Internal Revenue Service | Department of the Treasury

Washington, DC 20224

Person to Contact: [redacted]

Telephone Number: [redacted]

Refer Reply to: [redacted]

Date: OCT 31 1995

[redacted]

Employer Identification Number: [redacted]
Key District Office: [redacted]
Form: [redacted]
Tax Years: All Years
Accounting Period Ending: [redacted]

Dear Applicant:

This is our final adverse ruling as to your exempt status under section 501(c)(3) of the Internal Revenue Code.

This ruling is made for the following reason(s):

You are not organized or operated exclusively for exempt purposes within section 501(c)(3) of the Code. You are operated to provide commercial-type insurance and thus section 501(m) of the Code precludes you from exemption under section 501(c)(3). You are not a cooperative within the meaning of section 501(e) of the Code. You are a feeder organization within the meaning of section 502 of the Code.

Contributions to you are not deductible under section 170 of the Code.

You are required to file Federal income tax returns on the form specified above. Based on the financial information furnished, it appears that returns should be filed for the tax years shown above. You should file these returns with your key District Director for exempt organization matters within 30 days from the date of this letter, unless a request for an extension of time is granted. Returns for later tax years should be filed with the appropriate service center as indicated in the instructions for those returns.

If you decide to contest this ruling under the declaratory judgment provisions of section 7428 of the Code, you must initiate a suit in the United States Tax Court, the United States Court of Federal Claims, or the United States District Court for the District of Columbia, before the 91st day after the date this ruling is mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment.

[redacted]

Processing of income tax returns and assessment of any taxes due will not be delayed because a declaratory judgment suit has been filed under section 7428.

In accordance with section 6104(c) of the Code, the appropriate State officials will be notified of this ruling.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,

(signed) [redacted]

[redacted]
Director, Exempt Organizations
Division

cc: [redacted]

[redacted]

[redacted]

	Initiator	Reviewer	Reviewer	Reviewer
Code	[redacted]	[redacted]	[redacted]	
Surname	[redacted]	[redacted]	[redacted]	
Date	1-26-95	10/27/95	10/31/95	

[redacted]

[redacted]

[redacted]

[redacted]

JUN 15 1993

Employer Identification Number: [redacted]
Key District: [redacted]

Dear Applicant:

We have considered your application for recognition of exemption as an organization described in section 501(c)(3) of the Internal Revenue Code. Based on the information submitted, we have concluded that you do not qualify for exemption under that section.

FACTS

You were formed on [redacted], pursuant to the laws of [redacted], but started operations on [redacted]. You are a trust established by a number of tax-exempt healthcare organizations consisting of hospitals and their affiliates. You limit your membership to tax-exempt organizations. The sole purpose of your formation was to enable your members to fulfill their statutory obligation to procure workers' compensation insurance.

Your members make contributions in return for which they secure the benefits of payment by you of any workers' compensation claims. Pending the payment of claims, you invest the contributions and add all interest to the corpus of the trust fund for use in paying future claims. You also use the trust funds to pay administrative expenses including the purchase of excess ("stop loss") insurance.

You achieve an equitable apportionment of risks among members both in the calculation of funding and in determining any potential returns of excess funding to the members. You determine each member's contribution based on its own "Net Premium," which is calculated using [redacted]s own experience modification factor ("mod") and anticipated payroll figures for the year. Adjustments in payroll size or experience mod during your fiscal year are also taken into account through a retrospective reallocation of the funding requirements based on actual experience during the year. In addition, at the time of any distribution to the members of excess funding, each member's relative loss experience is again taken into account through a distribution formula that is heavily weighted toward consideration of actual loss experience. Although as required under [redacted] law and the trust instrument, self insurance programs must assume joint and several liabilities for all claims made against members of the group, you have established procedures designed to ensure that to the maximum extent possible under [redacted] law, each member bears a funding responsibility equitably based upon its own loss experience.

ANALYSIS

Section 501(a) of the Code provides that organizations described in subsection (c) shall be exempt from taxation. Subsection (c)(3) includes those organizations that are organized and operated for exclusively charitable, educational and scientific purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in said section of the Code. If an organization fails to meet either test it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i)(a) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit its purposes to one or more exempt purposes.

Section 501(e) of the Code provides for the exemption from federal income tax under section 501(c)(3) of the Code of "cooperative hospital service organizations." Section 501(e)(1)(A) lists the purposes for which such an organization must be organized and operated. This list does not include providing insurance. In HCSC-Laundry v. United States, 450 U.S. 1 (1981), the Supreme Court held that in order for an organization to qualify under section 501(e) it must provide one of the services there listed.

