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Date:  
January 27, 2026

Legend

Issuer =

Bonds =

State =

County =

Water Treatment Plant A =

Water Treatment Plant B =

Bond Resolution =

Act =

a =

b =

c =d =e =f =g =h =

Dear \_\_\_\_\_ :

This is in response to the request for a ruling submitted on behalf of Issuer that the use of the proceeds of the Bonds to finance the Project, as described below, will not cause the Bonds to meet the private business tests in § 141(b).

#### FACTS AND REPRESENTATIONS

Issuer was formed by State as a political subdivision to provide the County with safe, clean water for a healthy life, environment and economy. Issuer manages an integrated water resource system (the System) that includes the supply of clean and safe water, flood protection, stewardship of streams, and maintenance of the groundwater aquifer. Issuer manages groundwater basins, and owns, operates and manages dams, surface water reservoirs, and imports water from outside the boundaries of the County. In addition, Issuer operates a conventional water treatment plants, including Water Treatment Plant A and Water Treatment Plant B, and an advanced recycled water purification center, a water quality laboratory, groundwater recharge ponds, streams and related distribution facilities.

Issuer sells and distributes treated water from its water treatment plants at wholesale to b privately owned water utilities (Private Entities) and c governmentally owned water utilities (Governmental Entities) through Issuer owned pipelines. The Governmental Entities together with the Private Entities are collectively referred to herein as the Wholesale Customers. Issuer is a party to longstanding contracts (the Contracts) with Wholesale Customers whereby Issuer is to deliver the amount of treated water according to the approved delivery schedule for any given year. Every d years, Wholesale Customers submit to Issuer a proposed water delivery schedule for the following d years. Issuer may approve the schedule or make reductions, and it generally must approve a schedule for delivery for an amount of treated water for each fiscal year that is not less than e percent of the highest annual amount set forth in the then current d-year schedule. Generally, a Wholesale Customer agrees that it will never request an annual amount of water less than e percent of the fiscal year

containing the highest annual amount in the then current d-year schedule. The minimum payments to Issuer by the applicable party to the Contract are calculated based on the approved delivery schedule.

Issuer sells water under the Contracts at a price determined under a generally applicable rate scale. The price for the delivered water is based on a basic water charge, which is equal to Issuer's groundwater charge, plus a treated water surcharge. Together, such charges provide for recovery of Issuer's costs for operating its water resource system and providing treated water. In addition, the local land holders may pump water from the groundwater aquifer for which they pay according to an approved generally applicable rate scale. Such landholders have no arrangement with Issuer that conveys any priority rights or preferential benefits with respect to the groundwater. None of the Contracts require Issuer (directly or indirectly) to supply water output specifically from the Project, as described below, to any specific Wholesale Customer.

All the Governmental Entities are entities that have been delegated the right to exercise part of the sovereign power of the state or local governmental unit, are part of a larger governmental entity invested with some or all of such sovereign powers or are an instrumentality of an entity that has been delegated the right to exercise part of such sovereign power. All the Governmental Entities sell water directly to retail end-users, including natural persons not engaged in a trade or business. The Governmental Entities resell water to the retail end-users under a generally applicable rate scale and no retail customers of the Governmental Entities purchase water under an arrangement that conveys priority rights or other preferential benefits. The Governmental Entities in the aggregate receive a historic (within the last 10 years) average total of f and g acre-feet per year from Water Treatment Plants A and B, respectively.

Issuer plans to issue Bonds to finance an advanced water purifying facility (the Project). The Bonds will be secured by a pledge and lien of the Issuer's System-wide revenues under an indenture on a parity with other revenue obligations of the Issuer. Issuer represents that the pricing for Issuer's water is based on a rate scale that bears no relationship to the financing or cost of the Project.

The Project is proposed to be used for the purification of water to produce high quality purified water for drinking water use. The Project will include a treatment process building, a pump station, treatment tanks, other treatment systems and appurtenances, a parking lot area and driveways, and other site improvements and perimeter fencing. The Project will receive advanced secondary treated wastewater and, through the use of advanced technology, process the source water. The processed water, together with water from other sources, will be introduced into the System for delivery to Wholesale Customers at designated connection points so that it can be directed to supplement the water supply of any area to which Issuer distributes water throughout the System. In addition to constructing the Project and as part of integrating the Project into Issuer's System, Issuer will construct connecting pipelines to bring the advanced secondary treated wastewater to the Project and to distribute the purified water to its advanced

storage systems and for the purified water's subsequent uses as described further below. Issuer will own, for federal income tax purposes, the Project. Issuer will also manage and operate the Project. The Project is expected to produce up to h acre-feet per year of water output, which is less than the historic average annual amount of water delivered under the Contracts with Governmental Entities of f plus g.

The purified water is expected to be used to (1) supplement raw source water at Water Treatment Plant A and Water Treatment Plant B (Raw Water Supplementation), (2) integrate directly into the treated water distribution system bypassing Water Treatment Plants A and B (Treated Water Distribution), and/or (3) recharge the groundwater basin to replenish the groundwater aquifer (Groundwater Recharge).

Under Raw Water Supplementation, the purified water output from the Project will be combined with raw water supply at Water Treatment Plant A and Water Treatment Plant B. The purified water output produced at the Project will be conveyed through a new pipeline to integrate into Issuer's existing raw water system via a new tie-in connection station at a set of pipelines connected to Water Treatment Plants A and B, respectively. At these pipeline tie-in connections, the purified water will be combined with water from other sources and conveyed to Water Treatment Plant A and Water Treatment Plant B for treatment. Subsequently, the treated water, which will include purified water from the Project and water from other sources, will be delivered to Wholesale Customers.

Under Treated Water Distribution, the purified water output from the Project will not be introduced into Water Treatment Plant A or Water Treatment Plant B for further treatment, but instead, will be directly introduced into the pipelines for delivery to Wholesale Customers and may be combined with other water in Issuer's pipelines prior to delivery.

Under Groundwater Recharge, the purified water output from the Project will be used to recharge the groundwater basins. The purified water recharged into the groundwater basins will flow into the earth and will be combined with other groundwater. The Groundwater Recharge will minimize or prevent land subsidence and replenish the groundwater that has been pumped out by Issuer for its raw water supply or pumped and used by other local land holders.

Issuer represents that the amount and direction of flow of purified water, leaving the Project can and will be monitored and controlled using an array of analytical instruments such as, for example, flow meters and turbidity meters, and that Issuer will keep internal records of the output from the Project and the amount of System output sold pursuant to the Contracts. Issuer further represents that it will control both the flow and direction of purified water to ensure that, absent a force majeure event or other event outside Issuer's control, the aggregate amount of purified water produced by the Project will be equal to or less than the aggregate amount during the measurement period of the Bonds determined under §1.141-3(g) (the Measurement Period) of (A) purified water both commingled with other water in Water Treatment Plants A and B or Issuer's other

water facilities, and sold to a Governmental Entity, (B) purified water, not commingled in water treatment plants or Issuer's other water facilities, sold directly to (i) Governmental Entities or (ii) members of the general public (within the meaning of § 1.141-3(c)) under a generally applicable rate scale, and (C) purified water utilized by Issuer for groundwater recharge (collectively, the Project Output Restriction). For purposes of the Project Output Restriction, purified water will only be taken into account as used under (A), (B), or (C) above if it is physically possible to so deliver and use such water based on the physical flow of such water. The amount of any purified water that is used for Groundwater Recharge under (C) of the Project Output Restriction and is pumped by Issuer will be reduced for purposes of compliance with the Project Output Restriction by the amount of such purified water so pumped and delivered to the Private Entities; provided that such pumped purified water may be flowed and so utilized by Issuer in accordance with the restrictions of (A) or (B) above of the Project Output Restriction. Issuer represents that it will only take into account as used by the Governmental Entities and by the general public, the amount of water physically delivered based on the physical flow and connection points. Issuer currently projects that Governmental Entities' need for water will remain relatively stable over the Measurement Period.

Under the Act, Issuer has the authority to incur indebtedness, and to enter into contracts and do all acts necessary for the full exercise of all of the powers vested in Issuer. Pursuant to its authority under the Act, Issuer intends to enter into a binding contract (the Agreement) with the Bond Trustee that will require Issuer to comply with the Project Output Restriction during the Measurement Period. The Agreement will also provide that all Contracts by Issuer are consistent with, and will be consistent with, the Agreement. The execution and delivery of the Agreement was approved by a Bond Resolution adopted by the Issuer prior to the issuance of the Bonds.

## LAW AND ANALYSIS

Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or local bond. Section 103(b)(1) provides that § 103(a) shall not apply in the case of any private activity bond which is not a qualified bond (within the meaning of § 141).

Section 141(a) provides that the term "private activity bond" means any bond issued as part of an issue which meets the private business use test and the private security or payment test, or which meets the private loan financing test. 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. Section 141(b)(2) provides that an issue meets the private security or payment test if the payment of the principal of, or interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly (A) secured by an interest in (i) property used or to be used for a private business use, or (ii) payments in respect of such property, or (B) to be derived from payments (whether

or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 141(b)(6)(A) provides that for purposes of the private business use tests, 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. For this purpose, use as member of the general public shall not be taken into account. Section 141(b)(7) provides that the term “government use” means any use other than a private business use.

Under § 1.141-1(b), the term “governmental person” means a state or local governmental unit as defined in § 1.103-1 or any instrumentality thereof. Section 1.103-1(a) provides that the term “state or local governmental unit” means a state or any political subdivision of a state. Section 1.103-1(b) provides that the term “political subdivision” denotes any division of any state or local governmental unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the unit.

Section 141(b)(2) provides that the private security or payment test is met if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is directly or indirectly (1) secured by any interest in property used or to be used for a private business use, or payments in respect of such property, or (2) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 1.141-3(b)(1) provides that in most cases, the private business use test is met if a nongovernmental person has special legal entitlement to use the financed property under an arrangement with the issuer. In general, a nongovernmental person is treated as a private business user of proceeds and financed property as a result of ownership, actual or beneficial use of property pursuant to a lease, or a management or incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract.

Section 1.141-3(c)(1) provides that use as a member of the general public (general public use) is not private business use. Use of financed property by nongovernmental persons in their trades or businesses is treated as general public use only if the property is intended to be available and in fact is reasonably available for use on the same basis by natural persons not engaged in a trade or business. Section 1.141-3(c)(2) provides that, in general, use under an arrangement that conveys priority rights or other preferential benefits is not use on the same basis as the general public. Arrangements providing for use that is available to the general public at no charge or on the basis of rates that are generally applicable and uniformly applied do not convey priority rights or other preferential benefits. Under § 1.141-3(c)(2)(i), for this purpose, rates may be treated as generally applicable and uniformly applied even if different rates apply to

different classes of users, such as volume purchasers, if the differences in rates are customary and reasonable.

Section 1.141-7 provides special rules to determine whether arrangements for the purchase of output from an output facility cause an issue of bonds to meet the private business tests. For this purpose, unless otherwise stated, water facilities are treated as output facilities. Section 1.141-1(b) defines output facilities as electric and gas generation, transmission, distribution, and related facilities, and water collection, storage, and distribution facilities.

Section 1.141-7(c)(1) provides that the purchase pursuant to a contract by a nongovernmental person of available output of an output facility (output contract) financed with proceeds of an issue is taken into account under the private business test if the purchase has the effect of transferring the benefits of owning the facility and the burdens of paying the debt service on bonds used (directly or indirectly) to finance the facility (the benefits and burdens test). Section 1.141-7(c)(2) provides that the benefits and burdens test is met if a non-governmental person agrees pursuant to a take contract or a take or pay contract to purchase available output of a facility. Section 1.141-7(b)(4) provides in part that a take contract is an output contract under which a purchaser agrees to pay for the output under the contract if the output facility is capable of providing the output, while a take-or-pay contract is an output contract under which a purchaser agrees to pay for the output under the contract, whether or not the output facility is capable of providing the output. Section 1.141-7(c)(3)(iv) provides that , except as otherwise provided in § 1.141-7(c)(3), a requirements contract that is not a sale at wholesale does not meet the benefits and burdens test under § 1.141-7(c)(1). Section 1.141-7(d) provides that if an output contract results in private business use under § 1.141-7, the amount of private business use generally is the amount of output purchased under the contract.

Section 1.141-7(h)(1) provides that whether output sold under an output contract is allocated to a particular facility (for example, a generating unit), to the entire system of the seller of that output (net of any uses of that system output allocated to a particular facility), or to a portion of a facility is based on all the facts and circumstances. Significant factors to be considered in determining the allocation of an output contract to a financed property are the following:

- i. The extent to which it is physically possible to deliver output to or from a particular facility or system.
- ii. The terms of a contract relating to the delivery of output (such as delivery limitations and options or obligations to deliver power from additional sources).
- iii. Whether a contract is entered into as part of a common plan of financing for a facility.
- iv. The method of pricing output under the contract, such as the use of market rates rather than rates designed to pay debt service of tax-exempt bonds used to finance a particular facility.

Section 1.141-7(h)(2) illustrates the factors set forth in § 1.141-7(h)(1):

- i. Physical possibility. Output from a generating unit that is fed directly into a low voltage distribution system of the owner of that unit and that cannot physically leave that distribution system generally must be allocated to those receiving electricity through that distribution system. Output may be allocated without regard to physical limitations, however, if exchange or similar agreements provide output to a purchaser where, but for the exchange agreements, it would not be possible for the seller to provide output to that purchaser.
- ii. Contract terms relating to performance. A contract to provide a specified amount of electricity from a system, but only when at least that amount of electricity is being generated by a particular unit, is allocated to that unit. For example, a contract to buy 20 MW of system power with a right to take up to 40 percent of the actual output of a specific 50 MW facility whenever total system output is insufficient to meet all of the seller's obligations generally is allocated to the specific facility rather than to the system.
- iii. Common plan of financing. A contract entered into as part of a common plan of financing for a facility generally is allocated to the facility if debt service for the issue of bonds is reasonably expected to be paid, directly or indirectly, from payments under the contract.
- iv. Pricing method. Pricing based on the capital and generating costs of a particular turbine tends to indicate that output under the contract is properly allocated to that turbine.

Section 1.150-1(b) defines governmental bonds as any bond of an issue of tax-exempt bonds in which none of the bonds are private activity bonds.

The Project, which will be part of Issuer's System used for the collection, storage, and distribution of water, is an "output facility" as defined in § 1.141-1(b) and is subject to the restrictions of §§ 141 and 1.141-7. The use of output from the Project will satisfy the private business tests if the purchase of the output has the effect of transferring the benefits and burdens of owning the Project and paying the debt service on the Bonds to a nongovernmental person engaged in a trade or business.

The issue here is whether Issuer may allocate to the Project only the output sold under the Contracts with Governmental Entities and output sold to the general public (within the meaning of § 1.141-3(c)) without allocating to the Project any output sold under Contracts with Private Entities. Under § 1.141-7(h)(1), whether output sold under an output contract would be allocated to the Project is based on all the facts and circumstances.

In this case, the Governmental Entities are governmental persons within the meaning of § 1.141-1(b) because they are governmental entities that have been delegated the right to exercise part of the sovereign power of a state or local governmental unit, are part of a larger governmental entity invested with some or all of such sovereign power of the

state, or are an instrumentality of an entity that has been delegated the right to exercise part of such sovereign power. The Governmental Entities resell water directly to retail customers within their service area, including customers who are natural persons not engaged in a trade or business, under a rate scale of general applicability. No retail customers of the Governmental Entities purchase water under an arrangement that conveys priority rights or other preferential benefits. Accordingly, the Contracts with the Governmental Entities will not be taken into account for purposes of the private business use test under § 141(b)(1). However, the Contracts with the Private Entities will be taken into account for purposes of the private business use test under § 141(b)(1).

