

D-5200
LND-910

MAY 21 1998

MEMORANDUM

To: All Irrigation Districts Subject to the Acreage Limitation Provisions of Reclamation Law

From: **FOR** Margaret W. Sibley
Director, Program Analysis Office

Wayne O. DeBor
Acting

Subject: Implementation of Provisions for Religious and Charitable Organizations That Do Not Meet the Criteria in Section 219 of the Reclamation Reform Act of 1982

The Reclamation Reform Act of 1982 (RRA) provides special application of the acreage limitation provisions to religious or charitable organizations (organizations) that are exempt from taxation under section 501 of the Internal Revenue Code (IRC). However, in order to qualify for the special application, such organizations must meet the following three criteria in section 219 of the RRA:

- (1) The agricultural produce and the proceeds of sales of such produce must be directly used only for charitable purposes;
- (2) The organization's land must be operated by the individual religious or charitable entity or organization (or subdivision thereof); and
- (3) No part of the net earnings of such religious or charitable organization (or subdivision thereof) may inure to the benefit of any private shareholder or individual.

The revised Acreage Limitation Rules and Regulations (43 CFR Part 426) that became effective on January 1, 1998, include new provisions for organizations that are exempt from taxation under IRC section 501, but do not meet all three of the above criteria. The attached document provides guidance for implementing these new provisions and incorporates past decisions about the section 219 criteria that remain valid even under the new provisions. Throughout the remainder of this transmittal, it is assumed the organizations are exempt from taxation under IRC section 501. Organizations that are not exempt from taxation under IRC section 501 are not religious or charitable organizations for acreage limitation purposes.

The most significant changes to the provisions for organizations that do not meet the section 219 criteria are:

- (1) When a subdivision of an organization subject to the discretionary provisions fails to meet the section 219 criteria, only that subdivision and subdivisions under it will be affected. Under the previous rules, the central organization and other subdivisions of the central organization were also affected when one subdivision did not meet the criteria.
- (2) Discretionary provision organizations or subdivisions of such organizations that do not meet the section 219 criteria will be treated as a single legal entity with a limited recipient status if they have more than 25 members, or as a qualified recipient if they have 25 or fewer members. In the previous rules, discretionary provision organizations that did not meet the section 219 criteria were treated as limited recipients, regardless of the number of members in the organization.

This memorandum and the attached guidance focus mainly on religious and charitable organizations that do not meet the section 219 criteria. However, based on recent inquiries, we would also like to stress that the forms submittal threshold for religious and charitable organizations that meet the section 219 criteria is determined by the RRA forms submittal category of each district. Thus, if an organization holds land in a district with a "category 1" status, the RRA forms submittal threshold is 240 acres because that organization is considered to be a qualified recipient. An organization that meets the section 219 criteria and holds land in a district with a "category 2" status has an 80-acre form submittal threshold if the district is subject to the discretionary provisions, and a 40-acre threshold if the district is subject to prior law.

If you need assistance regarding the acreage limitation provisions for religious or charitable organizations, please contact your local Reclamation office.

Attachment

**IMPLEMENTATION OF THE
ACREAGE LIMITATION PROVISIONS
FOR RELIGIOUS OR CHARITABLE ORGANIZATIONS**

The questions and answers below provide guidance for implementing sections 426.9(b)(2) and (c)(2) in the revised Acreage Limitation Rules and Regulations (43 CFR Part 426). These provisions relate to religious and charitable organizations (organizations) that are exempt from taxation under section 501 of the Internal Revenue Code but **do not** meet the criteria set forth in section 219 of the Reclamation Reform Act of 1982 (RRA). The provisions became effective on January 1, 1998. This document does not address organizations that do not have a section 501 tax exemption. Such organizations are not religious or charitable organizations for acreage limitation purposes, and section 219 of the RRA does not apply to them.

Following is a summary of the topics addressed in this document:

- Section I: The criteria in section 219 of the RRA
- Section II: Organizations subject to prior law
- Section III: Organizations subject to the discretionary provisions
- Section IV: Organizations that are indirect landholders
- Section V: "Operator" criterion in section 219
- Section VI: RRA Form Requirements
- Section VII: Water deliveries to land in excess of an organization's acreage limitation entitlements
- Section VIII: Notification to organizations and districts

SECTION I. - CRITERIA IN SECTION 219

QUESTION 1: How can an organization qualify for the special application of the acreage limitations under section 219 of the RRA?

ANSWER: To qualify, the organization must meet the following three criteria:

1. The agricultural produce and the proceeds of sales of such produce are directly used only for charitable purposes;
2. Said land is operated by said individual religious or charitable entity or organization (or subdivision thereof); and
3. No part of the net earnings of such religious or charitable organization (or subdivision thereof) shall inure to the benefit of any private shareholder or individual.

Under the discretionary provisions, central organizations and each of their subdivisions will have a separate qualified recipient status if they meet all three of the preceding criteria. Under prior law, central organizations and each of their subdivisions will be treated as separate prior law corporations if they meet these criteria.

