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PLR-117853-06
Date:
October 27, 2006

LEGEND

Trust =

Corporation =

Association =

State =

LTD =

Country A =

Statute =

Dear :

This is in reply to a letter dated December 5, 2005, and subsequent correspondence, requesting rulings that, after certain changes, the income of Trust will continue to be excluded from gross income under section 115(1) and that the income of Corporation will be excluded from gross income under § 115(1) of the Internal Revenue Code.

FACTS

Association is a State non-profit corporation. It has received a determination letter that it is an organization described in section 501(c)(4) of the Code. Association's purpose is to promote public education and improve school board governance in State. All public school districts in State are currently members of Association. In addition, Association's bylaws also permit certain other enumerated public school entities to become members.

Association formed a common law trust (Trust) to provide insurance for the members of Association. Since its formation, Trust has provided the participants in its insurance program with risk management services, negotiated the design of policies with other insurance providers and endorsed such policies. Trust has also provided a variety of insurance-related services including safety and loss control services, advice regarding insurance programs and third-party administrator services with respect to the workers' compensation, professional liability, and property and casualty programs. Further, through LTD, a Country A based captive insurance company, Trust insured or reinsured risks for general liability, professional liability, errors and omissions, workers' compensation, property and casualty and similar risks.

Trust's income was derived primarily from premiums and investment income. It also received income from consulting fees and fees for third-party claims services. Upon the dissolution of Trust all of its assets were to be distributed to the participants in Trust's insurance programs.

Based upon the above facts, Trust received a private letter ruling that Trust's income was excluded from gross income under section 115(1) with the caveat that all of the public school entities that participate in the Trust insurance program must be political subdivisions of State or integral parts of State or its political subdivisions. The taxpayer now proposes to modify the above facts.

Trust proposes to domesticate its insurance operations by merging LTD into Corporation, a State chartered domestic insurance company, in what it represents is a section 368(a)(1)(F) reorganization pursuant to which all of the assets, operations and liabilities of LTD will become those of Corporation and the corporate existence of LTD will cease.

With respect to the insurance programs provided by Trust, the taxpayer represents that it will amend the Trust Agreement to clarify that only an entity that is a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under section 115(1) may participate in any of the insurance programs provided by Trust. Further, the Trust Agreement will be amended to provide that the Trust's trustees will be selected by the participants in Trust's insurance program.

Trust is the sole shareholder of Corporation. Corporation is a licensed insurance company in State. It will provide insurance and reinsurance to public school districts and other public school entities that participate in Corporation's insurance program. The taxpayer proposes to amend the bylaws of Corporation to state that Corporation will not provide insurance or reinsurance for any insurance policy for which the insured is not a state, a political subdivision of a state or and organization the income of which is excluded from gross income by section 115 of the Code.

The income of Corporation will be derived from insurance premiums and investment income. Its income is to be used to provide insurance and reinsurance and accumulate the capital necessary to meet the insurance needs of public school entities. When Corporation is dissolved any surplus remaining after satisfaction of all liabilities and obligations will be paid to participants in its insurance program.

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, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated 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 utility 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. In addition, pursuant to section 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined 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 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust

After carrying out the reorganization described above and adopting the proposed amendments to its Trust Agreement described above, Trust will continue to provide the participants in the Trust insurance program with insurance in a cost effective manner in order to protect their fiscal integrity. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust will perform an essential governmental function within the meaning of § 115(1) of the Code.

Further, the income of Trust will continue to accrue to the participants in Trust's insurance programs, all of which are required to be states, political subdivisions of state or entities the income of which is excluded from gross income under section 115(1) of the Code. No private interests will participate in or benefit from the operation of Trust other than as providers of goods or services. Any benefit to the employees of participants in the insurance programs is incidental to the public benefit. See Rev. Rul. 90-74. Accordingly, Trust's income will continue to be excludable from gross income under § 115(1) of the Code.

Corporation

Subsequent to the formation of Corporation and the merger of LTD and Corporation, the activities of Corporation will help to protect the public entities that are members of Association from financial loss by providing insurance products and services. Corporation will perform an essential governmental function similar to that provided by the taxpayer in Rev. Rul. 90-74. Further, no part of Corporation's income will accrue to a private person. The income of Corporation will accrue to the public school entities that participate in the Corporation insurance programs, all of which are required to be states, political subdivisions of state or entities the income of which is excluded from gross income under section 115(1). Accordingly, Corporation's income will be excluded from gross income under § 115(1) of the Code.

CONCLUSIONS

Based on the information and representations, provided the Trust Agreement of Trust and the bylaws of Corporation are amended as described above, we hold that the income of Trust will continue to be excluded from gross income under §115 and the income of Corporation will be excluded from gross income under §115(1).

Except as specifically provided otherwise, no opinion is expressed on the federal income tax consequences of the transaction described above, your representation that there was a section 368(a)1)(F) reorganization, or the classification of Trust or Corporation as a trust or corporation for federal tax purposes .

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,

David L. Marshall
Chief, Exempt Organizations
Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures;
Copy of this letter
Copy for § 6110 purposes