INTERNAL REVENUE SERVICE

TE/GE TECHNICAL ADVICE MEMORANDUM

Release Number: **201225019**
Release Date: 6/22/2012
Date: 1/19/12
UIL Code: 419.13-00

Internal Revenue Service
Attn: EO Mandatory Review
MC 4920 DAL
110 Commerce Street
Dallas, TX 75242

Taxpayer Name:

Taxpayer Address:

Taxpayer's Identification Number:

Years Involved:

Legend:

Z	=
Y	=
TR1	=
TR2	=
TR3	=
TR4	=
TR5	=
TR6	=
TR7	=
TR8	=
TR9	=
TR10	=

This memorandum responds to a request dated July 30, 2008, from TEGE Exempt Organizations Examinations for technical advice on the issues as presented below. We have consulted with the Office of Chief Counsel TEGE and TEGE Employee Plans Ruling & Agreements. Our findings are set forth below.

ISSUES:

1. Whether the post-retirement medical benefits can be aggregated with post-retirement life benefits pursuant to section 419A(h)(1)(B) of the

Internal Revenue Code ("Code") for purposes of computing the total unrelated business taxable income of the funds?

2. Can TR5 be aggregated with other funds when computing unrelated business taxable income although it contains an existing reserve from years prior to 1984 under section 1.512(a)5-T of the Temporary Regulations?

3. Is TR5 a welfare benefit fund described in section 419(e)?

FACTS:

Z sponsors several voluntary employees' beneficiary associations ( ), which are described in section 501(c)(9) of the Code. These were formed to provide life, medical and disability benefits to Z's nonunion employees, retirees and their beneficiaries. Z also maintains an account with Y through which it provides death benefits to retirees. The Y account is referred to as TR5. Z has separately maintained these funds for various business reasons, including the need to comply with cost accounting standards.

The following chart describes the funds:

Name of Fund	Benefit Provided
TR1	Long-term disability
TR2	Medical and dependent care
TR3	Post-retirement life
TR4	Post-retirement life
TR5	Post-retirement life
TR6	Post-retirement medical and dental
TR7	Post-retirement medical
TR8	Post-retirement medical
TR9	Post-retirement medical
TR10	Post-retirement medical and life

Z elected to permissively aggregate certain funds in order to reduce the total unrelated business income tax ("UBIT") reported on the Form 990-T for tax year 2003. In addition, amended tax returns for and were filed using the permissive aggregation for certain funds. These amended returns resulted in a refund due to Z. Z states that they are seeking refunds in the amounts of $ and $ for and respectively.

LAW:

Section 264(a)(1) of the Code provides that no deduction shall be allowed for premiums on any life insurance policy, or endowment or annuity contract, if the taxpayer is directly or indirectly a beneficiary under the policy or contract.

Section 419(a) provides that contributions paid or accrued by an employer to a welfare benefit fund (e.g., a) shall not be deductible under chapter I of the Code but, if they would otherwise be deductible, shall be deductible under section 419 in the taxable year when paid, subject to the limitation of section 419(b).

Section 419(e)(1) provides that the term "welfare benefit fund" means any fund which is part of a plan of an employer, and through which the employer provides welfare benefits to employees or their beneficiaries.

Section 419(e)(2) provides that the term "welfare benefit" means any benefit other than a benefit with respect to which section 83(h), section 404, or section 404A applies.

Section 419(e)(3) provides that the term "fund" means, among other things, (A) any organization described in section 501(c)(9) or (C) any account held for an employer by any person.

Section 419(e)(4)(A) provides that notwithstanding section 419(e)(3)(C), the term "fund" shall not include amounts held by an insurance company pursuant to an insurance contract (including a renewable premium stabilization reserve held thereunder) if (i) such contract is a life insurance contract described in section 264(a)(1), or (ii) such contract is a qualified nonguaranteed contract.

Section 419(e)(4)(B)(i) provides that for the purposes of this paragraph, the term 'qualified nonguaranteed contract' means any insurance contract (including a reasonable premium stabilization reserve held thereunder) if: (i) there is no guarantee of a renewal of such contract, and (ii) other than insurance protection, the only payments to which the employer or employees are entitled are experience rated refunds or policy dividends which are not guaranteed and which are determined by factors other than the amount of welfare benefits paid to (or on behalf of) the employees of the employer or their beneficiaries.

