DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

200204045

Date: OCT 30 2001

Contact Person:

Identification Number:

Uniform Issue List: 501.09-00
4976.01-00

Telephone Number:

T:EO:B2

Employer Identification Number:

LEGEND:
X =
Y =
Z =

Dear Sir or Madam:

We have considered your ruling request dated January 31, 2001, seeking rulings on the federal tax consequences of the amendment of two voluntary employees' beneficiary associations (the "Union VEBA" and the "Salaried VEBA" or, collectively, the "X VEBAs") as more fully described below.

In 1990, X adopted two separate welfare benefit plans -- the X Voluntary Employee Benefit Plan for Salaried Employees (the "Salaried Plan"), and the X Voluntary Employee Benefit Plan for Hourly Employees (the "Union Plan"). The purpose of the Plans was to provide for the payment of post-retirement medical and life coverage for eligible salaried and union employees of X and their eligible dependents. The X VEBAs, which were established to fund the Salaried and Union plans, are recognized as exempt under section 501(c)(9) of the Internal Revenue Code (the "Code"). Although the beneficiaries of the Union VEBA are generally employees covered by a collective bargaining agreement, the Union VEBA was established for the convenience of X and was not established pursuant to, or as a result of, the collective bargaining process.

Y, a public company, merged with Z in 1998 as part of a transaction qualifying under section 368(a)(1)(A) of the Code, with the result that Y and its subsidiary corporations (including X) became subsidiaries of Z. After the merger, the former employees of Y and its subsidiaries (including X) who continued their employment after the merger remained participants in their existing medical, life, and other welfare benefit plans. Also, as part of the merger, Z assumed sponsorship of the existing medical, life, and other welfare benefit plans of Y and its subsidiaries (including X).

X remains an operating subsidiary of Z and continues to have active employees. X's retirees continue to receive their post-retirement medical and life benefits through the X VEBAs.

Z and its subsidiaries other than X currently provide post-retirement medical and life benefits through commercial insurance contracts and partially on an unfunded basis from the general assets of Z and its subsidiaries (the "Non-X Plans").

Because the value of the X VEBAs' assets substantially exceeds liabilities, absent amendment of the VEBAs, those assets would continue to accumulate and yet would cease, in the very near future, to be available to provide any benefit to any current or former employees of Z or its subsidiaries. Z believes that these "excess" assets should be used, as intended, to provide medical and life benefits to retired employees. Such use will reduce operating expenses for the management and recordkeeping of the welfare benefit plans of Z and its subsidiaries.

Z intends to amend the X VEBAs, as well as the Salaried and Union Plans, to expand the class of employees and former employees eligible to participate in such Plans and receive benefits from the X VEBAs. This new class of participants (the "Non-X Participants") will include employees and former employees of Z and its subsidiaries (other than X) who are currently eligible to participate in the Non-X Plans. Consistent with the terms of the X VEBAs, Z and its subsidiaries other than X will adopt the VEBAs and the related Plans. Benefits under the X VEBAs will continue to be provided based on criteria that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees. Further, the X VEBAs will continue to be used exclusively to pay post-retirement medical and life benefits.

You have requested the following rulings:

1. The amendment of the X VEBAs (and the related Plans) and the use of the assets of the VEBAs to provide post-retirement medical and life benefits (through the payment of premiums or otherwise) for the Non-X Participants will not adversely affect the tax exempt status of the X VEBAs under section 501(c)(9).

2. The amendment of the X VEBAs (and the related Plans) and the use of the assets of the VEBAs to provide post-retirement medical and life benefits (through the payment of premiums or other wise) for the Non-X Participants will not be considered a disqualified benefit under Section 4976(b)(1)(C) subject to the excise tax under Section 4976(a).

Section 501(c)(9) of the Code provides for the exemption from federal income taxation 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.

Section 1.501(c)(9)-2(a)(i) of the Income Tax Regulations (the "regulations") provides that the membership of an 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 amount such individuals. Typically, those eligible for membership in an organization described in section 501(c)(9) are defined by reference to a common employer (or affiliated employers), to coverage under one or more collective bargaining agreements (with respect to benefits provided by reason of such agreement(s)), to membership in a labor union, or to membership in one or more locals of a national or international labor union.

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 "employee" includes the following:

(1) An individual who is considered an employee:

(i) For employment tax purposes under Subtitle C of the Internal Revenue Code and the regulations thereunder, or

(ii) For purposes of a collective bargaining agreement, whether or not the individual could qualify as an employee under applicable common law rules.

