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Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply to:

OP:E:EP:T:3

Date: SEP 1, 1999

Attention:

Legend:

Association A =

Association B =

Association C =

Department D =

State E =

Law M =

Regulation N =

Act P =

Dear

This is in response to your ruling request dated May 21, 1997, and received by this office on March 31, 1998, submitted by your authorized representative regarding whether Association A is an agency or instrumentality of State E. A letter dated May 20, 1998 supplemented your request.

Association A wants to establish a retirement plan that qualifies under section 403(b) of the Internal Revenue Code.

252

State E permits individual local school boards to self-insure. For practical reasons, however, this option, prior to 1983, was only available to school districts with large professional and non-professional labor forces and resources. State E recognized this, and, in 1983, enacted Act P, which permits a local school board to pool resources with other school boards in order to take advantage of the self-insurance option and other risk management programs.

Association A was formed as an association in 1983 pursuant to Act P. It is a school board insurance group, defined in Act P as an association formed by two or more local boards of education. Pursuant to Act P, each member school board must pass a resolution to join such an association. The general formation and operational requirements of school board joint insurance groups such as Association A are set forth in Act P.

The goal of Act P is to help local school boards reduce insurance costs by permitting them to pool risks. Participating school boards collectively participate in risk management programs and self-insurance programs. School boards, without the authority of Act P, would not be permitted to form such associations as the associations would be considered transacting the business of insurance, which is clearly not permitted under the laws regulating insurance in State E.

Department D regulates these school board insurance groups. The regulations to Act P ("Regulation N"), sets forth such requirements as: the form of Resolution to be drafted by member school boards; the form of Agreement among the members of the insurance group; the general operational requirements (including control of assets, purchase of goods and services, preparation of budgets, maintenance of records, reporting to members); the filing of by-laws and a risk management program with Department D; the requirements for the inclusion of certain information in the by-laws and risk management programs; the approval by the Commissioner of Department D of initial and amended by-laws; annual reporting to Department D; the effect of insolvency and/or bankruptcy of members; the effect of voluntary dissolution; the payment of claims; excess coverage or reinsurance; and Department D's ability to examine funds.

School board insurance groups are required, pursuant to Regulation N, to file the specified information and comply with operational guidelines to "ensure their solvency and viability, thereby protecting the interests of claimants and taxpayers."

In 1983, the Commissioner of Department D approved Association A's by-laws. Department D in 1996 issued new regulations. Association A must modify its by-laws to comply with the new rules, and it is presently in the process of rewriting them. Once adopted, the new by-laws will have to be submitted to Department D for its review and approval.

Association A is subject to State E's Law M, as it is considered a public body organized by law, collectively empowered as a multi-member voting body to spend public funds. Under Law M, Association A is required to provide the public and the press with advance notice of and an opportunity to attend its board meetings.

Currently, Association A has 99 members consisting of local school boards located throughout State E. Membership in Association A is open to all members of Association B.

Association B includes all local school boards in State E as members. Association B is a "body corporate and politic."

Association A's nine member board of trustees manages it. The trustees serve without compensation and will not participate in the retirement plan that is the subject hereof. The by-laws of Association A, authorized by Law M, provides for the nomination of the board of trustees of Association A. The board of trustees consists of residents of State E. A majority of the trustees shall be members of Association A's boards of education and shall be constituted as follows: six trustees to be appointed from Association B's Board of Directors; a trustee in a school district that is a member of Association C to be appointed who serves as a school business official; a trustee to be appointed who serves as Superintendent in a school district that is a member of Association A; and the Association A president or designee who shall serve *ex-officio*.

Association A provides programs and services to its members which are authorized by Act P. Association A offers insurance coverage in nine different lines of insurance, claim management services and risk management programs. The insurance provided by Association A covers only the assets of its members, and not the personal property of the employees of its members.

Each member makes a contribution to Association A based on the member's participation in the different lines of coverage. The aggregate amount required to be contributed by the members is designed to cover actual loss costs, claims adjusting expenses and administrative and reinsurance charges. There is no profit factor built into the contribution schedule. The amount of any given member's contribution is based on the costs of reinsurance, the member's exposure and its loss history. No private interests are involved in funding Association A. The member's payments and interest income from invested funds are Association A's sole source of funds. The payments represent public tax dollars contributed by the members of Association A.

Association A also manages and adjusts claims made against the participating members, with its employees having responsibilities similar to those of claim representatives or adjusters employed at an insurance company. In-house adjusters investigate claims, obtain information and, if possible, settle claims. If settlement is not possible, Association A uses either in-house counsel or appoints outside counsel. By managing all claims against participating member school boards, Association A creates cost efficiencies.

Risk management programs are also provided to the members. A monthly newsletter is sent out by Association A providing information on such topics as workplace safety, current discrimination issues, hiring contractors and obtaining indemnification from those contractors. Inspections are provided of member schools' boiler systems, smoke detectors, alarms, etc. Safety seminars are provided. The purpose of all these risk management programs is to reduce claims made against the participating member school boards, thereby further reducing insurance costs. These programs are either free or provided at a minimal fee to cover costs.

The employees of Association A are not elected or appointed officials. State E requires that employees of Association A be included in the State E retirement plan. It is these employees for whom Association A wants to provide for in the retirement plan under consideration.

Based on the foregoing, you request a ruling that Association A's employees perform services for an educational institution described in section 170(b)(1)(A)(ii) and that, for purposes of section 403(b) of the Code, it is an agency or instrumentality of State E or a political subdivision thereof.

Section 170(b)(1)(A)(ii) of the Code provides that to be considered an educational organization, the organization must normally maintain a regular body of students in attendance at the place where it regularly carries on educational activities. Included in this category are public schools, state colleges and universities.

Rev. Rul. 73-607, 1973-2 C.B. 145 provides that of the employees of a State's department of education appointed by the commissioner of education as required by State statute, the janitorial, custodial, and general clerical employees are not persons occupying appointive public office as described in section 1.403(b)-1(b)(5) of the Income Tax Regulations, but are indirectly performing services for an educational institution for the purposes of section 403(b) of the Code. Those employees who have a significant degree of executive or policy making authority and whose appointments are based on the required training or experience are also indirectly performing services for an educational institution for the purposes of section 403(b) of the Code.

Section 414(d) of the Code provides that a "governmental plan" means a plan established and maintained for its employees by the Government of the United States, by the government of any state or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.

Revenue Ruling 89-49, 1989-1 C.B. 117 provides that a plan will not be considered a governmental plan merely because the sponsoring organization has a relationship with a governmental unit or some quasi-governmental power. One of the most important factors to be considered in determining whether an organization is an agency or instrumentality of the United States or any state or political subdivision is the degree of control that a governmental entity or entities exercise over the organization's everyday operations. Other factors include: (1) whether there is specific legislation creating the organization, (2) the source of funds for the organization, (3) the manner in which the organization's trustees or operating board are selected, and (4) whether the applicable governmental unit considers the employees of the organization to be employees of the applicable governmental unit. Although all of the above factors are considered in determining whether an organization is an agency or instrumentality of a government, the mere satisfaction of one or all of the factors is not necessarily determinative.

In Revenue Ruling 89-49 the Service ruled that the retirement plan discussed in the ruling was not a governmental plan within the meaning of section 414(d) of the Code because, among other reasons, the degree of control which the municipalities exerted over the entity in its everyday operations was minimal.

These school board insurance groups are highly regulated by Department D. Regulation N sets forth such requirements as: the form of Resolution to be drafted by member school boards; the form of Agreement among the members of the insurance group; the general operational requirements (including control of assets, purchase of goods and services, preparation of budgets, maintenance of records, reporting to members); the filing of by-laws

and a risk management program with Department D; the requirements for the inclusion of certain information in the by-laws and risk management programs; the approval by the Commissioner of Department D of initial and amended by-laws; annual reporting to Department D; the effect of insolvency and/or bankruptcy of members; the effect of voluntary dissolution; the payment of claims; excess coverage or reinsurance; and Department D's ability to examine funds.

According to the information provided, Association A is a public entity, statutorily formed and operated for the purpose of helping local school boards reduce insurance costs by permitting them to pool risks. Its members are local boards of education throughout State E. Each of the members is a board of education that maintains a regular faculty, curriculum, and enrolled student body at its local public schools.

No private interests are involved in funding Association A. The member's payments and interest income from invested funds are Association A's sole source of funds. The payments represent public tax dollars contributed by the members of Association A.

The by-laws of Association A, authorized by Law M, provides for the nomination of the board of trustees of Association A. The board of trustees consists of nine members. The board of trustees consists of residents of State E. A majority of the trustees are members of Association A's boards of education.

State E treats the employees as governmental employees, as evidenced by the fact that State E requires that employees of Association A be included in the State E retirement system.

Accordingly, we conclude that Association A's employees perform services for an educational institution described in section 170(b)(1)(A)(ii) and that, for purposes of section 403(b) of the Code, it is an agency or instrumentality of State E or a political subdivision thereof.

No opinion is expressed as to the federal tax consequences of the transaction described above under any other provisions of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

A copy of this letter is being sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,

/s/ Frances V. Sloan

Frances V. Sloan
Chief, Employee Plans
Technical Branch 3

Enclosures:
Notice of Intention to Disclose
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256