

The System was established under the Statute. The Board established the Trust to hold assets of the System.

The State provides health benefits to retired State and Education Board employees and their beneficiaries. By way of the Agreement, the Board created and administers the Trust solely for the purpose of providing post-employment benefits (other than pension) to retired employees and their dependents. The State and the Education Board (a political subdivision of the State) contribute to the Trust for the maintenance of the System. All funds and investment income in the Trust are to be used exclusively to pay benefits to retired employees and their dependents under the System, as well as reasonable and legitimate administrative expenses.

The State represents that private interests do not participate in the Trust.

The Board is comprised of the State Controller, the State Budget Officer, the State Personnel Administrator, and the General Treasurer, or their designees. The Board serves as the initial trustee of the Trust.

The Board is responsible for the general administration and maintenance of the Trust and the System. It has the power to collect contributions from the State or any agency or division of the State and to direct benefit payments. The Board may adopt rules and regulations for conducting the business of the System and shall have such power as might be necessary to discharge its duties. If it designates a separate trustee, the Board may remove that trustee at any time with notice.

The Board may amend the Agreement. Under no condition, however, may any amendment result in or permit the return to the State of any portion of Trust income or assets, or result in or permit the distribution of Trust income or assets for the benefit of anyone other than the covered retired employees and their dependents, unless and until the Board has certified that all System liabilities have been satisfied.

The Board may terminate the Agreement, but only with written notice that includes a certification that all System liabilities have been satisfied, at which time remaining Trust assets will be transferred to the State. The State represents that in no event will Trust assets be transferred to an entity that is not a state, a political subdivision of a state, or an entity whose income is excluded from gross income under § 115.

LAW AND ANALYSIS

Section 115(1) 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 properly to 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 income of an organization formed, funded, and operated by political subdivisions to pool various risks arising from their obligations regarding public liability, workers' compensation, or employees' health is excludable from gross income under § 115. In this ruling, private interests did not materially participate in the organization, nor did they benefit more than incidentally from the organization.

The Trust provides health benefits to retired State and Education Board employees and their beneficiaries. 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, the Trust performs an essential governmental function within the meaning of § 115(1).

The funding and provision of retiree health benefits through the Trust satisfies the obligation of the State and the Education Board to provide those benefits; thus, the income of the Trust accrues to the State and the Education Board. Any amounts remaining in the Trust after all liabilities of the System have been satisfied shall be returned to the State. No private interests participate in, or benefit from, the operation of the Trust other than as providers of goods or services. The benefit to retired State and Education Board employees is incidental to the public benefit. See Rev. Rul. 90-74.

Issue 2 – § 6012(a)(4)

FACTS

The State created the Trust to provide a vehicle for funding retiree health benefits under Plan. The income of the Trust consists solely of contributions from the State and

the Education Board, plus investment income. No contributions will be made to the Trust by employees. No part of the Trust may be diverted to purposes other than the exclusive benefit of the participants and their beneficiaries. No part of the Trust's net earnings may inure to the benefit of any private person. The parties to the Trust Agreement are the State and the trustee of the Trust.

The Trust is governed by the Board, consisting of officials of the State or their designees. The Board holds all powers necessary to carry out the purpose of the Trust, including investment, management, and control of Trust assets. The Board is required to pay benefits solely to provide health benefits to retirees and their spouses and dependents.

The Agreement provides that the Board may amend or terminate the Trust at any time provided that Trust assets shall be used only for the purpose of providing health benefits to the participants of the Plan. In no event will the assets be transferred to an entity which is not a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under § 115.

LAW & ANALYSIS

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

Section 301.7701-4(a) 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.

Contributions to the Trust are to be used to pay retiree health benefits for eligible retired employees and their spouses and dependents. The Board, as trustee, is charged with the responsibility of protecting and conserving Trust property for the benefit of the beneficiaries of the Trust. The beneficiaries of the Trust cannot share in the discharge of the Board's responsibility for the protection and conservation of property and, therefore, are not associates in a joint enterprise for the conduct of business for profit. Assuming that the Trust is recognized as a separate entity under § 301.7701-1, we conclude that the Trust is an ordinary trust under § 301.7701-4(a).

Section 6012(a)(4) provides that every trust having taxable income for the tax year, or having gross income of \$600 or more for that year regardless of the amount of taxable income, must file a return with respect to income taxes under subtitle A.

RULINGS

Based solely on the facts and representations submitted by the Trust:

1. We conclude that the income of the 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). Consequently, we rule that the Trust's income is excludable from gross income under § 115(1).
2. We conclude that the Trust is classified as a trust within the meaning of § 7701(a) and § 301.7701-4(a). Section 6012(a)(4) does not require a trust without taxable income to make a return of income when gross income is less than \$600. Because the Trust's income is excludable from gross income under § 115(1), we rule that the Trust is not required by § 6012(a)(4) to file an annual income tax return.

Except for the specific rulings above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no representation is made that contributions or premiums paid on behalf of, or benefits received by, employees, former employees, retirees, spouses, dependents, or others will be tax-free. This ruling concerns only the federal tax treatment of the Trust's income and may not be cited or relied upon as to any matter relating to the taxation of accident or health contributions or benefits.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

SYLVIA HUNT
Assistant Chief
Exempt Organizations Branch 2
Office of Division Counsel /
Associate Chief Counsel
(Tax Exempt & Government Entities)

enclosures: copy for § 6110 purposes