Section 501(m) of the Code, as added by section 1012(a) of the Tax Reform Act of 1986, P.L. 99-514, provides that an organization described in section 501(c)(3) of the Code shall be exempt if no substantial part of its activities consists of

[redacted]

providing commercial type insurance. In this respect, the Code further provides that the term "commercial-type insurance" shall not include insurance provided at substantially below cost to a class of charitable recipients.

The General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99th Congress, P.L. 99-514) states that commercial-type insurance does not include arrangements that are not treated as insurance (*i.e.*, in the absence of sufficient risk shifting and risk distribution for the arrangement to constitute insurance). H.R. Rep. No. 426, 99th Cong., 1st Sess. 585.

In defining the term "insurance", the Supreme Court in Helvering v. Le Gierse, 312 U.S. 531, 539 (1941), stated that "historically and commonly insurance involves risk shifting and risk distributing." The sharing and distributing of insurance risks by all parties insured is essential. Thus, when there is no risk shifting or distribution of risk, there is no insurance arrangement."

In Allied Fidelity Corp. v. Commissioner, 572 F.2d 1190 (1978), the court stated that the common definition for insurance is "an arrangement to protect the insured against a direct or indirect economic loss arising from a defined contingency whereby the insurer undertakes no present duty of performance but stands ready to assume the financial burden of any covered loss. It is characteristic of insurance that a number of risks are accepted, some of which involve losses and that such losses are spread over all risks so as to enable the insurer to accept each risk at a slight fraction of the liability upon it."

In Group Life and Health Insurance Co. v. Royal Drug Co., Inc., 440 U.S. 205,211 (1979), the United States Supreme Court analyzed the definition of "insurance" as follows:

> The primary elements of an insurance contract are the spreading and underwriting of a policy holder's risk. It is characteristic of insurance that a number of risks are accepted, some of which involve losses, and that such losses are spread over all the risks so as to enable the insurer to accept each risk at a slight fraction of the possible liability upon it. 1 G. Couch, Cyclopedia of Insurance Law, § 1.3 (2nd ed. 1959). See also R. Keeton, Insurance Law, §1.2(a) (1971) ("Insurance is an arrangement for transferring and distributing risks."), 1 G. Richards, The Law of Insurance, §2 (W. Freedman, 5th ed. 1952).

In Clougherty Packing Company v. Commissioner, 811 F.2d 1297, 1300 (10th Cir. 1987), the court defined the concept of "risk

[redacted]

shifting" as that which "entails the transfer of the impact of a potential loss from the insured to the insurer." The court also defined the concept of "risk distribution" as meaning that the party assuming the liability distributes its potential loss among other insurers. Beech Aircraft Corp. v. Commissioner, 797 F.2d 920, 1922 (10th Cir. 1986).

In American Association of Christian Schools Voluntary Employees Beneficiary Association Welfare Plan Trust v. United States, 850 F.2d, 1510 (11th Cir. 1988), the court held that a trust providing various insurance benefits to employees of the members of a tax-exempt association of religious schools, was not itself a tax-exempt "religious organization" because it had a substantial private, nonexempt purpose, providing insurance in return for premiums.

In determining whether an organization that provides coverage against risks qualifies for exemption from federal income tax under section 501(c)(3) of the Code, it is necessary to determine whether the insurance arrangement constitutes "commercial type insurance" within the meaning of section 501(m) of the Code. As provided for in the legislative history of section 501(m) and in the cases previously cited, both risk shifting and risk distribution are necessary to a determination that an arrangement constitutes "commercial type insurance."

Here, the arrangement does contain some elements of risk shifting in that your members' potential future liabilities are shifted from them to you. Risk distribution is also present because the risk of having to pay claims is distributed among your members. This is so even though premiums are weighted to reflect a particular member's loss experience. This is a common practice among commercial insurance companies.

Thus, your sole activity consists of providing commercial-type insurance to your members. Since more than an insubstantial part of your activities consists of the provision of commercial-type insurance, you are precluded from qualifying for exemption as an entity described in section 501(c)(3) of the Code by operation of section 501(m). Also, you do not meet the requirements of the organizational test under section 501(c)(3) because your purposes are not limited to one or more exempt purposes. Furthermore, you are not described in section 501(c)(3) by reason of being a cooperative hospital service organization of the type described in section 501(e) since your activities are not among those listed in the statute.

Accordingly, based on all the facts and circumstances, we conclude that you do not qualify for exemption from federal income

[redacted]

tax under 501(c)(3) of the Internal Revenue Code. Contributions to you are not deductible under section 170 of the Code. You must file federal income tax returns.

You have the right to protest this ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted in duplicate within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under the Conference and Practice Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to the District Director, Brooklyn, New York, which is your key district for exempt organizations matters. Thereafter, any questions about your federal tax status or the filing of returns should be addressed to that office. If you want the matter reopened at a later time, you must pay a new user fee as provided in Rev. Proc. 93-23. Also, the appropriate State officials will be notified of this action in accordance with section 6104(c) of the Code.

Sincerely yours,

[redacted]

[redacted]

Chief, Exempt Organizations
Ruling Branch 1

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Person to Contact: [redacted]

Telephone Number: [redacted]

Refer Reply to: [redacted]

Date: NOV 22 1995

[redacted]

Employer Identification Number: [redacted]
Key District: [redacted]

Dear Applicant:

We have considered your application for recognition of exemption as an organization described in section 501(c)(9) of the Internal Revenue Code. Based on the information submitted, we have concluded that you do not qualify for exemption under that section.

FACTS

You were formed on [redacted], pursuant to the laws of Maine, but started operations on [redacted]. You are a trust established by a number of tax-exempt healthcare organizations consisting of hospitals and their affiliates. You limit your membership to tax-exempt organizations. The sole purpose of your formation was to enable your members to fulfill their statutory obligation to procure workers' compensation insurance. You intend to pay benefits at a level that is [redacted] percent above the level mandated by the [redacted] statutes.

Your members make contributions in return for which they secure the benefits of payment by you of any workers' compensation claims. Pending the payment of claims, you invest the contributions and add all interest to the corpus of the trust fund for use in paying future claims. You also use the trust funds to pay administrative expenses including the purchase of excess ("stop loss") insurance.

You achieve an equitable apportionment of risks among members both in the calculation of funding and in determining any potential returns of excess funding to the members. You determine each member's contribution based on its own "Net Premium," which is calculated using its own experience modification factor ("mod") and anticipated payroll figures for the year. Adjustments in payroll size or experience mod during your fiscal year are also taken into account through a retrospective reallocation of the funding requirements based on actual experience during the year. In addition, at the time of any distribution to the members of

[redacted]

excess funding, each member's relative loss experience is again taken into account through a distribution formula that is heavily weighted toward consideration of actual loss experience. Although as required under Maine law and the trust instrument, self insurance programs must assume joint and several liabilities for all claims made against members of the group, you have established procedures designed to ensure that to the maximum extent possible under Maine law, each member bears a funding responsibility equitably based upon its own loss experience.

ANALYSIS

Section 501(a) of the Internal Revenue Code exempts from federal income taxation organizations described in section 501(c)(9) of the Code. Section 501(c)(9) describes organizations that are voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of the Association or to their dependents or designated beneficiaries, if no part of the net earnings of the association inures to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-1(c) of the Income Tax Regulations provides that in order to be described in section 501(c)(9) of the Code, an organization must be operated for the purpose of providing life, sick, accident, or other benefits to its members or their dependents or designated beneficiaries. Furthermore, this section requires that substantially all of its operations are in furtherance of providing such benefits.

Section 1.501(c)(9)(a) of the regulations provides that a voluntary employees' beneficiary association is not operated for the purpose of providing life, sick, accident, or other benefits unless substantially all of its operations are in furtherance of the provision of such benefits. Further, an organization is not described in this section if it systematically and knowingly provides benefits (of more than a de minimis amount) that are not permitted.

In Rev. Rul. 74-18, 1974-1 C.B. 139, the Service ruled that an association formed to pay workers' compensation benefits required under state law does not qualify for exemption under section 501(c)(9) of the Code. The Service reasoned that the association did not provide to the employees any benefits other than those to which they were already entitled under state law. Instead, the association merely ensured that the employer would discharge its statutory obligation to the employees.

Like the organization in Rev. Rul. 74-18, supra, you were formed not through collective bargaining but unilaterally by a group of employers to satisfy their obligations to provide workers' compensation benefits required under the laws of [redacted]. As held in Rev. Rul. 74-18, providing workers compensation benefits merely to satisfy employers' obligations to their employees imposed by state law is not a permissible benefit under section 1.501(c)(9)-3 of the regulations. Therefore, we conclude that you do not satisfy the requirements for exemption under section 501(c)(9) of the Code. The provision of benefits at a level [redacted] percent above the level required by the [redacted] statutes does not change our conclusion.

Accordingly, you do not qualify for exemption from federal income tax under 501(c)(9) of the Internal Revenue Code.

You have the right to protest this ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted in duplicate within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under the Conference and Practice Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to the District Director, Brooklyn, New York, which is your key district for exempt organization matters. Thereafter, any questions about your federal tax status or the filing of returns should be addressed to that office. If you want the matter reopened at a later time, you must pay a new user fee as provided in Rev. Proc. 95-8, 1995-1 I.R.B. 187.

Sincerely yours,

(signed) [redacted]

[redacted]

Chief, Exempt Organizations
Technical Branch 1

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[redacted]

cc: [redacted]

[redacted]