

**Internal Revenue Service**

*Department of the Treasury*

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**Washington, D.C.**

**Person to Contact:**

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**Refer Reply to:**  
CC:TE/GE:EO2 - PLR-123401-00  
**Date:**

APRIL 13, 2001

**LEGEND**

Transit =

Parent =

State =

City =

County =

Dear :

This is in response to your letter dated September 20, 2000, and subsequent correspondence requesting a ruling on behalf of Transit. We have been requested to rule that income of Transit will be excluded from gross income under section 115 of the Internal Revenue Code.

**FACTS**

Transit is a captive insurance company incorporated under the laws of State. Transit was organized as a nonprofit corporation for the sole purpose of providing workers' compensation, general and auto liability insurance, and otherwise insuring the

excess losses of its sole member, Parent, through the purchase of commercial reinsurance policies. Parent is organized under State law as a nonprofit corporation, and is the transit management services contractor for City and County. Parent manages, operates and maintains City and County's bus system and special transit service.

Transit is governed by a board of directors composed of individuals appointed by Parent. Parent's income has been ruled to be excludable under section 115 of the Code. Transit's board of directors have general charge of the affairs, funds and property of Transit. Transit uses a servicing company to administer its claims and loss control services.

All the funds necessary for the initial capitalization of Transit, as well as the purchase of reinsurance policies and payment of operating and administrative expenses are provided by Parent. Transit's income is used to cover its administrative expenses, purchase reinsurance policies, and pay claims and expenses associated with claims of Parent. Transit's articles of incorporation provide that no part of the assets, funds, or earnings of the corporation shall inure to the benefit of any member, director or private person. Upon dissolution or liquidation, any remaining assets must be distributed to Parent, or if Parent no longer exists or is no longer an organization whose income is excludable from gross income under section 115, to City and County, or to its successor in interest, provided that the income of the successor in interest is excludable from gross income under section 115.

#### APPLICABLE LAW

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

In Rev. Rul. 77-261, 1977-2 C.B. 45, 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, was excludable from gross income under section 115. That ruling reasoned 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 provided that because the state and its participating political subdivisions had 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 pointed out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might 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). The ruling also holds 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.

Parent may take steps to protect its financial security. Transit was created to provide insurance and reinsurance for Parent with respect to workers' compensation, and general and auto liabilities. Thus, Transit is performing an essential governmental function that is within the scope of section 115.

Transit's income will be used to provide benefits to its sole member, the Parent. In the event of the dissolution of Transit, all its remaining assets, after the payment of debts and obligations, shall be distributed to its Parent so long as Parent's income is excludable from gross income under section 115. If the Parent is no longer in existence or if its income is no longer excludable from gross income under section 115, the assets shall be distributed to City and County, or to its successor in interest, provided that the income of the successor in interest is excludable from gross income under section 115.

## CONCLUSION

Transit's income is excludable from gross income under section 115 of the Code.

No opinion is expressed or implied as to the federal tax consequences of the arrangement described above under any other provision of the Code. Specifically, no opinion is expressed whether the Transit is an instrumentality of a state or political subdivision for purposes of section 103. In addition, because we have concluded that section 115 is applicable to Transit, no determination has been made and no opinion is expressed whether Transit meets the definition of an insurance company under sections 1.801-3(a) and 1.831-1(a) of the Income Tax Regulations or within the meaning of section 816 or 831.

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.

In accordance with a Power of Attorney on file, we are sending a copy of this letter to your representative.

Sincerely,

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Elizabeth Purcell, Chief  
Exempt Organizations  
Branch 2  
Division Counsel/Associate  
Chief Counsel  
(Tax Exempt and Government  
Entities)

Enclosures;

CC: