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

200211053

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: DEC 20 2001

Uniform Issue List
501.09-01
501.09-03
4976.00-00

T:EO:B4

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

M =
N =
O =
P =
Q =
R =

x =

Dear Sir or Madam:

We have considered M's ruling request dated June 14, 2001, as supplemented by a FAX submission dated December 6, 2001, regarding the tax consequences of a transfer of assets from a voluntary employees' beneficiary association ("VEBA") maintained by a wholly-owned subsidiary of M to a VEBA sponsored by M, and the proposed further transfer of such assets from a segregated subaccount within M's VEBA to the regular accounts in that VEBA.

Facts:

M is a holding company that owns numerous operating companies and various other companies with operations in States. N is a VEBA that is exempt from federal income tax under section 501(c)(9) of the Internal Revenue Code. N is sponsored by M and provides for the payment of medical, dental, life insurance, disability, and accidental death and dismemberment benefits to eligible retirees, employees, and beneficiaries of M and other related employers. Under M's welfare benefit plans funded through N, active employees pay an average of % of the cost of health insurance premiums, and retirees pay an average of % of the premium cost of post-retirement life insurance coverage. M pays the entire cost of $ x post-retirement life insurance coverage. Retirees may purchase up to an additional $ x of life insurance, but must pay the entire premium cost. M pays % of the cost of long-term disability, accidental death and dismemberment, and group term life insurance, up to $ x for

235

active employees. Employees may purchase, at their own expense, supplemental life insurance and supplemental accidental death and dismemberment insurance.

N covers approximately active and retired employees of M and participating employees. N does not provide benefits that discriminate in favor of highly compensated employees or officers.

Section 10.4 of the N Trust document states as follows:

> At no time (either by operation, amendment or termination of the plan or trust, or otherwise) shall any part of the fund (other than ... to pay taxes and administration expenses) be used for, or diverted to, purposes other than providing for the payment of life, sickness, accident and other benefits permitted by Section 501(c)(9) of the Code, as interpreted by the regulations promulgated, and rulings or technical guidance issued, thereunder, for the employees of the participating employers and their beneficiaries ....

O is a company which is wholly owned by M and is a participating employer in the N VEBA. P is an operating telephone company which is wholly owned by O and is also a participating employer in N. Prior to its acquisition by O in P participated in a multi-employer plan then known as the Q Plan and now known as the R Plan. The R Plan funded welfare benefits funded elected by participating employers through a number of VEBA trusts. P provided eligible employees and beneficiaries with post-retirement health, dental, and life insurance benefits through the R Plan. You have submitted copies of recent adoption agreements. The most recent one documents a cessation of coverage under the R Plan after

The R plan consists of funded trusts, each with a different industry group and State. Each is intended to be a VEBA that is tax exempt under section 501(c)(9) of the Code. The R Plan was invested primarily in insurance policies and annuity contracts.

According to the original Adoption Agreement, executed by the President of P in , a P employee who retired after at least 15 years of service and attainment of age 57 was entitled to post-retirement health, dental, and life insurance benefits. In addition, if an employee attained age 45 and then suffered a total disability (as defined in P's long term disability contract), the employee was entitled to post-retirement health and life insurance benefits.

The R Plan summary plan description ("SPD") for P indicates that % of the premium cost for health and dental insurance (% for spousal coverage, effective for employees retiring after October 1, 1994) would be paid by P for eligible retirees. This benefit differs from the description in the R Plan document, which defines medical benefits as a "flat dollar amount for all Participants at a specified entitlement date to be held in the plan and associated trusts for future medical benefit payments."

236

The SPD indicates that P was also to provide post-retirement life insurance coverage equal to the lesser of (a) $ x before age 70, or $ x after age 70; and (b) % of the coverage that P provided the employee before retirement.

As of December 31, 1992, there were retired employees of P and full-time active employees.

In 1993, P contributed approximately $ x to the R Plan Trust. In 1994, it contributed approximately $ x. P made additional annual contributions until it was acquired by O. It is M's understanding that no employee contributions were made to the R Plan Trust. Neither M nor O made any contributions to the R Plan Trust.

In O acquired P through a stock purchase. O and P then informed active and former employees of P that their post-retirement benefits would be the same as the post-retirement benefits of O employees. Accordingly, O caused P to stop paying premiums for dental insurance coverage of its retired employees (post-retirement dental benefits are not offered under the N VEBA) and to charge retired P employees for their health insurance coverage at the same rate that O charges its retired employees. At the same time, P became a participating employer in the N VEBA, which provides health and other welfare benefits to active and retired employees of M and its affiliated entities. Thus, effective , retirees and active employees of P became participants in the N VEBA.

Since the mid-nineties, the R Plan has been involved in several lawsuits between participating employers and the former plan administrator. Various participating employers sought to withdraw from the R Plan, the terms of which generally prohibited participating employers from withdrawing any of the Plan assets.

In , the parties agreed to settle the case on terms giving all participating employees a one-time right to exit from the R Plan and obtain a distribution of their share of the Plan assets. Under the settlement, each participating employer (including P) had a one-time right to exit from the R Plan by submitting an "exit-strategy election form" by a designated date in the fall of .

One of the five options for the exit election was to transfer the present value of the employer's post-settlement share to another VEBA covering the employer's employees and offering the same or comparable benefits.

In , the Court ruled that the settlement was fair. On , P elected to exit from the R Plan and to have its share of the VEBA assets held in the R Plan's collective investment account transferred to the N VEBA. P's share was valued at approximately $ x as of . This amount was based on the employer's contributions, benefits paid out, and a proportionate share of earnings. However, the share also represented settlement proceeds from the R Plan litigation, which increased each participating employer's funding in the Plan by more than %.

237

The sum of approximately $ x was transferred in a lump sum to a segregated subaccount in the N VEBA in This amount was net of the sum of approximately $36x paid to current P retirees who, effective with their commencement of participation in the VEBA, began paying a portion of their health and life insurance premiums. The amount reimbursed the retirees for premiums they paid from , through

The R plan assets are currently being held in a segregated subaccount within the N VEBA Trust pending receipt of a private letter ruling from the Service.

The N VEBA trust fund is divided into three accounts, as follows: (1) the Retiree Medical Account, which was established to provide post-retirement medical benefits to eligible retirees (and their eligible beneficiaries) of M and other participating employers; (2) the Retiree Life Insurance Account, which was established to provide life insurance benefits to eligible retirees (and their eligible beneficiaries) of M and other participating employers; and (3) the Employee Welfare Benefit Account, which was established to provide medical, life insurance, disability, and accidental death and dismemberment benefits to eligible current employees (and their eligible beneficiaries) of M and other participating employers.

M would like to dissolve the segregated subaccount currently holding the P R Plan assets and transfer those assets to the regular N VEBA accounts, to be applied toward the cost of benefits for eligible retirees and employees of M and other participating employers (including P retirees and employees and their eligible beneficiaries). M sets forth the following business reasons for the proposed transaction: (a) To streamline and improve the administration of benefits to eligible P retirees and their beneficiaries; (b) To reduce the administrative costs of providing benefits to eligible P retirees and their beneficiaries; and (c) To effect a uniform benefit policy with respect to all eligible employees and retirees of M and other participating employers, including eligible P retirees and their beneficiaries.

<u>Rulings Requested</u>

M requests the following rulings:

(1) M and its subsidiaries (including P) will not be subject to the excise tax imposed by section 4976 of the Code as a result of:

  (a) The transfer of assets from the R Plan to a subaccount in the N VEBA.

  (b) The transfer of assets from the P subaccount in the N VEBA and the use of such assets to provide benefits to M's eligible retirees and employees (and their beneficiaries) and employees and retirees of other participating employers (including P retirees and employees and their eligible beneficiaries).

(2) The transactions described above will not adversely affect the tax exempt status of the N VEBA under section 501(c)(9) of the Code.

Law:

Section 4976(a) of the Code imposes a tax on an employer for any disqualified benefit provided under a welfare benefit fund maintained by such employer. The term "disqualified benefit" includes, in pertinent part, any portion of a welfare fund reverting to the benefit of the employer. See Code section 4976(b). The term "welfare benefit fund" has the same meaning set forth in section 419(e).

Section 4976 was added to the Code by the Deficit Reduction Act of 1984 ("DEFRA"). The House and Senate Committee Reports on DEFRA provide no guidance as to the meaning of "reverting to the benefit of the employer." However, the Joint Committee on Taxation "Bluebook" on DEFRA included the following interpretation of section 4976:

> (I)f an amount is paid by a fund to another fund for the purpose of providing welfare benefits to employees of the employer, then the payment is not to be considered a reversion. Staff of the Joint Committee on Taxation, 98th Cong., 2nd Sess., General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, at 794 (1985).

Technical corrections to Code section 4976(b)(1)(C) were made by section 1851(a)(1) of the Tax Reform Act of 1986. However, the House Report explaining these changes described existing law as providing that a portion of a welfare benefit fund is not considered to revert to the benefit of an employer merely because it is applied, in accordance with the plan, to provide welfare benefits to employees or their beneficiaries. H.R. Rep. No. 426, 99th Cong., 1st Sess. (1985), 1986-3 C.B. (Vol. 2) at 985. The Senate Report includes a similar statement. S. Rep. No. 313, 99th Cong., 2nd Sess. (1986), 1986-3 C.B. (Vol. 3) at 1009.

Section 501(c)(9) of the Code describes a voluntary employees' beneficiary association ("VEBA") providing for the payment of life, sick, accident or other benefits to its members or their dependents or designated beneficiaries, and in which no part of its net earnings inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-1 of the Income Tax Regulations summarizes the requirements to be met in order to qualify as a tax exempt organization described in section 501(c)(9) as follows:

(A) The organization is an employees' organization;

(B) Membership in the organization is voluntary;

(C) The organization provides 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 paragraph (C) of this section, to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-4(a) of the regulations provides that no part of the net earnings of a VEBA may inure to the benefit of any shareholder or individual other than through the payment of permitted types of life, sick, accident, or other benefits. Whether prohibited inurement has occurred is a question to be determined with regard to all the facts and circumstances of a particular case.

Analysis:

The transfer of assets from the R Plan to a subaccount in the N VEBA is not a reversion to M and thus not a disqualified benefit subject to the excise tax under section 4976, nor is the transfer a form of prohibited inurement in contravention of the requirements for tax exempt status under section 501(c)(9). The trust in which P participated through the R Plan was recognized as a VEBA under section 501(c)(9). Therefore, the transfer of P's share of VEBA assets to the N VEBA was a VEBA-to-VEBA transfer.

The proposed transfer of assets currently held in the P segregated subaccount to the N VEBA to pay benefits for all eligible M employees and retirees (including P employees and retirees) does not result in a reversion or prohibited inurement for purposes of section 4976 of the Code, nor does it contravene the requirements of section 501(c)(9). In this regard, see the House Report explaining the technical corrections made to DEFRA, stating that, "a portion of a welfare benefit fund is not considered to revert to the benefit of an employer merely because it is applied, in accordance with the plan, to provide welfare benefits to employees or their beneficiaries." H.R. Rep. No. 426, 99th Cong., 1st Sess. (1985), 1986-3 C.B. (Vol. 2) at 985.

The N VEBA is used exclusively to provide life, health, and disability benefits, all permissible for a VEBA, for the employees and retirees of M and its subsidiaries. The benefits provided to P retirees through the N VEBA will be the same benefits after the transfer from the segregated subaccount as before the transfer. They are substantially the same benefits that were provided to P retirees under the P/R Plan VEBA. In addition, retirees must pay a portion of their health and life insurance premiums, whereas prior to O's acquisition of P, P paid virtually 100% of those costs. However, VEBAs may change the terms of their benefit plans, as long as the benefits funded through the VEBA are allowable benefits and such changes do not result in disproportionate benefits to officers, shareholders, or highly compensated employees.

There will be no reversion to M because it will not have access to any of the transferred R Plan assets for its own benefit but rather will apply such assets to continued funding of permissible VEBA benefits. Further, the transferred assets will not revert indirectly to the benefit of M: The assets are not being diverted from the funding of accrued liabilities with respect to P participants to the funding of benefits for other participants. Inasmuch as the P/R Plan funded premium costs rather than reimbursing medical expenses, there were no incurred but unpaid or incurred but unreported claims for benefits at the time of the asset transfer to the N VEBA, and there will be no such claims when assets are transferred out of the P subaccount.

Finally, there is no prohibited inurement because the transferred assets will not disproportionately benefit highly compensated personnel of M or P.

Rulings:

Based on the foregoing, we are able to rule as follows:

1. M and its subsidiaries (including P) will not be subject to the excise tax imposed by section 4976 of the Code as a result of: (a) the transfer of assets from the R Plan to a subaccount in the N VEBA; and (b) the transfer of assets from the P subaccount in the N VEBA to the regular accounts in the N VEBA and the use of such assets to provide benefits to M's eligible retirees and employees (and their eligible beneficiaries) and employees and retirees of other participating employers (including P retirees and employees and their eligible beneficiaries).

2. The transactions described above will not adversely affect the tax exempt status of the N VEBA under section 501(c)(9) of the Code.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon M's exempt status should be reported to the Ohio Tax Exempt and Government Entities (TE/GE) Customer Service Office. The mailing address is: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The telephone number there is 877-829-5500 (a toll free number).

Pursuant to a Power of Attorney on file in this office, we are sending a copy of this letter to your authorized representative.

We are also sending a copy of this ruling to the Ohio TE/GE Customer Service Office. Because this letter could help resolve any questions about N's exempt status, it should be kept with N's permanent records.

If there are any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

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 as precedent.

Thank you for your cooperation.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organization
Technical Group 4