

**Internal Revenue Service**

*Department of the Treasury*

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**Washington, D.C.**

**Person to Contact:**

Telephone Number:

Refer Reply to:  
CC:TE/GE:EO2 - PLR-107580-03  
**Date:**  
June 6, 2003

LEGEND

Corporation =

Authority =

Agency =

State A =

State B =

State C =

State D =

X =

Dear :

This is in reply to a letter dated January 28, 2003, requesting a ruling that the income of Corporation is excludable from gross income under § 115(1) of the Internal Revenue Code.

FACTS

PLR-107580-03

Corporation is a proposed nonmember, nonprofit corporation to be created by Authority for the purpose of reducing the cost of supplying electric energy to Authority's members. Authority is created under State A law and the intergovernmental cooperation laws of States A, B, C and D. It is a political subdivision within the meaning of § 1.103-1(b) of the Regulations. Membership in Authority is limited to municipally owned utility plants. All of Authority's members are political subdivisions located in States A, B, C or D. Corporation, if established in accordance with the proposed articles of incorporation and by-laws submitted, will be governed by a board of seven directors. The directors will be appointed by, and can be removed by, the board of Authority. Authority will have the right to consult with Corporation in setting Corporation's budget and establishing the fees Corporation charges governmental entities for its services.

Authority entered into a power supply contract with Agency to supplement the power Authority's members receive from the United States Department of Energy. Agency is a political subdivision of State B. Its membership consists of x State B municipalities, each of which owns and operates a utility for the distribution of electricity and each of which is a political subdivision of State B. Pursuant to its power supply contract with Agency, Authority has acquired sufficient power to supply a significant portion of the requirement of its members. However, it occasionally needs to acquire power from third parties in order to satisfy the requirements of its members. The electrical power Corporation proposes to purchase from third parties will be primarily for the benefit of the members of Authority. Governmental entities that are not members of Authority may also be allowed to buy electrical power that Corporation purchases from third parties, provided the governmental entities are states, political subdivision of states or entities the income of which is excludable from gross income under § 115(1).

Corporation will also perform services related to the operation of the utility plants. These services will be provided to the members of Authority and to other states, political subdivisions of states and section 115(1) entities. Corporation will also provide cost saving pools to purchase goods and services related to the operation of the utility plants. Participation in the cost savings pools will be restricted to Authority, the members of Authority and other governmental entities that are states, political subdivisions of states or entities the income of which is excluded from gross income under § 115(1).

Corporation's initial start up costs will be provided by either Authority or Agency. Corporation's income will be derived from charges paid by the members of Authority or other states, political subdivisions of states or entities the income of which is excluded from gross income under § 115(1) for goods and services received by them from Corporation. Authority represents that current income in excess of expenses will be returned to the members of Authority or other states, political subdivisions of states or entities the income of which is excluded from gross income under § 115(1) or used to reduce charges in the following year. Corporation's proposed articles of incorporation

PLR-107580-03

provide that no part of its net earnings will inure to the benefit of a director, an officer or any private person. In the event of dissolution, any assets of Corporation remaining after it satisfies its obligations will be distributed to Authority.

#### LAW AND ANALYSIS

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.

Rev. Rul. 77-261, 1977-2 C.B. 45, states that 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, is excludable from gross income for federal income tax purposes under § 115(1). The ruling indicates 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 utilities 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 to properly conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, states 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 facilitating the cost effective production and transmission of electrical power, a basic utility, by public utilities, Corporation will perform an essential governmental function.

The income of Corporation will accrue to Authority. Private parties will participate in Corporation only to the extent of selling electrical power to Corporation, and providing it with goods and services. The income of Corporation will not accrue to private parties, other than incidentally, as reasonable compensation for providing Corporation with power, goods and services. No more than incidental benefits will accrue to entities that are not a state, a political subdivision of a state or an entity the income of which is excluded from gross income under § 115(1). Upon the dissolution of Corporation, its assets shall be distributed to Authority.

PLR-107580-03

The income of Corporation will be derived from an essential governmental function and accrue to political subdivisions of a state or to entities the income of which is excludable from gross income under § 115(1). Accordingly, based on the representations made and provided the proposed articles of incorporation and by-laws are adopted and Corporation operates in accordance with the proposed articles of incorporation and proposed by-laws, the income of Corporation will be excludable from gross income for federal income tax purposes under § 115(1).

Except as specifically provided otherwise, 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 representative.

Sincerely,

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

Enclosures;

cc: