

INTERNAL REVENUE SERVICE

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November 24, 1999

X =

Y =

Z =

State =

Authority =

Law 1 =

Law 2 =

Law 3 =

Year =

Dear

This is in response to a letter dated June 7, 1999, requesting a private letter ruling on behalf of X regarding a ruling under section 115 of the Internal Revenue Code.

FACTS

X, a corporation, was created pursuant to the Law of State. X's articles of incorporation provide that its charitable and public purposes are (1) to purchase, lease or finance, or participate, assist or advise in the purchase, lease or finance of, equipment, materials, products or other property or services involving one or more states or political subdivisions thereof, or (2) participate in financing transactions with one or more states or political subdivisions thereof, or assist or advise one or more states or political subdivisions thereof with respect to their financing transactions.

Law 1 precludes X from distributing property, assets, profits or net revenue to any private person. Under X's bylaws, its directors will be the same individuals that serve as directors of Authority, a State authority organized pursuant to Law 2. These individuals serve without compensation other than reimbursement for necessary expenses incurred in the discharge of

their duties. All directors must comply with State law requirements concerning conflict of interest of public officials, including publicly reporting their sources of income. X's meetings are open, public and subject to State's open meeting law, Law 3. Upon dissolution, one-half of X's net assets will be distributed to the members of Y, and one-half will be distributed to the members of Z. Y's members are counties in State and Z's members are cities in State.

X was formed to serve several purposes:

1. To enable governmental entities to pool their purchasing power to take advantage of volume discounts available to bulk purchasers of goods and services.
2. To reduce governmental entities' costs by consolidating bidding and contracting procedures.
3. To serve as a products, services, and financing resource for government agencies nationwide.
4. To assist local government agencies with financing for businesses that contribute to the community.

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 performs a function similar to that performed by the membership organization in Rev. Rul. 90-74. X's performs an essential governmental function because it performs the same tasks that States and political subdivisions perform with respect to expenditures for their own property or for services rendered directly to them. The revenue of X accrues to these clients because the revenue reduces their costs.

Accordingly, X's income is excludible 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 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

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Enclosure (1)