Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:TE/GE:EOEG:TEB PLR-157034-01
Date:
April 19, 2002

Legend:

Authority	=
City	=
State	=
Division	=
Date 1	=
Date 2	=
Date 3	=
X	=

Dear

This in response to your letter requesting a ruling that certain bonds issued by the Authority will not be treated as “refunding issues” within the meaning of § 1.150-1(d) of the Income Tax Regulations of obligations previously issued by the City.

Facts:

The City is a political subdivision of the State with substantial police, eminent domain and taxing powers. The City, acting through an operating division (the “Division”), has operated water and sewer, electric, and gas utility systems (the “Systems”) to serve the needs of individuals and businesses within the boundaries of the City and in certain adjacent areas. City financed and refinanced the acquisition and improvement of the assets required to operate each of the Systems (the “System Assets”) through the issuance and sale of obligations issued by the City (the “City Bonds”).

The Division was not a political subdivision; it did not have taxing, eminent domain, or police powers. The Division was managed by the Board of Utility Commissioners (the “Division Board”), the members of which were elected for five-year,

staggered terms by the City Council. The members were removable only for good cause, and after proper hearing, by the City.

The Division operated each of the Systems on an independent, self-sustaining basis. However, the City controlled certain of the Division's operations. Certain contracts involving an obligation or expenditure above a certain dollar amount required City approval. In addition, generally, the Division could not issue debt except for debt that was to pay current operating expenses when that debt was to be repaid from operating revenues. The Division also was required to provide water to the City for fire protection and street cleaning at no charge.

The City also had limited control over increases in fees and charges imposed by the Division. Proposed increases in fees and charges were published in a newspaper of general circulation in the City, and the increase could not become effective until 30 days from the date of publication. If, during that period, at least one percent of the users of the services affected by the proposed increase filed notice of protest with the Division, then the proposed increase could not be effective unless approved by the City Council. There has never been a protest filed, and Authority expects that no protest will be filed in the future.

The Division has been dissolved and the Systems are now being operated by the Authority. The Authority is a political subdivision created by State legislation to own and operate water, wastewater, gas, telecommunications and electric utility systems serving customers located within and without the boundaries of the City. The Authority was created to permit the city to transfer the Systems to an independent government unit focused solely on the operation, maintenance, financing and expansion of the existing Systems, thereby relieving the City of the managerial and financial responsibilites and costs associated with ownership and operation of the Systems.

The Authority is governed by a five-person board of directors (the "Authority Board"). The initial members of the Authority Board are the current members of the Division Board, who serve terms equal to the period of time remaining on their Division Board terms. Thereafter, the Mayor, with the approval of the City Council, will appoint members of the Authority Board for five-year staggered terms. Members of the Authority Board may only be removed by a two-thirds vote of the City Council for "cause."

The Authority has the power to acquire and operate the Systems without oversight, input or approval from the City. The Authority has the following rights: to acquire and operate any type of utility asset; to borrow money, grant mortgages and other liens to secure its obligations; to enter into contracts relating to its activities; to condemn property through the exercise of the power of eminent domain; and to fix, charge and collect fees and other charges for the use of, or in connection with, the Systems or facilities, without the necessity of review or approval by the City, any other municipality, the State or any commission or authority of the foregoing (except rate increases are subject to the same limitation that existed for the Division). In addition, the City has no power under State law to require the Authority to use its funds or assets

for any particular purpose, to cause the dissolution of the Authority, or to review the Authority's books, other than the general right granted to all persons under State law. The City is, however, entitled to the assets of the Authority upon dissolution. Unlike the Division, the Authority is not required to provide free water to the Authority, however, the Authority provides free water to the City's fire hydrants because it is impractical to meter this water. The Authority must make in lieu of tax payments to the City and to any other jurisdiction in which it operates as is required of all utilities under State law.

State Constitution requires local approval of State legislation that is local or private in form, or affects a particular county or municipality. Thus, before jurisdiction and control of the System could be transferred to the Authority, the City had to approve the State law creating the Authority by a two-thirds vote of the City Council and grant the Authority a franchise to provide within the corporate limits of the City all of the services the State law creating the Authority. State law also authorizes the City to transfer the System Assets to the Authority, provided that upon such transfer, the Authority either redeems, defeases or assumes the City Bonds, and provided that such transfer does not impair the rights of the holders of the City Bonds. On Date 1, the City Council unanimously approved the State law creating the Authority.

