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Department of the Treasury

Washington, DC 20224

[Third Party Communication:

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Person To Contact:

, ID No.

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CC:TEGE:EO2

PLR-135806-07

Date:

November 30, 2007

LEGEND

City =

Plan =

Trust =

Dear :

This is in reply to your letter dated August 1, 2007, requesting a ruling that the income of Trust is excluded from gross income under section 115(1) of the Internal Revenue Code.

FACTS

Plan provides health benefits for the retired employees of City and their dependents. City, a political subdivision of State, is the only participating employer in Plan. Plan is administered by City and can be amended and terminated by City. Plan provides benefits through both insurance policies and self-funding agreements. These benefits include hospitalization, medical, dental, vision, and long-term care. City represents that in no event will contributions by retired employees be made on a pre-tax basis. In addition, City represents that it will take reasonable steps to identify individuals who do not qualify as a spouse or dependent within the meaning of section 152 of the Internal Revenue Code. City will include in the taxable income of a retired employee imputed income relating to the participation of any such individual.

As part of Plan, City established Trust. The funds in Trust are held exclusively to provide benefits to Plan participants and to defray the expenses of administering Plan and Trust. Trust's income is derived from employee contributions, City contributions and investment income. Contributions made to Trust are irrevocable. The Trustees are appointed by and can be removed by City. In the event of the removal or resignation of a Trustee, a successor Trustee is designated by City. The Trust agreement can be amended or terminated by City at any time for any reason. No private interests participate in or benefit from the operation of Trust other than as providers of goods or services.

City can dissolve Trust only after the payment of Trust's remaining debts and liabilities and the satisfaction of all obligations to provide benefits under the Trust Agreement. The Trust Agreement provides that upon satisfaction of Trust obligations and expenses any remaining assets in Trust are to be distributed in accordance with the direction of City. City proposes to amend the Trust Agreement to provide that upon satisfaction of all Trust obligations and expenses any remaining assets will be distributed to City.

LAW AND ANALYSIS

Section 115(1) of 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.

Trust provides health benefits to retired employees of City, 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, Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of Trust accrues to City, the sole participating employer in Plan. No private interests participate in or benefit from the operation of Trust. Any distribution of remaining funds in Trust to participating retirees upon the dissolution of Trust satisfies an obligation City 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.

Based on the information and representations submitted by Trust, and provided the proposed amendments described above to Plan and the Trust Agreement are adopted, we hold that the income of 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). Accordingly, Trust's income is excludable from gross income under § 115(1) of the Code.

No opinion is expressed on the classification of Trust as a trust or corporation for federal tax purposes. No opinion is expressed concerning the federal tax consequences of the Trust under any other provision of the Code other than those cited above. In particular, no representation is made regarding the federal tax consequences of contributions to or payments from Plan, including (but not limited to) whether contributions to Plan are excludable from the gross income of retirees under section 106 and whether payments from Plan (including reimbursements of medical expenses) are excludable from the gross income of retirees under sections 104 or 105.

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

Sincerely,

Sylvia F. Hunt
Assistant Chief, Exempt Organizations
Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures:

Copy of this letter
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CC: