

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200736022**
Release Date: 9/7/2007

[Third Party Communication:
Date of Communication: Month DD, YYYY]

Index Number: 115.00-00, 170.00-00

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:TEGE:EO2
PLR-157717-06

Date:
May 16, 2007

LEGEND

Fund =

Corporation =

City =

Act

State =

Dear :

This is in reply to your letter of December 1, 2006, requesting rulings that the income of Fund is excludable from gross income under section 115 of the Internal Revenue Code, and that contributions to Fund are deductible by donors under section 170 of the Code.

FACTS

Corporation is a municipal authority established by City. It was incorporated as a nonprofit corporation pursuant to Act for the purpose of promoting industry and developing trade in City. To accomplish this purpose Corporation is empowered by Act to acquire, enlarge, improve, expand, own, lease and dispose of properties, promote industry and develop trade by encouraging manufacturing, industrial, commercial and research enterprises to locate in State or to enlarge and expand existing enterprises, or both, and further the use of the agricultural products and natural resources of State. Corporation is governed by a board of seven directors. The directors are elected by the governing body of City. Subject to certain restrictions, the seven directors are chosen from the membership of the Chamber of Commerce of City. City proposes to amend the bylaws of Corporation to provide that the governing body of City has the power to remove a director, with or without cause. Corporation receives only very limited financial support from City. Pursuant to Act Corporation has the power to issue bonds for the purpose of carrying out development projects. Corporation receives income from bond proceeds, the lease or sale of any of its economic development projects and investment income. Corporation is a nonprofit corporation and no part of its net earnings remaining after the payment of its expenses shall inure to the benefit of any individual, firm or corporation. Upon the dissolution of Corporation by its board, title to all funds and properties owned by it at the time of the dissolution will vest in City. City is a political subdivision of State.

Act specifically authorizes Corporation to create an endowment trust fund for the purpose of receiving private contributions to be used by Corporation for its development projects. This increased funding will allow Corporation to increase its economic development activities. The charter document for Fund is a trust agreement entered into between Corporation and a trustee selected by Corporation. The Fund's trust agreement provides that the principal and income in Fund may only be used to attract new industry to City and to promote the expansion of enterprises already located in City. Fund's investment program is supervised by an investment committee appointed by the board of Corporation. The fund manager is also appointed by Corporation. Pursuant to Act, the fund manager reports no less than every six months to the board of Corporation and to the investment committee of Fund. Corporation proposes to amend the Fund's trust agreement to provide that the board of Corporation can remove a member of Fund's investment committee at any time with or without cause. Fund's trust agreement also provides that the board of Corporation can revoke or amend the trust agreement or terminate Fund at any time. Upon termination of Fund any funds or other assets held by Fund revert to Corporation.

LAW AND ANALYSIS

Section 115

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

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling 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 projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign properly to conduct. In addition, pursuant to section 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

By encouraging the development of local businesses, Corporation contributes to the economic development of City. Further, by increasing the level of funding available to Corporation for its economic development activities Fund also contributes to the economic development of City. Stimulating economic development is an essential governmental function for purposes of section 115.

The income of Fund is to be used solely to promote the economic development of City. No part of Fund's income will be distributed to a private party other than as payment for goods or reasonable compensation for services rendered. Upon dissolution, Fund's assets will be distributed to Corporation. Upon the dissolution of Corporation, its assets will be distributed to City. In no case will the assets of Fund be distributed to an entity that is not either a state, a political subdivision of state or an entity the income of which is excluded from gross income under § 115(1) of the Code.

Based on the information and representations submitted and provided that the proposed amendments described above are made to Fund's trust agreement and

Corporation's bylaws, we hold that the income of Fund is derived from an essential governmental function and accrues to a state, a political subdivision of a state or to an entity the income of which is excludible from gross income under § 115 of the Code.

Section 170

Section 170(a)(1) provides, subject to certain limitations, a deduction for any charitable contribution, as defined in § 170(c), payment of which is made within the taxable year.

Section 170(c)(1) provides that the term "charitable contribution" includes a contribution or a gift to or for the use of a State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

Rev. Rul. 75-359, 1975-2 C.B. 79, holds that contributions and gifts to a wholly-owned instrumentality of a political subdivision, formed and operated exclusively for public purposes, are deductible contributions "for the use of" political subdivisions, to the extent allowed under § 170. Under Rev. Rul. 75-359, the criteria for identifying wholly-owned instrumentalities of states or political subdivisions are set forth in Rev. Rul. 57-128, 1957-1 C.B. 311.

Rev. Rul. 57-128 provides that the following factors are considered in determining whether an entity is an instrumentality of a state or political subdivision: (1) whether it 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 public authority or authorities; (5) if express or implied statutory or other authority is necessary for the creation and/or use of such an instrumentality, and whether such authority exists; and (6) the degree of financial autonomy and the source of its operating expenses.

Fund is used for a governmental purpose and performs a governmental function by supporting and furthering the purposes and functions of Corporation. Corporation's governmental function, in turn, is to promote industry, develop trade, and further the use of the agricultural products and natural and human resources of City and State. Fund will receive and use contributions from private sources on behalf of Corporation and, through Corporation, City, a political subdivision of State.

Assets of Fund may be used only to induce new businesses to locate in City and its environs and to foster the prosperity of existing businesses. Such uses are declared to be for a public purpose by Act. Upon dissolution of Fund, its assets will be transferred to Corporation. Any net earnings of Fund may be transferred by Corporation only to City. In addition, no part of Corporation's net earnings may inure to the benefit

of any individual, firm, or corporation. Corporation's net earnings are paid over to City. Upon dissolution of Corporation, all assets will be transferred to City. Thus, City has powers and interests of an owner of Corporation and, through Corporation, Fund. Any private benefit inured from Corporation's activities, including the uses of Fund, is occasioned through the general purpose of Corporation to promote business activity in City.

Fund is governed by an investment committee, which is elected by Corporation's governing body, with two members of the investment committee being members of Corporation's governing body. Upon amendment of Fund's trust agreement, Corporation will have the power to remove, with or without cause, at any time any member of the investment committee. In addition, the Fund manager must, at least every six months, report on every investment of Fund to the investment committee and Corporation's governing body. In turn, City elects Corporation's governing body and, upon amendment of Corporation's by-laws, will have the power to remove, with or without cause, at any time any member of Corporation's governing body. Thus, City will have control and supervision of Corporation and, through Corporation, control and supervision of Fund.

Express authority for the establishment of Fund and Corporation is contained in Act. Although Corporation is financially autonomous, City will retain substantial control and supervision of Corporation and Fund through its power to elect, and remove, with or without cause, at any time, any member of Corporation's governing body.

Accordingly, (1) Corporation will be an instrumentality of City, provided that Corporation amends its by-laws so as to provide that City may remove, with or without cause, at any time any member of Corporation's governing body, and (2) Fund will be an instrumentality of City by virtue of it being controlled by Corporation, and indirectly controlled by City, provided that Corporation amends Fund's trust agreement so as to provide that Corporation may remove, with or without cause, at any time any member of the Fund's investment committee, as of the effective date of such duly adopted amendments.

CONCLUSIONS

1. The income of Fund is excludible from gross income under § 115(1) of the Code.
2. Fund is an instrumentality for purposes of § 170(c)(1). Fund is eligible to receive deductible contributions or gifts made for exclusively public purposes to the extent allowed under § 170 of the Code.

This ruling letter is effective as of the date the proposed amendments to Fund's trust agreement and Corporation's by-laws described above are adopted.

Except as specifically provided otherwise, no opinion is expressed on the federal tax consequences of the arrangement described above under any other provision of the Code.

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 the power of attorney on file with this office, we are sending a copy of the letter to your authorized representative.

Sincerely,

David L. Marshall
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: