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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
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Telephone Number:

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Date:
June 16, 2015

Trust =

City =
State =

x =

Dear :

This letter responds to a letter from your authorized representative dated November 14, 2014, and subsequent correspondence submitted on behalf of the Trust, requesting a ruling that the Trust's income is excludable from gross income under Internal Revenue Code (IRC) section 115. The Trust represents the facts as follows.

FACTS

The City is a political subdivision of the State. Through the Trust the City provides a length of service incentive plan that benefits its volunteer firefighters. Each firefighter who participates in the plan accrues a benefit equal to x, multiplied by his or her years of credited service. There are no general limitations on the amount of creditable service.

The Trust assets will be used for the exclusive purpose of providing the incentive benefit payments to active and former volunteer firefighters and their beneficiaries who are eligible to receive such payments under the terms of the Trust, and for paying reasonable and necessary expenses. Under the terms of the Trust, an eligible firefighter may elect to receive his or her benefits for life, or the firefighter can elect to receive a reduced benefit for his or her life plus certain additional benefits for his or her beneficiary upon the firefighter's death.

Seven Trustees, consisting of three selected by a committee representing the fire stations in the City, one councilmember selected by the City's city council, the City's manager (or designee), the City's financial services director (or designee), and one citizen of the City who is appointed by the City's mayor, manage and administer the assets of the Trust. The Trustees will employ an investment manager or managers to manage some or all of the assets of the Trust. The Trustees are responsible for holding, investing and reinvesting the Trust's assets, and for making payments from the Trust.

Neither active or former volunteer firefighters nor their respective beneficiaries have any preferred claim in, or any beneficial ownership interest in, any asset of the Trust.

The Trust may be terminated by the City. However, upon termination of the Trust, any remaining assets will be used to provide the incentive benefits under the terms of the Trust. Any assets remaining in the Trust after satisfying all benefit obligations must be returned to the City.

LAW AND ANALYSIS

IRC 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 any political subdivision thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income generated by an investment fund that is established by a state to hold revenues in excess of the amounts needed to meet current expenses is excludable from gross income under IRC section 115(1), because such investment constitutes an essential governmental function. The ruling explains that the statutory exclusion is 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 an entity engaged in the operation of a public utility or the performance of some governmental function that accrues to either a state or political subdivision of a state. 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 that are within the ambit of a sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (e.g., casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under IRC section 115(1), because the organization is performing an essential governmental function. The revenue ruling states that the income of such an organization is excludable from gross income so long as private interests do not participate in the organization or benefit more than incidentally from the organization. The benefit to the employees of the insurance coverage obtained by the member political subdivisions was deemed incidental to the public benefit.

Through the Trust, the City provides length of service incentive benefits to active and former volunteer firefighters and their beneficiaries. Providing these incentive benefits constitutes the performance of an essential government function within the meaning of IRC section 115(1). See Rev. Rul. 90-74 and Rev. Rul. 77-261.

The Trust's income accrues to the City. No private interests will participate in, or benefit from, the operation of the Trust other than the benefit to the firefighters or as providers of goods or services. The benefit to active or former volunteer firefighters and their beneficiaries is incidental to the public benefit. See Rev. Rul. 90-74.

Except for the benefit to the firefighters and for paying reasonable and necessary expenses, in no event, including dissolution, will the Trust's assets be distributed or revert to any entity or person that is not a state, a political subdivision of a state, or another entity the income of which is excludable from its gross income by application of IRC section 115.

Based solely on the facts and representations submitted by the Trust, we conclude that, because the income of the Trust derives from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof, the Trust's income is excludable from gross income under IRC section 115(1).

Except as expressly provided herein, no opinion is expressed or implied as to the federal tax consequences of the facts described above under any other provision of the IRC. Specifically, no opinion is expressed as to the taxation of plan participants and beneficiaries under IRC sections 457(f), 402(b), 83, and the economic benefit doctrine. Furthermore, no opinion is expressed as to the application of Federal Insurance Contributions Act (FICA) taxes, including social security tax and Medicare tax, and Federal Income Tax Withholding to the City, the Trust, or participants and beneficiaries.

It should be noted that the incentive plan component of the Trust for the City's volunteer firefighters fails the annual $3,000 accrual limit of IRC section 457(e)(11)(B)(ii), and therefore does not qualify for the exception from treatment as a deferred compensation plan subject to IRC section 457(f). To the extent the incentive plan is a deferred compensation plan subject to IRC section 457(f), involves the use of a nonexempt employees' trust under IRC section 402(b), results in a transfer of property under IRC section 83 as a transfer of an interest in a trust, or results in application of the economic benefit doctrine, the value of a participant's benefits under the plan is includible in the participant's gross income at the time the rights to those benefits are attained and no longer subject to a substantial risk of forfeiture (regardless of whether vested benefits have yet been paid).

Furthermore, the fact that a participant may be called a "volunteer" does not determine his or her status as an employee or an independent contractor for federal tax purposes. To the extent that a participant is a current or former employee of the City and is not covered under a state retirement system within the meaning of IRC section 3121(b)(7)(F) (or, alternatively, is covered under both a state retirement system and an agreement under section 218 of the Social Security Act), social security tax would generally apply. Also, to the extent that a participant is a current or former employee of the City, Medicare taxes would generally apply. In addition, if the participant is an employee or former employee of the City, income tax withholding obligations may apply to the extent that the arrangement involves the use of a nonexempt employees' trust under IRC section 402(b), results in a transfer of property under IRC section 83 as a transfer of an interest in a trust, or results in application of the economic benefit doctrine. To the extent that a participant is a current or former employee of the City, the amount included in income would generally be subject to Form W-2 reporting obligations under IRC section 6051. In addition, any social security wages, Medicare wages, and income tax withholding would be required to be reported on Form W-2.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by penalty of perjury statements executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. IRC section 6110(k)(3) provides that it may not be used or cited as precedent.

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

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Kenneth M. Griffin
Branch Chief
(Tax Exempt & Government Entities)

cc: