

INTERNAL REVENUE SERVICE

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X =

State =

Fund =

EDC1 =

Law 1 =

Law 2 =

Date 1 =

k =

m =

n =

p =

Dear

This is in reply to a letter dated July 9, 1999, requesting a private letter ruling on behalf of X. The rulings requested are under sections 115, 170, 3121, and 3306 of the Internal Revenue Code. This letter responds to the request under section 115. Rulings under the other Code sections will be considered separately by the offices with those subject matter responsibilities.

## FACTS

The State Law 1 provides that a public agency of State may exercise jointly with any other public agency of State any power that the agencies have in common and may exercise separately. The agencies may create by interlocal agreement a separate legal entity for purposes of State law to exercise that power. Under Law 1, the entity created is a "public body corporate or politic." The term "public agency" includes State and local government units.

An economic development corporation ("EDC") is also a public agency for purposes of Law 1. State Law 2 provides for the creation of EDCs. No part of the net earnings of an EDC may inure to any private person, and upon an EDC's dissolution all net assets must be distributed to the municipality that created it. Of the k counties in State, m have EDCs, and most or all of the rest have within them one or more cities or townships that have formed an EDC.

EDCs have the power to receive property condemned by a local unit of government and the power to issue bonds. EDCs conduct economic development projects involving industrial or commercial enterprises within the local unit of government. An EDC's board of directors consists of representatives of the governing body of the unit of government that created it and members from the private sector. The chief executive officer of a municipality, with the advice and consent of its governing body, or in the case of a county where there is not an elected chief executive officer, the chairperson of the county board of commissioners, with the advice and consent of the county board of commissioners, appoints the members of the board of directors of the EDC. A director may be removed by the governing body for cause.

On Date 1, Fund and EDC1 formed X, an EDC, by interlocal agreement pursuant to Law 1. Fund was established by executive order of the governor of State, and EDC1 is an EDC formed by a county of State. Any EDC may participate in X provided certain procedural requirements are met.

X has an executive committee of n members. All the members are appointed by the Governor of State. The committee includes m representatives from the EDCs and n additional members, of which p are from the private sector. Terms of office are staggered. The Governor of State serves ex officio as chairperson.

The corporation board of X authorizes and approves the annual audit of X and evaluates its performance pursuant to standards established by the executive committee and reviews its acts. The board consists of one member from each participant and

up to two additional members per each participant-appointed member; these additional members are appointed by the Governor.

Members of the board and executive committee receive no compensation but do receive reimbursements for reasonable expenses in discharging their duties.

Employees of State have been detailed to work for X. X will also hire its own employees, including a chief executive officer and other executives.

On X's termination, its assets remaining after provision for satisfaction of debts and liabilities will be distributed to Fund or its statutory successor, or in failure thereof, State. No participant will receive any assets upon termination.

#### APPLICABLE LAW

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 governmental function and accruing to a state or any political subdivision of a state.

Rev. Rul. 71-589, 1971-2 C.B. 94, provides that the income from property held in trust by a city that was to be used by the city for certain charitable purposes is not subject to federal income tax. Although Rev. Rul. 71-589 does not explicitly so state, the holding in the revenue ruling means that a determination was made that the income in question was derived from the exercise of an essential governmental function and accrued to a political subdivision within the meaning of section 115(1) of the Code. Rev. Rul. 71-589 specifically mentions several types of functions that the trust might perform, such as support of a hospital, schools, maintenance of a park, or other purposes ordinarily recognized as municipal functions.

Under Rev. Rul. 77-261, 1977-2 C.B. 45, the income from a fund, established under a written declaration of trust by a state for the temporary investment of cash balances of the state and its political subdivisions, which purchase units of participation and have an unrestricted right of withdrawal, is excludable from gross income. The fund, however, is classified as a corporation and must file a federal income tax return.

Rev. Rul. 90-74, 1990-2 C.B. 34, concerns an organization that is formed, operated and funded by political subdivisions to pool their casualty risks, or other risks arising from their obligations concerning public liability, workers' compensation, or employees' health. Rev. Rul. 90-74 states that the income of the organization is excluded from gross income under section 115(1) of the Code if private interests do not participate in the

organization or benefit more than incidentally from the organization. In Rev. Rul. 90-74 the benefit to the employees of the political subdivisions was excepted as incidental.

#### ANALYSIS and HOLDING

X was created to stimulate economic development in State. X's income is a component of its purpose. Expenditures are controlled by persons acting under authority granted by gubernatorial appointment and appointment by EDCs that have been established by the official action of local units of government. No income inures to the benefit of private persons other than incidentally, and upon dissolution the net assets of X are not distributed to or for the benefit of any private person.

Accordingly, provided that Fund and all participant EDCs are either (1) political subdivisions of State or (2) integral parts of State or political subdivisions of State, X's income is excludable from gross income under section 115(1) of the Code.

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

Except as specifically provided otherwise, no opinion is expressed on the federal income tax consequences of the transaction described above. In particular, no opinion is expressed whether Fund or participant EDCs are political subdivisions of or integral parts of political subdivisions of State.

In accordance with the terms of a power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to X's income tax return for the taxable year to which it relates.

Sincerely,  
Assistant Chief Counsel  
(Financial Institutions & Products)

By: \_\_\_\_\_  
William E. Coppersmith  
Chief, Branch 2