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section 115 of the Code. Under the law of State and Company's by-laws, every member is an insured, and every insured is a member.

There are currently n members of Company, most of which are municipal public utilities. There are three classes of membership in Company, each depending upon the amount of initial contribution to Company. All members are required to pay annual premiums as established by the Board of Directors ("Board"). Membership in Company terminates after a member ceases to be an insured of Company, ceases to be a participant in good standing of Association, or for a number of other reasons. Any member may elect not to renew its insurance and withdraw from membership by giving a minimum of one year's written notice to Company. Upon withdrawal, members are entitled to receive distributions of their premiums. However, the Board in its sole discretion, may defer, delay, or cancel such distributions.

Company's Board is comprised of at least nine directors, six of whom must represent members. One director must be a resident of State who is not a representative of a member, one must be an outside director who is a representative of a public utility trade association, and one must be an at-large director who is not a representative of a member.

The Board is authorized to hire employees, appoint an Executive Committee and other such committees as it deems necessary, hire outside service providers, and appoint an independent management company. The Board has contracted with Management Company, an unrelated corporation, to perform certain management, regulatory, and recordkeeping services for Company.

The Board of Directors has, in its sole discretion, the authority to declare and pay an annual dividend to members of Company, in respect to the insurance policies issued to them or otherwise. Members have no right to them. If declared, only "eligible organizations" may receive policyholder dividends.

Upon dissolution, Company's assets are to be liquidated and distributed to qualifying members in repayment of each member's surplus account (if any), after payment or provision of payment of all liabilities, obligations, and expenses of Company, in accordance with the law of State. Distribution of assets are to be made only to those members eligible to receive dividend distributions. If assets are insufficient to pay each member the total of its surplus account, the assets available for distribution will be distributed among the qualifying members on a pro rata basis.

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

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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 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.

Company was established under the authority of State law to pool the insurance risks of its member public utilities. 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, Company is helping its members protect their financial integrity similar to the entity in Rev. Rul. 90-74 and is thereby performing an essential governmental function.

In addition, the members of Company are all political subdivisions or section 115 entities. No part of the net earnings of Company inures to the benefit of or is distributed to a private individual or entity. Upon dissolution, distributions are only made to members. Thus, the income of Company accrues to a state or a political subdivision of a state.

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

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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.

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,

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

Enclosures:

Copy of this letter

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