Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

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Date: December 14, 1998

LEGEND:

Company =

Corporation Y =

Corporation Z =

State X =

This is in response to a letter dated May 15, 1998, requesting a ruling concerning the exclusion of income of the Company from gross income under § 115 of the Internal Revenue Code.

FACTS

The Company is a nonprofit corporation organized and licensed under the laws of State X. The Company provides health and medical insurance coverage and benefits solely and exclusively to individuals and their dependents who are employed by, affiliated with, or are members of municipalities and municipal school districts recognized under State X law. The Company represents that the phrase "employed by, affiliated with, or are members of municipalities and municipal school districts recognized under State X law" limits the provision of health and medical insurance coverage and benefits to the following groups:

(1) employees (and their dependents) of municipalities or municipal school districts; and
(2) retired employees (and their dependents) who receive pension benefits from a municipality, a municipal school district, or the State X Teachers Retirement System.

The Company essentially operates for the purposes of establishing and operating an insurance risk pool. The Articles of Association of the Company provide that no part of the net earnings inure to the benefit of or are distributable to any director, 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 the Company, any remaining assets are distributed to the participating municipalities.

Under the laws of State X, State X municipalities are authorized to establish and enter into collective agreements to obtain or effect insurance and to develop and administer a program to accomplish that goal. Municipalities are defined to include incorporated school districts, entities providing educational services and eligible for state aid, and supervisory unions. The Company is an autonomous entity whose sole source of funds is contributions made by participating municipalities for the purpose of funding the cost of health insurance premiums and/or coverage provided to employees, staff, and dependents, together with interest and investment returns.

Under the Non-Profit Corporation Act of State X, the Company is a mutual benefit corporation. It has no members; its business and affairs are managed by a Board of Directors consisting of eight members. The Company acts exclusively by and through its officers and directors and has no employees. Administrative support services and office quarters are provided by Corporation Y, an exempt organization under § 501(c)(3). The Board of Directors of the Company consists of eight members, all of whom must be residents of State X. Four directors are appointed by Corporation Y and four directors are appointed by Corporation Z.

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. Because the fund is classified as a corporation, it is required to file a federal income tax return (Form 1120) each year.

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

Under § 115(1) of the Code, income of the Company must accrue to states or their political subdivisions. No part of the Company's net earnings inures to the benefit of any private person. In addition, upon distribution or liquidation, the Company's remaining assets must be distributed to the participating municipalities. 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 the company, we hold that the income of the Company 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. Specifically, we express no opinion whether the Company qualifies as an insurance company under any provision of the Code, including subchapter L of Chapter 1.

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.

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