Number: **200637031**
Release Date: 9/15/2006

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Index Number: 115.00-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:TE/GE:EO2
PLR-104839-06
Date:
June 05, 2006

LEGEND

Corporation A =

Corporation B =

Dear :

This is in reply to a letter dated January 6, 2006, requesting a ruling concerning the exclusion of income of Corporation A from gross income under § 115 of the Internal Revenue Code after a proposed change in the membership of Corporation A.

FACTS

Corporation A is a captive insurance company formed to provide reinsurance and insurance protection to municipalities, counties, schools and other public entities. Corporation received a prior ruling that its income was excludable from gross income under section 115(1) of the Code. Corporation A now seeks a ruling that its income will continue to be excluded from gross income pursuant to section 115 after it admits Corporation B as a member and allows Corporation B to participate in its insurance programs. Corporation A is incorporated as a nonprofit mutual insurance company. It provides insurance for workers' compensation, property coverage and employee benefits as well as liability reinsurance.

Corporation A's members are public entities, all of which are political subdivisions of a state or entities the income of which is excluded from gross income under section 115 of the Code. The bylaws provide for a board of directors of not less than three nor more than eleven persons, with not more than one being elected by the board of directors. The exact number of directors shall be fixed from time to time by the members. The board elected director shall have management or consultant experience in captive insurance company or risk pool operations. With the exception of the board elected director, all directors are elected at the annual meeting and must be duly authorized representatives of a member. Any net income retained by Corporation A at the end of the year is added to surplus, reduces premium payments, or is distributed to the member public entities in the form of dividends. Upon dissolution the assets will be distributed to the member public entities.

Three federally recognized Indian tribes created Corporation B. Corporation B received a charter as a corporation organized under section 17 of the Indian Reorganization Act of 1934, 25 U.S.C. section 477 (1993). Corporation B is an interlocal risk pool that provides insurance for the three tribes that created it. It also provides insurance to other Indian tribes, various tribal entities, individual tribe members and businesses operated by individual tribe 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.

Section 7871 of the Code provides that Indian tribal governments are treated as states for certain specific purposes.

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.

The benefits provided by Corporation A are similar to those described in Rev. Rul. 90-74. Corporation A, like the organization described in Rev. Rul. 90-74, performs an essential governmental function within the meaning of section 115(1) by providing its members with insurance in a cost effective manner in order to protect their fiscal integrity. The income of Corporation A accrues to its members. Currently, the members of Corporation A are all states, political subdivisions of a state or entities the income of which is excludable from gross income under section 115(1). Although private individuals receive an incidental benefit, the primary beneficiaries of the coverage are the members of Corporation A.

With the proposed addition of Corporation B as a member of Corporation A, the primary beneficiaries of the insurance coverage provided by Corporation A would no longer be limited to states, political subdivisions of state or entities the income of which is excluded from gross income under section 115 because Corporation B is not a state, a political subdivision of a state or an entity the income of which is excluded from gross income under section 115. Corporation B, as a section 17 corporation, has a tax status similar to that of a federally recognized Indian tribe. See, Rev. Rul. 94-16, 1994-1 C.B. 19. However, the courts held that a tribe is not a state. White Mountain Apache Tribe v. Bracker, 448 U.S. 136, 143 (1980); United States v. Kagama, 118 U.S. 375, 381-84 (1886).

Congress, concluding that it was appropriate to provide Indian tribal governments with a status under the Internal Revenue Code similar to what is now provided to the states, responded by enacting section 7871. S. Rep. No. 97-646, 97th Cong,. 2nd Sess. 1, 11 (1982), 1983-1 C.B. 514, 518. This provision of the Code provides that a federally recognized Indian tribal government is treated like a state for certain specifically identified sections of the Code. However, section 115 is not one of the code sections identified in section 7871 under which a tribe is treated like a state.

Accordingly, after adding Corporation B as a member, the income of Corporation A will no longer accrue only to states, political subdivisions of states or entities the gross income of which is excluded from income under section 115(1).

CONCLUSION

Based on the information and representations submitted by Corporation A, we hold that when Corporation B becomes a member of Corporation A, Corporation A will not meet the requirements of section 115(1) of the Code.

This ruling letter is effective as of the date the proposed amendments to Corporation's articles of incorporation and by-laws are adopted.

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.

Sincerely,

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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