P. INSURANCE ACTIVITIES OF EXEMPT ORGANIZATIONS

1. Introduction

This article describes and discusses some of the insurance activities of exempt organizations. It amplifies the discussion of group insurance activities of IRC 501(c)(6) organizations published in the 1979 ATRI text at pages 338-341, "Oklahoma Cattlemen's Association Issues." As stated in the 1979 article, Service attention in this area has focused on whether group insurance activities are a trade or business and whether income from these activities is subject to the tax on unrelated business income under IRC 511-513.

In addition to group insurance activities and unrelated trade or business issues, this article discusses IRC 170 deductions in connection with group insurance programs and the exemption of various organizations whose primary activities are insurance-related.

1. Medical malpractice organizations -- Are these organizations exempt under IRC 501(c)(6)?

2. Home owners warranty program -- IRC 501(c)(6).

3. Auto liability reinsurance -- IRC 501(c)(6).

4. Credit union share insurance -- IRC 501(c)(6).

5. Risk-pooling trust for charitable organizations -- IRC 501(c)(3).

6. Annuities and insurance for charitable organizations and their employees -- IRC 501(c)(3).

Publication of revenue rulings in this area is limited. Court cases testing the Service positions are also few in number. Legislation that would overturn a Service position is, as always, possible. Accordingly, the current resolution of the issues considered in this article may not be the ultimate resolution. However, in stating the issues and current solutions, this article indicates the wide variety of issues that have arisen concerning insurance-related activities and clarifies the factual development required to support a conclusion.

2. Unrelated Business Income

This subtopic examines the consequences of an organization that otherwise qualifies for exemption acting as a group policyholder. We have published precedent setting forth the Service position concerning the taxation of a fee received by an organization exempt under IRC 501(c)(5) for services it provides to insurance companies. Rev. Rul. 60-228, 1960-1 C.B. 200. In addition, arguments against taxation of income received by an exempt organization for serving as an agent for insurance companies in selling insurance to members are weak. As insurance agent, the exempt organization is regularly engaged in a trade or business unrelated to its exempt purposes. See Private Letter Ruling 800651. Taxation of such income serves the congressional intent to tax activities that would otherwise result in unfair competition with for-profit entities. However, the question of taxation of income that results from an organization's function as a group policyholder for its members is a more difficult one, due to the limited amount of actual activity the exempt organization may conduct and the arguable absence of any unfair competition resulting from the organization's function as a group policyholder.

Under IRC 512 and 513, there are three basic requirements for an exempt organization's income to be taxed under IRC 511(a). The income must be from: (1) trade or business, (2) regularly carried on, and (3) unrelated to the organization's exempt purposes. Regarding group insurance, the first requirement, the trade or business characterization, has received a good deal of attention. What is necessary before the group insurance activity is a trade or business? Solicitation of members? Billing? Servicing of claims? Mere sale of membership list to insurer for its use in solicitation?

In the situation we are considering, an organization, typically one described in IRC 501(c)(5) or 501(c)(6), conducts a variety of activities that serve its exempt purposes. In addition, the organization serves as a group policyholder for certain insurance underwritten by an independent insurance company. The insurance may be personal (e.g., life insurance, medical or hospital insurance for a member of a professional association) or business-related (e.g., business liability insurance, insurance for a member's employees, or workmen's compensation insurance).

An exempt organization as group policyholder may have administrative duties (billing, recordkeeping, updating of membership list, etc.) and may receive a variety of receipts from the insurance companies with which it has negotiated a group insurance contract. Its arrangements with an insurance company may

provide that it bill members and collect their premiums, and retain an agreed-upon percentage designed to meet administrative expenses before transfer of the balance to the insurance company. The insurance company may directly bill members and remit a fee to the exempt organization for its services. The insurance company's agent may remit a portion of its commission income to the exempt organization.

The insurance company may remit experience rebates or credits or dividends to the exempt organization. Under state law, an insurance company may have to distribute its surplus to policyholders. Such distributions are known as experience rebates, experience credits, or dividends. Generally, where an exempt organization receives these distributions, premiums are calculated to result in surplus. The group policyholder may apply the distributions to reduce the insured individuals' premiums or increase benefits by amending the group policy. The exempt organization as group policyholder may also retain a portion of the dividends or credits received. Thus, the arrangements between an exempt organization that serves as group policyholder in an insurance company may require a variety of duties of the policyholder and provide for various receipts to the policyholder that may result in net income to the exempt organization.

Basic to the Service conclusion regarding the taxation of the various receipts from group insurance activities is the definition of a trade or business set forth in IRC 513. IRC 513(c) defines a trade or business as "any activity which is carried on for the production of income from the sale of goods or the performance of services." Under Regs. 1.513-1(b), the term "trade or business" has the same meaning it has in IRC 162 dealing with the deductibility of ordinary and necessary expenses incurred in carrying on a trade or business. Thus, although the legislative history of the unrelated business income tax provisions shows congressional concern regarding unfair competition, the Service need not demonstrate the existence of a direct commercial counterpart of an organization's insurance activity before concluding that the activity is a trade or business. See, Clarence La Belle Post No. 217 v. United States, 580 F.2d 270 (8th Cir. 1978). Nor is it necessary that the Service demonstrate the "active" nature of an organization's insurance activity. Rev. Rul. 69-574, 1969-2 C.B. 130, which based nontaxation on the passive nature of the underlying activity, may be restricted to its specific facts. Accordingly, as stated in the 1979 ATRI, the Service will not follow the decision in Oklahoma Cattlemen's Association, Inc. v. United States, 310 F. Supp. 320 (W.D. Okla. 1969), regarding an exempt organization's income from group insurance activity.

In Oklahoma Cattlemen's, the association, exempt under IRC 501(c)(5), was the group policyholder for a health, accident and life insurance program. Premiums were paid by participating members directly to the insurance company, which then paid the association a 5% "rebate" on these premiums. The association provided the insurance company continuing access to its membership files and allowed the use of its name and insignia by the company for use in its sale of insurance. In addition, the association forwarded correspondence concerning the insurance program to the insurance company. The selling of insurance, servicing of the policy, collection of premiums and payment of claims were wholly in the hands of the insurance company. The court found that the association was not engaged in trade or business because of the passive nature of its activities and its lack of control over the insurance activity, and that the association's insurance activity was substantially related to its exempt purposes. Accordingly, the court held that the rebates received by the association were not unrelated business income.

The Service rejects the Court's reasoning and instead believes that based on IRC 513(c) the determinative factor in the trade or business question is the existence of a profit purpose and not whether the activities may be characterized as passive or active. Rather than restrict the definition of trade or business, IRC 513(c) includes all profit-motivated activities. It is under IRC 512(b) and not IRC 513 that certain passive income, including dividends, interest and royalties are excluded from taxation. While we may then face the question of whether payments received by the group policyholder are royalties, we have under this theory removed the passive-active distinction from the process of determining whether a trade or business exists.

The exempt organization as group policyholder has done more than grant an insurance company the right to use its name. As group policyholder, the organization itself is involved in the insurance program. Accordingly, payments received as group policyholder are not royalties.

The question of the relationship between the group insurance activity and the organization's exempt purposes under IRC 501(c)(5) or IRC 501(c)(6) must also be resolved. If the group insurance activity, although a trade or business, is related to an organization's exempt purposes, income from the activity will not be taxable. To date, it is our position that these group insurance activities are not related to exempt purposes but are carried out for production of income or some other unrelated purpose. Members benefit from the exempt organization's group insurance activity in that insurance is made available to them at a more economical rate. This economic benefit to participating members rather than an industrywide

benefit is the direct result of the exempt organization's activity, and thus fails to support a relationship to exempt purposes under either IRC 501(c)(5) or IRC 501(c)(6).

The third component required for unrelated business income, that the activity be regularly conducted, has generally not been questioned in taxing an exempt organization's receipts from its activity as a group policyholder.

In recent private letter rulings, the Service has followed the above positions and concluded that organizations exempt under IRC 501(c)(6) receive unrelated business taxable income from their activities as group policyholders. These organizations administer their insurance programs in a variety of ways.

In Private Letter Ruling 7849003, the organization offers group life and health insurance to members. It receives monthly computer billings from the insurance carrier, breaks them down to separate billings mailed to participants, receives premium payments, performs the appropriate recordkeeping, and sends a check to the carrier for 95% of the premiums. Solicitations are made by the carrier itself. The organization does however describe the plans in brochures it sends to prospective members. The organization does not process claims although it will act in claim disputes to protect its members. Its insurance committee reviews the insurance plans and makes recommendations. The association also answers inquiries concerning the plans.

In Private Letter Ruling 7847101, the organization signed a master trust agreement with its group insurance trustees and an insurance company. The company directly bills members for their premiums. Premiums are mailed to the association payable to its insurance trust. The checks are deposited in a separate bank account maintained by the trust. On the premium due date, the association pays 95% of the gross premiums received over to the insurance company. The insurance company administers all claims, settlement, and enrollment of members. The association also receives 20% of the commissions paid to the exclusive insurance agent for another insurance company from members' business. (No details were provided concerning the duties performed by the association for the agent or insurance company.) No written agreement governs the relationship with the insurance agent, and the association has no control over the activities of the agent.

In Private Letter Ruling 7847001, the organization provides members with life, health and other group insurance plans administered by a trust. Trustees are

appointed by the chairman of the organization's governing body. The trustees contracted with an independent agent to do most of the administrative work involved in the insurance activities. Formerly, association employees did the administrative work. Funds in excess of those needed to operate the insurance plans are paid over to the organization. In addition, the organization receives a percentage of premiums and experience rebates.

In Private Letter Ruling 7847006, the organization provides members with group life, health, hospitalization and accident insurance, and executive life insurance. The organization conducts mailings, processes applications, bills members, collects and deposits premiums, and processes claims prior to forwarding them to the insurance carrier. The organization also offers group workmen's compensation insurance to both members and nonmembers. As handling fees, the organization receives a percentage of premiums collected and experience rebates.

In Private Letter Ruling 7841004, the organization provides group policies on life and health of members and their employees, life insurance on the life of customers of members, and workmen's compensation insurance. The organization provides the underwriting insurance companies access to its membership files and allows use of its name and insignia for the companies' solicitations. Administrative services in connection with the insurance plans are performed entirely by the insurance companies.

In Private Letter Ruling 7841031, an organization of auto equipment manufacturers and distributors initiated a program of product liability insurance underwritten by an insurance company. Insured members must participate in the association's program of product safety and claims control. In addition to premiums collected, the insurance company's agent collects a fee that is transmitted to the organization for its costs in conducting seminars, inspections and studies as part of the program.

In Private Letter Ruling 8041011, the organization provides members an insurance program underwritten by an insurance company. The organization processes members' enrollment cards, listing their participating employees. The organization bills members, receives their premium payments, and sends one monthly check to the insurance company. The organization reviews claims and forwards them to the insurance company for payment. The organization retains a percentage of premium payments received.

The above private letter rulings illustrate the wide variety of arrangements an exempt organization may make to administer programs of group insurance for its members, including administration through a trust controlled by the exempt organization, administration by the insurance company or its agent, and administration of certain duties by the exempt organization itself. In all situations considered, the organization's contractual agreement to act as group policyholder whatever the actual extent of its activities in connection with the group insurance policy, serves to subject the organization's receipts from the insurance relationship to taxation under IRC 511-513. It is arguable, however, that an organization such as that described in Private Letter Ruling 7841031 is receiving fees for activities related to its exempt purposes rather than fees for services as a group policyholder -- i.e., that the seminars, inspections and studies that are part of the organization's product safety and claims control program supported by the insurance company serve the common business interests of the industry. It does appear that because the services are required and paid for by the insurance company, the fees paid are best characterized as paid for services in the unrelated business relationship between the exempt organization and the insurance company, and are accordingly taxable.

