

**Internal Revenue Service**

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Date:  
March 31, 2006

LEGEND:

Authority =

State =

Dear :

This responds to your request for rulings, submitted by your authorized representative on behalf of Authority, that: (1) Authority qualifies as a political subdivision of State for purposes of § 103 of the Internal Revenue Code (the "Code"), and (2) bonds to be issued by a subsidiary of Authority will be considered issued on behalf of Authority under § 103.

**Facts and Representations**

You make the following factual representations. Authority was created pursuant to State legislation as a body corporate and politic constituting a public corporation of State. Authority was created for the purpose of conserving, developing, and utilizing the water and energy resources of State to make the benefit of those resources available to State residents, and thereby to promote the general welfare and increase commerce. To achieve these objectives, Authority produces, transmits, and generates electricity in State.

The governing body of Authority (the "Authority Board") has nine members. One member of the Authority Board, serving ex-officio, is the Secretary of Transportation and Public Works of State, six members are appointed by the Governor of State, and two members are consumer representatives elected through a referendum supervised by State's Department of Consumer Affairs. Authority is required to submit annually to the

State Legislature and Governor a financial statement and complete report of its business activities.

Authority is authorized under State law to acquire property by exercise of the power of eminent domain. Other than the procedural safeguards generally addressing matters such as due process, proper venue for the institution of condemnation proceedings, and just compensation, there are no limitations on Authority's power of eminent domain. Authority may initiate eminent domain actions in its own name.

Authority is also authorized under State law to create and own subsidiaries and affiliates for the purposes, among others, of developing, financing, constructing, and operating industrial projects and other infrastructures directly related to the maximization of Authority's electric infrastructure. Authority plans to create a subsidiary (the "Subsidiary") for these purposes. Debt service on any bonds issued by Subsidiary will be payable solely out of revenues and receipts from the operation of Subsidiary.

Authority will adopt a resolution (the "Authority Resolution") creating Subsidiary as a non-profit corporation or single member limited liability company and approving its formation documents. Under the formation documents, the board of directors of Subsidiary will be appointed by the Authority Board and will serve without compensation. The formation documents will provide that no part of the net earnings of Subsidiary will inure to the benefit of any private person. Further, upon dissolution of Subsidiary, the formation documents will provide that Authority or State will acquire title to all property owned by Subsidiary.

You represent that Subsidiary will be exempt from State income taxation and interest on bonds issued by Subsidiary will be exempt from State taxes.

## **Law and Analysis**

### **Political Subdivision**

The Internal Revenue Code does not define the term "political subdivision." Section 1.103-1(b) of the Income Tax Regulations provides that the term "political subdivision" denotes any division of any state or local governmental unit that is a municipal corporation or that has been delegated the right to exercise part of the sovereign power of the unit. As thus defined, a political subdivision of any state or local governmental unit may or may not, for purposes of this section, include special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts and divisions of these units.

Three generally acknowledged sovereign powers of states are the power to tax, the power of eminent domain, and the police power. Commissioner v. Estate of Alexander

V. Shamberg, 3 T.C. 131 (1944), acq., 1945 C.B. 6, aff'd, 144 F.2d 998 (2d Cir. 1944), cert denied, 323 U.S. 792 (1945). It is not necessary that all three of these powers be delegated in order to treat an entity as a political subdivision for purposes of the Code. However, possession of only an insubstantial amount of any or all of the sovereign powers is not sufficient. All of the facts and circumstances must be taken into consideration, including the public purposes of the entity and its control by a government. Rev. Rul. 77-164, 1977-1 C.B. 20.

Consideration of these principles as they apply to the facts of this case, leads us to conclude that Authority is a political subdivision of State for purposes of § 1.103-1(b). Authority was created pursuant to State legislation and is controlled by State. Of the Authority Board's nine members, one is the Secretary of Transportation and Public Works of State, six members are appointed by the Governor of State, and two members are consumer representatives elected through a referendum supervised by State's Department of Consumer Affairs. Authority is also required to submit annually to State a financial statement and complete report of its business activities.

Authority's purpose of conserving, developing, and utilizing the water and energy resources of State to make the benefit of those resources available to State residents is a wholly public purpose.

Under State law, Authority is granted powers of eminent domain to carry out authorized purposes. Other than certain procedural safeguards, Authority may initiate eminent domain actions in its own name without limitation.

#### On Behalf of Issuer

Section 103(a) provides that gross income does not include interest on any state or local bond.

Section 1.103-1(a) provides, in part, 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 government unit") is not includable in gross income.

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.

Revenue Ruling 57-187, 1957-1 C.B. 65, holds that bonds issued by an industrial development board formed under a state statute (the "entity") are considered issued on behalf of a political subdivision of the state where the following conditions are present: (1) the entity is formed only after the governing body of the political subdivision has formally approved the entity's creation and the form of certificate of incorporation; (2) a

board of directors of the entity is elected by the governing body of the political subdivision and serves without compensation; (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 find such action to be in furtherance of the purposes for which the entity is established; (4) all bonds are payable solely out of revenues and receipts derived from the leasing or sale by the entity of its projects; (5) the political subdivision is not liable for the payment of principal or interest on any of the bonds of the entity; (6) the entity is exempt from all state taxation, and interest on bonds issued by the entity is exempt from state taxes; (7) the entity is a nonprofit organization and none of its net earnings may inure to the benefit of any private person; and (8) 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, we conclude that Subsidiary will qualify as an "on behalf of" issuer for purposes of § 1.103-1(b). Subsidiary will be created by the Authority, a political subdivision, pursuant to State law that specifically provides for its creation. The board of directors of Subsidiary will be appointed by the Authority Board and will serve without compensation. As specifically permitted under State law, Subsidiary will have the power to issue bonds to finance its projects. Debt service on Subsidiary's bonds will be payable solely out of revenues and receipts derived by Subsidiary from its operation. Subsidiary will be exempt from State income taxation and interest on bonds issued by Subsidiary will be exempt from State taxes. Subsidiary will be a nonprofit corporation or single member limited liability company, and no part of the net earnings of Subsidiary will inure to the benefit of any private person. Upon dissolution of Subsidiary, Authority or State will acquire title to all property owned by Subsidiary.

### **Conclusions**

Based on the information submitted and representations made, we conclude that: (1) Authority is a political subdivision of State for purposes of § 103 since Authority has been delegated the right to exercise sovereign power and is also controlled by State and is motivated by a wholly public purpose; and (2) bonds to be issued by Subsidiary will be considered as issued on behalf of Authority for purposes of § 103.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any transaction or item discussed or referenced in this letter.

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

In accordance with a Power of Attorney on file with this office, a copy of this letter is being sent to Authority's authorized representative.

The ruling contained in this letter is based upon information and representations submitted by Authority and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the materials submitted in support of the request for a ruling, it is subject to verification upon examination.

Sincerely,

Assistant Chief Counsel  
(Exempt Organizations/Employment  
Taxes/Government Entities)

By: Johanna Som de Cerff  
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