9-26-91

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AUG 14 1991

Employer Identification Number: [redacted]
Key District Office: Atlanta

Dear Applicant: [redacted]

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

The information submitted indicates that you were established in [redacted] to provide a severance pay benefit to employees of the sponsoring employer, [redacted]. The benefit provided to each participating employee is equal to two times the average annual compensation of the employee for the year period of highest compensation in the immediately preceding five year period. The benefit is paid in a lump sum no later than six months after the date of the eligible employee's termination of employment with the employer unless valid, good faith reasons exist preventing such payment.

Your employee census data indicates that your membership includes [redacted] members, [redacted] and her husband, [redacted]. [redacted] is the president, director, and sole shareholder of the sponsoring employer. Both members' compensation from the employer for the previous year equaled $[redacted] and years of service totalled [redacted] years.

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 associations or their dependents or designated beneficiaries if no part of the net earnings of such associations inure (other than through such payments) to the benefit of any private shareholder or individual.

General guidelines for distinguishing a severance pay plan from a pension plan are provided at 29 CFR 2510.3-2(b). This section states, in pertinent part, that an arrangement shall not be deemed to constitute an employee pension benefit plan or pension plan solely by reason of the payment of severance

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benefits, provided that such benefits are not contingent, directly or indirectly, upon the employee retiring.

Section 1.501(a)-1(c) of the Income Tax Regulations provides that the words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization. Also, Section 1.501(c)(9)-1(d) includes as a requirement for exemption under section 501(c)(9) that no part of the net earnings of a section 501(c)(9) organization inures, other than by payment of benefits permitted by section 501(c)(9), to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-4(a) of the regulations provides the general rule that no part of the net assets of an employees' association may inure to the benefit of any private shareholder or individual other than through the payment of benefits permitted by section 1.501(c)(9)-3. Whether prohibited inurement has occurred is a question to be determined with regard to all of the facts and circumstances, taking into account the guidelines set forth in this section. The guidelines and examples contained in this section are not an exhaustive list of the activities that may constitute prohibited inurement, or the persons to whom the association's earnings could impermissibly inure.

For an organization to be described in section 501(c)(9), no part of its net earnings can inure to the benefit of any private shareholder other than through the payment of permissible benefits. 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 personal and private interest in the activities of the organization. The word "private" is the antonym of "public"--used merely to distinguish a private individual from the general public--and is intended to limit the scope of those persons who personally profit from the organization to the intended beneficiaries of the allowable activities. Clearly, an individual related to a VEBA as president, director and sole shareholder of the contributing employer has a personal interest in the VEBA's activities and is subject to the section 501(c)(9) inurement proscription.

Whether a VEBA meets the requirement that no part of its net income inures to the benefit of any private individual is a question to be determined with regard to all the facts and circumstances. Prohibited inurement arises when a VEBA serves an

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individual or individuals other than through the proper performance or functions characteristic of organizations described in section 501(c)(9). A VEBA functions primarily as a cooperative device for pooling funds and distributing risks 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 (or individuals) standing in relationship to the organization as an investor for private gain.

In your case, the benefits provided by you will be paid to [redacted], the sole shareholder, and her husband, [redacted]. In addition, by reason of her ownership and control over the employer corporation, [redacted] has ultimate control over the continued existence of the trust. Under these circumstances, we believe [redacted] maintains a posture that is incompatible with the inurement proscription of section 1.501(c)(9)-4(a) of the regulations. A limited membership in combination with allocation of a dominant share of the assets to the owner and her husband indicates that the VEBA is organized and operated for the benefit of its owner/member and not for any employee group. The trust is subject to termination at the discretion of the owner/member. By controlling the timing of trust termination, the owner/member is able to direct the distribution of her allocable share of the trust assets. Under these circumstances, the plan functions substantially as an investment fund for the direct personal and private benefit of its owner/member. An organization functioning in this manner is inconsistent with the exempt purpose of a VEBA of providing benefits to promote the common welfare of an association of employees, as opposed to the welfare of a single employee.

In addition, your severance benefit is contingent, in certain instances, upon a member's retirement.

Accordingly, based on all the facts and circumstances, we conclude that you do not 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.

You have a 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 in duplicate within 30 days from the date of this letter. You also have a right to a conference in this office after your statement

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is received. You must request a 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 Practice Procedures.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key district office. Thereafter, any questions about your federal income tax status or 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: [redacted], [redacted]. These symbols do not refer to your case, but rather to its location.

Sincerely,

(signed) [redacted]

[redacted]

Chief, Exempt Organizations
Rulings Branch 2

cc: DD, Atlanta
Attn: EO Group