

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **200346002**

Release Date: 11/14/2003

Index Number: 3121.02-05

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:TEGE:EOEG:ET2 PLR-129926-03

Date:

August 13, 2003

**Legend:**

State V =

X =

Y =

Z =

Date A =

Date B =

Dear :

This is in response to the request for a letter ruling made by your organization's attorney dated April 30, 2003, as supplemented on July 23, 2003. Your attorney requested a ruling on behalf of Y that Y is an instrumentality of State V (or a political subdivision thereof) within the meaning of Internal Revenue Code section 3121(b)(7)(F), and consequently is not required to withhold or pay Old Age, Survivors, and Disability Insurance tax under Code sections 3101(a) and 3111(a).

**Facts:**

Y is a State V non-profit corporation. On Date A, Y received a favorable determination letter from the Internal Revenue Service indicating that it is exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3).

In accordance with State V law, Y was formed to provide general management, risk management, technical and other services to X which was created by participating state

counties. X was created pursuant to intergovernmental agreements in accordance with State V law in order to provide self-insurance for workers' compensation, property and casualty risks, and group health benefits for county employees. The self-insurance pools were formed to pool risks and resources in order to lower individual insurance costs of participating counties. Y provides employees to carry out the functions of X. Through these employees, Y provides bookkeeping, accounting, file maintenance, claims review and administration, regulatory compliance, risk management and loss prevention services for X. As part of its risk management and loss prevention services, Y routinely provides consulting services on management and operational issues to participating counties to include: employment practices consultation, review of county policies and practices, review of proposed building plans, salary surveys, and human resource personnel training. These services specifically assist participating counties in minimizing risk and exposure to loss that produce insurance claims resulting in increased cost of operation and depletion of the insurance pools' loss fund from which claims are paid. By contract, Y provides the same services to Z, another State V governmental self-insurance pool. The employees of Y participate in the Public Employee's Retirement System of State V. There are no agreements under Section 218 of the Social Security Act in place with respect to Y or X.

The participating counties provide the funding for X, which has no employees, and which is governed by a board of directors appointed by the participating counties. On date B, X obtained a private letter ruling from the Internal Revenue Service indicating that the income of X is excludable from gross income under section 115 of the Code. In the ruling it was determined that the income to X was derived from the exercise of essential government functions. X provides funding to Y with respect to X activities. Risk management and loss prevention services are generally financed on a fee-per-service basis.

Y is governed by a six-member board of directors. Two directors each are appointed by the boards of X. Y's Bylaws provide that a director must be on a Board of Directors of X to be a director on the board of Y.

Law:

Code section 3121(b)(7)(F) provides that the definition of "employment" includes service in the employ of a State, of any political subdivision thereof, or of any instrumentality of the foregoing, by an individual who is not a member of a retirement system of such State. Section 3121(b)(7)(F) contains five exceptions to this rule, none of which are relevant in this case.

Code section 3101(a) imposes a tax on employees for Old Age, Survivors, and Disability Insurance on the income of every individual received by such individual with respect to employment.

Code section 3111(a) imposes a tax on employers for Old Age, Survivors, and Disability Insurance with respect to individuals in his employ paid by him with respect to employment.

In Revenue Ruling 57-128, 1957-1 C.B. 311, the Internal Revenue Service provided six factors to take into consideration in determining whether an organization is an instrumentality of a State or political subdivision for purposes of Code section 3121:

- (1) whether it is used for a governmental purpose and performs a governmental function;
- (2) whether performance of its function is on behalf of one or more states or political subdivisions;
- (3) whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner;
- (4) whether control and supervision of the organization is vested in public authority or authorities;
- (5) whether express or implied statutory or other authority is necessary or exists for the creation and/or use of the organization; and
- (6) the degree of financial autonomy and the source of its operating funds.

Analysis:

To determine if Y is an instrumentality within the meaning of Code section 3121(b)(7)(F), Y must be evaluated using the factors of Revenue Ruling 57-128.

1. Y is used for a governmental purpose and performs a governmental function. State V's Revised Statutes grant authority for public entities to pool insurance coverage by creating self-insurance pools. The bylaws of the Workers' Compensation Pool provide that the purposes of the pool are to provide a workers' compensation protected self-insurance pool and to assist members in controlling costs by providing specialized governmental risk management services. The second pool is the Health Pool. The bylaws of the Health Pool provide that the purpose of the pool is to provide members with a means of providing benefits to their employees, including benefit planning, funding, design and administration. The third pool is the Casualty and Property Pool. The bylaws of the Casualty and Property Pool provide that the purposes of the pool are to provide a risk management fund for defined property and casualty coverage and to

assist members in controlling costs by providing specialized governmental risk management services and systems.

