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Contact Person:

ID Number:

Telephone Number:

Employer Identification Number:

LEGEND:
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Dear Sir or Madam:

We have considered your ruling request dated March 12, 1999, in which you requested rulings on the proper treatment of the transfer of the assets of a subaccount under a voluntary employees' beneficiary association to the remainder of the trust fund under sections 501(c)(9), 4976(a), 4976(b)(l)(C), 511(a), 512(a)(3)(A), 419,419(A), 419(A)(c), 1 Il(a) and 61(a) of the Internal Revenue Code of 1986, as amended (the Code).

You have represented that you are an employer who has created a voluntary employees beneficiary association (VEBA) that has been recognized as exempt under section 501(c)(9) of the Code. The purpose of the VEBA is to provide a funding mechanism for employee health and welfare benefits provided under the benefits program.

B, your subsidiary, also created and maintained a long-term disability trust, (the"B Trust") also exempt under section 501(c)(9), consisting solely of after-tax employee contributions used to provide long-term disability benefits to participants in its plan.

Effective December 31, 1996, the B Trust was terminated, and its assets transferred to the VEBA. Under the terms of the VEBA, all assets transferred from the B Trust were deposited into a subaccount within the VEBA identified as the B account. Pursuant to the VEBA. a portion of the assets of the B account was to be used to purchase an annuity contract to provide continuing long-term disability benefits to persons receiving benefits under the B Plan on December 31, 1996.

The VEBA further provides that after purchase of this annuity contract, the B account may be used to fund any permissible 501(c)(9) benefits for active employee participants in the VEBA who were also participants under the B Trust.

Former participants in the B Trust who are now active employees of you or your affiliates now receive long-term disability coverage under your VEBA (the "Program"). Long-term disability benefits provided under the Program are substantially equal to long-term disability benefits provided under the B Trust.

284

You represent that it is administratively impossible to trace the assets of the B account to particular contributing employees and former employees. Furthermore, a large percentage of former B Trust participants have long since left your employ and that of your affiliates, and location of such participants would be extremely difficult, if not impossible. Accordingly, you desire to amend the VEBA to transfer the B account assets from the B account to the remainder of the VEBA, and use such transferred assets to provide permissible section 501(c)(9) benefits to all VEBA participants (the "Proposed Transfer and Use").

In a supplemental submission dated February 9. 2000, your representative modified the original request advising that the Proposed Transfer and Use [as originally described] would occur during the 2000 plan year, and that all VEBA assets, including the transferred assets, would be exhausted prior to the end of the 2000 plan year.

Section 501 (c)(9) of the Code provides for exemption from federal income tax of voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such associations or their dependents or designated beneficiaries if no part of the net earnings of such associations inure (other than through such payments) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-4(a) of the Income Tax Regulations provides, in part, that no part of the net earnings of an employees' association may inure to the benefit of any private shareholder or individual other than through the payment of permissible benefits. Whether prohibited inurement has occurred is a question to be determined with regard to all of the facts and circumstances, taking into account the guidelines set forth in this section.

Section 1.501(c)(9)-4(d) of the regulations provides, in part, that it will not constitute prohibited inurement if on termination of a plan established by an employer and funded through an association described in section 501(c)(9) of the Code, any assets remaining in the association, after satisfaction of all liabilities to existing beneficiaries of the plan, are applied to provide, either directly or through the purchase of insurance, life, sick, accident or other benefits pursuant to criteria that do not provide for disproportionate benefits to officers, shareholders or highly compensated employees of the employer.

Section 419A(c)(1) of the Code provides that except as otherwise provided in this subsection, the account limit for any qualified asset account for any taxable year is the amount reasonably and actuarially necessary to fund -

(A) claims incurred but unpaid (as of the close of such taxable year) for benefits referred to in subsection (a) and

(B) administrative costs with respect to such claims.

Section 4976(a) of the Code imposes an excise tax on an employer equal to 100% of any disqualified benefit provided by an employer-maintained welfare benefit fund.

Section 4976(b)(l)(C) of the Code provides that the term "disqualified benefit" includes any portion of a welfare benefit fund reverting to the benefit of the employer.

285

Section 511 (a) of the Code imposes a tax on the unrelated business income of organizations described in sections 401(a) and 501(c).

Section 512(a)(3)(A) of the Code states that, in the case of certain types of exempt organizations, including VEBAs exempt under section 501(c)(9) of the Code, the term "unrelated business taxable income" means the gross income of the organization (excluding any exempt function income), less the deductions allowed by law which are directly connected with the production of the gross income (excluding exempt function income) both the gross income and the deductions taken into account under this paragraph must be computed with certain modifications relating to the calculation of net operating losses and charitable contributions.

Section 512(a)(3)(B) of the Code states that, for purposes of subparagraph (A), the term "exempt function income" means the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid. Such term also means all income (other than an amount equal to the gross income derived from any unrelated trade or business regularly carried on by such organization) which is set aside either(i) for a charitable purpose specified in section 170(c)(4) of the Code, or (ii) to provide for the payment of life, sick, accident or other benefits.

Section 512(a)(3)(E) of the Code provides that, in the case of certain types of exempt organizations, including VEBAs, no amount set aside to provide for the payment of life, sick, accident or other benefits may be taken into account under section 512(a)(3)(B)(ii) to the extent that the aggregate amount set aside for these purposes exceeds the account limit determined under section 419A, reduced by any reserve for post-retirement medical benefits described in section 419A(c)(2)(A).

Section 61(a) of the Code provides that, unless otherwise excepted, gross income includes all income from whatever source derived.

Section 111 (a) of the Code provides that gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by Chapter 1 of the Code. That section, in part, codifies the "tax benefit rule". Generally, the tax benefit rule requires the inclusion in income of certain amounts that were deducted in a prior year and that generated a tax benefit through a reduction in the amount of tax liability in the prior tax year. Estate of Block v. Comm'r, 39 B.T.A. 338 (1939), aff'd sub nom. Union Trust Co. v. Comm'r, 111 F.2d 60 (7th Cir. 1939), cert. denied, 311 US. 658 (1940); Rev. Rul. 85-186, 1985-2 C.B. 84. In Hillsboro Nat'l Bank v. Comm'r, 460 U.S. 370 (1983), the Supreme Court, in part, held that income may arise under the tax benefit rule even though there is no actual recovery of funds that were previously deducted, if an event occurs that is "fundamentally inconsistent" with the premise on which a deduction was taken in a prior year.

The Proposed Transfer and Use involves a transfer of assets between sub-accounts of the VEBA only. Therefore, there is no reason to view the Proposed Transfer and Use as a reversion to the employer for purposes of the tax imposed by section 4976 of the Code.

286

Since the B Trust consisted solely of after-tax employee contributions and earnings thereon, which were not deductible by the employer, the B account contains only amounts attributable to contributions to the Trust that were not "allowable as a deduction under section 419 for the taxable year or any prior taxable year" within the meaning of section 4976(b)(3) of the Code. Accordingly, pursuant to that section, Code section 4976(b)(l)(C) does not apply to any portion of the B Trust account that may revert to you.

Because the assets will be used to provide for the payment of life, sick, accident or other permissible benefits under section 512(a)(3)(E) of the Code, the VEBA will neither be subject to tax on unrelated business income under section 511. nor violate the inurement proscription of section 1.501(c)(9)-4(d) of the regulations, either as a result of the asset transfer or investment income that is attributable to the transferred assets. Furthermore, the transferred assets can be taken into account in determining exempt function income to the full extent of the transfer, because the transferred assets will not result in an amount of assets set aside in excess of the account limit determined under section 419(A) of the Code.

Since no amounts attributable to contributions to the B Trust were allowable as a deduction when made, and neither you nor B took deductions in any taxable year with respect to those amounts, section 111 is irrelevant to the proposed transaction: the proposed use of funds in the B account cannot be "fundamentally inconsistent" with the premise on which a deduction was taken in a prior year because no deduction with respect to amounts in the B Trust was ever taken. Therefore, the proposed use of assets should not result in the realization or recognition of gross income by you under section 61.

The assets transferred plus the remainder of the VEBA assets will not result in an amount in excess of the amount that is reasonably and actuarially necessary to fund claims incurred by the Program in the 2000 plan year since all funds will be exhausted prior to the end of the plan year.

Under section 419A(c)(1) of the Code, the assets will exceed the qualified asset account limit if, as of the close of the year, the assets exceed the amount reasonably and actuarially necessary to fund claims incurred but not paid as of the close of the taxable year. Given that the VEBA will have no assets as of the close of the year, the assets will not exceed the account limit. Accordingly, the proposed transfer will not cause the qualified asset account limit of section 419A(c)(1) to be exceeded.

Based on the information submitted, and the representations made therein, we rule as follows:

1. The Proposed Transfer and Use will not affect the exempt status of the VEBA under section 501(c)(9) of the Code.

2. The Proposed Transfer and Use will not be considered a prohibited reversion under section 4976 of the Code: therefore, you will not be subject to a 100% excise tax under section 4976 of the Code.

3. The Proposed Transfer and Use will not subject the VEBA to tax on unrelated business income under section 511 (a) of the Code.

4. The Proposed Transfer and Use will not cause the qualified asset account limit of section 419A(c)(1) to be exceeded.

287

5. The Proposed Transfer and Use will not result in the realization or recognition of gross income to you, the VEBA, or any participant or beneficiary thereunder.

Because this ruling could help resolve future questions about your federal income tax status, you should keep it in your permanent records.

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

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Robert C. Harper, Jr.

Robert C. Harper, Jr.
Chief, Exempt Organizations
Technical Branch 3

288