SECTION II. - ORGANIZATIONS SUBJECT TO PRIOR LAW

This section applies to organizations subject to PRIOR LAW.

QUESTION 2: How will Reclamation treat a prior law organization if either the central organization or one of its subdivisions does not meet all the criteria in section 219?

ANSWER: Reclamation will treat the entire organization, including all subdivisions, as a single prior law corporation if either the central organization or any of its subdivisions do not meet the section 219 criteria.

SECTION III. - ORGANIZATIONS SUBJECT TO THE DISCRETIONARY PROVISIONS

The questions in this section apply to organizations subject to the DISCRETIONARY PROVISIONS.

QUESTION 3: How will Reclamation treat a central organization that does not meet all three section 219 criteria?

ANSWER: In such cases, the central organization, including all of its subdivisions, will be treated as a single legal entity.

QUESTION 4: How will Reclamation treat a subdivision of an organization if the subdivision does not meet all the section 219 criteria?

ANSWER: The subdivision not meeting the criteria and any subdivisions of it will be treated as a single legal entity. The central organization and any other subdivisions of it will not be affected by a particular subdivision's failure to meet the criteria.

QUESTION 5: What is the acreage limitation status of an organization that does not meet the section 219 criteria?

ANSWER: If the number of members in both the organization that has not met the criteria and any subdivisions that are under that organization totals more than 25, that organization and every subdivision under it will be treated as a single legal entity with a limited recipient status. If that number is 25 or less, that organization and every organization under it will be treated as a single legal entity with a qualified recipient status.

QUESTION 6: Will Reclamation determine the number of members in every organization that does not meet the section 219 criteria?

ANSWER: No. Reclamation will assume that each organization that does not meet the criteria, including any subdivisions under it, has more than 25 members. Thus, the organization will be considered to be a limited recipient. However, if the organization demonstrates to Reclamation's satisfaction that it and any subdivisions under it have a total of 25 or fewer members, it will be considered to be a qualified recipient.

QUESTION 7: How will Reclamation make status determinations in those cases where an organization believes it should be a qualified recipient?

ANSWER: If the organization has current and official membership rolls, Reclamation will count the number of natural persons on its rolls and the membership rolls of any subdivisions under it. In those cases where members are legal entities, each part owner of the legal entity will be counted as a member. If the total number of members is 25 or less, Reclamation will consider the organization and any subdivisions under it to be a single qualified recipient, provided there is no question as to the authenticity of the membership roll(s). If the number of members is more than 25, the organization and any subdivisions under it will be considered a single limited recipient. Organizations with membership rolls may also want to submit additional documentation, such as that listed in the answer to question 8 below, in case Reclamation does not find the membership rolls to be satisfactory.

QUESTION 8: How will status determinations be made if the organization does not have a membership roll or the roll is not satisfactory to Reclamation?

ANSWER: The burden of proof will be on the organization that believes it should be a qualified recipient. Reclamation will make determinations based on supporting documentation submitted by the organization. The organization may want to include the following as part of its supporting documentation: organizational documents, by-laws, application to the Internal Revenue Service (IRS) for a section 501 exemption, and the IRS's ruling or determination letter.

SECTION IV. - ORGANIZATIONS THAT ARE INDIRECT LANDHOLDERS

QUESTION 9: How do the section 219 criteria apply in cases where an organization holds land indirectly; for example, the organization is a beneficiary of a trust?

ANSWER: If an organization wants to realize the special application of the acreage limitations, it must meet the section 219 criteria on **all** land it directly or indirectly owns or leases. For example, if an organization is a part owner of a legal entity that leases its land to other parties, the organization would not meet the "operator" criterion in section 219. Thus, it would be treated as a single legal entity as set forth in Sections II and III above. The only exceptions would be in those type of situations explained in the answers to questions 11, 12, and 13 in Section V below.

SECTION V. - "OPERATOR" CRITERION IN SECTION 219

QUESTION 10: How will Reclamation administer the section 219 criterion that requires organizations to operate land in their holdings?

ANSWER: In order to meet the "operator" criterion in section 219, an organization must be the principal operator of the land it owns or leases. This means the organization must make the decisions and be responsible for the daily functioning of the land in question. Each farm must have one and only one principal operator at any given time. For example, if the organization should lease out its land, it cannot be the principal operator of that land. However, just because a determination has been made that a farm agreement is not a lease, it does not necessarily follow that the organization is the principal operator. Farm agreements that are not leases must be reviewed by Reclamation to determine whether the organization or another party is actually the principal operator.

QUESTION 11: An organization leases land to other parties. However, the land in question does not receive Reclamation irrigation water because, for example, the land has a nonproject water supply, project facilities have not yet been constructed, or the contract has expired for the district in which the land is located. In such situations, does the organization meet the "operator" criterion in section 219?

ANSWER: Organizations may lease their land to other parties and still meet the section 219 criteria, provided the land in question does not receive Reclamation irrigation water during the time the lease is in effect.

QUESTION 12: An organization owns both exempt and nonexempt land. Some of the exempt land is leased to other parties and receives Reclamation irrigation water. How does this affect the organization's ability to meet the "operator" criterion in section 219?

ANSWER: Leasing exempt land to another party does not jeopardize the organization's ability to meet the "operator" criterion and qualify for the special application of the acreage limitations on its nonexempt land, provided the acreage limitation exemption on the leased land remains in effect.

QUESTION 13: How does the "operator" criterion apply in those cases where an organization involuntarily acquires land?

ANSWER: If an organization acquires land involuntarily and designates the land as **nonexcess**, the "operator" criterion applies to that land in the same way it would have had the land not been involuntarily acquired. An organization that designates its eligible involuntarily acquired land as **excess** may lease the land out and still be considered as meeting the section 219 criteria during the 5-year grace period the land is permitted to receive Reclamation irrigation water. However, if the organization decides to redesignate the land as nonexcess before or after the grace period has expired, the land will be considered to have been nonexcess from the date it was acquired involuntarily. Accordingly, the organization would not have met the "operator" criterion. Reclamation would then need to determine if a different rate would have applied to the water delivered before the redesignation was made, and thus, if additional charges are owed.

SECTION VI. - RRA FORM REQUIREMENTS

See 11/02/01 letter

QUESTION 14: If an organization does not meet the three criteria in section 219, what RRA forms must they complete?

ANSWER: Organizations that do not meet all the section 219 criteria must complete Form 7-2181, Certification of Entity's Landholdings, if they are subject to the discretionary provisions and exceed the RRA forms submittal thresholds for qualified or limited recipients, as applicable. Organizations that are subject to prior law and hold land in excess of 40 acres must complete Form 7-2191, Report of Entity's Landholdings. In all cases, the organization's land will be attributed equally to its members and members of subdivisions under it, rather than to part owners. If the organization, including any subdivisions under it, has 25 or fewer members, it must list the names of all its members. If the organization, including any subdivisions under it, has more than 25 members, it must list the members' names if their attribution through the organization's landholding is greater than 40 acres. Members of organizations required to complete Form 7-2181 or 7-2191 are required to submit their own individual RRA forms if their westwide landholdings exceed the RRA forms submittal threshold applicable to them.

QUESTION 15: How is the administrative fee assessment for form violations to be applied to organizations that do not meet the section 219 criteria?

The administrative fee assessment for form violations applies to **organizations** that do not meet the section 219 criteria in the same way it does to any other landholder. Thus, the administrative fee assessment applies if an organization does not submit an RRA form for the year in question or the form is submitted after Reclamation irrigation water has been delivered. If the organization submits an RRA form for the year in question prior to receipt of Reclamation irrigation water, but it is not the correct form or the form contains errors, the district will be given 60 days in which to submit the appropriate form or correct the errors without imposition of the administrative fee assessment. Generally, the administrative fee assessment for form violations applies to **members** of organizations that do not meet the section 219 criteria in the same way it applies to other indirect landholders.

**SECTION VII. - WATER DELIVERIES TO LAND IN EXCESS
OF AN ORGANIZATION'S ACREAGE
LIMITATION ENTITLEMENTS**

QUESTION 16: What actions will be taken if an organization receives Reclamation irrigation water on land in excess of its ownership and/or nonfull-cost entitlements before Reclamation discovers that the organization did not qualify for the special application of the acreage limitations under section 219?

ANSWER: In such cases, Reclamation will instruct the district to terminate water deliveries to land in excess of the organization's ownership entitlement as a legal entity. The compensation rate (full-cost) and underpayment interest will be assessed for the Reclamation irrigation water already delivered to the excess land. The administrative fee also will be assessed in those cases where the deliveries occurred after January 1, 1998. Water deliveries to land in excess of the organization's nonfull-cost entitlement will be assessed at the full-cost rate, and underpayment interest will be charged, if applicable.

QUESTION 17: An organization does not qualify for the special application of the acreage limitations in section 219 because it leases its land to another party for 2 years. The organization is treated as a single legal entity and, as a result, is in excess of the applicable ownership entitlement. Once the lease term expires, how is the excess land to be treated?

ANSWER: After the lease has expired, the organization may again include the excess acreage as part of its nonexcess land, provided the organization meets all the section 219 criteria and has not already completed the ownership entitlement applicable to it under that section. As required by 43 CFR 426.12(b), the redesignation must be submitted to Reclamation for review and approval.

If an organization has excess land as a result of not meeting the section 219 criteria, generally the excess land may not be put under a recordable contract.

SECTION VIII - NOTIFICATION TO ORGANIZATIONS AND DISTRICTS

QUESTION 18: What actions will Reclamation take when it determines that an organization does not qualify for the special application of the acreage limitations under section 219?

ANSWER: Reclamation will send a letter notifying the organization that it does not qualify for the special application of the acreage limitations. In those cases where the letter is the regional director's final determination on the matter, Reclamation will provide a copy of the letter to the district(s) in which the organization holds irrigation land.