

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

In Re:

Refer Reply To:

CC:TEGE:EO1 – PLR-161612-03

Date:

May 28, 2004

Legend

X =

State =

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m =

r =

City =

Facility =

W =

Y =

Z =

p =

Dear

This is in response to a ruling request dated October 13, 2003, requesting rulings on behalf of X that (i) the income of X is excludable from gross income under section 115 of the Internal Revenue Code, (ii) as a consequence of a ruling on the foregoing, X can disregard its status as an organization described in section 501(c), and (iii) X is obligated to file Form 1120 under section 6012.

FACTS

X is a non-profit corporation organized under the laws of State for the purpose of benefiting its n member political subdivisions (the “members”) that operate municipal electric utility systems through the cooperative purchasing, selling, generating, and

PLR-161612-03

transmission of electric energy and other services. X has received a determination from the Internal Revenue Service stating that it is exempt from federal income tax under section 501(c)(12) of Code. X is governed by a board of trustees consisting of m of its members. No individual, non-member municipalities, or other entities or organizations are eligible to serve as or be represented by trustees. In the event of dissolution or liquidation of X, after the payment of all debts and initial capital contributions of members, any remaining assets shall be disposed of as follows: (1) membership fees shall be refunded to members or former members in order of receipt, and (2) remaining assets, if any, shall be distributed to members and former members on the basis of their patronage while they were members.

X generates and buys electric power for its members for use in their individual municipal electric utility systems. X sells to members at cost plus a small service fee. Some members obtain all of their power through X while others purchase only a portion through X. In addition, X provides technical services and training, serves as an information clearinghouse, and assists members involving project financings and telecommunications and other utility related issues. X also coordinates "mutual aid" among the members, wherein electric crews from members are voluntarily dispatched to other members to assist in emergency or disaster situations like tornadoes and floods. X derives its revenues from membership fees and dues, the sale of energy, and the provision of services to members.

X owns and operates a generating facility near City known as Facility. The power and energy associated with Facility and associated resources are sold pursuant to take-and-pay contracts to many of its members and the payments by such members for such output are pledged by X to the payment of debt service on bonds issued by X to finance Facility. X has sponsored the creation and organization of r municipal joint venture arrangements ("Joint Ventures") among certain of its members for the purpose of acquiring electric utility assets and providing technical services. X manages the Joint Ventures under individual contracts and provides services such as planning, construction and financial management, day-to-day operation, and other professional and technical services.

X has two non-profit affiliates, W and Y and one wholly owned for-profit subsidiary, Z. W is a section 501(c)(6) membership organization that serves as a legislative liaison and lobbying arm of State's municipally-owned power systems. Y is a section 501(c)(3) organization that collects and disseminates information concerning the public power industry in State to its members and the public. Z's activities are limited to providing aggregation-consulting services to municipalities. Z's income accrues only to X.

PLR-161612-03

From time-to-time, X generates revenue from sales to non-members, including industrial customers. Such non-member sales generally fall within the following four categories: (1) sales of unused capacity of energy generation assets, (2) sales of unused capacity with respect to supply contracts, (3) miscellaneous transactions, and (4) transactions resulting from federal deregulation mandates. Savings, or positive net margin, if any, from non-member sales are utilized to lower the costs of the members whose assets are involved. Historically, non-member revenues have been closely monitored by X so as to comply with the 85/15 test applicable to section 501(c)(12) entities. The percentage of non-member revenues has generally not exceeded p percent. These revenues have not been reported as “unrelated business taxable income” that would subject X to the tax under section 511 of the Code.

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 government function and accruing to a state or any political subdivision thereof.

Section 6012(a)(2) of the Code provides, in general, that every corporation subject to taxation under subtitle A shall make returns with respect to income taxes under subtitle A. In addition, section 1.6012-2(a)(1) of the Income Tax Regulations provides, in part, that every corporation, as defined in section 7701(a)(3), subject to taxation under subtitle A of the Code, shall make a return of income regardless of whether it has taxable income or regardless of the amount of its gross income.

Rev. Rul. 77-261, 1977-2 C.B. 45, concludes that 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 under section 115(1) of the Code. The revenue 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 a public utility or the performance of some governmental function that accrues 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. Further, the accrual to a number of political subdivisions of a state as well as that state itself is not inconsistent with the statute itself. 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, is required to file a federal income tax return each year.

Rev. Rul. 90-74, 1990-2 C.B. 34, concludes that the income of an organization formed, operated, and funded by political subdivisions to pool their casualty risks, or

PLR-161612-03

other risks arising from their obligations concerning public liability, workers' compensation, or employees' health is excludable 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.

X was formed to benefit its member political subdivisions by allowing them to use their pooled resources to purchase and sell electric power at favorable rates. Such activities are similar to those undertaken by the political subdivisions in Rev. Rul. 90-74 to obtain insurance coverage at the lowest possible rate. Thus, X derives its income from an essential governmental function that accrues to the benefit of political subdivisions of State. Private interests will benefit no more than incidentally from the business operations of X. Accordingly, based on the information presented, the income of X will be excludable from gross income under section 115(1) of the Code.

You have asked for a ruling that X can disregard its status under 501(c)(12). X may terminate its exemption under section 501(c)(12) by sending a written request and a copy of this letter to:

Internal Revenue Service
Exempt Organizations Division
1111 Constitution Ave., NW
Washington, D.C. 20224
Attn: SE:T:EO:RA:T3

Section 6012 of the Code and the regulations thereunder require every corporation subject to taxation under subtitle A of the Code to make a return of income. Should X successfully terminate its status under section 501(c)(12), section 6012 would require X to file returns of income regardless that X's income is excludable from income under section 115(1). See Rev. Rul. 77-261.

Except as specifically provided otherwise, no opinion is expressed on the federal tax consequences of any particular transaction

PLR-161612-03

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

Sincerely,

David L. Marshall
Chief, Exempt Organizations
Branch 2
Division Counsel/Associate
Chief Counsel
(Tax Exempt and Government
Entities)

Enclosures:

Copy of this letter

Copy for section § 6110 purposes