

Internal Revenue Service

Department of the Treasury

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Date:

February 11, 2003

LEGEND:

Taxpayer =

State =

Council =

Authority =

Act =

Dear _____ :

This is in response to a ruling request submitted on behalf of Taxpayer dated August 30, 2002. The request has been further supplemented by additional documentation and correspondence dated January 10, 2003 and January 23, 2003. Taxpayer requests a ruling that its income is excludable from gross income for federal income tax purposes under section 115(1) of the Internal Revenue Code.

FACTS

Taxpayer is a corporation created under the nonprofit public benefit corporation law of State. According to its articles of incorporation, Taxpayer is organized exclusively for the purpose of assisting in the provision of adequate, safe and sanitary residential housing nationwide and for any other public purposes related thereto. These related purposes will include making available low-cost financing opportunities to homebuyers for the purchase of residential housing, with particular emphasis on assisting low-income, minority and first-time homebuyers. Taxpayer will work in cooperation with local nonprofit agencies and regional lenders to provide mortgage loan financing and down-payment assistance to families and individuals in the State and nationwide who otherwise may not be able to afford to purchase a home.

Taxpayer will provide and service second mortgage, and in some cases first mortgage, loan opportunities to homeowners and will arrange for the availability of mortgage loans through its lenders or through the issuance of mortgage revenue bonds purchased by banks and other eligible investors. By offering second mortgage loan financing, Taxpayer can assist homebuyers in providing up to 100% of the cash needed at closing. As a result of the opportunities it will provide, Taxpayer will be assisting State counties (and other local governments nationwide) in satisfying their local government legal obligations of providing for the improvement and development of housing and making adequate provision for the housing needs of all segments of the community.

All of Taxpayer's directors must concurrently, in accordance with its bylaws, serve as certain board members or officers (or a designee) of the Council and of the Authority. The Council is a State nonprofit public benefit corporation organized exclusively for the purpose of exercising functions of government and other public purposes. More specifically, the Council's purpose is to represent the collective interests (including maximizing rural housing options) of its members, all of which are rural counties of the State.

The Authority was created pursuant to State Act. Its purpose is to assist its own member counties in satisfying their State law requirement to prepare and implement plans to improve and develop housing for all economic segments of the community. Among its activities, the Authority fulfills its purpose by financing residential mortgages, issuing bonds necessary to effect its purposes, and offering a variety of homebuyer assistance programs (including offering second mortgages) to residents within the borders of its member counties. It is represented that, given the success of the Authority, Taxpayer was formed to provide services to State counties not served by the Authority, as well as on a nationwide level, similar to those provided by the Authority for its member counties. Because Taxpayer's directors are also directors or officers of the Council and Authority selected by the member counties of those entities, Taxpayer's board of directors is determined by the State counties that are members of the Council and the Authority.

Taxpayer's articles of incorporation state that it is not organized for the private gain of any person. Accordingly, it is represented that no part of the funds of Taxpayer may inure to the benefit of or be distributed to any private individual, except that Taxpayer may pay reasonable compensation for services rendered and reimburse directors for reasonable and necessary expenses incurred in relation to their duties as directors. Initially, the Council will provide administrative services to Taxpayer for which Taxpayer will pay reasonable compensation. It is represented that Taxpayer will not engage in any type of partnership arrangement or share income with any organization that is not either a non-federal governmental entity or an entity whose income is excludable under section 115 of the Code.

Its articles of incorporation provide that, upon Taxpayer's dissolution, all of Taxpayer's assets (after satisfaction of Taxpayer's liabilities) will be distributed to the Council. It is further represented that any revenues generated by Taxpayer in excess of its business operating needs will be contributed to the Council. Should the Council cease to exist, Taxpayer's articles state that all remaining assets will be distributed directly to the State counties that were members of the Council.

All income received by the Council is to be used to accomplish its purpose of benefitting its member counties. It is represented that none of the Council's income will accrue to an organization that is not either a non-federal governmental entity or an entity whose income is excludable under section 115 of the Code. It is further represented that the Council intends to amend its articles of incorporation to provide that no part of the net earnings shall inure to the benefit of any member or private shareholder and that upon dissolution, the Council's assets (after satisfaction of the Council's liabilities) will be distributed only to its member counties. It is represented that the Council meets the requirements of section 115(1) of the Code.

LAW AND ANALYSIS

Both Taxpayer and the Council have executed a power of attorney with respect to the matters discussed in this ruling.

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

All the facts and circumstances relating to the organization are considered to determine whether the organization performs an essential governmental function and whether the income of the organization accrues to a state or political subdivision of the state.

Rev. Rul. 90-74, 1990-2 C.B. 34, concerns an organization formed, operated and funded by political subdivisions to pool their casualty risks and other risks arising from their obligations concerning public liability, workers' compensation, or employees' health obligations. The ruling states that the income of such an organization is excluded from gross income under section 115(1) so long as private interests do not participate in the organization or benefit more than incidentally from the organization. The benefit to the employees of the insurance coverage obtained by the member political subdivisions was deemed incidental to the public benefit.

Rev. Rul. 77-261, 1977-1 C.B. 45, holds that income from a fund, established under a written declaration of trust by a state, for the temporary investment of positive cash balances of a state and its political subdivisions, is excludable from gross income under section 115(1). The ruling reasons that the investment of positive cash balances

by a state or political subdivision in order to receive some 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 and raise revenue. The ruling also concludes that, for purposes of section 115, the investment fund's income accrues for the sole benefit of state X and its participating political subdivisions because they have an unrestricted right to their proportionate share of such income.

In this case, Taxpayer was formed exclusively for the purpose of assisting in the provision of adequate, safe and sanitary residential housing and for any other public purposes related thereto with emphasis on providing low-cost financing opportunities to families and individuals who otherwise may not be able to afford to purchase a home. Its current and proposed activities, as represented, are related to that purpose. The objectives of Taxpayer constitute an essential governmental function within the scope of section 115(1) of the Code.

In addition to deriving income from the performance of an essential governmental function, income of Taxpayer must accrue to the State or a political subdivision of the State. In this case, all income of Taxpayer accrues to the Council, or should it no longer exist, to the Council's member counties. It is represented that the Council meets the requirements of section 115(1) of the Code. As such, all income of the Council is used exclusively for the benefit of its member counties. Furthermore, it is represented that the Council intends to amend its articles of incorporation to provide that, in the event of the Council's dissolution, all of the Council's assets are distributed to its member counties. Based on the information submitted, the income of Taxpayer and the Council does not accrue, other than incidentally, to the benefit of any private individual. Accordingly, the income of Taxpayer accrues to political subdivisions of the State.

Based on the information submitted, representations made and authorities cited, we conclude that Taxpayer's income is excludable from gross income for federal income tax purposes under section 115(1) of the Internal Revenue Code. This ruling is contingent the continuing accuracy of the representations made and upon the Council's amending its articles of incorporation as represented. Because this ruling is dependent on the amendment of this document, the ruling applies only for periods on and after the date on which the amendments become effective.

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.

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

Sincerely,

Elizabeth Purcell
Chief, Exempt Organizations Branch 2
Office of the Division Counsel/Associate
Chief Counsel (Tax Exempt and
Government Entities)

Enclosure: