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Person To Contact:
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Refer Reply To:
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Date:
May 29, 2008

Legend

Cooperative =

Statute =

State =

County =

Town =

Compact =

Date 1 =

Date 2 =

Dear :

This is in response to your letter dated Date 1, in which you requested rulings on four issues. Pursuant to the Service's requests, you have withdrawn your original second request, and modified your third request. Thus, now you request the following three rulings:

- 1) Whether the Cooperative's income is exempt from federal income tax because it derives its income from the exercise of an essential government function, and the

income accrues to one or more political subdivisions of the State within the meaning of Internal Revenue Code section 115(1)?

- 2) Whether the Cooperative qualifies as an instrumentality of political subdivisions of the State, so that contributions made to it exclusively for public purposes are deductible as being made for the use of a state or political subdivision under section 170(c)(1)?
- 3) Whether interest on bonds issued by the Cooperative will be excluded from gross income under section 103, because the Cooperative is a constituted authority within the meaning of section 1.103-1(b) of the Income Tax Regulations?

FACTS

The Statute generally permits any number of persons to form a cooperative to transact any lawful business associated with the purchase, acquisition, distribution, sale, resale, supply, and disposition of energy or energy-related services to wholesale or retail customers. The Statute further provides that any natural person, firm, corporation, business trust, partnership, public or private agency, non-profit organization or corporation, cooperative, or local municipality may become a member or shareholder of a cooperative organized pursuant to the Statute. The Statute also provides that any member or shareholder may access any services a cooperative has to offer, while being permitted to participate in the cooperative's governance. Moreover, the Statute grants cooperatives the power, among others, to issue notes, bonds, certificates of indebtedness, and other obligations.

Pursuant to the Statute, the Cooperative was formed on Date 2. The Cooperative's Articles of Incorporation (the "Articles") and its Bylaws (the "Bylaws" and collectively with the Articles, the "Governing Documents") provide that the Cooperative was formed for the purposes of developing and/or owning renewable and non-renewable electric generation facilities, and procuring and/or selling long term electric supply or other energy-related goods or services at competitive prices to its members. The Bylaws further provide that the functions, policies, and goals of the Cooperative include, exploring appropriate options for acquiring the best market rate for electricity supply; promoting and supporting the development of renewable energy resources; providing and enhancing customer protection by improving the quality and reliability of service; and utilizing and encouraging conservation and other forms of energy efficiency.

The Cooperative's Governing Documents specifically limit its membership to any municipality or county (or political subdivisions thereof), or any entity that is exempt from federal income tax under Code section 115(1). In addition, pursuant to the Governing Documents, the governing body of each Cooperative member must authorize any new members. The Bylaws further provide that membership in the Cooperative is not transferable.

Membership in the Cooperative is currently comprised of the County, the Town, and the Compact. The County and the Town are each political subdivisions of the State. The Compact consists solely of counties and municipalities located within the State, including the County and the Town. All members of the Compact are political subdivisions of the State. The Compact was formed through an Inter-Governmental Agreement (“Agreement”) among its members. Pursuant to the terms of the Agreement, the Compact is governed by a board of community representatives (the “Governing Board”). Each member of the Compact may elect one member of its Governing Board.

The Governing Documents provide that the members of the Cooperative are entitled only to vote on the election of a board of directors (each a “Director” and collectively, the “Board”). Each member is entitled to representation on the Board by having the right to elect one Director. Any vacancy on the Board shall be filled in the same manner as the position was originally filled. Pursuant to the Bylaws, any Director may be removed at any time with or without cause by the member who elected him or her. A Director may also be removed any time with cause by a two-thirds vote of the Board. The Board may exercise all the powers of the Cooperative including the power to make, amend, or repeal bylaws. Pursuant to the Bylaws, business of the Cooperative is to be conducted by an executive committee (the “Executive Committee”), which consists entirely of Directors.

The Town’s council, the County’s commissioners, and the Compact’s Governing Board each formally approved the formation of the Cooperative. In addition, the County’s commissioners and the Governing Board of the Compact each selected their respective Director. The Town’s Manager, pursuant to the authority granted to him by the Town’s charter, appointed the Town’s Director.

The Bylaws provide that the Cooperative may issue bonds or incur other borrowings upon obtaining the affirmative vote of a majority of the members of the Executive Committee followed by a two-thirds vote of the Board of Directors. In addition, the Bylaws limit the issuance of bonds and other borrowings to those in furtherance of the Cooperative’s purposes, policies, and goals.

The Cooperative’s products, services, and programs will be available to its members, and to consumers living in its constituent jurisdictions. The Governing Documents provide that the Cooperative may accept funds only from its members, or other sources that will not jeopardize its tax-exempt status. However, the Governing Documents also provide that members have no individual or separate interest in the property or assets of the Cooperative, and that no part of the Cooperative’s net earnings may inure to the benefit of any Director, officer, or other individual.

Under the Governing Documents, the members of the Cooperative are exempt from liability for any of the Cooperative's debts to the full extent authorized by law. Upon the Cooperative's dissolution, the Governing Documents provide that any remaining assets after satisfaction of liabilities shall be distributed only to the Cooperative's members. The Governing Documents further provide that upon dissolution title to all debt-financed property shall revert to the members on a *pro rata* basis in proportion to their financial or in-kind contributions to, and/or pledges or guaranties on behalf of, the Cooperative. However, the Board may vary the post-dissolution allocation of debt-financed property among the members if it is in the best interest of the Cooperative, or there are other equitable interests to be taken into account. The Cooperative expects that this provision may be used to take into account additional financial or in-kind contributions, pledges, or guarantees made by one or more of the members.

LAW & ANALYSIS

Issue 1:

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.

Under Revenue Ruling 77-261, 1977-2 C.B. 45, the 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 political subdivisions, was excludable from gross income for federal income tax purposes under section 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 properly to conduct. In addition, pursuant to section 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 Revenue Ruling 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 section 115(1). In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

The Cooperative was formed for the purposes of developing and/or owning renewable and non-renewable electric generation facilities, and procuring and/or selling long term electric supply or other energy-related goods or services at competitive prices to its members. The Bylaws further provide that the Cooperative's functions, policies, and goals include, exploring appropriate options for acquiring the best market rate for electricity supply; promoting and supporting the development of renewable energy resources; providing and enhancing customer protection by improving the quality and reliability of service; and utilizing and encouraging conservation and other forms of energy efficiency. Thus, the Cooperative exercises an essential government function.

The Cooperative's income and the assets accrue to the benefit of its members. Currently, the Cooperative's membership consists of two political subdivisions, the County and the Town, and the Compact, an entity exempt from federal income tax under section 115(1). The Cooperative's Articles ensure that no part of its income and earnings shall inure to the benefit or profit of any private interest. Additionally, the Governing Documents, in general, further provide that upon dissolution title to all debt-financed property shall revert to the members on a *pro rata* basis in proportion to their financial or in-kind contributions to, and/or pledges or guaranties on behalf of, the Cooperative. Therefore, the Governing Documents sufficiently provide that the Cooperative's gross income accrues to a state or political subdivision for purposes of section 115(1). Governing Documents provide that any remaining assets after satisfaction of liabilities shall be distributed only to the Cooperative's members.

Based on the information and representations submitted, we hold that the Cooperative's income is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for the purposes of section 115(1). Accordingly, Cooperative's income is excludable from gross income under section 115(1).

Issue 2:

Section 170(a)(1) of the Internal Revenue Code provides, subject to certain limitations, a deduction for contributions and gifts to or for the use of organizations described in section 170(c), payment of which is made within the taxable year.

Section 170(c)(1) defines the term "charitable contribution" as including a contribution or gift to or for the use of a state, a possession of the United States, or any political subdivision of any of the foregoing, but only if the contribution or gift is made for exclusively public purposes.

An entity not expressly described in section 170(c)(1) may nevertheless qualify to receive deductible charitable contributions if it is an instrumentality of a state or an instrumentality of a political subdivision of a state and if the contributions are

made for exclusively public purposes. See Revenue Ruling 75-359, 1975-2 C.B. 79

Rev. Rul. 75-359 holds that contributions and gifts to a wholly-owned instrumentality of a political subdivision formed and operated exclusively for public purposes, are deductible contributions “for the use of” political subdivisions, to the extent allowed under section 170. Under Rev. Rul. 75-359, the criteria for identifying wholly-owned instrumentalities of states or political subdivisions are set forth in Revenue Ruling 57-128, 1957-1 C.B. 311.

Rev. Rul. 57-128, 1957-1 C.B. 311, sets forth the following factors to be taken into account in determining whether an entity is an instrumentality of one or more governmental units: (1) whether the organization is used for a governmental purpose and performs a governmental function; (2) whether performance of its function is on behalf of one or more states or political subdivisions; (3) whether there are any private interests involved, or whether the states or political subdivisions have the power and interests of an owner; (4) whether control and supervision of the organization is vested in a public authority or authorities; (5) whether express or implied statutory or other authority is necessary for the creation and/or use of the organization, and whether this authority exists; and (6) the degree of financial autonomy of the entity and the source of its operating expenses.

The Cooperative is used for a governmental purpose and performs a governmental function on behalf of its members. As mentioned above, the Cooperative was formed for the purposes of developing and/or owning renewable and non-renewable electric generation facilities, and procuring and/or selling long term electric supply or other energy-related goods or services at competitive prices to its members. Such purposes are generally regarded as governmental purposes.

There are no private interests involved. The power and interests of an owner, including net earnings, rest with the Cooperative’s members; two of which qualify as political subdivisions of the State for federal tax purposes, while the Cooperative’s third member qualifies as an entity exempt from federal income tax under section 115(1).

Control and supervision of the Cooperative rests with its members. The Cooperative’s Executive Committee runs the Cooperative’s day-to-day business as such powers are delegated from the Cooperative’s Board. The Executive Committee consists entirely of Directors from the Cooperative’s Board. Pursuant to the Cooperative’s Governing Documents, each member has the power to elect a Director. Any Director may be removed at any time with or without cause by the member who elected him or her. A Director may also be removed any time

with cause by a two-thirds vote of the Board. Thus, control and supervision of the Cooperative rests with public authorities.

Statutory authority for the creation of the Cooperative is found in State law.

The Cooperative's members, through the Board and the Executive Committee, control the Cooperative's financial affairs. The Board has the power to appoint the Cooperative's officers, including, the Treasurer. Any officers can be removed with or without cause by a majority vote of the Board. The Treasurer is entrusted with the duty to keep full and accurate books, while maintaining full custody over the Cooperative's funds, securities, and valuable documents. The Treasurer shall render a statement of the Cooperative's financial affairs at the Cooperative's annual meeting. The Cooperative's operating funds come primarily from its members, or customers from its member communities.

Accordingly, the Cooperative is an instrumentality of its members, and contributions made to the Cooperative exclusively for a public purpose may be deductible by a donor as charitable contributions under section 170(c)(1) to the extent otherwise provided under section 170.

Issue 3:

Section 103(c)(1) defines a "state or local bond" for purposes of section 103, and sections 141 through 150 as an obligation of a state or political subdivision thereof. Section 1.103-1(a) of the Income Tax Regulations provides, in part, that interest upon obligations of a state, territory, a possession of the United States, the District of Columbia, or any political subdivision thereof (hereinafter collectively or individually called "state or local government unit") is not includable in gross income. Section 1.103-1(b) of the Income Tax Regulations provides, in part, that an obligation issued by or on behalf of any governmental unit by a constituted authority empowered to issue such an obligation is the obligation of such a unit.

Revenue Ruling 57-187, 1957-1 C.B. 65, holds that bonds issued by an industrial development board are considered issued on behalf of a political subdivision of the state if the following conditions are met: (1) the entity is formed only after the governing body of the state or political subdivision has formally approved the entity's creation, (2) the board of directors of the entity is elected by the governing body of the state or political subdivision, (3) the entity is empowered to issue bonds in furtherance of the purposes for which it is established, (4) the entity is a nonprofit organization and none of its net earnings inure to the benefit of any private person, and (5) upon dissolution of the entity, title to all property it owns vests in and becomes the property of the state or political subdivision which creates it. Although this revenue ruling dealt with an industrial development board, the analysis contained therein has been applied to a variety of governmental entities.

Most of the facts of this ruling are similar to those in Rev. Rul. 57-187. The Cooperative is organized pursuant to the Statute and its formation was formally approved by the County, the Town, and the Compact. The governing body of each of Town, the County and the Compact selected its respective member of the Board and may remove the member with or without cause. The Cooperative is empowered to issue bonds. The Governing Documents provide that no part of the net earnings of the Corporation may inure to the benefit of any director, officer, or other individual. Pursuant to the Governing Documents, upon dissolution title to any remaining assets after satisfaction of liabilities may be distributed only to members of the Cooperative. The Governing Documents further provide that upon dissolution title to all debt-financed property reverts to the government members on a *pro rata* basis in proportion to their financial or in-kind contributions to, and/or pledges or guaranties on behalf of, the Cooperative except that the Board may vary the post-dissolution allocation of debt-financed property among the members if it is in the best interest of the Cooperative or there are other equitable interests to be taken into account.

Based on these factors, we conclude that Cooperative will qualify as a constituted authority eligible to issue bonds on behalf of Town, the County, and the members of the Compact.

CONCLUSIONS

- 1) The Cooperative's income is excludible from gross income under section 115(1) of the Code.
- 2) The Cooperative is an instrumentality for purposes of section 170(c)(1). Thus, the Cooperative is eligible to receive deductible contributions or gifts made for exclusively public purposes to the extent allowed under section 170 of the Code.
- 3) The Cooperative qualifies as a constituted authority under 1.103-1(b) of the Income Tax Regulations, and therefore, is eligible to issue bonds under section 103 of the Code on behalf of the Town, the County, and the members of the Compact.

These rulings are 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,

Sylvia F. Hunt
Assistant Branch Chief, Exempt Organizations
Branch 2 (Exempt Organizations/Employment
Tax/Government Entities)
(Tax Exempt & Government Entities)