Internal Revenue Service

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Person To Contact:
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Date:
March 29, 2005

In Re:

Legend

Taxpayer =
X =
Executive of X =
Secretary =
Corporation =
Organization =
Division 1 =
Division 2 =
Division 3 =
Division 4 =
X Senate =
A =
Address 1 =

Property =
A =
B =

C% =
Dear

This is in reply to your letter dated October 15, 2004, and subsequent submissions, requesting a ruling under section 170 of the Internal Revenue Code.

Taxpayer was created by statute under the laws of X as an official entity to preserve, promote, enrich and diffuse the cultural values of the people of X. X's laws provide that Taxpayer shall be the government body charged with carrying out the public policy regarding the development of the arts, humanities and culture of X. Taxpayer's operational activities are divided into four divisions: Division 1, Division 2, Division 3 and Division 4. Taxpayer's purposes include, among many others, operating X's archives; administering X's public libraries; planning and coordinating government activities connected with the development, financing, and administration of programs related to the humanities and culture in general; improving the cultural activities that the government offers the citizenry; and coordinating the efforts of all government agencies whose purposes and functions are related to those of Taxpayer.

Taxpayer has among other powers, the power to sue and be sued, adopt bylaws, acquire, use and dispose of property, bring, upon prior approval of the Executive of X, eminent domain proceedings on behalf of X, accept gifts and donations, and enter into contracts and cooperative agreements with the federal government, its departments and agencies, the government of X, municipalities, as well as other organizations and individuals.

Taxpayer has a board of directors (the "Board") composed of nine members, eight of whom are appointed by the Executive of X with the advice and consent of the X Senate. The Executive of X designates one of the eight members of the Board to serve as chairman of the Board. The ninth member of the Board is, *ex-officio*, the Chairman of Corporation, who is also appointed by the Executive of X. The Executive of X has power to remove any member of the Board. The Board appoints the executive director of Taxpayer who runs the day-to-day affairs of Taxpayer at the discretion of the Board.

Annual appropriations from X fund nearly all the costs of Taxpayer's activities. Taxpayer receives a small percentage of its funding from Organization and operational revenues. Specifically, out of $A budgeted for Taxpayer in fiscal year 2003-2004, only $B, or C%, originated from sources other than legislative appropriations. Taxpayer is required by X law to submit a report of its operations and its budget to X's Senate each year. Taxpayer's accounting system is subject to the approval of Secretary. Taxpayer also serves as the conduit for X's funding other cultural organizations and programs. Among the various projects under the Taxpayer's Divison 3, Taxpayer recently finished restoring the home of the first native born Executive of X, A.

The land and structures comprising A's home are owned in fee simple title by Taxpayer. The Property is located at Address 1. The Taxpayer intends to operate the Property as a historical museum and cultural center.

The museum project includes a multiuse building for the reception area and for community activities. The second building is A's house. The residence will have the original furniture and memorabilia of the A family, along with other objects from the same period, to achieve the appropriate atmosphere. The house's surroundings have been transformed into a recreational park, with nature paths and vegetation typical of the area, and identified with explicative signs.

As a fundamental aspect of Property, an educational, cultural, and recreational activity center has been created, lending special attention to the community on the northeast of X. The activities shall include workshops, talks, conferences, film and video series, and guided visits to the residence and the park.

It is anticipated that in some instances friends and relatives of A, or of his descendants, as well as business entities in general, may wish to make contributions to Taxpayer subject to the restriction that their contributions shall be used to cover costs and expenses relating to Property, including, but not limited to, costs and expenses that shall be incurred to furnish, operate, maintain, provide security and pay the wages or salaries of personnel engaged in activities related to Property (collectively, the Dedicated Uses). The Taxpayer is willing and administratively able to accommodate such requests for Dedicated Uses, and, for such purposes, will create a segregated account, designated as the "Property Account" (or a similar designation) into which it would deposit all contributions designated for application to Dedicated Uses and from which it may disburse funds to cover the costs or expenses of Dedicated Uses. The Taxpayer needs to provide assurance to its contributors that such contributions for Dedicated Uses shall likewise be deductible under section 170(a).

Taxpayer requests a ruling that:

1. Taxpayer is an instrumentality of X created by law to carry out a public purpose. Therefore, charitable contributions and gifts to Taxpayer are described in section 170(c)(1) and are deductible to the extent provided in sections 170 (b)(1)(A) or 170(b)(2), as applicable.

2. Charitable contributions and gifts to Taxpayer will be deductible to the aforesaid extent, even if the donors request that their donations be used to cover costs and expenses relating to that certain museum property and cultural center known as Property, and Taxpayer provides no more than assurances to such donors that it will attempt in good faith to honor such preferences.

<u>Issue One</u>

Rev. Rul. 57-128, 1957-1 C.B. 311, provides the following factors in considering the status of an organization as an instrumentality of one or more states or political subdivisions:

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.

Taxpayer's purposes and functions (more fully described above) include planning and coordinating government activities related to humanities and culture and operating the public libraries and X's archives. Taxpayer thus is used for a governmental purpose and performs a governmental function. X law specifically designates the Taxpayer as the governmental body in charge of carrying out the public policy regarding the development of the arts, humanities, and culture of X. Taxpayer's eminent domain powers are exercised on behalf of X. Therefore, Taxpayer performs its functions on behalf of X. Based on the facts submitted, no private interests are involved.

Control and supervision of Taxpayer is vested in public authorities as follows:

1. The Board members are, directly or indirectly, all appointed by the Executive of X upon the advice and consent of the X Senate and are subject to dismissal by the Executive of X;
2. Taxpayer's accounting system is subject to the approval of Secretary;
3. Taxpayer submits its budget and reports on its operations to the X Senate each year;
4. Taxpayer's eminent domain powers are subject to prior approval of the Executive of X.

The Taxpayer was created and exists by virtue of specific express statutory enactment by the X Legislature. Finally, the overwhelming majority of Taxpayer's funding derives from X appropriations, with minimal funding from grants and the revenues of its own operations. Therefore, the Taxpayer has limited financial autonomy as related to X, and X's budget is the main source for financing Taxpayer's operating and other expenses.

Issue Two

Section 170(c)(2) of the Code, in part, defines a charitable contribution as a contribution or gift to or for the use of a corporation, created or organized in the United States; organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes; no part of the net earnings of which inures to the benefit of any private shareholder or individual; and which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation.

As explained in DeJong v. Commissioner, 36 T.C. 896, 899 (1961), aff'd, 309 F.2d 373 (9th Cir. 1962), the term charitable contribution is synonymous with the word gift. A gift is generally defined as a voluntary transfer of property by the owner to another without consideration. If a payment proceeds primarily from the incentive of anticipated benefit to the payor beyond the satisfaction which flows from the performance of a generous act, it is not a gift.

An important element for a taxpayer donor of a qualified charitable contribution is the donee's control over the donated funds. The donor must show that the qualified donee organization retained control over the funds. To have control over donated funds is to have discretion as to their use. In instances where a donor designates a gift to benefit a particular individual, and the individual does benefit from the gift, the determination of whether the gift is deductible depends upon whether the donee organization has full control of the donated funds and discretion as to their use. Such control and discretion ensures the funds will be used to carry out the organization's functions and purposes.

If contributions to a fund are earmarked by the donor for a particular individual, and the donee organization exercises no control or discretion over their use, they are treated as gifts to the designated individual and are not deductible as charitable contributions. For example, in Tripp v. Commissioner, 337 F.2d 432 (7th Cir. 1964), taxpayer's illusory gifts to a scholarship fund subject to the college's discretionary use were in fact designated by the donor and used for the sole benefit of a named individual and did not qualify as deductions for charitable contributions. See also Rev. Rul. 61-66, 1961-1 C.B. 19 (no deduction under section 170 is permitted for a transfer of money to a university to enable a specified teacher to engage in research. University had no control over the disposition of the funds; it acted merely as a conduit.); Rev. Rul. 79-81, 1979-1 C.B. 107 (deduction denied for amounts contributed to religious organization to sponsor particular students, since sums contributed were earmarked by the donor for specific individuals.); Thomason v. Commissioner, 2 T.C. 441, 443 (1943) (contribution to qualified welfare agency to pay for a specific individual not deductible because it amounted to a gift to an individual).

When contributions are restricted by the donor to a class of beneficiaries, the class of potential beneficiaries may still be too narrow to qualify as a deductible charitable contribution. Thus, in Charleston Chair Co. v. United States, 203 F. Supp. 126 (E.D.S.C. 1962), a corporation was denied a deduction for amounts given to a foundation established to provide educational opportunities for employees and their children. The court noted that the narrow class of persons who might benefit, the more restricted group that did benefit and the preference given to the son of the director, stockholder and trustee disclose that the Foundation was not operated exclusively for charitable purposes.

However, a deduction is allowable where it is established that a gift is intended by the donor for the use of the organization rather than a gift to an individual. Rev. Rul. 62-113, 1962-2 C.B. 10. This revenue ruling concerned contributions to a church fund by the parent of one of the church's missionaries. The ruling noted that if contributions to the fund are earmarked by the donor for a particular individual, they are treated, in effect, as being gifts to the designated individual and are not deductible. However, a deduction will be allowable where it is established that a gift is intended by a donor for the use of the organization and not as a gift to an individual.

The test in each case is whether the organization has full control of the donated funds, and discretion as to their use, so as to insure that they will be used to carry out its functions and purposes. The ruling held that unless the taxpayer's contributions to the fund are distinctly marked by him so that they may be used only for his son or are received by the fund pursuant to a commitment or understanding that they will be so used, they may be deducted by the taxpayer to the extent provided by section 170.

A charitable contribution may be permitted where preferences expressed at the time of contribution are precatory rather than mandatory, or where preference is given to relatives who otherwise qualify as charitable beneficiaries. A deduction was permitted in Robinson Est. v. Commissioner, 1 T.C. 19 (1942), acq., 1943 C.B. 19, for contributions to a residuary trust established to give financial assistance to needy persons and which included a stated preference for relatives and friends of the testatrix. Similarly, deductions were permitted in Schoellkopf v. United States, 124 F.2d 982 (2d Cir. 1942), where the potential beneficiaries of a foundation included any worthy descendants of the creator's father who need money to complete their education or for their proper maintenance and support. In addition, retention by the donor, or his family members, of the right to determine which individuals actually receive benefits does not preclude a charitable deduction. Hunton v. Commissioner, 1. T.C. 821 (1943), acq., 1943 C.B. 12.

In Rev. Rul. 60-367, 1960-2 C.B. 73 the issue was gifts to a university for the purpose of constructing housing for a designated fraternity. The college accepted gifts designated for improving or building a house for a designated fraternity and honored such designation so long as it was consistent with the policy, needs, and activities of the college. The college retained and exercised discretion and control with respect to the amount spent on the fraternity house consistent with the standards and pattern of the college for other student housing and consistent with the expressed housing policy of the college. The ruling thus held that the contributions made to the college under such circumstances constituted allowable section 170 deductions.

Where funds are earmarked, it is important that the donee organization has full control of the donated funds and discretion as to their use, so as to ensure that the funds will be used to carry out the organization's functions and purposes. If the donee has such control and discretion and the gift is applied in accordance with the organization's exempt purposes, the charitable gift ordinarily will be deductible, despite the donor's expressed hope that the gift will be applied for a designated purpose. Thus, in <u>Peace v. Commissioner</u>, 43 T.C. 1 (1964), the court permitted a deduction for funds donated to a church mission society with the stipulation that specific amounts should go to each of four designated missionaries because an examination of the totality of the facts and evidence demonstrated that the contribution went into a common pool and the church retained control of the actual distribution of the funds.

In <u>Winn v. Commissioner</u>, 595 F.2d 1060 (5th Cir. 1979), at issue was a contribution in response to an appeal by a church to assist a certain person in her church missionary work. Central to the court's finding was that even though the contribution was made payable to a fund named for the individual, an officer of the church took the funds donated and dealt with them as the church wished. That is, possession of the contribution by a church official was held to be one of the elements establishing control by the donee.

> "We also note that a donor can earmark a contribution given to a qualified organization for specific purposes without losing the right to claim a charitable deduction….Such a contribution still would be to or for the use of a charitable entity despite the fact that the donor controlled which of the qualified entity's charitable purposes would receive the exclusive benefit of the gift.
>
> Proof that the church in Benoit sponsored 'Sara Barry Days' for the express purposes of collecting funds for this part of its work, that an officer of that church took the funds donated and dealt with them as the church wished, and that the funds went to the support of the work the church intended is sufficient to establish that the funds were donated for the use of the Benoit Presbyterian church…" 595 F.2d at 1065.

The 5th Circuit relied on the fact that the contribution passed through the hands of the church official in order to conclude that the control test had been met in <u>Winn</u>.

See also Kamalu v. Commissioner, T.C. Summary Opinion 1986-169 (checks made out by Mormon missionary's parents to the mission where son was a missionary were under the control of the exempt organization because the funds were pooled by the mission for the support of all of its missionaries).

In summary, funds donated to a charitable organization restricted for the benefit of a private individual are not deductible. Tripp, supra. This is in contrast to funds contributed for a particular purpose, but the charity maintains control and discretion over actual use of the funds. Peace, supra.

The Taxpayer must ensure that it maintains its discretion and control over all contributions. Accordingly, the Taxpayer may endeavor to honor donors' wishes that designate the use of donated funds. The Taxpayer, though, must maintain control over the ultimate determination of how all donated funds are allocated. Donors should be made aware that, although Taxpayer will make every effort to honor their contribution designation, contributions become the property of Taxpayer, and the Taxpayer has the discretion to determine how best to use all contributions to carry out the it's functions and purposes.

Therefore, based on the above we rule that:

1. Taxpayer is an instrumentality of X under Rev. Rul. 57-128, 1957-1 C.B. 311. Therefore, contributions to Taxpayer are described in section 170 (c)(1) and are deductible to the extent provided in sections 170(b)(1)(A) or 170(b)(2) as applicable.

2. Charitable contributions and gifts to Taxpayer will be deductible to the aforesaid extent, even if the donors request that their donations be used to cover costs and expenses relating to that certain museum property and cultural center known as Property, and Taxpayer provides no more than assurances to such donors that it will attempt in good faith to honor such preferences.

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 requesting it. Section 6110(K)(3) of the Code provides that it 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 the Taxpayer.

Sincerely yours,

CHRISTOPHER F. KANE
Branch Chief, Branch 3
Office of Associate Chief Counsel
(Income Tax and Accounting)

cc: