

Internal Revenue Service

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Washington, DC 20224

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November 05, 2003

Legend

Association =

State =
Constitution

Act =
Authority =

x date =
County =

Dear :

This is in response to a letter, dated May 12, 2003, requesting a ruling that the income of the Association will be excludable from gross income under section 115 of the Internal Revenue Code ("Code") and that the Association is not required to file annual federal information returns.

FACTS

Association is a public body corporate created through an interlocal cooperative agreement authorized by Legislation enacted by State. State's Constitution authorizes local governments to enter into interlocal agreements pursuant to the provisions of Act, which provides for contractual undertakings or agreements to establish separate and distinct government bodies to provide governmental services. Act provides that public agencies of State may exercise jointly with other public agencies of State any power, privilege or authority that each local government may exercise separately. Act specifies

that a legal or administrative entity created pursuant to an interlocal cooperative agreement shall be a public body corporate or politic. Further, Act requires that, upon termination of the interlocal agreement, title to all property owned by the entity shall vest in the public agencies or local governments that created it.

On x date, Association was created as a separate legal entity and body corporate upon the signing and filing of an interlocal agreement pursuant to Act. Association is composed of municipalities and Authority, all of whom are political subdivisions of State, for the purpose of providing maximum fire protection services to residents and effectively utilizing equipment and facilities, while lessening the cost to any single political subdivision. The political subdivisions formed Association because reductions in revenue-sharing and property tax limits have made it difficult for the municipalities to fund their governmental operations.

Association's purpose is to provide cooperative fire service efforts by the political subdivision members by lending personnel and equipment to provide fire protection as needed throughout County. Each party to the interlocal agreement provides specified fire fighting apparatus and two fire fighters who will participate in the Association's fire response team. Authority is supported by fees, dues, or assessments paid by the political subdivisions that are parties to the interlocal agreement. Any municipality or agency in close proximity to County is eligible to request membership in Association.

The Association is governed by the Association board, whose members are appointed by the governing bodies of the political subdivisions that are parties to the interlocal agreement. Upon dissolution of Association and after payment of liabilities, all remaining assets of Association will be distributed to the political subdivisions who are parties to the interlocal agreement.

LAW AND ANALYSIS

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 political subdivision of a state.

When determining if section 115(1) of the Code applies, the Service considers all the facts and circumstances relating to the organization to determine: (1) whether the organization performs an essential governmental function, and (2) whether the income of the organization accrues to a state or political subdivision of a state. The determination whether a function is an essential governmental function depends on the facts and circumstances of each case.

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, is excludable from gross income for federal income tax purposes under section 115(1). The ruling indicates 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 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.

Rev. Rul. 90-74, 1990-2 C.B. 34, concerns an organization formed, operated, and funded by political subdivisions to pool their casualty risks and other risks arising from their obligations concerning public liability, workers' compensation, or employees' health obligations. The ruling states that the income of such an organization is excluded from gross income under section 115(1) of the Code so long as private interests do not participate in the organization or benefit more than incidentally from the organization. The benefit to the employees of the insurance coverage obtained by the member political subdivisions was deemed incidental to the public benefit.

Association was established to provide an improved method for political subdivisions of State to provide fire protection services to the public. Further, the Association fulfills the obligation of the political subdivisions to exercise fiscal responsibility by providing a means for these necessary services to be delivered in a less costly manner. Association was created to further legitimate governmental public functions of political subdivisions of State. Thus, Association performs an essential governmental function within the meaning of section 115(1) of the Code.

In addition to the performance of an essential governmental function, income of the Association must accrue to the State or a political subdivision of the State. Association is wholly owned by political subdivisions of State. No part of the net earnings of Association inures to the benefit of or is distributed to any private entity or individual. After paying claims and expenses, Association's income will be paid to its member political subdivisions in the event the interlocal agreement is terminated. Accordingly, the income of Association accrues to political subdivisions of the State.

Section 6012(a)(2) of the Code and Treas. Reg. section 1.6012-2(a)(1) provide, in general, that every corporation, as defined in section 7701(a)(3) of the Code, subject to taxation under subtitle A is required to file an income tax return regardless of whether it has taxable income or regardless of its gross income. See Rev. Rul. 77-261.

CONCLUSION

Therefore, based on the information submitted, we rule as follows:

(1) The income of Association is excludable from gross income under section 115 of the Code.

(2) Association will be required to file an income tax return pursuant to section 6012(a)(2).

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(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Barbara E. Beckman
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Branch 2
Office of the Division Counsel/Associate
Chief Counsel
(Tax Exempt and Government Entities)

Enclosure: Copy for 6110 purposes