

FACTS

Association is an organization of local governments and political subdivisions of State. It was created for the purpose of allowing its members to act jointly to acquire electricity supply, electricity delivery and other energy-related services. Association was formed pursuant to State Statute A which authorizes municipalities and other government entities to aggregate their electricity supply requirements for the purpose of making joint purchases from electricity suppliers. State Statute B exempts the joint purchases of public bodies from its competitive sealed bidding and competitive negotiation requirements. Pursuant to State Statute C local governments are authorized to exercise powers jointly with other local governments that they are otherwise authorized to exercise independently.

The members of Association are local governments and political subdivision of State. Association represents that in no case may an organization other than a state, a political subdivision of a state, or an organization the income of which is excluded from gross income under § 115(1) be a member of Association. Association further represents that no private party has any ownership interest or control of Association. Association proposes to amend its bylaws to include the requirement that only a political subdivision of State may be a member of Association.

Association is governed by a board elected by its members. Each member of Association has a single vote which is cast by its designated representative. The designated representative is an employee of the member it represents. Board members are elected for a three year term. Association lacks any employees of its own and maintains no payroll. Designated representatives described above who are appointed or elected as officers or members of the board of Association perform all required activities for Association.

Association's core functions involve assisting its members when they purchase electrical power to meet their own power needs. Association serves as the members' agent, assisting in the purchase of energy services from competitive suppliers. It also assists members regarding the negotiation of standard form contracts with State Utility for the purchase of electric utility services, including electric supply, distribution and transmission, billing and ancillary services. In addition, Association provides certain non-core functions for the benefit of its members, who may elect to participate on a voluntary basis. Such non-core functions may include environmental compliance activities, metering services, billing services, economic load curtailment services and efficiency and managing services.

Association represents that it is formed as a cost-sharing enterprise among its members and will not have income or profits from its operations to allocate among its

members. Each member pays its pro rata share of the budget for the core functions. The pro rata share is based upon each member's energy consumption or upon such other equitable method of funding as may be determined by the board. Only members that participate in non-core functions will pay the fees for such non-core functions. Private parties will participate in Association only to the extent of selling it electrical power and providing it with goods and services. The income of Association will not accrue to private parties, other than incidentally, as reasonable compensation for providing Association with power, goods and services.

Any member may withdraw from Association upon written notice. The board can terminate the membership of any member who fails to pay its pro-rata share of the budget. The Association may be terminated at any time upon the concurrence of all members at the time of termination. In the event of termination the remaining funds available to Association, after providing for all outstanding obligations, shall be distributed exclusively to members at the time of termination.

LAW AND ANALYSIS

Section 115

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.

In Rev. Rul. 77-261, 1977-2 C.B. 45, 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, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated 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. In addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined 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 acquisition and transmission of electrical power, a basic utility, to member local governments, Association performs an essential governmental function

Any income of Association will accrue solely to its members. The income of Association will not accrue to private parties, other than incidentally, as reasonable compensation for providing Association with power, goods and services. Upon termination of Association, its remaining funds shall be distributed to its members.

Based on the information and representations submitted by Association, and provided that the proposed amendment described above is made to the by-laws, we hold that the income of Association is derived from the exercise of an essential governmental function and will accrue to a state, a political subdivision of a state or an entity the income of which is excluded from gross income under § 115(1). Accordingly, Association's income is excludable from gross income under § 115(1) of the Code.

Section 6012

Section 6012(a)(2) provides, in general, that every corporation subject to taxation under subtitle A shall make returns with respect to income taxes under subtitle A. In addition, § 1.6012-2(a)(1) of the regulations provides in part that every corporation, as defined in § 7701(a)(3), subject to taxation under subtitle A of the Code shall make a return of income regardless of whether it has taxable income or regardless of the amount of its gross income.

Section 6012(a)(4) provides, in general, that every trust having for a taxable year any taxable income, or having gross income of \$600 or over, regardless of the amount of taxable income, shall make returns with respect to income taxes under subtitle A. Section 7701(a) and § 301.7701-4 of the regulations define trusts for purposes of § 6012.

If Association is classified as a trust for federal income tax purposes, no annual income tax return must be filed by Association pursuant to § 6012(a)(4) since any income realized by Association is excluded from gross income under § 115(1). However, if Association is a corporation, as defined in § 7701(a)(3), it will be required to file an income tax return pursuant to § 6012(a)(2).

RULINGS

1. Upon amendment of the by-laws of Association as described above, the income of Association will be excludible from gross income under § 115(1) of the Code.
2. Association is not required to file a federal income tax return if it is classified as an Association for federal income tax purposes. If it is a corporation, as defined in § 7701(a)(3), it will be required to file an income tax return pursuant to § 6012(a).

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,

Barbara E. Beckman
Assistant Chief, Branch 2
Division Counsel/Associate
Chief Counsel
(Tax Exempt and Government
Entities)

Enclosures;
Copy of this letter
Copy for § 6110 purposes

CC: