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LEGEND

Taxpayer =

Trust =

Plan =

State =

State Statute =

Dear :

This is in reply to your letter dated December 19, 2007, and subsequent correspondence, in which you request various rulings on behalf of Taxpayer with respect to Plan and Trust.

Taxpayer is a public transportation district organized under State Statute. The governing body of Taxpayer consists of seven elected members. Taxpayer has the power to provide public transportation and terminal facilities for public transportation. It also has the power to levy certain taxes.

Taxpayer adopted Plan as a means of providing health benefits to its eligible retiree employees, their spouses, domestic partners, and dependents. Taxpayer proposes to adopt the Trust to provide an efficient mechanism for funding benefits under the Plan.

Trust will be administered by an Administrative Committee. Trust's income will consist of contributions from Taxpayer's general assets, Plan participants' after-tax contributions and investment earnings. Trust assets will be held in trust by a designated institutional trustee who will receive instructions from the Administrative Committee. Pursuant to the Trust Agreement, Trust assets may be used only to pay Plan benefits and to pay reasonable administrative expenses of the Trust. Taxpayer is the only employer that can participate in the Trust.

Taxpayer may terminate the Trust by action of its Board of Directors if Taxpayer determines that it is not possible to carry out the essential purpose of the Trust. In the event of termination, Taxpayer shall continue to provide benefits and pay reasonable and necessary termination expenses until the Trust funds are exhausted.

The cost of retiree-only coverage is paid for by retirees and by Taxpayer. Active employees of Taxpayer do not pay for any part of retirees' health coverage. Eligible retirees pay for a portion of their coverage and the coverage of their dependents by making after-tax contributions. The fair market value of the coverage provided to non-dependents of a retired employee, less any portion of the coverage paid for by the retiree with after-tax contributions, is included in the retired employee's income. The Plan does not permit retirees to convert sick or vacation days to pay for health coverage. Under no circumstances may contributions to the Trust by eligible employees be made on a pre-tax basis.

If an eligible retiree waives participation in the Plan, he or she cannot receive another benefit in lieu of coverage under the Plan. Employees cannot make any election with respect to retiree health coverage under the Plan.

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 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 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 eligible retired employees of Taxpayer. Providing health benefits to former public 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, its sole participating employer, a political subdivision or entity. No private interests participate in or benefit from the operation of Trust. Distribution of remaining funds in the Trust would satisfy an obligation the Taxpayer has assumed with respect to providing health benefits to retirees. The benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

Section 106(a) 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(a) of the Income Tax Regulations provides that the gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by him, his spouse, or his dependents, as defined in § 152. The employer may contribute to an accident or health plan either by paying the premium (or a portion of the premium) on a policy of accident or health insurance covering one or more of his employees, or by contributing to a separate trust or fund (including a fund referred to in § 105(e)) which provides accident and health benefits directly or through insurance to one or more of his 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. 32; Rev. Rul. 82-196, 1982-2 C.B. 53.

Section 104(a)(3) of the Code 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) of the Code 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) of the Code 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).

Based on the information submitted and 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) Contributions paid to Plan and payments made from Plan which are used exclusively to pay for the accident or health coverage of retired employees, their spouses and dependents (as defined in § 152) are excludable from the gross income of retired employees and retired employees' spouses and dependents under §§ 106 and 105(b) of the Code.

(3) Because the coverage provided to non-dependents of retired employees is paid for with after-tax contributions or the fair market value of the coverage is included in the gross income of the retirees, neither the retired employees nor the non-dependents will include in income any amount received as payment or reimbursement under Plan pursuant to section 104(a)(3) of the Code.

No opinion is expressed concerning the Federal tax consequences of Plan or Trust under any other provision of the Code other than those specifically stated herein. In particular, § 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) of the Code for a plan year. Accordingly, no opinion is expressed concerning whether 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 & Welfare Branch
Office of Division Counsel/Associate
Chief Counsel (Tax Exempt
& Government Entities)

cc: