

FACTS

Pool is an unincorporated association of public school districts and other public entities related to education. It was created pursuant to State Statute. Statute allows certain government bodies to jointly create an interlocal risk management pool to provide its members with risk management services and insurance coverage. Pool provides coverage against losses arising from general liability, auto liability, real or personal property damage, errors and omissions liability and workers' compensation, as well as healthy, dental, accident and life insurance. Pool self insures certain risks jointly and purchases commercial insurance and reinsurance in other cases. Participating in Pool allows its members to realize cost reductions with respect to both coverage and the related risk management services.

Membership in Pool is limited to State public school districts and education related public entities that execute interlocal agreements with Pool. Each member is a state, a political subdivision (as defined in § 1.103-1(b) of the Income Tax Regulations) of State, or an entity whose income is excluded from gross income under § 115 of the Code. Only organizations that are members in good standing with Association are eligible to participate in Pool. Association is a nonprofit, incorporated, membership corporation. Association's purpose is to contribute to the improvement of public education in State, including all matters related to administration and operation of public elementary and secondary schools. Voting membership in Association is limited to the boards of public school districts and the boards of other public education related entities, all of which are political subdivisions of State. Association has received a ruling from the Internal Revenue Service that it is exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(6). Sixty percent of Association's members participate in Pool.

Pool's governing documents consist of a Formation Agreement and Bylaws. According to the Formation Agreement, Pool is governed by a board of eleven directors. Nine of the directors are elected or appointed officials of members of Pool. The remaining two directors are the president and the executive director of Association.

Pool contracts for certain professional services essential to its operations. There are four contract agreements currently in place. Pursuant to two of the four contracts, Association provides management and loss control services. Pursuant to the other two contracts, unrelated parties provide administrative services and claim service administration. Pool is subject to oversight by Department. As part of this oversight, each of Pool's contracts for services must be reviewed and approved by Department.

Pool's income comes from premiums paid by its members and investment income. Members are required to pay a yearly deposit premium at the beginning of the year. Subsequent adjustments, including further assessments or the distribution of dividends to members, may take place later in the year. All funds are used for the

exclusive benefit of Pool's members. Any excess funds are distributed to its members. No income of Pool inures to the benefit of a private party. Upon dissolution of Pool, after all liabilities and expenses are paid, the remaining assets will be distributed to its members.

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.

By providing insurance to governmental entities in a cost effective manner, Pool is helping its members to protect their financial integrity. The type of benefits provided by Pool are similar to those described in Rev. Rul. 90-74. Pool, like the organization described in Rev. Rul. 90-74, performs an essential governmental function within the meaning of § 115(1). The income of Pool 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). The income of Pool will not accrue to private parties, other than incidentally, as reasonable compensation for providing goods and services. Upon the dissolution of Pool, its remaining funds will be distributed to its members.

CONCLUSION

Based on the information and representations submitted by Pool, we hold that the income of Pool is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Accordingly, Pool's income is excludable from gross income under § 115(1) of the Code.

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

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.

In accordance with a Power of Attorney on file, we are sending a copy of this letter to your representative.

Sincerely,

Barbara E. Beckman
Assistant Chief, Branch 2
Division Counsel/Associate
Chief Counsel
(Tax Exempt and Government
Entities)

Enclosures;
Copy of this letter
Copy for § 6110 purposes

CC: