

## Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

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### LEGEND:

Taxpayer =

Trust=

Council =

Holding Company =

Insurance Company =

Year A =

Year B =

Year C =

Year D =

Date A =

Date B =

Date C =

n=

p=

q=

Dear \_\_\_\_\_ :

This is in response to the ruling request dated June 20, 2000, on behalf of Trust, requesting a ruling regarding the applicability of section 4976 to the payment by Trust of certain amounts to members of Trust (Members). Taxpayer is a Member, and joined in the ruling request by letter dated January 23, 2001. The ruling request was further supplemented by submissions dated March 2, 2001, April 23, 2001, and August 24, 2001.

### FACTS

Trust provided group insurance coverage and other benefit programs to Members and their employees. Trust was originally established in Year A as two separate trusts, one providing hospital-medical insurance, and the other providing life insurance. In Year B, these two trusts were combined into Trust. Trust was designed to act as a conduit for payment of insurance premiums. Members of Trust consist primarily of firms from constituent chapters of Council. Some Members are companies with employees and others are sole proprietors.

Members contributed to Trust and, in turn, Trust purchased group policies from insurance carriers.

In Year C, Trust discontinued offering medical, dental, and life insurance coverage. As of Date A, Trust ceased offering long-term disability insurance. At the beginning of Year D, only approximately \$n remained in Trust.

Insurance Company was the underwriter for Trust's long-term disability insurance. All of Trust's premium payments to insurance carriers were paid with monies contributed by Members. No portion of any of the premium payments was paid by employees of Members.

It is represented that Trust is and has always been part of a ten or more employer plan described in section 419A(f)(6). It is further represented that neither Trust, nor any of the plans of which Trust is a part, maintains or ever maintained experience-rating arrangements with respect to individual employers. Your application indicates that you are not requesting a ruling on the issue of whether Trust satisfies the section 419A(f)(6) exception for ten or more employer plans, and we are not ruling on that issue. Rather, in addressing the issue raised in your application (the applicability of section 4976(b)(1)(C)), we are relying on the representation that Trust satisfies the section 419A(f)(6) exception.

While participating in Trust, each Member was part of a group insurance pool under a policy issued by Insurance Company, of which Trust was the policyholder. Members made contributions to Trust on a monthly basis, and these contributions were forwarded, after a fee was deducted for Trust expenses, to Insurance Company. When a Member withdrew from Trust, either by notice or by not paying a premium, no distributions were made by Trust to either the employer or its employees, except for the payment to providers of medical or disability claims that were covered at the time of withdrawal under the group insurance policies provided by Trust. Thus, all amounts contributed by Members for disability insurance were used either to pay Insurance Company (which paid only disability claims) or for Trust expenses.

Prior to Year D, Insurance Company was a mutual insurance company. On Date B, Insurance Company recorded its intent to demutualize the company and reorganize as a stock insurance company. In Year D, Insurance Company's policyholders voted to approve the demutualization. The terms of the demutualization plan provided that Insurance Company's policyholders as of Date B would receive shares of stock in Holding Company. To this end, on Date C, Trust was issued p shares of Holding Company common stock (Demutualization Proceeds) on account of its status as a policy holder. The value of these shares is estimated at over \$q.

To wind up Trust's business in order to terminate, Trust would like to pass the Demutualization Proceeds on to Members on a pro rata basis. Generally,

Members would receive Holding Company common stock, but some Members with a small interest may be partially compensated in cash.

### RULING REQUESTED

The payment of Demutualization Proceeds by Trust to Taxpayer will not result in Taxpayer incurring an excise tax pursuant to Code section 4976(b)(1)(C).

### LAW AND ANALYSIS

Section 419(a) of the Code provides that contributions paid or accrued by an employer to a welfare benefit fund are not deductible under Chapter 1 of the Code but, if they would otherwise be deductible, are (subject to the limitation of section 419(b)) deductible under section 419 for the taxable year in which paid.

Section 419(e)(1) of the Code provides that the term "welfare benefit fund" means any fund that is part of a plan of an employer, and through which the employer provides welfare benefits to employees or their beneficiaries. Section 419(e)(3)(B) defines "fund" to include a trust that is not exempt from tax under Chapter 1.

Section 419A(f)(6)(A) of the Code provides that Subpart D of Chapter 1 of Subtitle A of the Code (consisting of sections 419 and 419A) shall not apply to any welfare benefit fund that is part of a ten or more employer plan. However, section 419A(f)(6)(A) further provides that this exception does not apply to any plan that maintains experience-rating arrangements with respect to individual employers. Section 419A(f)(6)(B) of the Code provides that the term "ten or more employer plan" means a plan to which more than one employer contributes and to which no employer normally contributes more than ten percent of the total contributions contributed under the plan by all employers.

Section 4976(a) of the Code imposes an excise tax in the amount of 100 percent of the amount of any disqualified benefit provided by a welfare benefit plan. Section 4976(b)(1) provides that the term "disqualified benefit" means --

(A) any post-retirement medical benefit or life insurance benefit provided with respect to a key employee if a separate account is required to be established for such employee under section 419A(d) and such payment is not from such account,

(B) any post-retirement medical benefit or life insurance benefit provided with respect to an individual in whose favor discrimination is prohibited unless the plan meets the requirements of section 505(b) with respect to such benefit (whether or not such requirements apply to such plan), and

(C) any portion of a welfare benefit fund reverting to the benefit of the employer.

Section 4976(b)(3) of the Code provides that section 4976(b)(1)(C) does not apply to any amount attributable to a contribution to the fund that is not allowable as a deduction under section 419 for the taxable year or any prior taxable year.

Trust is a welfare benefit fund within the meaning of section 419(e)(1), because it is part of an employer plan, and Taxpayer and other Members provide welfare benefits to their employees through Trust.

It is represented that Trust is part of a ten or more employer plan to which the exception provided by section 419A(f)(6) applies. Based upon that representation, Taxpayer's contributions to Trust 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 section 4976(b)(3), section 4976(b)(1)(C) does not apply to amounts attributable to those contributions, including any payment of the Demutualization Proceeds by Trust to Taxpayer.

#### CONCLUSION

Pursuant to section 4976(b)(3), section 4976(b)(1)(C) does not apply to the payment of Demutualization Proceeds by Trust to Taxpayer.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the transaction described above under any provision of the Code. Specifically, this ruling addresses neither of the following issues: (1) whether Trust is in fact a ten or more employer plan to which the exception provided under section 419A(f)(6) applies; and (2) whether the payment of Demutualization Proceeds to Taxpayer will result in the realization and recognition of gross income to Taxpayer under section 61.

Sincerely,  
MARK SCHWIMMER  
Senior Technician Reviewer  
(Employee Benefits)  
Division Counsel/Associate Chief Counsel  
(Tax Exempt and Government Entities)