2. Y performs a governmental function on behalf of the participating counties. The State V Constitution recognizes the right of counties to cooperate and contract with each other to provide any function, service, or facility. Y's Articles of Incorporation provide that Y's primary purpose is to serve State V county governments, "including but not limited to, administrative, management, risk management, loss prevention, technical, and any other service which would or could otherwise be provided by [State V] county or governments."

3. There are no private interests involved. Y's Articles of Incorporation state that Y is not organized for profit and will have no capital stock. The articles provide:

No part of the net earnings of [Y] shall inure to the benefit of or be distributable to its directors, officers, or other private persons, except that [Y] shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth in these Article of Incorporation.

The participating counties have the powers and interests of an owner. The participating counties provide all of the funding for X, which in turn provides all of the funding for Y. The Articles of Incorporation also provide that Y "may do any and all acts or things which are deemed necessary or proper for carrying out its purposes." The articles also provide that upon dissolution any assets remaining in Y will be distributed to the participating counties.

4. Control and supervision of Y is vested in public authorities. Y's Bylaws provide that the business and affairs of Y shall be managed by its Board of Directors. Y's Articles of Incorporation provide that Y has six directors. Two directors are appointed from and by each Board of Directors of the three organizations that comprise X. The Board of Directors of each of the three organizations that comprise X are appointed by the participating counties. A director may hold office so long as the director continues to serve on the Board of Directors of one of the three organizations that constitute X. The officers of the corporation are elected by Y's Board of Directors. Y's Bylaws provide that the president, "subject to the control of the Board of Directors", will generally supervise and control all of the business and affairs of Y. The bylaws also provide that the Board of Directors of Y will adopt an annual budget and will have an annual audit of its financial affairs by a certified public accountant. A copy of the budget and audit is required to be given to the Boards of Directors of X.

5. Y is created pursuant to State V statute. State V Revised Statutes provide that counties can enter into a self-insurance pool for workers' compensation. State V Revised Statutes provide that counties can enter into a self-insurance pool for casualty coverage. State V Revised Statutes provide that counties can enter into a self-insurance pool for property coverage. State V Revised Statutes imply that counties can provide for group health benefits to their employees as part of their compensation. State V Revised Statutes provide that governments, to include counties, "may cooperate or contract with one another to provide any function, service, or facility lawfully authorized to each of the cooperating or contracting units, including the sharing of costs...." State V Revised Statutes give counties the authority to establish separate legal units to accomplish the agreed to cooperation. Accordingly, State V Revised Statutes provide for the creation of the insurance pools as well as the cooperation of the pools by establishment of a separate legal unit to facilitate the agreed to cooperation.

6. The major source of Y's operating expenses with respect to X are from X. The funding for X is provided by the participating counties. State V Revised Statutes provide that a county may fund for self-insurance workers' compensation coverage. State V Revised Statutes provide that a county may fund for self-insurance property coverage. State V Revised Statutes provide that a county may fund for self-insurance casualty coverage. State V Revised Statutes provide that a county may fix compensation and by implication may include a provision for group health benefits. Generally services under the category of risk management and loss prevention are free to the participating counties. However, certain services are rendered on a fee-for-service basis. Thus, Y has no financial autonomy but is dependent on the contributions of X and the participating counties.

#### Conclusion:

Accordingly, based on the above analysis, we conclude that Y satisfies the criteria of Revenue Ruling 57-128, and is an instrumentality of the counties that participate in X. Inasmuch as the counties that participate in X are political subdivisions of State V, within the meaning of Code section 3121(b)(7)(F), the services performed by Y's employees who are qualified participants in a retirement system within the meaning of section 3121(b)(7)(F) are excluded from employment for purposes of Code sections 3101(a) and 3111(a). No opinion is expressed on whether the retirement systems of State V constitutes a retirement system within the meaning of section 3121(b)(7)(F).

The ruling contained in this letter is based upon information and representations submitted by the taxpayer's representative 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 request for a ruling, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Code section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

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

Sincerely,

Lynne Camillo  
Chief, Employment Tax Branch 2  
Office of the Assistant Chief Counsel  
(Exempt Organizations/Employment  
Tax/Government Entities)

Cc:



