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

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Uniform Issue List

419.12-02 512.09-03
501.09-01 4976.00-00
505.01-00

Person to Contact:

Telephone Number

OP:E:EO:T:4

Employer Identification Number:
Key District:

Legend:

M =
N =
O =
P =
Q =
R =
S =

Dear Applicant:

This is in response to your letter dated March 10, 1999, prepared by your authorized representative, in which you requested rulings relating to the noted sections of the Internal Revenue Code.

M is a holding company created in conjunction with the merger in March 1998, of N and its subsidiaries and affiliates, with O and its subsidiaries and affiliates. A substantial number of N's employees are represented by one of two local unions affiliated with P. Approximately 42% of O's employees are represented by a third local union affiliated with P. None of the represented employees are employees who are owners, officers, or executives of the employer.

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Prior to the merger, N maintained a single trust fund, Q, an irrevocable trust that qualified for tax exemption under section 501(c)(9) of the Code. Q maintained five sub-trusts whose assets were pooled for investment purposes, but for which separate accounting was maintained. The assets of each sub-trust were available only to pay benefits under the following groupings:

1. One sub-trust provided post-retirement medical benefits for current and retired union-represented employees and their dependents, where such benefits were the product of good-faith labor negotiations;

2. One sub-trust provided post-retirement life insurance benefits for current and retired union-represented employees and their dependents, where such benefits were the product of good-faith labor negotiations (the first two sub-trusts have been identified by you as sub-trusts "DU");

3. One sub-trust provided post-retirement medical benefits for current and retired non-union ("management") employees and their dependents;

4. One sub-trust provided post-retirement life insurance benefits (not in excess of $50,000 per retiree) for current and retired management employees; and

5. One sub-trust provided post-retirement life insurance benefits (in excess of $50,000 per retiree) for some current and retired management employees (the three foregoing sub-trusts (3-5) have been identified by you as sub-trusts "DM").

None of the above sub-trusts benefit any key employee within the meaning of section 416(i) of the Code.

Contributions to Q were based on the amounts allowable for such purposes pursuant to the rate-making process of the agencies regulating public utilities in the States in which N operated, and were allocated to sub-trusts DU and DM on the basis of actuarial calculations. Contributions to sub-trusts DU were deducted by N on the basis that the account limits of section 419A of the Code do not apply to them because of the exception set forth in section 419A(f)(5), and contributions to sub-trusts DM were deducted to the extent allowed under the account limits of section 419A.

Prior to the merger, O maintained R, an irrevocable trust that qualified for tax exemption under section 501(c)(9) of the Code. R maintained two sub-trusts: one for post-retirement medical benefits and the other for post-retirement life insurance benefits. Although approximately 42% of O's employees were and are represented by a labor organization, and although post-retirement welfare benefits for active and retired employees of O and their dependents were the product of good faith labor negotiations, O did not segregate the assets of R

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attributable to such negotiated benefits. Contributions to R were based on the amounts allowable for such purposes pursuant to the rate-making process of the agencies regulating public utilities in the State in which O operated, and contributions to R were deducted to the extent allowed by the account limits of section 419A of the Code, without regard to the exception set forth in section 419A(f)(5).

Upon creation of S on June 17, 1998, the prior sub-trusts (DU, DM, and R) were maintained as separate accounts within S. S, which was recently recognized as tax exempt under section 501(c)(9) of the Code, now wishes to establish five sub-trusts, identical to those within Q as outlined above. The sub-trusts ("CU") providing post-retirement medical and life insurance benefits to union-represented employees and retirees of M's subsidiaries and affiliates, and their dependents will contain the assets of sub-trusts DU, along with a proportional amount (approximately 42%) of the two R sub-trusts. The proportional amount of R was determined by the actuarial consultant to M, such that the portion of R that is transferred to sub-trusts CU will bear a relation to the entire amount of R (prior to the transfer) equal to the relation that the actuarial present value of the collectively bargained post-retirement benefits earned by the O union-represented employees and retirees (and payable from R) bears to the total actuarial present value of all such benefits earned by all employees of O (and payable from R), allocated to the two sub-trusts on the basis of R's obligations for post-retirement medical and life insurance benefits (respectively) for such union-represented employees and retirees. The other three sub-trusts ("CM") will contain the assets of sub-trusts DM, along with the remainder of R, allocated on the basis of R's obligations for medical, life insurance under $50,000, and life insurance over $50,000, respectively.

The assets of CU may be used only to provide post-retirement benefits to current and retired employees of M, its affiliates and subsidiaries, and their dependents, whose benefits have been the subject of good-faith collective bargaining. Under no circumstances may the assets of sub-trusts CU be used for any purpose other than the provision of welfare benefits to union-represented employees and former employee (retirees) and their dependents, and under no circumstances may the assets of sub-trusts CM be used for any purpose other than the provision of post-retirement welfare benefits to non-union employees and former employees (retirees) and their dependents.

No key employee within the meaning of section 416(i) of the Code will be eligible to receive benefits from any of the sub-trusts. No individuals who are owners of M, its affiliates or subsidiaries (other than through shares held by qualified retirement plans or de minimis shares held personally by retirees), officers, or executives will be eligible to receive benefits from any of the sub-trusts.

M has requested the following rulings on behalf of S and the merging trusts, Q and R:

1. The merger of Q and R into S will not adversely affect the tax exempt status of Q and R under section 501(c)(9) of the Code.

2. The merger of Q and R into S, and the allocation of all of sub-trusts DU and a proportional share of R assets to sub-trusts CU as determined by an actuarial consultant, and the allocation of all of sub-trusts DM and the remainder of R assets to sub-trusts CM, will not result in any portion of a welfare benefit fund reverting to the benefit of the employer and therefore will not be subject to the imposition of any excise tax under section 4976 of the Code.

3. The CU sub-trusts, as established on the transfer date and with the allocation to them of sub-trusts DU and the proportional share of R assets as determined by an actuarial consultant, are separate welfare benefit funds maintained under a collective bargaining agreement within the meaning of section 419A(f)(5) of the Code, and therefore no account limits shall apply, so long as the assets of each sub-trust are not available to pay any benefits to be provided by the other sub-trusts.

4. The income of sub-trusts CU set aside to provide post-retirement welfare benefits for union-represented employees and their dependents is exempt function income and is not treated as unrelated business taxable income under section 512(a)(3) of the Code.

5. The non-discrimination rules of section 505(b) of the Code will not be applicable to benefits provided through the assets set aside in sub-trusts CU.

6. Sub-trusts CU do not have to meet the special limitation for medical reserves set out in section 419(e)(1) of the Code.

Inasmuch as we do not have jurisdiction with respect to the special limitation for medical reserves set out in section 419(e)(1) of the Code, we cannot respond to your last ruling request. Instead, we will forward this question to our Employee Plans Division, which will rule on the matter. You need not pay any additional user fee.

Section 501(c)(9) of the Code describes 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)-2(a)(ii) of the Income Tax Regulations identifies certain generally permissible restrictions on eligibility for benefits. Under subsection (F) of that section a VEBA may provide life benefits in amounts that are a uniform percentage of compensation received by the individual whose life is covered.

Section 1.501(c)(9)-4(a) of the regulations provides that no part of the net earnings of a VEBA may inure to the benefit of any shareholder or individual other than through the payment of permitted types of life, sick, accident, or other benefits. Whether prohibited inurement has occurred is a question to be determined with regard to al the facts and circumstances of a particular case.

The term "net earnings" is given a broad interpretation, subjecting all of the assets of an organization to the inurement prohibition. See, Knollwood Memorial Gardens v. Commissioner, 46 T.C. 764 (1969), appeal dismissed nolle pros. Section 1.501(a)-1(c) of the regulations provides that the "words 'private shareholder or individual' in section 501 refer to persons having a private interest in the activities of the organization."

Section 1.501(c)(9)-4(d) of the regulations provides that it will not constitute prohibited inurement if, upon the dissolution of a VEBA, remaining assets, 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 within the meaning of section 1.501(c)(9)-3 pursuant to criteria that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees of the employer.

Section 505(b)(2) of the Code provides that for purpose of the nondiscrimination requirements, there may be excluded from consideration, "(D) employees not included in the plan who are included in a unit of employees covered by an agreement between employee representatives and 1 or more employers which the secretary finds to be a collective bargaining agreement if the class of benefits involved was the subject of good faith bargaining between such employee representatives and such employer or employers."

Section 511 of the Internal Revenue 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 1.513-1(d)(2) of the Income Tax Regulations provides that a trade or business is "related " to exempt purposes only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income). Further, it is "substantially related", for purposes of section 513 of the Code, only if the causal relationship is a substantial one. For this relationship to exist, the production or the performance of the service from which the gross income is derived must contribute importantly to the accomplishment of exempt purposes. Whether the activities productive of gross income contribute importantly to such purposes depends, in each case, upon the facts and circumstances involved.

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 in furtherance of the purposes for which the organization is tax exempt. 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 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 benefits).

Section 419 of the Code sets forth rules with respect to the tax treatment of funded welfare benefit plans. A plan which is determined by the Service to be a VEBA under section 501(c)(9) is also considered a welfare benefit fund within the meaning of section 419 of the Code.

Section 419A of the Code provides that for purposes of section 512, the term "qualified asset account" means any account consisting of assets set aside to provide for the payment of disability, medical, SUB or severance pay benefits, or life insurance benefits.

Section 1.419A-2T of the Temporary Regulations states under Q-1 that contributions to a welfare benefit fund maintained pursuant to one or more collectively bargained agreements and the reserves of such a fund generally are subject to the rules of sections 419, 419A, and 512. However, neither contributions to nor reserves of such a collectively bargained welfare benefit fund shall be treated as exceeding the otherwise applicable limits of sections 419(b), 419A(b), or 512(a)(3)(E) until the earlier of: (i) The date on which the last of the collective bargaining agreements relating to the fund in effect on, or ratified on or before, the date of issuance of final regulations concerning such limits for collectively bargained welfare benefit funds terminates (determined without regard to any extension thereof agreed to after the date of issuance of such final regulations), or (ii) the date 3 years after the issuance of such final regulations..

Section 419A(f)(5)(A) of the Code provides that no account limits shall apply in the case of any qualified asset account under a separate welfare benefit fund formed pursuant to a collective bargaining agreement. Section 1.419A-2T, Q-2 of the regulations defines a welfare benefit fund maintained pursuant to a collective bargaining agreement.

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 representatives" shall not include any organization more than one-half of the members of which are employees who are owners, officer, 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 419A(h)(2) of the Code provides that, for purposes of section 419 and section 419A of the Code, related employers will be governed by rules similar to the rules that apply to controlled groups of employers under section 414 of the Code.

Section 4976 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)(1)(c) defines disqualified benefit to include any portion of a welfare benefit fund reverting to the benefit of the employer.

Concerning the present ruling request, M proposes to transfer assets currently allotted to seven separate funds into five new separate funds. Two new funds, CU, will provide benefits only to individuals who were represented by a labor organization prior to their retirement, and their dependents. All of the benefits to be paid out by the funds are permissible benefits under Code section 501(c)(9) and amplifying regulations. Further, you represent that an actuarial determination established that the amounts allocated to funds CU were reasonably and properly due to the qualifying members.

Inasmuch as the benefits provided through sub-funds CU were the subject of arms length negotiations between employee representatives (the three union locals) and the employers, and in light of the fact that none of the represented employees are executives, officers, or owner of more than a de minimis amount of employer stock, the various collective bargaining agreements meet the requirements of section 7701(a)(46) of the Code. Accordingly, sub-funds CU are maintained pursuant to a collective bargaining agreement within the meaning of section 512(a)(3) of the Code and section 1.419A-2T of the regulations.

Based on the foregoing, we are able to rule as follows:

1. The merger of Q and R into S will not adversely affect the tax exempt status of Q and R under section 501(c)(9) of the Code.

2. The merger of Q and R into S, and the allocation of all of sub-trusts DU and a proportional share of R assets to sub-trusts CU as determined by an actuarial consultant, and the allocation of all of sub-trusts DM and the remainder of R assets to sub-trusts CM, will not result in any portion of a welfare benefit fund reverting to the benefit of the employer and therefore will not be subject to the imposition of any excise tax under section 4976 of the Code.

3. The CU sub-trusts, as established on the transfer date and with the allocation to them of sub-trusts DU and the proportional share of R assets as determined by an actuarial consultant, are separate welfare benefit funds maintained under a collective bargaining

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agreement within the meaning of section 419A(f)(5) of the Code, and therefore no account limits shall apply so long as the assets of each sub-trust are not available to pay any benefits to be provided by the other sub-trusts.

4. The income of sub-trusts CU set aside to provide post-retirement welfare benefits for union-represented employees and their dependents is exempt function income and is not treated as unrelated business taxable income under section 512(a)(3) of the Code.

5. The non-discrimination rules of section 505(b) of the Code will not be applicable to benefits provided through the assets set aside in sub-trusts CU.

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 your tax status should be reported to your key District Director.

We are sending a copy of this ruling to your Key District Director for exempt organization matters. Because this letter could help resolve any questions about your tax status, you should keep it with 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.

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
Chief, Exempt Organizations
Technical Branch 4