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Person To Contact: _____, ID No.

Telephone Number:

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Date:
October 26, 2009

LEGEND:

- Association =
- Fund =

- State =
- Area =
- Authority =
- Bill 1 =

- Act =
- Plan =
- Windstorm =
- Treasurer =
- Commissioner =
- Department =
- a =
- Year 1 =
- Year 2 =
- Year 3 =
- l =
- J =
- K =
- Year 5 =
- L =
- Year 4 =

Dear _____ :

This is in response to your letter dated August 21, 2009, requesting the following rulings:

- 1) Whether Association's income is excludible from Federal income taxation under section 115(1) of the Code.
- 2) Whether Association is eligible to receive charitable contributions under section 170.

FACTS AND REPRESENTATIONS

Association was established by Bill 1 to provide an adequate Market for a insurance in State Area. It provides a residual market for a insurance in the State Area in compliance with State law. It acts in accordance with provisions of State Code to insure that residents of State Area always have a market for a insurance. As initially enacted, all insurance companies writing "essential property insurance," as defined in the a Insurance form approved by the Commissioner were required to be members of Association. Each member participated annually in Association's writings, expenses, profits and losses based on the member's proportionate share of the total net premiums written in State by all members during the preceding calendar year. For federal tax purposes, Association reported its activities as a partnership and filled annual partnership returns and each member received a Form K-1.

In Year 3, the State legislature passed Act. The stated purpose of Act was "To stimulate the growth and redevelopment within all areas of the state by promoting the availability of affordable commercial and residential casualty loss insurance." The Act revised Association's organizational structure and created the Fund. It was a response to the effects on the availability of insurance in the Area after devastation caused by Windstorm.

Act's enactment substantially changed Association. It no longer had members who now were assessable insurers, no longer having any rights to Association's assets or liabilities, but obligated for regular assessments. All of Association's assets now belong to Association and shall remain with Association. There shall be no distribution of Association's income and assets other than for Association's benefit and any and all income accrues to State. In the event of termination of Association by act of State's legislature, Association's assets shall be applied first to pay Association's debts, liabilities, and obligations, and all remaining assets of Association shall become property of State.

It is intended that Association be and act as a nonprofit entity, that it is free of taxation of every kind by the state and any political subdivision and instrumentality thereof. It is

State Legislature's intent it be exempt from all taxes, including Federal taxes and Association has the authority to take steps necessary to obtain federal tax exempt status.

Act provides Association with a variety of specific powers including: to issue policies of essential property insurance on insurable property of applicants; with the Commissioner's consent, to issue policies of related property insurance on insurable property of applicants; to purchase reinsurance for all or part of Association's risks; to levy and collect regular assessments; to issue bonds or incur other forms of indebtedness; to establish underwriting criteria consistent with Act and approved by the Commissioner; to invest and reinvest income and assets subject to the Commissioner's oversight; and all other powers necessary to carry out the intent and provisions of Act.

Act provides that the existing Board of the Directors was to serve as a temporary board with the duty of preparing, and submitting Plan to Commissioner for approval. Plan must provide for the efficient, economical fair and nondiscriminatory administration of Association. Commissioner must approve Plan and all amendments before they become effective, and may review Plan any time he feels expedient. Association has adopted Plan. After review of Plan, Commissioner may amend Plan after consulting with Association's directors and upon certification to the Directors of the amendment. The Act authorizes Association to incorporate.

Association's permanent Board of Directors, which has the power to act and make binding decisions on behalf of Association must consist of the following: State Treasurer; 5 of the assessable insurer companies with 3 appointed by Commissioner, 1 by the Governor and 1 by the Lieutenant Governor (with each insurer designating a representative to act and vote on its behalf); 3 agents with no less than 1 years experience in the property and casualty area two of which are residents of Area (one of who appointed by the Governor and one appointed by the Lieutenant Governor) and one not from Area appointed by Commissioner; 2 business leaders who have been residents of Area for no less than 1 years, one appointed by the Governor and one by Lieutenant Governor. Except for Treasurer, Directors serve staggered 3 year terms.

Authority, an agency of State, has awarded grants to Association in the amounts of \$J million in Year 2 and \$K million in Year 3. Such grants have been applied to the costs of insurance.

Act created in the State Treasury, Fund. The monies in Fund may be used by Department upon appropriation by the Legislature in defraying expenses and costs of insurance under State Code § 83-24-1 et. seq. Monies in Fund may not be used, expended or transferred for any other purposes except upon amendment of Act by bill enacted by Legislature with a vote of not less than 2/3 of the members of each House present and voting. Commissioner shall file a report with the Joint Legislative Budget Committee not later than September 1 of each year, recommending the amount of

assistance needed by Association for reinsurance expenses and costs. Association shall prepare and file detailed reports with designated legislative officials, the Secretary of State, Commissioner, Attorney General and Authority's Executive Director regarding receipt and expenditure of monies from the Fund by Association.

In fiscal years Year 3-Year 5, State's Tax Commission is required to deposit into the Fund from insurance premium tax revenue collected \$L million each fiscal year. This annual deposit is for the purpose of reducing premium rates charged for insuring property through Association. The premium tax would go into State's general fund if not directed by the legislature to a specific fund. Act also imposes a fee or tax on insurance placed by "nonadmitted insurers" anywhere in State not simply Area, on all premiums collected after January 1, Year 4. The fee is set by the Commissioner but no less than 5% of the total policy premium. This fee is in addition to the premium tax already levied on nonadmitted policy premiums.

Association, if an event produces losses in excess of funds immediately available or if Association determines it will otherwise have a claim or other deficit, may with the Commissioner's consent levy "regular assessments" against assessable insurers based on their percentage of participation. In any year the annual total of regular assessments shall not exceed 10% of statewide direct written premiums for property insurance for the prior calendar year of all assessable insurers. Within 120 days of the levy of regular assessments, the Commissioner shall implement a surcharge on all casualty and property insurance premiums in the state. The surcharge is to recover the amount of regular assessments to assessable insurers who paid the regular assessments.

Association's board of directors, subject to the approval of the Commissioner, has the power and authority to issue bonds, and other indebtedness. All such bonds and indebtedness are secured by the power of Commissioner to implement the surcharges against all property and casualty insurance premiums. Act also provides for a credit allowed against the premium tax.

Section 115

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.

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 section 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 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 section 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.

By providing an adequate market for essential property insurance in Area of State, Association is helping maintain its communities and stimulate the economic growth and redevelopment of all areas of State by promoting the availability of affordable commercial and residential casualty insurance. This policy is reflected by the fact that all residential property insurers writing direct policies in State are assessable insurers for Association and that all insurance sold by nonadmitted insurers is subject to a policy tax in addition to the state premium tax, as well as the control of Association's operations by the Commissioner, and the substantial financial contributions of State through grants from Agency and amounts from the premium tax. Furthermore, all of Association's profits must remain with Association and upon dissolution; all remaining assets after the payment of debts and liabilities shall become the property of State.

Furthermore, private interests do not materially participate in the organization nor benefit more than incidentally. Accordingly, Association's income is excluded from gross income under section 115(1).

Section 170(c)(1)

Section 170(c)(1) provides, in pertinent part that the term "charitable contribution" includes a contribution to or for the use of a State, a possession of the United States, or any political subdivision of any of the foregoing, but only if the contribution is made for exclusively public purposes.

In Rev. Rul. 57-128, 1957-1 C.B. 311, the Service stated that in determining whether an entity is an instrumentality of one or more states or political subdivisions, the following factors are considered: (1) whether the entity is used for a governmental purpose and performs a governmental function; (2) whether the entity performs on behalf of one or more states or political subdivisions; (3) whether there are any private interests involved, or whether the state or political subdivision involved has the powers and interest of an owner; (4) whether control and supervision is vested in a public authority; (5) whether authorization is necessary for the creation or use of the entity; and (6) the degree of financial autonomy and the source of the entity's operating expenses.

Rev. Rul. 75-359, 1975-2 C.B. 79, held that contributions to an association of counties that was found to be a wholly owned subsidiary of political subdivisions were deductible under section 170(c)(1) as contributions “for the use of” political subdivisions. Under Rev. Rul. 75-359, the criteria for identifying wholly owned instrumentalities of states or political subdivisions are set forth in Rev. Rul. 57-128.

In the instant case, the materials submitted establish that Association was authorized by statute for an important governmental purpose of State. As noted there are no private interests involved and upon dissolution of Association, all of its remaining assets go to the State. The selection of the board of directors by public officials and the Association’s operations are subject to review by Commissioner. The State has made substantial financial direct contributions as well as providing tax exemptions to fund Association’s operations. Association satisfies the factors enumerated in Rev. Rul. 57-128 and is an instrumentality of State.

Accordingly, contributions made to Association exclusively for public purposes may be deductible by a donor as charitable contributions for the use of a state or political subdivision within the meaning of section 170(c)(1).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it 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 your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer 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 rulings, it is subject to verification on examination.

Sincerely,

Sylvia F. Hunt
Assistant Branch Chief, Exempt Organizations
Branch 2 (Exempt Organizations/Employment
Tax/Government Entities)
(Tax Exempt & Government Entities)