The first factor to consider in determining how to allocate the output sold under the Contracts to the Project for purposes of § 1.141-7(h)(1) is the extent to which it is physically possible to deliver output from the Project to any specific Wholesale Customer. In this case, the purified water produced at the Project will be combined with other raw and untreated water by piping the purified water to a connection point and conveying it for treatment by Issuer's pipelines to Water Treatment Plants A and B. The resulting treated water (consisting of water from the Project as well as water from other sources) will be distributed from Water Treatment Plants A and B through Issuer's pipelines to Wholesale Customers (both Governmental Entities and Private Entities) for further sale at retail. Consequently, to the extent the purified water output from the Project is combined with water from other sources at Water Treatment Plants A and B, it is not physically possible to determine whether water from the Project or from other sources is being delivered to any specific Governmental Entity or Private Entity that is supplied from Water Treatment Plants A or B, respectively. Also, the Project water output used to recharge the groundwater basin will be combined with other water located in, or finding its way into, the groundwater basin and will lose its source identity. When pumped by Issuer for raw water supply, such combined groundwater will be further combined with water from other sources and piped to an Issuer's treatment plant for treatment and subsequent delivery to Wholesale Customers. On the other hand, any Project water that is directly piped to fulfill the Contract with a Wholesale customer or combined with other water in a manner that allows for the source and amount of water to be traced directly to the Project will be allocable to the specific Contract for, and the respective Wholesale Customer to, which it is distributed. See §§ 1.141-7(h)(1)(i) and 1.141-7(h)(2)(i).

Another factor to consider in determining how to allocate output from the Project is the terms of the Contracts relating to the delivery of the water (such as delivery limitations). See § 1.141-7(h)(1)(ii). Here, none of the Contracts require Issuer (directly or indirectly) to deliver water from any specified facility, including the Project, to any specific Wholesale Customer. Pursuant to the authority granted under the Act, Issuer will enter into the Agreement to restrict the sale of water from the Project. The Agreement requires Issuer to ensure that the Contracts comply with the Project Output Restriction during the Measurement Period.

The Project Output Restriction is comprised of the aggregate annual amount of water delivered under the Contracts with the Governmental Entities and the water directly sold to members of the general public (within the meaning of § 1.141-3(c)) either directly, after combination with water from other sources prior to treatment, or after groundwater recharge (other than groundwater recharge pumped for Private Entities). The Agreement will require that, absent an event out of the control of Issuer, the Project output will be at all times during the Measurement Period equal to or less than the Project Output Restriction. Thus, use by the Governmental Entities and the general public will at all times be equal to or greater than the Project Output Restriction. Issuer expects that the Governmental Entities' need for water will remain relatively stable over the Measurement Period. Issuer will monitor and keep reports on the amount of output from the Project and the amount of water delivered to the Governmental Entities under the Contracts and to members of the general public.

Another factor to examine in determining the allocation of output sold pursuant to the Contracts is whether a contract is entered into as part of a common plan of financing. See § 1.141-7(h)(1)(iii). A contract entered into as part of common plan of financing for a facility generally is allocated to the facility if debt service for the issue of bonds is reasonably expected to be paid, directly, from payments under the contract. See §1.141-7(h)(2)(iii). Here, Issuer entered into the Contracts with the Private Entities, prior to the proposed issuance of the Bonds and the amounts paid under those Contracts bear no relationship to the financing of the Project. Moreover, the debt service on the Bonds will be paid from System revenues. Accordingly, the Contracts with the Private Entities were not part of a plan of financing for the Project.

Finally, under § 1.141-7(h)(1)(iv), the method of pricing charged under the Contracts must be considered in determining the allocation of the Contracts to the Project. In this case, the rate charges under the Contracts with both the Governmental Entities and the Private Entities are based on Issuer's generally applicable rate scale, designed to ensure that Issuer recovers its overall costs to operate and maintain all of the facilities constituting Issuer's System. The rates charged to any Wholesale Customer are not based on the costs of operating and maintaining the Project or paying the debt service on the Bonds, but on the costs of owning, operating and maintaining the entire System.

## CONCLUSION

Based on all the facts and circumstances, we conclude that Issuer may allocate all of the output from the Project to the output sold under the Contracts with the Governmental Entities and members of the general public (within the meaning of § 1.141-3(c)) and that the use of the proceeds of the Bonds to finance the Project in the manner described above will not cause the Bonds to satisfy the private business tests in § 141(b).

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

this letter, including whether the interest on the Bonds will be excludable from gross income under § 103(a).

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

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

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

Sincerely,

Associate Chief Counsel  
(Financial Institutions & Products)

By: \_\_\_\_\_  
Zoran Stojanovic  
Acting Branch Chief, Branch 5

Enclosure  
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cc: