

Internal Revenue Service

Department of the Treasury

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Washington, D.C.

Person to Contact:

Telephone Number:

Refer Reply to:
CC:TE/GE:EO2 - PLR-107596-02

Date:
September 13, 2002

LEGEND

Authority =

State A =

Dear

This is in reply to a letter dated January 24, 2002, requesting a ruling that the income of Authority is an instrumentality for purposes of § 141 of the Internal Revenue Code..

FACTS

Authority is a corporation organized under the not-for-profit corporation law of State A. Its purpose is to facilitate cost savings and improve the operations of the utility businesses operated by its members. Authority expects to reduce the cost of supplies, inventory and services used by its members by aggregating their purchasing power. Currently, Authority has four members. Each member is a producer of electric power. The taxpayer represents that each of the current members is a political subdivision of a different state.

Authority is governed by a board of directors appointed by the members. Each member appoints one director and has the power to remove at any time, with or without cause, the director it appoints. A director must be an officer or employee of the appointing member.

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Generally, Authority performs activities for its members which the members have historically performed for themselves. It enters into contracts to purchase supplies and services from third parties. In addition, it is developing a master inventory of all parts that each member has available for use by the other members. Some of the inventoried parts are, or will be, engineered and constructed with the proceeds of tax-exempt bonds. Each new member will be assessed an appropriate capital contribution. Each member will also make annual contributions to Authority based on Authority's operating budget as determined by its board. Authority must provide each member with a balance sheet and profit and loss statement at the end of each month. It must further provide each member with the results of an audit conducted by an independent CPA at the end of each fiscal year. Each member also has the right to conduct internal audits of the books, records, and accounts of Authority. No less frequently than annually, distributions shall be made by Authority to its members to the extent funds are available after a reasonable amount is retained for operating purposes. Authority's articles of incorporation provide that no part of its net earnings or other funds will inure to the benefit of any private person. In the event of dissolution, any assets of Authority remaining after it satisfies its obligations will be distributed to its members.

LAW AND ANALYSIS

Section 103(a) of the Internal Revenue Code 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 obligations issued by or on behalf of any governmental unit by a constituted authority empowered to issue such obligations are the obligations 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 test.

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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.

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.

“Governmental person” is defined in § 1.141-1(b) as a “state or local governmental unit as defined in § 1.103-1 or any instrumentality thereof.” Under § 1.103-1 “governmental unit” includes any state or political subdivision thereof. Accordingly, we conclude that if Authority is an instrumentality of its members, each of which is a political subdivision of a state, Authority is also an instrumentality and thus a governmental person for purposes of § 141.

Applying the criteria of Rev. Rul. 57-128 to the facts as represented, we conclude that Authority is an instrumentality of the member utilities for purposes of § 141. Authority both facilitates the member cost savings and revenue retention, and enhances the operation and maintenance of the utility businesses owned or operated by the member. By providing these functions, Authority enables the member utilities to better serve their customers. Authority is thus used for a governmental purpose and performs a governmental function. Control and supervision of Authority is vested in the members. All of the members of the board of directors of Authority are appointed by the members, with each member appointing one director. Each member may remove the director it appointed, at any time, with or without cause. No part of the funds of Authority may inure to the benefit of any private person. Upon dissolution, all assets of Authority will be distributed exclusively to the members. Private individuals are prohibited from receiving any of Authority’s assets upon dissolution. Authority must provide each member with a balance sheet and profit and loss statement at the end of each month and must provide each member with the results of an audit conducted by an independent CPA at the end of each fiscal year. Each member also has the right to conduct internal audits of the books, records, and accounts of Authority. Each member will make annual contributions to Authority based on Authority’s operating budget as

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determined by the board.

Authority satisfies Rev. Rul. 57-128. Accordingly, we conclude that Authority is an instrumentality of the member. The trade or business of an instrumentality is that of the governmental units for which it acts. Thus, the trade or business of Authority is that of a governmental unit and is, therefore, not private business use within the meaning of § 141(b). However, this ruling applies only so long as each of the members is a political subdivision of a state.

CONCLUSION

Authority is an instrumentality for purposes of § 141 and its trade or business is not private business use within the meaning of § 141(b).

Except as specifically provided otherwise, no opinion is expressed on the federal tax consequences of any particular transaction.

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

In accordance with a Power of Attorney on file, we are sending a copy of this letter to your representative.

Sincerely,

Elizabeth Purcell, Chief
Exempt Organizations
Branch 2
Division Counsel/Associate
Chief Counsel
(Tax Exempt and Government
Entities)

Enclosures;
Copy of this letter
Copy for § 6110 purposes

CC: