

Internal Revenue Service

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:EO2
PLR-155923-05

In Re:

Date:
March 14, 2006

Legend

Corporation =

Trust = Alaska

State =

Act =

Transportation System =

Dear _____ :

This is in response to your letter dated November 2, 2005, and subsequent correspondence requesting the following rulings:

1. The income of Trust is excluded from gross income under section 115(1) of the Internal Revenue Code ("Code").
- 2A. Trust is an "ordinary trust" within the meaning of section 7701(a) of the Code and Section 301.7701-4(a) of the Procedure and Administration Regulations.
- 2B. Trust is not required under section 6012(a)(4) to file federal income tax returns.
3. Contributions to Trust by Corporation are excluded from gross income by section 105 of the Code.
4. Amounts paid from Trust on behalf of employees and their surviving spouses and dependents (as defined in section 152 of the Code) are excluded from gross income under section 106 of the Code (for insurance premiums) and section 105 (for medical expenses).

FACTS

Corporation is a public corporation of State. Congress enacted Act to transfer the operation of Transportation System from the Federal Government to State. The Act deemed the operation of Transportation System by a public corporation of State to be an exercise of an essential governmental function and the revenue derived from such operation shall be deemed to accrue to State for purposes of section 115(1). The operation of Transportation System by Corporation is the performance of an essential governmental function of State.

Corporation established and maintains a health insurance plan ("Plan") for its active and retired employees, their spouses and eligible dependents. Under Plan, employees may elect coverage under a major medical group insurance policy.

With respect to retirees, coverage is available to retirees who receive an annuity under Corporation's pension plan or through the Federal Civil Service Retirement System (CSRS). An employee who retires under Corporation's pension plan and meets Plan's age requirement for subsidized coverage (58 or older if not represented by collective bargaining or 62 or older if represented by collective bargaining) may continue health care coverage for the retired employee and the retired employee's spouse and dependents on a cost-sharing basis. Employees who retire on disability retirement are also eligible to receive subsidized coverage.

After the death of a retired employee, certain family members covered under the Plan may continue the health coverage. A surviving spouse who is entitled to a monthly annuity from Corporation's pension plan or from the Federal CSRS may continue coverage, as may surviving dependents enrolled in Plan at the time of the retiree's death. In the case of CSRS participants, a child eligible to receive an annuity from CSRS after the retiree's death may also continue coverage under Plan.

Corporation pays 40 percent of the insurance premium for the post-retirement medical coverage for each Plan participant eligible for subsidized health care coverage. The participants are responsible for paying the remaining 60 percent of premium amounts.

The Board of Directors of Corporation adopted Trust to fund its liability to provide health care coverage to retired employees, their spouses and dependents, and surviving spouses and dependents. Contributions by Corporation are the sole source of funds for Trust.

Corporation, acting through its Board and Chief Executive Officer, is the final authority in all matters pertaining to Trust. Corporation's Board has delegated management of day-to-day matters to a committee ("Committee") composed of officers of Corporation. Corporation has contracted with a bank to act as custodial trustee ("Trustee") for Trust. Corporation, Committee and Trustee are named as fiduciaries of Trust.

Article IV, section 4.3 of Trust, in general, prohibits any part of Trust to be used for or diverted to purposes other than for the exclusive purpose of providing benefits to participants and beneficiaries covered under Plan.

Article VIII, section 8.2 of Trust provides that upon termination of Trust, after payment of all trust liabilities, Trustee shall distribute the remaining Trust assets to Corporation.

LAW AND ANALYSIS

Section 115(1)

Section 115(1) provides that gross income does not include income derived from any essential governmental function and accruing to a state or political subdivision.

In determining if section 115(1) applies, the Service considers all the facts and circumstances relating to the organization to determine whether the organization performs an essential governmental function and whether the income accrues to a state or political subdivision

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, is excludable from gross income for federal income tax purposes under section 115(1). The revenue ruling reasons that the investment of cash balances by a state or political subdivision thereof in order to receive some yield on the funds until needed to meet expenses is a necessary incident of the power of the state or political subdivision to collect taxes and other revenue to fund government expenses. 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 Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined 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). Rev. Rul. 90-74 states that the income of such an organization is excluded from gross income under section 115(1) so long as private interests do not participate in the organization or benefit more than incidentally from the organization. The benefit to retirees, their spouses and dependents of the medical insurance coverage is deemed incidental to the public benefit.

Trust was established to fund Corporation's obligation to provide health care coverage for its retirees. Based on Rev. Rul. 77-261 and Rev. Rul. 90-74, the Trust performs an essential governmental function within the meaning of section 115(1).

To be excludable from gross income under section 115(1), the income of Trust must accrue to State, any political subdivision of the State, or another entity the income of which is excluded from gross income under section 115(1). No part of the Trust's net earnings may inure to the benefit of any private person. Private interests do not participate in or benefit from income of Trust, other than as provided in Rev. Rul. 90-74.

Article VIII, section 8.2 of Trust, provides that, upon Trust termination, after payment of all trust liabilities, the Trustee shall distribute the remaining Trust assets to Corporation. The Act deemed the revenue derived from the operation of Transportation System by a public corporation of State to accrue to State for purposes of section 115(1). Accordingly, the income of Trust accrues to Corporation, a public corporation, whose income is excludable from gross income under 115(1).

Section 301.7701-4(a)

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; § 301.7701-3 and § 301.7701-4 unless a provision of the Internal Revenue Code provides for special treatment of that organization.

Section 301.7701-4(a) provides that, in general, an arrangement will be treated as a trust 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. If an entity has both associates and a business purpose, it cannot be classified as a trust for federal income tax purposes. Trust is classified as a trust under § 301.7701-4(a).

Section 6012(a)(4)

Section 6012(a)(4) of the Code 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, shall make returns with respect to income taxes under Subtitle A. Section 7701(a)(1) and section 301.7701-4(a) define trusts for purposes of section 6012. Trust is classified as a trust under section 301.7701-4(a). Section 6012 does not require Trust to make returns of income when gross income is not \$600 or over. Because Trust's income is excludable from gross income under section 115(1), Trust will not have gross income of \$600 or over.

Section 106

Section 61(a) provides that, except as otherwise provided, gross income includes all income from whatever source derived.

Section 106(a) provides that the gross income of an employee does not include employer-provided coverage under an accident or health plan. Treas. Reg. § 1.106-1 states 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 the employee, the employee's spouse, or the employee's dependents as defined in section 152. The employer may contribute to an accident or health plan either by paying the premium on a policy of accident or health insurance covering one or more of the employees, or by contributing to a separate trust or fund which provides accident or health benefits directly or through insurance to one or more of the employees. However, if the insurance policy, trust or fund provides other benefits in addition to accident or health, section 106 applies only to the portion of the contributions allocable to accident or health benefits.

Rev. Rul. 62-199, 1962-2 C.B. 38, holds that employer contributions to an accident and health plan that provides insurance coverage to employees who continue health coverage into retirement are excludable from the retired employees' gross income.

Rev. Rul. 82-196, 1982-2 C.B. 53, holds that employer contributions to an accident or health plan that provides coverage for an employee and the employee's spouse and dependents before and after the employee's retirement, and for a deceased employee's surviving spouse and dependents, are excludable from the gross income of the participants under section 106.

Contributions to Trust made by Corporation and payments which are used to fund the cost of health insurance coverage of retirees, their spouses and dependents as defined in section 152 (and surviving spouses and dependents), under the Plan are excludable from gross income under section 106.

CONCLUSIONS

Based solely on the information submitted and the representations made, we conclude:

1. Trust's income is excludable from gross income under section 115(1).
- 2A. Trust is classified as a trust for federal income tax purposes under § 301.7701-4.

2B. Because Trust is classified as a trust, Trust will not be required to file an annual income tax return under section 6012 as Trust will not have gross income of \$600 or over.

3. and 4. Contributions to Trust made by Corporation and payments from Trust which are used to fund the cost of health insurance coverage of retirees, their spouses and dependents as defined in section 152 (and surviving spouses and dependents), under the Plan are excludable from gross income under section 106.

Except as specifically ruled upon above, no opinion is expressed or implied as to the federal tax consequences of the transaction described above under any other provision of the Internal Revenue Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the provisions of a power of attorney currently on file, we are sending a copy of this ruling to your authorized representative.

Sincerely,

David L. Marshall
Chief, Exempt Organizations Branch 2
Office of Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures: