Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
December 28, 2000

Legend

Act	=
Authority	=
Authority Bonds	=
City	=
City Bonds	=
Comptroller	=
Constitution	=
Mayor	=
State	=
Trustee	=
Year 1	=
a	=
b	=

Dear :

This letter is in response to your request on behalf of the City and the Authority for rulings that:

1. The Authority Bonds are not paid from substantially the same source of funds as the City Bonds within the meaning of § 1.150-1(c)(1)(iii) of the Income Tax Regulations;

2. The obligations comprising the Authority Bonds will not be treated as part of the same issue of obligations as the obligations comprising the City Bonds within the meaning of § 1.150-1(c); and

3. The obligations comprising the City Bonds will not be treated as part of the same issue as the obligations comprising the Authority Bonds within the meaning of § 1.150-1(c).

In connection with this request, the City and the Authority represent that the treatment of the Authority Bonds and the City Bonds as separate issues will not result in the avoidance of §§ 103 and 141 through 150 of the Internal Revenue Code.

FACTS AND REPRESENTATIONS

The City is a political subdivision of the State and has the ability to issue general obligation bonds to finance its capital projects. * * * * * The Authority was created in Year 1 pursuant to the Act for the purpose of issuing debt secured by collections of specified taxes to aid the City in financing its capital needs. The Authority and the City are related parties within the meaning of § 1.150-1(e).

* * * * *

The Authority expects to issue the Authority Bonds to finance a portion of the City's capital expenditures. The Authority Bonds will be issued pursuant to the Act and an indenture between the Authority and the Trustee (the "Indenture"). The City expects to issue the City Bonds to finance a portion of the City's capital expenditures. The City Bonds will be issued pursuant to the Constitution and the laws of the State. The Authority Bonds and the City Bonds will be marketed under separate offering memoranda, will have separate bond documents (within the meaning of § 1.150-1(b)) and will be separately rated by nationally recognized rating agencies. The Authority Bonds and the City Bonds will be sold within 15 days of each other, pursuant to a common plan of financing.

The Authority Bonds will be revenue bonds. The sources of payment and security for the Authority Bonds are (a) revenues from taxes imposed on the income of City residents, less overpayments and costs of administration (the "Personal Income Tax Revenues") and (b) revenues from a tax on the sale and use of tangible personal property and services in the City, less costs of administration and amounts applied to pay debt service on certain other bonds (the "Sales Tax Revenues" and together with the Personal Income Tax Revenues, the "Statutory Revenues"). The Sales Tax Revenues are available to the Authority only in the event that the projected Personal Income Tax Revenues in the current fiscal year are less than a, based on an annual certification of the Mayor. To date, the Personal Income Tax Revenues have always been and are expected to continue to be sufficient to meet the debt service requirements of the bonds issued by the Authority, and the Sales Tax Revenues have never been used to pay debt service on the Authority's bonds.

Only the State may change the law imposing or otherwise relating to personal income tax. Similarly, the sales tax may be increased only upon authorization of the State. In connection with each issuance of bonds by the Authority, the City pledges and agrees not to take any action to impair the security for the Authority's bonds while they remain outstanding (the "City Covenants"). The City may, however, change any local laws relating to the Statutory Revenues, provided the impact of such change does not cause the amount of projected Statutory Revenues during the fiscal years following the change, as projected by the City, to be less than a.

Personal income taxes are collected by the State. Pursuant to the Act, the Personal Income Tax Revenues are initially held by the Comptroller in trust for the

Authority and thereafter transferred to the Authority for application in accordance with the Indenture.

Sales taxes are also collected by the State. In the event that Personal Income Tax Revenues are projected to be less than a, the Act provides that the Sales Tax Revenues are initially held by the Comptroller in trust for the Authority and thereafter transferred to the Authority for application in accordance with the Indenture. In the event that Personal Income Tax Revenues are projected to be greater than a, the Act provides that the Sales Tax Revenues are paid directly to the City and deposited in the City's general fund (the "General Fund").

While held by the Authority, the Statutory Revenues may not be used to pay debt service on the City's bonds (including the City Bonds) or any other expenditure of the City. Moreover, the holders of the City Bonds cannot legally require the Authority or the Comptroller to pay such amounts to the City. Each month, any Statutory Revenues that exceed the amounts required to be retained under the Indenture to pay debt service, operating expenses and other obligations of the Authority are paid to the City (the "Excess Revenues"). These amounts are deposited into the City's General Fund, where they are commingled with other revenues of the City and may be used for any lawful purpose of the City.

The City is not obligated to pay, or guarantee the payment of, debt service on the Authority Bonds. Once the Excess Revenues are received by the City, such amounts will not be used to pay debt service on the Authority's bonds or other expenses of the Authority even if the Authority has insufficient Statutory Revenues at a later date. Thus, for example, if the Authority were to default on the Authority Bonds, bondholders would be limited to seeking recourse to the extent of the Statutory Revenues retained by the Authority. The holders of the Authority Bonds could not to look to the City or amounts on deposit in its General Fund for recourse, nor could they attempt to recover Excess Revenues that were deposited in the City's General Fund. Holders of the Authority Bonds may, however, sue the City to enforce the City Covenants. * * * * *

The City Bonds will be general obligation bonds guaranteed by the faith and credit of the City. The debt service on the City Bonds is payable from the general revenues of the City, including amounts on deposit in the City's General Fund. Under the Constitution, the City is authorized to levy a tax on real estate in any fiscal year providing for the payment of interest and principal of all indebtedness due in such fiscal year.

As a result of the foregoing structure, Statutory Revenues will be the sole security for the Authority Bonds and will be deposited in the City's General Fund and used for any lawful purpose of the City, including debt service payments on its general obligation bonds. The City has provided data indicating both historical amounts of the Statutory Revenues along with the projected amounts of such taxes and other City revenues over the next b years. Based on this information, less than 50 percent of the

City revenues available in any fiscal year to pay debt service on City obligations have been or are expected to be derived from the Statutory Revenues.

The City and the Authority represent that for all prior issues since the creation of the Authority, the Authority's bonds have been rated higher than the City's bonds by nationally recognized rating agencies.

LAW AND ANALYSIS

In general, § 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or local bonds. Sections 141 through 150 set forth additional rules applicable to bonds described in § 103.

Section 1.150-1(a)(1) provides that, except as otherwise provided in § 1.150-1, the definitions in § 1.150-1 apply for all purposes of §§ 103 and 141 through 150. Section 1.150-1(c)(1) provides that, except as otherwise provided in § 1.150-1(c), the term "issue" means two or more bonds that meet all of the following requirements:

(i) The bonds are sold at substantially the same time. Bonds are treated as sold at substantially the same time if they are sold less than 15 days apart.

(ii) The bonds are sold pursuant to the same plan of financing. Factors material to the plan of financing include the purposes of the bonds and the structure of the financing. For example, generally:

- (A) Bonds to finance a single facility or related facilities are part of the same plan of financing;
- (B) Short-term bonds to finance working capital expenditures and long-term bonds to finance capital projects are not part of the same plan of financing; and
- (C) Certificates of participation in a lease and general obligation bonds secured by tax revenues are not part of the same plan of financing.

(iii) The bonds are reasonably expected to be paid from substantially the same source of funds, determined without regard to guarantees from parties unrelated to the obligor.

Section 1.150-1(c)(5) provides that, in order to prevent the avoidance of §§ 103 and 141 through 150 and the general purposes thereof, the Commissioner may treat bonds as part of the same issue or as part of separate issues to clearly reflect the economic substance of a transaction.

Section 1.150-1(c)(6) provides that the sale date of any bond is the first day on which there is a binding contract for the sale or exchange of the bond.

The City and the Authority have requested a ruling that the City Bonds and the Authority Bonds will not be treated as part of the same issue. However, the City and the Authority have represented that the City Bonds and the Authority Bonds will be sold within 15 days of each other, pursuant to a common plan of financing. Therefore, the relevant inquiry is whether the City Bonds and the Authority Bonds are payable from substantially the same source of funds within the meaning of § 1.150-1(c)(1)(iii).

Based on the facts and circumstances, we conclude that the Authority Bonds and the City Bonds will not be paid from substantially the same source of funds and therefore are separate issues under § 1.150-1(c). This conclusion is based on the legally distinct structures to be used to issue the City Bonds and the Authority Bonds. The effect of these legally distinct structures is to separate the funds available to pay the debt service on the Authority Bonds from the funds available to pay the debt service on the City Bonds. Simply stated, holders of the City Bonds may not look to the Authority or any of its funds for payment, and holders of the Authority Bonds may not look to the City or any of its funds for payment.

The Authority Bonds will be revenue bonds and repayment will be solely from the Statutory Revenues. Thus, the Authority Bonds will be nonrecourse debt, payable only to the extent of the revenues retained by the Authority. While the Statutory Revenues are held by the Authority, they may not be used to pay debt service on the City's bonds (including the City Bonds) or any other expenditure of the City. Moreover, the holders of the City Bonds cannot legally require the Authority or the Comptroller to pay such amounts to the City.

If there are insufficient Statutory Revenues and the Authority defaults on the Authority Bonds, holders of the Authority Bonds have no right to demand payment from the City. The City is not obligated to pay, or guarantee the payment of, debt service on the Authority Bonds. Once the Excess Revenues are deposited in the City's General Fund, they are unavailable to the Authority or its bondholders. Holders of the Authority Bonds have the limited remedy of suing the City to enforce the City Covenants, * * * * *.

The City Bonds will be general obligation bonds and repayment will be secured by the City's faith and credit. The City Bonds will be recourse debt, payable from the City's general revenues, including amounts on deposit in the City's General Fund. While the General Fund includes the Excess Revenues, such amounts cannot be traced after being deposited into the fund. The City is authorized to levy a tax on real estate in any fiscal year providing for the payment of interest and principal of all indebtedness due in such fiscal year. Accordingly, in the event the City has insufficient funds to pay debt service on the City Bonds, the City may increase real estate taxes to make up any shortfall. This is contrasted with the personal income tax and the sales tax, which may not be changed without the participation of the State.

While the structure created by the City and the Authority does result in the Statutory Revenues being both the source of security for the Authority Bonds and a source of funds to the City, less than 50 percent of the City revenues available in any fiscal year to pay debt service on City obligations have been or are expected to be derived from the Statutory Revenues. We do not think this is significant enough to outweigh the legally distinct structures used to issue the City Bonds and the Authority Bonds.

Finally, while not controlling, the actions of the nationally recognized rating agencies in rating the Authority's bonds higher than the City's bonds reflects the difference in security for the Authority Bonds and the City Bonds.

Based on the information submitted and representations made, we conclude that:

1. The Authority Bonds are not paid from substantially the same source of funds as the City Bonds within the meaning of § 1.150-1(c)(1)(iii);

2. The obligations comprising the Authority Bonds will not be treated as part of the same issue of obligations as the obligations comprising the City Bonds within the meaning of § 1.150-1(c); and

3. The obligations comprising the City Bonds will not be treated as part of the same issue as the obligations comprising the Authority Bonds within the meaning of § 1.150-1(c).

Except as specifically ruled above, no opinion is expressed concerning this transaction under any other provision of the Code or regulations thereunder, including §§ 103 and 141 through 150. Specifically, no opinion is expressed concerning whether interest on the Authority Bonds or the City Bonds is excludable from gross income under § 103(a).

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. Pursuant to a Power of Attorney on file with this office a copy of this letter is being sent to the City's and the Authority's authorized representative.

Sincerely yours,
Assistant Chief Counsel (Exempt Organizations/Employment Tax/ Government Entities)
By: Bruce M. Serchuk
Senior Technician Reviewer
Tax Exempt Bonds Branch

Enclosure:
Copy for § 6110 purposes