3. Section 170 and Group Insurance

The question of taxation of an exempt organization's receipts from a group insurance activity has also been intertwined with a charitable contribution question. What if the group policyholder is an organization exempt under IRC 501(c)(3) that uses its income, including dividends or experience credits remitted to it, for charitable purposes? Are the dividends or experience credits retained by the organization subject to taxation under IRC 511-513? Are these receipts deductible by insured individuals as charitable contributions under IRC 170? The following fact pattern illustrates the above problem. Private Letter Ruling 80442012 states the Service conclusion with regard to IRC 511-513. Private Letter Ruling 8040036 concerns the IRC 170 question.

An organization exempt under IRC 501(c)(3) serves as group policyholder for life insurance, disability income insurance, major medical and accidental death and dismemberment coverage underwritten by insurance companies. The exempt organization extensively and continuously solicits new business and increased coverage. It processes applications, bills participating members, and transmits all amounts received to the insurance companies. Claims are processed by the insurance companies. Each group policy is handled through an established insurance broker who receives commissions. The insurance companies, brokers and insured individuals make no payments to the organization for its administrative

services. However, as a condition for enrollment in the group policy, the insured member must assign to the IRC 501(c)(3) organization his or her rights to any experience credits or rebates received from the insurer.

The organization argues that amounts received are charitable contributions to the extent they exceed the organization's cost of operating the insurance programs.

"Net cost" to the insured individual, i.e., the premiums less the tax benefit derived from the charitable contribution, is competitive with other group insurance costs computed with the profit element to a broker or group policyholder and without reference to tax considerations. Coverage is also considerably less costly than nongroup insurance. However, gross insurance premiums exceed the premiums for similar group insurance.

The Service has concluded that the rebates received represent compensation for the organization's services to all parties to the insurance transaction and accordingly are included in the organization's unrelated business taxable income. The organization performs valuable commercial services for the insured, broker and insurer without "compensation." The organization is responsible for bringing about the contractual relationship between the insured individuals and the insurance companies. It explains the function and availability of insurance and provides the application forms. It alone does what is necessary to sell the insurance. The retained rebates serve as compensation for the organization's service in providing the right and ability to participate in the group insurance and in conducting the administrative services described above. Further, if the organization were instead viewed as uncompensated for its services, it is arguable that it thereby provides substantial, direct private benefit to participants and thus endangers its exemption under IRC 501(c)(3).

With regard to the charitable contribution question under IRC 170 for the rebates "contributed" to the organization, the nature of the insurance transaction and the services provided by the exempt organization also establish that the rebates are not deductible as charitable contributions. The amounts are not paid voluntarily, but as a condition for obtaining insurance. Therefore, no gift or contribution has been made. See, for example, Perlmutter v. Commissioner, 45 T.C. 311 (1965). The assignment results primarily from the incentive of the insurance coverage offered rather than the charitable purpose to which the organization will dedicate its income, as shown by the time, effort and advertising concentrated by the organization on the merits of its insurance programs. In

addition, the organization has failed to show that the premium payments made for insurance exceed the fair market value of the benefits received by the insured individuals. The organization has not rebutted the presumption that the insureds receive full value for the commercial service sold. (See Rev. Rul. 67-246, 1967-2 C.B. 104, for a statement of the general rule that where a transaction is in the form of a purchase of an item of value, the presumption arises that no gift has been made for charitable contribution purposes, but instead that the payment made is the purchase price of the item.) There also is a problem here because of the statutory restrictions concerning deductions for a gift of a partial interest in property under IRC 170(f)(3). Although the insured individual assigns his or her entire interest in any experience rebates to the exempt organization, this assignment is one of only a partial interest in the insurance policy. Accordingly, even if the assignment were a gift, it would not be deductible under IRC 170(f)(3).

4. Exemption Under IRC 501(c)(6) for Various Insurance Organizations

The starting point in determining an organization's qualifications for exemption under IRC 501(c)(6) are the applicable regulations. Regs. 1.501(c)(6)-1 provide in part that a business league's purpose is to promote the common business interests of its members and "not to engage in a regular business of a kind ordinarily carried on for profit." Further, "its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services." Thus, insurance-related activities of an applicant for exemption may be examined from the viewpoint of both the "regular business of a kind ordinarily carried on for profit" question and the particular services question.

The Service also looks to whether an organization engages in additional activities other than its insurance activities. Overall operations may justify exemption despite the fact that a single activity resembles a commercial undertaking. If so, as discussed in Part 2, income from the organization's insurance-related activity may be taxable under IRC 511-513. In the following discussion, however, we are concerned with a variety of organizations whose primary activity is insurance-related.

Under IRC 501(c)(6), published precedent concerning the effect of insurance-related activities on exemption has been in terms of the particular services question. An organization whose insurance-related activities constitute particular services will not qualify for exemption. In contrast, an organization

whose insurance-related activities serve the common business interests of its members will qualify.

Rev. Rul. 74-81, 1974-1 C.B. 135, describes an organization whose principal activity is the sale of group workmen's compensation insurance to members in the contracting trade and related industries. The insurance is underwritten by an insurance company. The receipts consist of membership dues and amounts refunded by the insurance company which represent excess premiums and which in turn are refunded to members. The Service concluded that by providing the insurance to members, the organization relieves them of obtaining the insurance on an individual basis, resulting in a convenience in the conduct of their businesses. Thus, because the organization's principal activity is the performance of particular services for members, the organization does not qualify for exemption under IRC 501(c)(6).

Similarly, the Service revoked the exemption of an organization engaged primarily in providing insurance for its members. The revocation was upheld by the Tax Court in Associated Master Barbers & Beauticians of America, Inc. v. Commissioner, 69 T.C. 53 (1977). The organization administered self-insurance plans for sick and death benefits, and a voluntary supplemental benefit plan. In addition, at various times it offered hospitalization insurance, basic benefit programs, malpractice and personal liability insurance underwritten by independent insurance companies. A large majority of the organization's members participate in its self-insurance programs. The organization's officers and employees were involved on a daily basis with administrative duties connected with the self-insurance and underwriting programs, including recordkeeping, processing of claims, and payment of benefits. The court emphasized the organization's conduct of self-insurance programs and found that the organization was engaged in the insurance business. Considering both time and financial data, the insurance activities were substantial and disqualified the organization from exemption. The court also found that the insurance activities and other activities (eyeglass and lens replacement service; sale of supplies, shop emblems, textbook), that formed the bulk of the activities performed by the organization, constituted particular services.

In contrast, several published revenue rulings described organizations whose primary activity is insurance-related and that qualify for exemption under IRC 501(c)(6).

Rev. Rul. 71-155, 1971-1 C.B. 152, describes a state-mandated association composed of all insurance companies writing automobile liability insurance in a given state formed for the purpose of making insurance available to high-risk drivers who meet the organization's standards. The association accepts applications, and refers eligible applications to a member company which then performs the actual insurance functions. The association's income is from assessments against the members based on premiums written. The Service concluded that by spreading high-risk policies among members, the organization minimizes public criticism of the insurance industry by making insurance available to persons in high-risk categories who could not otherwise obtain coverage.

Rev. Rul. 73-452, 1973-2 C.B. 183, describes another state-mandated association of insurance companies. All insurance companies writing fire and casualty insurance in the state are required to join. The organization services and pays claims on policies issued by insolvent insurance companies. The organization's income is from membership assessments based on premiums written and amounts collected on claims brought against the assets of the insolvent insurance companies. The organization's activities serve the common business interest of its members by meeting a widespread need that is incident to the field of insurance; that could not be effectively met in the ordinary course of the individual insurance businesses of the members; and, that does not directly enhance the profitability of the individual businesses.

