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Department of the Treasury

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LEGEND:

Retirement System =

Trust =

Board =
Program =
State X =
Date A =
Date B =
Year C =

This is in response to a letter dated September 17, 1999, and subsequent correspondence, requesting a ruling concerning the exclusion of income of Trust from gross income under § 115 of the Internal Revenue Code.

FACTS

Retirement System was created by the legislature of State X on Date A, for the purpose of providing for retirement income for public school employees within State X. Membership in Retirement System is mandatory for all public school employees. Employers are required to make regular member contributions for current service credits. In addition to contributions from public elementary, middle, and high schools, contributions from state-owned colleges and universities as well as State X itself (for employees of the Department of Education) are required. The required employer contributions are actuarially determined. Retirement System provides for retirement annuity, disability, and death benefits. Since Year C, employer contributions have included the amount necessary to fund a health insurance premium assistance program for annuitants.

Trust was created by Board pursuant to a statute of State X in order to operate Program. Program is a participant-funded group health insurance program for annuitants, spouses of annuitants, survivor annuitants, and dependents. The General Assembly of State X amended the Retirement Code on Date B, giving the Board the authority to sponsor such a health insurance program as well as the authority to promulgate regulations concerning the health insurance program. All funds related to the health insurance program are maintained and accounted for separately from the Public School Retirement Fund.

The Board, ex officio, acts as the trustee of Trust. The Board consists of fifteen members as follows: (1) the Secretary of Education, ex officio; (2) the State Treasurer, ex officio; (3) two Senators of State General Assembly; (3) two members of the House of Representatives of State General Assembly; (4) the executive secretary of the State X School Boards Association, ex officio; (5) two members appointed by the Governor of State X; (6) three members elected by the active professional members of the Retirement System from among their number; (7) one member elected by the annuitants from among their number; (8) one member elected by the active nonprofessional members of the Retirement System from among their number; and (9) one elected by members of the State X public school boards from among their number. The expenses of administrative employees of the Board are paid by State X.

As trustee, the Board has fiduciary duties to operate Trust solely in the interest of and for the exclusive benefit of the annuitants (and those covered through them) who are participants in Program. The Declaration of Trust will be amended to provide that, upon termination of Trust, the remaining assets of Trust are to be used to pay the expenses of administration of Program as then in effect and to provide continuation of benefits under Program until Trust assets are exhausted.

Funding for Program is provided by the participants, either directly to the providers through a third-party administrator or by automatic deduction from their pension check. If the monthly insurance premium is covered entirely through a combination of the monthly health insurance assistance payment and deductions from the monthly annuity check, then the insurance premium is paid by Retirement System directly to Trust. If the monthly insurance premium cannot be covered through a combination of the health insurance assistance payment and a deduction from the participant's monthly annuity check, the participant pays the full amount of the premium directly to the third-party administrator.

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 governmental function and accruing to a state or political subdivision of a state.

When determining if § 115(1) applies, the Service considers all the facts and circumstances relating to the organization to determine whether the organization performs an essential governmental function and whether the income of the organization accrues to a state or a political subdivision of the state.

Rev. Rul. 90-74, 1990-2 C.B. 34, concerns an organization formed, operated, and funded by political subdivisions to pool their casualty risks and other risks arising from their obligations concerning public liability, workers' compensation, or employees' health obligations. The ruling states that the income of such an organization is excluded from gross income under § 115(1) 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. 77-261, 1977-2 C.B. 45, holds that income from a fund, established under a written declaration of trust by a state, for the temporary investment of positive cash balances of a state and its political subdivisions, is excludable from gross income under § 115(1) of the Code. The ruling reasons that the investment of positive cash balances by a state or political subdivision 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.

Trust was created pursuant to State statute to operate Program for participants in Retirement System. Participation in the Retirement System is mandatory for all individuals employed by or affiliated with public school entities recognized under State X law. Funding for Program is provided by public school entities within State X (in the form of health insurance premium assistance) and by deductions from annuity checks sent to participants. Trust was created by State X to provide a mechanism whereby public school employees, upon retirement, can participate in a group health insurance program. 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.

Under § 115(1) of the Code, income of Trust must accrue to states or their political subdivisions. Upon termination, Trust's remaining assets must be applied by the trustee to provide continuation of benefits under the Program until Trust assets are exhausted. Private interests do not participate in or benefit from income of Trust, other than as provided in Rev. Rul. 90-74. Accordingly, the income of Trust accrues to political subdivisions of states and entities whose income is excludable from gross income under § 115.

HOLDING

Based on the information and representations submitted by Trust, and provided that the dissolution clause in the Declaration of Trust is amended as described above, we hold that the income of Trust is excludable from gross income under § 115(1).

Except as specifically ruled upon above, no opinion is expressed or implied as to the federal tax consequences of the transaction described above under any other provision of the Internal Revenue Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. In accordance with the provisions of a power of attorney currently on file, we are sending a copy of this ruling letter to your authorized representative.

Sincerely,

Assistant Chief Counsel
(Financial Institutions and Products)

By: ____________________
Alice M. Bennett
Chief, Branch 3

enclosures: Copy of letter for section 6110 purposes