

Internal Revenue Service

Department of the Treasury

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Washington, D.C.

Person to Contact:

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Telephone Number:

Refer Reply to:

CC:TE/GE:EO2 PLR-107386-01

Date:

July 3, 2001

LEGEND

Fund =

Corporation =

State =

Act A =

Act B =

year a =

year b =

year c =

year d =

e =

f =

g =

h =

i =

Program =

Dear :

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This is in reply to a letter from your representative dated January 26, 2001, requesting a ruling that Fund is an integral part of State and that certain payments to Fund made by consumers pursuant to Program will be deductible by them as charitable contributions under § 170 of the Internal Revenue Code.

FACTS

Corporation was created in year a by Act A. Its purpose, as originally enacted, was to establish and operate one or more educational centers. The centers were intended to provide advanced education and practical training in emerging areas of science and technology in order to satisfy the education and employment needs of the state.

According to Act A, Corporation is a body, politic and corporate. It is placed in State's department of economic development but is not subject to the supervision or control of this department. Instead, Act A provides that Corporation is governed by a board of directors which consists of three state officials, four members selected from a list of persons nominated by the State legislature and sixteen members appointed by the governor. Any director may be removed by the governor for cause. With certain exceptions, the state statute regulating the conduct of public officials and employees applies to the directors, officers and employees of Corporation. In addition, the State statute governing public authorities and public agencies with respect to fraud and waste apply to Corporation.

In year b, Act A was amended to provide \$ e in state funds as State's contribution to the first education center established by Corporation. The books and records of Corporation are subject to an annual audit by the auditor of State. Act also requires Corporation to submit an annual report to the State legislature.

In year c, Act A was amended again. These amendments changed the purpose of Corporation. They directed Corporation to make the education center self-sufficient of regular, annual public maintenance funding. Instead, they authorized Corporation to aggressively use the resources of the center to directly support technology firms to maintain, expand and locate their business activities with the state, thereby increasing employment opportunities for the citizens of the state. The year c amendments also contained provisions allowing the formation of one or more technology partnerships with interested industrial firms and universities, the federal government and venture capital firms for the purpose of fully exploiting the substantial resources of the education centers. Such technology partnerships may involve the lease or licensing of all or part of the facilities, intellectual property or related resources, the furnishing of design and/or fabrication services, cooperative technology development and technology-sharing arrangements. Included in the amendments made to Act A in year c was a provision requiring that all income of Corporation be held and applied solely to accomplish the essential governmental functions of Corporation. In addition, the amendments include a provision that no income of Corporation shall accrue to any private individual or

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organization, and that upon dissolution of Corporation all of its assets shall be returned to the State.

Fund

Fund was created pursuant to an amendment to Act A in year d. Fund is a separate trust fund set up on the books of Corporation. Corporation is required to credit to Fund all amounts collected pursuant to Act B, also enacted in year d, and any income derived from the investment of amounts credited to Fund. All amounts credited to Fund are to be held in trust and used solely for activities consistent with the public purpose of Fund. The purpose of Fund is to promote the availability and use of renewable energy. Renewable sources are certain sources other than coal, oil, natural gas except when used in fuel cells, and nuclear power. According to Act A, as amended in year d, Fund is to accomplish its purpose by, among other things, the stimulation of increased public and private sector investment, and the stimulation of entrepreneurial activities in these and related enterprises, institutions, and projects. In furtherance of these purposes the board of Corporation is permitted to expend monies from the fund to make grants, contracts, loans and equity investments or rebates to customer or take any other actions it deems appropriate.

The governor of State shall, from the recommendation submitted by the chairman of the board of Corporation, appoint an advisory committee to assist Corporation in matters related to Fund. The advisory committee includes no more than 15 individuals with an interest in and knowledge and experience in related areas. The board shall consult with the advisory committee in discharging its obligations with respect to Fund. The books and record of Corporation relative to expenditures and investments of monies from Fund are subject to a biennial audit by the auditor of State. The board of Corporation, in conjunction with the advisory committee, is required to annually submit to the governor, to certain state committees, and to the state legislature, a report detailing the expenditure and investments of monies from Fund, as well as any recommendations for improving the ability of the Corporation, the board of Corporation, and Fund to meet the requirements and provisions of section of Act relating to Fund.

The board of Corporation is required, in consultation with the State division of energy and the advisory committee of Fund, to adopt a plan for the application of Fund to support a renewable energy program, subject to periodic revision by the board, that ensures the Fund will be employed to provide financial and non-financial resource to overcome barriers facing renewable energy enterprises, institutions and projects. Subject to the approval of the board of Corporation, investment activity of monies from Fund may include an equity fund, to provide risk capital to renewable energy enterprises, institutions, and projects.

In State, customers obtain electricity at the retail level either from investor owned utility companies or from municipally owned plants. The municipally owned plants are subject to substantially less state regulation. Act A, as amended in year d,

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was enacted to replace certain privileges enjoyed by investor owned utility companies in State under the prior regulatory system. Pursuant to Act B, certain charges are collected by the investor owned utility distribution companies and remitted to Corporation which deposits the charges into Fund. Corporation is charged with administering Fund consistent with the public purposes for which the charges were enacted, as provided in Act B.

The relevant provision of Act B imposes two charges. The first charge, the renewable energy charge, is approximately \$ f per kilowatt hour. Its purpose is to support the development and promotion of renewable energy projects in accordance with Act A. The second charge, the waste-to-energy charge, is \$ g per kilowatt hour of electricity. Its purpose is to provide grants to municipalities and certain other entities with existing renewable energy facilities that use waste-to-energy technology in municipal solid waste plants to pay for pollution control technology or to close the facility. Fund represents that the renewable energy charge is expected to generate approximately \$ h over the first five years, and the waste-to-energy charge is expected to generate approximately \$i. Act A provides that the waste-to-energy charge must be especially segregated in Fund and used only for the purposes specially designated by Act A for this charge. Although the charges are imposed by the State legislature on the customers of investor owned utilities and, in certain cases, on the customers of municipally owned plants, in practice, the charges falls only on the customers of investor owned plants. These charges do not constitute fees in exchange for services.

Fund established Program to support and encourage the development of power from renewable sources. Fund represents that under Program, consumers make donations to Fund on their monthly electric statements. In addition to their payment for the billed cost of standard power for their own account, a consumer will be able to elect to donate to the Fund an amount equal to the incremental cost of a corresponding amount of various types of power from renewable sources. Alternatively, the consumer's monthly statement will indicate that they can donate to Fund by overpaying their bills by \$1, \$5, \$10 or more with the amount designated going to Fund. These amounts are collected by the utility company and transferred to Corporation on a monthly basis for deposit in Fund.

Fund represents that it will make payments to certain qualifying consumers on the condition that they agree to purchase power from renewable sources. The amount of the payment corresponds to the incremental cost of the type of renewable source energy they choose to receive from Program. In fact, the qualifying consumers receive the same power at the same rates whether or not they receive a payment as a qualifying consumer from Program. Due to the nature of the power grid, consumers who pay for renewable power do not necessarily actually receive power from renewable sources because electricity delivered to customers cannot be physically traced to a specific generation asset. When customers buy a specific, grid-delivered power product they do not physically receive specific electrons. Instead, their generator of choice simply adds the electrons demanded to the entire power pool, which are then delivered to all customers indiscriminately. Thus, the sole consequence of a renewable

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source purchase by a qualifying consumer is to cause more renewable energy to be added to the pool of energy available to everyone through the power grid.

LAW & ANALYSIS

Integral Part

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; 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.

Section 301.7701-1 et seq. of the Procedure and Administration Regulations, the so-called "check-the-box" regulations, support the position that an entity that is recognized as separate from a state or political subdivision for local law purposes may still be an integral part of that state political subdivision. Section 301.7701-1(a) 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.

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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.

Corporation

The control State exercises over Corporation is substantial. According to Act A, Corporation's board of directors consists of three state officials, four directors chosen from a list submitted by the legislature, and sixteen directors elected by the governor. The directors can be removed by the governor for cause, and are subject to many of the state statutes regulating the conduct of public employees. Corporation was created by state legislation and placed in the State department of economic development. The books and records of Corporation are subject to an annual audit by the auditor of State. Act A also requires Corporation to submit an annual report to the State legislature. The financial commitment State has made to Corporation is also substantial. In year b, State provided \$ e in state funds as State's contribution to the first education center established by Corporation. State's contribution to Corporation represents a substantial portion of the net worth of Corporation.

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

Fund

The control State exercises over Fund is also substantial. Fund was created when the state legislature amended Act A, the statute which created Corporation. According to Act A, as amended, Fund is subject to the control of Corporation's board of directors. In addition, Fund has its own advisory board, consisting of fifteen members appointed by the governor. The board consults with the advisory committee in discharging its obligations with respect to Fund. The books and record of Corporation relative to expenditures and investments of monies from Fund are subject to a biennial audit by the auditor of State. The board of Corporation, in conjunction with the advisory committee, is required to submit to the governor, certain state committees, and the state legislature, a report detailing the expenditure and investments of monies from Fund. The financial commitment State has made to Fund is also substantial. State has assessed charges on the end users of electrical power distributed by private utility companies. The charge is not a fee in exchange for services. Fund is used for programs that benefit equally the entire populace of State. Approximately \$ h will be turned over to Corporation to deposit in Fund, as mandated by state legislation. This constitutes a substantial portion of Fund's net worth.

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

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Section 170

Section 170(a)(1) of the Code provides, subject to certain limitations, a deduction for contributions or gifts to or for the use of organizations described in § 170(c), payment of which is made within the taxable year.

Section 170(c)(1) of the Code states that the term “charitable contribution” includes a contribution or gift to or for the use of a State, a possession of the United States, any political subdivision of a State or any possession of the United States, or the District of Columbia, but only if the contribution is made for exclusively public purposes.

In this case, consumers will make contributions or gifts to Fund pursuant to Program. Since Fund is an integral part of State, contributions or gifts to or for the use of Fund are to or for the use of an entity described in § 170(c)(1) of the Code. Accordingly, contributions or gifts to or for the use of Fund are to or for the use of State and, provided they are made for exclusively public purposes, are generally deductible under § 170(c)(1) to the extent otherwise allowed by § 170.

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 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: