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Date:
June 01, 2017

State =
County =
Employer =
Association =
Trustee =

Master Trust =

Employer Trust =
County Trust =

Dear :

This letter responds to a letter from Master Trust's authorized representatives dated December 13, 2016, requesting rulings that:

(1) Master Trust's income is excludable from gross income under section 115(1) of the Internal Revenue Code (Code);[1] and

(2) Master Trust is not required to file an annual federal income tax return under section 6012(a)(4).

Master Trust represents the facts as follows:

FACTS

[1] Section 115 of the Internal Revenue Code of 1986, as amended, to which all subsequent section references are made unless otherwise stated.

County and Employer are political subdivisions of State. Association is a statutorily created retirement system in which County and Employer participate. County established County Trust to hold and invest assets to fund and pay benefits under County's Other Post-Employment Benefits (OPEB) program. Similarly, Employer established Employer Trust to hold and invest assets to fund and pay benefits under its OPEB program. Master Trust was created to co-invest and commingle the assets of County Trust and Employer Trust for investment purposes.

Master Trust, County Trust, and Employer Trust are governed by Trustee, which is comprised of a nine member board. Of those nine members, the majority are appointed by the County board of supervisors, including the County Treasurer and Tax Collector as an ex officio member. The remaining members are appointed by the membership of the Association.

Trustee has sole and exclusive authority, control over, and responsibility for directing the investment and management of Master Trust assets. Trustee maintains separate accounts for County Trust and Employer Trust reflecting contributions, earnings, and disbursements, and allocates investment transactions, valuations of assets, rates of return, and expenses between the separately tracked accounts.

Trustee is required to discharge its duties solely in the interest of, and for the exclusive purpose of County Trust and Employer Trust. No part of the principal or income of the Master Trust may be used for, or diverted to, purposes other than the exclusive benefit of County Trust and Employer Trust. In turn, County Trust's and Employer Trust's agreements prohibit any part of the principal or income of each trust from being used for, or diverted to, purposes other than the exclusive benefit of participants or for the payment of reasonable expenses of administering the trusts and the OPEB programs. County Trust and Employer Trust are prohibited from assigning any portion of their equity or interests in their separately tracked accounts.

Master Trust may be terminated by Trustee and will automatically terminate upon satisfaction of all liabilities under County Trust and Employer Trust's OPEB programs. Upon termination, assets in each separately tracked account will be distributed to the County Trust and Employer Trust after holding back a reasonable amount of assets necessary for outstanding expenses and administrative costs.

LAW AND ANALYSIS

Issue 1 – Section 115(1)

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 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 (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under section 115(1) because the organization is performing an essential governmental function. The revenue ruling states that the income of such an organization is excluded 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.

Pooling the investments of County Trust and Employer Trust, both of which are political subdivisions of State that fund OPEB programs, is an essential government function within the meaning of section 115(1). <u>See</u> Rev. Rul. 77-261.

No part of the net earnings of Master Trust inures to the benefit of, or is distributable to, any private entity or individual. No private interests are involved in or participate in the Master Trust. Upon dissolution, assets of Master Trust must be distributed to County Trust and Employer Trust. Thus, Master Trust's income accrues to a state or a political subdivision of a state within the meaning of section 115(1). <u>See</u> Rev. Rul. 90-74.

Based solely on the facts and representations submitted, Master Trust's income is excludible from gross income under section 115(1).

<u>Issue 2 – Section 6012(a)(4)</u>

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 a return with respect to income taxes under subtitle A.

Section 301.7701-1(b) of the Procedure and Administration Regulations provides, in part, that the classification of organizations that are recognized as separate entities is determined under §§ 301.7701-2 through 301.7701-4(a), unless a provision of the Code provides for special treatment of that organization.

Section 301.7701-4(a) of the Procedure and Administration Regulations provides, in general, that an arrangement will be treated as a trust under the Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

The purpose of Master Trust is to co-invest and commingle the assets of County Trust and Employer Trust for investment purposes. Trustee is charged with the responsibility of protecting and conserving Master Trust property for the benefit of County Trust and Employer Trust. County Trust and Employer Trust cannot share in the discharge of Trustee's responsibility for the protection and conservation of Master Trust property and, therefore, are not associates in a joint enterprise for the conduct of a business for profit. See § 301.7701-4(a). Thus, Master Trust is classified as a trust within the meaning of § 301.7701-4(a).

Section 6012(a)(4) does not require a Trust without taxable income to file a return when gross income is less than $600. Because Master Trust's income is excludable from gross income under section 115(1), it is not required to file an annual income tax return.

CONCLUSIONS

(1) Master Trust's income is excludable from gross income under section 115(1); and

(2) Master Trust is not required to file an annual federal income tax return under section 6012(a)(4).

The rulings contained in this letter are based upon information and representations submitted by or on behalf of Master Trust and accompanied by a penalty of perjury statement executed by an individual with authority to bind Master Trust and upon the understanding that there will be no material changes in the facts. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2017-1, § 11.05.

This letter does not address the applicability of any section of the Code or Regulations to the facts submitted other than with respect to the sections specifically described, and, except as expressly provided in this letter, no opinion is expressed or implied concerning the tax consequences of any aspects of any transaction or item of income discussed or referenced in this letter.

Because it could help resolve questions concerning federal income tax status, this letter should be kept in Master Trust's permanent records.

A copy of this letter must be attached to any tax return to which it is relevant. Alternatively, if Master Trust files a return electronically, this requirement may be satisfied by attaching a statement to the return that provides the date and control number of this letter.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Master Trust's authorized representatives.

This ruling letter is directed only to Master Trust. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

David L. Marshall
Assistant Branch Chief
Office of the Chief Counsel
(Tax Exempt & Government Entities)

cc: