M. UPDATE ON VEBAs

1. Introduction

While there is much that can be written about Voluntary Employees' Beneficiary Associations (VEBAs), there is also much that remains uncertain. Some issues left open by the publication of IRC 501(c)(9) regulations in 1981 have been resolved. Others have not. We are still without regulations covering the new nondiscrimination provisions of the Deficit Reduction Act of 1984 (DEFRA). As of this writing, we do not have final regulations covering the new IRC 419 and 419A rules for the deductibility of employer contributions to VEBAs and to other employee welfare benefit funds, and the existing temporary regulations concern only collectively bargained plans. In addition, the President's tax reform proposals would provide uniform nondiscrimination rules for exclusions from employee income for benefits received through welfare benefit plans, and Congress has drafted its own version of these proposals. Whether these legislative proposals will be enacted, in what form, and as of what effective date, are questions unanswerable at this time.

This topic will discuss recent VEBA developments and will include a brief outline of the 1984 legislation. It will not cover, except in the most general terms, those questions that can only be answered with reference to forthcoming regulations.

2. National Office v. Field Office Consideration

Jurisdiction over IRC 501(c)(9) determinations with certain exceptions has been returned to field offices. We anticipate that the vast majority of these cases will be suspended until there is sufficient public guidance to process IRC 501(c)(9) determinations with clear standards and with uniformity. At a minimum, this will require the publication of rules covering the IRC 505(b) nondiscrimination requirements enacted in DEFTA. A suspension of IRC 501(c)(9) determinations that are subject to the IRC 505(b) nondiscrimination requirements was announced in Announcement 85-164, 1985-48 I.R.B. 40.

Certain cases, such as those involving VEBAs with just a few members, including the owner of the sponsoring employer, will continue to be processed in the National Office. Those cases involving collectively bargained organizations that include within their membership only employees within the bargaining unit may be processed in field offices. The IRM will describe in detail the types of cases that may be worked in the field and those to be forwarded to the National Office.

3. Checking the Nuts and Bolts

(A) There Must be an Organization Separate from the Employer

As with any other applicant for exempt status under IRC 501(a), there must be an organization. Most applicants are trusts, but a VEBA may also take the form a corporation, or of an unincorporated association with enough characteristics of a corporation to be described in Reg. 301.7701-2. The organizational document (trust document, articles of incorporation, etc.) must accompany the application. In all cases a VEBA applicant must be an organization that is a separate entity from the employer.

Upon occasion, the Service receives IRC 501(c)(9) applications from taxable business corporations that intend to provide benefits to employees, but that have not created a separate entity for this purpose. The Form 1024 in such cases is usually in the name of the employer. Denial of exemption is automatic because the employer is clearly not described in IRC 501(c)(9).

(B) There Must be a Complete Description of the Benefits Offered

Every VEBA applicant must show what benefits are offered, to whom, in what amount, for what duration, and in what circumstances. There is no required format. The information may be entirely within one "plan document," in several different documents, or in the trust instrument or other organizational document. It must, however, be in writing, and must be sufficiently complete so that for each benefit offered it can be determined which persons are eligible recipients, what conditions trigger the payment or distribution of the benefit, whether and to what extent employees are offered the benefit upon different criteria or conditions, and how the amount of the benefit is calculated or determined. If any of this information is missing from the organization's application for exemption, the organization should be asked to furnish it.

Where benefits are provided through commercial insurance policies, copies of all such policies should accompany the application. If individual policies of insurance are provided to participants, single exemplar copies that are typical of policies generally issued to participants are acceptable if they adequately describe all forms of insurance available to participants. Insurance policies should be checked to verify that they are in the name of the VEBA rather than in the name of the employer.

4. The Employment-Related Common Bond

Reg. 1.501(c)(9)-2(a)(1) requires a VEBA to have a membership composed of individuals who have an employment-related common bond. The requirement that the membership must be composed of individuals, and not organizations, was upheld in Bricklayers Benefit Plans of Delaware Valley, Inc. v. Commissioner, 81 T.C. 725 (1983).

A VEBA may qualify for exemption even if some individuals are technically not employees, provided that these individuals share an employment-related common bond with the employee-members and that at least 90 percent of the membership on one day of each quarter of the taxable year consists of employees. Examples of persons who share an employment-related common bond with the membership, but who are not employees, include proprietors and partners.

The requirement that the individual members have an employment-related common bond can be met in a number of ways, and the determination whether an employment-related common bond exists is made taking into account all the facts and circumstances. The requirement will clearly be satisfied, however, if the membership is defined by reference to one of the criteria specified in (A) through (E) below.

