

**Internal Revenue Service**

Department of the Treasury

Number: **200214026**

Washington, DC 20224

Release Date: 4/5/2002

Index Numbers: 115.00-00, 6033.01-00

Person to Contact:

Telephone Number:

Refer Reply To:

CC:TEGE:EO2-PLR-143280-01

Date:

January 3, 2002

**LEGEND**

Association =  
EIN =  
State A =  
X =  
Year 1 =

Dear :

This is in response to your letter dated July 19, 2001, and subsequent correspondence and submissions, requesting a ruling on behalf of Association that: (1) the income of Association is excluded from gross income under section 115 of the Internal Revenue Code; and (2) Association is not required to file annual information returns on Form 990.

**FACTS**

Association is a non-profit corporation established pursuant to the nonprofit corporation law of State A. It is exempt from Federal income tax under section 501(c)(6) of the Code.

Association's stated purposes in its articles are to: (1) develop and disseminate information to special districts in State A, (2) cooperate with the congressional delegation of State A on national legislation of common interest to the special districts, (3) formulate and promote state legislation of common interest to the special districts, (4) provide information and assistance to the special districts in connection with administrative and judicial actions, (5) provide information and assistance to standardize and improve comprehensive planning with governmental units, (6) provide information and assistance on matters of mutual concern, including insurance, grants, budgets and group purchasing, (7) promote understanding with other units of local government and the public in fulfilling the role of special districts as responsible units of government, (8) foster the development of, and cooperate with, organizations serving special districts and (9) do all other things necessary and proper for the benefit of the special districts of State A.

Association engages in the following activities for the benefit of its members: (1)

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operation and maintenance of several self-insured retention pool and group purchase coverage programs for its members, including property, liability, workers compensation and employee benefits; (2) loss prevention programs; (3) providing expert legal advice; (4) legislative representation and advocacy services; (5) research and technical assistance on administrative, governance, risk management, safety and personnel issues; (6) training and developmental programs; (7) financing services for equipment and other essential governmental property; and (8) length of service award programs. In Year 1, Association established a trust to protect and manage insurance premiums and contributions, oversee management and administration of the insurance programs and approve the necessary contracts, insurance policies and premiums.

The bylaws provide that Association is governed by a board of directors, which shall consist of (1) one representative from each of the following six classes of regular members: fire, sanitary, water, irrigation, port, parks and recreation; (2) five at-large representatives, at least three of which must be from regular members other than the above six classes; and (3) the immediate past president. No more than two directors may be elected from each class of members.

The bylaws provide that regular membership in Association is limited to special districts authorized and regulated under State A statute, including such classes of districts as water control, port, fire, hospital, parks and recreation and soil and water conservation. The bylaws further provide that associate membership in Association is limited to (1) any intergovernmental agency, department, council or like entity created under State A statute, or (2) any statewide or regional associations of local government or any other public entities which qualify as political subdivisions or municipal, quasi-municipal or public corporations under State A statute. All of the associate members of Association are cities or counties in State A. Finally, Association has two affiliate members, which only may participate in Association's group purchase health benefits program. Affiliate membership in Association requires the advance approval of the board and is limited to public or private entities that regularly provide services or support to special districts of State A or Association. The bylaws provide that all members shall pay annual membership fees. The bylaws also provide that only regular members shall have voting privileges at annual or special meetings of Association.

Association has represented that all of Association's members and associate members are, and must be, a political subdivision of a state, an integral part of a political subdivision or an entity whose entire income is excludible from gross income under section 115(1) of the Code. Association has represented that its board of directors will adopt a resolution to (1) terminate participation by the affiliate members in Association's insurance policies, (2) amend Association's bylaws and declaration of trust to eliminate the affiliate members from membership in Association and (3) expressly restrict all new members in Association to entities that are a political subdivision of a state, an integral part of a political subdivision or an entity whose entire income is excludible from gross income under section 115(1) of the Code.

Association's articles of incorporation provide that no part of Association's net earnings or other assets shall inure to the benefit of any director or individual. Association's

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articles also provide that, in the event of dissolution of Association, the balance of all money received by Association for its operations, after the payment of all debts and obligations of Association, shall be distributed to X to be used in the interest of the special districts. Association has represented that X is an organization all of whose income accrues to a state or political subdivision in accordance with section 115(1) of the Code.

### LAW AND ANALYSIS

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 any political subdivision thereof.

Rev. Rul. 71-589, 1971-2 C.B. 94, provides that the income from property held in trust by a city, which was to be used by the city for certain charitable purposes, is not subject to federal income tax. Although Rev. Rul. 71-589 does not explicitly so state, its holding is based on a determination that the income in question was derived from the exercise of an essential governmental function and accrued to a political subdivision within the meaning of section 115(1). Rev. Rul. 71-589 specifically mentions several types of functions that the trust might perform, such as support of a hospital, schools, maintenance of a park, or other purposes ordinarily recognized as a municipal function.

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 excludible from gross income under section 115(1). Rev. Rul. 77-261 reasons that the investment of positive cash balances by a state or a political subdivision thereof, 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. Rev. Rul. 77-261 points out that Congress did not desire in any way to restrict a state's participation in enterprises which 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, concerns an organization that is 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. Rev. Rul. 90-74 states that the income of the organization is excluded from gross income under section 115(1) of the Code if private interests do not participate in the organization or benefit more than incidentally from the organization. In Rev. Rul. 90-74, the benefit to the employees of the political subdivisions was excepted as incidental. Furthermore, upon dissolution, the organization will distribute its assets to its members. Therefore, the income of the organization accrues to a political subdivision with the meaning of section 115(1).

Association engages in activities intended to improve local government in State A. It provides various services that reduce the operating costs for cities and counties in State

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A and special districts created under State A law to perform traditional governmental functions, including hospital care, fire protection, and maintenance of roads, ports and parks. Therefore, Association's activities constitute essential governmental functions.

Because Association uses its income to provide services to its members, Association's income accrues for the benefit of its members. Provided that Association terminates participation by the affiliate members in Association's programs and amends its bylaws and declaration of trust to eliminate the associate members, as Association represented, as of the date such actions become effective under State law, all of Association's members will be either a political subdivision of a state, an integral part of a political subdivision or an entity whose entire income is excludible from gross income under section 115(1) of the Code. Any benefit from Association's insurance programs to the employees of Association's members is incidental. See Rev. Rul. 90-74. Finally, upon dissolution, all of Association's remaining assets must be distributed to X, an organization all of whose income accrues to a state or political subdivision within the meaning of section 115(1). Therefore, all of Association's income accrues to a state or political subdivision.

Section 6012 of the Code requires every corporation subject to taxation under subtitle A of the Code to file an income tax return. Treas. Reg. § 1.6012-2(e) requires every organization described in section 511(a)(2) which is subject to the tax imposed by section 511(a)(1) on its unrelated business taxable income to make a return on Form 990-T.

Section 6033(a) of the Code generally provides that every organization exempt from tax under section 501(a) shall file an annual return stating its gross income, receipts and disbursements and such other information as the regulations require. Treas. Reg. § 1.6033-2(a)(2)(i) provides that every organization exempt from taxation under section 501(a) and required to file a return under section 6033 shall file its annual return on Form 990. Section 6033(a)(2)(B) provides that the Secretary may relieve any organization from filing such return when he determines that such filing is not necessary to the efficient administration of the internal revenue laws.

Rev. Proc. 95-48, 1995-2 C.B. 418, specifies that affiliates of governmental units which are exempt from federal income tax under section 501(a) of the Code are not required to file annual information returns on Form 990. Rev. Proc. 95-48 treats an organization as an affiliate of a governmental unit if (1) it is described in section 501(c) of the Code, and (2) it has a ruling or determination from the Service that its income, derived from activities constituting the basis for its exemption under section 501(c), is excluded from gross income under section 115(1). Rev. Proc. 95-48 only addresses the filing requirements under section 6033 of the Code; it does not exempt a taxpayer from filing returns with respect to unrelated business taxable income under section 511 of the Code. See section 6012(a); section 1.6012-2(e).

Association is an organization described in section 501(c)(6) and, as set forth herein,

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will have a ruling from the Service that its income is excluded from gross income under section 115(1). Accordingly, Association is an "affiliate of a governmental unit" for purposes of Rev. Proc. 95-48.

### CONCLUSIONS

Based on the information submitted and representations made by Association, and provided that Association terminates the affiliate members' participation in Association's insurance policies and amends its bylaws and declaration of trust to eliminate the affiliate members, as Association represented, we rule as follows: (1) Association's income is excludible from gross income under section 115(1) of the Code; and (2) Pursuant to Rev. Proc. 95-48, Association is not required to file an annual information return on Form 990. Because this ruling is contingent upon Association taking the necessary actions under State law to eliminate the affiliate members and terminate the affiliate members' participation in Association's insurance policies, this ruling applies only for periods on and after the date on which such actions by Association are effective under State law.

We express no opinion with respect to whether Association has or will have unrelated business taxable income under section 511 of the Code, and, therefore, must file a return on Form 990-T.

The rulings contained in this letter are based upon information and representations submitted by Association 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, such material 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.

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

A copy of this letter must be attached to any income tax return to which it is relevant.

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

Sincerely,  
Elizabeth Purcell  
Chief, Exempt Organizations Branch 2  
Office of Division Counsel/Associate Chief Counsel  
(Tax Exempt & Government Entities)

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cc: