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Department of the Treasury
Washington, DC 20224

[Third Party Communication:
Date of Communication: Month DD, YYYY]

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:TEGE:EB:HW
PLR-154552-06

Date: May 9, 2007

LEGEND:

Taxpayer =

Plan =

Trust =

Dear

This is in reply to your letter of September 29, 2006, and subsequent correspondence, in which you request various rulings on behalf of the Taxpayer with respect to its Plan and Trust.

Taxpayer has established Plan to provide medical benefits for retired firefighters and their spouses and dependents. Plan was established pursuant to a memorandum of understanding between Taxpayer and an entity that represents Taxpayer firefighters. A participant in Plan qualifies for benefits under Plan only if he or she has retired under the State public employee retirement system. Participants who qualify for Plan benefits are reimbursed quarterly for the payment of qualified expenses. Qualified expenses include the premium payments required for health coverage, on an individual or group

basis, premiums for Medicare Part B and Part D, premiums for Medicare Supplement plans, and any other expenses described under § 213(d) of the Internal Revenue Code (the Code). Plan is administered by Taxpayer. Plan can be amended or terminated by Taxpayer's Council. Although there is an advisory committee of two Taxpayer-appointed members and two firefighter-appointed members, its role is only advisory. Taxpayer has the responsibility for making all decisions with respect to the Plan.

You represent that Trust will be used solely to pre-fund retiree health insurance and for the payment of medical expenses as defined in § 213(d) of the Code on behalf of eligible retirees, their spouses and dependents, and nondependent domestic partners. You further represent that to the extent coverage is provided to nondependent domestic partners, the value of such coverage under the Plan for nondependent domestic partners will be included in gross income as such benefits are earned, and not when received. The value of such coverage will be included in a participant's gross income for a taxable year only if he or she is expected to have a nondependent domestic partner upon attaining eligibility for benefits under the Plan. Such participants will be identified by reasonable actions of the Taxpayer and the amounts to be included in the employees' gross income will be determined under an actuarial calculation that takes into account reasonable actuarial assumptions. Eligible retirees will not receive any amounts in cash or as any other taxable or nontaxable benefits.

Pursuant to Plan, all assets must be held in trust. To carry out the provisions of Plan, Taxpayer has adopted a Trust Agreement establishing Trust. Trust holds all contributions made under the terms of Plan, together with any income, gains or profits and taking account losses. All contributions to Plan are made by Taxpayer. No contributions are made by employees. Contributions are not allocated to separate participant accounts but are held in Trust as pooled funds which are available to pay the health benefits of all eligible retirees. No part of Trust may be diverted to purposes other than the exclusive benefit of the participants and their beneficiaries. Taxpayer has exclusive authority and discretion to manage and control the assets of Plan and direct the trustee on investments. The trustee for Trust is the Chief Financial Officer of Taxpayer. Taxpayer may remove and replace the trustee at any time.

The Trust Agreement will continue as long as Plan is in full force and effect. However, Plan can be terminated by the Taxpayer Council in accordance with a memorandum of understanding between Taxpayer and firefighters. Upon termination of Plan, after all assets held in Trust have been distributed pursuant to Plan, all benefits owed under Plan have been paid and all Plan and Trust expenses have been paid, if there are any assets remaining in Trust, the assets will revert to Taxpayer or be transferred to another entity the income of which is excluded from gross income under § 115 of the Code.

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 § 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 utilities 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 addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

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 § 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.

Trust provides health benefits to retired employees of Taxpayer, a political subdivision of the state. Providing health benefits to current and former employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of Trust accrues to Taxpayer. Taxpayer is the sole participating employer in Plan. No private interests participate in or benefit from the operation of Trust. Any distribution of remaining funds in Trust to participating retirees upon the dissolution of Trust satisfies an obligation Taxpayer has assumed with respect to providing health benefits to its employees. The benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

Section 6012(a)(2) and § 1.6012-2(a)(1) provide, in general, that every corporation, as defined in § 7701(a)(3), subject to taxation under subtitle A is required to file an income tax return regardless of whether it has taxable income or regardless of its gross income. See Rev. Rul. 77-261.

Section 6012(a)(4) provides that every trust having for the taxable year any taxable income or having gross income of $600 or more, regardless of the amount of taxable income, must file an annual income tax return.

Section 61(a)(1) of the Code and § 1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in subtitle A of the Code, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 1.61-21(a)(3) of the regulations provides that a fringe benefit provided in

connection with the performance of services shall be considered to have been provided as compensation for such services.

