DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

200126035

Date: APR -3 2001

Contact Person:

Identification Number:

Telephone Number:

UIL: 4976.00-00
511.00-00

T:EO:B2

X =

Employer Identification Number:

Dear Sir or Madam:

This is in reply to your letter of June 20, 2000, concerning the reversion of X's assets to you as the sponsoring employer of a welfare benefit plan.

You have been recognized as exempt under section 501 (c)(3) of the Internal Revenue Code and are other than a private foundation within the meaning of section 509(a) because you are a hospital within the meaning of section 509(a)(l) and l70(b)(1)(A)(iii).

You established X to provide post-retirement benefits to your employees. X has been recognized as exempt under section 501 (c)(9) of the Code.

Because of changes in the government policy in determining capitation rates, your for-profit subsidiaries have ceased operations. These subsidiaries never generated a profit or taxable income and never contributed any monies to the benefit plan. Employees of the for-profit subsidiaries were not eligible to participate in X. X currently has only a few remaining covered participants. You propose to establish a new plan for the benefit of the remaining participants and will fund it with the amount which has been determined by an actuary to be adequate to meet all future claims. You will then amend X's trust documents to permit the reversion of its remaining assets to you as the sponsoring employer and it will then be terminated.

You have requested rulings that the return of surplus assets to you will not retroactively revoke X's tax-exempt status nor trigger the imposition of the section 4976 excise tax on you. Further, you have requested that we rule that the reversion of assets will not be taxed as unrelated business income to either X or yourself.

Section 501(c)(9) of the Code provides for the 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 association or their dependents or designated beneficiaries if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

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Section 1501(c)(9)-I of the Income Tax Regulations provides that for an organization to be described in section 501 (c)(9), it must be an employees' association; membership in the association must be voluntary; the organization must provide for the payment of life, sick, accident, or other benefits to its members; and there can be no inurement (other than by payment of permitted benefits) to the benefit of any private shareholder or individual.

Section 1.501 (c)(9)-4(a) of the regulations provides 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 the facts and circumstances.

Section 1.50l1c)(9)-4(d) of the regulations provides 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), any assets remaining in the association, after the 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 within the meaning of section l.50l(c)(9)-3 pursuant to criteria that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees of the employer. Similarly, a distribution to members upon the dissolution of the association will not constitute prohibited inurement if the amount distributed to members are determined pursuant to the terms of a collective bargaining agreement or on the basis of objective and reasonable standards which do not result in either unequal payment to similarly situated members or in disproportionate payments to officers, shareholders, or highly compensated employees of any employer contributing to or other funding the employees' association. Except as otherwise provided in the first sentence of this paragraph, if the association's corporate charter, articles of association, trust instrument or other written instrument by which the association was created, as amended from time to time, provides that on dissolution its assets will be distributed to its member's contributing employers, or if in the absence of such provision the law of the state in which the association was created provides for such distribution to the contributing employers, the association is not described in section 501 (c)(9).

Section 511 (a) of the Code imposes a tax on the "unrelated business taxable income" of organizations described in section 501 (c).

Section 512(a)(l) of the Code defines the term unrelated business taxable income as gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it less allowable deductions directly connected with the carrying on of such trade or business both computed with the modifications provided in section 512(b).

Section 513(a) of the Code provides that the term "unrelated trade or business" means any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

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

Section 4976(b)(l)(C) of the Code defines "disqualified benefit" to include any portion of a welfare benefit fund reverting to the benefit of the employer.

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Re:

The information submitted establishes that because of an adverse change in government funding for your health care programs, you wish to use X's assets to continue your programs. Therefore, you will establish a new trust to continue to provide benefits to the few remaining participants in the welfare benefit plan and terminate X's operations. The remaining funds held by X will revert to you to be used to carry on your own charitable programs.

Because upon the dissolution of X, some of the assets will be distributed to you, X will be disqualified under section 50l(c)(9). See section l.50l(c)(9)-4(d) of the regulations. Although the amendment of X's trust documents and transfer of assets will affect its tax-exempt status, they will not affect, in any manner, its tax-exempt status prior to the adoption of the proposed Amendment and subsequent transfer of assets.

As a general rule the return of any portion of the funds held in a welfare benefit fund for the benefit of an employer is a disqualified benefit and subjects the plan sponsor to the section 4976(a)(2) excise tax. However, the section 4976 excise tax was enacted to establish a meaningful sanction that would prohibit an employer from accumulating funds in a qualifying trust on a tax free basis and subsequently modifying the plan so it would cease to qualify for exemption. It was felt the previously existing sanctions, loss of exemption or deductions from future contributions were insufficient determents. But no tax deduction is possible for an exempt organization for a contribution to a VEBA (other than in connection with an unrelated trade or business), and earnings on amounts held by the tax-exempt employer are not taxed whether or not transferred to a VEBA. In the case of a tax-exempt employer, therefore, we conclude that amounts contributed to a fund, unless directly connected with an unrelated trade or business are "not allowable as a deduction under section 419" within the meaning of section 4976(b)(3). Accordingly, section 4976(b)(l)(C) does not apply to any assets that may revert to you.

Accordingly, based on the information submitted and the representations you have made we rule that the return of surplus assets to you will not retroactively revoke X's tax-exempt status under section 50l(c)(9) of the Code nor trigger the imposition of the section 4976 excise tax. Further, the reversion of assets will not be taxed as unrelated business income to either X or yourself.

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.

We are informing the Ohio TE/GE Customer Service Office of this ruling. Because this letter could help resolve any questions about your exempt status, a copy of it should be kept in your permanent records.

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

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2

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