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TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

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

Uniform Issue List
501.09-01
512.09-03
419.03-00
419.12-07

Date:

DEC 18 2002

Contact Person:

Identification Number:

Telephone Number:

T:EO:B4

Employer Identification Number:

Legend:

M =
N =
O =

Dear Sir or Madam:

We have considered the ruling request dated July 12, 2001, as modified by the letter of December 16, 2002, both submitted on M's behalf by its authorized representative, wherein M requested that the Service rule as follows:

(1) The provision of supplemental unemployment and medical benefits by M in accordance with the terms of the Supplemental Benefits Plan will not result in the provision of benefits other than "life, sick, accident or other benefits" within the meaning of section 501(c)(9) of the Internal Revenue Code.

(2) Contributions to M to provide for supplemental unemployment and medical benefits will be deductible by employers who are signatory to collective bargaining agreements without regard to the reserve limits imposed by sections 419 and 419A of the Code.

(3) Investment income earned by M attributable to contributions for supplemental unemployment and medical benefits will be considered "exempt function income" within the meaning of section 512(a)(3)(B) of the Code.

Facts:

M is a multiemployer plan and an employee benefit plan as defined in sections 3(3) and 3(37) of the Employee Retirement Income Security Act (ERISA). M is also exempt from federal income tax as a voluntary employees' beneficiary association ("VEBA") described in section 501(c)(9) of the Code. In addition, M is a collectively bargained joint-trusteed fund organized

and operated pursuant to the provisions of section 302(c) of the Labor Management Relations Act, 29 U.S.C. sec. 186(c).

M provides health, dental, and vision benefits to eligible employees and their dependents pursuant to its trust and plan of benefits. M is jointly sponsored by N, a labor union local, and O, an association of employers which contributes to M pursuant to applicable collective bargaining agreements. N is exempt from federal income tax as a labor organization described in section 501(c)(5) of the Code. N represents individuals who are employed by employers who belong to O for the purposes of collective bargaining. N negotiates with O the terms and conditions of the employees' employment in accordance with federal labor law. More than 90% of the employees who are eligible to receive benefits from M are also covered by the collective bargaining agreements between O and N.

M is governed by a Board of Trustees ("Trustees") consisting of two N representatives and two O representatives. The Trustees are permitted under the Declaration of Trust to amend the Trust. The Trust will be amended to provide supplemental payment benefits to participants. The terms of the Supplemental Benefits Plan are described in a separate plan document, as outlined below.

In 1998, N and O negotiated a framework for the Supplemental Benefits Plan. Pursuant to the Plan's terms, benefit payments provided to participants will include supplemental unemployment benefits and supplemental medical benefits.

The Supplemental Benefits Plan provides that the contribution rate for participating employers is set by collective bargaining and may change periodically. An employee's credit balance is equal to the specified rate multiplied by the number of hours worked for which contributions were received (plus interest and less allocable administrative expenses) minus any Supplemental Benefits payments made. In order to be entitled to receive a Supplemental Unemployment Benefit or Supplemental Medical Benefit, an employee must have a credit balance of at least $2,500.

The Plan sets forth the various criteria for eligibility for the Supplemental Unemployment Benefit. The amount of benefit shall be $150 per week until the employee has collected $2,500 from M in unemployment benefits or his credit balance falls below $2,500, whichever occurs first. In the event the employee is receiving partial State unemployment benefits, the amount of benefit from the Plan will be prorated accordingly.

The section of the Plan dealing with Supplemental Medical Benefits states that, "In the event that an eligible employee with a credit balance of at least $2,500, or his eligible dependents require economic assistance to meet medical expenses – such as the deductibles, co-pay requirements, or amounts that exceed the maximum receivable sums under the Welfare Plan – the Trustees, on appropriate application by the employee, may make such payments to the extent that the need continues and until the employee's credit balance falls below $2,500."

Law and Analysis (Issue #1)

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

Section 1.501(c)(9)-3(a) of the Income Tax Regulations provides that a VEBA must provide for the payment of life, sick, accident, or other benefits. Further, an organization is not described in Code section 501(c)(9) if it systematically and knowingly provides benefits (of more than a de minimis amount) that are not permitted by paragraphs (b), (c), (d), or (e) of this section.

Section 1.501(c)(9)-3(d) of the regulations provides that the term "other benefits" includes only benefits that are similar to a life, sick, or accident benefit. A benefit is similar to such permissible benefit if (1) it is intended to safeguard or improve the health of a member or a member's dependents, or (2) it protects against a contingency that interrupts or impairs a member's earning power.

Section 1.501(c)(9)-3(e) of the regulations states, in providing examples of "other benefits", that these include "any benefit provided in the manner permitted by paragraphs (5) et seq. of sec. 302(c) of the Labor Management Relations Act of 1947, 61 Stat. 136, as amended, 29 U.S.C. 186(c) (1979)." Paragraph (e) further states that "other benefits" includes vacation benefits, the provision of child care facilities, income maintenance payments in the event of economic dislocation, temporary living expense loans and grants at times of disaster, supplemental unemployment compensation benefits (as defined in Code section 501(c)(17)), and educational or training benefits or courses.

The Supplemental Benefits Plan provides supplemental unemployment benefits and supplemental medical benefits under the terms and conditions described above. The supplemental unemployment benefit is a permissible benefit pursuant to section 1.501(c)(9)-3(e) of the regulations. The supplemental medical benefit is permissible under section 1.501(c)(9)-3(a). Accordingly, these provisions of the Plan should not jeopardize the tax exempt status of M under section 501(c)(9) of the Code.

Law and Analysis (Issue #2)

Section 419(a) of the Code provides that contributions paid or accrued by an employer to a welfare fund shall not be deductible under Chapter 1 of the Code but if they would otherwise be deductible such contributions shall (subject to the limitations of subsection (b)) be deductible under section 419 for the taxable year in which paid. Section 419(b) provides that the amount of the deduction allowable under subsection (a) for any taxable year shall not exceed the welfare benefit fund's qualified cost for the taxable year. Section 419(c) provides that the term "qualified cost" means the sum of (A) the qualified direct cost for such taxable year, and (B)

subject to the limitation of section 419A(b), any addition to a qualified asset account for the taxable year minus (c) after tax income.

Section 419(e)(1) of the Code provides that the term "welfare benefit fund" means any fund--

(A) which is part of a plan of an employer, and
(B) through which the employer provides welfare benefits to employees or their beneficiaries.

Section 419(e)(2) of the Code provides that the term "welfare benefit" means any benefit other than a benefit with respect to which--

(A) section 83(h) applies,
(B) section 404 applies (determined without regard to section 404(b)(2)), or
(C) section 404A applies.

Section 419(e)(3) of the Code provides, in pertinent part, that the term "fund" means any organization described in paragraph (7), (9), (17), or (20) of section 501(c).

Section 419A(a) of the Code provides that for purposes of this subpart and section 512 of the Code, the term "qualified asset account" means any amount consisting of assets set aside to provide for the payment of-

(1) disability benefits
(2) medical benefits
(3) SUB or severance pay benefits, or
(4) life insurance benefits.

Section 419A(f)(5) of the Code provides that no account limits shall apply in the case of any qualified asset account under a separate welfare benefit fund (A) under a collective bargaining agreement, or (B) an employee pay-all plan under section 501(c)(9).

Section 7701(a)(46) of the Code states that in determining whether there is a collective bargaining agreement between employee representatives and one or more employers, the term "employee representative" shall not include any organization more than one-half of the members of which are employees who are owners, officers, or executives of the employer. An agreement shall not be treated as a collective bargaining agreement unless it is a bona fide agreement between bona fide employee representatives and one or more employers.

Section 1.419A-2T, Q&A-1 of the temporary regulations provides, in part, that neither contributions to nor reserves of a welfare benefit fund maintained pursuant to a collective bargaining agreement shall be treated as exceeding the otherwise applicable limits of section 419(b), 419A(b), or 512(a)(3)(E) until the date 3 years after the issuance of final regulations concerning the limits for collective bargained welfare benefit funds.

Section 1.419A-2T, Q&A-2, of the temporary regulations defines a welfare benefit fund maintained pursuant to a collective bargaining agreement and states:

(1) For purposes of Q&A-1, a collectively bargained welfare fund is a welfare benefit fund that is maintained pursuant to a an agreement which the Secretary of Labor determines to be a collective bargaining agreement and which meets the requirements of the Secretary of the Treasury as set forth in paragraph (2) below.

(2) Notwithstanding a determination by the Secretary of Labor that an agreement is a collective bargaining agreement, a welfare benefit fund is considered to be maintained pursuant to a collective bargaining agreement only if the benefits provided through the fund were the subject of arm's length negotiations between the employee representatives and one or more employers, and if such agreement between the employee representatives and one or more employers satisfies section 7701(a)(46) of the Code. Moreover, the circumstances surrounding a collective bargaining agreement must evidence good faith bargaining between adverse parties over the welfare benefits to be provided through the fund. Finally, a welfare benefit fund is not considered to be maintained pursuant to a collective bargaining agreement unless at least 50 percent of the employees eligible to receive benefits under the fund are covered by the collective bargaining agreement.

(3) In the case of a collectively bargained welfare benefit fund, only the portion of the fund (as determined under allocation rules to be provided by the Commissioner) attributable to employees covered by a collective bargaining agreement, and from which benefits for such employees are provided, is considered to be maintained pursuant to a collective bargaining agreement.

(4) Notwithstanding the preceding paragraphs and pending the issuance of regulations setting account limits for collectively bargained welfare benefit funds, a welfare benefit fund will not be treated as a collectively bargained welfare benefit fund for purposes of Q&A-1 if and when, after July 1,1985, the number of employees who are not covered by a collective bargaining agreement and are eligible to receive benefits under the fund increases by reason of an amendment, merger, or other action of the employer or the fund. In addition, pending the issuance of such regulations, for purposes of applying the 50 percent test of paragraph (2) to a welfare benefit fund that is not in existence on July 1, 1985, "90 percent" shall be substituted for "50 percent".

The collective bargaining agreements with N mandate that the employers make contributions to M to allow M to provide benefits to its participants. M has represented that more than 90% of employees eligible to receive benefits from M are covered by the collective bargaining agreements. No owners, executives, or officers of any employer are covered by M.

The information provided concerning the negotiations between O and N evidences the arm's length nature of the collective bargaining process. M has represented that the Secretary of Labor would hold that the agreements between N and O are collective bargaining agreements.

Based on the information provided, we conclude that the Supplemental Benefits Plan is maintained pursuant to collective bargaining agreements within the meaning of section 1.419A-2T, Q&A-2 of the regulations. Because the supplemental benefits are being provided pursuant to a collective bargaining agreement between N and each employer, pursuant to Code section 419(f)(5)(A), there are no account limits imposed on the portion of the funds attributable to employees covered by a collective bargaining agreement and from which benefits for such employees are provided. Pursuant to section 1.419A-2T, Q&A-1 of the regulations, contributions to a collectively bargained welfare benefit fund shall not be treated as exceeding the limits of section 419(b). Therefore, contributions to M to provide benefits for collective bargaining employees under the Supplemental Benefits Plan should be deductible by employers who are signatory to the collective bargaining agreements without regard to the reserve limits imposed by sections 419 and 419A.

Law and Analysis (Issue #3)

Section 511 of the Code imposes a tax on the unrelated business taxable income (defined in section 512) of organizations exempt from tax under section 501(c).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" to mean the gross income derived by any organization from any unrelated trade or business (defined in section 513) regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

Section 513(a) of the Code provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption.

Section 512(a)(3)(A) of the Code provides that in the case of an organization described in section 501(c)(9), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the deductions allowed by Chapter 1 which are directly connected with the production of the gross income (excluding exempt function income), both computed with the modifications set forth in certain paragraphs of section 512(b).

Section 512(a)(3)(B) of the Code provides 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 (other than an amount equal to the gross income derived from any related trade or business regularly carried on by such organization computed as if the organization were subject to section 512(a)(1)), which is set aside, in the case of a section 501(c)(9) organization, to provide for the payment of life, sick, accident, or other benefits. If, during the taxable year, an amount which is attributable to income so set

aside is used for a purpose other than that just described, such amount shall be included under subparagraph (a), in unrelated business taxable income for the taxable year.

Section 512(a)(3)(E)(i) of the Code provides that in the case of an organization described in section 501(c)(9), a set aside for the payment of life, sick, accident, or other benefits may be taken into account under section 512(a)(3)(B) only to the extent that such set aside does not result in an amount of assets set aside for such purpose in excess of the account limit determined under section 419A for the taxable year (not taking into account any reserve described in section 419A(c)(2)(a) for post-retirement medical bills).

Section 1.512(a)-5T, Q&A-3(a) of the regulations provides, in part, that the amounts set aside in a VEBA as of the close of a taxable year to provide for payment of life, sick, accident, or other benefits may not be taken into account for purposes of determining "exempt function income" to the extent that such amounts exceed the qualified asset account limit, determined under Code sections 419A(c) and 419A(f)(7), for such taxable year of the VEBA.

Section 1.512(a)-5T, Q&A-3(b) of the regulations provides, in part, that the unrelated business taxable income of a VEBA for a taxable year generally will equal the lesser of two amounts: the income of the VEBA for the taxable year (excluding member contributions); or, the excess of the total amount set aside as of the close of the taxable year (including member contributions and excluding certain assets with a useful life extending beyond the end of the taxable year to the extent they are used in provision of welfare benefits) over the qualified asset account limit (calculated without regard to the otherwise permitted reserve for post-retirement medical benefits) for the taxable year.

The gross income of M will be set aside to provide for life, sick, accident, or other benefits, and as a result will constitute exempt function income within the meaning of section 512(a)(3)(B). The amount of such set aside will not be in excess of the maximum amount permitted by section 1.512(a)-5T, Q&A-3(b) of the regulations, such amount being determined by reference to the account limit, because M's qualified asset account will not have an account limit.

Rulings:

Based on the foregoing, we rule as follows:

1. The provision of supplemental unemployment and medical benefits by M in accordance with the terms of the Supplemental Benefits Plan will not result in the provision of benefits other than "life, sick, accident or other benefits" within the meaning of section 501(c)(9) of the Code. Accordingly, the implementation of this Plan with regard to these benefits will not jeopardize the tax exempt status of M.

2. Contributions to M to provide for supplemental unemployment and medical benefits, as described above, will be deductible by employers who are signatory to collective bargaining agreements without regard to the reserve limits imposed by sections 419 and 419A of the Code.

3. Investment income earned by M attributable to contributions for supplemental unemployment and medical benefits will be considered "exempt function income" within the meaning of section 512(a)(3)(B) of the Code. Accordingly, M will not have unrelated business taxable income under section 512(a)(3)(A) from such earnings.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon M's exempt status should be reported to the Ohio Tax Exempt and Government Entities (TE/GE) Customer Service Office. The mailing address is: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The telephone number there is 877-829-5500 (a toll free number).

Pursuant to a Power of Attorney on file in this office, we are sending a copy of this letter to your authorized representative.

We are also sending a copy of this ruling to the Ohio TE/GE Customer Service Office. Because this letter could help resolve any questions about M's exempt status, it should be kept with M's permanent records.

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

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.

Thank you for your cooperation.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organization
Technical Group 4