



APR 22 1993

Employer Identification Number: [REDACTED]
Key District Office: [REDACTED]
Tax Years: All Years
Accounting Period Ending: [REDACTED]
Form: [REDACTED]

Dear Applicant:

This is our final adverse ruling as to your exempt status under section 501(c)(3) of the Internal Revenue Code.

This ruling is made for the following reason(s):

You are not operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code because you do not meet the requirements of section 501(c)(e). Furthermore, the provision of insurance in the manner described in your application does not further exclusively exempt purposes within the meaning of section 501(c)(3) because your primary activity is providing commercial-type insurance. Therefore, you are precluded from exemption by section 501(m) of the Code

Contributions to you are not deductible under section 170 of the Code.

You are required to file federal income tax returns on the above form. Based on the financial information you furnished, it appears that returns should be filed for the tax years shown above. You should file these returns with your key District Director for exempt organization matters within 30 days from the date of this letter, unless a request for an extension of time is granted. Returns for later tax years should be filed with the appropriate service center as indicated in the instructions for those returns.

If you decide to contest this ruling under the declaratory judgment provisions of section 7428 of the Code, you must initiate

a suit in the United States Tax Court, the United States Court of Federal Claims, or the United States District Court for the District of Columbia, before the 91st day after the date this ruling is mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. Processing of income tax returns and assessment of any taxes due will not be delayed because a declaratory judgment suit has been filed under section 7428.

In accordance with section 6104(c) of the Code, the appropriate State officials will be notified of this ruling.

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

Sincerely yours,

(signed) [Redacted]

[Redacted]

Director, Exempt Organizations
Technical Division

cc: [Redacted]

[Redacted]

[Redacted]

[Redacted]

	Initiator	Reviewer	Reviewer	Reviewer
Code	[Redacted]	[Redacted]	[Redacted]	[Redacted]
Surname	[Redacted]	[Redacted]	[Redacted]	[Redacted]
Date	4-16-93	4/16/93	4-16-93	

[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

JAN 24 1992

Employer Identification Number: [REDACTED]
Key District: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption as an organization described in section 501(c)(3) of the Internal Revenue Code. Based on the information submitted, we have concluded that you do not qualify for exemption under that section.

You were organized on [REDACTED], but did not become operational until [REDACTED] when you were authorized to operate by the Department of Labor and Industry of the State of [REDACTED]. Your application for exemption was submitted on [REDACTED].

You are the result of a cooperative effort on the part of area tax exempt health care providers to reduce their cost of operations through self-insurance and the purchase of specific and aggregate excess insurance for worker's compensation and occupation disease. You represented that while each of your members could have operated such a program they have decided to join together for reasons of administrative efficiency and risk distribution.

All your members are shareholders of [REDACTED], or are operated under contract by a member of the Network. No other relationship exists between your members other than their association through the Network. Your members must all be exempt from Federal income tax under section 501(c)(3) of the Code. You describe yourself as simply a conduit for administration of your members' self-insurance programs. You project that over half of your budget will be used directly for self-insurance claims.

Insurance coverage is provided to your members at actual cost. The cooperative effort is expected to result in administrative efficiency and risk distribution, with an overall cost reduction to your members.

Your organizational document entitled "[REDACTED]" is dated [REDACTED]. It states that you were "created for the sole purpose of performing on a centralized basis the provision of Workers' Compensation and Occupational Disease coverage, including purchase of such insurance coverage, for the employees of the shareholders of [REDACTED] which are organizations described in Section 501(c)(3) of the Internal Revenue Code of 1954, as amended, and are exempt from taxation under subsection (a) of such Section, and those health care facilities, operated under contract by shareholders of [REDACTED] which are organizations described in Section 501(c)(3) of the Internal Revenue Code of 1954, as amended, and are exempt from taxation under subsection (a) of such Section."

Your activities include:

- a. The development and implementation of a program for loss control, including loss control services such as inspections and surveys, and training programs;
- b. Determination, assessment, and collection of a "premium" sufficient to cover the claims of the employees, and to pay for excess insurance;
- c. Supervision of a timely issuance of checks for workers' compensation claims and mandatory vocational rehabilitation obligations to members' employees.

Your only sources of support are contributions by members and investment income on excess contributions.

ANALYSIS

Section 501(a) of the Code provides that organizations described in subsection (c) shall be exempt from taxation. Subsection (c)(3) includes those organizations that are organized and operated for exclusively charitable, educational and scientific purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in said section of the Code. If an organization fails to meet either test it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i)(a) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit its purposes to one or more exempt purposes.

Section 501(e) of the Code provides for the exemption from federal income tax under section 501(c)(3) of the Code of "cooperative hospital service organizations." Section 501(e)(1)(A) lists the purposes for which such an organization must be organized and operated. This list does not include providing insurance. In HCSC-Laundry v. United States, 450 U.S. 1 (1981) the Supreme Court held that in order for an organization to qualify under section 501(e) it must provide one of the services there listed.

Section 501(m) of the Code, as added by section 1012(a) of the Tax Reform Act of 1986, P.L. 99-514, provides that an organization described in section 501(c)(3) of the Code shall be exempt if no substantial part of its activities consists of providing commercial type insurance. In this respect, the Code further provides that the term "commercial-type insurance" shall not include insurance provided at substantially below cost to a class of charitable recipients.

The General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99th Congress, P.L. 99-514) states that commercial-type insurance does not include arrangements that are not treated as insurance (i.e., in the absence of sufficient risk shifting and risk distribution for the arrangement to constitute insurance). H.R. Rep. No. 426, 99th Cong., 1st Sess. 585.

In defining the term "insurance", the Supreme Court in Halvering v. Le Gierse, 312 U.S. 531, 539 (1941), stated that "historically and commonly insurance involves risk shifting and risk distributing." The sharing and distributing of insurance risk by all parties insured is essential. Thus, when there is no risk shifting or distribution of risk, there is no insurance arrangement.

In Allied Fidelity Corp. v. Commissioner, 572 F.2d 1190 (1978), the court stated that the common definition for insurance is "an arrangement to protect the insured against a direct or indirect economic loss arising from a defined contingency whereby the insurer undertakes no present duty of performance but stands ready to assume the financial burden of any covered loss. It is characteristic of insurance that a number of risks are accepted, some of which involve losses and that such losses are spread over all risks so as to enable the insurer to accept each risk at a slight fraction of the liability upon it."

In Group Life and Health Insurance Co. v. Royal Drug Co., Inc., 440 U.S. 205,211 (1979) the United States Supreme Court analyzed the definition of "insurance" as follows:

"The primary elements of an insurance contract are the spreading and underwriting of a policy holder's risk. It is characteristic of insurance that a number of risks are accepted, some of which involve losses, and that such losses are spread over all the risk so as to enable the insurer to accept each risk at a slight fraction of the possible liability upon it.' 1 G. Couch, Cyclopedia of Insurance Law § 1.3 (2nd ed. 1959). See also R. Keeton, Insurance Law, §1.2(a) (1971) ('Insurance is an arrangement for transferring and distributing risk.' 1 G. Richards, The Law of Insurance §2 (W. Freedman 5th ed. 1952)."

In Clougherty Packing Company v. Commissioner, 811 F.2d 1297, 1300 (10th Cir. 1987), the court defined the concept of "risk shifting" as that which "entails the transfer of the impact of a potential loss from the insured to the insurer." The court also defined the concept of "risk distribution" as meaning that the party assuming the liability distributes its potential loss among other insurers. Beech Aircraft Corp. v. Commissioner, 797 F.2d 920, 1922 (10th Cir. 1986).

In American Association of Christian Schools Voluntary Employees Beneficiary Association Welfare Plan Trust v. United States, 850 F.2d, 1510 (11th Cir. 1988), the court held that a trust providing various insurance benefits to employees of the members of a tax-exempt association of religious schools, was not itself a tax-exempt "religious organization" because it had a substantial private, nonexempt purpose, providing insurance in return for premiums.

In determining whether an organization that provides coverage against risks, qualifies for exemption from federal income tax under section 501(c)(3) of the Code, it is necessary to determine whether the insurance arrangement constitutes "commercial type insurance" within the meaning of section 501(m) of the Code. As provided for in the legislative history of section 501(m) and in the cases previously cited, both risk shifting and risk distribution are necessary to a determination that an arrangement constitutes "commercial type insurance."

Here, the arrangement does contain some elements of risk shifting in that your members' potential future liabilities are shifted from them to you. Risk distribution is also present because the risk of having to pay claims is distributed among your members.

Thus, your sole activity consists of providing commercial-type insurance to your members. Since more than an insubstantial part of your activities consists of the provision of commercial-type insurance, you are precluded from qualifying for exemption as an entity described in section 501(c)(3) of the Code by operation of section 501(m). Also, you do not meet the requirements of the organizational test under section 501(c)(3) because your purposes are not limited to one or more exempt purposes. Furthermore, you are not described in section 501(c)(3) by reason of being a cooperative hospital service organization of the type described in section 501(e) since your activities are not among those listed in the statute.

Accordingly, based on all the facts and circumstances, we conclude that you do not qualify for exemption from federal income tax under 501(c)(3) of the Internal Revenue Code. Contributions to you are not deductible under section 170 of the Code. You must file federal income tax returns.

You have the right to protest this ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted in duplicate within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under the Conference and Practice Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to the District Director, Chicago, Illinois, which is your key district for exempt organization matters. Thereafter, any questions about your federal tax status or the filing of returns should be addressed to that office. If you want the matter reopened at a later time, you must pay a new user fee as provided in Rev. Proc. 90-17. Also, the appropriate State officials will be notified of this action in accordance with section 6104(c) of the Code.

[Redacted]

Sincerely yours,

(signed) [Redacted]

[Redacted]
Director, Exempt Organizations
Technical Division

cc: [Redacted]

[Redacted]

	Initiator	Reviewer	Reviewer	Reviewer
Code	[Redacted]	[Redacted]	[Redacted]	[Redacted]
Surname	[Redacted]	[Redacted]	[Redacted]	[Redacted]
Date	1-15-92	1-15-92	1-22-92	1/22/