

# **Bond Case Briefs**

*Municipal Finance Law Since 1971*

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## **IRS LTR: IRS Discusses Income Exclusion Relating to Public Utilities.**

The IRS advised that income from any public utility or the exercise of any essential governmental function that otherwise qualifies for exclusion under section 115 will not cease to qualify for that treatment merely because the entity earning the income is a co-owner of an electric generating facility as long as certain requirements are met.

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Refer Reply To:

CC:TEGE:EOEG:E0 - GENIN-113227-12

Dear \* \* \*:

This letter responds to your request for information dated February 29, 2012. You requested information about whether the income an entity derives from any public utility or the exercise of any essential governmental function can qualify for exclusion from gross income under section 115 of the Internal Revenue Code (the "Code") if the entity and a nongovernmental entity each own an undivided interest in an electric generating facility under a structure that would not result in private business use of the entity's interest by the nongovernmental co-owner under the tax-exempt bond rules.

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 any political subdivision thereof or the District of Columbia.

Section 115(1) of the Code applies not to the income of a State or political subdivision resulting from its own direct participation in industry, but rather to income of a separate entity engaged in the operation of a public utility or the performance of some governmental function that accrues to a State or political subdivision. See Rev. Rul. 77-261, 1977-2 C.B. 45. Rev. Rul. 77-261 concludes that income of a State investment fund "accrues" to the State and the participating political subdivisions because the State and the political subdivisions have an unrestricted right to receive in their own right their proportionate share of the investment fund's income as it is earned. Rev. Rul. 90-74, 1990-2 C.B. 34, concludes that income of an organization formed by political subdivisions to pool their casualty risks "accrues" to the member political subdivisions because the organization's income is used to reimburse casualty losses incurred by the members or to reduce the annual fees that they otherwise would be required to pay to the organization, and upon dissolution the organization will distribute its assets to its member political subdivisions.

Section 141 of the Code defines obligations of a State or political subdivision thereof that are "private activity bonds." It distinguishes between government use and private business use of bond-financed facilities. The Treasury Regulations under Section 141 describe circumstances in which a

governmental entity's undivided ownership interest in an electric generating facility is not treated as used by the other, nongovernmental owner of the facility and, therefore, the bonds are not private activity bonds. Example 1 of section 1.141-7(i) of the Treasury Regulations involves a facility that is owned under a co-ownership structure involving both governmental and nongovernmental co-owners, and concludes that this arrangement does not result in "private business use" by the nongovernmental co-owner of the governmental co-owner's tax-exempt bond financed portion of the facility. This example describes the ownership structure as joint ownership as tenants in common, with each of the participants sharing in the ownership, output, and operating expenses of the facility in proportion to its contribution to the cost of the facility. The governmental entity funded its portion of the cost of the facility using tax-exempt bond proceeds and the nongovernmental entity used its own funds to pay its share of the facility's costs.

Co-ownership of an electric generating facility that is structured in the manner described in Example 1 of section 1.141-7(i) of the Treasury Regulations will not prevent the income of a governmental co-owner of the facility from accruing to a State or a political subdivision. Thus, income derived from any public utility or the exercise of any essential governmental function that otherwise qualifies for exclusion from gross income under section 115 will not cease to qualify for such treatment merely because the entity earning the income is a co-owner of an electric generating facility if the co-ownership arrangement is structured in accordance with Example 1 of section 1.141-7(i) of the Treasury Regulations.

This letter has called your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. See Rev. Proc. 2012-1, I.R.B. 2012-1 (Jan. 3, 2012). If you have any additional questions, please contact me at \* \* \*.

- Sincerely,
- Sylvia F. Hunt
- Assistant Branch Chief,
- Exempt Organizations Branch
  - (Tax Exempt & Government Entities)