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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:TEGE:EB:HW
PLR-103900-07

Date: March 22, 2007

LEGEND:

Taxpayer =

Fund =

Plan =

Dear :

This is in reply to your letter of October 20, 2005, in which you request various rulings on behalf of the Taxpayer with respect to its Plan and Fund.

You represent that the Taxpayer established the Fund in accordance with a municipal ordinance to provide post retirement medical benefits for its employees under the Plan. The Fund is an irrevocable trust created by a trust agreement. Any funds deposited in the Fund are separate and apart from the general revenues of the Taxpayer. Funds are deposited into the Fund by the Taxpayer. They are used to meet the Taxpayer's obligation to pay the health insurance premiums needed to provide medical benefits for its employees after retirement. The Fund is administered by a board of five trustees. Three of the trustees are selected by the Taxpayer's governing body, one is selected by the Taxpayer administrator and one is the Taxpayer treasurer. The trustees are responsible for the general administration, investment and maintenance of the Fund and

for the payment of insurance premiums in amounts sufficient to satisfy the Taxpayer's obligation for post retirement medical benefits. Any decisions not within the scope of the trustees are referred to the Taxpayer's governing body.

The income of the Fund is derived from payments made by the Taxpayer and from investment income. Expenditures are used solely to pay for post retirement health insurance premiums provided pursuant to the Plan. The trust agreement under which the Fund was established may be amended but not revoked. Under no condition may an amendment result in the return to the Taxpayer of any portion of the Fund or of the income earned by the Fund, or result in the distribution of the Fund or its income for the benefit of anyone other than covered retirees for post retirement medical benefits. In the event the Plan is terminated, the Fund's remaining assets must be used to fulfill the Taxpayer's obligation to provide medical benefits for retirees covered under the Plan.

You represent that the Fund will be used solely to pre-fund its retiree health insurance obligations under the Plan. Retirees of the Taxpayer who retire with 20 years of service are eligible to receive health insurance benefits from the Plan. Under the Plan, retirees will be provided with medical coverage through an insurance company. No person other than eligible retirees of the Taxpayer, their spouses or dependents may receive benefits from the Plan. Retirees will receive health insurance benefits from the Plan until the first of the following occurs: death, eligibility for Medicare or other federally subsidized programs, or the availability of equivalent medical insurance from another employer of the retiree or the retiree's spouse. You represent that the Plan will be used solely for the payment of health insurance premiums on behalf of eligible retirees of the Taxpayer, their spouses and dependents and not for life insurance or any other benefit now or in the future. Eligible retirees will not receive any amounts in cash or any other taxable or nontaxable benefits. Amounts in the Plan will not be used to reimburse unreimbursed medical expenses.

Employees will be required to contribute a portion of the insurance premiums paid by the Taxpayer to the Fund based on a percentage of the employees' wages. The amount of the contribution, if not otherwise determined by an applicable collective bargaining agreement, will equal up to one-half of the actuarially deferred cost of the post-retirement health insurance coverage. You represent that employee contributions to the Fund are mandatory for all employees who will derive a benefit from the Plan and are a condition of employees' continued employment with the Taxpayer. Contributions will not be subject to any election by the employee.

Issue One

Section 115(1) of the Internal Revenue Code ("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 utilities 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 section 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.

The Fund provides health benefits to retired employees of Taxpayer, a political subdivision of State. Providing health benefits to current and former employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Fund performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of the Fund accrues to the Taxpayer. The Taxpayer is the sole participating employer in the Plan. No private interests participate in or benefit from the operation of the Fund. Any distribution of remaining funds in the Fund to participating retirees upon the dissolution of the Fund satisfies an obligation the Taxpayer has assumed with respect to providing health benefits to its employees. The benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

Issue Two

Section 61(a)(1) of the Code and §1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in Subtitle A, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 106(a) of the Code provides that the gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.106-1 of the regulations 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 §152 of the Code. 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 Plan 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.

Section 3121(a)(2) provides that the term "wages" does not include any payment (including any amount paid by an employer for insurance) made to, or on behalf of an employee or any of his dependents on account of medical or hospitalization expenses.

Coverage provided under an accident and health plan to former employees and their spouses and dependents is excludable from gross income under §106. See, Rev. Rul. 62-199, 1962-2 C.B. 38; Rev. Rul. 82-196, 1982-2 C.B. 53.

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

(1) Income of the Fund 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, Fund's income is excludable from gross income under § 115(1) of the Code.

(2) Amounts paid to the Fund and amounts paid from the Fund which are used solely to pay for health insurance premiums of retired employees and their spouses and dependents as defined in § 152 (determined without regard to §152(b)(1), (b)(2), and (d)(1)(B)) are excludable from gross income under §106 and do not constitute "wages" under § 3121(a)(2) of the Code.

No opinion is expressed concerning the Federal tax consequences of the Fund or Plan under any other provision of the Code other than those specifically stated herein.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) of the Code 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.

Sincerely,

Harry Beker
Chief, Health and Welfare Branch
Office of Division Counsel/
Associate Chief Counsel
(Tax Exempt & Government Entities)