

**Internal Revenue Service**

Department of the Treasury

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Telephone Number:

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Date:

04/02/2002

**LEGEND**

Authority =

State =

Town =

Dear :

This is in reply to the letter dated November 7, 2001 from your authorized representative, requesting a ruling that Authority is a political subdivision, as defined in Treas. Reg. § 1.103-1(b), and that its income is not subject to federal income tax.

**FACTS**

The Authority was created pursuant to special legislation by the State general assembly (the "Legislation") to provide adequate water supplies for all the residents of the Town. The Legislation found that the lack of water adversely affects the welfare, safety and prosperity of the people resident in the Town. To correct these problems the Legislation created the Authority, a public corporation separate and apart from the State and the Town, with the power to acquire, develop, construct, operate and maintain all properties necessary to provide adequate water to the residents of the Town. The powers of the Authority are vested in a board of directors composed of seven members appointed by the Town's administrator with and after the advice and consent of the local governing body of the Town.

The Legislation gives the Authority the power to acquire any real property through the process of eminent domain. The Authority's board of directors may exercise their power of eminent domain by an affirmative vote of not less than five directors. The Authority must obtain the consent of the State or of the Town to acquire property owned by the State or Town through the process of eminent domain.

## LAW AND ANALYSIS

In general, the income of states and their political subdivisions is not subject to federal income tax, 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.

The term “political subdivision” is not defined in the Code. Under §1.103-1(b) of the Income Tax Regulations, however, the term “political subdivision” denotes any division of any State or local governmental unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the unit. In Commissioner v. Shamberg’s Estate, 144 F. 2d 998 (2d Cir. 1994), cert. denied, 323 U.S. 792 (1945) the three recognized sovereign powers are described as the power to tax, the power of eminent domain, and the police power. Section 1.103-1(b) and the Second Circuit in Shamberg require that only “part” of these powers need to be delegated for a division of a state or local government unit to be considered a “political subdivision.” However, the Service has consistently held that if only an insubstantial amount of any or all such sovereign powers are delegated, the entity will fail to qualify as a political subdivision. See Rev. Rul. 77-164, 1977-1 C.B. 20; Rev. Rul. 77-165, 1977-1 C.B. 21; and Philadelphia National Bank v. United States, 81-2 U.S.T.C. paragraph 9821 (3<sup>rd</sup> Cir. 1981).

The facts and representations submitted show that the Authority is a division of a State or local government that has been granted a substantial power of eminent domain. Therefore, the Authority qualifies as a political subdivision of the State or local governmental unit, and its income is not subject to federal income tax.

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.

Sincerely yours,  
Elizabeth Purcell, Chief  
Exempt Organizations  
Branch 2  
Division Counsel/Associate Chief Counsel  
(Tax Exempt and Government Entities)

Enclosures:  
Copy of this letter  
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