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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Date: MAR 13 2002

Contact Person:

Identification Number:

Telephone Number:

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4976.01-00

LEGEND:
M =
N =
P =
Q =
R =
x =

Dear Sir or Madam:

We have considered your letter dated September 6, 2001, in which you requested certain rulings concerning the federal tax consequences of the proposed terminating distribution of M as further described below.

M is a group insurance trust that was formed pursuant to a Declaration of Trust and Agreement (the "Trust Agreement") between N, certain designated Trustees, and certain participating member employers ("Members"). N (subsequently renamed R) is a trade association exempt from federal income tax under section 501(c)(6) of the Internal Revenue Code (the "Code"). The stated purpose of M was to provide certain group-insured welfare benefits to N and the Members.

The Trust Agreement was substantially amended to confirm M's compliance and operation as a voluntary employee beneficiary association ("VEBA"). The Service has determined that M is exempt from federal income tax under section 501(c)(9) of the Code.

In recent years the majority of M's operations involved the provision of medical insurance benefits through insured contracts issued by P. In 1999, P notified M of its desire to terminate the health insurance program provided by M. Because M could no longer viably provide group medical insurance benefits to participants, the Trustees and Members elected to terminate M's ongoing welfare benefit programs. All outstanding claims for benefits under M's benefit programs have since been paid, and M has ceased providing any medical insurance benefits or other welfare benefits.

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In 2000, as part of the demutualization of P, M, as a former policyholder, received 19x shares of common stock of the reorganized P (the "Demutualization Proceeds").

In connection with the process of terminating M, the Trustees resolved to dispose of the surplus assets remaining in M, including the Demutualization Proceeds (hereinafter collectively the "Surplus Assets") by transferring M's Surplus Assets to Q.

Q is exempt from federal income taxation under section 501(c)(3) of the Code and is not a private foundation within the meaning of section 509(a) because it is an organization described in section 509(a)(3). Q was organized to carry out the charitable and educational purposes of R and, in particular, to conduct educational activities and programs related to the industry in which R's Members are engaged. Q is not an employer of employees who are beneficiaries of M, has never made contributions to M, and does not maintain M.

To effectuate the Trustees' resolution, the Trust Agreement was amended to provide, in relevant part, that the Trustees shall distribute Surplus Assets to an organization or organizations exempt under section 501(c)(3) of the Code, and in no event shall such surplus be paid to a Member of R.

The following rulings have been requested:

1. The transfer of the Surplus Assets from M to Q will not be treated as a reversion under section 4976 of the Code, and, therefore, the transfer will not be subject to that section's 100% excise tax penalty and thereby will not result in the imposition of the 100% excise tax on M, R, any of the Members, or Q.

2. The transfer of the Surplus Assets to Q will not jeopardize the tax-exempt status of M under section 501(c)(9) of the Code.

3. The transfer of the Surplus Assets (including the gain, if any, on the sale of the Demutualization Proceeds prior to the transfer) to Q will not result in unrelated business taxable income to M, R, or Q.

Section 501(a) of the Code provides an exemption from federal income taxation for organizations described in section 501(c).

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)-4(a) of the Income Tax Regulations (the "regulations") provides that no part of the net earnings of an employee's 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 1.501(c)(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 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 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)(1)(C) of the Code defines "disqualified benefit" to include any portion of a welfare benefit fund reverting to the benefit of the employer.

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

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 modifications.

Section 512(a)(3)(B)(i) of the Code provides that, in the case of an organization described in section 501(c)(9), the term "exempt function income" includes 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 for a purpose specified in section 170(c)(4).

Section 170(c)(4) of the Code provides that the term "charitable contribution" includes a contribution or gift by an individual to or for the use of a domestic fraternal lodge, order, or association, operating under the lodge system, but only if such contribution or gift is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

The information submitted establishes that the Trustees of M intend to terminate M and transfer the Surplus Assets to Q, an organization exempt under section 501(c)(3), to carry out Q's educational purposes. The Surplus Assets will not revert to R or to any Member of R. Therefore, the transfer of the Surplus Assets to Q will not result in prohibited inurement under section 501(c)(9), and will not, of itself, affect the tax exempt status of M under section 501(c)(9).

Q is not an employer with respect to N, nor is it an organization that otherwise is merely an alter ego of a Member. It is a charitable organization, the assets of which are dedicated to charitable purposes and cannot be used for the private benefit of a Member. Therefore, the

transfer of M's Surplus Assets to Q is not a reversion "to the benefit of the employer" as defined in section 4976(b)(1)(C) of the Code.

The provisions of section 512(a)(3)(B) of the Code indicate that the income of an organization exempt under section 501(c)(9) set aside for a purpose specified in section 170(c)(4) is exempt function income and, therefore, is excluded in computing such organization's unrelated business taxable income. Since the income generated by M's assets will be transferred to Q for purposes specified in section 170(c)(4), such income is considered exempt function income for purposes of section 512(a)(3), and is excluded from gross income in determining the unrelated business taxable income of M, R, or Q.

Accordingly, based on the information you have submitted, we conclude that:

1. The transfer of the Surplus Assets from M to Q does not constitute a disqualified benefit under section 4976(b)(1)(C) of the Code and, therefore, the transfer will not result in the imposition of the excise tax under section 4976(a) on either, M, R, any of R's Members, or Q.

2. The transfer of the Surplus Assets from M to Q will not affect M's tax-exempt status under section 501(c)(9) of the Code.

3. The transfer of the Surplus Assets (including the gain, if any, on the sale of the Demutualization Proceeds prior to the transfer) from M to Q will not result in unrelated business taxable income to M, R, or Q.

Except as we have ruled above, we express no opinion as to the tax consequences of the transactions under the cited provisions of the Code or under any other provisions of the Code.

Because this ruling letter could help to resolve any questions, please keep it in your permanent records.

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

Sincerely,
(signed) Terrell M. Berkovsky

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2