, confirmation that the protégé is not a disqualified person to the foundation, the amount and purpose of any assets spent, how the mentorship was supervised and how any possible diversion of funds was investigated and addressed.

You closely monitor and evaluate the expenditure of funds and the progress made by each recipient. A representative from the foundation will attend conferences and exhibitions at which protégés are participating, and will also continue to maintain frequent contact with all of the participants of the program, including the mentors. Much of the support is provided in the form of in-kind support (such as hotel rooms), or in the reimbursement of specific expenses documented by the protégé. While mentors provide guidance, support, and networking opportunities, the foundation acts as a kind of sub-mentor by monitoring the protégés' progress, finding adequate housing and other necessary facilities, recording all expenses, and sponsoring foreign individuals for visa or other purposes. To the extent the support is distributed in the form of a stipend/grant to a protégé, the protégé will be required to sign a letter or agreement committing to how the funds will be used, and agreeing to oversight by the foundation and to fulfilling any reporting requirements. Upon completion of each mentorship, the foundation and the protégé will work together to produce a summary report describing the goals achieved, the work produced, and the protégé's use of resources. If the mentorship goes beyond one year in duration, the foundation will require annual interim reports.

Any possible diversion of grant funds will be promptly investigated. If the foundation discovers that funds have been misused, it will take all reasonable and appropriate steps to recover diverted funds, and will make no further distributions to that recipient, unless it is able to obtain assurances that future diversion will not occur and protégé will take extraordinary precautions to prevent future diversion from occurring.

BASIS FOR OUR DETERMINATION

The law imposes certain excise taxes on the taxable expenditures of private foundations (Code section 4945). A taxable expenditure is any amount a private foundation pays as a grant to an individual for travel, study, or other similar purposes.

However, a grant that meets all of the following requirements of Code section 4945(g) is not a taxable expenditure.

The foundation awards the grant on an objective and nondiscriminatory basis.

The IRS approves in advance the procedure for awarding the grant.

The grant is:

A scholarship or fellowship subject to section 117(a) and is to be used for study at an educational organization described in section 170(b)(1)(A)(ii); or

A prize or award subject to the provisions of section 74(b), if the recipient of the prize or award is selected from the general public; or

To achieve a specific objective; produce a report or similar product; or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar skill or talent of the recipient.

To receive approval of its grant procedures, Treasury Regulations section 53.4945-4(c)(1) requires that a private foundation demonstrate that:

The grant procedure includes an objective and nondiscriminatory selection process.

The grant procedure results in the recipients performing the activities the grants were intended to finance.

The foundation plans to obtain reports to determine whether the recipients have performed the activities that the grants were intended to finance.

OTHER CONDITIONS THAT APPLY TO THIS DETERMINATION

This determination covers only the grant program described above. This approval will apply to succeeding grant programs only if their standards and procedures don't differ significantly from those described in your original request.

This determination applies only to you. It may not be cited as precedent.

You cannot rely on the conclusions in this letter if the facts you provided have changed substantially.

You must report any significant changes in your program to the Cincinnati Office of Exempt Organizations at:

Internal Revenue Service

Exempt Organizations Determinations

P.O. Box 2508

Cincinnati, OH 45201

You cannot make grants to your creators, officers, directors, trustees, foundation managers, or members of selection committees or their relatives.

All funds distributed to individuals must be made on a charitable basis and must further the purposes of your organization. You cannot award grants for a purpose that is inconsistent with Code section 170(c)(2)(B).

You should keep adequate records and case histories so that you can substantiate your grant distributions with the IRS if necessary.

We've sent a copy of this letter to your representative as indicated in your power of attorney.

Please keep a copy of this letter in your records.

If you have any questions, please contact the person listed at the top of this letter.

Sincerely,

Holly O. Paz

Director, Exempt Organizations

IRS: Settlement Agreement Won't Result in Self-Dealing.

The IRS ruled that the execution, delivery, and performance of a settlement agreement providing for the purchase of limited partnership interests by the trustees of a private foundation will not result in self-dealing.

Dear * * *

We have considered your ruling request dated October 5, 2012. You are requesting a ruling under § 4941 of the Code with regard to a Settlement Agreement affecting certain testamentary bequests to a private foundation described in §§ 501(c)(3) and 509(a).

FACTS

A and B are the surviving children of C. C, a resident of State, died on Date 1.

D is a limited partnership, in which each of A, B and C held certain partnership interests at the time of C's death. The assets held by C at C's death included a x% general partnership interest in D and a y% limited partnership interest in D (collectively, the "Interests").

E is a private foundation described in §§ 501(c)(3) and 509(a) of the Code. The two Executors of C's estate also serve as the two co-Trustees of E.

Prior to C's death, A, B and C executed an agreement granting each of A and B the right, upon C's death, to purchase one-half of C's limited partnership interests in D at a price equal to the value of those interests as of the date of C's death as determined by an independent qualified appraiser, subject to increase or decrease equal to the final determination of the value of those interests in the federal estate tax proceedings for C's estate (the "First Option").

C's Will, as submitted for probate in the court with jurisdiction over C's estate, bequeathed C's general partnership interest in D outright to E.

The Will further directed the Executors to offer (subject to the terms and conditions of the Partnership Agreement of D) in writing to each of A and B the option to purchase for cash up to one-half of C's limited partnership interests in D that C owned at C's death, at its value as finally fixed and determined for federal estate tax purposes after independent appraisal (the "Second Option").

In addition, C's Will provided that the residue of C's estate, after satisfaction of certain specific bequests set forth in C's Will and after satisfaction of debts, administrative expenses and taxes attributable to C's estate, would pass to E.

Subsequent to submission to the court of C's Will for probate, a series of arbitration and court proceedings were launched involving A, B, the Executors and the Trustees. Each of the First Option, the Second Option and the bequests to E was challenged as part of the various proceedings. In addition, the Executors filed claims against A and B for alleged over distributions from D to A and B.

After approximately z years of litigation and arbitration proceedings regarding the Interests, the Attorney General of State intervened in an attempt to help resolve the parties' disputes. With the

help of the Attorney General of State, A, B, the Executors and the Trustees entered into a Settlement Agreement, effective as of Date 2.

Under the Settlement Agreement, A and B will purchase all of the Interests at a price set forth in the Settlement Agreement. This price is equal to the value of the Interests as reported by C's estate for federal estate tax purposes. In addition, A and B will pay a designated amount in settlement of all additional claims made by the Executors against A and B with regard to the Interests.

The Attorney General of State consented to the Settlement Agreement. On Date 3, the court with jurisdiction over C's estate issued an order approving the Settlement Agreement.

RULING REQUESTED

The execution, delivery, and performance of the Settlement Agreement, and the consummation by the parties of the transactions contemplated therein, will not constitute acts of direct or indirect self-dealing under § 4941, and none of the parties to the Settlement Agreement, including their executors, trustees, directors, officers, owners, employees, agents, and attorneys, will be liable for tax under § 4941 for such actions.

LAW

Section 4941(a) imposes certain excise taxes on direct and indirect acts of self-dealing between a disqualified person and a private foundation, and also imposes a separate excise tax on the participation by any foundation manager in an act of self-dealing between a disqualified person and a private foundation, knowing it is such an act, unless such participation is not willful and is due to reasonable cause.

Section 4941(d)(1)(A) provides that for purposes of § 4942 the term self-dealing means any direct or indirect sale or exchange, or leasing, of property between a private foundation and a disqualified person.

Section 4941(d)(1)(E) defines self-dealing to include any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation. Section 4946(a) provides that the term "disqualified person" with respect to a private foundation includes a substantial contributor to the foundation, a family member of a substantial contributor (including children), and foundation managers (including trustees and individuals with similar powers or responsibilities).

Section 53.4946-1(a)(1)(i) of the Foundation and Similar Excise Tax Regulations, with reference to § 507(d)(2) of the Code, defines the term "substantial contributor" as (1) any person who contributed or bequeathed an aggregate amount of more than $5,000 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the private foundation in the year of such contribution; and (2) in the case of a trust, the creator of the trust.

In Rockefeller v. United States, 572 F. Supp. 9 (E.D. Ark. 1982), aff'd 718 F.2d 290 (8th Cir. 1983), cert. den. 466 U.S. 962 (1984), the court held that purchase by a decedent's son, who was also executor of the estate, of estate property earmarked for a private foundation was indirect self-dealing.

In Estate of Reis v. Comm'r, 87 T.C. 1016 (1986), the court held that because a foundation which was a beneficiary of an estate had an expectancy interest in the estate, sale of estate property otherwise passing from the estate to the foundation constituted acts of indirect self-dealing under § 4941.

ANALYSIS

Self-dealing under § 4941 may occur by virtue of the transfer of property held in an estate to which a private foundation has an interest or expectancy. Rockefeller v. United States, 572 F. Supp. 9 (E.D. Ark. 1982), aff'd 718 F.2d 290 (8th Cir., 1983), cert. den. 466 U.S. 962 (1984); Reis, 87 T.C. 1016 (1986). Absent the litigation and arbitration proceedings, E arguably had an expectancy under the terms of C's will (as submitted for probate) either in the Interests themselves or, with regard to the limited partnership interests, in an amount of money equal in value to the option price. In fact, E's ultimate expectancy with regard to the Interests depended on final resolution of the litigation and arbitration proceedings.

Although the parties to the Settlement Agreement could have awaited the end of those proceedings, doing so may have taken many more years, cost a considerable amount in legal fees, and ultimately resulted in less property for E. Instead, the parties chose to settle the dispute. All parties to the Settlement Agreement were represented by independent counsel, and there is no suggestion of collusion to benefit any particular party. The Attorney General of State participated in facilitating the Settlement Agreement and consented to its terms. The court with appropriate jurisdiction over C's estate has approved the Settlement Agreement.

Entering into the Settlement Agreement will eliminate the risk that E's expectancy with regard to the Interests might be reduced if the litigation and arbitration proceedings continued, will preclude the need to expend additional charitable funds pursuing the litigation, and will allow E to access the property passing to it from C's estate and begin to use that property in furtherance of its charitable activities. Because the Settlement Agreement was the product of arm's-length negotiations, including the participation and consent of the Attorney General of State and approval of the court with jurisdiction over C's estate, E's expectancy in C's estate with regard to the Interests is established by the Settlement Agreement. All parties acting in performance of the Settlement Agreement are viewed as merely carrying out their legal rights and obligations with regard to the Interests.

RULING

Accordingly, based on the facts and circumstances discussed above, we rule that the execution, delivery and performance of the Settlement Agreement, and the consummation by the parties of the transactions contemplated therein, does not give rise to self-dealing under § 4941, and no tax under § 4941 is due with regard to the transactions described in the Settlement Agreement.

This ruling will be made available for public inspection under § 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning federal tax liabilities, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Matthew L. Giuliano

Manager, Exempt Organizations

Guidance Group 1

IRS: Detention Facilities Aren't Healthcare Facilities for REIT Purposes.

The IRS ruled a corporation's correctional, detention, and re-entry residential and nonresidential facilities won't be treated as healthcare facilities under section 856(l)(4)(B) and contract payments from government tenants for the residential facilities will be treated as rents from real property for purposes of section 856(d)(1).

Dear * * *:

This is in reply to a letter dated July 18, 2012, and further submissions, in which Taxpayer requests rulings in connection with its intent to elect to be taxed as a real estate investment trust ("REIT") under section 856 of the Internal Revenue Code.

Taxpayer is a publicly traded State A corporation that intends to elect to be taxed as a REIT. Taxpayer presently owns, leases, and operates correctional, detention, and re-entry facilities. Taxpayer also presently provides community based services to supervise and assist parolees and probationers. Taxpayer's facilities include residential facilities and non-residential facilities. Taxpayer's residential facilities include correctional and detention facilities, community-based services ("CBS") halfway houses, and youth services residential facilities (collectively the "Residential Facilities"). Taxpayer's non-residential facilities include CBS day reporting centers and youth services non-residential facilities ("Non-Residential Facilities").

Following its election to be taxed as a REIT, Taxpayer intends to create one or more TRSs to operate and provide services that it presently provides in connection with its Residential Facilities and Non-Residential Facilities. Taxpayer also intends to create one or more TRSs to which it will contribute certain contracts and facilities, as described below.

Taxpayer is seeking rulings that (1) the Residential Facilities and Non-Residential Facilities are not "health care facilities" in whole or in part under section 856(l)(4)(B); (2) the amounts received under Taxpayer's contracts with government tenants for the Residential Facilities will be treated as "rents from real property" for purposes of section 856(d)(1); and (3) the payments Taxpayer collects on behalf of its TRSs for the Services (as later defined) the TRSs provide at a Financed Facility (as later defined) will not be disqualified income for purposes of the REIT income tests.

Taxpayer's Current Business

Residential Facilities

Correction and Detention Facilities

Taxpayer contracts with federal, state, and foreign government entities ("government tenants") to provide facilities to house offenders or detainees on their behalf. The contracts are generally awarded through a competitive bid process.

Taxpayer owns or leases correctional and detention facilities that are currently under contract with government tenants. Taxpayer also has manage-only contracts under which it operates correctional and detention facilities that government tenants either own directly or lease from a third party. Taxpayer represents that the fair market value of the personal property that will be owned by the REIT in the owned and leased Residential Facilities will not exceed fifteen percent of the total fair market value of the owned and leased Residential Facilities.

Under a majority of the contracts for the correctional and detention facilities that Taxpayer owns or leases, Taxpayer receives a monthly lump sum amount from a government tenant for the use of the facility. Taxpayer agrees to house a certain number of occupants (the "guaranteed minimum") and provide related services. The monthly lump sum amount is calculated pursuant to the terms of the contract by multiplying the guaranteed minimum by a daily rate per occupant. If a government tenant needs space for more occupants than are included in the guaranteed minimum, it will pay an additional amount for each day that an extra occupant spends in the facility. The rate for extra occupants is generally lower than the rate for the occupants covered by the guaranteed minimum. Some of Taxpayer's contracts do not have a guaranteed minimum, and a government tenant's monthly payment will be based on a daily rate per occupant.

The contracts typically have terms from three to five years with multiple renewal options, ranging from one to five years, with a total contract period ranging from ten to fifteen years. At the end of the contract period, Taxpayer must competitively bid to receive the contract for another term.

Although Taxpayer's contracts vary by customer, Taxpayer is generally required to provide the following services (the "Services"):

- Facility security, including guard supervision
- Food service
- Counseling and substance abuse treatment
- Basic medical and dental care
- Academic and vocational programming
- Administrative and management services, including recordkeeping and reporting
- Facility maintenance and utilities
- Secure transportation of occupants
- Intake and screening

As mentioned above, the Services required by the contracts include some level of medical, dental, and mental health services. To avoid the security risk and expense of taking an occupant offsite to receive medical services, Taxpayer employees perform routine medical, dental, and mental health services in a segregated area of the facility. These employees also do an intake screening when a resident arrives at the facility to ascertain the health status of the inmate. The screenings are necessary to shield the other occupants and the staff from exposure to contagious illness. Medical employees may include doctors, nurses, and/or technicians but Taxpayer only provides basic medical services. None of the facilities are licensed as medical or dental facilities. A few of the facilities have a license from a state agency to provide substance abuse counseling. None of the facilities are

licensed as medical facilities that are operated by a provider that is eligible for participation in the Medicare program.

CBS Facilities: Halfway Houses

Taxpayer also owns, leases, and manages CBS facilities. There are two types of CBS facilities: halfway houses and youth services residential facilities, which are Residential Facilities, and day reporting centers and youth services non-residential facilities, which are Non-Residential Facilities and are described below.

Residential Facilities

The halfway houses provide a home to federal or state offenders who are reentering society after incarceration. Taxpayer's halfway house contracts are awarded by government tenants in a competitive bid process and generally have a term of one to two years with three to four annual renewal periods. Taxpayer bills government tenants monthly pursuant to the contract terms, based on a formula price. The monthly payment is calculated based on the number of occupants residing at the facility at a daily rate per occupant.

Pursuant to the contracts with government tenants to house these newly released individuals, Taxpayer is required to provide drug testing, recordkeeping and reporting, food services, vocational and educational programming, employment assistance, and substance abuse and family counseling.

A few of the halfway houses employ a psychologist, but generally no other medical care is available onsite. One halfway house employs a nurse who provides basic medical services. None of the halfway houses are licensed as medical facilities that are operated by a provider that is eligible for participation in the Medicare program.

Residential Youth Services Facilities

Taxpayer owns, leases, and manages residential and non-residential youth services facilities. Government tenants use Taxpayer's residential youth services facilities to provide housing for juvenile offenders.

Taxpayer contracts with multiple government tenants to house youths in its residential youth services facilities. Taxpayer bills government tenants monthly pursuant to the contract terms, based on a formula price. The monthly payment is calculated based on the number of youths residing at the facility at a daily rate per youth. Each facility houses residents for several government tenants. The contracts do not have guaranteed minimums and government tenants do not have any specific amount of space reserved.

Taxpayer's residential youth services facilities provide multiple, residential, education programs specifically designed to address the needs of individuals within the juvenile justice system with programs tailored to the specific needs of youthful offenders. The programs typically vary in length from one to fourteen months. Taxpayer expects youths to stay at the facility for the entire length of the relevant programs, as approximately 90% of youths complete their programs.

As part of its contracts with government tenants for the use of facilities to shelter youths, Taxpayer is required to provide food service, counseling, supervision, vocational and culinary training, and transportation to the occupants.

Employees at the residential youth services facilities provide therapy and substance abuse counseling to the occupants. Nurses provide some basic medical care, but most medical needs are

met offsite. Six of the youth services residential facilities are licensed by the state to treat alcoholism and substance abuse. Additionally, three of the youth services residential facilities are licensed by the state to provide mental health services. None of the residential youth services facilities are licensed as medical facilities that are operated by a provider that is eligible for participation in the Medicare program.

Non-Residential Facilities

Community-Based Services: Day Reporting Centers

Taxpayer operates CBS day reporting centers where it is required to provide drug testing, supervision, vocational and educational programming, and some counseling to offenders who are reentering society after incarceration. Offenders report to the day reporting centers a few days a week and spend at most a few hours at the facility per day. These contracts typically require Taxpayer to lease specific storefronts in a shopping center in which to provide the services. For a few CBS day reporting centers, a government tenant leases the space and Taxpayer only operates the center. Several of the CBS day reporting centers employ therapists, but generally no other medical care is available. Furthermore, the day reporting centers are not licensed as medical facilities that are operated by a provider that is eligible for participation in the Medicare program.

Non-Residential Youth Services Facilities

The non-residential youth services facilities are similar to the day reporting centers discussed above. They are operated in storefronts. Taxpayer provides programming, counseling, and mental health case management, but it does not house the youths on behalf of government tenants. No medical care is provided. They are not licensed as medical facilities operated by a provider that is eligible for participation in the Medicare program.

Financed Facility

In some cases, Taxpayer leases land from a state agency, builds a facility on the leased land, and then operates the facility for a government tenant for the duration of the contract. At the end of the contract, title to the facility shifts to the government tenant ("Financed Facilities").1

Taxpayer's Proposed Restructuring

Taxpayer intends to operate as a REIT beginning with an election to be taxed as a REIT for its Year 1 taxable year. Taxpayer also intends to create one or more wholly-owned subsidiaries, which will elect to be treated as TRSs (Taxpayer's TRSs). Taxpayer's TRSs will provide the Services described above to government tenants and will be compensated by Taxpayer at an arm's length rate. Taxpayer will contribute the manage-only Residential Facilities contracts and the Non-Residential Facilities to TRSs or make TRS elections for the existing entities that hold these assets.

LAW AND ANALYSIS

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from specified sources that include rents from real property, and section 856(c)(3) provides that at least 75 percent must be derived from sources, that likewise include, rents from real property.

Section 856(d)(1) provides that rents from real property include (subject to exclusions provided in section 856(d)(2)): (A) rents from interests in real property; (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated; and (C) rent attributable to personal property leased under, or in connection

with, a lease of real property, but only if the rent attributable to the personal property for the taxable year does not exceed 15 percent of the total rent for the tax year attributable to both the real and personal property leased under, or in connection with, the lease. With respect to each lease of real property, rent attributable to personal property for the taxable year is that amount which bears the same ratio to total rent for the taxable year as the average of the fair market values of the personal property at the end of the taxable year bears to the average of the aggregated fair market values of both the real property and the personal property at the beginning and at the end of such taxable year.

Section 1.856-4(b) provides that subject to the exceptions in sections 856(d) and section 1.856-4(b), the term, "rents from real property" means, generally, the gross amounts received for the use of, or the right to use, real property of the REIT. Section 1.856-4(b) provides that the term rents from real property includes charges for services customarily furnished or rendered in connection with the rental of real property, whether or not the charges are separately stated. Services furnished to tenants of a particular building will be considered as customary if, in the geographic market in which the building is located, tenants in buildings of similar class are customarily provided with the service. Where it is customary, in a particular geographic marketing area, to furnish electricity or other utilities to tenants in buildings of a particular class, the submetering of utilities to tenants in such buildings will be considered a customary service.

Section 856(d)(2)(C) provides that any impermissible tenant service income is excluded from the definition of rents from real property. Section 856(d)(7)(A) defines impermissible tenant service income to mean, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for services furnished or rendered by the REIT to tenants at the property, or for managing or operating the property.

Section 856(d)(7)(C) provides certain exclusions from impermissible tenant service income. Section 856(d)(7)(C) provides that for purposes of section 856(d)(7)(A), services furnished or rendered, or management or operation provided, through an independent contractor from whom the REIT does not derive or receive any income or through a TRS of such trust shall not be treated as furnished, rendered, or provided by the REIT, and any amount which would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2) shall not be taken into account.

Section 512(b)(3) provides, in part, that there shall be excluded from the computation of unrelated business taxable income all rents from real property and all rents from personal property leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

Section 1.512(b)-1(c)(5) provides that payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, motor courts or motels, or for the use or occupancy of space in parking lots, warehouses, or storage garages, do not constitute rents from real property. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways and lobbies, and the collection of trash are not considered as services rendered to the occupant.

Section 856(d)(7)(B) provides that if the amount of impermissible tenant service income exceeds one

percent of all amounts received or accrued during the tax year directly or indirectly by the REIT with respect to the property, the impermissible tenant service income of the REIT will include all of the amounts received or accrued with respect to the property.

In Rev. Rul. 2002-38, 2002-2 C.B. 4, a REIT pays its TRS to provide noncustomary services to tenants. The REIT does not separately state charges to tenants for the services. Thus, a portion of the amounts received by the REIT from tenants represents an amount received for services provided by the TRS. TRS employees perform all of the services and TRS pays all of the costs of providing the services. The TRS also rents space from the REIT for carrying out its services to tenants. The revenue ruling concludes that the services provided to the REIT's tenants are considered to be rendered by the TRS, rather than the REIT, for purposes of § 856(d)(7)(C)(i). Accordingly, the services do not give rise to impermissible tenant service income and do not cause any portion of the rents received by the REIT to fail to qualify as rents from real property under § 856(d).

Section 856(l) provides that a REIT and a corporation (other than a REIT) may treat such corporation as a TRS if the REIT directly or indirectly owns stock in the corporation, and the REIT and the corporation jointly elect such treatment.

Section 856(l)(3)(A) provides that a TRS cannot directly or indirectly operate or manage a lodging facility or a health care facility. Section 856(l)(4)(B) provides that the term "health care facility" has the meaning given such term in section 856(e)(6)(D)(ii).

A "health care facility" is defined in section 856(e)(6)(D)(ii) as a hospital, nursing facility, assisted living facility, congregate care facility, qualified continuing care facility (as defined in section 7872(g)(4)), or other licensed facility which extends medical or nursing or ancillary services to patients and which was operated by a provider of such services that is eligible for participation in the Medicare program under Title XVII of the Social Security Act [subchapter XVIII of chapter 7 of Title 42 (42 U.S.C.A. § 1395 et seq.)] with respect to the facility.

Ruling 1: The Residential Facilities and Non-Residential Facilities are not "health care facilities" in whole or in part under section 856(l)(4)(B).

The Residential Facilities and Non-Residential Facilities are not hospitals, nursing facilities, assisted living facilities, qualifying continuing care facilities or other licensed facilities that were eligible for participation in Medicare. Therefore, unless they are congregate care facilities, the Residential Facilities and Non-Residential Facilities are not health care facilities.

Although congregate care facility is not defined in either the statute or the regulations, there are commonly used definitions of congregate care. The common theme among these definitions is the sharing of living space, dining space, transportation, and group activities. The definitions do not describe any level of medical or health care services. Nevertheless, further refinement to these definitions is needed for section 856 definitional purposes.

Congregate care facility must be read in context. Section 856(l)(4)(B) and section 856(e)(6)(D)(ii) describe various facilities that provide health care, not as an auxiliary function, but as part of the primary function of the facility (e.g., hospitals and nursing facilities) or in connection with a facility that has the primary function of providing health care (e.g., assisted living facilities). We conclude that it is not enough that a facility that meets the general definitions of congregate care offers medical services; to be a congregate care facility under section 856(l)(4)(B), the facility's health care concerns must be part of the primary function of the facility or sufficiently related to the provision of health care as implied under section 856(l)(4)(B). In the present case, the Residential and Non-Residential Facilities are not related to a health care facility and the medical care provided by the

those facilities is not part of the primary function of those facilities.

Taxpayer is obligated to provide space that government tenants use to incarcerate prisoners and detainees. As part of its operations, Taxpayer provides a certain level of shared dining and living space and group activities. The contracts require Taxpayer to provide the Services, including some level of medical, dental, and mental health services, as required by the prisoners and detainees. While Taxpayer's correctional facilities may provide a certain level of medical care, these services are not part of the primary function of the Residential and Non-Residential Facilities and thus these facilities are not congregate care facilities within the meaning of 856(e)(6)(D)(i).

Ruling 2: The amounts received under Taxpayer's contracts with government tenants for the Residential Facilities (excluding the Financed Facilities) will be treated as "rents from real property" for purposes of section 856(d)(1).

Under Taxpayer's owned and leased Residential Facilities contracts, government tenants pay to use specific real property to house their prisoners, detainees, probationers, and parolees. The contract payments received by Taxpayer are payments for the right to use space within a specific building. Therefore, the contract payments received by Taxpayer will be treated as "rents from real property" under section 856(d). Furthermore, Taxpayer has represented that the aggregate fair market value of the personal property owned by the REIT in the Residential Facilities is less than 15 percent of the aggregate fair market value of all property provided under the contracts. Because less than 15 percent of the contract fees is attributable to personal property under section 856(d)(1)(C), the entire contract fee will be treated as "rents from real property" within the meaning of section 856(d).

The Services provided to government tenants will be provided by a TRS of Taxpayer. The fees for the Services will be included in the rent received by Taxpayer, but Taxpayer will compensate the TRS on an arm's-length basis for providing the Services. All costs associated with providing the Services will be paid by the TRS. Accordingly, income from the Services provided by the TRS to government tenants will be excepted from the definition of impermissible tenant service income, and the amounts received by Taxpayer from government tenants will not be treated as other than rents from real property under section 856(d).

Ruling 3: The payments Taxpayer collects on behalf of its TRSs for the Services the TRSs provide at a Financed Facility2 are considered to be rendered by the TRS, rather than the REIT, and do not cause any portion of the payments received by the REIT that otherwise qualify to be disqualified for purposes of the REIT income tests.

Taxpayer represents that it will assign the service components of its Financed Facilities contracts to its TRSs, which will be fully responsible for directly providing the Services in those facilities. Taxpayer will collect the amounts that government tenants pay for the Services in the Financed Facilities on behalf of the TRSs and remit these amounts to the TRSs.

Taxpayer collects the charges for these services on behalf of the TRSs. Therefore, these arrangements do not cause payments Taxpayer collects on behalf of its TRSs for the Services the TRSs provide at a Financed Facility are considered to be rendered by the TRS, and do not cause any portion of the payments received by the REIT to the extent they otherwise qualify to be disqualified for purposes of the REIT income tests.

CONCLUSION

Based on the facts as represented, we rule that:

(1) The Residential Facilities and Non-Residential Facilities will not be treated as “health care facilities” in whole or in part under section 856(l)(4)(B);

(2) The amounts received under Taxpayer’s contracts with government tenants for the Residential Facilities will be treated as “rents from real property” for purposes of section 856(d)(1); and

(3) The payments Taxpayer collects on behalf of its TRSs for the Services the TRSs provide at a Financed Facility are considered to be rendered by the TRS, rather than the REIT, and do not cause any portion of the payments received by the REIT that otherwise qualify to be disqualified for purposes of the REIT income tests.

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under any other provision of the Code. Specifically, we do not rule on whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code. We also do not rule on whether a contract for a Financed Facility is treated in part as a loan from Taxpayer to a government tenant with respect to the Financed Facility. Furthermore, we do not rule whether payments received by the REIT on behalf of its TRS at a Financed Facility constitute gross income under section 61. In addition, we do not rule on whether Taxpayer’s TRSs are adequately compensated for the Services.

This ruling is directed only to the taxpayer requesting it. Taxpayer should attach a copy of this ruling to each tax return to which it applies. Section 6110(k)(3) of the Code 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 representatives.

Sincerely,

Jonathan D. Silver

Assistant Branch Chief, Branch 2

Office of Associate Chief Counsel

(Financial Institutions & Products)

IRS: Organization's Exemption Jeopardized by Reimbursement Payments.

The IRS ruled that the tax-exempt status of an organization providing environmental cleanup services will be affected by payments the organization makes to a company under a reimbursement agreement and that the reimbursement payments inure to the benefit of the company.

Dear * * *

We have considered your ruling request dated February 11, 2011, on the federal income tax consequences of a proposed agreement between you and Company.

FACTS

You are exempt under § 501(c)(4) of the Internal Revenue Code (“Code”) as an organization that

promotes the public welfare by mitigating environmental damage. Your sole member is Parent, a business league that is organized and operated to further the interests of Industry and is exempt under § 501(c)(6).

The relationship between you and members of Parent with respect to your provision of cleanup services, such as Company, is governed by a standard service agreement (SSA). The SSA provides generally that you will provide cleanup services at designated rates, and that a member of Parent, such as Company, will reimburse you for your out-of-pocket expenses and pay a mark-up equal to 10-percent of all third-party service provider charges. The 10-percent markup provision is intended to compensate you for the costs and risks associated with the management and oversight of third-party contractors assisting in the cleanup response.

In this case, Company was responsible for the Incident. You have some of your own equipment, which you keep on call for cleanups. The scale of the Incident, however, was beyond your equipment capacity. Accordingly, and in compliance with the SSA, you hired third party contractors to help with the cleanup. The 10-percent markup resulted in an obligation for Company of approximately x1 dollars.

Company initiated the request for a reconsideration of the 10-percent markup amount because it felt that the size of the Incident and the resulting sizeable 10-percent markup amount produced an unexpected “windfall” to you. After considering the request, you and Company entered into the Agreement on Date and presented it to the board of Parent.

Parent, in the interest of preserving your tax-exempt status, agreed that it was appropriate for you to negotiate the Agreement with Company, but made the receipt of a favorable letter ruling from the Internal Revenue Service (IRS) a condition of Parent’s accepting the Agreement between you and Company.

The Agreement calls for the creation of a fund. You agreed to place in the fund 75 percent of the dollar amount resulting from the 10-percent mark-up assessed with respect to any charges related to the Incident where you invoiced and Company paid a 10-percent markup. Under the Agreement, you are entitled to keep 25 percent of the amounts received from the 10-percent markup paid by Company. The remaining 75 percent placed in the fund may be used by you and Company for specified expenses related to the Incident. Many of the Agreement provisions provide for reimbursement of Company by you from the fund. Once all qualifying expenses are paid from the fund, the remainder, if any, is to be released to you.

Specifically, the Agreement provides, in part, that:

1. Company will be reimbursed from the fund for costs it incurs in auditing third-party contractors who performed work in the cleanup of the Incident. The SSA is silent on who is responsible for paying for such auditing costs, but the standard Contractor Services Agreement (CSA) you use when engaging third-party contractors provides that you have the right to access contractors’ books and records to audit them at your expense.

2. You will be reimbursed from the fund for costs you incur in auditing third-party contractors if Company directs you to do so. As noted above, the CSA provides that you would normally be responsible for paying for such costs. However, under the SSA or CSA, you would audit third-party contractors in your own discretion and Company would not have the power to direct you to audit such contractors.

3. Reimbursements for audit costs in (1) and (2) are capped at x3 percent of the original amount in

the fund, approximately x4 dollars.

4. Company will be reimbursed for collections costs in pursuing collections of incorrect billings from third-party contractors. You state that, under the CSA, you would be liable to pay for collections expenses for any overcharges made by contractors discovered through your audits of contractors.

5. You will be reimbursed for collection costs you incur in pursuing collections of incorrect billings from third-party contractors. Under the CSA, you would normally be liable for paying collections expenses.

6. Reimbursements for collection costs in (3) and (4) are capped at the lesser of x5 percent of the amounts collected or x6 percent of the original amount in the fund.

7. Company will be reimbursed for any incorrect billing amounts it identifies but are otherwise not recoverable, in addition to the 10-percent markup on such amounts.

8. Company will be reimbursed for the 10-percent markup on any incorrect billing amounts Company recovers.

9. You will be reimbursed for costs related to certain personal injury claims, to the extent they are not covered by the SSA, payable by insurance, or payable by a third party.

10. You and Company waive the right to challenge the validity of contracts that do not conform to the provisions of the SSA, but were entered in good faith.

Company is represented on the board of Parent by Director, who is employed by Affiliate, an affiliate of Company. You state that Director, while present for, and participating in discussions relating to the original intention underlying the 10-percent markup, the unexpected magnitude of contractor billings on which the 10-percent markup was based in the case of the Incident, and the disproportionate gross revenues produced by the 10-percent markup compared with the extra costs borne by you in connection with managing contractors engaged to assist with the Incident, did not "participate in the final deliberations or decision" by Parent to approve your negotiations with Company. You further state that "the Parent Board's decision was made consistent with the exercise of the remaining board members' fiduciary duties, based solely on the best interests of Parent and its sole grantee, [you]."

You maintain that the reconsideration of the amount that Company owes you under the SSA is consistent with the original intent of the 10-percent markup, which was to cover management and oversight costs of third-party contractors. You state that the actual management and oversight expenses related to the Incident are much lower and are estimated to total approximately x2 dollars. You also state that the exchange under the Agreement between you and Company reflects the "give and take" of negotiations. Further, you state that, had Company not been a member of Parent, you would have been equally receptive to renegotiating the 10-percent markup liability, given the unanticipated size of that liability under the unique facts and circumstances presented by the Incident, and the limitations on liability and other concessions you received from Company under the Agreement.

To date, you have responded to a total of x7 calls for cleanup services, including the Incident. You have never before discounted any of the rates you charged for cleanup. You state that Company's status as a member of Parent does not affect the reconsideration agreement, and that you would have been willing to make such an agreement as the Agreement for any other organization contracting with you. You also state that you do not intend to modify the existing service agreement

with Company or any other entity. You cite the unprecedented size and financial impact of the Incident, which produced a “windfall” for you, as the reasons you were willing to negotiate with Company.

RULINGS REQUESTED

You requested the following ruling:

Payments made to Company pursuant to the Agreement will not adversely affect your tax-exempt status and will not result in inurement or impermissible private benefit directly or indirectly to Company by you.

LAW

Section 501(c)(4) of the Code exempts from federal income tax organizations operated exclusively for the promotion of social welfare, provided that no part of the net earnings of such an organization inures to the benefit of any private shareholder or individual.

Section 1.501(c)(4)-1(a)(2)(i) of the Treasury Regulations (“regulations”) provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.

Rev. Rul. 69-383, 1969-2 C.B. 113, holds that an agreement for fixed-percentage compensation of a radiologist does not result in inurement when the agreement results from arm’s-length negotiation and the radiologist has no control over, or management authority with respect to, the hospital.

Rev. Rul. 79-316, 1979-2 C.B. 228, holds that a nonprofit organization whose purpose is to prevent liquid spills within a city port area and to develop a program for the containment and cleanup of liquid spills that occur is entitled to exemption as a social welfare organization under § 501(c)(4), provided that its services are equally available to members and nonmembers and both members and nonmembers are charged on the same basis for cleanup services rendered.

Contracting Plumbers Cooperative Restoration Corp. v. United States, 488 F.2d 684 (2d Cir. 1973), holds that an organization that repairs damage to city streets in the course of plumbing activities does not promote the common good, although its activities benefit the community, because its services are available only to repair damages caused by members.

Harding Hospital, Inc. v. United States, 505 F.2d 1068 (6th Cir. 1974), holds that “net earnings” is a broader term than net profits according to financial statements. If a particular individual or limited number of individuals reaps commercial benefits from the operation of the instrumentality, though they do not do so by direct acquisition or payment over to them of its earnings, the earnings may nevertheless inure to their benefit.

United Cancer Council, Inc. v. Comm’r., 165 F.3d 1173 (7th Cir. 1999), holds that the inurement prohibition requires an organization not to siphon its earnings to its founder, or the members of its board or their families, or anyone else fairly to be described as an insider, that is, as the equivalent of an owner or manager. The test is functional. It looks to the reality of control rather than to the insider’s place in a formal organizational chart of an organization. The insider could be a mere employee or even a nominal outsider, such as a physician with hospital privileges in a charitable hospital.

The prohibition on inurement denies exempt status to an organization whose founders or controlling members have a personal stake in that organization’s receipts. People of God Community v.

Comm’r., 75 T.C. 127 (1980).

The term “net earnings” may include refreshments, goods, and services furnished to members of an exempt organization. Spokane Motorcycle Club v. United States, 222 F. Supp. 151 (E.D. Wash. 1963).

ANALYSIS

Section 501(c)(4) exempts from federal income tax organizations operated exclusively for the promotion of social welfare. An organization is operated exclusively for the promotion of social welfare it is if primarily engaged in promoting in some way the common good and general welfare of the community. Treas. Reg. § 1.501(c)(4)-2(a)(i).

Revenue Ruling 79-316, 1979-2 C.B. 228, holds that preventing and cleaning up liquid spills that endanger marine life and befoul recreational beaches and shorefront property are activities designed to benefit all inhabitants of the community served by an organization. Furthermore, such an organization is exempt under section 501(c)(4), provided that its services are equally available to members and nonmembers and both members and nonmembers are charged on the same basis for the cleanup services rendered. Similarly, Rev. Rul. 66-221, 1966-2 C.B. 220, holds that an organization engaged in fighting fires and related activities promotes the common good and general welfare of the people of the community as a whole. However, services provided by an organization exclusively, or at a preferential price, to its contributors or members do not promote the common good or general welfare even though they may incidentally benefit a community. See Contracting Plumbers Cooperative Restoration Corp. v. United States, 468 F.2d 684 (2d Cir. 1973) (holding that an organization that repaired damage to city streets caused in the course of plumbing activities did not promote the common good, even though its activities benefited the community, because its activities were available only to repair damage caused by its members).

Your historical purpose and operations are consistent with these authorities regarding exemption under § 501(c)(4). However, the Agreement will change the basis upon which members and nonmembers of Parent are charged. You generally have charged members and nonmembers on the same basis. The Agreement, however, changes the basis upon which you charge a particular member, Company, thus providing a member a better price than nonmembers.

Under the Agreement, you will reimburse Company for audit costs for which you would normally be liable under the SSA and CSA. As a result of auditing third-party contractors, Company will be reimbursed for any incorrect billing amounts it identifies, in addition to the associated 10-percent markup for such amounts. Because Company will be reimbursed for audit costs, it is incentivized to audit third-party contractors to identify incorrect billings, and is reimbursed for both the audit costs and incorrect billings. Although Company would normally be reimbursed for incorrect billings and the associated 10-percent markup under the SSA and CSA, the subsidization of Company’s auditing is likely to identify more incorrect billings than under the SSA and CSA. This is because, under the SSA and CSA, you are responsible for auditing and have less incentive to audit third parties. Therefore, Company stands to benefit under the Agreement from the subsidized auditing activity. You cite the cap on audit costs as a benefit to you under the Agreement. The cap for reimbursements for audit costs is capped at x3 percent of the original fund amount. Given that the cap allows for approximately x4 dollars in audit costs, however, the cap is so high that it is not meaningful.

Under the Agreement, you will also reimburse Company for collection costs for which you would normally be liable under the SSA and CSA. Company will be reimbursed for collection costs in recovering incorrect billings and for the 10-percent markup on the amount it recovers. Because Company will be reimbursed for collection costs, it is incentivized to undertake collection activities

so that it can be reimbursed for the 10-percent markup on such amounts. Although Company would normally be reimbursed for the recovered incorrect billing amounts under the SSA and CSA, the subsidization of Company's collection activity is likely to cause Company to recover more incorrect billings and be reimbursed for more 10-percent markups on such amounts. This is because, under the SSA and CSA, you are responsible for collections and have less incentive to collect amounts from third parties. You cite the cap on collection costs as a benefit to you under the Agreement. The cap for reimbursements for collection costs is the lesser of x5 percent of amounts collected or x6 percent of the original fund amount. Given that the cap allows for reimbursement of millions of dollars in collection costs, this cap, like the cap on audit costs, is also not particularly meaningful.

As described above, the Agreement reduces the amount Company is required to pay under the SSA and CSA, changing the basis upon which you charge Company, a member of Parent, for your services. You have never reduced the amounts you charge for cleanup services in hundreds of service calls, either for members or nonmembers of Parent. Now, however, you propose to discount the amounts you charge for cleanup services for a member of Parent that is represented on the Board of Parent. Because you will charge a member of Parent (i.e., Company) on a different basis from nonmembers, and at a preferential price, you are not like the organization in Rev. Rul. 79-316, supra. Accordingly, upon making such payments pursuant to the Agreement, you may not be operated exclusively for the promotion of social welfare under § 501(c)(4). See Rev. Rul. 79-316, supra, and Contracting Plumbers Cooperative Restoration Corp. v. United States, 468 F.2d 684 (2d Cir. 1973). As a result, you may jeopardize your exemption under § 501(c)(4).

No part of the net earnings of an organization exempt under § 501(c)(4) may inure to the benefit of any private shareholder or individual. The inurement prohibition requires an organization not to pass its earnings to its founder, or the members of its board or their families, or anyone else fairly to be described as an insider — that is, as the equivalent of an owner or manager. United Cancer Council, Inc. v. Comm'r., 165 F.3d 1173 (7th Cir. 1999). The test is functional: it looks to the reality of control rather than to the insider's place in a formal table of organization. The insider could be a mere employee or even a nominal outsider, such as a physician with hospital privileges in a charitable hospital. Similarly, the prohibition on inurement denies exempt status to an organization whose founders or controlling members have a personal stake in that organization's receipts. People of God Community v. Comm'r., 75 T.C. 127 (1980).

"Net earnings," in the context of the prohibition on inurement, is a broader term than net profits according to financial statements. If a particular individual or limited number of individuals reaps commercial benefits from the operation of an instrumentality, though they do not do so by direct acquisition or payment over to them of its earnings, the earnings may nevertheless inure to their benefit. Harding Hospital, Inc. v. United States, 505 F.2d 1068 (6th Cir. 1974). The term "net earnings" may even include refreshments, goods, and services furnished to members of an exempt organization. Spokane Motorcycle Club v. United States, 222 F. Supp. 151 (E.D. Wash. 1963).

An agreement for fixed-percentage compensation of a radiologist does not result in inurement when the agreement results from arms-length negotiation and the radiologist has no control over, or management authority with respect to, the hospital. Rev. Rul. 69-383, 1969-2 C.B. 113.

Here, Company can fairly be described as an insider with respect to you. See United Cancer Council v. Comm'r, 165 F.3d 1173 (7th Cir. 1999). Company is the equivalent of an owner or manager with respect to you, given that it has a voice in the control of Parent through its representative on Parent's board. Parent is your sole member, its board has control over you and, by virtue of its representation on Parent's board, Company has a voice in controlling you. As a member of Parent that stands to benefit from the Agreement, Company has a personal stake in your receipts. See People of God Community v. Comm'r, 75 T.C. 127 (1980).

You state that Company's representative, Director, recused himself from Parent's board meetings during deliberations and voting on the Agreement. He was, however, present for discussions of the Agreement. As described, the transaction appears to be at arm's-length. Nonetheless, you are different from the radiologist in Revenue Ruling 69-383, supra, because Company has a degree of control over you by virtue of its representation on the board of Parent, which is the sole and controlling member of you. Company is therefore distinguishable from the radiologist in the revenue ruling and can be described as an insider with respect to you.

You cite the unprecedented size of the Incident as the main reason you were willing to negotiate with Company, but you have never reduced the amount you charge for cleanup services for any member or nonmember of Parent. Neither do you propose to make any changes to the SSA to address the problem of similar clean up situations in the future. The only instance in which you have been willing to reduce the fees you charge is with a member of Parent that is also an insider with respect to you. Because you have not reduced your standard cleanup charges and you state that you do not plan to change the SSA going forward, it appears that Company's status as an insider may have influenced your willingness to negotiate with Company. Regardless of whether Company's status as an insider influenced your willingness to negotiate, the Agreement you have negotiated with Company, in fact, benefits Company by relieving it of amounts it owes you under the SSA in return for illusory benefits in your favor. Also, regardless of whether Company's status as an insider actually influenced your decision to accept the Agreement, the Agreement does, in fact, benefit an insider with respect to you.

Given that Company is an insider with respect to you, the reduction of Company's liability under the SSA, pursuant to the Agreement, effectively reduces the price Company pays for your services. Such a reduction in liability, or in price for services, qualifies as "net earnings" within the meaning of section 501(c)(4). See Harding Hospital, inc. v. United States, 505 F.2d 1068 (6th Cir. 1974). The reimbursement of Company for expenses for which it is liable to you under the SSA from the Agreement fund will cause your net earnings to inure to the benefit of Company. As a result of your providing services at a preferential price to Company, you will no longer be operated exclusively for the promotion of social welfare and accordingly, your status under § 501(c)(4) will be adversely affected.

CONCLUSION

Based on the foregoing, we rule as follows:

Payments made to Company pursuant to the Agreement will adversely affect your tax-exempt status under § 501(c)(4) and will result in inurement to Company by you.

This ruling will be made available for public inspection under § 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Theodore R. Lieber

Manager, Exempt Organizations

Technical Group 3

IRS Announces Maximum Values of Employer-Provided Vehicles for 2013.

The IRS has announced (Notice 2013-27, 2013-18 IRB 985) the maximum value of employer-provided vehicles first made available to employees for personal use in 2013 for which the vehicle cents-per-mile valuation rule or the fleet-average valuation rule may be applicable.

In previous years, the IRS has provided by revenue procedure the maximum vehicle values and guidance on their calculation and application. Beginning in 2013 with Notice 2013-27, only the maximum vehicle values as adjusted for inflation will be published annually in a notice, the IRS stated.

Maximum Vehicle Values for 2013 for Use of Vehicle Cents-Per-Mile

and Fleet-Average Valuation Rules

PURPOSE

This notice provides the maximum vehicle values for 2013 that taxpayers need to determine the value of personal use of employer-provided vehicles under the special valuation rules provided under section 1.61-21(d) and (e) of the Income Tax Regulations.

BACKGROUND

If an employer provides an employee with a vehicle that is available to the employee for personal use, the value of the personal use must generally be included in the employee's income and wages. Internal Revenue Code § 61; Regulation section 1.61-21. If the employer meets certain requirements, the employer may elect to determine the value of the personal use using certain special valuation rules, including the vehicle cents-per-mile rule and the fleet-average value rule set forth in Regulation section 1.61-21(d) and (e), respectively. Both the vehicle cents-per-mile rule and the fleet-average value rule provide that those rules may not be used to value personal use of vehicles that have fair market values exceeding specified maximum vehicle values on the first day the vehicles are made available to employees. These maximum vehicle values are indexed for inflation and must be adjusted annually by referring to the Consumer Price Index. In previous years these maximum vehicle values and guidance on their calculation and application have been provided by Revenue Procedure. For example, the maximum vehicle values for vehicles first placed into service in 2012 were published in Revenue Procedure 2012-13 I.R.B. 2012-3 (January 17, 2012). Guidance

on the calculation and application of these maximum vehicle values is set forth in section 1.61-21(d) and (e) of the Regulations and does not change from yearto-year. Accordingly, beginning this year, only the maximum vehicle values as adjusted for inflation will be published annually in a shorter notice.

MAXIMUM VEHICLE VALUES

The maximum value of employer-provided vehicles first made available to employees for personal use in calendar year 2013 for which the vehicle cents-per-mile valuation rule provided under Regulation section 1.61-21(e) may be applicable is $16,000 for a passenger automobile and $17,000 for a truck or van.

The maximum value of employer-provided vehicles first made available to employees for personal use in calendar year 2013 for which the fleet-average valuation rule provided under Regulation section 1.61-21(d) may be applicable is $21,200 for a passenger automobile and $22,300 for a truck or van.

EFFECTIVE DATE

This notice applies to employer provided passenger automobiles first made available to employees for personal use in calendar year 2013.

Comments Requested on Bond Information Return Form.

The IRS requested comments on Form 8038-B, "Information Return for Build America Bonds and Recovery Zone Economic Development Bonds." Comments are due by June 24.

Direct all written comments to Yvette Lawrence, Internal Revenue Service, room 6129, 1111 Constitution Avenue NW., Washington, DC 20224.

IRS Requests Comments on Low-Income Housing Credit Agency Report.

The IRS asked for public comment on Form 8610, "Annual Low-Income Housing Credit Agencies Report," and its related Schedule A, "Carryover Allocation of Low-Income Housing Credit." Comments are due by June 24.

Direct all written comments to Yvette Lawrence, Internal Revenue Service, Room 6129, 1111 Constitution Avenue NW., Washington, DC 20224.

Comments Sought on Exempt Organization Return.

The IRS asked for public comment on Form 990, "Return of Organization Exempt From Income Tax Under Section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except black lung benefit trust or private foundation)," and related schedules. Comments are due by June 25, 2013.

Send comments regarding the burden estimate, or any other aspect of the information collection, including suggestion for reducing the burden, to (1) Office of Information and Regulatory Affairs, Office of Management and Budget, Attention: Desk Officer for Treasury, New Executive Office Building, Room 10235, Washington, DC 20503, or email at OIRA_Submission@OMB.EOP.GOV and (2) Treasury PRA Clearance Officer, 1750 Pennsylvania Ave. NW., Suite 8140, Washington, DC 20220, or email at PRA@treasury.gov.

IRS Requests Comments on Private Activity Bond Election Form.

The IRS asked for public comment on Form 8328, "Carryforward Election of Unused Private Activity Bond Volume Cap." Comments are due by June 24, 2013.

Direct all written comments to Yvette Lawrence, Internal Revenue Service, Room 6129, 1111 Constitution Avenue NW., Washington, DC 20224.

Comments Requested on Guidance on Stripping Transactions for Qualified Tax Credit Bonds.

The IRS requested comments on guidance (Notice 2010-28) on stripping transactions for qualified tax credit bonds under section 54A and on some income tax accounting matters associated with holding and stripping qualified tax credit bonds. Comments are due by June 24, 2013.

Direct all written comments to Yvette Lawrence, Internal Revenue Service, room 6129, 1111 Constitution Avenue NW., Washington, DC 20224.

Place Holder

IRS: Affordable Care Act Provisions: What you need to know!

In keeping with the IRS mission of providing America's taxpayers with top-quality service by helping you understand and meet your tax responsibilities, we will be conducting a phone forum on April 30, 2013 to discuss key provisions of the Affordable Care Act that are currently in effect. These provisions which impact federal, state, and local government employers include:

- W-2 Reporting: Employer Sponsored Health Coverage; and
- Additional Medicare Tax on High Income Earners

To learn more, we cordially invite you to attend the "ACA Provisions: What you need to know!" Phone Forum. This forum is tailored for federal, state and local government employers, payroll and benefits administrators.

During this 60 minute presentation we will cover:

- What is included in the cost of coverage (i.e. health, dental/vision, FSA benefits); and
- Additional Medicare Tax: application, calculation, and reporting.

We are sorry, but we have reached maximum capacity for the ACA Phone Forum. A recorded version and transcript will be posted on our website after the phone forum. If you want notification of the posting, please e-mail your request to te.ge.fslg.outreach@irs.gov. Please add "ACA Recorded Phone Forum" in the subject line. Thank you.

FASB Proposal Addresses Affordable Housing Project Investments.

The Financial Accounting Standards Board on April 17 issued proposed guidance that would modify the conditions for allowing the use of an effective yield method to account for investments in affordable housing projects that qualify for the low-income housing tax credit.

The Financial Accounting Standards Board on April 17 issued proposed guidance that would modify the conditions for allowing the use of an effective yield method to account for investments in affordable housing projects that qualify for the low-income housing tax credit (LIHTC).

According to FASB, the proposed accounting standards update, "Investments — Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force)," would amend existing guidance and permit a reporting entity to use the effective yield method of accounting if specific conditions are met.

FASB noted in the proposal that stakeholders had indicated that the effective yield method of accounting provides users of financial statements with a better understanding of the entity's investment returns from affordable housing projects.

The board added that the proposed guidance would apply to all reporting entities that invest in a qualified affordable housing project "through a limited liability entity that is a flow-through entity for tax purposes." The board said that current guidance requires some LIHTC investments to be accounted for as an equity method investment or cost method investment in accordance with Accounting Standards Codification Topic 970, "Real Estate — General."

FASB's proposal also includes disclosure objectives that should enable users of financial statements to understand the nature of investments in qualified affordable housing projects and the effect those investments and related tax credits have on an entity's financial statements. The proposal provides some information an entity should consider disclosing in order to meet those objectives, including the amount of affordable housing tax credits recognized during the year and the amount and nature of write-downs during the year that resulted from the "forfeiture or ineligibility of tax credits or other circumstances."

FASB said that an effective date will be determined after the Emerging Issues Task Force (EITF) reviews the feedback received on the proposal. The board did confirm that the proposed amendments should be applied retrospectively and that early adoption of the guidance will be permitted.

FASB on March 28 agreed to ratify the EITF's final consensus to expose the proposed guidance on accounting for investments in affordable housing projects for a 60-day comment period. (Prior coverage .)

FASB will accept written comments on the proposal until June 17.

For the proposal, see:

http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176162357127

IRS Publishes Proposed Regs on Reporting Requirements for Bond, Acquisition Premium.

The IRS has published proposed regulations (REG-154563-12) on the information reporting requirements for bond premium and acquisition premium under section 6049.

The text of simultaneously issued temporary regs (T.D. 9616) serves as the text of the proposed regs. Comments are due by July 17.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-154563-12), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-154563-12), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-154563-12).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Pamela Lew, (202) 622-3950; concerning submissions of comments, Oluwafunmilayo (Funmi) Taylor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in the Rules and Regulations section of this issue of the Federal Register amend the Income Tax Regulations (26 CFR part 1) relating to section 6049. The temporary regulations set forth information reporting requirements related to bond premium and acquisition premium. The text of the temporary regulations also serves as the text of these proposed regulations.

Consideration of Administrative Burdens Related to Basis Reporting

A number of commenters have indicated that compliance with basis reporting requirements and the use of basis and other information reported by brokers will require considerable resources and effort on the part of return preparers and information recipients. The Treasury Department and the IRS are continuing to review all aspects of the information reporting process and are exploring ways to reduce the compliance burden for both brokers and for information recipients.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Request for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS as prescribed in the preamble under the "Addresses" heading. The Treasury Department and the IRS welcome comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available at www.regulations.gov for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for a public hearing will be published in the Federal Register.

New Requirements for 501(c)(3) Hospitals Under the Affordable Care Act.

The Affordable Care Act (ACA), enacted March 23, 2010, added new requirements that hospital organizations must satisfy in order to be described in section 501(c)(3), as well as new reporting and excise taxes.

Because many of these provisions are effective for tax years beginning after the date of enactment, revision of the core Form 990, the Form 990 Schedule H and instructions has been a priority for the Internal Revenue Service (IRS).

As the IRS develops the new forms and guidance to implement the ACA, the IRS goals will be to:

- Allow hospitals to clearly describe their activities and policies;
- Minimize burden to the extent possible; and
- Capture compliance information as required for adherence with the statute.

New Requirements for Charitable 501(c)(3) Hospitals

Section 501(r), added to the Code by the ACA, imposes new requirements on 501(c)(3) organizations that operate one or more hospital facilities (hospital organizations). Each 501(c)(3) hospital organization is required to meet four general requirements on a facility-by-facility basis:

- Establish written financial assistance and emergency medical care policies;
- Limit amounts charged for emergency or other medically necessary care to individuals eligible for

assistance under the hospital's financial assistance policy;
- Make reasonable efforts to determine whether an individual is eligible for assistance under the hospital's financial assistance policy before engaging in extraordinary collection actions against the individual; and
- Conduct a community health needs assessment (CHNA) and adopt an an implementation strategy at least once every three years. (These CHNA requirements are effective for tax years beginning after March 23, 2012).

The ACA also added new section 4959, which imposes an excise tax for failure to meet the CHNA requirements, and added reporting requirements under section 6033(b) related to sections 501(r) and 4959.

Schools Describe Impact of Proposed Employer Shared Responsibility Regs.

Many school administrators, board members, and teachers have commented on proposed health insurance regulations (REG-138006-12) implementing the employer shared responsibility provisions, addressing how the regs would affect their schools, staff, and students.

[Editor's Note: The document at this citation contains a representative sampling of a larger number of comment letters submitted to the IRS on REG-138006-12.]

To Whom It May Concern:

The impact of the RULE being proposed for education concerning the PPACA is going to be very detrimental to our school corporation. The majority of our employees have traditionally worked only nine (9) months out of the year. They work for our school corporation because they like being off work in the summer when their children are off school. This saves families the expense of child care year round. These employees are truly seasonal or part-time and therefore should not be included in the rule that forces school corporations to provide insurance to employees working over 30 hour per week. They should be viewed the same as a person that works at a theme park or pool for the summer.

Funding for school corporations keeps getting reduced every year. As a result of limited funds we will be forced to reduce hours for most of our part-time employees who are already on a limited income. In some instances we will have to hire more part-time employees in order to keep offering the same services to our students. Several of the employees that we will be forced to offer insurance to have the spousal rule, but these employees are better off financially on their spouse's insurance. Some of them have already told us that they will quit if they are offered insurance thus making this rule a financial hardship for the employee and the school corporation.

Please reconsider this interpretation of the act so as to not adversely affect the education of our students. Our primary concern is the best education we can provide for the students in our school corporation. As our expenses continue to increase this becomes increasingly more difficult to accomplish.

Sincerely,

[signed]

Deputy Treasurer

Southeast Dubois County School

Corporation

Ferdinand, IN

* * * * *

March 6, 2013

To Whom It May Concern,

I would like to express my concern over the proposed IRS regulation 138996-12. Since the Patient Protection and Affordable Care Act was enacted three years ago, public schools were told that they were exempt from the rule because a large number of our school employees work only 180 days a year. On January 2, 2013 this assumption changed with a new IRS regulation. The new rule for public schools will force our school (which has only 200 employees) to provide hundreds of thousands of dollars in health insurance for employees. Public schools have been underfunded since 2007 and this comes at a time when schools cannot afford health insurance for part-time employees. We have also been in deficit financing since 2005 and this has placed a huge strain on the schools.

Although cost is an issue, public schools believe we have been singled out by the rule. Our attorney has informed us that businesses do not have to provide health insurance for their workers who work the 180 days a year. This new rule you are proposing requires public schools to provide health insurance for individuals while businesses are exempt.

Our school would appreciate if you would reconsider IRS regulation 138996-12. Thank you for your time on this matter.

Sincerely,

Andy Wandersee

School Board Member

Centerville-Abington Community

School Corporation

Centerville, IN

School Boards Group Comments on Impact of Proposed Employer Shared Responsibility Regs.

Francisco Negrón Jr. of the National School Boards Association has commented on proposed regulations (REG-138006-12) implementing the employer shared responsibility provisions, suggesting that the regs may have an unintended impact on schools, including the treatment of long-term assignments, substitute teachers, coaches, and school board members.

Dear Ms. Bjornstad and Ms. Taylor:

The National School Boards Association (NSBA), representing through our state associations approximately 13,800 school districts nationwide, offers the following comments to the proposed rule, Shared Responsibility for Employers Regarding Health Coverage, REG-138006-12, issued by the Internal Revenue Service (IRS) on January 2, 2013. NSBA appreciates the opportunity to share with the IRS: (1) the perhaps unanticipated impact certain provisions of the proposed rule may have as public school districts across the country wrestle with questions about which service hours of various categories of staff members are to be included in the full-time equivalent employee counts for "large employer" determinations; and (2) the need for clarification in some before the rule becomes final to minimize any adverse impact on the nation's schools and students' educational outcomes.

I. Who is an "Employee" for Purposes of "Large Employer" Determinations?

In the proposed rule, the IRS states that an employer determines if it meets the definition of a "large employer" for "Shared Responsibility" purposes by totaling the number of full-time employees working an average of at least 30 hours per week, along with a calculation using a formula adding all the service hours of the employer's part-time employees to determine the number of full-time equivalent employees (FTEs) to be added to the employer's total count. It is this second piece of the calculation that causes some concern for public school districts.

The IRS proposed rule specifically addresses teachers and other employees of educational organizations, including public school districts, in terms of the look-back measurement period, breaks in service for summer and winter breaks, a calendar year versus an academic year (typically, a school's "fiscal" year), breaks in service for certain types of leave, variable-hour and seasonal employees, and calculating average weekly hours for school employees (both hourly and non-hourly) when they typically will not work a full twelve-month period.

Public school districts employ many different types of employees with various work schedules and duties that make it difficult to determine who is an "employee" such that they should be included in the FTE count, and whether such inclusion is appropriate or fair to the school district. Some extremely small districts that do not employ more than 50 full-time employees may come under the heading of an "applicable large employer" when the hours of the part-time workers are included in the calculation of the number of FTEs as required by the IRS proposed rule. The question then becomes "who is an employee?"

The IRS proposed rule states that it has adopted the "common law standard" position for determining when an individual is an "employee". The IRS states in its discussion of this matter that

"[u]nder the common law standard, an employment relationship exists when the person for whom

the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. Under the common law standard, an employment relationship exists if an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if the employer has the right to do so." 78 Fed. Reg. 218, 221 (Jan. 2, 2013).

While offering some guidance, this standard does not resolve whether many different categories of people who perform work for school districts should be counted as an employee for purposes of determining whether a school district is an "applicable large employer," and, consequently, who must then be offered health insurance. As demonstrated below in the following examples and questions, certain staffing situations exist on a daily,1 weekly, and monthly basis that make a public school district's frequent calculation of full-time employees (including the FTEs) and subsequent insurance-related responsibilities, as suggested by the IRS proposed rule, administratively arduous and quite confusing.

A. Short-Term Substitute Teachers (typically individual assignments of three consecutive months or less)

Some individuals (both licensed and unlicensed) seeking temporary work on a substitute basis have their names on lists for multiple school districts simultaneously. This occurs not through any type of employment agency but through the individual's own selection of districts for which he/she would like to work. Such substitute work could be for teachers, teaching assistants, bus drivers, cafeteria workers, custodians, etc. For these individuals, school district employers do not have a reasonable expectation at each individual's start date that any one individual will perform an average of 30 hours/week of substitute employee services. Moreover, any one of these individuals may perform substitute services for more than one district in any number of counties or education service agency configurations in any given week or month.

