

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply to:
CC:TE/GE:EO2 - PLR-161845-02
Date:
March 21, 2003

LEGEND

Association =

State =

Trust =

year 1 =

year 2 =

date a =

date b =

Agreement =

Dear :

This is in reply to a letter dated October 23, 2002, requesting a ruling that the income of Association is excludable from gross income under § 115(1) of the Internal Revenue Code.

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FACTS

Association was formed to provide certain services and benefits to the boroughs of State. Boroughs of State constitute political subdivisions of State for purposes of federal income taxes. Formed in year 1 and incorporated as a State nonprofit corporation in year 2, Association received a ruling from the Service on date a that it was exempt from federal income tax under § 501(c)(4) of the Code. Subsequently, on date b, Association received a ruling that it was an instrumentality of its member boroughs.

Association is governed by a board of directors composed of one borough official selected by each county association having at least five borough members in the state association, two borough officials selected by each county association having at least sixty borough members in the state association, the elected officers of Association and the immediate past president. The members of Association are individual boroughs of State and county associations of two or more boroughs. Association proposes to amend its charter documents to eliminate associate and honorary memberships and to provide that membership in Association is limited to states, political subdivisions of state and organizations the income of which is excluded from gross income under § 115(1).

Association provides administrative services to the boroughs. It carries on research on issues of importance to the boroughs, provides educational and training conferences for borough officials, represents the boroughs before the State legislature, and provides the boroughs and other local government entities with assistance with respect to state and local legislation. Association's activities include the administration of various self-insured funds for the member boroughs. These funds permit the members to pool their risks and achieve the benefits of lowered costs in providing insurance. Agreement, the document under which Association created the insurance program, provides that members and governmental affiliates of the member boroughs may insure themselves through Association. Association proposes to amend Agreement to limit participation in any of the insurance plans to states, political subdivisions of State and entities the income of which is excluded from gross income by § 115(1). All of the earnings derived from the insurance program are used for operating expenses of the risk pools or returned to participants in the form of lower insurance costs.

The principal source of Association's revenue is membership dues. No part of Association's earnings inure to the benefit of any private interests. Upon the dissolution of Association, its assets, after the payment of all of its debts, charges and expenses of dissolution, will be distributed to the member boroughs.

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LAW AND ANALYSIS

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

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, is excludable from gross income for federal income tax purposes under § 115(1). The ruling indicates that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utilities or the performance of some governmental function that accrued to either a state or municipality. The ruling points 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 projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, states that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115(1). In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

By providing administrative services to the boroughs and by providing insurance to governmental entities and their employees in a cost effective manner, Association performs an essential governmental function.

The net income of Association accrues to its members, all of which are states, political subdivisions of a state or entities the income of which is excludable from gross income under § 115(1). Upon the dissolution of Association, its assets shall be distributed to the member boroughs. Private parties do not materially participate in Association or benefit more than incidentally from the organization. Accordingly, the income of Association is excludable from gross income for federal income tax purposes under § 115(1).

This ruling is based on the information and representations provided and is effective as of the date the proposed amendments to Association's charter documents and to Agreement are adopted.

Except as specifically provided otherwise, no opinion is expressed on the federal tax consequences of any particular transaction.

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

Sincerely,

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

Enclosures;

cc: