995290

[redacted]

[redacted]

Surname

Date

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Date 2/11/99

Surname [redacted]

OP:E:EO:T:4

October 22, 1998

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax as an organization described in section 501(c)(9) of the Internal Revenue Code.

You were created [redacted] to provide benefits for employees of [redacted] You provide life benefits under individual whole-life insurance policies to three employees of the sponsor employer.

According to the adoption agreement as originally submitted, the benefit provided is [redacted]% of compensation, up to a maximum of $[redacted] You have since amended the plan to provide for a benefit of [redacted] times compensation. Upon termination of the plan, any remaining assets are to be distributed proportionately based on salary. The employer may terminate the plan at any time.

The most recent employee census furnished to us states that [redacted] employees were eligible to participate. One declined coverage and one was uninsurable, leaving [redacted] participants. Of these [redacted] participants, [redacted], has a salary of $[redacted] and receives a benefit of $[redacted] The annual compensation of [redacted] is $[redacted] Under the terms of the plan, he would be entitled to a benefit of $[redacted] The benefit provided by the insurance policies submitted is $[redacted] The annual compensation of [redacted] is $[redacted] Under the terms of the plan, she would be entitled to a benefit of $[redacted]. The benefit provided by the insurance policies submitted is $[redacted].

[redacted] the plan states:

In the event that an insurance or annuity contract purchased by the Trust contains any endorsements or riders which together with the basic contract provides more life insurance than would normally be issued for the Participant . . . the additional premiums therefor shall be stated separately from the premiums on the basic contract. No such additional

[redacted]

premiums shall be paid by the Trust unless the Participant . . . consents, in writing, to reimburse the Trust for the cost of such additional premiums.

[redacted]he plan provides:

In the event that a Participant is not insurable or refuses to comply with the requirements of an insurer for the issuance of insurance contracts on his life, the premiums at standard rates published by the insurer which would otherwise have been applied by the Trust to the purchase of life insurance on the life of such Participant, may be used to purchase an annual premium deferred annuity for such Participant payable at the Participant's Normal Retirement Date.

When asked the purpose for establishing a VEBA to provide fully insured benefits, you stated: "The purpose for establishing the VEBA under these circumstances is to make the employer contributions tax deductible, enhancing the benefits provided and the employer's profitability."

Section 501(c)(9) of the Code, in conjunction with section 501(a), exempts from federal income tax 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, if no part of the net earnings of the association inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-3(d) of the income tax 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 benefits 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.

In providing examples of nonqualifying benefits, section 1.501(c)(9)-3(f) of the regulations provides that the term "other benefits" does not include any benefit that is similar to a pension or annuity payable at the time of mandatory or voluntary retirement, or a benefit that is similar to the benefit provided under a stock bonus or profit-sharing plan. For purposes of section 501(c)(9) and these regulations, a benefit will be considered similar to that provided under a pension, annuity, stock bonus or profit-sharing plan if it provides for deferred compensation that becomes payable by reason of the passage of time, rather than as a result of an unanticipated event.

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 private shareholder or individual

[redacted]

other than through the payment of the permitted types of life, sick, accident, or other benefits. Whether prohibited inurement has occurred is a question to be determined with regard to all of the facts and circumstances of a particular case.

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 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. Similarly, a distribution to members upon the dissolution of the association will not constitute prohibited inurement if the amounts distributed to members are determined pursuant to the terms of a collective bargaining agreement or on the basis of objective and reasonable standards which do not result in either unequal payments to similarly situated members or in disproportionate payments to officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association.

Whether a VEBA meets the definitional requirement that no part of its net income can inure to the benefit of any individual is a question to be determined with regard to all the facts and circumstances. Prohibited inurement arises when a VEBA serves the use or benefit of an individual other than through the proper performance of functions characteristic of organizations described in section 501(c)(9). A VEBA functions primarily as a cooperative device for pooling funds and distributing risks over and benefits to a defined group of employees sharing an employment-related common bond. While an organization may provide benefits to promote the common welfare of an association of employees in a manner consistent with section 501(c)(9), the inurement proscription bars the tax-exempt treatment of an organization predominantly organized and operated to promote the interest of an individual standing in relationship to the organization as an investor for private gain.

By its terms, your plan provides for [redacted] to receive a dominant share (approximately [redacted]%) of the benefits provided. Although [redacted] are receiving benefits higher than those specified in the plan, the terms of the plan require them to pay for the insurance coverage in excess of the amount provided for in the plan. To the extent that they are making such payments, these excess benefits cannot be considered as being provided by the VEBA. Even if they are not actually making such payments, we must rely on the terms of the plan itself in determining whether you qualify for exemption.

You are comprised of a small number of members, and you provide, according to the terms of the plan, a dominant share of aggregate benefits to [redacted]

[redacted] the highly compensated member who is also [redacted] has ultimate control over the trust in that he determines the level of contributions and benefits and reserves the right to appoint and control the activities of trustees and the right to terminate the trust at any time and for any reason. Because of his control of the employer, he can at any time direct the termination of the plan and trust and the distribution of remaining assets pursuant to [redacted] the Adoption Agreement. Upon trust termination trust assets will be distributed to [redacted] in proportion to his dominant share of aggregate benefits.

A limited membership in combination with the allocation of a dominant share of benefits to [redacted] indicates that you are organized and operated for the benefit of [redacted] and not for any employee group. Prior to termination, you accumulate funds mainly for the current benefit of [redacted]. With effective control over the contributing employer, [redacted] has the power to determine the extent of contributions and benefits, manage trust operations, and direct the investment of trust assets. Further, with effective control, you are subject to termination by [redacted] By controlling the timing of trust termination, [redacted] is able to direct the distribution of his allocable share of trust assets.

Under these circumstances, you function substantially as an investment fund for the direct personal and private benefit of [redacted] An organization functioning in this manner is inconsistent with the exempt purpose of a VEBA in providing benefits to promote the common welfare of an association of employees as opposed to the welfare of a single employee. Additionally, by serving as an investment fund for [redacted], who has discretion over contributions and over withdrawal upon termination, you are providing a nonqualifying benefit under section 1.501(c)(9)-3(f) of the regulations. Clearly, a vehicle for the accumulation of investment funds for the personal benefit of the [redacted] does not fall within the ambit of permissible "other benefits" as described in section 1.509(c)(9)-3(d) and (e) of the regulations. Accordingly, your net earnings would improperly inure (other than through the payment of permissible benefits) to the benefit of [redacted].

Furthermore, asset distributions to [redacted] upon trust termination would constitute nonqualifying deferred compensation benefits under section 1.501(c)(9)-3(f) of the regulations. Based on [redacted] control over trust termination, such distributions would be payable by reason of the passage of time and not as a result of an unanticipated event. Further, the fact that termination distributions originate from a trust organized and operated primarily for the benefit of [redacted] indicates that such distributions are similar to those provided under a plan or arrangement of deferred compensation.

In addition, [redacted] the plan permits the purchase of annuities for participants if life insurance cannot be purchased for them. Such annuities are not

[redacted]

permissible benefits, pursuant to section 1.501(c)(9)-3(f) of the regulations.

Therefore, we rule that you are not exempt from federal income tax as an organization described in section 501(c)(9) of the Code.

You have the right to protest our ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of the date of this letter and must be signed by one of your officers. You also have a right to a conference in this office after your statement is submitted. If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your officers, he/she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director. Thereafter, if you have any questions about your federal income tax status, including questions concerning reporting requirements, please contact your key District Director.

Although not directly relevant to the determination of your exempt status, you should know that deductibility of employer contributions to you is determined solely with reference to sections 162, 419, and 419A of the Code. For this purpose, the exempt status (or lack thereof) of a trust to which such contributions are made is irrelevant. Under these Code sections, the employer's allowable deduction is generally limited to the plan's qualified cost. The qualified cost includes only the cost of pure insurance protection, as reduced by any earnings on the life insurance policies used, and not the premiums actually charged, which may include investment features. See *Robert D. Booth and Janice Booth, et al. v. Commissioner*, 108 T.C. 524 (1997).

You will expedite our receipt of your reply by using the following address:

Internal Revenue Service
OP:E:EO:T:4, Room 6236
1111 Constitution Ave., NW
Washington, DC 20224

Sincerely,

Gerald V. Sack

Gerald V. Sack
Chief, Exempt Organizations
Technical Branch 4

Code	OP:E:EO:T:4	OP:E:EO:T:4
Surname	[redacted]	[redacted]
Date	[redacted]	[redacted]