



May 13, 2016

Mr. John Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

Re: Comments on the Proposed Regulations Regarding Definition of Political Subdivision

Dear Commissioner Koskinen,

This letter provides comments on behalf of the City of Bloomington, Minnesota (the "City"), the Port Authority of the City of Bloomington, Minnesota (the "Port Authority"), and the Housing and Redevelopment Authority in and for the City of Bloomington, Minnesota (the "HRA"), with respect to the proposed amendments to the definition of "political subdivision" found in Section 1.103-1 of the Treasury Regulations promulgated under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), published on February 23, 2016 by the Internal Revenue Service ("IRS") in the Federal Register (Vol. 81, pages 8870-8874) (the "Proposed Regulations"). The City, the Port Authority, and the HRA respectfully request that the Proposed Regulations be withdrawn or, if the Proposed Regulations are not withdrawn, that the Proposed Regulations be amended as proposed in this letter.

Existing Definition of Political Subdivision

The existing provisions of Treasury Regulations, Section 1.103-1, include the following:

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.

The term "political subdivision," as used in Section 103 and Sections 141-150 of the Code, is significant in two respects. First, under Section 103(a) of the Code, gross income does not include interest on any State or local bond. The term "state or local bond" is defined in Section 103(c) to mean an obligation of a State or a political subdivision thereof. Therefore, an obligation will constitute a tax-exempt obligation only if it is issued by a State of the United States of America or a political subdivision of a State. Second, under Section 141 of the Code, a private activity bond is defined as an obligation which meets the private business use test and the private security or payment test or which meets the private loan financing test. Generally, the interest on a private activity bond is not exempt from federal income taxation (unless the private activity bond meets the requirements of a "qualified bond," as defined in Section 141(e) of the

Code). The determination of whether an obligation constitutes a private activity bond (or a qualified bond) depends on the private business use with respect to such bond, and private business use means any use by any person other than a governmental unit. The term "governmental unit" is defined as a State or a political subdivision of a State, as such terms are defined in Treasury Regulations, Section 1.103-1. Therefore, the determination as to whether an entity is a political subdivision will determine whether that entity can issue tax-exempt bonds and it will also determine whether the use of a bond-financed facility by such entity will cause the obligations that financed such facility to be or become private activity bonds.

Previous federal court decisions and IRS rulings have recognized three generally acknowledged sovereign powers: (i) the power to tax; (ii) the power of eminent domain; and (iii) the police power. It is not necessary that all three enumerated powers be delegated to the entity in order that such entity qualify as a political subdivision under existing regulations. However, the entity must be able to exercise a substantial amount of at least one of these powers. Possession of only an insubstantial amount of any of these sovereign powers or even an insubstantial amount of all of these powers is not sufficient.

Each of the City, the Port Authority and the HRA is deemed to be a political subdivision under the laws of Minnesota. Under the existing regulations as described above, cities and counties in Minnesota clearly constitute political subdivisions of the State of Minnesota. In addition, Minnesota bond counsel have uniformly concluded that port authorities, housing and redevelopment authorities, and economic development authorities organized and existing under the laws of the State of Minnesota also constitute political subdivisions for purposes of Section 103 and Sections 141-150 of the Code.

Analysis of the Proposed Regulations

To qualify as a political subdivision under the Proposed Regulations, an entity must meet three requirements, taking into account all the facts and circumstances: (i) the sovereign powers test; (ii) the governmental purpose test; and (iii) the governmental control test.

Sovereign Powers Test. The sovereign powers test is satisfied if, pursuant to a State or local law of general application, the entity has a delegated right to exercise a substantial amount of at least one of the following recognized sovereign powers of a State or local governmental unit: (i) the power of taxation; (ii) the power of eminent domain; and (iii) the police power. This is a restatement of the test under the existing regulations. Minnesota port authorities (under Minnesota Statutes, Section 469.055, subdivision 8), housing and redevelopment authorities (under Minnesota Statutes, Section 469.012, subdivision 1g), and economic development authorities (under Minnesota Statutes, Section 469.101, subdivision 4) all have the delegated right to exercise the power of eminent domain and, therefore, each of these Minnesota entities satisfies the sovereign powers test. In the case of Minnesota port authorities, there is also a power to impose a mandatory tax levy (limited to 0.01813 percent of estimated market value of the city in which the port authority exercises its powers under Minnesota Statutes, Section 469.053, subdivision 4) which also constitutes a delegated right to exercise the power of taxation. Since this sovereign powers test is a restatement of the existing law defining the entities that qualify as political subdivisions, the City, the Port Authority, and the HRA have no objection to this test.

Governmental Purpose Test. The governmental purpose test is satisfied if the entity serves a governmental purpose. Under the Proposed Regulations, the determination of whether an entity serves a governmental purpose is based on, among other things, whether the entity carries out the public purposes that are set forth in the entity's enabling legislation and whether the entity operates in a manner that provides a significant public benefit ***with no more than incidental private benefit.***

The governmental purpose test requires not only that an entity have governmental purpose but also that while performing activities to meet the governmental purpose, there can be only incidental private benefit. If a governmental purpose test must be imposed, it should not include a further requirement to measure the amount of private benefit derived from the activities performed to meet the governmental purpose. Determining whether "incidental private benefit" exists is unnecessary and does not establish an appropriate test as to whether a purpose is in fact a governmental purpose. Many activities performed by political subdivisions provide more than an incidental private benefit but such activities are still considered proper governmental purposes. For example, the promotion of private development and redevelopment in order to avoid or cure blighted conditions, create safe and affordable housing, stimulate job creation, and increase the tax base of a community is often the governmental purpose of the port authorities, housing and redevelopment authorities, and economic development authorities established under the laws of the State of Minnesota. These types of activities have long been considered public purposes in the State of Minnesota because the activities promote the greater good and benefit the public. These activities also provide more than an incidental benefit to private parties. The fact that private parties derive more than an incidental benefit from these types of activities should not factor into the determination of whether the activities are performed with respect to a governmental purpose.

If, for example, a port authority or a housing and redevelopment authority issues bonds and applies the proceeds from the sale of such bonds to construct a parking ramp for the use of a private commercial development (for the public purpose of creating jobs, ameliorating blight and/or increasing tax base) or to acquire land that it conveys at a cost less than the cost of acquisition and improvement of the land for the use of a private rental housing development (for the public purpose of building affordable housing), the private benefits are more than incidental. In such cases, the Proposed Regulations would preclude the issuance of tax-exempt bonds for such purposes and could cause tax-exempt bonds previously issued for such purposes to become taxable bonds.

It is important to note that this test is applicable to general purpose governmental entities, such as the City, as well as to special purpose governmental entities, such as the Port Authority and the HRA. If a city attempts to meet one or more of its governmental purposes (fire protection, policing, emergency medical service, infrastructure) and in attempting to do so causes more than incidental private benefit, the City would not satisfy the governmental purpose test and therefore could not be considered a political subdivision.

Governmental Control Test. The governmental control test is satisfied if a State or local governmental unit exercises control over the entity. Control is exercised when there is an ongoing right or power to direct significant actions of the entity and such control is vested in a State or local governmental unit or an electorate described in the Proposed Regulations.

With respect to an ongoing right or power to direct significant actions of the entity, the Proposed Regulations state that among the rights or powers that may establish control, an ongoing ability to exercise one or more of the following significant rights or powers, on a discretionary and non-ministerial basis, constitutes control: (i) the right or power both to approve and to remove a majority of the governing body of the entity; (ii) the right or power to elect a majority of the governing body of the entity in periodic elections of reasonable frequency; and (iii) the right or power to approve or direct the significant uses of funds or assets of the entity in advance of that use.

None of these controls are applicable to Minnesota port authorities, housing and redevelopment authorities, or economic development authorities. Although the mayor of a city has the power to appoint commissioners to the governing boards of these authorities and the city council confirms the appointments of such commissioners, there is no power under applicable Minnesota law for the mayor or city council to remove a majority of the members of such governing bodies as a routine matter. (Some powers do exist to remove members for neglect of duty or misconduct in office, but the power required by the Proposed Regulations appears to be the power to remove without cause.) The governing bodies of these authorities are appointed and are not elected. Also, the laws of Minnesota do not require that cities have significant control over the significant uses of the funds or assets of these entities (although individual cities often put restrictions in place by resolution).

The governmental control test requires that an entity be made up of elected members or is significantly controlled by an entity that is made up of elected members in order to be considered a political subdivision. This is not how port authorities, housing and redevelopment authorities, or economic development authorities have traditionally been established in Minnesota. The governing bodies of Minnesota port authorities, housing and redevelopment authorities, and economic development authorities are comprised of either the same people who serve as the elected city council or a mix of city council members and individuals appointed by the mayor of the city and approved by the city council. The governing boards are made up of volunteers who are willing to spend their time in service to the city and whose meetings are required by Minnesota law to be open to the public. Conflict of interest laws preclude the board members from voting on issues that may result in personal financial gain.

The governing boards of Minnesota port authorities, housing and redevelopment authorities, or economic development authorities focus their attention on economic development, redevelopment, and housing and are often made up of experts in the fields of economic development, affordable housing, and redevelopment. These boards complement and often work in concert with the city council of the city. Unfortunately, short of requiring the members of these boards to be subject to election, the boards of Minnesota port authorities, housing and redevelopment authorities and economic development authorities cannot meet the governmental control test. If a governmental control test must be imposed, it should provide more flexibility for boards like the Minnesota port authorities, housing and redevelopment authorities and

economic development authorities, members of which are appointed by the mayor and approved by the city council and that are subject to other common statutory restraints like open meeting laws, freedom of information laws, and conflict of interest laws.

Request for Action

Based on the foregoing discussion, we respectfully request that the Proposed Regulations be withdrawn. The existing test to determine whether an entity is a political subdivision works well and does not need revision. Please consider another method for dealing with those entities that claim the status of political subdivision but are really created exclusively for private benefit.

If the Proposed Regulations are not withdrawn, we request the following changes to the Proposed Regulations:

- A. That Section 1.103-1(c)(3) of the Proposed Regulations (the Governmental Purpose Test) be changed as follows:

(3) Governmental purpose. The entity serves a governmental purpose. The determination of whether an entity serves a governmental purpose is based on, among other things, whether the entity carries out the public purposes that are set forth in the entity's enabling legislation and whether the entity operates in a manner that provides a significant public benefit with no more than incidental private benefit.

- B. That Section 1.103-1(c)(4)(i) of the Proposed Regulations (the Governmental Control Test) be changed as follows:

(4) Governmental control. A State or local governmental unit exercises control over the entity. For this purpose, control is defined in paragraph (c)(4)(i) of this section and a State or local governmental unit exercises such control only if the control is vested in persons described in paragraph (c)(4)(ii) of this section.

(i) Definition of control. Control means an ongoing right or power to direct significant actions of the entity. Rights or powers may establish control either individually or in the aggregate. Among rights or powers that may establish control, an ongoing ability to exercise one or more of the following significant rights or powers, on a discretionary and non-ministerial basis, constitutes control: the right or power both to approve and or to remove a majority of the governing body of the entity; the right or power to elect a majority of the governing body of the entity in periodic elections of reasonable frequency; or the right or power to approve or direct the significant uses of funds or assets of the entity in advance of that use. Procedures designed to ensure the integrity of the entity but not to direct significant actions of the entity are insufficient to constitute control of an entity. Examples of such procedures include requirements for submission of audited financial statements of the entity to a higher level State or local governmental unit, open meeting requirements, and conflicts of interest limitations.

Conclusion

Minnesota port authorities, housing and redevelopment authorities, and economic development authorities are divisions of a local governmental unit (the city), are municipal corporations and are delegated the ability to exercise at least one sovereign power. Under existing Minnesota law and federal law, they are political subdivisions. Under the Proposed Regulations, Minnesota port authorities, housing and redevelopment authorities, and economic development authorities would remain political subdivisions for purposes of Minnesota law but would not be considered political subdivisions for purposes of federal tax law. If the Proposed Regulations are adopted, Minnesota port authorities, housing and redevelopment authorities, and economic development authorities would no longer be able to issue tax-exempt bonds, and their use of facilities financed with tax-exempt bonds may cause such bonds to become taxable bonds. As described above, the "incidental private benefit test" might cause many cities to fail the governmental purpose test, and therefore be unable to satisfy the requirements necessary to be a political subdivision. This result will significantly limit the ability of these entities to accomplish their governmental purposes. We believe this result is an unintended consequence of the Proposed Regulations and we respectfully request that the Proposed Regulations be withdrawn or amended as described above.

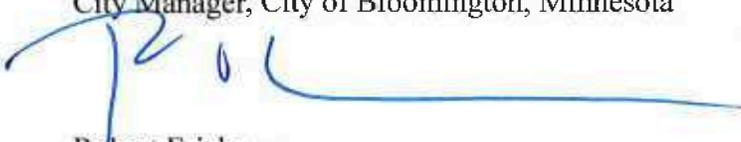
We appreciate your consideration of our comments. If you have any questions, please contact Lori Economy-Scholler, Chief Financial Officer at 952,563-8791 or leconomy@bloomingtonmn.gov.

Sincerely,



Gene Winstead
Mayor, City of Bloomington, Minnesota

James D. Verbrugge
City Manager, City of Bloomington, Minnesota



Robert Erickson
President, Port Authority of the City of Bloomington



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Mark Thorson
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cc: Sandra Johnson, City Attorney
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