

## Internal Revenue Service

## Department of the Treasury

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**CC:TEGE:EOEG:EO2-PLR-116691-00**

Date:

January 4, 2001

### LEGEND:

Corporation =  
City =  
State =  
Convention Center =  
Consulting Firm =  
Authority =  
Franchise =

Year 1 =  
Year 2 =  
Year 3 =

:

This is in response to a letter dated August 24, 2000, from your authorized representative, requesting a ruling that the income of the Corporation will be excludable from gross income under section 115 of the Internal Revenue Code.

### FACTS

We understand the facts to be as follows. In Year 1, the City, an incorporated municipality that is a political subdivision of State, constructed the Convention Center in order to create economic benefits for the City by providing a space for events that would attract out-of-town visitors to the City. The Convention Center is owned by a nonprofit corporation controlled by the City. From its inception, the revenues of the Convention Center have been insufficient to cover its operating expenses and debt service. The City has appropriated moneys annually from its general fund to fund the deficits of the Convention Center.

In Year 2, the City was advised by consultants and users of the Convention Center that the location of a high-quality convention hotel facility would greatly enhance utilization of the Convention Center and its expansion. According to a report prepared by the Consulting Firm, the addition of the hotel would significantly increase the

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Convention Center's ability to book city-wide conventions. Following extensive exploration of the possibilities for effecting the construction of such a facility, the City decided to establish the Corporation as the instrumentality through which a hotel would be financed, constructed, owned and operated. The Corporation was incorporated in Year 3. The Corporation is a public benefit nonprofit corporation formed under the provisions of the State's Non-Profit Corporation Act.

As provided in its Articles of Incorporation, the purpose of the Corporation is to assist the City in the financing, acquisition, construction and operation of a convention center hotel, and to do all things necessary or convenient to the provision of a convention center hotel, its economic and beneficial financing, use and maintenance in the City, in order to promote the health, safety, and general welfare of the residents of the City, to increase their commerce and industry, to promote their economic development and to advance the efficiency of the citizens of the City. It is also anticipated that the hotel facility, constructed along with an adjacent parking facility, will eliminate or reduce the operating deficits of the Convention Center.

The hotel will be physically interconnected with the Convention Center and will share certain areas of the Convention Center by leasing those areas from the City. It will be constructed on land owned by the City and leased to the Corporation. It is anticipated that the cost of acquiring and constructing the convention center hotel will be financed through bonds issued by the Authority.

The Corporation is controlled by the City and the City Council of the City. Pursuant to the Articles of Incorporation and bylaws of the Corporation, the City Council appoints all directors of the Corporation and has the power at any time to remove a director with or without cause and to appoint a successor for such director. Directors serve without compensation for their services as such.

Pursuant to its bylaws, the Corporation's Board of Directors must prepare and submit to the City Council a budget for the Corporation prior to the beginning of the fiscal year for the City Council's approval. No funds of the Corporation may be expended except in accordance with the approved budget, which may be modified with City Council approval. The City Council has the right to demand an audit of the financial statements, books and records of the Corporation annually or at any time, and the City Council must receive a copy of the audit that is performed.

The Corporation does not have the power to engage in any of the following activities without the approval of the City Council:

- (i) A lease by the Corporation to a third party of a material portion of the Corporation's assets;
- (ii) A sale or other disposition by the Corporation of a material portion of the

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Corporation's assets;

- (iii) A mortgage or other encumbrance by the Corporation of a material portion of the Corporation's assets;
- (iv) Any change in the franchise or management under which the Corporation's hotel is operated; or
- (v) Any expenditure of funds other than in accordance with the budget of the Corporation approved by the City Council.

The Corporation has the right to retain all or any part of any securities or property acquired by it, and to invest any funds held by it, provided that any investment of any funds of the Corporation must first be approved in writing by the finance director of the City.

The Corporation will contract with the Franchise for the management of the convention center hotel and the space shared with the Convention Center pursuant to a 15-year management contract. The selection of the Franchise was made through a competitive process in accordance with the City's procurement ordinance. The Corporation's contract with the Franchise will comply with Rev. Proc. 97-13, 1997-1 C.B. 632. All arrangements by the Corporation for the development and management of the convention center hotel are subject to the City's procurement ordinance and will contain arms-length terms obtained through the competitive bidding process.

The Corporation is not organized for profit and no part of the net earnings of the Corporation shall inure to the benefit of, or be distributable to, its directors, officers, employees, agents or other private shareholders or persons, except that the Corporation may pay reasonable compensation for services rendered and, pursuant to its bylaws, it may make payments and distributions in furtherance of the purposes set forth in its Articles of Incorporation. The Articles of Incorporation of the Corporation provide that upon dissolution of the Corporation, all of the Corporation's assets must be distributed to the City for a public purpose. The Articles of Incorporation and the bylaws cannot be amended without the approval of the City Council.

## 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 thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, concludes that income from a fund established under a written declaration of trust by a state, for the temporary investment of positive cash balances of the state and its political subdivisions, is excludable from

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gross income under section 115 of the Code. That ruling reasons that the investment of positive cash balances by a state or a political subdivision thereof 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 revenues. Rev. Rul. 77-261 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 those projects desirable from the standpoint of the state government which, on a broad consideration of the question, may be the function of the sovereign to conduct.

In this case, the purposes and functions of the Corporation include assisting the City in the financing, acquisition, construction, and operation of a convention center hotel, and doing all things necessary or convenient to the provision of a convention center hotel, its economic and beneficial financing, use and maintenance in the City, in order to promote the health, safety, and general welfare of the residents of the City, to increase their commerce and industry, to promote their economic development and to advance the efficiency of the citizens of the City. In addition, the City seeks to raise revenues through the Corporation to lessen the current operating deficit of the Convention Center that the City has annually covered with moneys appropriated from its general fund. Based on the facts presented, the activities of the Corporation are the type contemplated in Rev. Rul. 77-261, and any income derived therefrom is derived from the exercise of an essential governmental function within the meaning of section 115 of the Code.

We further find that the income of the Corporation accrues to the City, a political subdivision of the State, for purposes of section 115(1) of the Code. No part of the earnings of the Corporation may inure to the benefit of, or be distributable to, any private person other than incidentally. Furthermore, all of the Corporation's assets must be distributed to the City for a public purpose upon dissolution of the Corporation.

In addition, the Corporation's Board of Directors must prepare and submit to the City Council a budget annually for the City Council's approval, and no funds of the Corporation may be expended except in accordance with the approved budget. The City Council has the right to demand an audit of the financial statements, books and records of the Corporation annually or at any time, and the City Council must receive a copy of the audit that is performed. Also, the amounts payable to the Franchise have been represented to have been made through a competitive request-for-proposal process conducted in accordance with the City's procurement ordinance. Finally, although the Corporation has the right to retain all or any part of any securities or property acquired by it and to invest any funds held by it, it may so invest only with the written approval of the finance director of the City. Accordingly, the income of the Corporation accrues to the City, a political subdivision of the State, for purposes of section 115(1) of the Code.

## CONCLUSION

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Accordingly, because the income of the Corporation will be derived from the exercise of an essential governmental function and will accrue to the City, we conclude that the income derived by the Corporation from the activities set forth above will be excludable from the gross income of the Corporation pursuant to section 115(1) of the Code.

No opinion is expressed or implied as to the federal tax consequences of the transaction described above under any other provision of the Code.

This ruling is 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.

Sincerely,  
By: Elizabeth Purcell  
Chief, Exempt Organizations 2  
Office of the Assistant Chief Counsel  
(Tax Exempt and Government Entities)

Enclosure: Copy for Section 6110 purposes