O. IRC 501(c)(9)--FINAL REGULATIONS

1. Introduction

IRC 501(c)(9) exempts from federal income tax voluntary employees' beneficiary associations (VEBA) providing for the payment of life, sick, accident or other benefits to their members (or their dependents or designated beneficiaries) if no part of the net earnings inures (other than through such payments) to the benefit of any private shareholder or individual.

Proposed regulations under IRC 501(c)(9) were published in the Federal Register on January 23, 1969, and on July 17, 1980. Final regulations under IRC 501(c)(9) were published in the Federal Register on January 8, 1981 (T.D. 7750), and a copy appears at the end of this topic.

The final regulations clarify the basic requirements that an organization must meet in order to be a "voluntary employees' beneficiary association" within the meaning of IRC 501(c)(9). Generally, the basic requirements are that:

(a) the organization is an association of employees;

(b) membership in the association is voluntary;

(c) the purpose of the organization is to provide for the payment of life, sick, accident, or other benefits to its members or their dependents or designated beneficiaries, and substantially all of its operations are in furtherance of providing such benefits; and,

(d) no part of the net earnings of the organization inures, other than by payment of the benefits referred to in (c), to the benefit of any private shareholder or individual.

The purpose of this topic is to review the final regulations, and to highlight changes made in the 7-17-80 proposed regulations, which were the subject of a topic in the 1981 CPE text.

2. Procedures

With the publication of final regulations under IRC 501(c)(9), IRM 7664.43 and 7(10)62.4 have been eliminated. Now, key District Directors can issue determination letters under IRC 501(c)(9) in most cases. Cases can be sent to the National Office if they contain issues not covered by the regulations or other precedents.

There are a number of outstanding revenue rulings dealing with IRC 501(c)(9) that have been effectively obsoleted by the final regulations. These are Rev. Rul. 57-61, 1957-1 C.B. 197, Rev. Rul. 57-494, 1957-2 C.B. 315, Rev. Rul. 58-442, 1958-2 C.B. 194, Rev. Rul. 59-28, 1959-1 C.B. 120, Rev. Rul. 64-258, 1964-2 C.B. 134, Rev. Rul. 65-81, 1965-1 C.B. 225, and Rev. Proc. 66-30, 1966-2 C.B. 1212. These should not be relief on in disposing of cases.

Three other revenue rulings, Rev. Rul. 66-212, 1966-2 C.B. 230, Rev. Rul. 66-354, 1966-2 C.B. 207, and Rev. Rul. 74-18, 1974-1 C.B. 139, appear to remain viable, except as will be discussed below.

Announcement 81-95, 1981-21 I.R.B. 37, indicates that an organization already recognized as exempt under IRC 501(c)(9) can submit a written request to its key District Director for a determination that it continues to qualify for exemption in light of the publication of the final regulations. If an organization proposes changes in its operations to conform its operations to comply with final regulations, it may apply for a ruling from the National Office.

3. Discussion

A. Membership

Generally, only employees are entitled to come members. In addition, eligibility for membership must be defined by reference to objective standards that constitute an employment related common bond among such individuals. This "bond" can be a common employer, coverage under a collective bargaining agreement, or a labor union affiliation. In addition, employees of the voluntary employees' association and employees of the union whose members are members of the VEBA will be considered to share an employment related common bond. See Reg. 1.509(c)(9)-2(a). See also the discussion of membership restrictions in part 3(e) of this topic.

1. Multiple Employer Trusts

Employees of one or more employers engaged in the same line of business in the same geographic locale share an employment related common bond. However, the geographic locale limitation effectively denies exemption to national or statewide multiple employer trusts, unless they are established pursuant to a collective bargaining agreement. This provision is intended to prevent IRC 501(c)(9) from being used as a tax exempt vehicle for offering insurance products to unrelated individuals scattered throughout the country that would then undermine those provisions of the IRC concerning insurance companies. In addition, where an organization such as a national trade association or business league exempt under IRC 501(c)(6) operates a group insurance program for its members, the organization is engaged in unrelated trade or business. To allow trade associations to provide insurance benefits through an IRC 501(c)(9) organization would facilitate circumvention of the unrelated trade or business income tax otherwise applicable to this situation. Prior to the publication of the final regulations, some multiple employer trusts formed by trade associations received favorable rulings. However, under the final regulations, multiple employer trusts, whether formed by trade associations or insurance companies, will not qualify for exemption under IRC 501(c)(9) unless they qualify under the geographic locale limitation.

