

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Date:

March 16, 2004

Legend

Pool =

Association =

State =

State Laws =

Dear :

This is in response to your letter dated May 23, 2003, and subsequent correspondence, requesting a ruling that the income of Pool is excluded from gross income under section 115 of the Internal Revenue Code.

FACTS

Pool is an unincorporated association of counties and county-related political subdivisions of State. It was established by means of participation agreements with its members to provide health and employee benefits to officers, employees, retirees, and eligible dependents of its members, pursuant to State Laws.

Pool is organized exclusively for the benefit of State counties and other county related political subdivisions to provide a pool for its members' health and employee benefits.

Membership in Pool is limited to State counties and other county related political subdivisions of State that execute participation agreements with Pool. Pool represents

that each current or future member must be: (1) a “political subdivision” (as defined in section 1.103-1(b) of the federal Income Tax Regulations) of State; (2) an organization constituting an integral part of a “political subdivision” of State; or (3) an entity whose income is excluded from gross income under section 115 of the Code. Pool’s participation agreement will be amended to conform to these representations by Pool.

Association is a nonprofit membership corporation established by resolution of the State legislature and later incorporated. The Association’s articles of incorporation provide that it was organized and shall be operated to: augment the efforts of State county officials to provide a responsive form of government for the people of State; further the interest of local government for the people of State; and assist the people and counties of State in accomplishing their goals toward meeting the challenge of modern society and acts necessary to achieve that end. Voting membership in Association is limited to counties of State. Association has received a ruling from the Internal Revenue Service that it is exempt from federal tax under section 501(a) of the Code as an organization described in section 501(c)(4).

Pool is governed by a board of trustees elected by the members of Pool. All board members must be an employee or an elected or appointed official of a member of Pool.

Association is under contract with Pool to provide administrative services and serve as Pool’s manager. Association acts as an independent contractor and has control of its services and the manner in which they are performed. Association is free to contract for similar services to be performed for other trusts, funds or pools sponsored by Association, while it is under contract with Pool. Pool pays Association a fee for the services rendered pursuant to the contract. The contract provides that either party may terminate the contract at any time upon thirty days written notice.

Pool’s income is from contributions and fees from its members and investment income. Pool makes expenditures to cover claims payable, the costs of certain insurance premiums, program administration fees, royalties and miscellaneous expenses. Any surplus resulting from an excess of revenues over expenditures may be distributed or refunded to Pool’s members at the discretion of Pool’s board of trustees.

No net earnings of Pool may inure to the benefit of, or be distributed to, any private person, except that reasonable compensation for services rendered may be paid by Pool. In the event of Pool’s dissolution, all its assets, after payment of debts and obligations, shall be distributed to its members or to a successor entity, the income of which is excluded under section 115(1) of the Code.

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

In 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 cash balances of the state and its political subdivisions, is excludable from gross income under section 115(1) of the Code. That ruling reasons that the investment of positive cash balances by a state or political subdivision thereof, in order to receive 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 or other revenue for use in meeting governmental expenses. In addition, the ruling also provides that since the state and its participating political subdivisions have an unrestricted right to their proportionate share of the investment fund's income, the fund's income accrues to them within the meaning of section 115(1). Rev. Rul. 77-261 points out that Congress did not desire in any way to restrict a state's participation in enterprises that may be useful in carrying out those projects desirable from the standpoint of the state government which, on a broad consideration of the question may be the function of the sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that income of an organization formed, operated and funded by political subdivisions of a state to pool their casualty risks is excluded from gross income under section 115(1) of the Code. The ruling states that income of such an organization formed to pool risks in lieu of purchasing insurance to cover their public liability, workers' compensation, or employees' health obligations is excluded under section 115(1) if private interests do not, except for incidental benefits to employees of the participating state and political subdivisions, participate in or benefit from the organizations.

Pool was created to provide a vehicle for providing health and employee benefit plans and related services to its members and their employees. The type of benefits provided are similar to those mentioned in Rev. Rul. 90-74. Pool, therefore, like the organization described in Rev. Rul. 90-74, performs an essential governmental function within the meaning of section 115(1) of the Code.

The income of Pool is used solely to provide benefits to members and their employees. Only counties and other political subdivisions of State are allowed to become members of Pool. In the event of the dissolution of Pool, all its remaining assets, after the payment of debts and obligations, shall be distributed to its members or to a successor entity, the income of which is excluded under section 115(1) of the Code. Private interests do not participate in or benefit from income of Pool, other than as provided in Rev. Rul. 90-74. Therefore, the income of Pool accrues to political subdivisions within the meaning of section 115(1) of the Code.

CONCLUSION

Provided that Pool amends its participation agreement as provided above, we conclude that the income of Pool is excluded from gross income under section 115(1) of the Code. A copy of this letter should be attached to any income tax return to which it is relevant.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Barbara E. Beckman
Assistant Chief, EO Branch 2
Office of Division Counsel/Associate Chief
Counsel
(Tax Exempt and Government Entities)

Enclosures:

Copy of this letter
Copy for § 6110 purposes