



excluded from gross income under Section 115(1) after it modifies its business operations by expanding the number of longshoremen it hires directly, rather than through outside entities.

Taxpayer's purpose is to benefit Authority in fulfilling its statutory objectives of, in part, increasing commerce, operating and maintaining ports, port facilities, and providing services. To this end, Taxpayer carries out some of Authority's responsibilities, including operation of terminals in a manner that is efficient and competitive with other marine terminal facilities. Taxpayer's stated purpose in its articles of incorporation is to foster the development of commerce in State ports.

Taxpayer is governed by a Board of Directors consisting of seven members who are appointed by Authority. The executive director of Authority, ex officio, is a permanent member of Board. Any director may be removed, with or without cause, at any time by Authority. An executive committee, which includes the directory of Authority, is authorized to exercise all the powers of the board and to carry on the business of Taxpayer when Board is not in session. Taxpayer's articles of incorporation provide that no part of the net earnings of Taxpayer may inure to the benefit of or be distributed to its directors, officers, or other private persons. Upon dissolution of Taxpayer, its net assets will be distributed to Authority pursuant to Statute of State.

Cargo handling by longshoremen in State involves two classifications of workers: (1) direct hires who work directly for Taxpayer; and (2) indirect hires who work for stevedoring companies. Direct hire employees provide shore-side labor for steamship lines such as loading and unloading cargo from ships and using expensive equipment. Indirect hire employees provide shipside services after the containers and other cargo have been loaded or unloaded by direct hire employees. The division of labor has existed since Taxpayer's inception because of a historical reluctance by the stevedoring companies to operate Authority's expensive equipment.

Steamships wanting to load and unload cargo at State's ports must contract with both Taxpayer and stevedoring companies. Because Taxpayer does not control the cost of services provided by the stevedoring companies, Taxpayer has no control over the total cost of handling cargo at State ports. As such, Taxpayer cannot assure that the rates for services at State's ports are competitive and foster Authority's mission. Other ports which hire shipside longshoremen directly, rather than through stevedoring companies, offer one bundled rate for facilities and services. In order to offer a bundled rate, Taxpayer proposes to increase its hiring of shipside longshoremen directly, rather than through indirect hires. At the same time, shipping lines that wish to continue contracting for shipside labor with stevedoring companies will be free to do so. Other than the increase in direct hire employees, Taxpayer proposes no other changes in its activities.

LAW AND ANALYSIS

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

In Rev. Rul. 77-261, 1977-2 C.B. 45, 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, is excludable from gross income under section 115. The ruling explains that the investment of positive cash balances by a state or political subdivision thereof in order to receive yield on the funds until needed to meet expenses is a necessary incident of the power of the state or political subdivision to collect taxes or other revenue for use in meeting governmental expenses. In addition, the ruling also provides that because the state and its participating political subdivisions have an unrestricted right to their proportionate share of the investment fund's income, the fund's income accrues to them within the meaning of section 115(1). Rev. Rul. 77-261 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 those projects desirable from the standpoint of the state government which, on a broad consideration of the question, may be the function of the sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that income of an organization formed, operated and funded by political subdivisions of a state to pool their casualty risks is excluded from gross income under section 115(1). The ruling also holds that income of such an organization formed to pool risks in lieu of purchasing insurance to cover their public liability, workers' compensation, or employees' health obligations is excluded under section 115(1) if private interests do not, except for incidental benefits to employees of the participating state and political subdivisions, participate in or benefit from the organizations.

The Service previously concluded in PLR 8347094 that Taxpayer's income is excluded from gross income under section 115 of the Code. The Service based its conclusion on the fact that Authority, a political subdivision, has substantial control over the operation of the terminal facilities by Taxpayer, the establishment of fees and charges for use of the facilities, and the amounts that Taxpayer may expend from the revenue derived from the facilities; staff members of Authority and security personnel provided by Authority are involved in the operation of the facilities by Taxpayer; Authority has the right to receive Taxpayer's monthly income; and, upon dissolution of Taxpayer, its net assets will be distributed to Authority.

Taxpayer's current proposal to increase the number of direct hire employees so that it may offer a bundled rate to clients, and thereby remain competitive with other ports, conforms with Taxpayer's purpose to benefit Authority in fulfilling its statutory objectives of, in part, increasing commerce, operating and maintaining ports, port facilities, and providing services.

**RULINGS**

Based on the information and representations submitted, we hold that the income of Taxpayer is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for the purposes of §115(1). Accordingly, Taxpayer's income is excludable from gross income under §115(1) of the Code.

Except as otherwise specifically provided, 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 representatives.

Sincerely,

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SYLVIA F. HUNT  
Assistant 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: