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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply to:
CC:TE/GE:EO2 PLR-106327-01

Date:
June 6, 2001

LEGEND

Authority =

State =

year a =

Act =

b =

c =

d =

e =

f =

g =

h =

Corporation =

Parent =

Dear :

This is in reply to a letter dated January 22, 2001, requesting a ruling that Authority is an integral part of State.

FACTS

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Authority was created in year a by Act. Its purpose is to encourage commercial space flight in State by promoting research and participating in the development of a commercial flight center. According to its bylaws, "Authority shall be governed by the Board of Directors and shall at all times be under the control of the legislature of State." Authority's board of directors consists of twelve members. Four are public officials and eight are appointed by the governor of State. The eight board members chosen by the governor must be approved by both houses of the state legislature. The board members are subject to removal for cause under the state statute that applies to the removal of public officials.

Act directed Authority to present a detailed initial plan for the use of the funds appropriated for Authority to the Governor, the Chairmen of the Senate Finance and House Appropriations Committees and the Director of the Department of Planning and Budget before the end of year a. Authority is also required to submit an annual report containing an audited financial statement to the governor and the legislature. In addition, Act directs the Auditor of Public Accounts (a State official elected by the State legislature) to examine the accounts and books of Authority annually.

Authority has received grants of \$ b from the federal government and \$ c from State. All moneys received by Authority will be deemed to be trust funds to be held and applied solely for the purposes provided in Act. The federal agency made its grant on the condition that the moneys are expended for infrastructure development and for research on the viability of commercial space flight. According to Act, Authority is exempt from state income, sales and use taxes, and any bonds issued by Authority are exempt from state and local taxation. Authority represents that its bylaws will be amended to provided that upon termination, all of the assets of Authority will be disposed of exclusively for the purposes of Authority set forth in Act. Any assets not so disposed of shall become the property of State.

Authority formed a State limited liability company (LLC) to construct and operate launch pads, a vertical service tower, and other structures and related equipment (Flight Center). LLC has two members, Authority and a for-profit entity incorporated in State (Corporation). Corporation is a wholly owned subsidiary of Parent. In order to construct Flight Center State will contribute \$ d and Corporation will contribute up to \$ e. In addition, Corporation will provide a \$ f bridge loan to be used until permanent financing is in place. The net distributable revenue of the LLC shall be allocated g% to Authority and h% to Corporation. The LLC agreement provides that neither the members nor the LLC shall take any action which would cause the company to be treated in any manner other than as a partnership for income tax purposes.

All property involved in the enterprise shall be owned by Authority and leased to the LLC. With certain exceptions, management decisions will be made by mutual agreement of the two members. Authority is principally responsible for construction of the facility and the general control and oversight of the enterprise. The annual budget

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is subject to the unanimous vote of the members. The members agree that in the development of the annual budget they will seek to maximize net distributable revenue. Corporation will be responsible for the day-to-day operations of the facility as well as for business development.

LAW & ANALYSIS

Generally, if income is earned by an enterprise that is an integral part of a state or political subdivision of a state, that income is not taxable in the absence of specific statutory authorization to tax that income. See Rev. Rul. 87-2, 1987-1 C.B. 18; § 511(a)(2)(B); Rev. Rul. 71-131, 1971-1 C.B. 28; Rev. Rul. 71-132, 1971-1 C.B. 29.

In Maryland Savings-Share Ins. Corp. v. United States, 308 F. Supp. 761 (D. Md. 1970), rev'd on other grounds, 400 U.S. 4 (1970) (MSSIC), the State of Maryland formed a corporation to insure the customer accounts of state chartered savings and loan associations. Under MSSIC's charter, the full faith and credit of the state was not pledged for MSSIC's obligations. Only three of eleven directors were selected by state officials. The district court rejected MSSIC's claim of intergovernmental tax immunity because the state made no financial contribution to MSSIC and had no present interest in the income of MSSIC. Thus, the imposition of an income tax on MSSIC would not burden the State of Maryland. Although the Supreme Court reversed the lower court on other grounds it agreed with the lower court's analysis about the treatment of state created enterprises.

In State of Michigan and Michigan Education Trust v. United States, 40 F. 3d 817 (6th Cir. 1994), rev'g 802 F. Supp. 120 (W.D. Mich. 1992), the court held that the investment income of the Michigan Education Trust (MET) was not subject to current taxation under section 11(a). The court's opinion is internally inconsistent because it concludes that MET qualifies as a political subdivision of the State of Michigan (Id. at 825), that MET is "in a broad sense" a municipal corporation (Id. at 826), and that MET is in any event an integral part of the State of Michigan (Id. at 829). Moreover, the court's reliance on the factors listed in Rev. Rul. 57-128, 1957-1 C.B. 311, to reach its conclusion is misplaced. The revenue ruling applies to entities that are separate from the state. The factors in the revenue ruling do not determine whether an enterprise is considered to be a separate entity or an integral part of the state.

In determining whether an enterprise is an integral part of the state, it is necessary to consider all of the facts and circumstances, including the state's degree of control over the enterprise and the state's financial commitment to the enterprise.

The control State exercises over Authority is substantial. According to Act, Authority's board of directors consists of four state officials and eight directors chosen by the governor. The eight directors appointed by the governor must be confirmed by both houses of the legislature. They are all subject to removal for cause under the state statute for the removal of public officials. Authority was created by state

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legislation. Authority is required, by the legislation creating it, to submit a detailed initial plan for the use of general funds appropriated for the use of Authority to the governor and the state legislature. Authority is also required to submit an annual report and financial statement to the governor and the state legislature. The financial commitment State has made to Authority is also substantial. State has contributed \$ x.

CONCLUSION

Accordingly, after considering the financial commitment that State has made to Authority and the degree of control exercised over Authority by State, we conclude that Authority is an integral part of State.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning the status of LLC for federal tax purposes or concerning the allocation of the income, profits, losses, gains or deductions of LLC.

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

Sincerely,
Elizabeth Purcell, Chief
Exempt Organizations
Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures:

Copy of this letter
Copy for § 6110 purposes

CC: