

Internal Revenue Service

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Date:
February 02, 2006

LEGEND
Association =

Trust =

Program =

Trust Agreement =

State =

Dear

This is in reply to a letter dated July 15, 2005, and subsequent correspondence, submitted by Association on behalf of Trust, requesting a ruling that the income of Trust is excluded from gross income under § 115(1) of the Internal Revenue Code.

FACTS

Association is a State non-profit corporation that was created to provide leadership in public education in State and to support school board governance at the district and county levels. Members of Association are public school agencies or other

public agencies. Association is the sponsor of Program. Program, as created under the Trust Agreement, provides health care benefits for retired former employees of public school districts and other public agencies and for their dependents. These benefits are provided pursuant to each participating employer's applicable policy and/or collective bargaining agreements. Program is a multiple employer trust arrangement established to provide economies of scale and efficiency of administration to public agencies. Only an employer that is a state, a political subdivision of a state, or an entity the income of which is excludible from gross income under § 115 of the Code is permitted to participate. Agency members of Association are not required to participate in Program. Each employer that chooses to participate in Program must enter into an adoption agreement under which it agrees to be bound by the Trust Agreement.

Initially, Association will serve as Program Administrator for Program. Association represents that the Trust Agreement will be amended to provide that the Program Administrator can be removed at any time by the participating employers, and that subsequent Program Administrators shall be elected by the participating employers. Trust was created to hold and invest funds contributed to Program. The initial Trustee has been selected by Association. Association represents that the Trust Agreement will be amended to provide that the Trustee can be removed by the participating employers and that a Trustee that resigns or is removed will be replaced by a Trustee elected by the participating employers.

Program is to be funded by employer contributions. In addition, Trust will receive income from the investment of contributed funds. A separate account will be established for each employer. Monies received for Program will be used to pay the cost of providing benefits and administering Program. At no time will any part of the Trust funds be used for, or diverted to, purposes other than for the exclusive benefit of participants under Program and for defraying the expenses of administering Program.

Association represents that the Trust Agreement will be amended to provide that the participating employers can vote to amend or terminate the Trust Agreement. Upon termination of the Trust Agreement, the Trust funds allocated to the separate accounts of individual retirees are used to pay Trust obligations and distributed to the participating retiree to fulfill the obligations of the participating employer under Program. Any overages in the contribution of a participating employer in excess of its obligation to contribute to the separate account of its employees and to contribute toward Trust expenses are returned to the employer.

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 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) 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, as a part of Program, provides health benefits to retired employees of the participating employers in Program, all of which are political subdivisions of a state or entities the income of which is excluded from gross income under § 115(1) of the Code. 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 its participating employers, all of whom are political subdivisions or entities the income of which is excluded from gross income under § 115(1) of the Code. No private interests participate in or benefit from the operation of Trust other than as providers of goods or services. The distribution of remaining funds in the separate accounts of the participating employees to the respective employees upon the termination of the Trust Agreement satisfies an obligation the participating employers have assumed with respect to providing health benefits to their employees. The benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

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

Except as specifically provided otherwise, no opinion is expressed on the classification of Trust as a trust or corporation for federal tax purposes, or the federal tax consequences of any particular transaction, including but not limited to the tax consequences to participants, retirees, or their beneficiaries from any payments received from any plan, trust or fund or compliance with COBRA continuation coverage requirements.

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,

David L. Marshall
Chief, Exempt Organizations
Branch 2
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures;
Copy of this letter
Copy for § 6110 purposes

CC: