

**Internal Revenue Service**

Department of the Treasury  
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Employer:

Entity:

Area:

Trust:

Agreement:

Covenant:

States:

Dear \_\_\_\_\_ :

This letter responds to a letter from your authorized representative dated June 22, 2011, in addition to supplemental information, submitted on behalf of the Employer, requesting rulings that (1) the Trust's income is excludable from gross income under

§ 115 of the Internal Revenue Code and (2) the Trust is not required to file an annual federal income tax return under § 6012(a)(4) of the Code. The Employer represents the facts as follows.

### FACTS

The Employer was created by the Covenant as a federally-designated Entity for Area, to organize and conduct, *inter alia*, a regional transportation program. The Employer, as specified by the Covenant, is a duly established agency of the States, with such duties and responsibilities so that area governments and government agencies might qualify for all available federal funds.

The Employer consists of commissioners, as designated in the Covenant, who are officials or appointees of the governments of the States and the Area. Each appointed representative serves at the pleasure of the governor or governing body who appointed him. The Board of Commissioners (Board) elects a chairman, vice chairman, secretary, and treasurer from among its membership, with the first two elected from among officials or appointees of the States, and the other officers selected from among board members representing the local governments of the Area. The Board creates and defines the duties of the Employer's executive director, and the Employer's executive committee is authorized to adopt an annual budget.

The Employer has adopted a plan to provide healthcare benefits for eligible full-time and retired employees, along with their eligible spouses and dependents (beneficiaries), as defined by § 152. The plan provides employer-paid health and prescription insurance for the employees of the Employer. Before age 65, retirees eligible for post-employment health benefits are covered the same as the active employees. At 65 years of age, a retiree must enroll in the Medicare program, and the Employer's plan becomes secondary. Retiree health benefits cease upon the death of the retiree; however, the retiree's spouse and dependents may continue on the Employer's plan for 36 months, in accordance with COBRA.

Plan benefits are funded entirely by the Employer through the Trust. The Employer intends to make periodic contributions to the Trust, and intends that payments from the Trust be used exclusively to defray the Employer's share of the cost of retiree healthcare coverage and related administrative expenses. Although the Agreement does not preclude the use of the Trust for payment of healthcare benefits for active employees, that is not the Entity's current intent.

The Employer represents that no private interests participate in, or benefit from, the Trust, except in a manner incidental to the public benefit provided by the Trust.

According to the Agreement, the funds in the Trust are held exclusively to provide benefits under the Employer's healthcare plan to plan participants who are eligible retirees, along with their eligible spouses and dependents, and to defray

expenses of administering the plan and the Trust. Trust income is from Employer contributions and investment earnings. Trust contributions are irrevocable.

The Trust is administered by the Board acting as trustee. The Board establishes Trust investment policy, invests Trust assets, has the discretion to appoint or terminate an investment manager, and directs payments from the Trust. The Board may appoint a directed trustee, who will be responsible for implementing the instructions of, and may be removed by, the Board.

The Employer's executive director, along with the Board, has the authority to amend the Agreement and terminate the Trust. Upon Trust termination, assets of the Trust cannot be distributed to the Employer before satisfaction of all Trust liabilities. In no case will Trust assets (including any remaining federal funds) be distributed to an entity that is not a state, political subdivision of a state, or an entity the income of which is excluded from gross income under section 115(1) of the Code.

#### 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 beneficiaries. Providing health benefits to former public employees constitutes the performance of an essential governmental 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).

The funding and provision of retiree health benefits through the Trust satisfies the obligation of the Employer to provide those benefits; thus, the income of the Trust accrues to the Employer. Any amounts remaining in the Trust after all trust liabilities have been satisfied shall be paid out to the Employer for public purposes. 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. 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 pay health benefits for certain retired employees of the Employer and their eligible spouses and dependents. The Board as trustee is responsible for protecting and conserving the Trust's assets for trust beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of a business for profit. Assuming that the Trust is recognized as a separate entity under § 301.7701-1, we conclude that the Trust is an ordinary trust under § 301.7701-4(a).

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 Trust:

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. Assuming that the Trust is a separate entity under § 301.7701-1, we conclude that the Trust is classified as an ordinary 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