

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

December 19, 2000

**LEGEND:**

Corporation =

Authority =

City =

State =

a =

b =

c =

d =

e =

Dear . :

This letter is in response for your request for several rulings. You have requested rulings that:

- (1) Corporation is an integral part of Authority (a political subdivision of the State) and not subject to federal income taxation.
- (2) As a state or local governmental unit, Corporation is not required to file federal income tax returns.
- (3) Alternatively, Corporation's income is excluded from gross income pursuant to section 115 of the Internal Revenue Code.

**FACTS AND REPRESENTATIONS**

Corporation was founded as a nonprofit charitable corporation under the laws of State. Its articles of incorporation state that it is "formed for benevolent, civic or charitable purposes, ... and, more particularly to, to engage in, assist in, and otherwise carry out, either individually or in cooperation with other entities, either public or private, or both, all or any of the development, redevelopment, financing related to public housing in the [City], all in furtherance of the purposes of the [Authority]... .' An amendment to the articles states that Corporation is organized exclusively for

charitable, religious, educational, and scientific purposes, including for such purposes, the making of distributions that qualify as exempt organizations of section 501(c)(3) of the Internal Revenue Code or to a state, possession of the United States, or any political subdivision of the foregoing, or the United States, but only if such contribution is for exclusively public purposes, pursuant to section 170(c)(1) of the Internal Revenue Code, or corresponding sections of any future federal tax code.

According to Corporation's Articles, Authority is its sole member, and all the directors of the Corporation shall be officers or employees of the sole member of the Corporation and shall be elected or appointed by the member. Corporation's articles of incorporation further provide that the Authority shall monitor and review the Corporation's performance and have access to all books and records of the Corporation.

Corporation's articles of incorporation also state that it has powers under State's laws to the extent these powers do not conflict with the Corporation's function as a charitable corporation under the Internal Revenue Code. The Corporation shall not dispose of any interest in real or personal property or other assets nor shall it alter or amend its Articles or any bylaws without the express written consent of the Authority in advance.

Corporation's articles of incorporation provide that no part of its earnings shall inure to the benefit of, or be distributable to its members, trustees, officers or other private persons except that (1) the organization shall be authorized and empowered to provide reasonable compensation for services rendered and to make payments and distributions in furtherance of the Corporation's purposes, and (2) so long as the organization's sole member shall be the Authority, the net earnings of the organization shall be used exclusively to support the Authority. Upon dissolution, all assets and interest in any real or personal property of the Corporation shall vest in the Authority.

Authority's statutory purpose is to provide public housing to low income persons in the City. It finances its activities in part by the selling of interests in certain housing developments to limited partnerships, through the federal low income housing tax credit program under section 42 of the Internal Revenue Code. Corporation holds the funds received from the syndication of interests in the developments, along with other funds (grants from the United States Department of Housing and Urban Development, for example) and pays them out, in accordance with the terms of the agreements of the parties, as needed by Authority for construction and other phases of the housing projects. You represent that under the laws of the State, the Authority has the power of eminent domain. Also the Authority operates a police force, under authority delegated to it by the City, and within the limit of its property, the Authority's officers have duties comparable to the authority, powers, and duties of police officers of cities and towns.

As of date a, the Authority was maintaining b developments encompassing c federally funded units and d state funded units. The Authority also has a leased

housing assistance program which provides housing assistance to approximately e tenants.

Among its activities, the Authority has entered into agreements with several private entities for the development of mixed-financed, mixed income housing, including replacing public housing units at some of the Authority's developments under United States Department of Housing and Urban Development (HUD) Hope VI grant program. These agreements require the Authority to provide partial financing and future assistance to preserve the affordable housing initiatives as outlined in its annual contribution contracts with HUD. The agreements also require the private entities to provide equity participating for which they receive allocation of low income housing tax credits.

The Authority has assigned to the Corporation certain loans receivable from the syndication of interests in the Authority's developments. These loans have substantial value. The Corporation holds the funds received from the syndication of interests in the developments along with other funds, such as grants from HUD, and pays them out, in accordance with the terms of the agreements of the parties, as needed by the Authority for construction and other phases of the development of the housing projects.

While Corporation's amended articles suggest Corporation is intended to qualify as an organization under section 501(c)(3), you have advised that Corporation has not applied for recognition of tax-exempt status an organization described in section 501(c)(3), nor does it intend to.

## LAW AND ANALYSIS

### Issue 1

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; section 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 Insurance Corp. v. United States, 308 F. Supp. 761, 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 of the instrumentality and section 115 issues.

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 a 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 a state.

Nevertheless, in determining whether an enterprise is an integral part of a 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.

Section 301.7701-1 et. seq. of the Procedure and Administration Regulations, the so-called "check-the-box" regulations, supports the position that an entity that is separate from a state or political subdivision may still be an integral part of that state or political subdivision. Section 301.7701-1(a)(3) provides, in part, that:

An entity formed under local law is not always recognized as a separate entity for federal tax purposes. For example, an organization wholly owned by a State is not recognized as a separate entity for federal tax purposes if it is an integral part of the State.

Section 301.7701-2(a) provides:

For purposes of this section and section 301.7701-3, a business entity is any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under section 301.7701-3) that is not properly classified as a trust under section 301.7701-4 or otherwise subject to special treatment under the Internal Revenue Code. A business entity with two or more members is classified for federal tax purposes as either corporation or a partnership. A business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.

Section 301.7701-2(b) provides, in part:

For federal tax purposes, the term corporation means --

(1) A business entity organized under a Federal or State statute, or under a statute of a federally recognized Indian tribe, if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic;

(2) An association (as determined under section 301.7701-3);

\* \* \*

(6) A business entity wholly owned by a State or any political subdivision thereof.

Thus, the check-the-box regulations indicate that even if Corporation were classified as a separate entity from Authority, it nevertheless could be treated as an integral part of the Authority if it so qualifies.

In this case, Corporation was formed by Authority. You represent that Authority is a political subdivision of the State. The Authority created the Corporation to fulfill some of its functions. Authority controls the Corporation. The Authority is the sole member of the Corporation and all the Corporation's directors are officers or employees of the Authority, which elects or appoints them. You represent that the Authority's officers, directors and employees hold similar positions as officers, directors and employees of the Corporation, and provide services to the Corporation similar to those they provide to the Authority, without additional compensation. The Authority monitors and reviews the Corporation's performance and has access to all books and records of the Corporation. The Corporation cannot dispose of any interest in real or personal property or other assets nor can it alter or amend its articles or any bylaws without the express written consent of the Authority in advance.

The Authority has assigned a substantial amount of loans receivable to the Corporation for the Corporation hold and manage in enabling the Authority to carry out its operations. The assignment of the loans receivable to Corporation shows a substantial financial commitment from the Authority.

Because we have determined that Corporation is an integral part of a political subdivision of the State, we need not address whether its income is excludable from gross income under section 115(1).

## Issue II

The Corporation has requested a ruling that as an integral part of a political subdivision of the State, it is exempt from the filing requirements of section 6033(a)(1) of the Code. Section 6033 does not apply to Corporation because section 6033 applies only to organizations recognized as exempt from federal income taxation under section 501(c). Moreover, the return-filing requirements of section 6012 do not apply to states or their political subdivisions.

## CONCLUSIONS

(1) Corporation is an integral part of Authority (a political subdivision of the State) and not subject to federal income taxation.

(2) As a state or local governmental unit, Corporation is not required to file federal income tax returns.

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.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,  
By: Elizabeth Purcell  
Chief, Exempt Organizations Branch 2

Enclosure:  
Copy for section 6110 purposes