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Department of the Treasury

Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

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PLR-126890-05

Date:

November 10, 2005

Legend

Taxpayer =

Act =

County =

Plan =

Trust =

System =

Statute =

Dear _____ :

This is in reply to your letter dated May 3, 2005 and subsequent correspondence, in which you request various rulings on behalf of the Taxpayer.

Taxpayer was established pursuant to Act and is a county-level agency. Taxpayer has no taxing authority. Taxpayer is separate from the County's general government and is governed by a three-member board pursuant to Act. The members of Taxpayer's board are appointed by the County's board of commissioners and serve pursuant to provisions of Act.

In order to provide medical benefits for Taxpayer's eligible retirees and their spouses and dependents, Taxpayer has established Plan. Retirees who retired on or after attaining 55 years of age with 25 years of service or 60 years of age with 8 years of service are eligible to participate in Plan. In addition, retirees who submitted a written request for deferred retirement are also eligible to participate in Plan upon attaining age 60.

Plan provides coverage solely for medical care expenses as defined in § 213(d) of the Internal Revenue Code (the "Code"). Plan offers self-funded medical coverage that is administered by an insurance company and that provides benefits that mirror those of an insured product. Alternatively, participants may elect to receive coverage from a PPO or an HMO provided through third-party insurance contracts. There is an open enrollment period each year during which participant elections are made. If a participant is age 65 or older, Medicare will be the participant's primary coverage and coverage under Plan will be supplemental. Plan will reimburse the participant for Medicare Part B premiums. No persons other than eligible retirees of Taxpayer, their spouses or dependents may participate in Plan.

Taxpayer will establish Trust to pre-fund its retiree medical obligations under Plan. The establishment of Trust is authorized by Statute. The board of trustees for System will administer Trust.

Taxpayer will make all contributions to Trust. All contributions are irrevocable and made solely by Taxpayer. No other employers will participate in Trust. No contributions will be made by employees or retirees through salary reduction agreements or otherwise. Trust assets will be used solely for the payment of medical benefits on behalf of eligible retirees of Taxpayer, their spouses and dependents who participate under Plan and for the payment of the cost of administering Plan and Trust. Participants will not receive any amounts in cash or any other taxable or nontaxable benefits. There are no individual participant accounts under Plan.

Taxpayer represents that no portion of the principal or income of Trust may be used or diverted to any purpose other than the exclusive benefit of persons participating in Plan and the payment of reasonable Plan and Trust expenses. Upon termination of

Trust, any assets remaining in Trust will be used solely to meet its obligations to provide health benefits to Taxpayer's retirees, their spouses and dependents who participate in Plan and to satisfy any other remaining debts or liabilities of Trust. Any assets remaining in Trust after meeting its obligations to participants and satisfying any remaining liabilities of Trust shall revert solely to Taxpayer. Taxpayer's board may prospectively amend or terminate Trust at any time.

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 is excludable from gross income for federal income tax purposes under § 115(1). The ruling indicates 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 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.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that the income of an organization formed, funded, and operated by one or more political subdivisions to pool risks (casualty, public liability, workers' compensation, and employees' health) is excluded from gross income under §115(1) of the Code. In this ruling, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

In order for Trust's income to be excluded from gross income under § 115(1) of the Code, its income must be derived from a public utility or the exercise of an essential government function. Trust provides medical benefits to those retired employees of Taxpayer who are eligible to participate in Plan, their spouses, and dependents. Taxpayer is the sole participating employer in Plan and is a political subdivision of a state. Taxpayer's provision of medical benefits to former employees, their spouses and dependents, as specified in the Trust document, constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261 and on Taxpayer's representations, Trust performs an essential governmental function within the meaning of § 115(1).

In addition, Trust's income must also accrue to a state or any political subdivision thereof. Trust assets are to be used for expenditures in providing health care benefits to Plan participants. Payments made to the insurance company either reimburse the

insurance company for health care coverage provided to Plan participants or pay administrative expenses of the insurance company in administering Plan. Any benefit to the insurance company is incidental to the public benefit of Taxpayer's funding of health benefits to Plan participants. Similarly, the benefit to the participating retirees, their spouses and dependents is incidental to the public benefit. See Rev. Rul. 90-74. Accordingly, no private interests will participate in or benefit from the operation of the Trust for purposes of § 115(1). Upon termination of Trust, any assets remaining in Trust are to be used solely to meet Taxpayer's obligations to provide health benefits to Plan participants and to satisfy any other remaining debts or liabilities of Trust. Any Trust assets remaining after meeting these obligations are to revert solely to Taxpayer. Based on Taxpayer's representations, Trust's income accrues to Taxpayer. Taxpayer is a political subdivision of a state, and Trust's income therefore accrues to a state or any political subdivision thereof within the meaning of § 115(1) of the Code.

Section 61(a)(1) of the Code and §1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in Subtitle A, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 106(a) of the Code provides that the gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.106-1 of the regulations states that the gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by the employee, the employee's spouse, or the employee's dependents as defined in §152 of the Code. The employer may contribute to an accident or health plan either by paying the premium on a policy of accident or health insurance covering one or more of the employees, or by contributing to a separate trust or fund which provides accident or health benefits directly or through insurance to one or more of the employees. However, if the insurance policy, trust or fund provides other benefits in addition to accident or health, §106 applies only to the portion of the contributions allocable to accident or health benefits.

Coverage provided under an accident and health plan to former employees and their spouses and dependents is excludable from gross income under §106. See, Rev. Rul. 62-199, 1962-2 C.B. 38; Rev. Rul. 82-196, 1982-2 C.B. 53.

Based on the information submitted and representations by Taxpayer, and contingent upon Taxpayer's executing and filing with the state the Trust document as described in Taxpayer's letter dated September 29, 2005, we conclude as follows:

- (1) The income of Trust is excluded from gross income under § 115(1).

- (2) Contributions paid to Trust by Taxpayer and payments made from Trust which are used exclusively to pay for the accident or health coverage of retired employees and retired employees' spouses and dependents as defined in §152 (determined without regard to §§152(b)(1), (b)(2), and (d)(1)(B)) are excludable from the gross income of retired employees and retired employees' spouses and dependents under §106 of the Code.

No opinion is expressed concerning the Federal tax consequences of Trust under any other provision of the Code other than those specifically stated herein. In addition, no opinion is expressed concerning whether Plan satisfies the nondiscrimination requirements under § 105(h) of the Code. Finally, no opinion is expressed as to the qualified status of Plan, System, or of any account established pursuant to § 401(h) of the Code.

This ruling 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.

Sincerely,

Robin J. Ehrenberg
Senior Counsel, Exempt Organizations Br. 2
(Exempt Organizations/Employment Tax/
Government Entities)
(Tax Exempt & Government Entities)

cc: