INTERNAL REVENUE SERVICE
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Date: Dec. 29, 1998

RE:

<u>Legend</u>:

Corporation =

City =

State =

Statute A =

Issuer =

Dear :

This is in response to a letter dated June 5, 1998, and subsequent correspondence, requesting a ruling on behalf of Corporation. We have been asked to rule that Corporation's income is excludable from gross income under § 115 of the Internal Revenue Code.

FACTS:

City owns a parcel of land which contains a deteriorated 1600 space parking garage in the downtown area adjacent to a vacant mall site which formerly housed, among others, a major department store. A developer has acquired the former mall site and plans to construct a three-level recreational and entertainment center. City has determined that redevelopment of the parking garage to serve the general public as it visits the new center as well as other sites in the downtown area would spur economic development within the downtown area, thereby increasing commercial development of the downtown area, local employment, and local shopping and entertainment opportunities.

Corporation was incorporated for the purpose of demolishing the old parking structure and constructing a new one. Corporation was incorporated as a not-for-profit local development

corporation under State Statute A. As a not-for-profit corporation it is required by Statute A to be operated exclusively for charitable or public purposes such as reducing unemployment and encouraging the development of, or retention of, an industry in the community. This project is to be financed by bonds issued by Issuer, a political subdivision of State.
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The members of Corporation are the mayor and city manager of City, two officials or employees of Issuer, and one person appointed by the Board of Directors. These five members also constitute Corporation's Board of Directors.

Any income earned by Corporation in excess of the rental income from City which Corporation uses to pay the bond related lease payments to Issuer will be retained by Corporation to further its corporate purposes. No part of the income of Corporation will inure to the benefit of any member or private interest. Upon dissolution of Corporation the remaining assets will be distributed to City.

In order to build the parking structure the following transaction has been arranged.

(i) Issuer has issued revenue bonds for the purpose constructing a new parking facility (the Bonds). The term of the Bonds is 25 years.

(ii) City, as owner of the land, has entered into a 40 year ground lease with Issuer for the payment of $1 of annual ground rent. Issuer holds title to the new parking structure built on the land subject to the ground lease. At the end of the 40 year term title to the parking structure reverts to City.

(iii) Issuer has simultaneously entered into both a 40 year ground sublease and a 25 year lease with Corporation. The 25 year lease provides for the demolition of the existing parking structure and construction of a new parking structure. Issuer, City and Corporation are all liable as mortgagors on a mortgage secured by the parking structure. Under the 25 year lease Corporation is required to make rental payments to Issuer that are keyed to the amounts due on the outstanding Bonds. At the end of the 25 year lease the Bonds are repaid and no more Bond related payments are due. Thereafter Corporation operates the property subject to the terms of the 40 year ground lease.

(iv) Corporation has simultaneously entered into a 25 year sublease with City relating to the land and the parking facility. City, as sublessee, will operate the parking facility. City is required to make rental payments to Corporation that are keyed to the rental payments Corporation is required to make to Issuer. At the end of the 25 year lease between City and Corporation, the possession of the parking structure reverts to Corporation.

During the 25 year term of the Bonds City will operate the parking facility and Corporation will use the rental income it receives from City to make rental payments to Issuer. Once the Bonds have been repaid and the 25 year sublease between City and Corporation has expired, Corporation will operate the facility for the final 15 years that remain on the term of the 40 year ground lease. Upon the expiration of the 40 year ground lease, Corporation will dissolve. Upon dissolution, any assets held by Corporation (including the parking facility) will be distributed to City.

LAW

Section 115(1) excludes from gross income any income derived from the exercise of an essential governmental function and accruing to a state or a political subdivision of the state.

When determining if § 115(1) applies, the Service considers all the facts and circumstances relating to the organization to determine whether the organization performs an essential governmental function, and whether the income of the organization accrues to a state or a political subdivision of the state.

Rev. Rul. 90-74, 1990-2 C.B. 34, concerns an organization formed, operated and funded by political subdivisions to pool their casualty risks and other risks arising from their obligations concerning public liability, workers' compensation or employees' health. The ruling states that the income of such an organization is excluded from gross income under § 115(1) so long as private interests do not participate in the organization or benefit more than incidentally from the organization. The benefit to the employees of the insurance coverage obtained by the member political subdivisions was deemed incidental to the public benefit. Furthermore, upon dissolution, the organization will distribute its assets to its members. Therefore, the income of the organization accrues to a political subdivision within the meaning of § 115(1).

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income from a fund, established under a written declaration of trust by a state, for the temporary investment of positive cash balances of a state and its political subdivisions, is excludable from gross income under § 115(1). The ruling reasons that the investment of positive cash balances by a state or a political subdivision thereof 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 raise revenue. Rev. Rul. 77-261 points out that it may be assumed that 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.

ANALYSIS

Corporation was incorporated to construct parking facilities for City as part of City's efforts to promote redevelopment of the downtown area. Redevelopment is an essential governmental function for purposes of section 115(1).

Corporation's income, in excess of the rental income from City used to pay the Bond related lease payments to Issuer, will be retained by Corporation to be used exclusively for its corporate purposes. No part of the income or earnings may inure to the benefit of a member or a private interest. Upon dissolution, Corporation's assets will be distributed to City. Accordingly, the income of Corporation accrues to the state or a political subdivision thereof for purposes of section 115(1).

CONCLUSION

Based on the information and representations Corporation has submitted, we conclude that the income of Corporation is excludable from its gross income under § 115(1).

We express no opinion, implied or otherwise, on any other federal income tax consequences regarding Corporation or any of its transactions. In particular, no opinion is expressed as to whether interest on any of the Bonds is excludable from the gross income of the respective holders thereof under § 103.

This ruling is directed only to the taxpayer requesting it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours.

Assistant Chief Counsel
(Financial Institutions & Products)

By: William E. Coppersmith
William E. Coppersmith
Chief, Branch 2

Enclosures;
Copy of this letter
Copy for § 6110