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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

SIN 0501.09-00
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Contact Person:

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Telephone Number: XXXXXXXXXXXXXXXXXX
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In Reference to:
OP:E:EO:T:3

Date: OCT 26 1999

Employer Identification Number: XXXXXXXXXX

Legend:
X= XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
Y= XXXXXXXXXXXXXXXXXXXXXXX
Z= XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

Dear Sir or Madam:

This is in response to your letter dated December 21, 1998, as supplemented by subsequent correspondence. You requested six rulings on a proposed transaction. These six rulings involved sections 501(c)(9), 419, 419A, 512(a)(3)(B), 61(a), 83(a), 105(b), 129, 79, 3121(a), and 3306 of the Internal Revenue Code. We are responding only to those ruling requests which are under our jurisdiction. The other ruling requests will be the subject of separate correspondence.

Specifically, you request us to rule that:

1. The provision of the Supplemental Benefits by X in accordance with the terms of the Supplemental 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.

2. Supplemental contributions would be deductible by employers who are signatory to the Collective Bargaining Agreement without regard to the reserve limits imposed by sections 419 and 419A of the Code.

3. Investment income earned by the Supplemental Fund will be considered "exempt function income" within the meaning of section 512(a)(3)(B) of the Code.

Facts:

You are a multi-employer health and welfare fund maintained pursuant to a collective bargaining agreement between Y, a local union and Z, an association of employers.

You provide health and welfare benefits to employees of Z's members, as well as to their dependents. Specifically, you provide medical, hearing, vision, dental, and prescription drug benefits to your participants. Benefits, other than vision [illegible] on a self-insured basis.

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You were recognized as exempt from federal income tax in September of 1955. You continue to be recognized as exempt from federal income tax under section 501(c)(9) of the Code.

Your trustees operate under a written plan document, that was most recently amended and restated on December 1, 1990. This plan document sets out the terms and conditions for the employees' eligibility for coverage as well as describing the specific benefits provided to eligible employees.

The plan document provides that employees who no longer are eligible for benefits as a result of termination of employment, or reduction of hours may extend eligibility for 20 months by making monthly self-contributions. Also, the plan document provides that employees who retire on disability, or who retire earlier than the normal retirement age, may extend eligibility by making monthly self-contributions. In addition, the plan document provides that spouses and dependents may extend eligibility by making monthly self-contributions.

Y and Z entered into a Memorandum of Understanding on June 1, 1998, under which they agree to amend section 6.02 of the Collective Bargaining Agreement to provide that:

> "Effective June 1, 1998, employer contributions to X shall be paid at the rate of four dollars per hour for hours paid, provided that one dollar of such hourly contributions shall be set aside exclusively for the payment of additional medical benefits, supplemental unemployment compensation benefits, and other fringe benefits for such employees, their spouses and eligible dependents...."

The terms of the Memorandum of Understanding required that your Trustees set aside these additional hourly contributions to pay additional benefits to the employees. Specifically, those "additional supplemental benefits" were identified as:

- Medical Benefits
- Dependent Care Assistance Benefits
- Group-Term Life Insurance
- Vacation Benefits
- Supplemental Unemployment Compensation Benefits

However, your Trustees have decided to only fund medical benefits. You represent that the dependent care assistance benefits, the group-term life insurance, the vacation benefits, and the supplemental unemployment compensation benefits will not be funded.

Section 15.3A of the Supplemental Plan (hereafter SP) states that the Trustees have established a segregated account from which to pay the "supplemental medical benefits". Section 15.3B of the SP provides that the accounts will be maintained

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entries rather than segregated amounts held for each participant. Section 15.3C authorizes the crediting of each participant's account at the close of each month. Section 15.3D authorizes the debiting of each participant's account at the close of each month.

Section 15.4 of the SP provides that medical expenses not covered by the current plan document would be paid from the SP for the benefit of the participant, the participant's spouse and/or dependents, if any. Section 15.4B(1)(2)(3) of the SP means any amount paid for (i) the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of any structure or function of the body; (ii) transportation for and essential to medical care; (iii) for insurance covering medical care. Section 15.4B specifically provides that monthly self-contributions made to maintain coverage under the plan would be medical expenses for those whose employment has been terminated and/or hours reduced, as well as early retirees or disability retirees. Further, upon the death of the participant, the account would be used to provide continued medical benefits to the deceased participant's spouse and/ dependents.

Section 15.5A of the SP provides that in the event of a participant's death that the credit balance of the participant's account would be forfeited and applied as set out in section 15.3. However, section 15.5B provides that, notwithstanding the provisions of section 15.5A, in the event a participant is survived by a spouse or eligible dependent, the spouse and/or eligible dependent shall be eligible to receive continued reimbursements from the SP for medical benefits during the period of eligibility provided for under the terms of the plan and no forfeiture of the participant's account would occur until the demise of the participant's spouse and/or dependents.

Law:

Section 501(c)(9) of the Internal Revenue Code of 1986 (hereinafter "Code") provides for the exemption of voluntary employees' beneficiary associations that provide 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.

Section 1.509(c)(9)-3(c) of the Income Tax Regulations (hereinafter "regulations") provides that the term "sick and accident benefits" means amounts furnished to or on behalf of a member or a member's dependents in the event of illness or personal injury to a member or dependent. Such benefits may be provided through reimbursement to a member or a member's dependents for amounts expended because of illness or personal injury, or through the payment of premiums to a medical benefit or health insurance program.

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Section 511(a) of the Code imposes a tax for each taxable year on the unrelated business taxable income of every organization which is exempt from taxation under section 501(a) of the Code.

Section 512(a)(3)(A) of the Code provides, in part, that in the case of an organization described in section 501(c)(9) of the Code, the term "unrelated business income" means the gross income (excluding exempt function income),less the deductions allowed which are directly connected with the production of gross income (excluding exempt function income).

Section 512(a)(3)(B) of the Code provides that, for the 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. Exempt function income 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 computed as if the organization were subject to paragraph (1)), which is set aside -

> (i) for a purpose specified in section 170(c)(4), or
> (ii) in the case of an organization described in section 501(c)(9), to provide for the payment of life, sick, accident, or other benefits, including reasonable costs of administration directly connected with a purpose described in this paragraph.

Section 512(a)(3)(E)(i) of the Code provides, in part, that in the case of an organization described in paragraph (9) of section 501(c), a set-aside for any purpose specified in clause (ii) of subparagraph (B) may be taken into account under subparagraph (B) only to the extent that such set-aside does not result in an amount of assets set aside for such purposes in excess of the account limit under section 419A.

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 of the VEBA to provide for the 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 section 419A(c) and section 419A(f)(7), for such taxable year of the VEBA.

Section 419(a) of the Code provides that contributions paid or accrued by an employer to a welfare benefit fund -

(1) shall not be deductible under this chapter, but

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(2) if they would otherwise be deductible, shall (subject to the limitations of subsection (b)) be deductible under this section for the taxable year in which paid.

Section 419(b) of the Code provides that the amount of the deduction allowable under subsection (a)(2) for any taxable year shall not exceed the welfare benefit fund's qualified cost for the taxable year.

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 account consisting of assets set aside to provide for the payment of-

(1) disability benefits
(2) medical benefits
(3) SUB or severance benefits
(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 1.419A-2T, Q&A1 of the 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), 512(a)(3)(E)... until the date 3 years after the issuance of ... final regulations [concerning limits for collective bargained welfare benefit funds]."

Conclusions:

You are recognized as exempt from federal income tax under section 501(c)(9) of the Code, and you provide health and welfare benefits to employees of Z's members. You propose to fund supplemental medical benefits in addition to the benefits you already fund. The supplemental medical benefits are sick and accident benefits within the meaning of section 1.509(c)(9)-3(c) of the regulations.

The written agreement between Y and Z is a collective bargaining agreement. The SP is maintained pursuant to a collective bargaining agreement 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 Y and Z, we conclude that, pursuant to section 419A(f)(5)(A) of the Code, there are no account limits imposed on the benefits provided by the SP. Pursuant to section 1.419A-2T, Q&A1 [illegible] contributions to a collectively

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bargained welfare benefit fund shall not be treated as exceeding the limits of section 419(b). Therefore, supplemental contributions by employers are deductible without regard to the reserve limits imposed by sections 419 and 419A.

Even though section 1.512(a)-5T, Q&A-3(a) of the regulations provides that the amounts set aside in a VEBA 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 under section 419A(c) of the Code, because there is no asset account limit under 419A(c) for welfare benefit funds established under a collective bargaining agreement, the investment income, employer contributions, and other income received by the SP for the payment of life, sick, accident, or other benefits is "exempt function income" within the meaning of section 512(a)(3)(B) of the Code.

Accordingly, we rule as follows:

1. The provision of the supplemental medical benefits by X in accordance with the terms of the Supplemental Plan will not result in the provision of benefits other than "medical benefits" within the meaning of section 501(c)(9) of the Code.

2. Supplemental contributions would be deductible by employers who are signatory to the Collective Bargaining Agreement without regard to the reserve limits imposed by sections 419 and 419A of the Code.

3. Investment income earned by the Supplemental Fund will be considered "exempt function income" within the meaning of section 512(a)(3)(B) of the Code.

A copy of this ruling will be sent to your Key District Director. Please keep a copy of this ruling in your permanent records. As noted above ruling requests four, five, and six will be the subject of separate correspondence.

Please continue to use your employer identification number on all returns which you file and in all correspondence with the Internal Revenue Service.

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

Sincerely yours,

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