(2) An individual who became entitled to membership in the association by reason of being or having been an employee.

(3) The surviving spouse and dependents of an employee.

Section 501(c)(9)-3(b) of the regulations provides that the term "life benefits" means a benefit payable by reason of the death of a member or dependent. A "life benefit" may be provided directly or through insurance. It generally must consist of current protection, but also may include a right to convert to individual coverage on termination of eligibility for coverage through the association, or a permanent benefit as defined in, and subject to the conditions in, the regulations under section 79. A "life benefit" also includes the benefit provided under any life insurance contract purchased directly from an employee-funded association by a member or provided by such an association to a member. The term "life benefit" does not include a pension, annuity, or similar benefit, except that a benefit payable by reason of the death of an insured may be settled in the form of an annuity to the beneficiary in lieu of a lump-sum death benefit (whether or not the contract provides for settlement in a lump sum).

Section 1.501(c)(9)-3(c) of the regulations provides that the term "sick and accident benefits" means amounts furnished to or on behalf of a member or a member's dependents in the event of illness or personal injury, or through the payment of premiums to a medical benefit or health insurance program. Similarly, a sick and accident benefit includes an amount paid to a member in lieu of income during a period in which the member is unable to work due to sickness or injury. Sick benefits also include benefits designed to safeguard or improve the health of members and their dependents. Sick and accident benefits may be provided directly by an association to or on behalf of members and their dependents, or may be provided indirectly by an association through the payment of premiums or fees to an insurance company, medical clinic, or other program under which members and their dependents are entitled to medical services or to other sick and accident benefits.

Section 1.501(c)(9)-4(a) of the regulations provides that no part of the net earnings of an employee's 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.

Section 1.501(c)(9)-4(b) of the regulations provides that, for purposes of subsection (a), the payment to any member of disproportionate benefits, where such payment is not pursuant to objective and nondiscriminatory standards, will not be considered a benefit within the meaning of section 1.501(c)(9)-3 even though the benefit otherwise is one of the type permitted by that section. For example, the payment to highly compensated personnel of benefits that are disproportionate in relation to benefits received by other members of the association will constitute prohibited inurement. In general, benefits paid pursuant to standards or subject to conditions that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees will not be considered disproportionate.

Section 4976(a) of the Code provides that if an employer maintains a welfare benefit plan, and there is a disqualified benefit provided during any taxable year, a tax is imposed on such employer equal to 100 percent of such disqualified benefit.

Section 4976(b)(1)(B) of the Code provides that, for purposes of subsection (a), the term "disqualified benefit" means any post retirement medical benefit or life insurance benefit provided with respect to an individual in whose favor discrimination is prohibited unless the plan meets the requirement of section 505(b) with respect to such benefit.

Section 4976(b)(1)(C) of the Code provides that, for purposes of subsection (a), the term "disqualified benefit" means any portion of a welfare benefit fund reverting to the benefit of the employer.

Section 4976(c) of the Code provides that the terms used in that section will have the same respective meanings as when used in sections 419 and 419A. Under section 419(e), the term "welfare benefit fund" includes (among other entities) a VEBA that is exempt under section 501(c)(9).

The proposed use of the assets of the X VEBAs to provide post-retirement medical and life benefits to Non-X Participants will not adversely affect the tax-exempt status of such VEBAs because no prohibited inurement will occur. Participants will continue to share an employment-related bond, and no impermissible benefits will be provided. The participants will all be employees of the same controlled group of employers. Further, benefits provided will be those described in the X VEBAs' documents and the related Plans, which have been determined to be permissible benefits. The X VEBAs' assets will continue to be applied to provide post-retirement medical and life benefits pursuant to criteria that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees.

Accordingly, we rule as follows:

1. The amendment of the X VEBAs (and the related Plans) and the use of the assets of the VEBAs to provide post-retirement medical and life benefits (through the payment of premiums or otherwise) for the Non-X Participants will not adversely affect the tax-exempt status of the X VEBAs under section 501(c)(9) of the Code.

2. The amendment of the X VEBAs (and the related Plans) and the use of the assets of the VEBAs to provide post-retirement medical and life benefits (through the payment of premiums or otherwise) for the Non-X Participants will not be considered a disqualified benefit under section 4976(b) of the Code subject to the excise tax under section 4976(a).

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent. A copy of this ruling should be maintained in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter. For other matters, including questions concerning your reporting requirements, please contact the Ohio TE/GE Customer Service Office.

Sincerely,

(signed) Terrell M. Berkovsky
Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2