Thus, under the IRS proposed rule, one individual could be an "employee" of more than one employer simultaneously. This situation calls into question the applicability of the discussion in the IRS proposed rule about "Employees Rehired After Termination of Employment or Resuming Service After Other Absence," 78 Fed. Reg. at 228. It is uncommon, though not completely impossible, for substitutes to go for long periods of not performing substitute services for any one particular district for several months at a time, all completely unrelated to being "terminated" or on some "other absence". Thus, substitutes are not being rehired for each assignment, nor are they "returning" to service for a substitute assignment, nor experiencing a "break in service" since the school district may still be "open" and operational when they are called in to cover a substitute assignment. And applying "averaging methods" would be inappropriate, since substitutes are not guaranteed any minimum hours of service on any given day, or in any given week or month during the school year. Notwithstanding, issues arise with one individual subbing for more than one school district in any given school year, and what obligations each school district may have regarding each substitute's hours of service.

For example, over the course of one week, Steve Q is a full-day substitute (roughly 7 hours) to cover the Chemistry classes at School District A's high school on Monday. Mr. Q then does a half-day 4th grade substitute assignment (roughly 3.5 hours) at School District B's elementary school on Wednesday. And on Thursday, Mr. Q does a full-day assignment (again, roughly 7 hours) at a School District C middle school to cover 8th grade classes. Mr. Q does not provide any additional substitute services for any other school districts on Tuesday and Friday of that week. Given that schedule for that week, Mr. Q typically would not be performing, nor expected to perform, an average of 30

hours/week for a single employer over the course of a calendar/fiscal year or other measurement period. Under the IRS proposed rule, Mr. Q. would not meet the definition of a "full-time employee", but that of a variable-hour employee, at last.

However, the same IRS proposed rule seems to suggest that Mr. Q's "part-time" hours for each substitute assignment that week would have to be included in the calculation of FTE hours for each respective school district for which the service hours were performed in the "large employer" determination. Thus, on paper, the IRS proposed rule appears to deem Mr. Q as an "employee" of all three school districts for purposes of determining whether each school district is a "large employer." Yet, for some extremely small districts [less than 50 full-time employees (including FTEs)], the inclusion of Mr. Q's "part-time" hours in the FTE hours calculation might have the effect of pushing one or more of these three small districts into the category of an "applicable large employer", which would then be required to offer health insurance coverage to its full-time employees. Similar to long-term substitute teachers as discussed below, it seems unfair that the federal government would allow one individual to have this kind of effect on multiple school districts in any one given year.

NSBA posits that this dilemma would not change if, for example, over the course of an entire school year, Mr. Q completed 65 total hours of substitute assignments for School District A, 36 total hours for School District B, and 47 total hours for School District C. Again, over the course of each week and over the course of the school year (i.e., measurement period), none of these three school districts expects Mr. Q to work an average of 30 hours/week at the start of any of his substitute teacher positions. All the while, the full-time employees who are absent, necessitating the reason for Mr. Q's substitute personnel employment, are also being counted as full-time employees for "large employer" determination purposes, and are still being paid despite their absence. Thus, it would seem that requiring Mr. Q's substitute hours be included in the FTE calculation for "large employer" purposes results in some "double counting" of employees, in a manner unfair to each school district using Mr. Q's substitute services in any given week or month.

To remedy this wrinkle and not place "small-employer" school districts in such an unfair position, NSBA recommends that the IRS revise the Shared Employer proposed rule to permit "small-employer" school districts to exclude the hours of service of short-term substitutes (although otherwise characterized as variable-hour employees) from the calculation of FTEs for purposes of determining if a school district is an "applicable large employer".

B. Long-Term Substitute Teachers (typically individual assignments of more than three consecutive months)

The IRS proposed rule also discusses the treatment of new, variable-employees who, based on the circumstances at the start date, are expected to work an average of at least 30 hours/week, but for a period of limited duration not to last the entire measurement period. Specifically, the IRS proposed rule states that:

"[a] new employee who is expected to be employed initially at least 30 hours per week may be a variable hour employee if, based on the facts and circumstances at the start date, the period of employment at more than 30 hours per week is reasonably expected to be of limited duration and it cannot be determined that the employee is reasonably expected to be employed on average at least 30 hours per week over the initial measurement period." 78 Fed. Reg. at 227.

This proposed rule seems reasonable in the case of a long-term substitute placed on a school assignment that is expected to last longer than three months. Though the same concerns arise regarding "double counting", as mentioned in the Short-Term Substitute section above.

However, the discussion in the IRS proposed rule further states that:

"Effective as of January 1, 2015,. . . ., the employer will be required to assume for this purpose that although the employee's hours of service might be expected to vary, the employee will continue to be employed by the employer for the entire initial measurement period; accordingly, the employer will not be permitted to take into account the likelihood that the employee's employment will terminate before the end of the initial measurement period." 78 Fed. Reg. at 227 (emphasis added),

This language is both problematic and unfair for school districts, as it has the potential to result in school districts not hiring individuals for long-term substitute assignments, and instead breaking up the assignment into a series of assignments of a short-term duration, bringing in different people for each segment, resulting in a lack of continuity in teaching methodologies for students and even the assignment of less qualified teaching staff which could ultimately affect students' educational outcomes. The next example will demonstrate how long-term substitute assignments work in actual practice:

In School District A, a physical education teacher goes on medical leave in mid-January for the rest of the school year (a total of approximately five months) due to a back injury. The P.E. teacher intends to return to the classroom at full-duty status at the beginning of the following school year. School District A brings on Miss T as a long-term substitute teacher to cover the P.E. teacher's classes during his absence. For purposes of this example, assume this is Miss T's first substitute assignment for School District A, i.e., she is a new variable hour employee.

At the start of her long-term substitute assignment, the school district and Miss T are fully aware that this is a finite term of service for Miss T while she covers the P.E. classes. Miss T works a full-time schedule during the course of her long-term assignment, just as the original P.E. teacher would have, but for the injury. Additionally, the policies and regulations of School District A contain provisions that specifically state that substitutes and "temporary teachers", such as Miss T, are not entitled to benefits of any kind from the school district during the course of their assignments. Also, there is no guarantee that Miss T will have any future substitute assignments, short- or long-term, at the conclusion of this particular long-term P.E. class assignment.

Is Miss T an "employee" of School District A for "large employer" determinations under the IRS proposed rule? It is true that at the start date of Miss T's long-term substitute assignment, she is expected to work an average of at least 30 hours per week during the approximately 5-month period of service. However, once this current assignment is over, School District A will have no basis to reasonably expect that Miss T will work those same hours during the remainder of the measurement period. Thus, Miss T will not experience a "break in service" at the end of the school year, as discussed in the IRS proposed rule. So, would Miss T be considered a part-time employee, even though she worked full-time hours during those 5 months, such that her hours of service should be counted in the FTE hours calculation?

Additionally, school districts would likely find the "Effective as of January 1, 2015, . . . required to assume . . . will continue to be employed" language problematic in this and similar situations. Specifically, if School District A is a small district, i.e., unlikely to meet — but is close to — the 50-full-time employee threshold, and including Miss T as a "full-time employee" or including her hours of service as a variable-hour employee for FTE hours calculation purposes would push School District A over the 50-full-time employee (plus FTEs) threshold, it seems unfair to now allow a one-time incident (having a long-term substitute) to result in School District A having the responsibilities of a "large employer" for the following school year or applicable stability period, even if School District A is fully aware that Miss T's period of work has long since ended.

Also, it is not uncommon for individuals who are on multiple school districts' substitute lists to have worked primarily for some portion of a school year in one school district, but ultimately be hired on as a full-time employee in another neighboring (or even out-of-state) school district mid-school-year, as vacancies occur throughout the school year. Thus, it is unclear what the purpose is of the "Effective as of January 1, 2015" language requiring school districts to assume these types of variable hour employees "will continue to be employed" by those districts for the remainder of the initial measurement period. Thus, NSBA would recommend the IRS final rule regarding Shared Employer Responsibilities exclude such variable hour employees, i.e., short- and long-term substitutes and temporary teachers of any kind, from this proposed "required assumption".

C. Independent Contractors

The IRS proposed rule does not address independent contractors, and it is not clear under what circumstances, if any, a school district may need to include an independent contractor either as a full-time employee or as an FTE in the total employee count for purposes of "large employer" determinations and for the "assessable payment" (i.e., penalty) provisions contained in the IRS proposed rule. The IRS states in this proposed rule that it plans to follow the "common law standard" for determining who is an employee for consideration of shared employer responsibilities. As such, it is unclear if the IRS intends for such employment arrangements to be considered as establishing an employment relationship and thus an independent contractor could come under the definition of an "employee". Since the "common law standard" explained by the IRS in this proposed rule looks at the nature of the work itself being done, and the authority of the employer to direct, supervise, and manage such work, it is worth looking at a few examples of typical independent contractors a school district might engage, and into some of the elements of the employment contracts being entered into.

An independent contractor who performs work for a school district usually does so for a finite period of time. For some independent contractors, the period of work may run longer than three months;2 for others, it may run shorter. For example, an independent contractor might be a construction company hired to build a new school over the course of a school year. Another might be a private law firm hired under an annually negotiated contract to provide representation to a school board of a public school district in all special education matters before administrative tribunals, and state and federal agencies and courts. Yet another may be a trainer who will provide one week of professional development for a school district's building principals on new employee evaluation procedures. And still another may be a private auditor who will be conducting an internal investigation of a school district's finance department, the audit and final reporting of which is expected to last the duration of one school year or nine months.

Ordinarily, the types of independent contractors suggested above are either self-employed or are wholly separate business entities outside the school district, with these entities administering and managing the health insurance plans of the individuals who will be performing the contracted work for the school district. Another possibility is that, for example, the trainer and/or the auditor, if solo practitioners, might have their own individual health insurance policies or be included in their spouses' policies.

The specifically identified terms of a contract for the services of an independent contractor are usually negotiated between the school board and the independent contractor, and typically are governed by state law. Such contract terms may include the rate of compensation; the scope of work; the expected duration of the contract; what outcomes and forms of work product are expected and by when; the methods and levels of access, if needed, to school property, student/staff records, and district staff both at school sites and at the Central Administration Office; areas of liability in the event of injury or work stoppages; where the independent contractor(s) would be physically

performing their work under the contract; the levels of confidentiality in any information gained by the independent contractor in the course of the work; and most importantly, the degree to which the work under the contract can be directed, supervised, and/or controlled by school district employees.

Also, these independent contractor services contracts may, and typically do, contain provisions, negotiated in good faith, that for the life of the contract, the independent contractor(s) performing the work is not considered an "employee" of the school district, and is not eligible for any health or other benefits typically made available to school district employees. This last provision about the lack of eligibility for health or other district benefits is also sometimes contained in school district policies and regulations, similar to short- and long-term substitutes and "temporary" teachers.

While the construction company, the private law firm, and the trainer would seem to provide the easiest examples of individuals working as independent contractors who would not consider themselves to be "employees" of the school district for purposes of this IRS proposed rule, nor likely would the school district, a more definitive statement to this effect from the IRS would be helpful to ensure that all entities are of the same mind with regard to the application of this proposed rule.

The example of the auditor, however, is not as clear. For the sake of argument, assume that while performing her contract, the auditor is given office space at the central administration building, a phone, a school district email address, unlimited access to office supplies and equipment, and is even given a badge to be able to move freely from school to school, and through the various departments. The auditor also has unfettered access to district staff during the internal investigation, and provides regular reports, both verbally and in writing to the superintendent and department of risk management. To some degree, the Superintendent, both directly and through his senior staff, is able to direct the work of the auditor during the course of the contract, but cannot impede the investigation, nor affect the findings and recommendations of the auditor. And during the life of her contract, the auditor averages to work consistently at least 40 hours per week.

Under the IRS proposed rule, would this auditor be considered an "employee" during the life of the contract under the "common law standard" used by the IRS, such that the auditor's hours of service pursuant to the contract must be included in the school district's calculation for determining "large employer" status? If so, would this still be the case even though the contract specifically states that the auditor is not an employee of the district during the life of the contract? In essence, can/does the IRS proposed rule trump whatever language is in the contract that was negotiated in good faith between the school board and the auditor?

Similarly, assuming the IRS would deem the auditor to be an "employee" of the school district, despite the negotiated terms of the employment contract, since the auditor consistently worked at least 40 hours per week for the life of the contract, should the school district have offered the auditor health insurance coverage at the end of the auditor's third completed month of work? If so, would this still be the case even though the contract specifically contains a negotiated provision, which is also consistent with the district's policies and regulations, that the auditor would not be eligible for the district's benefits?

Under this proposed rule, if the IRS should deem the auditor to be an "employee" such that the school district should have offered the auditor health insurance coverage after the end of month three, it seems that the IRS proposed rule is encroaching on a school board's rights with regard to crafting contract language in such transactions. Additional information would be helpful about whether school boards can continue to include language in those negotiated, good faith contracts as to the independent contractor's eligibility for district benefits, including health insurance, and for "employee" status.

D. Individuals Performing Extracurricular or Additional Duties

In addition to staff members that help a school district run day-to-day, there are individuals who perform extracurricular or additional duties for after-school activities for which they receive additional pay above their existing annual school district salary, or a separate stipend whether they are a current school district employee or a private citizen. Such individuals ("coaches") may be athletic coaches, student mentors, leaders of student clubs such as drama or debate, cheerleading, foreign language clubs, music clubs, etc. As school districts of all sizes begin analyzing how the IRS proposed rule is to be implemented, questions have arisen as to how coaches are to be accounted for, both for "large employer" determinations and for determining who must be offered health insurance coverage to avoid the "assessment payments" (the penalty provisions in this proposed rule).

1. Are Coaches "Seasonal Workers" to be Included/Excluded in the FTE Count?

Under the IRS proposed rule, "if an employer's workforce exceeds 50 full-time employees for 120 days or fewer during a calendar year, and the employees in excess of 50 who were employed during that period of no more than 120 days were seasonal workers, the employer is not an applicable large employer." 78 Fed. Reg. at 222 (the "seasonal worker exception"). The discussion in the proposed rule also states that "an employee would not necessarily be precluded from being treated as a seasonal worker merely because the employee works, for example, on a seasonal basis for five consecutive months." Id. Lastly, but most importantly, the discussion in the proposed rule related to the look-back measurement method specifically states that "[i]t is not a reasonable good faith interpretation of the term seasonal employee to treat an employee of an educational organization, who works during the active portions of the academic year, as a seasonal employee." 78 Fed. Reg. at 227. This issue is very relevant and significant for extremely small school districts, and for certain individuals in large districts, given the timing and amount of work performed by coaches. To assist the IRS in its analysis of these comments related to coaches, we provide a brief description of how coaching services operate at the school site.

After-school athletic teams and certain other extracurricular activities usually run for a defined period of time during the school year: (Depending on the school calendar,) Fall sports typically run from August to October; Winter sports — February to late March; Spring sports — April to late May. These "seasons" are usually defined by each state's athletic associations. Coaches for these activities typically provide their "coaching" services for two to four hours a day, up to all five school days each week during the particular activity's "season". This does not include any outside "planning" that a coach may engage in to prepare for each practice and/or competitive event. Also, coaches generally do not perform coaching services on a full-time basis in public school districts. These services are provided outside of the regular school day.

In reviewing the proposed rule and its application to coaches, school districts need clarification from the IRS on the following situations:

a. Given the above factual descriptions about how coaching activities operate in practice, can each coach be considered a "seasonal worker", allowing a school district to exclude their coaching hours of service from the calculation for a "large employer" determination?

b. Under the "seasonal worker exception", given that a coach typically performs coaching services for roughly 2-4 hours per day, does that 2-4 hour time period each afternoon constitute a "day" toward the 120-day limit in the proposed rule?

c. If an individual performs coaching services for a separate sport in each of the three seasons, again

not at full-time status, is that individual's coaching hours to be included in the FTE count because the 4-month time period has been exceeded? What if even though the four-month period has been exceeded, but the 120-day period has not?

d. When an existing full-time school division employee is also a coach in a given school year, irrespective of for how many seasons that year, and that employee is already included in the full-time employee count for "large employer" determinations due to the employee's non-coaching full-time job, does the school district also have to include that employee's coaching hours of service in the FTE count too? Or can the school district exclude the coaching hours of service to avoid "double-counting" that employee? It does not seem fair or reasonable for a small school district that has already included the employee in the count for the full-time work, to then be pushed over the edge into "large employer" status because that same employee is also a coach.

e. When a person performing coaching duties, irrespective of the number of seasons each school year, is NOT otherwise employed by the school district in any capacity but is paid a small stipend for the coaching services provided, is that coach an "employee" under the common law standard to be used by the IRS? Even if, for example, that coach has a separate job wholly unrelated to the school district? And if so, is the school district required to include that coach's service hours in the FTE count for "large employer" determinations? Would the outcome change if the non-district-employee coach is also a parent of one of the student-athletes on the team?

E. School Board Members

In some local jurisdictions throughout the country, school board members are paid a small salary or per diem for the work they perform on the school board. However, typically, school board members also have jobs elsewhere during the day that are their primary source of income, or they are simply retired workers who are serving on the school board. Questions that affected school districts have are:

1. Under the IRS proposed rule, are those school board members receiving salaries considered "employees" of the school division, given that the school board itself is the governing body of a school district, and is not directed, managed, or supervised by any school district staff, as referenced by the "common law standard"?

2. Since the work involved in being a school board member does not constitute a full-time job, is the school district required to include in the FTE count for "large employer" determinations the hours of service worked by each member in serving on the school board?

F. Re-hired Retired Employees

Many school districts have re-hired employees who have retired from the district or another school district. Such re-hired, retired employees often receive health insurance as part of their retirement package. The IRS proposed rule does not appear to provide school districts with the flexibility to NOT offer health insurance to these rehired retirees who are already receiving health insurance otherwise. It would be beneficial for school districts if the IRS created an exemption or waiver to give school districts the flexibility to accommodate these re-hired retirees.

II. Issues in the IRS Proposed Rule for Which Public School Districts Seek Clarification

In addition to the individual inquiries of clarification raised in Part I, there are certain broader provisions of the IRS proposed rule for which school districts need assistance from the IRS.

As discussed in the IRS proposed rule, a large employer may be "liable for an assessable payment"

(i.e., “penalty”), if (a) for any month, any full-time employee is certified to receive an applicable premium tax credit or cost-sharing reduction because the employer did not offer to at least 95% of “its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage (MEC) under an eligible employer-sponsored plan; or (b) if an employer does not offer an MEC to its full-time employees (and their dependents) under an eligible employer-sponsored plan for which the employer covers at least 60% of the costs of the coverage to the employee, or the MEC costs to the employee for self-only coverage is not affordable to the employee.

A. Section 4980H(a) — Employer Offers MEC to at Least 95%

In those states that have collective bargaining for school district employees (not all of them do), some school districts have more than one, and perhaps even several bargaining units within the district. For example, a school district could have a bargaining unit for its teachers, a bargaining unit for its custodians, a bargaining unit for its bus mechanics, a bargaining unit for its bus drivers, a bargaining unit for the cafeteria workers, etc. And each bargaining unit has its own collective bargaining agreement (CBA) that is negotiated and entered into wholly separate and apart from all the other CBAs. As the health insurance exchanges are coming online in various states, individual school districts are beginning to face an unexpected dilemma, one that was likely unanticipated by the IRS in drafting this proposed rule.

Assume the following facts (which are similar to those some school districts are actually experiencing right now):

School District XYZ has 1,000 full-time employees. The district has been involved in negotiations of the CBAs for some of the district’s bargaining units for the past few months. The district’s CBA negotiators are preparing to enter negotiations with the bargaining unit for custodians. The custodians’ bargaining unit makes up 10% of the district’s full-time employees. As the negotiation period draws near, the custodians’ bargaining unit has informed the district that it has been reviewing the health insurance plans becoming available through the state’s exchange. As a result, the bargaining unit has decided that it does not want to be offered MEC by the district, and wants the forthcoming CBA to reflect that. The district has notified the bargaining unit that it will not do that, because if that language (not offering MEC) was included in the CBA, the district would be put under the 95% threshold stated in Section 4980H(a), subjecting it to the $2,000 per person penalty in that provision for the other 90% of full-time employees (minus the first 30).

In response, the custodians’ collective bargaining unit warns the district that if it does not include such language in the CBA, the bargaining unit will bring the district before the state’s labor commissioner, who may rule in favor of the bargaining unit and order the district to draft a CBA that specifically does NOT include any provision about offering MEC to the bargaining unit.

Thus, the district will be placed in the untenable situation of either violating the labor commissioner’s order and including the MEC offer language in the CBA to meet the 95% threshold, or complying with the commissioner’s order and excluding the language in the CBA, but then falling under the 95% threshold and being subjected to an astronomical penalty for each year the custodians’ CBA is in effect.

Given that this is surely NOT what the Affordable Care Act intended, how does the school district handle this situation? NSBA recommends creating an exemption or waiver of some sort from this penalty provision when a district is forced NOT to offer MEC to at least 95% of its full-time employees through no fault of its own. Also, districts question whether the penalty under Section 4980H(a) should be the same whether the employer offered MEC to 94% of its full-time employees, or 0% of its full-time employees? Clarification is needed to assist school districts as they navigate

through the implementation of the IRS proposed rule.

B. Administrative Burdens for “Long-Term” Assignments

Separate and apart from the aforementioned issues regarding long-term substitutes, the IRS proposed rule requested comments on whether any special rules would be appropriate with respect to “short-term employees” (which the IRS seems to define as those employed for three months or less, 78 Fed. Reg. at 229), with regard to the application of the Section 4980H “assessable payments” (i.e., penalties) provisions. In that discussion, the IRS stated that “section 4980H issues may arise for short-term employment exceeding three months.” 78 Fed. Reg. at 229. In school district parlance, “short-term employment” assignments typically exceed three months, thus bearing the moniker of “long-term” assignments, but they may not typically last a full school year. The dilemma school districts face is that, under the IRS proposed rule, if an individual takes on a temporary assignment of longer than three months, but not for a full school year, the individual might become an “employee” during the assignment, and the school division would be required to at least offer health insurance coverage to that temporary employee by the completion of the third month of service.

The administrative burden of offering health insurance coverage by the end of the third continuous month of service to such a temporary employee, knowing that the particular employee is only going to be employed for a 4-month or 6-month or whatever non-permanent period of time is an unreasonable one for the IRS to place on public school districts, given their extremely limited, and ever-decreasing funding resources. The administrative costs and burdens of insuring such an employee for such a limited duration cannot possibly be what the Affordable Care Act intended for public school districts to endure, at the ultimate cost of drawing funding streams away from classrooms and the education of this nation’s students and future leaders. NSBA recommends that the proposed rule be revised to incorporate language that removes the requirement that a school district must offer a long-term (more than three months) non-permanent employee MEC after the end of the third month.

NSBA thanks the IRS for its review and consideration of the issues specific to school districts raised as a result of the IRS proposed rule regarding Shared Employer Responsibilities. NSBA and its members look forward to the IRS’ response to, and resolution of, these comments, and urge the IRS to do so in a way that minimizes the potential adverse impact on school districts, and the educational services they provide to our nation’s students.

Sincerely,

Francisco M. Negrón, Jr.

General Counsel

National School Boards Association

Alexandria, VA

IRS Releases Report on Avoiding Troubled Tax-Advantaged Bonds.

The Internal Revenue Service office of Tax Exempt Bonds (TEB) released the report, Avoiding Troubled Tax-Advantaged Bonds. This report produced by the TEB Compliance Practice Research Team seeks to provide aid to issuers of tax-advantaged bonds municipal bonds. It identifies some considerations for issuers of such bonds and is TEB's initial step toward producing public resource products that assist issuers in avoiding troubled transactions. For more than a decade, TEB observed some of the worst problems in the municipal industry and then witnessed the efforts taken (by leaders in state and local government, the professional communities that support them, and various regulatory bodies) to address them. Many of these complex compliance issues facing issuers of tax-advantaged municipal debt still exist.

Publishing Avoiding Troubled Tax-Advantaged Bonds is a part of TEB's continuing effort to provide practical steps and products that may be helpful to issuers of tax-advantaged municipal bonds. As such, we welcome comments and feedback from the tax-advantaged municipal bond community that provide further tools and clarification for issuers. Please submit your comments and feedback to TaxExemptBondQuestions@irs.gov inserting "Avoiding Troubled Tax-Advantaged Bonds Question" on the Subject: line.

The report covers three phases of the life cycle of bonds, each with various considerations, of which an issuer should be aware. These three identified phases are: 1) the transaction development phase; 2) the transaction execution phase; and 3) the post-issuance phase.

Watch for the TEB presentation of phase one "Transaction Development," in an upcoming Webinar scheduled for this fall.

TEB hopes that the tax-exempt bond community will use this information to create related products beneficial to their members. These products will provide additional tools that facilitate issuer adoption of practices and procedures that avoid abusive or questionable transactions.

The full report is available at:

http://www.irs.gov/pub/irs-tege/Avoiding%20Troubled%20Tax%20Advantaged%20Bonds.pdf

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New Voluntary Closing Agreement Program Request Form.

The Internal Revenue Service released the new Form 14429, Tax Exempt Bonds Voluntary Closing Agreement Program Request. Completion, in full, of the new form is a requirement before the submission to the Tax Exempt Bonds Voluntary Closing Agreement Program (TEB VCAP) is accepted. The purpose of the new form is to assist issuers in organizing TEB VCAP submission requests and to ensure that their submissions are complete, in accordance with the requirements under Notice 2008-31, 2008-11 I.R.B. 592 and IRM 7.2.3. Use of the new form should avoid delays in processing a request because of missing information as well as facilitating the process for accepting and assigning requests.

The Tax Exempt Bonds (TEB) function, within the Tax Exempt & Government Entities Division, administers TEB VCAP. Generally, TEB VCAP provides remedies for issuers of tax-advantaged bonds (tax-exempt bonds, tax credit bonds, and direct pay bonds) who voluntarily come forward to resolve a violation of the federal tax requirements applicable to a bond issue that the issuer cannot self-correct under programs described in the Income Tax Regulations (Regulations) or other published guidance. An issuer will generally receive a more favorable treatment in resolving its tax violation under TEB VCAP than it would for the same tax violation discovered during an IRS examination of

their bonds. As such, TEB VCAP encourages issuers, and other parties involved in tax-advantaged bond transactions, to exercise due diligence in complying with the applicable federal tax laws. TEB VCAP also provides a vehicle to correct violations as expeditiously as possible before discovery of the violations during an IRS examination.

The improvement of the TEB VCAP program, through procedural enhancements, is a TEB commitment. The new Form 14429 is an example of the latest effort by TEB to improve the administration of the TEB VCAP program and further this commitment. Last year, TEB provided web content to provide more information about the TEB VCAP program as well as descriptions (provided in IRM 7.2.3.4) of the resolution standards for identified violations both for tax-exempt and certain direct pay bonds. TEB believes that these resolution standards encourage due diligence by providing certainty, to issuers and other parties, in understanding the methodologies available to resolve eligible violations.

The new Form 14429 is available at:

http://www.irs.gov/pub/irs-pdf/f14429.pdf

Private Letter Ruling: IRS Provides Information on Changes to Exempt Organization's Activities.

The IRS provided general information about the procedures for an exempt organization to declare any changes in the character, operations, or purpose for which it was originally created.

Dear * * *:

This letter provides general information in response to your letter dated August 17, 2012, regarding follow up submissions to the Determinations office concerning change of a tax-exempt organization’s activities.

Procedures for submitting an exempt organization’s structural and operational changes to the Service can be found in Publication 4221-PC, Compliance Guide for 501(c)(3) Public Charities, Publication 4221-PF, Compliance Guide for 501(c)(3) Private Foundations and Publication 4221-N, Compliance Guide for Tax Exempt Organizations (Other than 501(c)(3) Public Charities and Private Foundations). The appropriate publication is provided with all current exemption letters. These guides provide that any changes should be reported on the organization’s annual information return. It also provides that an organization may submit changes to the EO Determinations office, but that such submissions do not absolve the organization from reporting such changes on its annual return.

Additionally, section 1.6033-2(i)(1) of the regulations provide that exempt organizations that are not required to file an information return must notify the IRS in writing of any changes in its character, operations, or purpose for which it was originally created.

Revenue Procedure 2012-4, 2012-1 IRB 125, § 7.04(2) provides that the IRS will not issue determination letters approving or disapproving any completed transaction, or determination letters on the effect of changes in activities on tax-exempt status (except for areas enumerated in the revenue procedure). This revenue procedure, updated annually, has contained this provision since 2007.

In order to receive the protection from retroactive revocation of a ruling or determination letter

found in Rev. Proc. 2012-4, §§ 13 and 14, that could result from an organization's change in activities, an organization must follow the procedures found in that revenue procedure for requesting a private letter ruling. These procedures include the payment of the $10,000 fee. These are the only procedures that provide any protection from retroactive revocation upon structural or operational changes. Reporting a change on Form 990, Form 990-EZ, or Form 990-PF will not prevent the retroactive revocation of a ruling or determination letter.

This letter is for informational purposes only and provides general statements of well-defined law. It is not a ruling. (Rev. Proc. 2012-4, 2012-1 I.R.B. 125). We will make this letter available for public inspection after deleting names, addresses and other identifying information, as appropriate, under the Freedom of Information Act (Announcement 2000-2, 2000-2 I.R.B. 295). A copy of this letter with the proposed deletions is attached.

I hope this information is helpful. If you have any questions, please contact me at * * * or * * * at * * *.

Sincerely,

[signature omitted]

Manager, Exempt Organizations

Guidance

Private Letter Ruling: IRS Summarizes Purpose of Exempt Entities Code.

The IRS explained that the National Taxonomy of Exempt Entities code assigned to an exempt organization to characterize the organization in terms of its primary exempt activity is not relevant to any determination under the internal revenue laws or to tax-exempt status.

Release Date: 3/29/2013

Date: January 14, 2013

Dear * * *:

This letter responds to your letter dated July 31, 2012, requesting that we change the National Taxonomy of Exempt Entities (NTEE) Code of ORGANIZATION. You stated that your current activity code, as shown on the Exempt Organizations Business Master File (EOBMF), does not reflect the activities of your organization.

The National Taxonomy of Exempt Entities (NTEE) Code is a three or four-character code that attempts to characterize the organization in terms of its primary exempt activity. The IRS began issuing new exempt organizations an NTEE code as part of the determination process in 1995. The determination specialist assigns an NTEE code to each organization exempt under I.R.C. § 501(a) as part of the process of closing a case when the organization is recognized as tax-exempt. The many variables involved in applying the codes, including the fact that organizations often have numerous activities, can provide challenges when attempting to precisely capture an organization's primary exempt activity.

Prior to 1995, the exemption application provided space for the taxpayer to identify three activity codes. EOBMF may contain an activity code for these organizations rather than an NTEE code. These activity codes do not coincide with the newer NTEE codes.

The NTEE code is not relevant to any determination under the internal revenue laws or to tax-exempt status. Accordingly, no procedures are currently in place by which an organization can request a change to their self-identified activity codes, or an NTEE code, or to request the issuance of a NTEE code when one was not previously issued.

In addition, there is no formal guidance issued by the IRS that either permits or requires any person, or organization, to rely on NTEE codes for any purpose under the internal revenue laws. An organization's application for tax-exempt status and Forms 990 are required to describe in sufficient detail the organization's exempt purpose and activities.

This letter is for informational purposes only and provides general statements of well-defined law. It is not a ruling and taxpayers cannot rely on it as such. (Rev. Proc. 2011-1, 2011-1 I.R.B. 1; Rev. Proc. 2011-4, 2011-1 I.R.B. 123). We will make this letter available for public inspection after deleting names, addresses and other identifying information, as appropriate, under the Freedom of Information Act (Announcement 2000-2, 2000-2 I.R.B. 295). A copy of this letter with the proposed deletions is attached.

I hope this information is helpful. If you have any questions, please contact me at * * * or * * * at * * *.

Sincerely,

[signature omitted]

Manager, Exempt Organizations

Guidance

Enclosure

Private Letter Ruling: IRS Rules on Liquidation of Subsidiary Into Country Club.

The IRS ruled that a country club's tax-exempt status will not be affected when its subsidiary is liquidated into the club because there will be no recognition of gain or loss when the club receives the subsidiary's assets and liabilities.

Release Date: 4/12/2013

Date: January 16, 2013

This is in response to your ruling request, dated October 21, 2009, requesting certain rulings with respect to the income tax consequences to you of the complete liquidation and dissolution of your wholly owned subsidiary that is tax exempt under § 501(c)(2) of the Internal Revenue Code ("Code").

FACTS

You are a State nonprofit membership corporation organized in 1982 and recognized in 1984 as tax-exempt under § 501(c)(7) to operate as a country club. State statutes prohibited stock ownership of not-for-profit entities. Therefore in order to provide a mechanism for members to recoup all or part of their investment in the country club assets upon withdrawal, death, or change in membership classification, in 1984 the members formed Subsidiary, a State for-profit corporation recognized in 1995 as tax-exempt under § 501(c)(2) retroactive to its 1984 inception. Subsidiary owned all tangible property for a country club (the "Property"), leased the Property to you for use in furtherance of your exempt purposes, and paid all income to you less operational expenses. The amount of Subsidiary income you received was typically less then 3% of your gross receipts. Only your members could own stock in Subsidiary.

Your members were the only shareholders of Subsidiary until 2006. You state that this affiliate structure was administratively expensive requiring, among other things, separate accounting, auditing, and tax returns, therefore you decided to simplify and streamline the structure. On Date 1, you bought one (1) share of the common stock of Subsidiary through an issuance of Subsidiary. Immediately thereafter, Subsidiary redeemed all other shares of its stock, which shares were held by your members. As a result, Subsidiary became your wholly owned subsidiary. You and Subsidiary were eligible to filed consolidated returns but did not.

All profits derived by Subsidiary, after payment of all ordinary and necessary expenses, have been turned over to you for your use and benefit in its operation as a social club. You propose to completely liquidate Subsidiary (the "Liquidation"). A plan of liquidation was adopted in 2009. Under the liquidation plan, all of the stock of Subsidiary will be redeemed and cancelled and Subsidiary will be dissolved. You, as the sole shareholder of Subsidiary, will receive all assets and assume all liabilities of Subsidiary in the liquidation. You will continue to use the assets distributed from Subsidiary in the direct performance of your exempt function.

Upon the Service's issuance of this private letter ruling, Subsidiary will make its first liquidating distribution. At the same time, Subsidiary will cease to be a going concern and its activities will be limited to winding up its affairs, paying its debts, and distributing its remaining assets to you.

Once all the assets of Subsidiary are liquidated into you, Articles of Dissolution will be filed with State X with respect to Subsidiary, and Subsidiary will be dissolved.

REPRESENTATIONS

In connection with the proposed Liquidation, you represent as follows:

1. You, on the date of adoption of the liquidation plan and at all times until the final liquidating distribution is completed, will be the owner of at least * * * percent of the single outstanding class of Subsidiary stock.

2. No shares of Subsidiary stock will have been redeemed during the three (3) years preceding the adoption of the plan of complete liquidation of Subsidiary.

3. Subsidiary has adopted a liquidation plan specifying that the final liquidating distribution is to be completed within 3 years from the close of the taxable year of Subsidiary in which the first liquidating distribution is made.

4. Subsidiary will retain no assets following the final liquidating distribution.

5. As soon as the first liquidating distribution has been made, Subsidiary will cease to be a going concern and its activities will be limited to winding up its affairs, paying its debts, and distributing

its remaining assets to its shareholders

6. Subsidiary will not have acquired assets in any nontaxable transaction at any time, except for acquisitions occurring more than 3 years prior to the date of adoption of the liquidation plan.

7. No assets of Subsidiary have been, or will be, disposed of by either Subsidiary or you except for dispositions in the ordinary course of business and dispositions occurring more than three (3) years prior to adoption of the liquidation plan.

8. The liquidation of Subsidiary will not be preceded or followed by the reincorporation in, or transfer or sale to, a recipient corporation ("Recipient") of any of the businesses or assets of Subsidiary, if persons holding, directly or indirectly, more than twenty percent (20%) in value of the Subsidiary stock also hold, directly or indirectly, more than twenty percent (20%) in value of the stock in Recipient. For purposes of this representation, ownership will be determined by application of the constructive ownership rules of § 318(a) as modified by § 304(c)(3).

9. Prior to adoption of the liquidation plan, no assets of Subsidiary will have been distributed in kind, transferred, or sold to you, except for (i) transactions occurring in the normal course of business and (ii) transactions occurring more than 3 years prior to adoption of the liquidation plan.

10. Subsidiary will report all earned income represented by assets that will be distributed to its shareholders such as receivables being reported on a cash basis, unfinished construction contracts, commissions due, etc.

11. The fair market value of the assets of Subsidiary will exceed its liabilities both at the date of the adoption of the liquidation plan and immediately prior to the time the first liquidating distribution is made.

12. There is no intercorporate debt existing between you and Subsidiary and none has been cancelled, forgiven, or discounted, except for transactions that occurred more than three (3) years prior to the date of adoption of the liquidation plan.

13. All other transactions undertaken contemporaneously with, in anticipation of, in conjunction with, or in any way related to, the proposed liquidation of Subsidiary have been fully disclosed.

14. You have satisfied all the requirements to be classified as tax exempt under § 501(c)(7).

15. Subsidiary receives tax-exempt status under § 501(c)(2) and holds all tangible Property of the country club which is leased to you for use in connection with your exempt purpose.

16. Subsidiary has not engaged in activities that would give rise to unrelated business taxable income within the meanings of §§ 511 and 514.

17. All assets (including proceeds of sales of assets) distributed to you by Subsidiary in the liquidation will be used by you in the performance of your exempt function.

18. You will not use any of the assets received in the liquidation, or the proceeds from the sale of such assets, in any activity that would give rise to unrelated business taxable income within the meanings of §§ 511 and 514.

19. You represent that you intend to continue to use the assets distributed from Subsidiary in the direct performance of your exempt function.

20. If Property is sold by Subsidiary or by you, you will, within the period beginning one year before the date of such sale and ending three years after the date of such sale, reinvest the entire amount of the proceeds from the sale in the purchase of new exempt function property.

RULINGS REQUESTED

1: You will recognize no gain or loss upon the receipt of the assets and liabilities of Subsidiary in the liquidation. Section 332.

2: No gain or loss will be recognized by Subsidiary on the distribution of its assets to, or the assumption of liabilities by, you. Sections 337(a) and 336(d)(3). In particular, § 337(b)(2)(A) will not apply to the liquidation.

3: Your basis in each asset received from Subsidiary as a result of the liquidation will be the same as the basis of that asset in the hands of Subsidiary immediately before the liquidation. Section 334(b)(1).

4: Your holding period in each asset received from Subsidiary as a result of the liquidation will include the period during which that asset was held by Subsidiary. Section 1223(2).

5: That the liquidation of Subsidiary into you will not adversely affect your tax exempt status.

LAW

Section 332(a) provides that no gain or loss shall be recognized on the receipt by a corporation of property distributed in a complete liquidation of another corporation. Section 332(b) sets forth various requirements that must be met in order for a distribution to be considered in complete liquidation for purposes of § 332.

Section 337(a) provides that no gain or loss shall be recognized to the liquidating corporation on the distribution to the 80-percent distributee of any property in a complete liquidation to which § 332 applies.

Section 337(b)(2)(A) generally provides that §§ 337(a) and (b)(1) shall not apply where the 80-percent distributee is an organization (with limited exception not relevant on these facts) which is exempt from the tax imposed by Chapter 1.

Section 337(d) authorizes the Secretary to prescribe regulations as may be necessary or appropriate to carry out the purposes of the amendments made by subtitle D of title VI of the Tax Reform Act of 1986, including regulations to ensure that such purposes may not be circumvented through the use of a tax-exempt entity. The legislative history concerning a 1988 amendment to § 337(d) explains that the grant of authority in § 337(d) "includes rules to require the recognition of gain if appreciated property of a C corporation is transferred to . . . a tax-exempt entity in a carryover basis transaction that would otherwise eliminate corporate level tax on the built-in appreciation." S. Rep. No. 445, 100th Cong., 2d Sess. 66 (1988) (footnote omitted).

Section 501(c)(2) provides for the exemption of corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under § 501(a) of the Code.

Section 501(c)(7) provides for the exemption from federal income tax of clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private

shareholder.

Pub. L. 94-568 amended § 501(c)(7) in 1976 so such organizations could receive some outside income without losing their exempt status.

S. Rep. No. 1318, 94th Cong., 2d Sess. 4 (1976) explains how Congress intends the amended § 507(c)(7) work including limits on gross receipts from outside sources and non-members, and certain exclusions such as unusual income.

Section 1.337(d)-4(a)(1) of the regulations sets forth the general rule that if a taxable corporation transfers all or substantially all of its assets to one or more tax-exempt entities, the taxable corporation must recognize gain or loss immediately before the transfer as if the assets transferred were sold at their fair market values.

RULINGS

Based solely on the information submitted and representations provided, we rule as follows:

1: You will recognize no gain or loss upon the receipt of the assets and liabilities of Subsidiary in the liquidation. Section 332.

2: No gain or loss will be recognized by Subsidiary on the distribution of its assets to, or the assumption of liabilities by, you. Sections 337(a) and 336(d)(3). In particular, § 337(b)(2)(A) will not apply to the liquidation.

3: Your basis in each asset received from Subsidiary as a result of the Liquidation will be the same as the basis of that asset in the hands of Subsidiary immediately before the liquidation. Section 334(b)(1).

4: Your holding period in each asset received from Subsidiary as a result of the liquidation will include the period during which that asset was held by Subsidiary. Section 1223(2).

5: As there is no recognition of gain or loss as described in rulings (1), (2), and (3), the liquidation of Subsidiary into you will not adversely affect your tax exempt status.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Theodore R. Lieber

Manager, Exempt Organizations

Technical Group 3

Private Letter Ruling: Extinguishable Conservation Easement May Qualify as Conservation Contribution.

The IRS stated that granting a deed for a conservation easement that allows the easement to be extinguished under state law if circumstances change to make the easement impractical or impossible may nonetheless be a qualified conservation contribution under section 170(h).

Release Date: 3/29/2013

Date: September 18, 2012

Attention: * * *

Dear * * *:

This letter responds to your request for information dated July 19, 2012.

In your request, you asked whether a contribution of an easement can be a qualified conservation contribution if the easement deed simply allows for extinguishment under applicable State law upon subsequent, unexpected changes in the conditions surrounding the property that make impractical or impossible the continued use of the property for conservation purposes.

Property rights have been described "as a 'bundle of sticks' — a collection of individual rights which, in certain combinations, constitute property." U.S. v. Craft, 535 U.S. 274, 278 (2002) (citations omitted). State law dictates what rights make up a person's bundle. Id. Once a person's property rights are established under State law, the tax consequences of a transaction involving that property are decided under Federal law. Patel v. Commissioner, 138 T.C. No. 23, slip op. 16, 2012 WL 2427326 at *7 (2012) (citing Commissioner v. Estate of Bosch, 387 U.S. 456 (1967); Aquilino v. United States, 363 U.S. 509, 512-513 (1960); Morgan v. Commissioner, 309 U.S. 78, 80-81 (1940)).

A "qualified conservation contribution" is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. I.R.C. § 170(h)(1). A contribution is not exclusively for conservation purposes unless it protects the conservation purpose in perpetuity. I.R.C. § 170(h)(5)(A).

Under the Treasury regulations, a conservation purpose may be treated as protected in perpetuity if, upon a subsequent change in conditions that makes impossible or impractical the continued use of the subject property for conservations purposes, the easement is extinguished by judicial proceeding and all of the donee's proceeds from a subsequent sale, exchange, or involuntary conversion of the

property are used by the donee in a manner consistent with the conservation purposes of the original contribution. Treas. Reg. § 1.170A-14(g)(6)(i). The donee's proceeds must be at least equal to the proportionate value of the perpetual conservation restriction. Treas. Reg. § 1.170A-14(g)(6)(ii).

State law may provide a means for extinguishing an easement for State law purposes. However, the requirements of § 170(h) and the regulations thereunder must nevertheless be satisfied for a contribution to be deductible for Federal income tax purposes.

This letter has called your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. See section 2.04 of Rev. Proc. 2012-1, 2012-1 I.R.B. 7 (Jan. 3, 2012). If you have any additional questions, please contact me or * * * at * * *.

Sincerely,

Karin Goldsmith Gross

Acting Branch Chief, Branch 1

(Income Tax & Accounting)

IRS: Published Volume Cap Limit for Tribal Economic Development Bonds.

In Notice 2012-48, 2012-31 I.R.B. 102 (July 30, 2012), the Treasury Department and the IRS provided guidance regarding applications for allocations of the available amount of national bond volume limitation authority (volume cap) for tribal economic development bonds. The Notice provides that, except as otherwise provided in the Notice, for applications filed with the IRS that meet the requirements detailed in the Notice, the IRS will allocate an amount of available volume cap equal to the amount requested in the application on a first-come, first-served basis by order of submission date (as defined in the Notice).

The Notice also provides that no Indian tribal government will receive an allocation of volume cap that would cause the aggregate amount of volume cap allocated to that Indian tribal government pursuant to the Notice (not including certain amounts forfeited as described in the notice) to exceed the Published Volume Cap Limit in effect for the period that includes the submission date. The Published Volume Cap Limit for any period is the greater of (1) 20% of the amount of available volume cap as of the first day of such period (determined as described in the Notice); or (2) $100 million

The Published Volume Cap Limit for the period commencing April 1, 2013 is $308,726,846 (20% of the amount of available volume cap of $1,543,634,230 determined as described in the Notice).

For purposes of this limitation, an Indian tribal government includes the Indian tribal government, together with any political subdivisions of the Indian tribal government, and any entities controlled by the Indian tribal government. An application that requests an allocation of volume cap in an amount that would cause the Published Volume Cap Limit in effect on the date of submission to be exceeded will be treated as incomplete until the day the applicant supplements the application in a manner that complies with the requirements of the notice and does not cause such limit to be exceeded.

IRS: Proposed Collection; Comment Request for Regulation Project.

Currently, the IRS is soliciting comments concerning qualified conservation contributions (§ 1.170A–14). Written comments should be received on or before June 11, 2013 to be assured of consideration.

Direct all written comments to Yvette Lawrence, Internal Revenue Service, room 6129, 1111 Constitution Avenue NW., Washington, DC 20224. Requests for additional information or copies of the regulations should be directed to Katherine Dean at Internal Revenue Service, Room 6242, 1111 Constitution Avenue NW., Washington, DC 20224, or at (202) 622–3186, or through the Internet at Katherine.b.dean@irs.gov.

IRS: Comments Sought on Regs on Qualified Conservation Contributions.

Internal Revenue Code section 170(h) describes situations in which a taxpayer is entitled to a deduction for a charitable contribution for conservation purposes of a partial interest in real property. This regulation requires a taxpayer claiming a deduction to maintain records of (1) the fair market value of the underlying property before and after the donation and (2) the conservation purpose of the donation.

Request for Comments: Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval. All comments will become a matter of public record. Comments are invited on: (a) Whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (b) the accuracy of the agency's estimate of the burden of the collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

IRS: Comments Sought on EO Reporting Requirement Guidance.

The IRS has requested public comment on information collections under Rev. Proc. 98-19, which provides guidance to tax-exempt organizations on exceptions to the reporting and notice requirements under section 6033(e)(1) and the tax imposed by section 6033(e)(2); comments are due by June 11, 2013.

