

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Date:  
January 04, 2024

Taxpayer =  
Authority =

State 1 =  
State 2 =  
State 2 Act =  
Liability Type 1 =  
Liability Type 2 =  
Liability Type 3 =

Dear :

This is in response to your letter dated June 22, 2023, and additional information submitted on July 28, 2023, December 1, 2023, and December 21, 2023, in which Taxpayer requested a private letter ruling involving § 115 of the Internal Revenue Code.<sup>1</sup>

**FACTS**

Taxpayer was formed by Authority as a State 1 nonprofit corporation to be a captive insurance company that provides reinsurance coverage to Authority. Authority is

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<sup>1</sup> The Internal Revenue Code of 1986, as amended, to which all subsequent "section" references are made unless otherwise indicated.

Taxpayer's sole member, and Taxpayer's articles of incorporation and bylaws provide that only Authority may be a member of Taxpayer.

Authority was formed pursuant to State 2 Act and is a public agency under State 2 Act whose income is excludable from gross income under § 115(1). The participants in Authority are independent public charter schools approved by a State 2 local school district, a State 2 county board of education, or State 2 Board of Education.

Authority's purpose is to provide its participants with a way to acquire insurance coverage that would otherwise be unavailable or too expensive for its participants to obtain by allowing participants to collectively purchase or finance insurance coverage and providing means for the participants to share risk, pool reserves, self-insure, or self-reinsure.

Authority underwrites insurance policies for various types of risks faced by its participants. It assumes coverage related to the policies by administering risk-based insurance pools. Where the pool coverage is insufficient, Authority reinsures its policies through third-party commercial insurers. Taxpayer represents that because these third-party insurance policies can be expensive and have burdensome requirements, Authority created Taxpayer to reduce reliance on third-party commercial insurance policies by having Taxpayer provide a portion of the reinsurance requirements of Authority. Taxpayer does not provide services to anyone other than Taxpayer.

Taxpayer currently underwrites reinsurance policies for Liability Type 1 and Liability Type 2 for Authority. Authority currently uses third-party commercial insurance providers for its reinsurance needs involving Liability Type 3, but Taxpayer plans to offer Authority underwriting for reinsurance policies for Liability Type 3.

Under each reinsurance agreement, Authority pays premiums to Taxpayer and in return it receives reinsurance coverage from Taxpayer. Taxpayer's board of directors invests these premiums to earn additional income. Taxpayer's only sources of income are this investment income and the premiums received from Authority. This income is used by Taxpayer to pay the reinsurance policy and other operational expenses of Taxpayer, including a range of professional services it represents it cannot otherwise effectively or responsibly provide internally. All payments to third-party service providers are at arm's length for fair market value. These professional services include insurance-based accounting and finance solutions, policy documentation, claims management and administration, and various compliance services.

Taxpayer's articles of incorporation provide that Taxpayer's net assets are distributable to its sole member, Authority, upon dissolution. In the event that when Taxpayer dissolves, Authority no longer exists or fails to be an organization whose income is excludable from its gross income under § 115, Taxpayer's articles of incorporation provide that its net income will go to one or more organizations whose income is excludable from gross income under § 115.

## **RULING REQUESTED**

Taxpayer's income from underwriting reinsurance policies for Authority for Liability type 1, Liability type 2, and Liability type 3 is excludable from gross income under § 115(1) because Taxpayer's income from these reinsurance activities is derived from its exercise of an essential governmental function and such income accrues to a state or any political subdivision thereof.

## **LAW AND ANALYSIS**

Section 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or political subdivision thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that the income from an investment fund, established pursuant to State law for the temporary investment of cash balances of a State and its participating political subdivisions, is excludable from gross income under § 115. That ruling reasons that the investment of positive cash balances by a state or political subdivisions thereof to receive yield on the funds until needed to meet expenses is a necessary incident of the power of the state or political subdivision to collect taxes and other revenue for use in meeting governmental expenses. In addition to concluding that income from such an investment activity was income from the exercise of an essential governmental function, the ruling also concludes that since the state and its participating political subdivisions had an unrestricted right to their proportionate share of the investment fund's income, the fund's income accrued to them.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that income of an organization formed, operated and funded by political subdivisions of a state to pool their casualty risks is excluded from gross income under § 115(1). The ruling also holds that income of such an organization formed to pool risks in lieu of purchasing insurance to cover their public liability, workers' compensation, or employees' health obligations is excluded under § 115(1) if private interests do not, except for incidental benefits to employees of the participating state and political subdivisions, participate in or benefit from the organizations.

Taxpayer was created to provide reinsurance for Authority with respect to certain risks. Authority is a public agency pursuant to State Act whose income is excludable from gross income under § 115 and all participants of Authority must be public charter schools or government entities. By providing reinsurance to a public agency, Taxpayer performs an essential governmental function. See Rev. Rul. 90-74.

Taxpayer's income will be used solely to provide benefits to Authority. Upon Taxpayer's dissolution, its net assets will be distributed to Authority. In the event that when

Taxpayer dissolves, Authority no longer exists or fails to be an organization whose income is excludable from its gross income under § 115, Taxpayer's income will go to one or more organizations whose income is excludable from gross income under § 115. Additionally, private interests do not benefit from Taxpayer's activities more than incidentally. Therefore, income of the Taxpayer accrues to a state or political subdivision thereof within the meaning of § 115(1).

### **RULING**

Based on the foregoing, and assuming the accuracy of the facts and representations set forth herein, we rule that Taxpayer's income from underwriting reinsurance policies for Authority for Liability type 1, Liability type 2, and Liability type 3 is excludable from gross income under § 115(1) because Taxpayer's income from these reinsurance activities is derived from its exercise of an essential governmental function and such income accrues to a state or any political subdivision thereof.

The ruling contained in this letter is based upon information and representations submitted by or on behalf of Taxpayer and accompanied by a penalty of perjury statement executed by an individual with authority to bind Taxpayer, and upon the understanding that there will be no material changes in the facts. 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. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2023-1, section 11.05.

This letter does not address the applicability of any section of the Code or Regulations to the facts submitted other than with respect to the sections specifically described, and, except as expressly provided in this letter, no opinion is expressed or implied concerning the tax consequences of any aspects of any transaction or item of income discussed or referenced in this letter. In particular, this letter does not render an opinion on any activities other than Reinsurance Activity 1, Reinsurance Activity 2 and Reinsurance Activity 3.

Because it could help resolve questions concerning federal tax status, this letter should be kept in Taxpayer's permanent records.

A copy of this letter must be attached to any tax return to which it is relevant. Alternatively, if Taxpayer files a return electronically, this requirement may be satisfied by attaching a statement to the return that provides the date and control number of this letter.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Taxpayer's authorized representative.

This ruling letter is directed only to Taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Seth Groman  
Senior Counsel  
Office of the Chief Counsel  
(Employee Benefits, Exempt Organizations,  
and Employment Taxes)

cc: