Internal Revenue Service

Department of the Treasury

Washington, DC 20224

[redacted]

Person to Contact:

Telephone Number:

Refer Reply to:

DO: Midstates (Dallas, TX)
EIN: [redacted]

Date: APR 10 1996

Dear Applicant:

This is in regard to your application for recognition of exemption under section 501(c)(9) of the Internal Revenue Code.

On [redacted], we issued a proposed adverse determination on your application for recognition of exemption as an organization described in section 501(c)(9) of the Code. In your letter of [redacted], you protested our determination. We have attempted to set a date for a conference with you and your legal representative since [redacted].

In your most recent letter of [redacted], you indicated that you were terminating as part of a settlement of litigation to which you are a party with the [redacted]. You requested that we delay any further action until you complete this process and then you will waive any further action in the matter. In accordance with your request we have delayed our processing this matter for approximately 3 weeks.

It is our understanding that the termination process should be completed by now and that issuing a final adverse determination regarding your status as an organization described in section 501(c)(9) of the Code should have no impact on this matter.

Therefore, we have reviewed all the materials you have submitted and have concluded that our proposed adverse determination of August 22, 1995, is correct.

Accordingly, we have concluded that you are not exempt from federal income tax under section 501(c)(6) of the Code and you will be treated as a taxable organization as of the date of your establishment. Please file federal income tax returns for all years in question.

cc: [redacted]

cc: Attorney

Sincerely yours,

(signed) [redacted]

Chief, Exempt Organizations
Technical Branch 5

[redacted]

4/8/96

[redacted]

4/8/96

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply to:

Date: AUG 22 1995

[redacted]

DO: Chicago
EIN: [redacted]

Dear Applicant:

This is in reply to your application for recognition of exemption under section 501(c)(9) of the Internal Revenue Code of 1986.

We have reviewed the additional information you submitted in your letter of [redacted]. While we believe that our proposed adverse ruling was correct, this letter supersedes our proposed adverse ruling of [redacted], and provides additional reasons why we do not believe that you qualify for recognition of exemption under section 501(c)(9) of the Code.

As stated in our proposed adverse determination of [redacted], you have not been able to establish that a sufficient number of your members are employees within the meaning of section 501(c)(9) of the Code, or have an employment-related common bond. In that letter we also concluded that you do not satisfy the geographic locale requirements set forth in the regulations and you are not controlled by your members.

The new information you submitted clarifies certain of the information previously submitted. In light of this clarifying information we also reconsidered all the information previously submitted. Based on this reconsideration we have concluded that your agreement should not be treated as a collectively bargained agreement for the purposes of section 501(c)(9). In addition, the inclusion of supervisory personnel, owners and other highly compensated individuals indicates that these benefits may constitute disproportionate benefits within the meaning of section 1.501(c)(9)-4(b) of the Income Tax Regulations. Providing disproportionate benefits constitutes inurement within the meaning of section 501(c)(9) of the Code. We also have concluded that your members do not have an employment related common bond within the meaning of section 1.501(c)(9)-2(a) of the regulations.

The information you have submitted indicates that you were established as a multi-employer welfare benefit trust to provide flexible benefits to the employees of the employers who are

contributing to the fund under what you represent as being a "collective bargaining agreement." A brochure you have submitted indicates that you were established to enable "small businesses to provide its employees with flexible benefit programs similar to those available to Fortune 500 Companies and organized labor." Your Constitution and Bylaws state that you "exist to serve the interests of office, clerical, sales, administrative, distribution, technical and professional employees of small to medium-sized businesses."

You also state that in addition to providing benefits to employees who are represented under the collective bargaining agreement with [redacted], you provide benefits to individuals covered under other bargaining agreements that permit participation in your program, and any individual for whom a participating employer is obligated to make contributions by reason of some other agreement. The Trust Agreement specifically states that any "full time employee of a participating employer may be included." In addition, "employees under a different collective bargaining agreement may expand their medical care protection through voting for participation in this program." It also appears that employees who no longer work for an employer covered under the fund can continue to receive benefits where the board has determined that they continue to be eligible, provided they pay for such benefits. The Trust document also emphasizes that "an individual's right to benefits from the Trust fund are based solely on the eligibility requirements of the Trust Agreement and no preference or bias can or is prohibited on union membership." There is no union membership requirement in the Trust Agreement. You have also submitted two letters from the National Labor Relations Board which indicate that you are the certified representative of certain employers. Neither of these companies appear on the list of participating employers you have provided us.

You have both associate and regular members. Associate members are those members who would be classified as supervisory employees under the National Labor Relations Act. They do not have voting rights but are covered under the collective bargaining agreement to a limited extent and can participate in the welfare benefit program. Regular members enjoy full rights under the agreement.

You do not knowingly permit self-employed individuals to participate but you permit supervisors, managers, stockholders and owners to participate if they are treated as corporate employees for other purposes. Although we requested a complete census you state that you have "no records regarding service, salary, ownership interest, or non-[redacted] benefits" regarding participating employers. We note from the information submi ed

that your membership includes the members of a nurses association, who have their benefits paid directly by their employers and not by the nurses association, and certain [redacted] school board employees, whose participation in the benefit program came from the inclusion of your benefit program in the overall benefit program the state makes available to these employees. The agreement with the nurses association contains the same clauses as the agreements with most of your other employer members. However the agreement is with the association and no documents binding the actual employer to the agreement have been submitted. The agreement for the [redacted] school board employees specifically notes that "nothing contained herein shall impose any representational duty upon [redacted] concerning any collective bargaining relationship." In addition a large group of members of the [redacted] (hereinafter referred to as the Machinists) through their collective bargaining agreement offer participation in your medical plan in place of the existing plan sponsored by their employer. The submitted information establishes that participants in the program come from states as far apart as [redacted] and [redacted].

[redacted] has a prototype collective bargaining agreement which each participating employer signs. The arrangement with the nurses association is with the nurses association and not with their employers. The agreement indicates that each employer's agreement is unique to that employer. However, the only agreements submitted that differed from the prototype substituted a different minimum wage. This agreement provides that your members will not participate in any job action or interruption and that [redacted] is recognized as the exclusive representative of the employer's non-supervisory employees unless provided otherwise under another collective bargaining agreement. You state that you provide your members more than welfare benefits. Your agreements provide that an employer is not permitted to discriminate on grounds of race, creed or religion. Seniority rights are recognized, as is merit pay. A grievance procedure has also been established but is limited to matters under this agreement. The agreement with the participating employers is terminable at will after a year. In your letter of [redacted], you state that the association, "satisfies all objective standards as to the characteristics of a labor union and has been recognized by the Service as a labor union in its determination letter of [redacted]." You discuss the various clauses in the agreement and describe them as being typical of a collective bargaining agreement.

In discussing the relationship that exists between your members who are not under a collective bargaining agreement and

the trust and those who are, you emphasize that they have a common employment-related bond established through participation in this agreement. You also describe the relationship between the employees of the [redacted]. You liken the situation with the [redacted] employees and the members of the Machinists union to a building and construction trades group which has banded together for a single health care fund. On the other hand, you state that the nurses are employees who have their working conditions controlled by their Association.

In both the Machinists and [redacted] Board of Education situations other representational matters are handled by other unions. You and the [redacted] are merely an option for health coverage. In your [redacted], letter your representatives argue that the inclusion of these groups of employees represents a common and unobjectionable method of providing affordable health care coverage. They argue that this allows the consolidation of bargaining units into a large enough group of participants to take advantage of economies of scale and to spread the risk of adverse experience over a large enough number of covered employees to minimize the chance that a few costly illnesses among the members of the group will increase premiums to unacceptable levels.

The trust has [redacted] union trustees and [redacted] employer trustees. You state that under your agreement the union officers will be appointed by the officers of the association and not elected by the members until such time as the Association has [redacted] members or in the year [redacted].

The information submitted indicates that you have more than [redacted] members from [redacted] separate employers. Of this number there are [redacted] associate members, and [redacted] employees of the [redacted] school system. Out of the participating employers, [redacted] have only one employee. Of these [redacted] employers, [redacted] are clearly identifiable as being employers where the owner is the sole participant. In other cases where there is more than one employee, some appear to include only the owner(s) and his or her spouse or another family member.

You have indicated that the benefits you provide are limited to those in what you describe as a cafeteria plan. In your [redacted], letter you state that your actual benefits are listed in the [redacted] Group Health Plan, which only includes an unspecified amount of life insurance and health coverage. The amount of life insurance appears to vary and is established by the participating employers.

Re: [redacted]

Section 501(c)(9) of the Code provides for the exemption from federal income tax of voluntary employees' beneficiary associations providing 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.

In T.D. 7750, 1977-2 C.B. 338, the Preamble to the final regulations under section 501(c)(9) of the Code states that "allowing section 501(c)(9) to be used as a tax-exempt vehicle for offering insurance products to unrelated individuals scattered throughout the country would undermine those provisions of the Internal Revenue Code that prescribe the income tax treatment of insurance companies."

Section 1.501(c)(9)-1 of the Income Tax Regulations provides that for an organization to be described in section 501(c)(9), it must be an employees' association; membership in the association must be voluntary; the organization must provide for the payment of life, sick, accident, or other benefits to its members; and there can be no inurement (other than by payment of permitted benefits) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-2(a) of the regulations provides that membership of any organization described in section 501(c)(9) must consist of individuals who become entitled to participate by reason of their being employees and whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond among such individuals. Typically, those eligible for membership are defined by reference to a common employer, coverage under one or more collective bargaining agreements or employees of one or more employers engaged in the same line of business in the same geographic locale. For example, membership in an association might be open to all employees of a particular employer, or to employees in specified job classifications for certain employers at specified locations and who are entitled to benefits by reason of one or more collective bargaining agreements. In addition, employees of one or more employers engaged in the same line of business in the same geographic locale will be considered to share an employment related bond for purposes of an organization through which their employers provide benefits. Whether a group of individuals is defined by reference to a permissible standard or standards is a question to be determined with regard to all the facts and circumstances in the case. An association will be considered to be composed of employees if 90 percent of the total membership of the association on one day of each quarter of the

association's taxable year consists of employees. Whether a group of individuals is defined by reference to a permissible standard or standards is a question to be determined with regard to all the facts and circumstances in the case.

Section 1.501(c)(9)-2(a)(2)(i) of the regulations provides, in part, that eligibility for benefits may be restricted by objective conditions relating to the type or amount of benefits offered. However, any such restriction may not have the effect of limiting benefits to officers, shareholders, or highly compensated employees or of entitling them to benefits that are disproportionate in relation to benefits to which other members of the association are entitled.

Section 1.501(c)(9)-2(b) of the regulations provides that whether an individual is an employee is determined by reference to the legal and bona fide relationship of employer and employee. The term includes an individual who is considered an employee for employment tax purposes and the Labor Management Relations Act of 1947.

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. For the purposes of section 501(c)(9) 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 the result of an unanticipated event.

Section 1.501(c)(9)-4(a) of the regulations provides that no part of the net earnings of an employees' 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(b) of the regulations provides that payment to any member of disproportionate benefits, where such payment is not pursuant to objective and nondiscriminatory standards, will constitute prohibited inurement.

Section 7701(a)(46) of the Code provides that 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 301.7701-17T Q & A 2(c) of the Procedure and Administrative Regulations provides that even if a finding is

Re: [redacted]

made by the Secretary of Labor that the union has been recognized as exempt and the 50 percent limitations of the regulations are satisfied (not applicable to our inquiry), the Internal Revenue Service has the authority to determine whether there is a collective bargaining agreement under the Code.

In National Association of Postal Supervisors v. U.S., 66 AFTR 2d 90-5393 (Cl. Ct., 1990), the court held that a tax-exempt labor organization engaged in unrelated trade or business when it provided insurance to nonpostal members in return for annual dues. In this case associate members only received the right to enroll in the health plans provided by the labor organization.

In American Postal Workers v. U.S., 67 AFTR 2d 91-571, 925 F. 2d 480 (7th Cir., 1991) the Court held that the provision of health insurance to non-postal associate members was not substantially related to exempt purposes of the postal employees. Further, substantial profits from dues and fees indicated that the union was engaged in the trade or business of providing health insurance.

The submitted information establishes that membership in the association covers numerous employers in different occupations located in different states. Membership includes [redacted] employees of [redacted], whose participation is limited to having your benefit program included in the package of welfare plans or benefits in which they can elect to participate; and members of a nurses association, whose participation is by reason of an agreement between you and their association and paid for by the direct employer. Furthermore, you state that you have [redacted] associate employees who are defined as supervisory employees, but who also appear to include sole proprietors. In addition, you state that participation in your program is open to anyone covered by another collective bargaining agreement who wants to participate in your benefit program.

In order to qualify as a voluntary employees' beneficiary association described in section 501(c)(9) of the Code there must be an association of employees with an employment-related common bond.

Even if we could conclude that your membership is composed of individuals at least 90% of whom are employees for the purposes of section 501(c)(9) of the Code, we are unable to conclude that your members have an employment-related common bond.

Whether a group of individuals satisfies the affiliation or employment-related common bond requirements of section 1.501(c)(9)-2(a) of the regulations is determined with regard to

all the surrounding facts and circumstances in the case. Factors such as reference to a common employer, coverage under one or more collective bargaining agreements, or employees of one or more employers engaged in the same line of business in the same geographical locale are each grounds for finding that an employment-related common bond exists. However, the Service has the responsibility for tax purposes to make an independent determination as to whether participation under a collectively bargained agreement is sufficient to satisfy the employment-related common bond requirements. See section 301.7701-17T Q&A 2(c) of the regulations and National Association of Postal Supervisors v. U.S., supra and American Postal Workers v. U.S., supra.

The submitted information establishes that your membership is comprised of employees of the [redacted] school board, members of [redacted] union, the members of a nurses association, and the owners and or employees of numerous small employers located in several states stretching from [redacted] to [redacted].

In the case of the [redacted] school board employees, and the participating members of Machinists Union, [redacted] does not represent the individuals in collective bargaining matters; [redacted] merely provides the opportunity for employees and employers to purchase insurance from you. Furthermore, the above described members appear to have no ties to the other members of the bargaining units you represent other than the desire to purchase medical insurance at a group rate. These employees do not have a common employer nor are they in the same line of business located in the same geographic locale.

We recognize that a common benefit package is often made available to the members of several different unions working in the same plant, or job site, or in an industry characterized by fragmentation of job classifications and short-term employment, such as the building and construction trades. However, you have not provided any information to establish that unique problems or characteristics are present in this case that would tend to show a commonality of interest among your members other than a desire to purchase benefits from you.

We also believe that you do not have an employment-related common bond by virtue of membership in a common union. In addition to the inclusion of union members represented by other bargaining units, we do not believe that sole proprietors and supervisory employees can be classified as "union members" for purposes of establishing an employment-related common bond. See National Association of Postal Supervisors v. U.S., supra and American Postal Workers v. U.S., supra.

Finally, we do not believe that your employee members share an employment-related common bond through one or more collective bargaining agreements. While some of the individuals participating in your program work for employers who are signatories of a "collective bargaining agreement", this agreement appears designed to have minimal, if any, impact on the rights of the employer. It is terminable after one year at the will of the employer. In the case of a sole proprietor or where the owner of a company or members of his or her family are the sole participants in the "agreement", characterization of the arrangement as "collectively bargained" appears inappropriate. We do not believe a collective bargaining agreement exists where the owner and the sole employee with whom the owner bargains are the same individual. Although you characterize the provisions of your agreement as being typical of a collectively bargained agreement, in reality the employers have given up few rights.

You also indicate that participation in the union is not required and basically anyone can join the union.

Therefore, we have concluded that your members participation in your program under the "collective bargaining agreement" is not sufficient to establish an employment related common bond for purposes of section 1.501(c)(9)-2(a)(1) of the regulations. You have not submitted satisfactory evidence to establish that the benefits you provide are negotiated in good faith. Accordingly, we are unable to conclude that your program is entitled to the treatment accorded bona fide programs negotiated through the collective bargaining process. See section 7701(a)(46) of the Code and section 301.7701-17T, Q&A 2(c) of the regulations.

The submitted information also establishes that several of your participating employers only provide benefits to a few individuals and that these individuals appear to be the owner(s) of the company or the owner and members of his or her family. This constitutes no more than a self-selection of benefits by that employee. Furthermore, this arrangement permits the participating employer to purchase disproportionate benefits when compared with the amount of benefits other employers might be entitled to obtain. Section 1.501(c)(9)-4(b) of the regulations provides that the payment of disproportionate benefits is prohibited inurement for the purposes of section 501(c)(9) of the Code. Therefore, you cannot qualify for recognition of exemption under section 501(c)(9).

Accordingly, we have concluded that you have not established that you qualify for recognition of exemption from federal income tax under section 501(c)(9) of the Code. Therefore, you are required to file federal income tax returns.

Re: [redacted]

Although we have used the term "cafeteria plan" in this letter, the use of that term should not be interpreted either directly or indirectly as a ruling that your plan satisfies the requirements of section 125 and other related sections of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Procedures. In responding, you need not resubmit any arguments that you have already made in your protest of [redacted].

If we do not hear from you within 30 days, this ruling will become final and a copy of it will be forwarded to your key District Director. Thereafter, any questions about your federal income tax status of the filing of tax returns should be addressed to that office.

When submitting additional letters with respect to this case to the Internal Revenue Service, you will expedite their receipt by placing the following symbols on the envelope: CP:E:EO:T:5, Room 6236. These symbols do not refer to your case but rather to its location.

cc: [redacted]

cc: Attorney

Sincerely yours,

(signed) [redacted]

[redacted]
Chief, Exempt Organizations
Technical Branch 5

[redacted]

8-22-95

8/21/95