(A) The Membership is Defined by Reference to a Common Employer

(B) The Membership is Defined by Reference to Affiliated Employers

To determine whether two or more employers are affiliated, the rules contained in IRC 414(b), (c), and (m), and the temporary regulations thereunder, may be considered. Generally, these rules look to affiliation in terms of stock or profits interest ownership. There are some situations, however, where these rules cannot be used to establish affiliation. For example, if the employers are of a nonstock character, the surrounding circumstances are examined to determine whether there is a substantial degree of close control and supervision by a common parent organization, or whether one employer has a substantial degree of close control and supervision over the others. Rev. Rul. 68-26, 1968-1 C.B. 272, describes a situation where a church appoints the board of directors of a nonstock organization that supplies printed material solely for the church's parochial school system and that is responsible to the church for the organization's finances. All profits are returned to the parochial school system. Although control cannot be established under the ownership rules of IRC 414(b), (c) or (m), the organization described in Rev. Rul. 68-26 is under the close supervision and control of the church to the extent necessary to be considered affiliated with the church for purposes of Reg. 1.501(c)(9)-2(a)(1).

(C) <u>The Membership is Defined by Reference to a Labor Union</u>

An employment-related common bond may have as its focus a labor union, or one or more locals of the same national or international labor organization. Employees of a labor union will be considered to share an employment-related common bond with members of the union.

(D) <u>The Membership is Defined by Reference to One or More Collective Bargaining Agreements</u>

The collective bargaining agreements must have been as a result of good faith negotiations between the employer and employees. We have seen cases where purported "collective bargaining agreements" covered only the principal officers of corporations, and the only apparent bargaining was with an insurance agent for the amount and cost of the benefit.

(E) <u>The Membership is Defined by Reference to Employers in the Same Line of Business in the Same Geographic Locale</u>

Organizations may qualify as VEBAs if the employers of the member-employees are engaged in the same line of business in the same geographic locale. Many multiple-employer trusts that seek to establish exemption under IRC 501(c)(9) have been created by trade associations exempt under IRC 501(c)(6). Typically, the trust provides commercial group insurance to the employees of the association's member-employers. By expanding the size of the insurance pool to cover the entire industry, the association seeks to lower insurance costs for its member-employers.

If an IRC 501(c)(6) trade association itself provides group insurance for its members, it is considered to be carrying on unrelated trade or business. See Rev. Rul. 66-151, 1966-1 C.B. 152; Rev. Rul. 73-386, 1973-2 C.B. 191. The Service position on group insurance provided directly by IRC 501(c)(6) organizations has been subject to much recent litigation and has been upheld in the 4th, 5th, and 6th Circuits. Louisiana Credit Union League v. U.S., 693 F.2d 325 (5th Cir. 1982); Carolinas Farm and Power Equipment Dealers Association v. U.S., 699 F.2d 167 (4th Cir. 1983); Professional Insurance Agents of Michigan v. Commissioner, 726 F. 2d 1097 (6th Cir. 1984). (For further discussion of this subject, see Topic F of this CPE text.) Because the provision of insurance benefits is generally permissible for a VEBA, trade associations may seek to establish IRC 501(c)(9) trusts to provide these benefits without incurring tax under IRC 511.

Two policy considerations motivated the geographic locale and line of business limitations of Reg. 1.501(c)(9)2(a)(1). First, they were designed to prevent national associations (such as national trade associations) from accomplishing through the use of VEBAs what they could not do directly. Second, they were designed to prevent VEBAs from being used as tax-exempt vehicles for marketing insurance throughout the country in a manner that would undermine those provisions of the Code covering the income tax treatment of insurance companies.

(1) The Same Geographic Locale

Employers engaged in business in the same state, metropolitan statistical area (MSA), or consolidated metropolitan statistical area (CMSA) are engaged in business in the same geographic locale. The Office of Management and Budget periodically publishes a description of existing MSAs and CMSAs, and maps are published in the County and City Data Book, U.S. Department of Commerce, Bureau of the Census. In general, employers operating in areas larger than a single state, MSA, or CMSA, are not considered to be engaged in business in the same geographic locale. However, the facts and circumstances of each case must be considered to determine whether organizations operating in areas outside a single state, MSA, or CMSA share the same geographic locale.

The geographic locale limitation was challenged in Water Quality Employees' Benefit Corp. v. U.S., 85-1 USTC Paragraph 9332 (N.D. Ill., 1985). The association, which served member employers in many states, claimed that Reg. 1.501(c)(9)-2(a)(1) went beyond the scope of the IRC 501(c)(9) statute in imposing the limitation, and that the Service was appropriating to itself law-making powers vested in Congress alone. The court, however, held that Reg. 1.501(c)(9)-2(a)(1) was a reasonable interpretation of the statute. It noted that the geographic locale limitation was not made applicable to all VEBAs, but only to multiple-employer VEBAs. The association has appealed to the 7th Circuit.

(2) The Same Line of Business

To determine whether the employers in a multiple-employer VEBA are in the same line of business, each employer's major economic activity should be determined. It is not sufficient for the employers merely to be members of the same trade association.

The Service will consider two or more employers to be in the same line of business if, in carrying on their major economic activity, they use similar production or marketing facilities, produce products or provide services with markedly similar characteristics, and compete in the same markets. Generally, the Service will accept as in the same line of business employers who share the same 3-digit "Industry Group" number in the Standard Industrial Classification Manual of the Office of Management and Budget (1972).

5. Permissible Benefits

There have been few developments in the last several years in concerning what benefits may be provided by an organization described in IRC 501(c)(9). Generally, the discussions in the 1983 and 1984 CPE Topics are still applicable.

The following chart provides a summary of benefits that are permissible under Reg. 1.501(c)(9)-3:

PERMISSIBLE BENEFITS (ALL VEBAs)

Term Life Insurance
Group Whole Life Insurance (as defined in IRC 79)
Accidental Death and Dismemberment (AD&D)
Medical Dental Disability (both long and short-term)
Vacation Pay
Vacation Facilities
Recreational Expenses
Child-care
Job Readjustment Allowances
Income Maintenance Payments in Times of Economic Dislocation
Temporary Living Expenses Loans and Grants in Times of Disaster
Supplemental Unemployment Compensation (SUB) Benefits
Severance Pay (if provided in accordance with 29 CFR Section 2510.3-2(b))
Education or Training Benefits or Courses for Members
Personal Legal Service Payments (through IRC 501(c)(20) organizations only)
Any other benefit meeting the criteria of Reg. 1.501(c)(9)-3(b), (c), (d), or (e)

ADDITIONAL PERMISSIBLE BENEFITS FOR COLLECTIVELY BARGAINED VEBAs ONLY

Benefits provided in the manner permitted by paragraphs (5) et. seq. of section 302(c) of the Labor Management Relations Act. The only significant types of benefits referred to, for practical purposes, are

1) Educational or Training Benefits for Dependents of Members

2) Personal Legal Service Benefits (other than through an IRC 501(c)(20)

IMPERMISSIBLE BENEFITS

Whole Life Insurance (nonqualifying under IRC 79)
Accident Insurance on Property
Homeowners' Insurance
Commuting Expenses
Malpractice Insurance
Loans (Other than in times of distress)
Savings facilities
Pensions Annuities, payable at retirement
Stock Bonus or Profit-sharing Plans
Any other deferred compensation benefits
Dependents' Education (noncollectively bargained plans)

6. <u>The Impact of DEFRA: Mandatory Filing Requirements</u>

IRC 505(c) was enacted in DEFRA to require all organizations to file notice with the Service in order to be recognized as exempt under IRC 501(c)(9). This provision is also applicable to IRC 501(c)(17) and IRC 501(c)(20) organizations. As of this writing, regulations have not been issued, but we expect that the requirements for IRC 501(c)(9) and IRC (c)(17) organizations will be similar to those in existence for 501(c)(3) organizations under Reg. 1.508-1(a). For organizations described in IRC 501(c)(20), we expect that the filing of the notice required by IRC 120(c)(4) and Reg. 1.120-3 will suffice for purposes of IRC 505(c), provided that a copy of the trust document accompanies that notice.

We anticipate that the rules under IRC 505(c) will be as follows:

[Chart not shown here]

7. <u>The Impact of DEFRA: Nondiscrimination Rules</u>

IRC 505(b) was enacted in DEFRA to provide additional nondiscrimination requirements for benefits provided by most IRC 501(c)(9) and 501(c)(20) organizations. It is expected that when rules for implementing IRC 505(b) are published, they will provide standards that are stronger and more encompassing than the old rules against disproportionate benefits of Reg. 1.501(c)(9)-2(a)(2). Consequently, for those organizations to which IRC 505(b) is applicable, we expect that a test for discrimination under IRC 505(b) will eliminate the need for determining whether disproportionate benefits are provided under Reg. 1.501(c)(9)-2(a)(2). However, Reg. 1.501(c)(9)-2(a)(2) will retain its significance where IRC 505(b) does not apply.

(A) Organizations Not Subject to IRC 505(b)

IRC 505(a)(2) excepts collectively bargained plans from the nondiscrimination rules of IRC 505(b). Also not subject to IRC 505(b) are taxable years beginning before January 1, 1985 for all organizations.

(B) Organizations Subject to IRC 505(b), but with Benefits Tested Under Other IRC Provisions

For those organizations that are subject to the IRC 505(b) rules, IRC 505(b)(3) provides that benefits for which other IRC sections provide nondiscrimination rules will be tested under the specific nondiscrimination rules of the applicable other IRC section rather than the rules of IRC 505(b)(1). Thus, for example, if a VEBA subject to IRC 505(b) provides group-term life insurance benefits, the nondiscrimination rules of IRC 79 apply to those particular benefits. Examples of other benefits with specific nondiscrimination rules are medical benefits (IRC 105); group legal service benefits (IRC 120); educational assistance benefits (IRC 127); and dependent care assistance (IRC 129).

(C) The General Rule -- Organizations Subject to IRC 505(b), with Benefits Tested Under IRC 505(b)(1)

When a VEBA that is subject to IRC 505(b) provides benefits for which there are no specific nondiscrimination rules in the Code, the general nondiscrimination rules of 505(b)(1) apply to those benefits. Severance benefits and disability benefits, for example, will be tested under these rules. IRC 505(b)(1) requires that:

1) each class of benefits is to be provided under a classification of employees which is set forth in the plan and which is found by the Secretary not to be discriminatory in favor of highly compensated individuals; and

2) the benefits are to be provided on a basis that does not discriminate in favor of highly compensated individuals.

Highly compensated individuals are defined in IRC 505(b)(5) and IRC 105(h)(5) to mean one of the five highest paid officers of the employer, a shareholder who owns more than ten percent of the value of the stock of the employer, or employees who are among the highest paid ten percent of participating employees.

IRC 505(b)(2) allows certain employees to be excluded from consideration for purposes of the general nondiscrimination rule of IRC 505(b)(1). These include:

1) employees with less than three years of service with the employer;

2) employees under 21 years of age;

3) seasonal employees or less than halftime employees;

4) employees not included in the plan who are covered by a collective bargaining agreement under which the benefits involved were the subject of good faith bargaining; and

5) non-resident aliens who receive no U. S.-source income.

Until the publication of rules to implement IRC 505(b)(1), there remains no guidance for considering applications from VEBAs that provide benefits that are subject to IRC 505(b)(1). We expect that these applications will remain under suspense until implementing rules are issued.

8. The Impact of DEFRA: Deductibility Rules

We are also without regulations governing most aspects of the deductibility of employer contributions to VEBAs under IRC 419 and IRC 419A. IRC 419 and 419A are effective for contributions made after December 31, 1985.

Under the pre-DEFRA rules, an employer could deduct ordinary and necessary expenses for employee welfare benefits under IRC 162 as long as they were not deferred compensation-type benefits. In general, employer deductions were not limited to the amount includible in the employee's gross income.

The new rules, in general, allow employer deductions for employee welfare benefits only under IRC 419 and not under IRC 162, and only in the year that:

1) the benefits are includible in the employee's gross income, or

2) the benefits would be includible in the employee's gross income but for a provision of the Code.

In addition, the new rules also allow employer deductions for providing funds for certain benefit accounts, up to specified levels.

The above rules apply to any welfare benefit fund, whether exempt under IRC 501(c)(7), IRC 501(c)(9), IRC 501(c)(17), or IRC 501(c)(20), or nonexempt.

In essence, the new rules are intended to prevent employers from obtaining current welfare benefit deductions for amounts that may never, or only at some remote time, be received by employees.

The new rules also prevent overfunding and sheltering abuses by limiting deductions for amounts that can be contributed to disability, medical, severance, life and supplemental unemployment accounts, and by subjecting income from these accounts to taxation to the extent account limits are exceeded.

A summary of the deductibility rules of IRC 419 and IRC 419A follows in the Appendix.

APPENDIX

Section 511 of the Deficit Reduction Act of 1984.

Treatment of Funded Welfare Benefit Plans

(For detailed discussion, see Parts B through F).

A. SCOPE

Summary

Creates new IRC 419 and 419A, which provide rules for deductibility of employer contributions to employer-established welfare benefit funds, including organizations described in IRC 501(c)(7), (9), (17), and (20) as well as nonexempt welfare benefit funds. Limits amount of deduction that can be taken by employer to the fund's qualified cost, computed under rules provided in IRC 419. Permits a carryover of excess contributions to the employer's succeeding taxable year. IRC 419A limits amounts set aside for disability, medical, severance, supplemental unemployment, or life benefits to those that are reasonably and actuarially necessary to fund claims incurred but unpaid, with specific further limitations for particular benefits. Provides special other limitations where no actuarial certification is furnished. Requires separate accounting and nondiscrimination requirements for post-retirement life and medical benefits for key employees, and requires that all such post-retirement benefits for key employees be paid from a separate account. Coordinates post-retirement medical benefit contributions for key employees with IRC 415. Excepts certain multi-employer plans from application of IRC 419 and 419A. Provides a downward ratchet transition rule over four years for funds currently with excess reserves. Subjects amounts exceeding the account limits of IRC 419A to unrelated business income taxation under IRC 512(a)(3) or, in the case of a non-exempt fund, subjects the employer to income taxation on the excess. Creates new IRC 4976 imposing a 100% excise tax on employers when fund amounts revert to the employer or when post-retirement medical or life benefits do not meet nondiscrimination or separate accounting requirements.

Effective Date

Section 511 of the Act applies to contributions paid or accrued after December 31, 1985. However, the provisions are effective June 22, 1984, in the case of contributions of facilities. Collectively bargained plans in existence or ratified by July 1, 1985, are not subject to these provisions until contracts currently in existence have terminated. The Service has issued temporary regulations in T.D. 8034, 1985-33 IRB 12 defining "collective bargaining plans" for purposes of IRC 419 and 419A.

B. IRC 419

Summary

Provides that contributions made by employers to welfare benefit funds are not deductible under IRC 162 or 212, but are instead deductible under IRC 419 if the "ordinary and necessary" and other requirements of IRC 162 or 212 are met. Limits the amount of deduction to the welfare benefit fund's qualified cost, which for any taxable year is the sum of the fund's qualified direct cost and the additions to its qualified asset accounts (subject to the limitations of IRC 419A), reduced by the fund's after-tax income.

For these purposes qualified direct cost is the aggregate amount, including administrative expenses, that would have been allowable as a deduction to a cash basis employer if the employer had provided the benefits directly. Benefits are only considered "provided" if they are includible in the recipient employee's gross income in the same tax year (or would be includible except for exclusions provided for in the Code). A special rule for child care facilities allows a fund to amortize costs as qualified direct costs over 60 months in lieu of depreciation.

After-tax income, for these purposes, means the fund's gross income, reduced by any income taxes paid (including UBI taxes, but not excise taxes) and by expenses directly connected with the production of gross income. Gross income does not include employer contributions, but does include employee contributions. The effect of these rules is to reduce otherwise allowable employer deductions by the amount of net investment income of the fund and by the amount of employee contributions to the fund.

Employers must carry over contributions in excess of the fund's qualified cost to the succeeding taxable year for deductibility purposes, and for purposes of determining the fund's qualified cost for the succeeding year.

Welfare benefit fund is defined as any fund that is part of an employer plan and through which an employer provides benefits. It includes employer-funded organizations under sections 501(c)(7), 501(c)(9), 501(c)(17), and 501(c)(20), as well as nonexempt organizations or accounts. However, benefits that are pensions and profit-sharing plans are not considered welfare benefits for purposes of IRC 419.

The provisions of IRC 419 cover employer plans for independent contractors as if they were employees.

C. IRC 419A - Qualified Asset Accounts

Summary

Defines the term "qualified asset account" as used in IRC 419 to mean any account set aside to pay disability, medical, supplemental unemployment, severance, or life benefits. Limits additions to qualified asset accounts, for purposes of IRC 419, to amounts that do not exceed an account limit as defined in IRC 419A. Requires separate accounts to be maintained for medical and life benefits provided for key employees after retirement and requires that all such benefits to key employees be paid from these accounts. Requires amounts for retired medical reserves for key employees to be treated as an annual addition to a defined contribution plan under IRC 415(c). Defines key employee by reference to IRC 416(i) as officers, the ten largest shareholders, any 5% shareholder, or any 1% shareholder with a salary of over $150,000.

Excepts from the application of IRC 419 and 419Amulti-employer benefit funds for plans of at least 10 employers to which more than one employer contributes, to which no employer normally contributes more than 10% of the total contributions, and which do not maintain experience ratings with respect to individual employers. Requires the employer to include in gross income the deemed unrelated income of a nonexempt fund, defined as the income that would have been unrelated income under IRC 512(a)(3) if the fund were described in section 501(c)(7), (9), (17), or (20).

For purposes of IRC 419 and 419A, allows the employer to elect to aggregate two or more funds so as to be treated as one fund. Prescribes that rules "similar to the rules" of IRC 414 shall apply in the treatment of related employers. Calls for regulations to be drafted to administer IRC 419 and 419A, and that these regulations may provide that the plan administrator of a plan to which more than one employer contributes shall submit necessary funding information to the contributing employers.

D. IRC 419A(c) - Account Limit

Summary

IRC 419A provides a limit beyond which amounts added to a qualified asset account cannot be included in a fund's qualified cost under IRC 419. The general rule of IRC 419A(c)(1) is that the account limit for any qualified asset account for any taxable year is the amount reasonably and actuarially necessary to fund claims incurred and unpaid as of the close of the taxable year, as well as administrative costs for such claims. Also, the account limit may be expanded to include an additional reserve for funding post-retirement life and medical benefits for current employees, with funding actuarially determined on a level basis. (Separate accounts must be maintained for key employees for these pre-funded post-retirement benefits.) Additional reserves for prefunded post-retirement life and medical benefits will not be considered to be within the account limit if they are discriminatory under new IRC 505, or to the extent that they include life benefits that are includible in gross income under IRC 79 or 101(b); i.e., over $50,000 of employer-provided group-term insurance coverage or of employer death benefit coverage.

IRC 419A(c) establishes for particular benefits a specific account limit that may vary depending upon whether the account limit has been actuarially certified. Where there is no actuarial certification, the account limit may not exceed the sum of the safe harbor limits. The conference report indicates that even if the safe harbor limits are not exceeded, the taxpayer must show that the reserves are reasonable.

[Chart not shown here]

Collectively bargained account limits will be higher than those of noncollectively bargained plans, as provided under regulations to be completed. Temporary regulations have been issued defining collectively bargained plans for purposes of IRC 419 and 419A. (T.D. 8034, 1985-33 IRB 12.)

TRANSITION RULE

The account limit for the first four taxable years after the date of enactment is increased by a declining percentage each year of the excess reserves.

E. AMENDMENT TO IRC 512(a)(3)

Summary

Amends IRC 512(a)(3) to extend its coverage to IRC501(c)(17) and 501(c)(20) organizations in addition to its current coverage of IRC 501(c)(7) and 501(c)(9) organizations. Generally, IRC 512(a)(3) defines "unrelated business taxable income" for these organizations as their gross income (excluding exempt function income) less applicable deductions and modifications. Thus, all income of these organizations is unrelated income unless it can be categorized as exempt function income as defined in IRC 512(a)(3)(B).

IRC 512(a)(3)(B) includes within the definition of exempt function income, amounts set aside by an IRC 501(c)(9) organization to provide life, sick, accident, or other benefits. The Act extends this provision of IRC 512(a)(3)(B) to IRC 501(c)(17) and 501(c)(20) organizations, but not to IRC 501(c)(7) organizations.

The Act adds new IRC 512(a)(3)(E), which limits the amount of a set aside under IRC 512(a)(3)(B) to amounts that are within the account limit of IRC 419A. No set-asides for facilities are allowed. Consequently, amounts in excess of the IRC 419A account limit or amounts set aside for facilities will not be considered exempt function income.

Income derived from reserves now in existence (as of the close of the last plan year before the date of enactment) for post-retirement medical or life benefits will not be subject to the limitation of IRC 512(a)(3)(E), but all payments of post-retirement medical or life benefits must be charged against these reserves.

The Act exempts from coverage under IRC 512(a)(3)those funds substantially all the contributions to which are made by tax-exempt employers that have been tax-exempt for at least five years.

F. IRC 4976 - TAXES WITH RESPECT TO FUNDED WELFARE BENEFIT PLANS

Summary

The Act adds new IRC 4976, which imposes a 100% excise tax on disqualified benefits of welfare benefit funds under IRC 419. Disqualified benefits are defined as:

1) medical or life benefits for key employees other than from a separate account under 419A(d).

2) post-retirement medical and life benefits that are discriminatory under IRC 505;

3) amounts reverting from the fund to the benefit of the employer.