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Dear Ms. Tsilas and Mr. Polfer:

The National Association of Bond Lawyers ("NABL") respectfully submits the attached memorandum to supplement our prior submission dated November 21, 2013, regarding concerns raised by the analysis set forth in Technical Advice Memorandum 201334038, dated August 23, 2013 (the "TAM"), with respect to the status of certain types of special purpose districts having a limited number of property owners, electors or taxpayers ("Districts") as political subdivisions. In that prior submission we stated that the position in the TAM is not supported by existing authority and has had a chilling effect on the issuance of tax-exempt bonds by Districts throughout the country. We concluded the prior submission by proposing a safe harbor under which Districts would be treated as political subdivisions for purposes of section 103 of the Internal Revenue Code of 1986, as amended (the "Code"). We believe the safe harbor reflects existing legal authority in the area. The attached memorandum was prepared by an ad hoc task force comprised of those individuals listed in Exhibit A, and was approved by the NABL Board of Directors.

NABL exists to promote the integrity of the municipal market by advancing the understanding of and compliance with the law affecting public finance. We respectfully provide this submission in furtherance of that mission.

If NABL can provide further assistance, please do not hesitate to contact Bill Daly in our Washington, D.C. office at (202) 503-3300.

Sincerely,

Allen K. Robertson

SUPPLEMENTAL MEMORANDUM
GUIDANCE ON “POLITICAL SUBDIVISION”

Political Subdivision Examples

We hereby supplement our prior submission by providing the following examples applying the standards underlying existing legal authority to a variety of fact patterns.

1. In each example in this paragraph No. 1, District A is a local unit of special purpose government formed under specific State law (the "Act") the boundaries of which are located entirely within County B. The governing board of District A is elected by eligible electors of the District, defined under the Act as individuals who have certain specified interests in property within the boundaries of District A (or, in the case of corporate property owners, their representatives).¹ The election of governing board members is subject to State election laws generally applicable to governmental elections. The Act authorizes the formation of special districts for the purpose of financing specified categories of infrastructure improvements through the issuance of bonds by a district and sets forth the powers and duties of the governing body of the District. Under the Act, prior to formation of District A, a petition must be submitted to County B generally describing the public infrastructure to be constructed, the anticipated cost of constructing the public improvements, the amount of bonds to be issued, and the source for repayment of the bonds, and County B must approve the formation of District A on the basis of the information in the petition. Under the Act, District A must provide annual financial reports and audits to County B and/or the State in a manner similar to other governmental entities. District A is subject to State public meeting and public records laws applicable to governmental entities, and its governing body members and employees are subject to State public conflict of interest, financial reporting and disclosure and other ethics laws generally applicable to government officials and government employees (the violation of which may result in removal from office and/or criminal prosecution).² Upon dissolution, the assets of District A will be liquidated to pay its obligations, and the remainder distributed to County B. Under the Act, District A has been delegated more than a substantial amount of one or more of the power to tax, the power of eminent domain, and police power. The Act may be amended by the State legislature from time to time.

- (a) District A is formed in accordance with the Act. All of the property in District A is initially owned by D, a for-profit real estate developer. D expects to develop and subdivide some of the property located within the boundaries of District A into residential units (the "Residential Property") over a number of years and to eventually sell substantially all of the Residential Property in the District to unrelated parties. D expects to develop some of the property located within the boundaries of District A into retail space and an office park (the "Commercial Property"). D (or another commercial entity) is expected to retain ownership

¹ In some states, the eligible electors may include residents of the district, or there may be a transition of eligible electors from landowners to residents of the district.

² The exact list of such statutory provisions applicable to a district will vary from state to state.

of all of the Commercial Property located in District A for the foreseeable future and to lease space to retail and business tenants. Most of the land in District A is used for Commercial Property. District A issues bonds to finance the construction of public infrastructure improvements necessary for the development of the property. On the date the bonds are issued, D owns all of the property located within the boundaries of the District. Over the course of the following several years D may or may not be successful in developing and subdividing the Residential Property located within the boundaries of District A. Regardless of whether such sales of Residential Property occur, by reason of owning all of the Commercial Property located within the boundaries of District A, D will control the election of at least a majority of the members of the governing board of District A for the foreseeable future. District A is a political subdivision because it (i) is a division of state or local government, and (ii) has been delegated more than an insubstantial amount of the power of eminent domain, the power to tax or police power. The fact that D, by reason of owning all of the Commercial Property located within the boundaries of District A, will control the election of members of the governing board of District A for the foreseeable future, does not prevent District A from being a division of state or local government and a political subdivision. The result would be the same if there were no Residential Property in the District.

- (b) The facts are the same as (a) above, except that District A is part of a multi-district development plan that includes Districts X, Y and Z, which are also districts approved by County B and formed under and subject to the provisions of the Act. The property in District A is expected to be used entirely for commercial purposes and to be owned by D for the foreseeable future, while the property in Districts X, Y, and Z is expected to be developed and subdivided into residential units in phases over a number of years and eventually sold to unrelated parties. District A issues bonds to finance the construction of public infrastructure improvements necessary for the development of the property. Pursuant to an "intergovernmental agreement" between Districts A, X, Y, and Z, District A will issue bonds to finance the construction of public infrastructure improvements in Districts A, X, Y and Z, and Districts X, Y and Z agree to collect certain ad valorem tax revenues or special assessment revenues from the owners of properties within their respective boundaries to be used by District A, together with other revenues of District A, to pay debt service on the bonds. The intergovernmental agreement and the taxes or special assessments imposed by Districts X, Y and Z must be approved by the governing boards of each district. The conclusion that District A is a division of state or local government and a political subdivision is the same as in (a) above. The fact that D, by reason of owning all of the property located within the boundaries of District A, will control the election of members of the governing board of District A for the foreseeable future does not prevent District A from being a division of state or local government and a political subdivision.
- (c) The facts are the same as (a) above except that District A was formed to obtain and distribute water for irrigation of lands within the District. There is more than one landowner in the district; however Landowner L owns more than fifty percent of the land in the District. Under the Act, the governing board of a district that is formed to obtain and distribute water for irrigation is elected by landowners within the boundaries of the district,

