Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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UIL No: 0115.02-00, 115.06-00

Refer Reply to:
CC:DOM:FI&P:3/PLR-122663-98

Date:
MAR 16 1999

Legend:

Taxpayer =

State X =

Year 1 =

This responds to a request for ruling dated December 21, 1998, as supplemented, you submitted on the Taxpayer's behalf. You requested a ruling on whether the Taxpayer's income is subject to federal income tax.

FACTS

The Taxpayer is a public corporation that was created by the legislature of State X in Year 1. The Taxpayer was created initially to manage State X's gas tax revenues. Since its creation, the Taxpayer's activities have grown to include: (1) supervising monies and other assets applicable to bonds, notes, and other forms of indebtedness of State X's counties, special road and bridge districts, or any other special taxing districts of State X, and (2) managing and administering certain of other of State X's funds. The Taxpayer also supervises debt service payments on the debt instruments under its supervision and invests funds in sinking funds created for such debt instruments.

The Taxpayer prepares and approves an operating budget annually. State X originally funded the Taxpayer through the gas tax assignment of revenue and now funds the Taxpayer by allowing it to charge State X operations and funds for its services.

The Taxpayer is empowered, by statute, to make purchases, sales, exchanges, investments, and reinvestments for the funds it administers, invest fund monies in the best interests of State X, account for investments, retain investment advisers or managers, prepare and approve its annual operating budget, establish fees to cover expenses, and promulgate rules governing its operating procedures which have the force and effect of a statute.

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The state constitution of State X grants the Taxpayer the statutory powers of several categories of political subdivisions of State X. Among these powers are the power to tax and the power of eminent domain.

The Taxpayer is comprised of three individuals all of whom are elected officials of State X. These individuals are the Governor, Treasurer, and Comptroller of State X. The Taxpayer is held to prescribed fiduciary standards in its management of State X monies. The Taxpayer is also subject to investment restrictions with respect to a prescribed percentage of the monies under its management. The types of investments the Taxpayer may make are also restricted by State X law.

LAW AND ANALYSIS

In general, if income is earned by an enterprise that is an integral part of a state or a 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; GCM 14407, C.B. XIV-1, 103 (1935), superseded by Rev. Rul. 71-131, 1971-1 C.B. 28.

The term "political subdivision" is not defined in the Code. Section 1.103-1(b) of the Income Tax Regulations, however, generally provides that the term "political subdivision" denotes any division of any state or local governmental unit that is a municipal corporation, or which has been delegated the right to exercise a portion of the sovereign power of the governmental unit.

The three generally acknowledged sovereign powers are the police power, the power to tax, and the power of eminent domain. Estate of Shamberg, 3 T.C. 131, 143, aff'd, 144 F.2d 998 (2nd Cir. 1944), cert. denied 323 U.S. 79 (1945). It is not necessary that all three of these powers be delegated to treat an entity as a political subdivision for purposes of the Code. Rather, all of the facts and circumstances must be taken into consideration, including the public purposes of the entity and the extent to which it is subject to control by a governmental body. Rev. Rul. 77-164, 1977-1 C.B. 20.

In the instant case, the Taxpayer's operations are subject to the control of three of State X's highest elective office holders. These operations are highly regulated under State X law. The funds administered by the Taxpayer are created under State X law, under the auspices of State X and political subdivisions of State X. The state constitution of State X indirectly delegates the powers to tax and of eminent domain to the Taxpayer.

HOLDING

Based on the above representations, we conclude that, for federal income tax purposes, the Taxpayer is a political subdivision of State X. Accordingly, the Taxpayer is not required to file federal income tax returns or pay federal income tax on its income.

Except as specifically ruled upon above, no opinion is expressed or implied regarding the federal tax aspects of this transaction.

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

Sincerely yours,

Assistant Chief Counsel
(Financial Institutions
and Products)

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Alice M. Bennett
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Enclosure:
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