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Person To Contact:
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CC:TEGE:EOEG:EO2
PLR-155635-09

Date:
March 30, 2010

Legend

Trust =
State =
City =

Dear _____ :

This is in reply to your letter dated November 19, 2009, and subsequent correspondence in which you request various rulings on behalf of the Trust.

FACTS

The City is a State municipal corporation. The City is governed by its City Council. The Trustees and the City adopted a trust agreement (Trust Agreement) creating the Trust in order to provide eligible retirees of the City and their dependents with health care benefits in accordance with the terms of the City's underlying program of Medical and Dental Plans (Plans).

The Trust has a Board of Trustees consisting of five members. Three of the board members are ex officio, consisting of the City's Director of Finance/City Treasurer, the City's Director of Human Resources and the City's Assistant Director of Finance for Accounting and Financial Reporting. Two of the Trustees are elected from those retired employees of the City who actively participate in the Plans by the beneficiaries of the Plans who are of legal age and currently receiving health care benefits under the Plans. Under the terms of the Trust Agreement, the Mayor of the City, with the approval the City Council, may remove and replace a trustee of the Trust at any time, in accordance with the State Municipal Code. In the event of the Trustee's removal or resignation, a successor ex officio Trustee will be appointed by the City. A

successor elected Trustee shall be elected for the unexpired term at a special election called by the City.

Except for investment income, the income of the Trust consists solely of contributions from the City. The Trust will not allow or accept employee contributions, except as might be permitted under the Internal Revenue Code ("Code"). The City represents that there are no current or past employee contributions to the Trust and that the Trust will not accept future employee contributions without a written determination by the Internal Revenue Service ("Service") that the Trust will continue to qualify as an ordinary trust within the meaning of § 7701(a) of the Code and § 301.7701-4(a) of the Procedure and Administration Regulations. The Trust Agreement provides, in general, that no portion of the principal or income of the Trust shall revert to the City, or shall be used for or diverted to any purpose other than to provide health and welfare benefits to retirees and their dependents and to pay reasonable expenses of the Trust.

The Trust assets are only available to pay post-employment health care benefits of the employees of the City and their dependents. The Trust Agreement provides that the Trustees shall receive and accept all contributions and shall hold, reinvest, manage, administer, and distribute property and the increments, proceeds, earnings, and income solely to provide health and welfare benefits to retirees and their dependents. The Trustees may invest the Trust assets in such securities or property as the Trustees deem advisable; provided, however that investments generally shall be so diversified as to minimize the risk of large losses.

No private interests participate in or benefit from the operation of the Trust other than for reasonable payment as providers of goods or services. No amendment of the Trust Agreement by the Trustees shall divert the corpus or income of the Trust to a purpose other than providing post-employment health care benefits. The City will amend the Trust Agreement to provide that upon liquidation or dissolution of the Trust any assets remaining after payment of retirement benefits and expenses shall be distributed to the City for municipal purposes.

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) of the Code. 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 to properly conduct. In addition, pursuant to section 6012(a)(2) of the Code 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 Trust provides health benefits to retired employees of the City, their dependents and survivors. 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) of the Code.

The income of the Trust accrues to the City. No private interests participate in or benefit from the operation of the Trust other than as providers of goods or services. The Trust's dedication of its corpus or income exclusively for the benefit of the retirees and their dependents satisfies an obligation the City has assumed or been assigned with respect to providing health benefits to its employees. The benefit to the City's participating employees and their dependents is incidental to the public benefit. See Rev. Rul. 90-74.

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 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.

The City's contributions to the Trust are to be used to pay retiree health benefits for eligible retired employees and their dependents. The Trustee is charged with the

responsibility of the protection and conservation of the Trust property for the benefit of the beneficiaries of the Trust. The beneficiaries of the Trust cannot share in the discharge of the Trustee'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 a trust under § 301.7701-4(a).

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.

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

(1) As of the effective date of the proposed amendment to the Trust as described above, the income of the Trust will be 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) of the Code. Accordingly, the Trust's income will be excludable from gross income under § 115(1) of the Code.

(2) The Trust is classified as a trust within the meaning of § 7701(a) of the Code and § 301.7701-4(a) of the regulations. The Trust is not required to file an annual income tax return under § 6012(a)(4) of the Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. No opinion is expressed concerning the Federal tax consequences of the Trust under any other provision of the Code other than those specifically cited above. In particular, no representation is made that contributions or premiums paid to the City's Plans or payments of benefits to employees, former employees, retirees, spouses or eligible dependents pursuant to the Plans will be tax-free. The Trust has obtained a ruling concerning only the Federal tax treatment of the Trust's income. That ruling may not be cited or relied upon by the Trust whatsoever as precedent concerning any matter relating to the taxation of contributions or benefits under the Plans. The Federal tax consequences to employees, former employees, retirees, spouses and eligible dependents depend on the terms and operation of the Plans.

This ruling letter 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.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Sylvia F. Hunt
Assistant Branch Chief, EO Branch 2
(Tax Exempt & Government Entities)

Enclosure: copy for § 6110 purposes

cc: