

Internal Revenue Service

Department of the Treasury

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Date: September 20, 2001

LEGEND:

Fund =

Date 1 =

Defendants =

Plaintiffs =

Product 1 =

Product 2 =

Foundation =

Association 1 =

Association 2 =

Association 3 =

Investment Manager =

This is in response to a letter dated January 4, 2000, and subsequent correspondence requesting rulings concerning the federal tax status of the Fund. Specifically, the letter requested a ruling that the income earned by the Fund is income excluded from gross income under § 115 of the Internal Revenue Code.

FACTS

The Fund was established on Date 1 to receive the proceeds of settlement agreements between the Defendants and the Plaintiffs, where the Plaintiffs charged the Defendants with violations of state consumer protection, antitrust, and other laws with

regard to goods made from Product 1. The Plaintiffs either are integral parts of states or are governmental bodies that are eligible to exclude income from gross income under § 115. Monies from the Fund will be disbursed to the Plaintiffs, the Foundation, and Association 1.

At the request of the Plaintiffs, the settlement agreements require the establishment of the Foundation under the auspices of Association 1. The Foundation will support educational and other programs associated with the use of Products 1 and 2 by certain classes of product users and educational and disease prevention programs associated with the use of Product 1. In the event that the Foundation is dissolved, its remaining assets will be distributed equally among Associations 1, 2, and 3. The Foundation represents that Associations 1, 2, and 3 are all entities eligible to exclude all of their income from gross income under section 115.

Association 1 will receive monies from the Fund to facilitate the enforcement of the settlement agreements.

The Fund is responsible for investing and accounting for monies paid by the Defendants prior to disbursements to the Plaintiffs, the Foundation, and Association 1. The Fund will be managed pursuant to a written investment policy set forth in the Escrow Agreement entered into on Date 1. The terms of the Escrow Agreement were provided for in the settlement agreements, and the Escrow Agreement was signed by the Defendants and the Plaintiffs. The Fund has hired the Investment Manager to oversee actual management of Fund monies. The Investment Manager will be compensated through a quarterly charge levied on Fund accounts.

LAW AND ANALYSIS

Section 115(1) of the Code excludes from gross income any income derived from the exercise of an essential governmental function and accruing to a State or political subdivision thereof.

When determining if § 115(1) of the Code applies, the Service considers all the facts and circumstances relating to the organization to determine: (1) whether the organization performs an essential governmental function; and (2) whether the income of the organization accrues to a state or political subdivision of a state. The determination whether a function is an essential governmental function depends on the facts and circumstances of each case.

Rev. Rul. 90-74, 1990-2 C.B. 34, concerns an organization formed, operated, and funded by political subdivisions to pool their casualty risks or other risks arising from their obligations concerning public liability, workers' compensation, or employees' health. The ruling states that the income of such an organization is excluded from gross income under § 115(1) of the Code so long as private interests do not participate in the organization or benefit more than incidentally from the organization. The benefit to the employees of the insurance coverage obtained by the member political subdivisions was deemed incidental to the public benefit. Rev. Rul. 90-74 illustrates that § 115 does not apply to an entity's income if there is more than an incidental

private benefit connected with the income.

Rev. Rul. 77-261, 1977-2 C.B. 45, addresses the treatment of income from a fund for the temporary investment of cash balances of a state and its political subdivisions. The fund was authorized by state statute, managed by the state treasurer, and benefitted only the state and its political subdivisions. The ruling reasons that the investment of positive cash balances by a state or a political subdivision thereof in order to receive some yield on the funds until needed to meet expenses is a necessary incident of the power of the state or political subdivision to collect taxes and raise revenue. Rev. Rul. 77-261 holds that the income of a fund, established under a written declaration of trust to pool the temporary investments of the state and its political subdivisions, is excludable from gross income under § 115(1) of the Code. The ruling further notes that the determination of whether a function is an essential governmental function depends on the facts and circumstances of each case. Additionally, the ruling concludes that § 115(1) does not require that the income in question accrue only to a single state, a single political subdivision, or a single governmental entity.

The Fund was established to facilitate the management and investment of monies prior to distribution to the Plaintiffs, the Foundation, and Association 1. This is similar to the activities undertaken in Rev. Rul 77-261, where governmental entities banded together to temporarily invest funds until needed. Thus, the Fund performs an essential governmental function.

In addition to the performance of an essential governmental function, to qualify to exclude income from gross income under § 115, the income of an entity must also accrue to a state or political subdivision of a state. Further, as is described in Rev. Rul. 90-74, § 115 does not apply to an entity's income if there is more than an incidental private benefit connected with the income.

The Fund may disburse monies only to the Plaintiffs, the Foundation, and Association 1. In the event the Foundation is dissolved, its assets will be distributed to Associations 1, 2, and 3. The Plaintiffs are all either integral parts of states or governmental bodies that are eligible to exclude income from gross income under § 115. The Fund has represented that the Foundation and Associations 1, 2, and 3 are all entities eligible to exclude income from gross income under § 115. Thus, all of the Fund's income is used to provide funds for entities eligible to exclude income from gross income under § 115.

Based upon the information provided, the income of the Fund will accrue to integral parts of states or entities eligible to exclude income from gross income under § 115. To the extent that other persons will receive benefits from the Fund, these benefits are not more than incidental. We therefore conclude that the Fund may exclude income from gross income under § 115.

CONCLUSION

Based on the information and representations submitted by the Fund, we hold

that the Fund may exclude income from gross income under § 115.

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

Except as specifically set forth above, no opinion is expressed regarding the federal tax consequences of the transactions described above under any other provisions of the Code or Regulations. In particular, no ruling is expressed as to whether the Fund is a qualified settlement fund under § 1.468B-1.

Sincerely,
Alice M. Bennett
Chief, Branch 3
Office of Associate Chief Counsel
(Financial Institutions and Products)

enclosures:

copy of this letter
section 6110 copy