

**Internal Revenue Service**

Department of the Treasury

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**LEGEND:**

Authority =

Date 1 =

State A =

State B =

State C =

State D =

E =

F =

G =

H =

W =

\$X =

\$Y =

\$Z =

Dear Sir or Madam:

This is in response to your ruling request submitted on behalf of Authority, concerning the status of Authority for purposes of § 141 of the Internal Revenue Code of 1986. On Date 1 we issued a ruling that the Authority is a wholly owned instrumentality of the Members (as defined below) for purposes of §§ 141, 3121(b)(7) and 3306(c)(7). You have requested a ruling that, for purposes of § 141, Authority remains an “instrumentality” of its governmental members.

**FACTS:**

Authority was formed by E, F, and G as a nonprofit corporation organized under the provisions of the not-for-profit corporation law of State A. The current members of Authority are E, F, G, and H (collectively referred to as “the Members”). E is a body corporate and politic organized and existing under the laws of State B and is an agency of State B. F is a body corporate and politic organized under the laws of State C and is an agency of a City of State C. G is a body corporate and politic organized and existing under the laws of State A and is an instrumentality of State A. H is a public corporation organized and existing under the laws of State D. For federal income tax purposes, you represent that E, F, G, and H are political subdivisions of their respective states. E, F, G, and H each have outstanding obligations the interest on which is excluded from gross income under § 103.

Authority is a nonprofit corporation whose purpose is to coordinate the operation of electric generation resources (including the purchase of natural gas) and the purchase and sale of electric power on behalf of its Members. Membership in Authority is expressly limited to political subdivisions and governmental instrumentalities. Authority was formed to perform the functions and to carry out the purposes of each of its Members. If any Member ceases to be a political subdivision, the entity will no longer be a member of the Authority and will have no rights to any distributions or assets of the Authority.

Authority is governed by a board of directors. Persons serving on the board of directors are required to be officers or employees of the Member which appointed such person. Members are divided into “Class A Members” and “Class B Members.” Class A Members have at least W megawatts of generation and purchased power capacity. Current Class A Members are E, F, G, and H. Members with less than W megawatts of generation and purchased power capacity will be Class B Members. Presently there are no Class B Members. Each Class A Member appoints three directors and each Class B Member appoints one director. Each Member has the power to remove (with or without cause) any of the directors that it appointed. A removed director’s successor is appointed by the Member that removed the director to serve the unexpected term. Except as otherwise provided in its bylaws, the act of two-thirds ( $\frac{2}{3}$ ) of directors present at a meeting, at which a quorum is present, is an act of the board of directors.

The bylaws of the Authority specify that certain actions of Authority require the

unanimous approval of Class A Members and two-thirds ( $\frac{2}{3}$ ) approval of all Members. Examples of actions of the Authority that require this approval include: dissolution of Authority and admission of new members; approval, amendment, or supplementation of Authority's annual budget or strategic plan; employment of Authority's president and election of the chairman; amendment of Authority's bylaws; approval of Authority entering into resource management or marketing contracts with nongovernmental persons; modification of Authority's risk management policies; and, transfer of any assets of the Authority (other than in the ordinary course of business).

Authority expects to effectuate its purposes by providing the following services: purchasing surplus electricity or electric capacity (collectively, "Electricity") from one or more of its Members for sale to one or more of its Members; purchasing Electricity from one or more third parties for sale to one or more of its Members; purchasing Electricity from one or more of its Members for sale to one or more third parties; purchasing and selling options and futures contracts to enable Members to hedge their risk of adverse price exposure; and, purchasing Electricity from one or more third parties for sale to one or more third parties ("third party transactions"). Third party transactions also include resource management agreements and resource marketing agreements. Authority enters into third party transactions to increase reliability and reduce risk to its Members, to obtain market discovery, to maintain credibility as a willing market participant, and to assist other political subdivisions.

Authority is funded as follows: each Class A Member has contributed \$X, made further capital contributions not to exceed \$Y for operation and maintenance of Authority, and agreed to provide an additional \$Z of collateral in order to bolster the Authority's creditworthiness. Class B Members make the same type of financial contribution as Class A members, but at one-third ( $\frac{1}{3}$ ) the amount. Authority can not conduct business without the financial commitment made by Members in the form of capital contributions and guarantees.

The Authority submits detailed monthly, quarterly, and annual financial reports to the Members and maintains separate accounts for each Member. In addition, Authority's independent certified public accountant provides each Member certified financial statements showing the assets, liabilities, properties, net worth, profits, losses, and income for each fiscal year. Each Member also has the right to conduct, at its own expense, internal audits of the books, records, and accounts of Authority. Authority's articles of incorporation provide that no part of the net earnings of Authority will be paid or inure to the benefit of any private person. The expenses of Authority are allocated among the Members in an equitable manner. Authority regularly distributes all of its income to its Members (other than amounts required for working capital). In the event of dissolution, any assets remaining after Authority satisfies its obligations will be distributed ratably to its Members.

### **Law and Analysis:**

Under § 103(a) gross income does not include interest on any State or local bond. Section 103(b)(1), however, provides that the exclusion under § 103(a) does not apply to any private activity bond unless it is a qualified bond under § 141(e). A bond is

a private activity bond if the bond satisfies the private business tests set forth in § 141(b). Under §1.141-1(b) of the Income Tax Regulations, a governmental person includes instrumentalities of states or political subdivisions.

Rev. Rul. 57-128, 1957-1 C.B. 311, involves a voluntary unincorporated organization formed by the heads of insurance departments of several states to promote uniformity in insurance legislation and rulings, to disseminate information to insurance supervisory officials, and to protect the interests of insurance policyholders. No part of the net profits of the organization inures to the benefit of any private individual. In concluding that the organization is an instrumentality wholly owned by one or more states or political subdivisions, the revenue ruling sets forth the following factors that are taken into consideration:

1. Whether it is used for a governmental purpose and performs a government 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 or supervision of the organization is vested in public authority or authorities;
5. If express or implied statutory, or other authority is necessary for the creation and/or use of such instrumentality, and whether such authority exists; and
6. The degree of financial autonomy and the source of its operating expenses.

Authority was formed and continues to be used to coordinate the operation of electric generation resources and the purchase and sale of electric power on behalf of its Members, all political subdivisions or governmental instrumentalities. Authority's sales and purchase of options and futures contracts and its third party transactions are used to hedge the market risk of its Members. Authority effectively performs the functions that each Member would otherwise have to perform. There is no proprietary interest in Authority other than that of the Members who receive the assets of Authority in the event of its dissolution. Control of Authority vests in the Members through the selection of (and the power to remove) the directors who govern Authority and through financial control over the Authority.

## **CONCLUSION:**

Accordingly, based on the above factors, we conclude that Authority is a wholly owned instrumentality of its Members for purposes of § 141.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be cited as precedent. More specifically, concluding that the

Authority is a wholly owned instrumentality of its Members for purposes of § 141, is not precedent for purposes of § 115. No ruling has been requested and no conclusion is implied for purposes of §§ 115, 3121(b)(7) and 3306(c)(7).

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