

Internal Revenue Service

Number: **201634012**
Release Date: 8/19/2016
Index Number: 115.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

ID No.

Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:EO2
PLR-137724-15

Date:
May 17, 2016

Legend

Trust	=
Association	=
Subsidiary	=
Company	=
State	=
Year 1	=
Trust	=
Agreement	
Year 2	=
Year 3	=
Date 1	=

Dear :

This letter is in response to the ruling request your authorized representative submitted on November 17, 2015. That request, and subsequent correspondence, seeks several rulings, including that income the Trust receives upon completion of the transaction described below will be excludable from gross income under section 115(1) of the Internal Revenue Code (Code).

Facts

The Association is incorporated in State and is treated as an organization described in section 501(c)(4) of the Code. Its membership is limited to certain types of public school entities, as enumerated in its bylaws, in State. Each of its current members qualifies as a state of the United States, a political subdivision of a state of the United

States, or an entity, the income of which is excluded from gross income under section 115(1) of the Code. The Association's mission is to promote public education and improve public school board governance in State.

The Association formed the Trust in Year 1. Trust was formed to provide risk management and insurance related services to the Association's members. 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.

In order to be a participant in Trust, an entity must be a member of the Association, qualify as one of the enumerated types of public school entities in State, and participate in one of the Trust's programs. To participate in one of the Trust's programs, an entity must qualify as a state of the United States, a political subdivision of a state, or an entity, the income of which is excluded from gross income under section 115 of the Code.

A member of the Association has the option, but is not required, to participate in the Trust's programs. The Trust is governed by a board of trustees consisting of between seven and eleven Trustees. The Trustees are elected by members of the Association who are also participants. The Trust Agreement provides that on termination no distribution will be made unless the entity receiving the distribution qualifies as a state, a political subdivision of a state, or an entity, the income of which is excluded from gross income under section 115(1) of the Code.

The IRS issued a private letter ruling to the Trust in Year 2, concluding that its income is excludable from gross income under section 115 of the Code. The IRS issued a second private letter ruling to the Trust in Year 3, confirming that its income would continue to be excluded from gross income under section 115 of the Code, after the Trust placed the majority of its insurance programs in Subsidiary, a State licensed for-profit insurance company, and thereby altered the way it serves its participants. Subsidiary also received a private letter ruling from the IRS in Year 3, concluding that its income is excludable from gross income under section 115 of the Code.

Trust owns all of the outstanding stock of Subsidiary and is the sole member of Company, a State limited liability company that is treated as a disregarded entity for purposes of federal income taxes. Subsidiary provides insurance and reinsurance to Trust's participants. Company provides services related to insurance claims, risk management, employee benefits, and benefits counseling to the public school members of Association. Trust has determined that owning Subsidiary and Company is no longer economically feasible and that a buyer with greater capital and risk tolerance will be positioned to offer better insurance products to its participants.

Under the proposed transaction, the Trust will sell all of the outstanding stock of Subsidiary, and substantially all of the assets of Company, to an unrelated third party for fair market value. Certain insurance activities that were discussed in the Year 2 and Year 3 private letter rulings have been conducted directly by the Trust and have not been placed in Subsidiary or Company. Thus, these insurance activities will not be part of the proposed transaction. And upon completion of the transaction, the Trust will continue to conduct these insurance activities, as discussed in the Year 2 and Year 3 private letter rulings.

Upon completion of the transaction, the Trust will engage primarily in programs that strive to advance public education in State through financial and educational support for its participants (referred to herein as “expanded activities”). According to the Trust, the expanded activities will promote the adoption of policies and practices that will improve the quality of public education in State. The Trust represents that the expanded activities will accomplish the Trust’s mission by providing training sessions and conferences, disseminating information pertinent to the successful operation of public education, studying and interpreting legislation that will impact public education, contracting with third-party vendors to provide necessary consulting and additional resources to the Trust’s participants, and informing the public of the conditions and needs of public schools. The Trust Agreement was amended on Date 1 to list the expanded activities in its purpose provision. With respect to contracts with third-party vendors, the Trust represents that it will conduct this expanded activity in a manner which will ensure that the agreements do not provide more than an incidental benefit to private interests.

The Trust administers a student accident insurance program. Upon completion of the transaction, the Trust will continue to administer the student accident insurance program, which provides benefits for medical expenses related to injuries to student athletes participating in school-supervised or sponsored activities, as part of the expanded activities. The coverage also includes accidental death and dismemberment benefits. The Trust markets this policy to the participants, bills the participants, and collects their premiums. The Trust represents that it has and will continue to take the appropriate precautions to ensure that its operation of this program does not provide more than an incidental benefit to private interests. The student accident insurance program was not discussed in the Year 2 or Year 3 private letter rulings.

The Trust plans to use a majority of the proceeds from the sale of its insurance assets to fund the Trust’s expanded activities, including its administration of the student accident insurance program as discussed above. The remaining proceeds will be utilized to conduct the Trust’s insurance activities as discussed in its Year 2 and Year 3 private letter rulings.