Section 419(e)(4)(B)(ii) states that in the case of any qualified nonguaranteed contract, subparagraph (A) shall not apply unless the amount of any experience rated refund or policy dividend payable to an employer with respect to a policy year is treated by the employer as received or accrued in the taxable year in which the policy year ends.

Section 419A(c)(2)(B) provides that in general, the account limit for any qualified asset account for any taxable year is the amount reasonably and actuarially necessary to fund claims incurred but unpaid as of the close of such taxable year for benefits referred to in section 419A(a) and administrative costs with respect to such claims. In addition, the account limit for any taxable year may include a reserve funded over the working lives of the covered employees and actuarially determined on a level basis as necessary for post-retirement medical or life insurance benefits to be provided to covered employees.

Section 419A(g)(1) states that in the case of any welfare benefit fund which is not an organization described in paragraph (7), (9), (17), or (20) of section 501(c), the employer shall include in gross income for any taxable year an amount equal to such fund's deemed unrelated income for the fund's taxable year ending within the employer's taxable year.

Section 419A(g)(2) states that for purposes of paragraph (1), the deemed unrelated income of any welfare benefit fund shall be the amount which would have been its unrelated business taxable income under section 512(a)(3) if such fund were an organization described in paragraph (7), (9), (17), or (20) of section 501(c).

Section 419A(h)(1)(B) permits an employer to elect to permissively aggregate two or more of its welfare benefit funds as one fund for any purpose (other than with respect to the provisions for which the mandatory aggregation rules apply) to the extent that this treatment is not inconsistent with the purposes of section 419, section 419A, or section 512.

Section 511(b) imposes for each taxable year a tax on the unrelated business taxable income (as defined in section 512) of every trust which is exempt from tax under section 501(a) and which, were it not for such exemption, would be subject to taxation under subchapter J (relating to estates, trusts, beneficiaries, and decedents).

Section 512(a)(3)(A) provides that in the case of an organization described in section 501(c)(9), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), both computed with certain modifications provided in section 512(b) relating to net operating losses and charitable contributions.

Section 512(a)(3)(B) provides that the term "exempt function income" means the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid. Such term also means all

income (other than an amount equal to the gross income derived from any unrelated trade or business regularly carried on by such organization) which is set aside to provide for the payment of life, sick, accident, or other benefits.

Section 512(a)(3)(E) provides that in the case of organizations described in section 501(c)(9), a set-aside to provide for the payment of life, sick, accident, or other benefits may be taken into account under section 512(a)(3)(B) only to the extent that such set-aside does not result in an amount of assets set aside for such purpose in excess of the account limit determined under section 419A for the taxable year (not taking into account any reserve described in section 419A(c)(2)(A) for post-retirement medical benefits).

Section 1.419-1T Q&A-3(a) of the regulations states that a "welfare benefit fund" is any fund which is part of a plan, or method or arrangement, of an employer and through which the employer provides welfare benefits to employees or their beneficiaries. For purposes of this section, the term "welfare benefit" includes any benefit other than a benefit with respect to which the employer's deduction is governed by section 83(h), section 404 (determined without regard to section 404(b)(2)), section 404A, or section 463.

Section 1.419-1T Q&A-3(c) states that section 419(e)(3)(C) also provides that the term "fund" includes, to the extent provided in regulations, any account held for an employer by any person. Pending the issuance of further guidance, only the following accounts, and arrangements that effectively constitute accounts, as described below, are "funds" within section 419(e)(3)(C).

A retired lives reserve or a premium stabilization reserve maintained by an insurance company is a "fund," or part of a "fund," if it is maintained for a particular employer and the employer has the right to have any amount in the reserve applied against its future years' benefit costs or insurance premiums. Also, if an employer makes a payment to an insurance company under an "administrative services only" arrangement with respect to which the life insurance company maintains a separate account to provide benefits, then the arrangement would be considered to be a "fund." Finally, an insurance or premium arrangement between an employer and an insurance company is a "fund" if, under the arrangement, the employer has a right to a refund, credit, or additional benefits (including upon termination of the arrangement) based on the benefit or claims experience, administrative cost experience, or investment experience attributable to such employer. However, an arrangement with an insurance company is not a "fund" under the previous sentence merely because the employer's premium for a renewal year reflects the employer's own experience for an earlier year if the arrangement is both cancellable by the insurance company and cancellable by the employer as of the end of any policy year and, upon cancellation by either of the parties, neither of the

parties can receive a refund or additional amounts or benefits and neither of the parties can incur a residual liability beyond the end of the policy year (other than, in the case of the insurer, to provide benefits with respect to claims incurred before cancellation).

Section 1.512(a)-5T, Q&A-3(b) provides that the unrelated business taxable income of a for a taxable year generally will equal the lesser of two amounts: the income of the for the taxable year (excluding member contributions) or the excess of the total amount set aside as of the close of the taxable year (including member contributions) over the qualified asset account limit (calculated without regard to the otherwise permitted reserve for post-retirement medical benefits) for the taxable year.

Section 511(b) imposes a tax on the unrelated business taxable income (as defined in section 512) of every trust which is exempt from tax under section 501(a).

Section 512(a)(3)(A) provides special rules for computing the unrelated business taxable income ("UBTI") of an organization described in section 501(c)(7), (9), (17), or (20). The term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the deductions allowed which are directly connected with the production of the gross income.

ANALYSIS:

Based on your facts and representations we rule as follows:

Issue 1: Whether the post-retirement medical benefits can be aggregated with post-retirement life benefits pursuant to section 419A(h)(1)(B) of the Code for purposes of computing the total UBTI of the funds?

The aggregation of welfare benefit funds is permissible under section 419A(h)(1)(b) unless inconsistent with sections 419, 419A, or 512.

In this case, Z elected to permissively aggregate the above listed under section 419A(h)(1)(B) of the Code for the purpose of calculating UBTI. Such aggregation is not inconsistent with sections 419, 419A, or 512; therefore, permissive aggregation is permitted for the purpose of computing UBTI under section 512(a)(3) for the above listed VEBAs.

Issue 2: Can TR5 be aggregated with other funds when computing UBTI when it contains an existing reserve from years prior to 1984 under section 1.512(a)5-T of the Temporary Regulations?

TR5 is a welfare benefit fund (see issue 3 below); therefore, it can be combined with

other funds even though it contains an existing reserve.

First, even though TR5 is a non-exempt fund, generally, under section 419A(h)(1)(B), an employer can elect to aggregate and non-exempt funds for purposes of calculating UBIT under section 512(a)(3) and deemed UBIT under section 419A(g).

Second, the fact that TR5 contains existing reserves for post-retirement medical or life insurance benefits, within the meaning of section 1.512(a)-5T, Q&A-4(a) of the regulations, would not prevent it from being aggregated with the for purposes of calculating UBIT. Since section 512(a)(3)(E)(ii)(I) provides that the set aside limitation in section 512(a)(3)(E)(i) does not apply to income attributable to an existing reserve, the income of TR5 is not generally subject to UBIT. Therefore, it is consistent with the purpose of section 512 to aggregate TR5, which has an existing reserve, with the VEBAs, which do not have existing reserves.

Issue 3: Is TR5 a welfare benefit fund described in section 419(e) of the Code?

The agreement entered into between Z and Y provided for the creation of TR5 to be maintained by Y for Z for the purpose of paying premiums towards group insurance policies covering the lives of retired employees of Z. Under the agreement, Z has a right to credits based on the experience of Z and the agreement can not be cancelled by either party without Y incurring a residual liability equal to the balance in TR5.

The exception provided under section 419(e)(4)(A) of the Code to the general definition of a fund as provided in 419(e)(3) does not apply in this case. TR5 is not a life insurance contract as described in section 264(a)(1) nor is it a qualified nonguaranteed contract within the meaning of section 419(c)(4)(B)(i). TR5 is not a life insurance contract because it is not a life insurance policy, endowment, or annuity contract. TR5 is not a qualified nonguaranteed contract because Z is entitled to experience rated refunds which are determined based on the welfare benefit paid to the employees or their beneficiaries of Z.

Therefore, whether TR5 is viewed as a retired lives reserve or an experience-rated noncancellable arrangement between an employer and an insurance company, TR5 is a fund within the meaning of section 1.419T Q&A-3(a) of the regulations.

CONCLUSION:

1. The above listed post-retirement medical benefits may be aggregated with the post-retirement life benefits pursuant to section 419A(h)(1)(B) of the Code for purposes of computing the total unrelated business taxable income of the funds under section 512(a)(3).

2. TR5 can be permissively aggregated with the funds listed above when computing UBTI under section 512(a)(3) of the Code, even though it contains an existing reserve from years prior to 1984 under section 1.512(a)-5T of the regulations.

3. TR5 is a welfare benefit fund as described in section 419(e) of the Code.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolved questions concerning your federal income tax status, this ruling should be kept in your permanent records.

A copy of this memorandum is to be given to Z. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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