

Rev. Rul. 63-20, 1963-1 CB 24 January 1, 1963

Advice has been requested whether interest received on bonds issued by a nonprofit industrial development corporation organized under the general nonprofit corporation law of a state is excludable from gross income under section 103(a)(1) of the Internal Revenue Code of 1954.

The S corporation was incorporated as a membership corporation under the general nonprofit corporation law of a state. The corporation was organized for the general purpose of stimulating industrial development within P county. The articles of incorporation authorize the S corporation to purchase, lease and sell industrial sites and buildings and to build industrial facilities for lease or sale to new or expanding businesses within P county. The S corporation does not contemplate pecuniary gain to its members, who consist of representatives of the local chambers of commerce and other private business groups in P county, the county commissioners and officials of participating municipalities. The S corporation will have perpetual existence. The articles of incorporation further provide that upon retirement of any outstanding corporate indebtedness, or upon dissolution of the corporation, the beneficial interest of any property owned by the S corporation will be solely in P county.

Funds for the operating expenses of the corporation are provided by P county, local chambers of commerce and manufacturing associations and the department of commerce of the state involved.

The S corporation purchased land in P county and erected and equipped a factory thereon which it leased to an industrial firm for a period of 2 x years under a lease agreement. The S corporation financed this project through the issuance of its interest bearing revenue bonds. The total rental to be paid by the industrial firm under the lease agreement is an amount sufficient to pay the principal of and interest on the bonds.

The indenture of trust, under which the bonds were issued, provides that the S corporation will deliver to the indenture trustee a deed of title to the land and factory, which the trustee will hold until the bonds are fully retired. In the event of a default by the S corporation in the payment of the principal and interest on the bonds, the trustee has the power to sell the property and use the proceeds to pay the bondholders.

The Internal Revenue Service holds that obligations of a nonprofit corporation organized pursuant to the general nonprofit corporation law of a state will be considered issued "on behalf of" the state or a political subdivision thereof for the purposes of section 1.103-1 of the Income Tax Regulations, provided each of the following requirements is met: (1) the corporation must engage in activities which are essentially public in nature; (2) the corporation must be one which is not organized for profit (except to the extent of retiring indebtedness); (3) the corporate income must not inure to any private person; (4) the state or a political subdivision thereof must have a beneficial interest in the corporation while the indebtedness remains outstanding and it must obtain full legal title to the property of the corporation with respect to which the indebtedness was incurred upon the retirement of such indebtedness; and (5) the corporation must have been approved by the state or a political subdivision thereof, either of which must also have approved the specific obligations issued by the corporation.

In the instant case, P county does not have a beneficial interest in the S corporation during the period the revenue bonds will be outstanding; nor will the county necessarily acquire full legal title to the land and factory upon retirement of the bonds. The articles of incorporation provide only that, upon retirement of any corporate indebtedness, or upon dissolution of the corporation, P county will have a

beneficial interest in the assets of the S corporation. Therefore, there will not necessarily be a vesting of full legal title to the land and factory in P county.

Furthermore, while the fact that P county and its participating municipalities are represented among the membership of the S corporation and contribute money to its operations indicates governmental authorization of the corporation and approval of its general objectives, such activities alone are not deemed to constitute approval of the specific bonds issued by the S corporation.

Under the circumstances in the instant case, it is held that the revenue bonds issued by the S corporation are not issued "on behalf of" a political subdivision within the meaning of section 1.103-1 of the regulations. Therefore, the interest received on the bonds will be includible in the gross income of the bondholders under the provisions of section 61(a)(4) of the Code.

Revenue Ruling 54-296, C.B. 1954-2, 59, and Revenue Ruling 59-41, C.B. 1959-1, 13, are distinguishable from the instant case. In both of those rulings, the political subdivision involved had a beneficial interest in the nonprofit corporation prior to the retirement of the indebtedness.

In Revenue Ruling 54-296, a municipality leased to a nonprofit corporation a municipally-owned building in exchange for all its stock. The corporation proposed to issue bonds to finance improvements to the building and it was held that interest on the bonds would be excludable from gross income under section 103 of the Code. The beneficial interest of the municipality consisted in its ownership of all the stock of the corporation and its right under the lease at any time to acquire the improvements by discharging the corporation's indebtedness. Moreover, the municipality retained title to the building which it leased to the corporation.

In Revenue Ruling 59-41, it was held that the bonds of a nonprofit corporation organized under general state law at the request of a municipality to operate the local water system would be issued on behalf of the municipality for purposes of section 103. The municipality which had the right pursuant to law to purchase the water system, waived such right and entered into a contract with the corporation ratifying and approving the purchase of the system by the corporation. The beneficial interest of the municipality consisted in its right under the contract at any time to purchase the water system for an amount equal to the indebtedness then outstanding with interest.

Also, in each of those rulings the political subdivision involved was to become absolute owner of the property in question upon retirement of the corporate indebtedness.

Revenue Ruling 57-187, C.B. 1957-1, 65, and Revenue Ruling 60-248, C.B. 1960-2, 35, are also distinguishable from the instant case. They hold that interest on bonds issued by a public corporation or corporate governmental agency organized pursuant to a special state statute providing for the creation of such corporations for the particular purpose specified therein and authorizing such corporations to issue bonds to enable them to carry out the specified purpose, is excludable from gross income under section 103 of the Code. In the instant case the corporation in question is not a public corporation or corporate governmental agency organized under such a special state statute; it is a private corporation organized under the general nonprofit law of the state.

The conclusion reached in the instant case is not inconsistent with Revenue Ruling 54-106, C.B. 1954-1, 28, which states that bonds issued by or on behalf of a municipality for the purpose of financing the acquisition or construction of municipally-owned industrial plants for lease to private industry constitute

obligations of a political subdivision of a state within the meaning of section 22(b)(4) of the 1939 Code (section 103 of the 1954 Code). That Revenue Ruling did not consider the question what constitutes issuance of bonds “on behalf of” a political subdivision, which is the issue in the instant case.