with the vote of each landowner weighted according to the acreage owned. District A is a political subdivision because it (i) is a division of state or local government, and (ii) has been delegated more than an insubstantial amount of the power to tax. The fact that L, by reason of owning a majority of the acreage within the boundaries of District A, will control the election of members of the governing board of District A does not prevent District A from being a division of state or local government and a political subdivision.

2. H is an investor-owned utility organized as a corporation under the laws of State B to provide electric service to the general public. Under the laws of State B, H has been delegated the power of eminent domain to be utilized by H as reasonably necessary in the provision of electric service. The Board of H is chosen by the shareholders of the corporation and H's finances are autonomous of the State. Neither H nor its board members are subject to public meeting or public records laws applicable to governmental entities, and its governing body members and employees are not subject to State public conflict of interest, financial reporting and disclosure and other ethics laws generally applicable to government officials and government employees. Upon dissolution of H, any assets remaining after the satisfaction of creditors are distributed among the shareholders of the corporation. Even though H has been delegated the right to exercise part of the sovereign power of State B, H is not a political subdivision because it is not a division of state or local government.

Analysis of Existing Private Letter Rulings

We further hereby supplement our prior submission by providing the following analysis of existing IRS private letter rulings relating to political subdivision status for federal income tax purposes.

We reviewed over 250 IRS private letter rulings which dealt in whole or in part with the issue of whether a particular entity is a political subdivision for federal income tax purposes (the "PLRs"). Substantially all of the PLRs cite Treasury Regulation § 1.103-1(b) as setting forth the applicable legal standard:

The term "political subdivision," for purposes of this section, 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. As thus defined, a political subdivision of any State or local governmental unit may or may not, for purposes of this section, include special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts and divisions of any such unit.

Further, the majority of the PLRs cite Commissioner v. Estate of Alexander J. Shamberg, 3 T.C. 131 (1944), acq., 1945 C.B. 6; aff'd, 144 F.2d 998 (2d Cir. 1944); cert. denied, 323 U.S. 792 (1945), for the proposition that the three generally acknowledged sovereign powers are the power to tax, the power of eminent domain, and police power. Finally, the majority of PLRs state that it is not necessary for all three powers to be delegated to an entity in order for it to be characterized as a political

subdivision, but possession of an insubstantial amount of sovereign power is not sufficient, typically citing Rev. Rul. 77-164, 1977-1 C.B. 20, and/or Rev. Rul. 77-165, 1977-1 C.B. 21.

As described in our prior submission, the portion of the TAM that is causing the most concern among members of the municipal finance community is its assertion that an entity is not a division of State or local government, and therefore cannot be a political subdivision, if the entity is "organized and operated in a manner intended to perpetuate private control, and to avoid indefinitely responsibility to a public electorate." Accordingly, we further focused our review on those PLRs that specifically discuss whether an entity is a division of State or local government. We found that no more than 10 of the PLRs separately analyze as a specific requirement for political subdivision status whether the entity in question is a division of State or local government, and none of these PLRs provide that "responsibility to a public electorate" is a requirement for status as a division of State or local government.

Only one of the PLRs (out of more than 250 rulings) referred to control by an electorate as a relevant factor. Private Letter Ruling 9725038 provided that, in determining whether an entity is a division of a state,

consideration must be given to factors that indicate it will be a governmental rather than a private entity. These factors include, but are not limited to, its public purpose and attributes, whether its assets or income will inure to private interests, the degree of its control by a state or local government or government official, and the degree of its control by an electorate.

Thus, the ruling lists "the degree of control by an electorate" as one of a number of factors to be considered, not as a requirement. In reaching its conclusion that the district in question was a division of a state or local government, the ruling notes favorably that "there will be public elections of the governing board of [the district]." This public election is described in the recitation of facts in the ruling as follows:

Within the geographical area of [the district], all property owners (and other purchasers of services from [the district]) will become members of [the district], entitled in accordance with State Law to vote for the board of directors of [the district].

The "public election" favorably noted in the ruling refers to a vote of owners of property within the district (and other purchasers of services), with no requirement that there be a minimum number of property owners. It appears that all that was necessary to establish this favorable factor was an election of the board pursuant to a legally mandated public election process. As described in greater detail in our prior submission, the governing boards of districts are typically elected through such legally mandated public election processes.

In conclusion, our review of the over 250 PLRs dealing in whole or in part with the issue of whether a particular entity is a political subdivision for federal income tax purposes revealed only one ruling that mentioned control by an electorate, and that ruling (i) listed control by an electorate

as one of a number of factors to be considered, not as a requirement, (ii) did not indicate any requirement that there be a minimum number of voters, and (iii) favorably ruled on an election process that was generally limited to owners of property within the district.

Exhibit A

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