

***For general informational purposes only. Should not be relied upon as legal advice.***

### ACA Health Benefit Exchanges Summary of Federal Tax Issues Related to Entity Choice

	State governmental agency	State instrumentality [1]	Taxable, nonprofit corporation	Tax-exempt IRC §501(c)(3) entity [5]	Tax-exempt IRC §501(c)(4) entity [5]
State relationship	Part of State	Owned or controlled by State	May be State controlled or independent	May be State controlled or independent	May be State controlled or independent
Related income subject to Federal income tax	No	Generally No – provided IRC §115 applies	Yes – all net income subject to tax unless IRC §115 applies [1]	No [3]	No [3]
Eligible to use tax-exempt bond proceeds	Yes	Yes	Generally No [4]	Yes	Generally No [4]
Application to IRS for tax-exempt status	None	None	None	Form 1023	Form 1024
Employment taxes (Social Security and Medicare taxes)	See note [2]	See note [2]	Yes	Yes	Yes
Ongoing Federal income tax return filing requirements	None	Form 1120 (typically with zero income if IRC §115 applies)	Form 1120 (typically with zero income if IRC §115 applies)	Form 990 or 990-PF, with exceptions (and Form 990-T if applicable)	Form 990, with exceptions (and Form 990-T if applicable)
Federal return open to public inspection	No (No return is required)	No	No	Yes	Yes
Eligible for tax-deductible charitable contributions	Yes	Yes	No	Yes	No
Subject to operational restrictions linked to tax status	No	No	No	Yes – limits depend upon status as a public charity or private foundation	Yes - no excess benefit transactions

**Note:** This is provided for general informational purposes only and should not be relied upon as legal advice regarding structuring of any particular State Exchange. This document considers certain aspects of Federal tax law only – it does not include other important considerations that may apply, including State laws regarding operations of State agencies, instrumentalities and tax-exempt organizations. An Exchange would have to meet specific tax law requirements to qualify under IRC §§115, 501(c)(3), or 501(c)(4). This document does not provide any assurance an Exchange will qualify for any particular federal tax status. The tax rules associated with entity choice and qualifying for treatment under IRC §§115, 501(c)(3) or 501(c)(4) are complex and not all relevant rules are set forth here. States are advised to seek the advice of competent legal counsel regarding the tax and non-tax considerations involved in creating an Exchange entity.

## **Footnotes**

[1] Generally speaking, factors that determine whether an entity is an instrumentality include whether it performs a governmental function on behalf of, and whether it is owned or controlled by, one or more states or political subdivisions. (See Revenue Ruling 57-128, 1957-1 C.B. 311, for a list of factors indicating instrumentality status. Link provided below.) Often an instrumentality will also qualify for the income exclusion under IRC §115. The income of an instrumentality or a nonprofit entity may qualify for exclusion under §115 if it is derived from the exercise of an essential governmental function and accrues to a state or political subdivision of a state.

[2] State and local governments and instrumentalities are generally exempt from Social Security taxes if the employees are participants in a qualifying retirement system. Employees not covered by a qualifying retirement system or whose employer has entered into a social security coverage (Section 218) agreement with SSA are subject to social security taxes. State and local governments and instrumentalities are generally subject to Medicare taxes, except for any employees who are eligible for the continuing employment exception.

[3] Net income from activities unrelated to an organization's exempt purpose could be subject to tax.

[4] There are cases in which certain entities may use proceeds for facilities financed with tax-exempt private activity bonds.

[5] For additional information concerning IRC §501(c)(3) and §501(c)(4) see IRS.GOV (links provided below) and seek the advice of competent legal counsel.

## **Links to Additional Information**

Compliance Guide for 501(c)(3) Public Charities: <http://www.irs.gov/pub/irs-pdf/p4221pc.pdf>

Compliance Guide for 501(c)(3) Private Foundations: <http://www.irs.gov/pub/irs-pdf/p4221pf.pdf>

Compliance Guide for Tax-Exempt Organizations (other than 501(c)(3) Public Charities and Private Foundations): <http://www.irs.gov/pub/irs-pdf/p4221nc.pdf>

Life Cycle of a Public Charity: <http://www.irs.gov/charities/charitable/article/0,,id=122670,00.html>

Life Cycle of a Private Foundation: <http://www.irs.gov/charities/foundations/article/0,,id=127912,00.html>

Life Cycle of a IRC section 501(c)(4) Social Welfare Organization: <http://www.irs.gov/charities/nonprofits/article/0,,id=156354,00.html>

Tax Information for Federal, State, & Local Governments: <http://www.irs.gov/govt/fslg/index.html>

Employment Taxes for Exempt Organizations: <http://www.irs.gov/charities/article/0,,id=128716,00.html>

Revenue Ruling 57-128: <http://www.legalbitstream.com/scripts/isyswebext.dll?op=get&uri=/isysquery/irlf0f2/1/doc>