Direct all written comments to Yvette Lawrencde, Internal Revenue Service, room 6129, 1111 Constitution Avenue NW., Washington, DC 20224. Requests for additional information or copies of the revenue procedure should be directed to Katherine Dean at Internal Revenue Service, Room 6242, 1111 Constitution Avenue NW., Washington, DC 20224, or at (202) 622–3186, or through the Internet at kathernie.b.dean@irs.gov.

Comments are invited on: (a) Whether the collection of information is necessary for the proper

performance of the functions of the agency, including whether the information shall have practical utility; (b) the accuracy of the agency's estimate of the burden of the collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

IRS: Comments Sought on Reimbursement Bond Regs.

The IRS requested public comment on information collections under final regulations (T.D. 8394) under section 150 that provide rules to tax-exempt bond issuers for allocating proceeds of reimbursement bonds; comments are due by June 11, 2013.

Direct all written comments to Yvette Lawrence, Internal Revenue Service, room 6129, 1111 Constitution Avenue NW., Washington, DC 20224. Requests for additional information or copies of the regulation should be directed to Katherine Dean, at (202) 622–3186, or at Internal Revenue Service, room 6242, 1111 Constitution Avenue NW., Washington, DC 20224, or through the Internet, at Katherine.b.dean@irs.gov.

This regulation clarifies when the allocation of bond proceeds to reimburse expenditures previously made by an issuer of the bond is treated as an expenditure of the bond proceeds. The issuer must express a reasonable official intent, on or prior to the date of payment, to reimburse the expenditure in order to assure that the reimbursement is not a device to evade requirements imposed by the Internal Revenue Service.

Which states and counties have the highest taxes?

With taxes a hot topic in Washington and around the dinner table in millions of American homes, this analysis features interactive maps that look at how states and counties stack up against one another when it comes to income and property taxes. There is also a map that shows the ZIP codes throughout the U.S. where residents are most likely to use tax software to prepare their returns.

The map is available at:

http://smartblogs.com/finance/2013/04/12/tax-day-cometh/

IRS Issues Proposed Regs on Community Health Needs Assessment Requirement for Tax-Exempt Hospitals.

The IRS has issued proposed regulations (REG-106499-12) that provide guidance to charitable hospital organizations on the community health needs assessment (CHNA) requirements and related excise tax and reporting obligations. The regs also clarify the consequences for failing to meet these and other requirements for charitable hospital organizations.

Comments and requests for a public hearing must be received by July 5. The regs are proposed to be effective for returns filed on or after the date they are published in the Federal Register as final or temporary regulations.

Section 501(r)(1) imposes four additional requirements that organizations described as hospital organizations must satisfy to be tax exempt under section 501(c)(3), one of which is to conduct a CHNA every three years. In July 2011 Treasury and the IRS issued guidance (Notice 2011-52) on the anticipated regulatory provisions.

As a general rule, the proposed regs provide that a hospital organization operates a hospital facility if it is a partner in a joint venture, limited liability company, or other entity treated as a partnership for federal income tax purposes that operates the hospital facility. A hospital organization also operates a hospital facility under the proposed regs if it does so through a wholly owned entity that is disregarded as separate from the hospital organization for federal tax purposes. A hospital organization is not required, however, to meet the requirements of section 501(r) for any activities unrelated to the operation of a hospital facility.

The proposed regs provide that a hospital organization meets the requirements of section 501(r)(3) in any tax year for a hospital facility it operates only if the hospital facility has conducted a CHNA in that tax year or in either of the two immediately preceding tax years. Also, an authorized body of the hospital facility is required to have adopted an implementation strategy to meet the community health needs identified through the CHNA by the end of the tax year in which the hospital facility conducts the CHNA. The regs include extensive rules for conducting a CHNA and developing implementation strategies.

Under the proposed regs, a hospital facility's omission of required information from a policy or report described in reg. section 1.501(r)-3 or 1.501(r)-4 or error regarding the implementation or operational requirements described in reg. section 1.501(r)-3 through 1.501(r)-6 will not be considered a failure to meet a requirement of section 501(r) if the omission or error was minor, inadvertent, and due to reasonable cause and the hospital facility corrects the omission or error as promptly after discovery as is reasonable given the nature of the omission or error. Also, the IRS will consider for purposes of determining whether revocation of section 501(c)(3) status is warranted the relative size, scope, nature, and significance of any failures to meet the section 501(r) requirements as well as the reasons for the failures and whether the same type of failures have previously occurred. The proposed regs include rules that apply if one hospital facility within a hospital organization fails to meet a section 501(r) requirement during a tax year, even though the hospital organization as a whole continues to be recognized as a section 501(c)(3) organization.

http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/New-Requirements-for-501(c)(3)-Hospitals-Under-the-Affordable-Care-Act

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Tax Analysts: Joint Strategies for Meeting Community Health Needs Possible Under Proposed Regs.

Tax-exempt hospital facilities that collaborate with other facilities and organizations to develop ways to meet the healthcare needs of their communities could in some cases also adopt joint implementation strategies, according to proposed regulations released April 3.

Tax-exempt hospital facilities that collaborate with other facilities and organizations to develop ways

to meet the healthcare needs of their communities could in some cases also adopt joint implementation strategies, according to proposed regulations released April 3.

Under REG-106499-12 , which provides proposed guidance under section 501(r) on rules requiring nonprofit hospitals to conduct community health needs assessments (CHNAs) at least once every three years and develop strategies to meet identified needs, a hospital facility may work with other facilities and organizations to develop its implementation strategy but must document its strategy in a separate written plan. The facility could adopt a joint implementation strategy if it also adopts a joint report of its CHNA and the strategy is clearly identified as applying to the facility, identifies the facility's role in developing the strategy, and includes a summary or other tool to help people find the portions of the strategy that involve the facility.

Douglas M. Mancino of Hunton & Williams LLP told Tax Analysts the provision recognizes that "there is a lot of joint planning that gets done even among unrelated hospitals in a particular region." T.J. Sullivan of Drinker Biddle & Reath LLP said the provision reflects an IRS effort to provide added flexibility to hospitals while ensuring that the intent underlying the statute is carried out. Although only a few systems are likely to choose the approach, it may save them a lot of time without undercutting the contributions of the CHNAs, Sullivan said.

Also under the proposed regs, only significant health needs identified through a CHNA would have to be addressed in an implementation strategy, which would have to describe how the hospital facility would address the health needs and what the expected result would be. If a hospital facility does not plan to address a particular need, it would need to explain why not. Some of the reasons could be resource constraints, lack of expertise, or that the need is being addressed by other facilities or organizations.

The proposed regs also would require a hospital facility to adopt an implementation strategy by the end of the tax year in which the CHNA is conducted. Commentators responding to Notice 2011-52, 2011-30 IRB 60 , which spelled out the expected provisions in the proposed regs, asked for more time. The proposed regs deny that request, although they offer transition relief for hospitals that may not have had three full years during which to conduct their first CHNA.

Sullivan said that while he did not like that approach, "the definition of when a CHNA is 'conducted' that is keyed to when it is posted on the Web makes it much easier to control the timing than it may have initially appeared."

Reporting Requirements

A hospital organization also would have to attach to its Form 990, "Return of Organization Exempt From Income Tax," the most recent implementation strategies for each of its hospital facilities. Alternatively, it could report on the return the URLs of the Web pages on which the implementation strategies have been posted.

"Widely Available" Requirement

The proposed regs would require CHNA reports to be posted conspicuously online and remain there until two subsequent CHNA reports have been added. Also, a hospital facility could not require an individual to create an account or otherwise provide identifiable information to access an online report, which also would have to be available in paper format.

Mancino said he doubted making multiple reports available online would be burdensome and that he did not think there would be many requests for paper copies because the documents are available electronically. It's also unlikely many people will ask to see the reports, he said.

“There will be some public health advocates and people who are advocates for different disadvantaged classes of individuals that will be interested in this,” Mancino said. “But by and large I think the general public probably will have little or no interest in the community health needs assessment documentation.”

Sullivan also said he did not think the requirements will be too burdensome, adding that the IRS is becoming increasingly deft at balancing the interests of the hospital community and those of patient advocates.

Self-Correction
The proposed regs say Treasury and the IRS will publish guidance to help hospital facilities correct failures to fulfill CHNA requirements and other rules under section 501(r) and disclose how the errors were corrected.

Mancino commended the government for offering clear guidance on self-correction and self-disclosure.

“That aspect of the proposed regulations is probably the most welcome, in my mind,” Mancino said, adding that in his experience, it is rare for a nonprofit hospital to intentionally break laws.

Public Health Departments
In conducting a CHNA, a hospital facility would be required to seek input from state or local public health departments. Sullivan was pleased that the proposed regs eliminated a provision in Notice 2011-52 that would have required consultation with a public health expert, explaining that having to identify particular individuals consulted by hospitals probably would not have been well received.

Revocations, Excise Taxes

The proposed regs also say that although section 501(r) empowers the IRS to revoke the exempt status of noncompliant hospitals, the agency should consider all facts and circumstances when considering revocation, including the scope of and reasons for the noncompliance and whether the same sorts of violations have occurred before. Willful or egregious violations ordinarily will lead to revocation, according to the proposed regs.

Hospital organizations that do not meet the CHNA requirements face a $50,000 excise tax. The tax is applied on a facility-by-facility basis, meaning a hospital organization with multiple facilities could be taxed $50,000 on each facility.

IRS: Upcoming Workshops for Small and Medium-Sized 501(c)(3) Organizations.

IRS Exempt Organizations offers one-day workshops for small and medium-sized 501(c)(3) organizations around the country in collaboration with colleges and universities as part of our Academic Institutions Initiatives in an effort to help develop the nonprofit leaders of tomorrow. These popular workshops are presented by experienced IRS Exempt Organizations specialists and explain the nuts and bolts of what 501(c)(3) entities must do to keep their tax-exempt status and comply with tax obligations.

http://www.irs.gov/Charities-&-Non-Profits/Upcoming-Workshops-for-Small-and-Medium-Sized-501(c)(3)-Organizations

NABL Seeks Guidance on Tax-Exempt Status of Debt Issued by Accountable Care Organizations.

Scott Lilienthal of the National Association of Bond Lawyers has written to Treasury and the IRS requesting guidance on what constitutes private business use when a tax-exempt bond borrower participates in an accountable care organization.

H.R. 1268 Would Provide Flood Mitigation Expenses Credit.

H.R. 1268, the Flood Mitigation Expense Relief Act of 2013, introduced by Rep. Steven M. Palazzo, R-Miss., would provide a tax credit for qualified flood mitigation expenses incurred for homes with increasing premium rates under the national flood insurance program, and increase funding for mitigation programs.

Firm Seeks Guidance on Reinvestment of Redemption Proceeds in Treasury Bills.

Alexander Deland of Winston & Strawn LLP has urged Treasury and the IRS to immediately issue guidance to relieve some qualified and recovery zone facility bonds from a significant risk created by a recently enacted law suspending the debt limit that could cause the loss of tax-exemption or the premature redemption of the bonds.

IRS: Government Grants for Railroad's Crossing Improvements Are Tax Free.

In field attorney advice, the IRS concluded that grants a railroad received under Transportation Department regulations governing railroad crossing safety improvements did not constitute gross income to the railroad.

The railroad received one type of grant for constructing a grade crossing and installing train-activated warning devices. Those grants included a statement that the funds provided no net benefit to the railroad. A second type of grant was for installing active warning devices and required the railroad to pay no more than 10 percent of the construction costs. That portion, according to the grant, would represent the railroad’s net benefit. The railroad argued the grants were not taxable income because it did not receive a net benefit as described under the Transportation Department regulations and that therefore it had no accession to wealth.

The IRS agreed with the railroad, finding that any benefit it received was incidental and not an accession to wealth. The IRS explained that the Transportation Department provisions governing railroad crossing safety improvements appear to be a cost-sharing arrangement between the federal government and the railroads and imply that Congress views the grants as having a public rather than a private purpose.

White House Announces Plan to Encourage Private Infrastructure Investment.

President Obama's "Rebuild America Partnership" plan to stimulate private infrastructure investment would exempt foreign pension funds from taxes on gains from U.S. real property investments, create a new permanent bonds program, and modify some of the restrictions on qualified private activity bonds, according to a March 29 White House release.

IRS Addresses Reporting Requirements for Condemnation Payments.

In e-mailed advice, the IRS concluded that a state's transportation department that makes payments for property acquired through condemnation proceedings has a section 6045(e) reporting requirement and must issue Forms 1099-S reflecting the entire cash payments unless the transaction or recipient is exempt from the reporting requirement.

IRS Publishes Population Figures for Housing Credit, Private Bond Purposes.

IRS Publishes Population Figures for Housing Credit, Private Bond Purposes.

Notice 2013-15, page 739. This notice advises State and local housing credit agencies that allocate low-income housing tax credits under section 42 of the Code, and States and other issuers of tax-exempt private activity bonds under section 141, of the population figures to use in calculating: (1) the 2013 calendar year population-based component of the State housing credit ceiling (Credit Ceiling) under section 42(h)(3)(C)(ii); (2) the 2013 calendar year volume cap (Volume Cap) under section 146; and (3) the 2013 volume limit (Volume Limit) under section 142(k)(5).

Generally, § 146(j) requires determining the population figures for the population-based component of both the Credit Ceiling and the Volume Cap for any calendar year on the basis of the most recent census estimate of the resident population of a State (or issuing authority) released by the U.S. Census Bureau before the beginning of the calendar year. Similarly, § 142(k)(5) bases the Volume Limit on the State population.

Sections 42(h)(3)(H) and 146(d)(2) require adjusting for inflation the population-based component of the Credit Ceiling and the Volume Cap. The adjustments for the 2013 calendar year are in Rev. Proc. 2012-41, 2012-45 I.R.B. 539. Section 3.03 of Rev. Proc. 2012-41 provides that, for calendar year 2013, the amount for calculating the Credit Ceiling under § 42(h)(3)(C)(ii) is the greater of $2.25 multiplied by the State population, or $2,590,000. Further, section 3.07 of Rev. Proc. 2012-41 provides that the amount for calculating the Volume Cap under § 146(d)(1) for calendar year 2013 is the greater of $95 multiplied by the State population, or $291,875,000.

For the 50 states, the District of Columbia, and Puerto Rico, the population figures for calculating the Credit Ceiling, the Volume Cap, and the Volume Limit for the 2013 calendar year are the resident population estimates released electronically by the U.S. Census Bureau on December 20, 2012, in Press Release CB12-250. For American Samoa, Guam, the Northern Mariana Islands, and the U.S. Virgin Islands, the population figures for the 2013 calendar year are the 2012 midyear

population figures in the U.S. Census Bureau's International Data Base (IDB). The U.S. Census Bureau electronically announced an update of the IDB on June 27, 2012, in Press Release CB12-118.

IRS Confirms Excludability of Income Derived From Essential Governmental Function.

The IRS has ruled that the income of a nonprofit corporation created to coordinate the operation of electric generation resources and the purchase and sale of electricity on behalf of members will continue to be excluded from gross income under section 115(1), even if the corporation enters into proposed transactions with nongovernmental entities. Letter Ruling 201310010.

IRS Releases New Required Form for TEB VCAP Submissions.

The Internal Revenue Service has released Form 14429, Tax Exempt Bonds Voluntary Closing Agreement Program Request, which is a new form required for a Tax Exempt Bonds Voluntary Closing Agreement Program submission request. The purpose of the new form is to assist issuers in organizing submission requests and to ensure that their submissions are complete and in accordance with the requirements under Notice 2008-31, 2008-11 I.R.B. 592 and IRM 7.2.3.

http://www.irs.gov/pub/irs-pdf/f14429.pdf

IRS: Trust's Income Excludable From Gross Income.

The IRS has ruled that the income of a trust established to fund post-employment health benefits for the employees of a government entity was excludable from gross income under section 115(1) because the income was derived from the exercise of an essential government function. Citations: Letter Ruling 201310026.

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