

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:TEGE:EOEG:EO1

PLR-130956-04

Date:

October 08, 2004

Attn

Agency =

State =

The Act =

Dear :

This is in response to your ruling request dated June 1, 2004, in which you requested a ruling that the income the Agency receives from its operations is excludable from gross income under section 115 of the Internal Revenue Code ("Code").

The Agency is an unincorporated association comprised solely of State municipalities, municipal health districts, and State boards of education and regional school districts. It was formed initially by two municipalities pursuant to the Act in response to the unpredictable pricing of commercial insurance. The Agency obtained a certificate from the State Insurance Commissioner authorizing it to act as an interlocal risk management agency for the worker's compensation risks of its members, including claims for hypertension or heart disease. The Agency may also purchase public liability insurance, workers' compensation insurance, property perils insurance, automobile insurance, and reinsurance for any risk. Subject to the Insurance Commissioner, the Agency may seek to form such additional risk management pools and/or purchase insurance and reinsurance for any risks.

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The Act provides that any two or more municipalities may form and become members of an “interlocal risk management agency” and a local public agency other than a municipality may join an interlocal risk management agency by resolution of its governing body. The Act defines a “local public agency” as any political subdivision of the state, including any city, town, or borough or certain other defined districts, or other district, department of health, school board, housing authority, or other authority established by law.

In accordance with the Act, the bylaws of the Agency limit membership in the Agency to municipalities and other political subdivisions of State. Eligible members must apply for membership and be accepted by the Board of Directors (the “Board”). The Board manages the Agency. At least two-thirds of the directors must be a member of the governing body or an employee of a member. The Board shall have at least three but not more than nine directors. The Board is authorized to hire employees, appoint an Executive Committee or other committees, and hire an administrator to perform certain management functions and coordinate services. The Board has also appointed a President who reports directly to the Board. Among its essential functions, the President executes all Board-approved policies and oversees the day-to-day administration of the Agency

Each member of the Agency is required to pay initial and annual contributions. In addition to the annual contribution, the Board is authorized to assess the members for their pro rata share of the reserve for contingencies required to be set aside under the Act and for other assessments as determined by the Board.

The Board is authorized under the bylaws to make distributions only to its members. In the event of dissolution, the Agency is required to pay its members their pro rata share of the remaining funds.

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.

When determining if section 115(1) of the Code applies, the Service considers all the facts and circumstances relating to the organization to determine: (1) whether the organization performs an essential governmental function, and (2) whether the income of the organization accrues to a state or political subdivision of a state. The determination whether a function is an essential governmental function depends on the facts and circumstances of each case.

Rev. Rul. 77-261, 1977-2 C.B. 45, concludes that 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 under section 115(1) of the Code. The revenue ruling

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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 utility or the performance of some governmental function that accrues 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. Further, the accrual to a number of political subdivisions of a state as well as that state itself is not inconsistent with the statute itself. Rev. Rul. 90-74, 1990-2 C.B. 34, concludes that the income of an organization formed, operated, and funded by political subdivisions to pool their casualty risks, or other risks arising from their obligations concerning public liability, workers' compensation, or employees' health is excludable 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.

The Agency was established under the authority of State law to pool the insurance risks of its member political subdivisions and government entities. Any private benefit to public employees from insuring against these various risks is incidental to the public benefit. By providing such insurance coverage in a cost effective manner, the Agency is helping its members to protect their financial integrity similar to the entity in Rev. Rul. 90-74 and is thereby performing an essential government function.

Membership in the Agency is limited by the Bylaws and the Act to include only municipalities and other political subdivisions of the State. As such, all members of the Agency are political subdivisions or section 115 entities. No part of the net earnings of the Agency inures to the benefit of or is distributed to a private entity or individual. Upon dissolution, distributions are made only to the members of the Agency.

Based on the information submitted by the Agency, we conclude that the income of the Agency is excludable from gross income for federal income tax purposes under section 115(1) of the Code.

No opinion is expressed or implied on the federal tax consequences of the transaction described above under any other provision of the Code.

As provided in the power of attorney enclosed with this letter, we are sending a copy of this letter to your authorized representative.

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This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that the 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: