Internal Revenue Service

Number: **200921024**
Release Date: 5/22/2009

Index Number: 115.00-00

Department of the Treasury
Washington, DC 20224

[Third Party Communication:
Date of Communication: Month DD, YYYY]
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CC:TEGE:EO2
PLR-146327-08
Date:
January 27, 2009

LEGEND

Trust =

Board =

County =

State =

Plan =

Dear :

This is in reply to a letter September 19, 2008, requesting a ruling that the income of Trust is excluded from gross income under § 115(1) of the Internal Revenue Code.

FACTS

Board oversees the public school system in County. Board, a publicly elected body, is a political subdivision of State. Board adopted Plan to provide post-employment welfare benefits to eligible retirees, their spouses, and dependents. The County public school system is the only participating employer in Plan. Plan provides benefits through a selfinsurance arrangement. Benefits provided by Plan include medical, dental, vision, prescription drug, life, and long-term care benefits.

There is no cash-out of any amounts paid for Plan benefits and no conversion of sick or vacation days to post-retirement medical benefits. Plan does not permit any benefits to be paid by pre-tax salary reduction. In administering Plan, reasonable efforts will be made to identify individuals who do not qualify as a spouse or dependent (under § 152 of the Internal Revenue Code) of the retiree who participates in Plan. The fair market value of coverage under Plan for such individuals will be included in the gross income of the retiree.

Board created Trust as a vehicle to pre-fund the benefits provided by Plan. Trust funds are used to pay for Plan benefits and Trust administration expenses. Trust is governed by a board of between five and nine trustees. The trustees consist of five County public school employees who serve as a condition of their employment and up to four additional trustees selected by Board. Board may remove any trustee immediately upon providing written notice to the trustee. Board can also amend Trust.

The income of Trust consists of contributions to Plan and investment income. No part of Trust may be diverted to purposes other than the exclusive benefit of the Plan participants and their beneficiaries. No part of Trust's net earnings may inure to the benefit of any private person other than the incidental benefit to the Plan participants.

Upon termination of Trust, the Trust Agreement provides that any assets remaining in Trust will be used for the exclusive benefit of participants entitled to benefits under Plan and to defray reasonable expenses of administering Plan. In no event will any Trust assets be transferred to an entity that is not a state, a political subdivision of a state or an entity the income of which is excluded from gross income under § 115(1) of the Code.

LAW & ANALYSIS

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 § 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 retired employees of Board, which is a political subdivision of State. Providing health benefits to retired employees of a political subdivision of a state 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 Board, the sole participating employer in Plan. Upon termination of Trust, its remaining assets will be distributed to fulfill an obligation assumed by Board with respect to its employees. In no case will Trust assets be distributed to an entity that is not a state, a political subdivision of a state or an entity the income of which is excluded from gross income under section 115 of the Code.

Based on the information and representations submitted by Trust, we hold that 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.

Section 6012

Section 6012(a)(2) and Treas. Reg. § 1.6012-2(a)(1) of the regulations provide, in part, 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 the amount of its gross income.

Section 6012(a)(4) provides that every trust having for the taxable year any taxable income or having gross income of $600 or over, regardless of the amount of taxable income, must file an annual income tax return. Section 7701(a) and § 301.7701-4 of the regulations define trust for purposes of § 6012.

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).

No opinion is expressed on the classification of Trust as a trust or corporation for federal tax purposes. No opinion is expressed concerning the federal tax consequences of Trust under any other provision of the Code other than those specifically cited above. This ruling concerns only the federal tax treatment of the Trust's income. No opinion is expressed regarding the treatment of Plan under any particular section of the Code. In particular, no opinion is expressed concerning the Federal tax consequences of contributions to or payments from Plan including (but not limited to) whether amounts are excludable from the gross income of employees, former employees or retirees under §§ 104, 105 or 106.

Section 3.01(10) of Rev. Proc. 2008-3, 2008-1 I.R.B. 110 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 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 who requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

In accordance with a Power of Attorney on file, we are sending a copy of this letter to your representative.

Sincerely,

____

Sylvia F. Hunt
Assistant Chief, Exempt Organizations
Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures:
Copy of this letter
Copy for § 6110 purposes