Rev. Rul. 76-410, 76-2 C.B. 155, describes a state-mandated association of insurance companies that provides personal injury protection for state residents who sustain injury in situations where the injuring party has no liability insurance coverage or very limited coverage or the injuring party is unknown. The injured party files a claim with the association, which then assigns the claim to a member company for servicing. The servicing member pays the claim, and is reimbursed by the association for the amount paid plus administrative expenses. The organization's activities serve the common business interests of its members by fulfilling a state- imposed obligation and by enhancing the image of the industry.

The above three rulings do not expressly consider the question of whether the organizations are engaged in "trade or business" or apply the provision of Regs. 1.501(c)(6)-1 that an organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit is not a business league. However, by finding the organizations exempt, the rulings necessarily imply that the organizations are not operated for a business purpose.

The Service has also similarly reached a favorable conclusion concerning exemption under IRC 501(c)(6) for an organization formed to provide an industry home owners warranty program. The organization's primary activity is the conciliation and arbitration of disputes between buyer and builder arising under the warranty program. The organization's other major activity is to advertise the warranty program. The program is designed to assure that new homes purchased from participating builders conform to certain standards. Membership is composed of interested residential builders. Members pay a small administrative fee for each home covered in addition to membership fees. Nonmembers may also participate, upon payment of a participation fee. Under the warranty program, a home buyer enters into a home warranty agreement with a participating builder, paying the organization a fixed rate based upon the price of the home as part of the mortgage costs. The organization then transfers these funds to a casualty insurer, and the buyer receives a master home warranty insurance policy issued by the insurer. For the first two years of the warranty, the insurer agrees to indemnify the home buyer concerning the home. In the event of disagreement between buyer and builder, the buyer mails a "demand for dispute settlement" to the organization. For the third through tenth years of the warranty period, the insurer agrees to repair, replace or pay the cost of repair or replacement of any major construction defects.

The Service concluded that the benefit to individual participating builders is incidental to the organization's primary purpose of improving business conditions in the home building industry, and that the organization therefore qualifies for exemption under IRC 501(c)(6).

The Service in recent years has also seen a variety of new, generally state-mandated, organizations that perform insurance-related functions. The Service has carefully examined their qualifications for exemption under IRC 501(c)(6). The Service has taken a position that because the organizations are substantially engaged in the insurance business, they do not qualify for exemption. Although the focus here has moved to the business issue under Regs. 1.501(c)(6)-1, the organizations may also be described as primarily engaged in the provision of particular services.

A state legislature created an association to guarantee the availability of auto liability insurance by accepting for reinsurance high-risk customers that member companies would ordinarily reject. Membership is mandatory for all companies writing auto insurance in the state. Membership assessments based on the member's share of the state's auto insurance market make up the organization's annual deficit. Members may cede up to 50% of their insurance business to the

association. If claims paid out on ceded business are less then premiums received by the company from ceded business, the company must pay the association the difference. If, instead, claims paid out exceed premiums received, the association reimburses the company for the difference. Also, the individual insurance companies are given credit for all expenses incurred in processing ceded risks. Thus, the actual risk of loss rests on the association, although the association itself never collects premiums or pays claimants. The association then spreads this risk among members by means of the required membership assessments.

A state legislature created an association of all insurers writing liability insurance other than auto, workmen's compensation and certain other specified lines of liability insurance. The association sells medical malpractice insurance to health-care providers on a nonprofit, self-supporting basis, so long as insurance is not otherwise available. Receipts consist of premium payments and annual "stabilization reserve fund" payments. If underwriting losses exceed premiums and reserve fund assets, member insurance companies are assessed a proportionate share of the total amount necessary to meet the losses.

In determining whether an organization qualifies for exemption under IRC 501(c)(6), the Service distinguishes between the "nature" of an activity and the manner in which the activity is conducted. The actual nature of the activity, rather than the profitability or other factors that describe the manner in which it is conducted, is crucial to the "business of a kind ordinarily carried on for profit" question under Regs. 1.501(c)(6)-1. The reinsurance facility bears the actual risk of loss, and thus is engaged in the insurance business. The medical malpractice underwriting association sells high-risk insurance, and thus also is engaged in the insurance business. The Service rejected the argument that because both the reinsurance facility and the medical malpractice underwriting association sell unprofitable insurance, they do not engage in a business of a kind ordinarily carried on for profit. Instead, the organizations have as their sole activity the business of insurance as an insurer or reinsurer, and thus fail to qualify for exemption under IRC 501(c)(6).

The organizations described in Rev. Ruls. 71-155, 73-452, and 76-410 are distinguishable. None is directly engaged in the insurance business. There is no insurance contract between the organization described in Rev. Rul. 71-155 and the individuals it refers to member companies that then must perform the actual insurance functions. In Rev. Ruls. 73-452 and 76-410, there is no insurance contract between a policyholder and the member paying company or the association. Payments to claimants are gratuitous; the services provided by the

association serve primarily to enhance the industry's image and to improve business conditions in the insurance industry rather than to perform particular services. In contrast, the reinsurance facility directly benefits insurance companies and the medical malpractice association directly benefits policyholders. The benefits of the reinsurance facility's operations run to the insurance companies indemnified against loss on the high-risk policies the state legislature requires them to sell. The medical malpractice association benefits its policyholders by relieving them of the responsibility of self-insurance. Both organizations thus provide insurance services aimed at maintaining the profitability of individuals' or policyholders' business rather than encouraging improvement of business conditions.

In one special situation, the Service had to consider whether recognition of exemption under IRC 501(c)(6) would frustrate congressional policies underlying another exemption subsection. The issue arose concerning the qualification for exemption under IRC 501(c)(6) for a membership corporation of credit unions organized after September 1, 1957, pursuant to state statute. The organization insures individual deposits and provides interest-free loans to member credit unions in order to enable them to avoid insolvency or possible liquidation. The organization is supported by membership dues.

Under IRC 501(c)(14)(B), an organization organized before September 1, 1957, to provide reserve funds and insurance for shares or deposits in domestic building and loan associations, cooperative banks, and mutual savings banks qualifies for exemption. The term "cooperative banks" as used in IRC 501(c)(14)(B) includes credit unions. Accordingly, a corporation or association organized before September 1, 1957, which insures shares or deposits in credit unions may qualify for exemption under IRC 501(c)(14)(B). However, Congress has considered and rejected extension of the cutoff date beyond September 1, 1957. The rejection was based in part on adverse effects on the federal organizations created to insure shares or deposits in the financial institutions described in IRC 501(c)(14)(B) that would follow if state-organized insurers could obtain recognition of exemption under IRC 501(c)(14)(B).

Accordingly, the above organization of credit unions does not qualify for exemption under IRC 501(c)(14)(B) because it fails to meet the September 1, 1957, cutoff date. The Service also concluded that the organization does not qualify under IRC 501(c)(6) because recognition of exemption under this more general provision of IRC 501(c) would negate the congressional policies underlying the restrictions of IRC 501(c)(14)(B). Although it could be argued that

this organization's insurance of member deposits serves a similar function to the payment of claims against insolvent insurance companies described in Rev. Rul. 73-452 and thus promotes the common business interests of the credit union industry, because of the specific legislation concerning insurers of shares or deposits, the Service will not recognize this organization exempt.

5. Exemption Under IRC 501(c)(3)

The Service has recently considered the question of exemption under IRC 501(c)(3) of organizations that provide insurance for charitable organizations. One such organization is a risk-pooling trust created under state law to finance property and liability insurance claims against charitable organizations exempt under IRC 501(c)(3). The organization functions both through self-insurance and the purchase of commercial insurance. The organization was formed with the help of a major charitable organization that also donates the time of one of its executives to act as managing director, pays printing and other developmental costs, and supplies office space and clerical help. The organization's commercial insurance program is structured so that the trust retains a share of the cost of claims, but its total cost of claims for any year is limited to that portion of the beneficiaries' premiums for that year that were retained by the trust. Because of the organization's retention of risk program, premium costs are reduced, and beneficiaries receive the benefits of the organization's income from the investment of premiums in the time period between the receipt of premiums and the payment of claims. Additional savings accrue to the beneficiaries through the trust's elimination of agent commissions in the purchase of insurance and of payments to intermediate insurance companies, brokers and agents in the trust's reinsurance dealings. Data submitted by the trust shows that it provides insurance coverage at charges substantially below the actual cost of the service. Accordingly, the Service has concluded that the organization may qualify for exemption under IRC 501(c)(3). As in Rev. Rul. 71-529, 1971-2 C.B. 234, the provision of commercially available goods or services to unrelated charitable organizations at substantially below cost supports exemption under IRC 501(c)(3). If the organization had instead merely shown that it provided insurance at fees below fair market value, i.e., at fees lower than those charged by commercial entities, it would not have demonstrated that it qualified for exemption.

The Service has also considered the exemption of an organization that serves both charitable organizations and their employees. The organization sells annuity contracts and insurance policies solely to institutions of higher education and their employees. Its stated purpose is to strengthen nonprofit institutions of higher

education or research by providing annuities, life insurance, and sickness and accident benefits suited to the needs of the institutions and their employees, and to offer counseling on pensions or other forms of employee security. Initial capital was supplied by means of grants. A grant also supported development of certain major benefit programs. However, all insurance programs are self-supporting with the exception of the income the organization's grants continue to generate. Certain insurance benefit programs offered by the organization were unavailable from commercial insurers at the time they were first offered by the organization. Qualifying individuals may purchase benefit coverage whether or not their employing educational institution maintains a benefit program offered by the organization. Further, individual policies remain in effect regardless of whether participants continue educational employment.

Because this organization provides ordinary commercial services for a group of structurally unrelated charitable organizations, as was true for the risk-pooling trust described above, exemption under IRC 501(c)(3) is dependent on its showing that it provides the insurance services to the educational institutions at substantially below cost and thus operates essentially like a grant-making charity. Here, while the organization's income from its grants is used to reduce the prices charged the educational institutions, such prices were not substantially below the actual cost of the service and insurance provided. Accordingly, the organization's sale of insurance contracts to other exempt organizations does not support exemption.

Further, the organization's transactions with individual educational employees demonstrates nonincidental private benefit. The sale of insurance to the individuals is not educational nor is it charitable as the individuals are not members of a charitable class. Any benefit to the employing educational institutions from the organization's transactions with their employees is indirect and outweighed by the direct private benefit to the employees.

6. Summary

Recent rulings concerning exemption under IRC 501(c)(6) of organizations that provide insurance or insurance-related services and recent rulings concerning taxation under IRC 511(a) of exempt organizations' income from group insurance activities show that the Service has applied nonrestrictive definitions of the terms "business of a kind ordinarily carried on for profit" under IRC 501(c)(6) and "trade or business" under IRC 513. In general, an organization whose primary activity is the provision of insurance or insurance-related services to its members will be unable to qualify for exemption under IRC 501(c)(6). And, in general, an exempt

organization's income from its activity as a group policyholder will be taxable under IRC 511(a).

Similarly, an organization that provides insurance services to individuals or to charitable organizations will have to show that it offers its services at substantially below its actual cost solely to members of a charitable class or charitable organizations in order to qualify for exemption under IRC 501(c)(3). Without such a clear showing of outside support, the organization is engaging in the provision of commercial services.