

Statute B =

Statute C =

Trust Agreement =

Dear :

This is in reply to a letter dated June 6, 2003, submitted by Corporation 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, and that Trust is not required to file an annual federal income tax return.

#### FACTS

State enacted Statute A to establish a retirement system for municipal employees. Corporation is a non-profit public corporation created by State to administer the retirement programs and health care benefit program authorized by Statute A. A municipality may elect to become participating employers in Corporation but is not required to do so. Plan, the charter document for Corporation, defines the term municipality to include several enumerated municipal entities. Corporation represents that it will amend Plan to require that an entity may become a participating employer in Corporation only if it 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.

Corporation is governed by a board of nine directors. Each participating employer is entitled to select two delegates who each have a vote in the election of Corporation's board of directors. Six of the directors are elected by the delegates. One director, a retiree of a participating employer in Corporation, is appointed by the board and approved by the delegates. Two directors are appointed by the board. The board of Corporation administers the municipal retirement programs and the health care program. It prepares an annual financial and actuarial report for the governor, each member of the legislature and each participating employer.

The board of Corporation is the sole trustee of Trust. Trust was created to hold and invest amounts contributed by participating employers in Program. Program was established in year 1 to provide health benefits for retirees. The participating employers are local municipal entities that have undertaken the obligation, either on their own initiative or as a result of collective bargaining, to provide retirement health benefits to

their employees. Investment of funds in Trust is governed by State Statutes B and C which apply to the investment of public funds.

Program is funded by employer contributions. Monies received for Program by the board constitute funds of Trust to be used to pay the cost of providing benefits and administering Program. Separate accounts are maintained by Trust for each participating employee. State is not a participating employer and does not provide funds of any kind to Trust. The Trust Agreement provides that all participating employers in Program must be municipalities as defined by Plan. Corporation represents that it will amend the Trust Agreement to require that all of Trust's participating employers must be a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under § 115 of the Code. 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.

Board can amend Trust Agreement or terminate Trust at any time. Upon complete termination of Program, 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. No part of the principal or income is distributed to State.

## LAW AND ANALYSIS

### SECTION 115

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 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. 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 provides health benefits to retired employees of the participating employers of System, 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. The distribution of remaining funds in the separate accounts of the participating employees to the respective employees upon the dissolution of Program 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.

## FILING REQUIREMENT

Section 6012(a)(2) provides, in general, that every corporation subject to taxation under subtitle A shall make returns with respect to income taxes under subtitle A. In addition, § 1.6012-2(a)(1) of the Income Tax Regulations (Regulations) provides in part that every corporation, as defined in § 7701(a)(3), subject to taxation under subtitle A of the Code shall make a return of income regardless of whether it has taxable income or regardless of the amount of its gross income.

Section 6012(4) provides, in general, 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. Section 7701(a)(1) and the corresponding Regulations define trusts for purposes of § 6012.

Section 6012 and the Regulations thereunder, require every corporation subject to taxation under subtitle A of the Code to make a return of income. If Trust is classified as a corporation within § 7701(a)(3), § 6012 requires Trust to file returns of income,

regardless that Trust's income is excludable from gross income under § 115(1). See Rev. Rul. 77-261.

If Trust, however, is classified as a trust within § 7701(a)(1), § 6012 does not require Trust to make returns of income when gross income is not \$600 or over. Because Trust's income is excludable from gross income under § 115(1), the trust will not have gross income of \$600 or over. Therefore, Trust will not be required to make returns of income pursuant to § 6012.

## CONCLUSIONS

Based on the information and representations submitted by Trust, we hold as follows.

1. Provided the proposed amendments described above to Plan and Trust Agreement 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).
2. Trust's § 6012 reporting obligations depend on whether Trust is classified as a corporation or trust within § 7701. If Trust is a corporation, it must file an annual income tax return. If Trust is classified as a trust, however, it will not be required to file an annual income tax return because Trust will not have gross income of \$600 or over.

Except as specifically provided otherwise, no opinion is expressed on 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,

---

Barbara E. Beckman  
Assistant 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: