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Internal Revenue Service

Department of the Treasury

Index Number: 115.00-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:FI&P:3/PLR-111145-99
Date: October 25, 1999

LEGEND:

Trust =

State X =

Association A =
Association B =
Association C =
Association D =

Federation F =

This is in response to a letter dated June 2, 1999, requesting a ruling concerning the exclusion of income of Trust from gross income under § 115 of the Internal Revenue Code. Trust also has requested a ruling under § 509 of the Code. Pursuant to Section 8.02(1) of Rev. Proc. 99-1, 1999-1 I.R.B. 6, 30, that ruling will be addressed in a separate response.

FACTS

Trust was created by five organizations affiliated with public school entities in State X to pool health care risks and to provide health care insurance and benefits to public school entities. The purpose of Trust is to provide health care coverage to various public school entities within State X: public school districts, intermediate units, vocational-technical schools, and community colleges. The existence of each of these entities is authorized and established by specific provisions under the statutes of State X.

Trust has fourteen trustees, appointed as follows: (1) six voting trustees are appointed by Association A; (2) six voting trustees are appointed by Association B and Federation F as determined by those organizations; (3) one non-voting trustee is appointed by Association C; and (4) one non-voting trustee is appointed by Association D. All trustees must be affiliated with public schools.

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Trust will receive its funds from the contributions of participating employers and will use the funds to purchase and/or provide health care benefits for employees (and their dependents) of public school entities. Trust anticipates that its start-up expenses will be covered by a one-time grant from a private foundation described in §§ 501(c)(3) and 509. However, Trust anticipates that its on-going expenses will be funded solely by contributions made by participating employers.

Trust essentially operates for the purposes of establishing and operating an insurance risk pool. The Agreement and Declaration of the Trust provide that no part of the net earnings inure to the benefit of or are distributable to any Trustee, officer, employee, agent, or other private individual, person, group, or association. Net earnings are used exclusively to acquire and deliver health insurance and health insurance benefits to the organization's permitted participants. Upon dissolution of Trust, any remaining assets are distributed to public school entities within State X.

LAW AND ANALYSIS

Section 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or political subdivision of a state.

When determining if § 115(1) applies, the Service considers all the facts and circumstances relating to the organization to determine whether the organization performs an essential governmental function and whether the income of the organization accrues to a state or a political subdivision of the state.

Rev. Rul. 90-74, 1990-2 C.B. 34, concerns an organization formed, operated, and funded by political subdivisions to pool their casualty risks and other risks arising from their obligations concerning public liability, workers' compensation, or employees' health obligations. The ruling states that the income of such an organization is excluded from gross income under § 115(1) so long as private interests do not participate in the organization or benefit more than incidentally from the organization. The benefit to the employees of the insurance coverage obtained by the member political subdivisions was deemed incidental to the public benefit.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income from a fund, established under a written declaration of trust by a state, for the temporary investment of positive cash balances of a state and its political subdivisions, is excludable from gross income under § 115(1) of the Code. The ruling reasons that the investment of positive cash balances by a state or political subdivision in order to receive some yield on the funds until needed to meet expenses is a necessary incident of the power of the state or political subdivision to collect taxes and raise revenue.

Trust provides health and medical insurance coverage for its members and their dependents, all of whom are employed by or affiliated with public school entities recognized under State X law. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

Under § 115(1) of the Code, income of the Trust must accrue to states or their political subdivisions. No part of Trust's net earnings inures to the benefit of any private person. In addition, upon distribution or liquidation, Trust's remaining assets must be distributed to public school entities. Thus, the income of the Company accrues to political subdivisions of states and entities whose income is excludable from gross income under § 115.

HOLDING

Based on the information and representations submitted by Trust, we hold that the income of Trust is excludable from gross income under § 115(1).

Except as specifically ruled upon above, no opinion is expressed or implied as to the federal tax consequences of the transaction described above under any other provision of the Internal Revenue Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. In accordance with the provisions of a power of attorney currently on file, we are sending a copy of this ruling letter to your authorized representative.

Sincerely,

Assistant Chief Counsel
(Financial Institutions and Products)

By: Alice M. Bennett
Alice M. Bennett
Chief, Branch 3

enclosures: Copy of letter for section 6110 purposes

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