2. Employees

The regulations define the term "employee" broadly. (See Reg. 1.501(c)(9)-2(b)). In addition, a person is considered to be an employee if that person first becomes entitled to participate in the association by reason of being an employee. Thus, a person and the dependents of a person may receive benefits even though the person is on a leave of absence working temporarily for another employer, or as an independent contractor, or terminated from employment by reason of retirement, disability, or layoff. It is permissible to have non-employee members if at least 90% of the total membership of the association on one day of each quarter of the association's taxable year consists of employees, and the non-employee members share an employment related bond with the employee members. Such individuals may include, for example, the proprietor of a business whose employees are members of the association. The surviving spouse and dependents of an employee are "employees" if they are considered to be members of the association prior to the death of the employee member. Thus, if the surviving spouse and dependents meet this condition, they will not be subject to the10% limitation on non-employees.

B. Control

The regulations require that the VEBA must be an entity having an existence independent of the member-employees or their employer(s), and that it be controlled by either its membership, independent trustees or trustees or other fiduciaries some of whom are designated by the membership. A financial intermediary such as a bank, acting in a fiduciary capacity, generally will be considered to be an independent trustee. In a major change from the proposed regulations, the final regulations hold that a VEBA will be considered to be controlled by independent trustees if it is an "employee welfare benefit plan" as defined in section 3(1) of the Employee Retirement Income Security Act of 1974 (ERISA) and, as such, is subject to the requirements of Parts 1 and 4 of Subtitle B, Title 1 of ERISA. Under section 3(1) of ERISA, the term "employee welfare benefit plan" means any plan established or maintained by an employer or by an employee organization, or by both, for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services; or (B) any benefit described in section 302(c) of the Labor Management Relations Act of 1947 (other than pensions on retirement or death, and insurance to provide such pensions). This provision does not apply to any employee welfare benefit plan if:

1. such plan is a governmental plan (as defined in section 3(32) of ERISA);

2. such plan is a church plan (as defined in section 3(33)) with respect to which no election has been made under IRC 410(d);

3. such plan is maintained solely for the purpose of complying with applicable workmen's compensation laws or unemployment compensation or disability insurance laws;

4. such plan is maintained outside of the United States primarily for the benefit of persons substantially all of whom are nonresident aliens; or

5. such plan is an excess benefit plan (as defined in section 3(36)) and is unfunded.

<u>Thus, the vast majority of VEBAs will meet the control requirement by coming under section (3)1 of ERISA</u>.

An association will be considered to be controlled by its membership if it is controlled by one or more trustees designated pursuant to a collective bargaining agreement (whether or not the bargaining agent of the represented employees bargained for and obtained the right to participate in selecting the trustees). See Reg. 1.509(c)(9)-2(c).

C. Permissible Benefits

Reg. 1.501(c)(9)-3 describes the types of benefits an IRC 501(c)(9) organization can provide. Generally, IRC 501(c)(9) organizations can provide life, sick, accident, and other benefits to members, their dependents, and designated beneficiaries. Dependents include a member's spouse, his or her children, if the children are minors or students, and other minor children living with the member. Dependents also include any other individual who an association, relying on information furnished to it by a member, in good faith believes is a person described in IRC 152(a).

The regulations further provide that substantially all of an IRC 501(c)(9) organization's operations must be in furtherance of providing permissible benefits. This means that while an organization may provide some nonqualifying benefits, it will not qualify for exemption if it systemmatically and knowingly provides nonqualifying benefits of more than a de minimis amount. Reg. 1.501(c)(9)-1.

