

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

March 2, 2000

Legend:

Corporation =

Authority =

State =

Act =

Company =

State 2 =

Town =

County =

Date 1 =

Dear:

This is in response to your request for rulings on behalf of the Corporation that (1) any income derived by the Corporation as a result of its proposed activities, as further described below, will be excludable from gross income under § 115 of the Internal Revenue Code, (2) the Bonds to be issued by the Corporation will be considered as issued on behalf of the State under § 103, and (3) the Corporation is an instrumentality of the State under § 141.

Facts and Representations

You make the following factual representations. The Corporation was specifically created by an act of the State legislature effective Date 1 as a subsidiary of the Authority. The Corporation has the power to issue bonds on behalf of the State for certain projects.

The Authority was specifically created by the Act as an instrumentality of the State. The Authority has the power to perform such governmental functions as issuing bonds for activities or projects authorized by one or more political subdivisions of the State. The members of the Board of Directors of the Authority are appointed by the Governor of the State and confirmed by the Senate of the State. Members of the Board serve without compensation, and no part of the funds of the Authority may inure to the benefit of, or be distributed to, its employees, officers, directors, members, or any private individual, except that the Authority is authorized to pay reasonable compensation for services rendered and to reimburse its directors for reasonable and necessary expenses related to their duties as directors. Upon dissolution of the Authority, all of its assets will be disposed of exclusively to the State.

The Act provides that the members of the Board of Directors of the Corporation must be the same as the members of the Board of Directors of the Authority. Upon any change in the members of the Board of Directors of the Authority, any new members will automatically become members of the Board of Directors of the Corporation.

Also under the Act, no part of the funds of the Corporation shall inure to the benefit of, or be distributed to, its employees, officers, directors, members, or any private individual, except that the Corporation is authorized to pay reasonable compensation for services rendered and to reimburse its directors for reasonable and necessary expenses related to their duties as directors. Upon dissolution of the Corporation, all assets of the Corporation will be disposed of exclusively to the State or an instrumentality thereof for a public purpose. Private individuals are prohibited from receiving any of the Corporation's assets upon its dissolution.

The Act further provides that any bonds issued by the Corporation shall be issued only after a redevelopment district is established by the Authority and a redevelopment plan is approved by the Authority for a "project of statewide as well as local importance." A redevelopment district may be established only after the secretary of commerce and housing of the State has certified that the district will contain a "project of statewide as well as local importance", and a redevelopment agreement between the Corporation and a developer with respect to implementing the redevelopment plan has been executed and approved by the board of county commissioners of the county in which the redevelopment district is located. Once the redevelopment district has been established, the project may be undertaken by the Corporation, or a developer on behalf of the Corporation, in one or more phases within such redevelopment district.

In accordance with the Act, the Company is expected to request that the Corporation issue sales tax revenue bonds and tax increment financing bonds (the Bonds) pursuant to a redevelopment agreement with the Company. The proceeds from the sale of the Bonds would be used by the Company to develop and construct a destination resort on the Property which will be anchored by a theme park (the "Project").

Pursuant to its Articles of Incorporation, the Corporation is organized exclusively for the following purposes: (a) to acquire or convey on behalf of the State, any “project of statewide as well as local importance” as defined in the Act; (b) to issue bonds on behalf of the State pursuant to the Act to finance any “project of statewide as well as local importance”, or otherwise finance on behalf of the State pursuant to the Act any “project of statewide as well as local importance”; and (c) to do all things necessary, proper, advisable, or convenient for the accomplishment of the purposes set forth above, and to do all things incidental thereto or connected therewith which are not forbidden by the laws of the State or the Authority’s Articles of Incorporation. In accomplishing its purposes, the Corporation is subject to the same restrictions and limitations as to purposes to which the Authority is subject.

In addition, upon receipt of this letter ruling, the Authority and the Corporation will amend their respective bylaws to provide that upon the request of the Governor of the State, Board members shall tender their resignations to the Governor, effective immediately, or on such effective date as may determined by the Governor. Also upon receipt of this letter ruling, the Corporation will amend its bylaws to provide that (1) the Corporation shall obtain the approval of the Authority for the adoption of any annual or long-term capital and operational budget or for any expenditures in excess of such annual or long term capital and operational budgets, and (2) the Authority shall have a right to demand an audit of the books and records of the Corporation annually or at any time, and a copy of such audit will be provided to the Authority.

The first project expected to be presented to the Corporation is a proposal by the Company, a corporation of State 2, that the Corporation acquire title to a tract of land located near the Town (the “Property”), and convey that title to the Company. In conveying title to the Company, the Corporation will receive consideration from the Company which will be no less than the amount paid by the Corporation for the Property.

Potential sources of income to the Corporation include income derived from the transfer of the Property to the Company as well as fees from the issuance of the Bonds. The Corporation also may receive income as a result of the Company’s agreement to indemnify the Corporation, pursuant to the terms of the redevelopment, land conveyance, and bond issuance agreements. The income of the Corporation will be used solely for purposes related to its activities pursuant to the Act, and no income of the Corporation will inure to or benefit private interests.

Law and Analysis

Section 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision of a state.

Rev. Rul. 71-589, 1971-2 C.B. 94, provides that the income from property held in trust by a city that was to be used by the city for certain charitable purposes is not subject to federal income tax. Although Rev. Rul. 71-589 does not explicitly so state, the holding in the revenue ruling means that a determination was made that the income in question was derived from the exercise of an essential governmental function and accrued to a political subdivision within the meaning of § 115(1). Rev. Rul. 71-589 specifically mentions several types of functions that the trust might perform, such as support of a hospital, schools, maintenance of a park, or other purposes ordinarily recognized as municipal functions.

Under Rev. Rul. 77-261, 1977-2 C.B. 45, the income from a fund, established under a written declaration of trust by a state for the temporary investment of cash balances of the state and its political subdivisions, which purchase units of participation and have an unrestricted right of withdrawal, is excludable from gross income. The fund, however, is classified as a corporation and must file a federal income tax return.

Rev. Rul. 90-74, 1990-2 C.B. 34, concerns an organization that is formed, operated, and funded by political subdivisions to pool their casualty risks, or other risks arising from their obligations concerning public liability, workers' compensation, or employees' health. Rev. Rul. 90-74 states that the income of the organization is excluded from gross income under § 115(1) if private interests do not participate in the organization or benefit more than incidentally from the organization. In Rev. Rul. 90-74 the benefit to the employees of the political subdivisions was excepted as incidental.

The Corporation was created to stimulate economic development in the State. The Corporation's income is a component of its purpose. Its expenditures are ultimately controlled by persons acting under authority granted by gubernatorial appointment with approval by the State senate. No income inures to the benefit of private persons other than incidentally, and upon the Corporation's dissolution its net assets are not distributed to or for the benefit of any private person. Accordingly, the Corporation's income is excludable from gross income under § 115(1).

Section 103(a) provides that gross income does not include interest on any State or local bond. Section 103(b)(1) provides that § 103(a) does not apply to any private activity bond which is not a qualified bond (within the meaning of § 141).

Section 1.103-1(a) of the Income Tax Regulations provides that interest upon obligations of a State, territory, a possession of the United States, the District of Columbia, or any political subdivision thereof (hereinafter collectively or individually called "State or local governmental unit") is not includable in gross income except as provided under § 103(c) and (d) and the regulations thereunder.

Section 1.103-1(b) provides, in part, that an obligation issued by or on behalf of any governmental unit by a constituted authority empowered to issue such an obligation is the obligation of such a unit.

Section 141(a)(1) provides that a “private activity bond” is any bond issued as part of an issue that satisfies the private business use test of § 141(b)(1) and the private security or payment test of § 141(b)(2), or the private loan financing test of § 141(c).

Section 141(b)(1) provides that an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use.

Section 141(b)(6)(A) provides that for purposes of § 141(b), the term “private business use” means use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit.

Section 1.141-1(b) provides in part that a governmental person means a state or local governmental unit as defined in § 1.103-1 or any instrumentality thereof.

Revenue Ruling 57-187, 1957-1 C.B. 65, holds that bonds issued by an Industrial Development Board are considered issued on behalf of a political subdivision of the state because the following conditions are met: (1) the entity (i.e., the Industrial Development Board) is formed only after the governing body of the state or political subdivision has formally approved the entity’s creation; (2) a board of directors of the entity is elected by the governing body of the state or political subdivision; (3) the entity may issue bonds to carry out any of its corporate powers, which include the power to acquire, improve, maintain, equip, and furnish projects, to lease such projects and collect rent, and to sell and convey any and all of its property whenever the board of directors finds such action to be in furtherance of the purposes for which the entity is established. All bonds shall be payable solely out of revenues and receipts derived from the leasing or sale by the entity of its projects. The political subdivision shall not be liable for the payment of principal or interest on any of the bonds of the entity; (4) the entity is a nonprofit organization and none of its net earnings may inure to the benefit of any private person; (5) upon dissolution of the entity, title to all property it owns would vest in and become the property of the state or political subdivision which creates it.

Applying the criteria of Rev. Rul. 57-187 to the facts as represented, we conclude that the Corporation qualifies as an “on behalf of” issuer for purposes of § 1.103-1(b). The Corporation was specifically created by an act of the State legislature. The members of the Board of Directors of the Corporation are appointed by the Governor and confirmed by the State Senate. The Corporation has the power to issue tax-exempt obligations to carry out its corporate powers. No part of the funds of the Corporation may inure to the benefit of any private person. Upon dissolution, all assets of the Corporation will be disposed of exclusively to the State or an instrumentality thereof for a public purpose. Private individuals are prohibited from receiving any of the Corporation’s assets upon dissolution.

Under Revenue Ruling 57-128, 1957-1 C.B. 311, the following factors are taken into account to determine whether an entity is an instrumentality of one or more governmental units: (1) whether the organization 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 a public authority or authorities; (5) whether express or implied statutory or other authority is necessary for the creation and/or use of the organization, and whether this authority exists; and (6) the degree of financial autonomy of the entity and the source of its operating expenses.

Applying the criteria of Rev. Rul. 57-128 to the facts as represented, we conclude that the Corporation is an instrumentality of the State for purposes of § 141. The Corporation performs a governmental function on behalf of the State since it was specifically created under state statute to acquire or convey on behalf of the State projects of statewide as well as local importance and to issue bonds on behalf of the State to finance projects of statewide as well as local importance. Control and supervision of the Corporation is vested in a public authority. The members of the Board of Directors of the Corporation are appointed by the Governor and confirmed by the State Senate. No part of the funds of the Corporation may inure to the benefit of any private person. Upon dissolution, all assets of the Corporation will be disposed of exclusively to the State or an instrumentality thereof for a public purpose. Private individuals are prohibited from receiving any of the Corporation's assets upon dissolution. In addition, upon receipt of this letter, the Corporation will amend its bylaws to provide that (1) upon the request of the Governor, Board members shall resign, (2) the Corporation shall obtain the approval of the Authority for the adoption of any annual or long-term capital and operational budget or for any expenditures in excess of such annual or long term capital and operational budgets, and (3) the Authority shall have a right to demand an audit of the books and records of the Corporation annually or at any time, and a copy of such audit will be provided to the Authority.

Conclusions

The Corporation's income is excludable from gross income under § 115(1).

The Corporation satisfies Rev. Rul. 57-187. Accordingly, we conclude that Corporation qualifies as an "on behalf of" issuer for purposes of § 1.103-1(b).

The Corporation satisfies Rev. Rul. 57-128. Accordingly, we conclude that the Corporation is an instrumentality of the State. The trade or business of an instrumentality is that of the governmental unit for which it acts. Thus, the trade or business of the Corporation is that of a governmental unit and is, therefore, not private business use within the meaning of § 141(b).

No implication should be drawn from the above discussion or conclusions that Rev. Rul. 57-128 applies for purposes of § 115.

Except as specifically ruled above, no opinion is expressed concerning this transaction under any provision of the Code or regulations thereunder. Specifically, no opinion is expressed concerning whether interest on the Bonds will be excludable from gross income under § 103(a). Neither is any opinion expressed on the effect of any subsequent action or event that is inconsistent with the facts and representations stated herein. The taxpayer may rely upon this ruling only so long as the above referenced amendments to the bylaws of the Authority and the Corporation are made and remain in effect.

This ruling is addressed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,
Assistant Chief Counsel
(Financial Institutions & Products)
By: Timothy L. Jones
Assistant to the Chief, Branch 5

Enclosure:
Copy for § 6110 purposes