Section 1.61-21(a)(4) of the regulations provides that, in general, a taxable fringe benefit is included in the income of the person performing the services in connection with which the fringe benefit is furnished. Thus, a fringe benefit may be taxable to a person even though that person did not actually receive the fringe benefit. If a fringe benefit is furnished to someone other than the service provider, such benefit is considered as furnished to the service provider, and use by the other person is considered use by the service provider.

Section 1.61-21(b)(1) of the regulations provides that an employee must include in gross income the fair market value of the fringe benefit. In general, fair market value, under the principles set forth in § 1.61-21(b)(2) of the regulations, is determined on the basis of the amount that an individual would have to pay for the particular fringe benefit in an arm's-length transaction. In the case of group medical coverage, the amount includible in the individual's gross income is the fair market value of the group medical coverage.

Section 106 of the Code provides that gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.106-1 of the regulations provides that the gross income of an employee does not include contributions which the employee's employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by the employee or the employee's spouse or dependents (as defined in § 152). The employer may contribute to an accident or health plan either by paying the premium on a policy of accident or health insurance covering one or more of the employees, or by contributing to a separate trust or fund which provides accident or health benefits directly or through insurance to one or more of the employees. However, if the insurance policy, trust or fund provides other benefits in addition to accident or health, § 106 applies only to the portion of the contributions allocable to accident or health benefits.

Coverage provided under an accident and health plan to former employees and their spouses and dependents is excludable from gross income under § 106. See, Rev. Rul. 62-199, 1962-2 C.B. 38; Rev. Rul. 82-196, 1982-2 C.B. 53.

Section 104(a)(3) provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not included in the gross income of the employee, or (B) are paid by the employer).

Section 105(a) provides that, except as otherwise provided in § 105, amounts received

by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

Section 105(b) provides that except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care (as defined in § 213(d)) of the taxpayer, his spouse, and his dependents (as defined in § 152 of the Code).

Employer-provided coverage under an accident or health plan for personal injuries or sickness incurred by individuals other than the employee, his or her spouse, or his or her dependents (as defined in § 152), is not excludable from the employee's gross income under § 106. In addition, reimbursements received by the employee through an employer-provided accident and health plan are not excludable from the employee's gross income under § 105(b) unless the reimbursements are for medical expenses incurred by the employee, his or her spouse, or his or her dependents, as defined in § 152. However, reimbursements that are not excludable under § 105(b) may be excludable under § 104(a)(3) if they are attributable to employer contributions that were included in the employee's income.

Based on the information submitted and the representations made, we conclude as follows:

1. The income of Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Accordingly, Trust's income is excludable from gross income under § 115(1) of the Code.

2. If Trust is classified as a trust for federal income tax purposes, no annual income tax return is required to be filed by Trust pursuant to § 6012(a)(4) since any income realized by Trust is excluded from gross income under § 115(1). However, if Trust is a corporation, as defined in § 7701(a)(3), it will be required to file an income tax return pursuant to § 6012(a)(2).

3. Employer contributions paid to the Plan and payments made from the Plan which are used exclusively to provide for the medical care as defined in § 213(d) of retired employees, their spouses and dependents (as defined in §152 of the Code) are excludable from gross income under §§ 106 or 105(b) of the Code.

4. With respect to domestic partners who do not qualify as § 152 dependents, neither the employee nor the domestic partner will include in income any amount received as payment or reimbursement under the Plan to the extent the coverage was paid for with after-tax employee contributions or the fair market value of the coverage was included in the gross income of the employee pursuant to the provisions of §104(a)(3) of the Code.

5. The medical coverage provided to nondependent domestic partners will not otherwise adversely affect the exclusions from gross income under §§ 106 or 105(b) of amounts contributed by Taxpayer or paid by Plan for the medical care of employees, their spouses, and dependents (as defined in § 152 of the Code).

This ruling is contingent upon Taxpayer amending the Plan so that it is consistent with proposed amendments as set forth in the Taxpayer's letter dated April 30, 2007. Because this ruling is dependent upon the amendment of the Plan document as represented by Taxpayer, the ruling applies only for periods on and after the date on which the amendments become effective.

No opinion is expressed concerning the Federal tax consequences of the Plan or Trust under any other provision of the Code other than those specifically stated herein. In particular, section 3.01(9) of Rev. Proc. 2007-3, 2007-1 I.R.B. 108 provides that the Service will not issue a ruling concerning whether a self-insured medical reimbursement plan satisfies the requirements of § 105(h) for a plan year. Accordingly, no opinion is expressed concerning whether the Plan satisfies the nondiscrimination requirements of § 105(h) of the Code and § 1.105-11 of the regulations.

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.

Sincerely,

Harry Beker, Chief
Health and Welfare Branch
Office of Division Counsel/Associate Chief Counsel
(Tax Exempt & Government Entities)