1. Life Insurance Benefits

"Life benefits" are benefits payable on the lives of members or their dependents. The regulations permit the payment of benefits that are either furnished pursuant to a contract of insurance with a life insurance company or paid directly by the VEBA.

Generally, the regulations require that life benefits consist of current protection only, and do not permit various forms of "permanent" life insurance contracts. There are three exceptions to this general rule. First, any organization may provide a certificate of eligibility to a participant in a group life insurance contract for individual coverage without evidence of insurability on termination of the member's relationship with the association. Second, life benefits generally include any "permanent benefit" provided in the manner prescribed in the regulations under IRC 79. This provision will be relevant to employer-funded organizations and permits, to the extent provided in the regulations under IRC 79, the provision of permanent benefits the cost of which is required to be included currently in the gross income of the employee. Third, an organization that is funded with employee, rather than employer, contributions generally may offer life benefits that involve permanent protection. Where permanent benefits are allowed, cash surrender and policy loan benefits are permitted as these are commonly provided in permanent life insurance contracts.

Some employer-funded organizations may offer a term life insurance benefit that has an effective date coinciding with the employee's retirement. Such plans, known as "retired life reserves" may not meet the requirement that a life benefit be for current protection. Cases involving this form of insurance coverage should be forwarded to the National Office because they are not covered by published precedent.

The regulations permit settlement of a life insurance policy in the form of an annuity where the treatment of the annuity is the same as if the annuity had been taken in lieu of a lump sum; that is, where the interest element in the periodic annuity payment is includable in the recipient's gross income.

2. <u>Sick and Accident Benefits</u>

The term "sick and accident benefits" means amounts furnished to or on behalf of a member or a member's dependents in the event through illness or personal injury. These benefits may be provided through reimbursement for amounts paid by a member or through the payment of premiums to a medical benefit or health insurance program. (See Reg. 1.501(c)(9)-3(c)).

Rev. Rul. 66-212, 1966-2 C.B. 230, holds that an organization that is exempt from federal income tax under IRC 501(c)(9) may reimburse its members for premiums paid under the medical benefits program (medicare) provided under the Social Security Amendments of 1965, Public Law 89-97, 1965-2 C.B. 601.

3. <u>Other Benefits</u>

The regulations provide that "other benefits" are those that are similar to life, sick, and accident benefits. A benefit is similar if:

a. it is intended to safeguard or improve the health of a member or a member's dependents, or

b. it protects against a contingency that interrupts or impairs a members earning power.

The following are examples of permissible other benefits:

1. paying vacation benefits.

2. providing vacation facilities.

3. subsidizing recreational activities.

4. providing child-care facilities.

The following paragraphs contain discussions of other qualifying benefits.

a. <u>Loans</u>

The regulations permit benefits in the form of temporary living expense loans at times of disaster, such as fire or flood, but do not allow such organizations to provide loans to members in the ordinary course of a banking or financing business.

b. <u>Job Readjustment Allowances</u>

The regulations provide that job readjustment allowances may be paid as an example of a benefit provided to protect against a contingency that interrupts earning power, as it allows a worker to bridge the period between jobs without the loss of income.

c. <u>Severance and Supplemental Unemployment Compensation Benefits</u>

Permissible supplemental unemployment compensation benefits are defined by reference to IRC 501(c)(17(D)(i). This takes into account IRC 501(c)(19)(E) which states that exemption as an IRC 501(c)(9) organization shall not be denied because of the provision of supplemental unemployment compensation benefits. Permissible severance benefits are defined by reference to 29 CFR 2510.3-2(b). This is a labor law provision that distinguishes a severance pay plan from a pension plan for purposes of Title I of ERISA. General guidelines include a maximum amount of payment not to exceed twice the employee's most recent annual compensation payment must be within two years after the termination of employment. 29 CFR 2510.3-2(b) is excerpted below:

(b) Severance pay plans. (1) for purposes of Title I of the Act and this chapter, an arrangement shall not be deemed to constitute an employee pension benefit plan or pension plan solely by reason of the payment of severance benefits on account of the termination of an employee's service, provided that:

(i) Such payments are not contingent, directly or indirectly, upon the employee's retiring;

(ii) The total amount of such payments does not exceed the equivalent of twice the employee's annual compensation during the year immediately preceding the termination of his service; and

(iii) All such payments to any employee are completed,

(A) In the case of an employee whose service is terminated in connection with a limited program of terminations, within the later of 24 months after the termination of the employee's service, or 24 months after the employee reaches normal retirement age; and

(B) In the case of all other employees, within 24 months after the termination of the employee's service.

(2) For purposes of this paragraph (b),

(i) "Annual compensation" means the total of all compensation, including wages, salary, and any other benefit of monetary value, whether paid in the form of cash or otherwise, which was paid as consideration for the employee's service during the year, or which would have been so paid at the employee's usual rate of compensation if the employee had worked a full year.

(ii) "Limited program of terminations" means a program of terminations:

(A) Which, when begun, was scheduled to be completed upon a date certain or upon the occurrence of one or more specific events;

(B) Under which the number, percentage or class or classes of employees whose services are to be terminated is specified in advance; and

(C) Which is described in a written document which is available to the Secretary upon request, and which contains information sufficient to demonstrate that the conditions set forth in paragraphs (b)(2)(ii)(A) and (B) of this section have been met.

d. Benefits Under the Labor Management Relations Act (LMRA)

Reg. 1.501(c)(9)-3(e) provides that for collectively bargained trusts, other benefits also include any benefit provided in the manner permitted by paragraph (5) et. seq. of section 302(c) of the Labor Management Relations Act of 1947. In applying this portion of the regulations the following points should be kept in mind:

1. the regulations permit benefits allowed by paragraph (5) et. seq. of section 302(c), "except to the extent otherwise provided" in the regulations. This resolves the apparent inconsistency of pension benefits that are allowed under 302(c)(5) but which are expressly prohibited in Reg. 1.501(c)(9)-3, in favor of the regulations.

2. the benefits must be provided "in the manner permitted" by section 302(c). This includes the establishment of a trust by the employees' representative (i.e. labor union), the existence of a written collective bargaining agreement, employer-representation in the administration of the organization, etc.

At present, the only significant benefits that the reference to section 302(c) allows are the provision of educational benefits to members' dependents and the direct provision of personal legal service benefits.

e. Legal Benefits

The final regulations permit the provision of personal legal service benefits in the case of collectively bargained trusts because they are specifically enumerated as allowable under section 302(c)(8) of the Labor Management Relations Act (LMRA) which is discussed in detail above. However, trusts that do not participate in the collective bargaining process are restricted to personal legal service benefits that consist of payments or credits to one or more organizations or trusts described in IRC 501(c)(20). This requires the existence of a qualified group legal services plan within the meaning of IRC 120. A plan is defined under IRC 120 as a separate written plan of an employer for the exclusive benefit of his employees or their spouses or dependents. In this situation, in order to provide personal legal service benefits, the trust or organization to which the IRC 501(c)(9) organization provides funds, must be funded, at least partially, by the members' employers.

f. Educational Benefits

Education or training benefits or courses such as apprentice training programs for members are permissible other benefits. In addition, because collectively bargained trusts may provide the benefits described in section 302(c) of the Labor Management Relations Act, these organizations can provide educational benefits, such as scholarships, to dependents of members.

In Ohio Teamsters Educational and Safety Training Trust Fund v. Commissioner, 77 T.C. No. 16, the Tax Court held that a trust established pursuant to a collective bargaining agreement between a labor union and an employers association that proposed to award scholarship grants to union members and their families did not qualify for exemption under IRC 501(c)(3). It is likely, on the other hand, that this type of organization would qualify for exemption under IRC 501(c)(9).

4. Non-Qualifying Benefits

The following categories of benefits are impermissible:

a. benefits similar to those provided by a pension, stock bonus or profit-sharing plan;

b. deferred compensation benefits, defined as being payable by reason of passage of time rather than as the result of an unanticipated event. For example, supplemental unemployment benefits generally become payable by reason of unanticipated layoff, and thus become payable by reason of an unanticipated event;

c. property or malpractice insurance;

d. loans (other than loans at times of disaster or whole life insurance policy loans);

e. savings plans (See Example (2) of Reg. 1.501(c)(9)-3(g)); and,

f. commuting expenses.

Rev. Rul. 66-354, 1966-2 C.B. 207, holds that an organization established by a collective bargaining agreement between an association of manufacturers and a labor union to collect federal and state employment taxes which the manufacturers are required to deduct from the wages of their employees who are members of the union, and pay over the amounts so collected to the appropriate tax authorities, does not qualify for exemption under IRC 501(c)(4), 501(c)(5), 501(c)(6) or 501(c)(9). This Rev. Rul. appears to remain valid under the final regulations. The organization is not itself providing any benefits. Rather, it is merely providing an administrative service to the employers.

Rev. Rul. 74-18, 1974-1 C.B. 139, holds that an association formed by a corporation to provide workmen's compensation benefits that the corporation was already obligated to pay under state law does not qualify for exemption under IRC 501(c)(9).

It is not clear if Rev. Rul. 74-18 is still valid, since section 302(c) of the LMRA lists compensation for injuries or illness resulting from occupational activity as a permissible benefit. Thus, at least in the case of a collectively bargained trust, it could be argued that workmen's compensation benefits are permissible. Cases involving such trusts should probably be sent to the National Office for consideration.

D. <u>Inurement</u>

No part of the net earnings of an IRC 501(c)(9) organization may inure to the benefit of any private shareholder or individual other than through the payment of permitted benefits. "Private shareholder or individual" refers to persons having a personal or private interest in the activities of the organization and includes the members, officers, trustees, employees and fiduciaries of the organization and contributing employers.

Generally, the payment of unreasonable compensation to the trustees or employees of the association, or the purchase of insurance or services for amounts in excess of their fair market value from a company in which one or more of the association's trustees, officers or fiduciaries has an interest, will constitute prohibited inurement.

Inurement can also consist of the disposition of property to, or the performance of services for, a person for less than the greater of fair market value or cost to the association, other than as the provision of a permissible benefit.

Experience rated insurance rebates to employers are allowed. Also, on dissolution, assets may be distributed to members, or used for benefits until depleted, but may not be returned to the contributing employers. In addition, administrative adjustments can be made. For example, if an employer erroneously makes excessive contributions, the excessive amounts can be returned to the employer.

It is important to note that many instances of inurement, such as the payment of unreasonable compensation to the trustees or employees of the association, or the purchase of insurance or services for amounts in excess of their fair market value from a company in which one or more of the association's trustees, officers, or fiduciaries has an interest, may constitute violations of the fiduciary responsibility rules of ERISA. If such a case arises during an examination, the procedures for coordination with the Department of Labor must be followed. See IRM 7(11)90. The DOL-IRS agreement to exchange examination information is contained in IRM Exhibit 7(11)90-2.

E. Membership Restrictions and Disproportionate Benefits

Eligibility for membership may be restricted by geographic proximity, or by objective conditions or limitations reasonably related to employment, such as a limitation to a reasonable classification of workers, a limitation based on maximum compensation, or a requirement that a member be employed on a full-time basis. Similarly, eligibility for benefits may be restricted by objective conditions relating to the type or amount of benefits offered. Any objective criteria used to restrict eligibility for membership or benefits may not, however, be selected or administered in a manner that limits membership or benefits to officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association. Similarly, eligibility for benefits may not be subject to conditions or limitations that have the effect of entitling officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association to benefits that are disproportionate in relation to benefits to which other members of the association are entitled.

For example, in the case of an employer-funded organization, a provision that excludes or has the effect of excluding from membership in the organization or participation in a particular benefit plan, employees who are members of another organization or covered by a different plan, funded or contributed to by the employer, to the extent that such other organization or plan offers similar benefits on comparable terms to the excluded employees will be considered a reasonable restriction. Similarly, the provision of life benefits in amounts that are a uniform percentage of the compensation received by the individual whose life is covered will be considered a reasonable restriction. See Reg. 1.501(c)(9)-2(a)(2)(ii).

The regulations indicate that while an employer-funded organization may not restrict membership or eligibility for benefits to officers, shareholders, or highly compensated employees of the employer, VEBA's need not comply with antidiscrimination rules as stringent as those that apply to qualified pension trusts described in IRC 401.

The payment of disproportionate benefits to members who are officers shareholders or highly compensated employees of a contributing employer constitutes inurement. The parts of the regulations dealing with inurement (1.501(c)(9)-4(b)) and membership restrictions (1.501(c)(9)-2(a)(2)) should be considered together in considering problems involving disproportionate benefits.

The National Office is currently considering two issues in this area. First whether life benefits can be integrated with social security coverage. In this case, the organization determines a life benefit to members proportionate to each member's income. Each employees' benefit is then reduced by the value of his social security coverage. The practical result of this is that only highly compensated individuals receive a life benefit from the organization. The second situation involves an employer with a number of different operating plants. Employees at each facility are covered by a different benefit package, with the result that similarly situated employees receive disproportionate benefits. We are considering in both cases whether these practices violate the regulations. Similar cases should be sent to the National Office.

F. <u>Record-Keeping and Taxability of Benefits</u>

Every IRC 501(c)(9) organization must maintain records indicating the amount contributed by each member and contributing employer, and the amount and type of benefits paid by the organization to or on behalf of each member. Reg. 1.501(c)(9)-5. Cash and noncash benefits realized by a person on account of the activities of an IRC 501(c)(9) organization must be included in the gross income of the recipient to the extent provided in the Internal Revenue Code. Reg. 1.501(c)(9)-6.

Many of the benefits received by members of IRC 501(c)(9) organizations are statutorily excluded from the gross income of the recipient. For example, the following benefits are excluded if they meet the requirements under the sections provided: health and accident plans under IRC 105, compensation for injuries under IRC 104 certain death benefits under IRC 101 employer contributions to accident and health plans under IRC 106, and certain educational assistance under IRC 127. It should be remembered that these statutory exclusions govern the question of taxability of benefits and this issue is not governed by whether an individual is eligible for membership in the IRC 501(c)(9) organization or by the permissibility of the benefit paid. For example, if a benefit is paid by an employer-funded IRC 501(c)(9) organization to a member who is not an "employee," a statutory exclusion from gross income that is available only for "employees" would be unavailable in the case of a benefit paid to such individual. In addition, for example, the fact that educational benefits constitute "other benefits" under some circumstances does not of itself mean that such benefits are eligible for the exclusion under either IRC 117 or IRC 127. On the other hand, the fact that amounts paid under a self-insured medical expense reimbursement plan discriminate in favor of highly paid individuals within the meaning of IRC 105(h), (resulting in taxable benefits to such individuals), does not necessarily mean that such payments will result in disproportionate benefits under Reg. 1.501(c)(9)-2(a)(2).

Benefits realized by an employee may constitute taxable income to the employee to the extent provided in the Code including, but not limited to, IRC 61, 72, 101, 104, and 105. See also other appropriate sections of the Code such as IRC 79, 106, 120, and 127. Taxable benefits may be taxable when the employer makes a contribution to the trust or when the trust pays the benefit. Benefits are generally subject to tax at the time a benefit is "realized."

Benefits will generally be considered "realized" when the employer makes contributions to the trust if they are definable and nonforfeitable at that time. In these cases, the employer must report the contributions as wages paid to the employee unless excludable under IRC 106 or other applicable Code section. If benefits are forfeitable, that is, contingent on some event not within the employee's control, such as involuntary unemployment, income will not be realized until payments are made by the IRC 501(c)(9) trust. In Rev. Rul. 67-351, 1967-2 C.B. 86, a vacation plan was established for employees (pursuant to a collective bargaining agreement). The employer funded the plan and each employee's interest in the plan was fully vested and nonforfeitable from the time the money was paid by the employer. The amounts were required to be paid to employees 16 months after the end of the fiscal year in which they were paid to the trust. The Rev. Rul. held that the employer contributions were realized by the employee when paid by the employer. However, in Rev. Rul. 57-316, 1957-2 C.B. 626, vacation plan contributions by an employer were held not to be realized by the employee at the time the money was paid by the employer where the trustees of the IRC 501(c)(9) organization had "control" of the payment of the vacation benefit under IRC 3401(d). In this case, the IRC 501(c)(9) organization is responsible for withholding at the time of payment to the employee. In Rev. Rul. 77-347, 1977-2 C.B. 363, supplemental unemployment compensation benefits were "realized" by employees in the year of receipt. Employees did not receive the benefits until employment was terminated because of permanent discontinuance of the company's business, acquisition by another company, etc. See also Rev. Rul. 70-51, 1970-1 C.B. 192.

If a benefit is taxable it will either be wages (subject to income tax withholding, FICA and FUTA and reporting on Forms W-2 or W-3), or it will be subject to the information return requirements of IRC 6041. Generally, payments by an IRC 501(c)(9) organization in excess of $600 constituting taxable benefits (other than wages) must be reported on Forms 1096 and 1099. (Reg. 1.6041-1(a)(2)). Wages or benefits that are treated as wages are reported on Forms W-2 and W-3. See IRC 3401 and regulations thereunder.

Vacation benefits generally constitute wages under Reg. 31.3401(a)-1(b)(3) (but note exception above) as do supplemental unemployment compensation payments. Dismissed or severance payments generally constitute wages (reg. 31.3401(a)-1(b)(4)). If a benefit is taxable when the employer pays it, the employer is responsible for withholding, FICA and FUTA, (assuming it is wages) and if the benefit is taxable when the IRC 501(c)(9) organization pays it, the organization is responsible for the reporting and any other requirements. However, an IRC 501(c)(9) organization may be responsible for income tax withholding, while the employer is directly responsible for FICA and FUTA taxes. See Rev. Rul. 57-316, 1957-2 C.B. 625. Under Reg 31.3504-1, the IRC 501(c)(9) organization may receive authorization from the District Director or Director of a service center to pay over FICA and FUTA taxes on behalf of the employer. See Rev. Rul. 70-51, 1970-1 C.B. 192, and Rev. Proc. 68-21, 1968-1 C.B. 817.

Since Exempt Organizations specialists are not normally responsible for determining whether an employer is meeting its responsibilities in this area, cases indicating that employer problems exist should be referred to the Examination Division under existing procedures (See IRM 7(10)(40). For example, an EO specialist may discover that an employer is treating payments to an IRC 501(c)(9) organization as being made solely to an accident and health plan under IRC 106 when in reality these payments are also payments for a severance benefits plan. Since the employer is required to allocate the portion of the payment on account of the health plan (because the employer is required to withhold on the portion allocable to the severance plan) the information should be referred to the Examination Division. However, Exempt Organizations specialists are responsible for determining whether IRC 501(c)(9) organizations are meeting their responsibilities with respect to income tax withholding, FICA and FUTA, and reporting on W-2s and W-3s, in the case of wages, and the reporting requirements of IRC 6041, in the case of other taxable benefits. See IRM 7(10)62 2:(8).

G. Effective Dates

The regulations generally apply to taxable years beginning after December 31, 1954. However, the regulations provide transitional rules for existing IRC 501(c)(9) organizations. The membership (Reg. 1.501(c)(9)-2(a)) and control (Reg. 1.501(c)(9)-2(c)(3)) requirements apply only to taxable years beginning after December 31, 1980. In addition, the regulations will not apply to organizations created pursuant to collective bargaining agreements in effect on December 31, 1980, until such agreements terminate. However, any VEBA may, at its option, subject itself to the regulations prior to the applicable effective date. In cases where, under the transitional rules, the regulations do not apply, the clear meaning of the statute should be applied to determine qualification for exempt status Reg. 1.501(c)(9)-8.

[Final Regulations not shown here]