

Business leagues; insurance companies; automobile insurance.

A nonprofit association of insurance companies that accepts for reinsurance high-risk customers who would ordinarily be turned down by member companies is not exempt under section 501(c)(6) of the Code as a business league. Rev. Rul. 71-155 distinguished.

#### ISSUE

Does the nonprofit organization described below qualify for exemption from federal income tax under section 501(c)(6) of the Internal Revenue Code?

#### FACTS

The organization is a nonprofit association composed of insurance companies that are licensed to write automobile insurance in a particular state. The organization was created by an act of the state legislature for the purpose of guaranteeing the availability of automobile insurance to persons who are in high-risk categories and cannot otherwise obtain coverage. The organization assures the availability of this insurance by accepting for reinsurance high-risk customers that member companies would ordinarily turn down.

Member companies are required by state statute to furnish insurance to any customer who applies to them for insurance, irrespective of the degree of risk involved. The companies may then reinsure up to 50 percent of their insurance business through the organization. If the premiums received by an individual company from reinsured business exceed claims paid out on reinsured business, the company must annually pay the association the difference between the two. If claims paid out by an individual company on referred policies exceed the premiums received on referred policies, the association annually reimburses the company for the difference. Also, the individual companies are given credit for all expenses incurred in processing referred risks. By this procedure the companies are guaranteed that they will at least break even on all high-risk insurance that they are required by state law to write, because the risk of loss rests on the association for any given year.

Membership in the organization is mandatory for all companies writing automobile insurance in the state. Member companies are required to support the organization by making up any deficit through an annual assessment. Each company's assessment is based on its share of the overall statewide market for this type of insurance for the prior year. Any profits are to be distributed to members on the same basis.

#### LAW

Section 501(c)(6) of the Code provides for the exemption from

federal income tax of business leagues not organized for profit, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. The activities of the organization must be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league.

#### ANALYSIS

The organization is formed for the purpose of, and has as its sole activity, regularly engaging in the business of insurance as a reinsurer. Even though the organization's reinsurance business may not create a profit, it is the nature of the activity that determines whether it is a business ordinarily carried on for profit. Since reinsurance is a business ordinarily carried on by commercial insurance companies for profit, the organization is not operated as a business league within the requirements of section 1.501(c)(6)-1 of the regulations.

Equally important, since the organization's method of operation involves it in its member companies' insurance business through accepting the risk of insuring their high-risk customers, and through reimbursing certain sums to the member companies, the organization is providing an economy or convenience to members in the operation of their own insurance businesses. Thus the organization is engaged in the performance of particular services for its member companies. See *Associated Master Barbers & Beauticians of America, Inc., v. Commissioner*, 69 T.C. 53 (1977).

Rev. Rul. 71-155, 1971-1 C.B. 152, is distinguishable. In Rev. Rul. 71-155, a state-mandated association composed of all insurance companies writing a specified type of insurance in a given state was formed for the purpose of making insurance available to all persons in high-risk categories. The organization operated by accepting applications, and then assigning them to a member company, which performed the actual insurance functions. Unlike the organization in this case, the organization described in Rev. Rul. 71-155 did not assume the risk on a policy, and therefore was not itself engaged in the insurance business.

Compare Rev. Rul. 81-174, page 13, this Bulletin, which holds that an association that is composed of insurance companies within a given state, and that provides medical malpractice insurance to

health care providers in the state, is engaged in the operation of a business ordinarily carried on for profit, performs particular services for its member companies and policyholders, and therefore is not exempt under section 501(c)(6) of the Code.

#### HOLDING

The organization described above does not qualify for exemption from federal income tax under section 501(c)(6) of the Code.

#### EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 71-155 is distinguished.