Rulings Requested:

The Trust requests the following rulings:

1. The expanded activities that the Trust will perform qualify as the exercise of an essential governmental function under section 115;
2. The income from the transaction is excluded from the Trust's income under section 115;
3. After the Trust engages in the expanded activities, its income will be excluded from gross income under section 115; and
4. The use of the proceeds from the transaction to fund the expanded activities will be the exercise of an essential governmental function and such income will accrue to a state, or political subdivision thereof, within the meaning of section 115.

Law

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 governmental function and accruing to a state or any political subdivision thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income generated by an investment fund established by a state to hold revenues in excess of the amounts needed to meet current expenses is excludable from gross income under section 115(1) of the Code.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (e.g., casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under section 115(1). The revenue ruling states that the income of such an organization is excluded from gross income as long as private interests do not participate in the organization or benefit more than incidentally from the organization.

Analysis

Ruling 1: the expanded activities that the Trust will perform qualify as the exercise of an essential governmental function under section 115.

After the transaction, the Trust plans to provide training sessions and conferences; disseminate information pertinent to the successful operation of public education; study and interpret legislation that will impact public education; contract with third-party vendors to provide necessary consulting and additional resources to the Trust's participants; and inform the public of the conditions and needs of public schools. The Trust's engagements with third-party vendors will not provide more than an incidental benefit to private interests. The Trust also plans to continue to administer the student

accident insurance program in a manner that does not provide more than an incidental benefit to private parties.

The activities described above relate directly to the provision of public education and its accompanying responsibilities and obligations, and utilize economies of scale on behalf of State, political subdivisions of State, and entities in State whose incomes are excluded under section 115, to assist them in their provision of public education and in meeting their accompanying responsibilities and obligations. The activities do not provide more than an incidental benefit to private parties. Accordingly, they are essential governmental functions under section 115(1) of the Code.

Ruling 2: the income from the transaction is excluded from the Trust's income under section 115.

Trust has determined that owning Subsidiary and Company is no longer economically feasible or beneficial to its participants due to regulatory and market pressures. Trust has also determined that a buyer with greater capital and risk tolerance will be positioned to offer better insurance products to its participants.

Under the proposed transaction, the Trust will sell all of the outstanding stock of Subsidiary, an entity whose income is excluded under section 115(1) of the Code. The Trust will also sell substantially all of the assets of Company, an entity for which the Trust is the sole member and that is disregarded for purposes of federal income tax. The buyer of these assets is an unrelated third party and the assets will be sold for fair market value. Based upon your representations, we conclude that the proposed transaction will ensure the financial integrity of State entities, political subdivisions of State, or entities in State whose incomes are excluded under section 115(1). The proposed transaction will not provide more than an incidental benefit to private parties. Accordingly, the income derived from the proposed transaction will be derived from the exercise of an essential governmental function under section 115(1) of the Code.

The Trust Agreement provides that on termination no distribution will be made unless the entity receiving the distribution qualifies as a state, a political subdivision of a state, or an entity, the income of which is excluded from gross income under section 115(1) of the Code. Accordingly, income derived from the proposed transaction will accrue to a state or a political subdivision of a state under section 115(1) of the Code.

Ruling 3: after the Trust engages in the expanded activities, including the Student Accident Insurance Program, its income will be excluded from gross income under section 115.

Under Ruling 1, we have concluded that the expanded activities qualify as essential governmental functions under section 115(1) of the Code. The Trust Agreement provides that on termination, no distribution will be made unless the entity receiving the

distribution qualifies as a state, a political subdivision of a state, or an entity whose income is excluded from gross income under section 115(1) of the Code. Accordingly, income to the Trust will accrue to a state or a political subdivision of a state under section 115(1) of the Code after the Trust engages in the expanded activities.

Ruling 4: the use of the proceeds from the transaction to fund the expanded activities will be the exercise of an essential governmental function and such income will accrue to a state, or political subdivision thereof, within the meaning of section 115.

Under Ruling 1, we have concluded that the expanded activities qualify as essential governmental functions under section 115(1) of the Code. Under Ruling 2, we have concluded that the income derived from the proposed transaction will be derived from the exercise of an essential governmental function under section 115(1) of the Code. Accordingly, the use of the proceeds from the transaction to fund the expanded activities will be the exercise of an essential governmental function.

Under Rulings 2 and 3, we have concluded that income derived from the proposed transaction will accrue to a state or a political subdivision of a state under section 115(1) of the Code.

Conclusion

Based on the foregoing, we rule that:

Ruling 1: the expanded activities that the Trust will perform qualify as the exercise of an essential governmental function under section 115(1) of the Code.

Ruling 2: the income from the transaction is excluded from the Trust's income under section 115(1) of the Code.

Ruling 3: after the Trust engages in the expanded activities, its income will be excluded from gross income under section 115(1) of the Code.

Ruling 4: the use of the proceeds from the transaction to fund the expanded activities will be the exercise of an essential governmental function and such income will accrue to a state, or political subdivision thereof, within the meaning of section 115(1) of the Code.

This ruling is based on the facts as they were presented in the ruling request and on the understanding that there will be no material changes to those facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections expressly described herein.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, that material is subject to verification during an examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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

Sincerely,

Andrew F. Megosh, Jr.
Senior Tax Law Specialist
(Tax Exempt & Government Entities)

cc: