

Internal Revenue Service

Number: **201114010**
Release Date: 4/8/2011

Index Number: 103.00-00, 103.02-00,
103.02-01, 150.00-00,
150.01-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:FIP:BR5
PLR-132892-10

Date:
December 10, 2010

LEGEND:

Department =

Trustees =

Authority =

City =

District =

State =

County =

System =

a =

b =

c =

d =

Dear _____ :

This responds to Department's request for rulings that (1) Authority qualifies as a political subdivision for purposes of § 103 of the Internal Revenue Code (the "Code"), and (2) Authority is not a "related party" to either City or District under § 1.150-1(b) of the Income Tax Regulations.

Facts and Representations

You make the following factual representations. Department, a political subdivision, was created over a years ago by the State legislature pursuant to State statute as an independent department of City free from political influence from the Mayor of City or the City-County Council. Department is a broad-based utility that serves more than b customers and manages a growing utility services business. Exclusive management and control of Department is vested in its c-member board of directors (the "Department Board").

Members of the Department Board must be residents of City and are appointed annually by the Trustees, a d-member board of trustees with no oversight by City. The initial Trustees were appointed by the City Mayor, the City-County Council, and the County Circuit Court judge with varying initial terms. Thereafter, the Trustees have served staggered terms of four years. Upon expiration of a Trustee's term (or if a Trustee dies, resigns, becomes a nonresident of City or is otherwise removed), the remaining Trustees nominate a successor, who is appointed by the City Mayor within 10 days. A Trustee may be removed from office only for cause, and only by an order and judgment following the filing of a complaint by City in the local circuit or superior courts. The Trustees may remove summarily and at any time any member of the Department Board. City has no power to remove a member of the Department Board.

Department Board is granted the power to adopt rules for service and rates for service in connection with the furnishing of service to its customers, subject to State approval. Department Board has exclusive authority over expenditure of its funds. While Department Board is required to make certain accounting and other reports to the City controller, the books, accounts, records and transactions of Department and of

Department Board are only subject to examination, audit, and supervision by the State Board of Accounts to the same extent as other municipal governments or departments of municipal governments.

Department is granted the power of eminent domain by State statute. Department may act to condemn and hold any real estate within the City or within five miles of the corporate limits of the City needed for the proper giving of service. There are no conditions or restrictions on Department's exercise of its power of eminent domain other than those imposed on all government entities exercising eminent domain in State. Department is not required to seek approval from or act through City or State to exercise its power of eminent domain. Title to any property so acquired remains with Department.

Department is also granted by State statute the power to levy a special tax upon all property within the corporate limits of City for the purpose of raising money to pay the principal of and interest accruing on bonds issued by Department.

Department has exclusive authority under State statute to issue utility district bonds in the name of City, and may issue such bonds without City's authorization. These bonds are an indebtedness of Department as a special taxing district and are not an obligation or indebtedness of City.

City and District own and operate the System. District was established under City's municipal code. City has the power to appoint and remove the members of District's board of directors.

District has financed a portion of the System with revenue bonds (the "District Bonds") which were authorized by resolution of City and were issued by the District in the name of the City. The District Bonds are payable from the revenues of the operation of the System.

Department, City, and District have entered into an agreement (the "Agreement") pursuant to State's interlocal cooperation statute, to form Authority, a non-profit corporation, to acquire and operate the System. The Agreement provides that Authority will possess all of the "appropriate and requisite authorizations, powers, functions and duties" of the three creating entities to allow it to administer and operate the System. City and District will vest in Authority all of their respective powers and authority related to the operation of the System (other than their powers of taxation). Department will transfer all of its relevant powers to Authority, including its eminent domain, taxing, and regulatory powers, and the Department Board is charged under the Agreement to use such powers as the board of directors of Authority. Authority will be authorized to exercise eminent domain powers on its own, without Department's approval.

While Authority will own the System as a separate entity, the Agreement requires that Authority be wholly controlled by, and the System solely operated by, Department. The Department Board will serve as the board of directors of Authority and will have responsibility for Authority's budget. Department's treasurer is responsible to receive, disburse, and account for all monies of Authority which are required to be segregated from those of any other utility. Upon dissolution of Authority and after all liabilities of Authority have been paid, all assets of Authority will be distributed to Department or such other entity as Department shall determine to be operating for the benefit of the inhabitants of City.

After Authority was created, and the Department (and Authority) Board adopted an approving resolution, Department and Authority entered into an asset purchase agreement (the "Purchase Agreement") with City and District for the acquisition of the System assets to be held by Authority. Authority will issue bonds (the "Authority Bonds") to pay at least a portion of the purchase price.

Law and Analysis

Political Subdivision

Section 103(a) provides generally 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, 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 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 of 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 for purposes of § 1.103-1(b). Authority will be wholly controlled by Department, a political subdivision. The Department Board will serve as the board of directors of Authority. Department is responsible for receiving, disbursing, and accounting for all monies of Authority. Upon dissolution of Authority all remaining assets of Authority will be distributed to Department or such other entity operating for the benefit of the inhabitants of City as Department shall designate.

Department will transfer its powers to Authority, including its eminent domain, taxing, and regulatory powers, and the Department Board is charged under the Agreement to use such powers as the board of directors of Authority. Department's power of eminent domain allows it to condemn and hold any real estate within the City or within five miles of the corporate limits of the City needed for the proper giving of service. Department is not required to seek approval from or act through City or State to exercise its power of eminent domain. Authority will be authorized to exercise eminent domain powers on its own, without Department's approval.

Authority's purpose of operating the System is a wholly public purpose.

Related Party

Under § 1.150-1(a)(1), except as otherwise provided, the definitions in § 1.150-1 apply for all purposes of §§ 103 and 141 through 150. Section 1.150-1(b) provides, in part, that "related party" means, in reference to a governmental unit or a 501(c)(3) organization any member of the same controlled group.

A "controlled group" is defined in § 1.150-1(e) as a group of entities controlled directly or indirectly by the same entity or group of entities. Section 1.150-1(e)(1) provides that the determination of direct control is made on the basis of all the facts and circumstances. One entity or group of entities (the controlling entity) generally controls another entity or group of entities (the controlled entity) if the controlling entity possesses either of the following rights or powers and the rights or powers are discretionary and non-ministerial – (i) the right or power both to approve and to remove without cause a controlling portion of the governing body of the controlled entity; or (ii) the right or power to require the use of funds or assets of the controlled entity for any purpose of the controlling entity.

Section 1.150-1(e)(2) states that if a controlling entity controls a controlled entity under this test, then the controlling entity also controls all entities controlled, directly or indirectly, by the controlled entity or entities.

An entity is not a controlled entity under § 1.150-1(e)(3) if the entity possesses substantial taxing, eminent domain, and police powers. For example, a city possessing substantial amounts of each of these sovereign powers is not a controlled entity of the state.

The issue is whether Authority is related to City or District. Section 1.150-1(e)(3), which provides an entity is not a “controlled entity” if it possesses substantial taxing, eminent domain, and police powers, is not applicable in this case, because Authority does not possess substantial amounts of all three sovereign powers. Thus, in order to determine whether Authority is controlled by City or District under § 1.150-1(e), we must examine all the relevant facts and circumstances.

Authority has been created as a separate entity wholly controlled by and solely operated by Department. Department Board serves as Authority’s board of directors and is responsible for its budget. Neither City nor District has the power to appoint, remove, or to cause the removal of, a member of the Department Board. Neither City nor District has the power to appoint any Trustee. Trustees may be removed from office only for cause, and only by an order and judgment from a circuit or superior court. In addition, neither City nor District has control over Department Board’s ability to set rules and rates. Department Board is granted the power to adopt rules for service and rates for service, subject only to State approval. While Department Board is required to make certain accounting and other reports to the City controller, the books, accounts, records and transactions of Department and of Department Board are only subject to examination, audit, and supervision by the State Board of Accounts. Neither City nor District has the right to use the funds or assets of Department or Authority. Accordingly, based on all the relevant circumstances, neither Department nor Authority is controlled within the meaning of § 1.150-1(e) by either City or District. As neither City nor District controls Department or Authority, Authority is not a member of City’s or District’s controlled group. Therefore, Authority will not be a related party as described in § 1.150-1(b) to either City or District.

Conclusions

Based on the information submitted and representations made, we conclude that (1) Authority qualifies as a political subdivision for purposes of § 103, and (2) Authority is not a related party to either City or District under § 1.150-1(b).

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 the authorized representatives of Department.

The ruling contained in this letter is based upon information and representations submitted by Department 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,

Associate Chief Counsel
(Financial Institutions and Products)

By: Johanna Som de Cerff
Johanna Som de Cerff
Senior Technician Reviewer
Branch 5

cc: