



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: **201016090**

Release Date: 4/23/10

Date: January 29, 2010

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Uniform Issue List:

501.12-00

501.12-01

Legend:

C =

G =

MD =

CD =

JD =

a% =

b% =

c% =

d% =

\$p =

\$t =

\$u =

\$v =

\$x =

\$y =

\$z =

T =

Dear _____ :

This is in response to your ruling requests as to whether the proposed transactions will jeopardize your section 501(c)(12) of the Internal Revenue Code tax-exempt status.

FACTS:

You are a not-for-profit organization, tax-exempt under section 501(c)(12) of the Code. You describe yourself as a mutual irrigation company who primarily delivers water to entities that provide water to the public. The public owns more than 90% of your shares.

You, G, and certain participants plan to embark on a reconstruction project (the "Project") involving the enclosure of a canal, a water reservoir with an open water unlined canal that lies within a corridor. G holds the title to the canal and corridor (the canal and corridor, collectively as the "Canal"), but hired you, pursuant to a contract, to manage, operate, and maintain the Canal. Nonetheless, over the past years, you and G have considered the idea of enclosing the Canal, but funding restricted this endeavor. G is a government entity and various representatives of G represent G in this endeavor. However, for the purposes of this ruling, we refer to G and its representatives, collectively, as G. The remainder participants include:

1. C, a not-for-profit mutual irrigation corporation, tax-exempt under section 501(c)(12) of the Code. C primarily delivers water to entities that provide water to the public. The public owns more than 85% of C's shares, and C, presently, is a shareholder of you.
2. MD, a governmental entity that operates pursuant to a state law as a metropolitan water district, and in addition, owner of more than 60% of your outstanding shares.
3. CD, a governmental entity that operates pursuant to a state law as a water conservancy district.
4. JD, a governmental entity operating pursuant to state law as a water conservancy district.

You, G, C, MD, CD, and JD, collectively, shall be known as (the "Participants").

The benefits you anticipate receiving from the Project include public safety improvement, water quality improvement, and the construction of a recreational public trail through the Canal with the cooperation of various governmental entities within the State of T. Additional benefits include the conservation of water through the reduction of seepage and evaporation, the expansion of the Canal capacity to meet water demand, and the facilitation of flow of stream water to ensure the protection of certain endangered fish species. In addition, completion of the Project shall ensure the saving of several thousands acre-feet of water annually indirectly by CD.

After completion of the Project, title to the Canal shall transfer from G to you. However, G, CD, MD, and JD shall retain certain easement rights to the Canal.

To implement the Project, you and the rest of the Participants, except G, shall enter into an agreement (the "Master Agreement"). Content of the Master Agreement includes the Project design, construction terms, the Project funding, and the Canal's capacity allocation. Further, the Master Agreement provides that upon completion of the Project, a committee comprising of certain members of the Participants shall maintain and manage the Canal.

Furthermore, Participants, except MD, shall enter into a second agreement (the "Funding Agreement"), referenced in the Master Agreement. The Funding Agreement memorializes G's responsibility throughout the Project, the Project's funding, and the Project funding arrangement among the funding Participants.

Pursuant to the Master Agreement and the Funding Agreement, most of the Participants shall agree to fund the total cost of the Project, \$p, in the following percentages;

You = a%

C = b%

CD = c%

JD = d%

CD shall make two sets of contributions. Pertaining to the first contribution, CD shall contribute \$t to the Project. Pursuant to the Reclamation Projects Authorization and Adjustment Act of 1992 and under CD's Water Conservation Program pursuant to Section 207 of Central State of T Project Completion Act, upon CD's contribution of \$t, G shall reimburse CD, \$u, via a grant. CD has applied for the grant, and you refer to the contribution, \$t, from CD as the Section 207 Fund. Pertaining to the second contribution, CD shall pay an additional amount of \$v directly to G.

C and JD shall pay their portion of the funding contribution, total \$x, directly to G. You, through your shareholders, which includes MD and C, shall contribute \$y, your portion of the Project funding. If the Participants, exclusive of G, should require additional funds to complete the Project; loans, interest rates buy-down, other means from the State of T Board of Water Resources or other means; are available.

Under the authority of the Federal Reclamation law, G shall commence the Project as provided in the Funding Agreement while you shall serve as the primary contractor on the Project. Under G's control and supervision, you shall complete the Project design, solicit proposals, award the construction contract, and hire the project manager. G will select a resident engineer, chief inspector, plant inspector, half of the inspectors, and quality assurance personnel.

G shall control and disburse all of the funds contributed from CD, JD, and C, for Project purpose, with your assistance. Because G is bound to a budget measure, CD shall pay the Section 207 Fund in the amount of \$t directly to you instead of to G, and you shall hold the Section 207 Fund and apply it towards the Project. You shall also hold on to your funding contribution and apply it towards the Project.

Upon the completion of the Project, you represent that G shall transfer title of the Canal to you via a quitclaim deed. The transfer shall be subject to G's retention of certain easement rights; subject to the retention of certain rights by the rest of the Participants; and subject to CD, MD, and JD signing off on the Canal title transfer.

An agreement ("Title Transfer Agreement") between you, MD, CD, JD, and G, memorializes the agreement that G shall transfer certain lands inclusive of the Canal to you subject to certain conditions and subject to certain reservations and use rights of others. Under the Title Transfer Agreement, you shall pay G \$z or an amount equal to the base value of the Canal and certain other property, adjusted to reflect annual payment made after the Title Transfer Agreement execution. With the backing of MD, CD, JD, and G, G is authorized to transfer title to the Canal to you.

Under the Title Transfer Agreement, G reserves the water, mineral and perpetual easement rights of ingress and egress on, over, and across the Canal, and shall continue to participate in

the maintenance, reconstruction, and management of the Canal. In addition, consistent with a Congressional Authorization in 2004 and the Title Transfer Agreement, you shall transfer to the remainder Participants, except C, easements rights through the Canal for future water facilities. In operating the Canal, the Canal capacity shall be allocated among you, C, CD, and JD. You and C shall receive the most capacity.

All the agreements you submitted with this private ruling request are in draft form. However, you do not anticipate any change that can affect the outcome of this ruling.

RULINGS REQUESTED:

Based on the above facts, you requested the following rulings:

1. No funds paid to G pursuant to the Funding Agreement for the payment of Project costs, and in light of title to the Canal transfer to you, shall be treated as income by you for the purposes of meeting the requirements of section 501(c)(12) of the Code; and
2. No Section 207 Fund paid to you, in your capacity as a nominee, for the payment of Project costs, and in light of title to the Canal transfer to you, will be treated as income by you for purposes of meeting the requirements of section 501(c)(12) of the Code; and
3. Your status as an organization described in section 501(c)(12) of the Code will not be affected or impaired by any of the transactions falling within the Project's scope.

LAW:

Pursuant to section 501(c)(12) of the Code there shall be exemption from federal income 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.

Pursuant to section 1.501(c)(12)-1(a) of the Code of Federal Regulations ("regulations"), an organization described in section 501(c)(12) of the Code must receive at least 85 percent of its income from amounts collected from members for the sole purpose of meeting losses and expenses.

Pursuant to Rev. Rul. 67-265, 1967-2 C.B. 170, making water services available are like activities within the meaning of section 501(c)(12) of the Code, as water services are public-utility services similar to services provided by the organizations specified in section 501(c)(12)(A).

National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949), provides that where generally recognized attributes of an agency relationship are present, an agent may handle the property and income of its owner-principal without being taxable therefor.

ANALYSIS:

Pursuant to section 501(c)(12), there shall be exemption from federal income mutual ditch or irrigation companies, or like activities, 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. Further, pursuant to section 1.501(c)(12)-1(a) of the regulations, an organization described in section 501(c)(12) must receive at least 85 percent of its income from amounts collected from members for the sole purpose of meeting losses and expenses. Furthermore, making water services available are like activities within the meaning of section 501(c)(12). See, Rev. Rul. 67-265, 1967-2 C.B. 170.

You, C, MD, CD, JD, and G plan to embark on the Project, an enclosure of the Canal. You and C, section 501(c)(12) of the Code organizations, perform mutual irrigation operations and facilitate water supply to entities that make water available to the public. MD, CD, and JD, statewide government entities, perform water and waterways conservation. G, a non-state governmental entity, also performs water and waterways conservation. All of you, except MD, plan to make financial contributions to see the Project completed. G, indirectly, shall make a grant to CD to finance the Project.

G has title to the Canal, and pursuant to a contract between you and G, you currently manage, operate and maintain the Canal. G shall oversee the Project, controlling and supervising the completion of the Project. Pursuant to the Fund Agreement, the monies contributed shall be under either G's control or pursuant to G's permission, under your control. Nonetheless, G shall oversee the use of all of the contributed funds to complete the Project. Benefits from the Project include better water conservation and greater water output for public use.

Nonmember Income

CD, JD, and G are all nonmembers of you. However, the funding contributions made by CD, JD, and indirectly by G do not constitute income to you for purposes of the 85 percent member income test of section 501(c)(12) of the Code because CD, JD, and G did not make their contributions to you. Rather they contributed their contributions directly to the fund required to carry out the Project.

The fact that CD contributed the Section 207 Fund directly to you instead of G does not negate the fact CD contributed the Section 207 Fund to G for the consummation of the Project. The Section 207 Fund contribution was paid to carryout the project to reconstruct the canal owned by G. You do not yet have title to the canal and won't receive title to the canal until after the Section 207 Fund is already used to complete the reconstruction of the canal. If not for budget reasons, CD would have contributed the Section 207 Fund directly to G. Under G's control and supervision, you shall perform and complete the Project. As such, G shall supervise and control the use of the Section 207 Fund irrespective of the fact that CD shall contribute the Section 207 Fund directly to you. Thus, we believe that based upon your factual representation of an agency relationship, the agency principles provided in National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949) are present in this situation, and we conclude that though CD contributed the Section 207 Fund to you, you merely received the Section 207 Fund on G's behalf and are merely holding the Section 207 Fund as a nominee or agent of G.

Membership Income

MD, a majority shareholder of outstanding shares of you, did not contribute contribution funds directly to G. Rather you shall make a contribution of funds provided by your shareholders, which includes MD and C.

Pursuant to section 1.501(c)(12)-1(a) of the regulations, an organization described in section 501(c)(12) of the Code must receive at least 85 percent of its income from amounts collected from members for the sole purpose of meeting losses and expenses. The payment by you to the fund for the Project is an expense of your organization. Because of the benefits from the Project such as increase in water production to meet demand, any contributions by MD or C to you to be made to the fund for the project would be amounts collected by your members for expenses and would constitute member income for purposes of the 85 percent member income test.

Section 501(c)(12) Status

The fact that you paid G the amount of \$z for the title transfer is irrelevant and not a misuse of members' funds, but rather a business initiative that shall benefit your members. There is no doubt that the acquisition of the Canal ensures your capacity and ability to continue to perform a section 501(c)(12) of the Code activity (provision of water for public use) that directly benefits your members. Thus, your status as an organization described in section 501(c)(12) of the Code will not be affected by any of the transactions for the project.

RULINGS:

Based on the information submitted, we rule as follows:

1. No funds paid to G pursuant to the Funding Agreement for the payment of Project costs, and in light of title to the Canal transfer to you, shall be treated as income by you for the purposes of meeting the requirements of section 501(c)(12) of the Code; and
2. No Section 207 Fund paid to you, in your capacity as a nominee, for the payment of Project costs, and in light of title to the Canal transfer to you, will be treated as income by you for purposes of meeting the requirements of section 501(c)(12) of the Code; and
3. Your status as an organization described in section 501(c)(12) of the Code will not be affected or impaired by any of the transactions falling within the Project's scope.

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,

Robert W. Malone
Acting Manager,
Exempt Organizations
Technical Group 3

Enclosure
Notice 437