



## FACTS

The Employer, established as a political subdivision of State, is charged with maintaining the public school system of County. It provides medical and prescription drug benefits under the Plan to eligible retirees and their survivors and dependents, as defined by § 152.

On Date, the Employer established Trust to subsidize the cost of retiree health benefits provided under the Plan. The assets of the Trust consist solely of contributions from the Employer and earnings on these contributions. No contributions will be made to the Trust by employees, former employees, or any other employers. Retirees and their eligible spouses and dependents will be the exclusive beneficiaries of the Trust. The Trust will serve solely as a funding mechanism for the Plan to defray the cost of the Employer's retiree health benefits provided under the Plan.

The Trust is administered by a retiree benefit committee of Employer and union representatives, established under a collective bargaining agreement, and acting as trustee (the Committee). The Committee has investment authority over the Trust, including the authority to participate in the Pool. The Pool is a State-wide pooled investment trust by which governmental employers may jointly invest funds of trusts established to cover the costs of health and welfare benefits for their current or future retirees. The IRS ruled in PLR 200951025 that the income of the Pool is excludable from gross income under § 115(1). The Committee must ensure that the trustees of the Pool maintain records sufficient to keep the funds of the Trust separate from the trust funds of the other governmental employers participating in the Pool.

The Trust agreement provides that the Employer may amend or terminate the Trust at any time, upon written notice to the Committee. Upon termination, any remaining Trust assets shall be transferred to another trust, provided that those assets be used solely to subsidize the cost of post-retirement health benefits for Plan participants. In no case will Trust assets be distributed to an entity that is not a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under § 115 of the Code.

The Employer represents that no private interests participate in, or benefit more than incidentally from, the Trust.

Issue 1 – § 115(1)

## 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 employees of the Employer and their survivors and eligible dependents. Providing health benefits to former public employees constitutes the performance of an essential governmental function. See Rev. Rul. 90-74 and Rev. Rul. 77-261.

The income of the Trust accrues to the Employer. 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 employees of the Employer is incidental to the public benefit. Upon termination of the Trust, any remaining assets will be used to provide health benefits to retirees pursuant to the Plan. In no event will Trust assets be distributed to any entity that is not a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under § 115. See Rev. Rul. 90-74.

Issue 2 – § 6012(a)(4)

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.

The Employer's contributions to the Trust are to be used to subsidize health benefits for certain retired employees of the Employer and their eligible spouses and dependents. The Committee is responsible under State law for protecting and conserving Trust property for the benefit of Trust beneficiaries. These beneficiaries cannot share in the discharge of the Committee's responsibility for the Trust and, therefore, are not associates in a joint enterprise for the conduct of a business for profit.

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 Employer:

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  
Office of Division Counsel /  
Associate Chief Counsel  
(Tax Exempt & Government Entities)

enclosures: copy for § 6110 purposes