On Date 2, the City Council adopted a resolution (the "City Resolution") granting the Authority a franchise to maintain and operate the Systems. The City Resolution authorized the Mayor to transfer the System Assets to the Authority conditioned upon the Authority's making arrangements to pay or assume the City Bonds.

On Date 3, the Authority Board adopted a resolution (the "Authority Resolution") authorizing the issuance of up to $ X of bonds (the "Authority Bonds") to be issued in several series, with each series payable solely from the revenues of the Systems to which the refinanced City Bonds relate. The proceeds of the Authority Bonds will be used to make a payment to the City in the amount necessary to redeem or defease all of the outstanding City Bonds.

Law and Analysis:

Generally, for all purposes of §§ 103 and 141 through 150, a refunding issue is an issue of obligations the proceeds of which are used to pay principal, interest, or redemption price on another issue, including the issuance costs, accrued interest, or capitalized interest on the refunding issue, a reserve or replacement fund, or similar costs, if any, properly allocable to that refunding issue. § 1.150-1(d)(1). An issue is not a refunding issue to the extent that the obligor of one issue is neither the obligor of the other issue nor a related party with respect to the obligor of the other issue. § 1.150-1(d)(2)(ii)(A). Section 1.150-1(d)(2)(ii)(B) generally defines "obligor" as the actual issuer of the issue. Section 1.150-1(b) provides that "related party" means, in reference to a governmental unit, any member of the same controlled group.

Section 1.150-1(e) provides that "controlled group" means a group of entities controlled directly or indirectly by the same entity or group of entities within the meaning

of § 1.150-1(e). Under § 1.150-1(e)(1), the determination of direct control is made on the basis of all the relevant facts and circumstances. In addition, § 1.150-1(e)(1) provides that one entity or group of entities (the "controlling entity") generally controls another entity or group of entities (the "controlled entity") for purposes of § 1.150-1(e) if the controlling entity possesses either of the following rights or powers and the rights or powers are discretionary and non-ministerial -- (1) The right or power both to approve and to remove without cause a controlling portion of the governing body of the controlled entity; or (2) The right or power to require the use of funds or assets of the controlled entity for any purpose of the controlling entity.

Under § 1.150-1(e)(3), an entity is not a controlled entity under § 1.150-1(e) if the entity possesses substantial taxing, eminent domain, and police powers. For example, a city possessing substantial amounts of each of these sovereign powers is not a controlled entity of the state.

The City is the issuer of the City Bonds and under §1.150-1(d)(2)(ii)(B) is the obligor on the City Bonds. The Authority will be the issuer on the Authority Bonds and will be the obligor on the Authority Bonds. The issue is whether the Authority is related to the City or an entity related to the City. We conclude that, even if we assume that the Division is related to the City, the Authority is not related to the City.

While the City has the right to appoint members of the Board of Directors of the Authority, it cannot remove a director except for cause upon two-thirds vote of the City Council. Moreover, the City does not have the right to use the funds or assets of the Authority, except upon dissolution of the Authority. While the Authority succeeds to the operations of the Division, the scope of its operations is different from the Division. In addition to the services provided by the Division, the Authority provides telecommunications systems. The Authority also has the power of eminent domain and operates the Systems with less oversight by the City than the Division operated. For example, the Division needed approval of certain contracts and debt. No similar requirements exist for the Authority.

Conclusion:

We conclude that the Authority is neither the obligor of the City Bonds nor a related party with respect to the City Bonds. Accordingly, the Authority bonds will not be treated as “refunding issues” of the City Bonds within the meaning of § 1.150-1(d) of the income tax regulations.

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.

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, including whether the City Bonds or the Authority Bonds comply with the requirements of the Code and regulations for interest on those bonds to be excluded from gross income under §103.

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.

Assistant Chief Counsel (Exempt
Organizations/Employment Tax/Government Entities)
By: s/Rebecca Harrigal
Rebecca Harrigal
Chief Tax Exempt Bonds Branch

Enclosure: Copy for § 6110 purposes

cc and copy for § 6110 purposes