Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:HW
PLR-130292-17

Date:
March 20, 2018

Legend:

Taxpayer =

Trust =

Plan =

Date 1 =

Date 2 =

Date 3 =

$A =

$B =

$C =

$D =

Year 1 =

Year 2 =

Dear :

This responds to your letter, dated September 26, 2017, requesting a ruling regarding the tax consequences under sections 4976, 419 and 419A of the Internal Revenue Code ("Code") of an amendment to Trust. The amendment would permit assets of

Trust, currently a separate welfare benefit fund under a collective bargaining agreement as described in section 419A(f)(5) of the Code, to be used to provide health benefits for active, non-collectively bargained employees.

FACTS

Taxpayer sponsors Trust, which holds assets used to provide postretirement health benefits under Plan to collectively bargained employees who retire from Taxpayer. Plan also provides health benefits to Taxpayer's active collectively bargained and non-collectively bargained employees. Taxpayer represents that Trust received a determination letter, dated Date 1 and effective Date 2, stating that it is a voluntary employees' beneficiary association under section 501(c)(9).

Taxpayer contributed $A to Trust in Year 1 and deducted $A on its tax return for Year 1. Taxpayer has made no further contributions since then. Trust holds $B as of Date 3. $A is more than $B.

Taxpayer represents that, at all times since its establishment, Trust has been a separate welfare benefit fund under a collective bargaining agreement within the meaning of section 419A(f)(5) and section 1.419A-2T of the Income Tax Regulations ("Regulations"). Taxpayer further represents that it deducted contributions to Trust in accordance with sections 419 and 419A, including specifically section 419A(f)(5), and that the amount of Trust assets to be made available to active, non-collectively bargained employees is less than the amount contributed to Trust for which a deduction was taken.

Taxpayer represents that current assets in Trust greatly exceed the postretirement health actuarial liability, which as of Date 3 was $C for current retired employees and $D for future expected retired employees. Taxpayer represents that Trust has become overfunded primarily due to increased cost shifting to participants, lower participation in Plan coverage, and changes in Plan design.

In Year 2, Taxpayer will amend Trust to include, as an additional class of participants, active employees participating in Plan who are not covered under a collective bargaining agreement. Taxpayer represents that neither Taxpayer nor its subsidiaries have any current or future obligation to provide Plan health benefits to active, non-collectively bargained employees. Trust provides that no amendment may be made that would cause any part of the income or corpus of the trust fund to be used for or diverted to purposes other than for the exclusive benefit of the participants or their eligible beneficiaries. Taxpayer represents that all amounts in Trust will at all times continue to be held for the exclusive benefit of the participants and beneficiaries of Trust.

Taxpayer represents that the amendment will permit all of Trust assets to be used to provide health benefits under Plan to retired, collectively bargained employees and to active, non-collectively bargained employees. Taxpayer represents that all Trust assets will be available to both groups of Plan participants until Trust assets are exhausted. Taxpayer represents that its taxable year is the calendar year. Taxpayer further represents that it will include in gross income under the tax benefit rule in Year 2 the value of assets held by Trust. Taxpayer represents that it is not asserting that any portion of the assets is excludable under the exclusionary part of the tax benefit rule.

RULING REQUESTED

Taxpayer requests the following rulings:

(1) The amendment of Trust and the use of Trust assets to provide health benefits to active, non-collectively bargained employees for whom Taxpayer and its subsidiaries have no current or future obligation to provide such benefits will not be treated as a disqualified benefit under section 4976(b)(1)(C), and will not, in and of itself, result in excise tax under section 4976.

(2) The amount of Trust assets that are used to fund active, non-collectively bargained employees health benefits under Plan and included in Taxpayer's income in the tax year in which the Trust amendment is effective will be treated as a contribution to Trust in that tax year (within the meaning of section 419(a)), and Taxpayer will be permitted to take deductions with respect to such Trust contributions used for active, non-collectively bargained employees Plan health benefits to the extent permitted by sections 419 and 419A.

(3) The amendment of Trust will not, in and of itself, affect the status of Trust as a separate welfare benefit fund under a collective bargaining agreement within the meaning of section 419A(f)(5) for periods prior to the adoption of the amendment.

LAW

Section 61(a) of the Code provides that, unless otherwise excepted, gross income includes all income from whatever source derived.

Section 111(a) provides that gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent that the amount did not reduce the amount of tax imposed by Chapter 1 of the Code.

Generally, the tax benefit rule requires a taxpayer who received a tax benefit from a deduction in an earlier year to recognize income in a later year if an event occurs that is fundamentally inconsistent with the premise on which the deduction was initially based. Hillsboro National Bank v. Commissioner, 460 U.S. 370 (1983); see also Hughes & Luce, LLP v. Commissioner, 70 F.3d 16 (5th Cir. 1995), cert. denied, 517 U.S. 1208

(1996). The term "tax benefit rule" encompasses two concepts, an inclusionary part and an exclusionary part. Frederick v. Commissioner, 101 T.C. 35, 40-41 (1993). The inclusionary part has been developed in the courts and requires a taxpayer to include a previously deducted amount in the current year's income when a fundamentally inconsistent event has occurred. The exclusionary part is partially codified at section 111(a) and permits a taxpayer to exclude an amount that did not previously provide a tax benefit when it was deducted; the exclusionary part cannot apply unless the inclusionary part applies.

The tax benefit rule allays some of the inflexibilities of the annual accounting system under specific circumstances. Hillsboro National Bank, 460 U.S. at 377. The general purpose of the tax benefit rules is to approximate the results produced by a tax system based on transactional rather than annual accounting. Id. at 381. The tax benefit rule will "cancel out" an earlier deduction when a later event is "fundamentally inconsistent" with the premise on which the deduction was initially based, even in situations where there is no actual recovery of funds. Id. at 381-383. One must consider the facts and circumstances of each case in light of the purpose and function of the provisions granting the deductions. Id. at 385. Although it is usually helpful to determine whether the later event would have foreclosed the deduction if it had occurred within the same tax year, that inquiry is not an exclusive test. See American Mutual Life Insurance Co. v. United States, 267 F.3d 1344, 1350 (Fed. Cir. 2001).

Section 419(a) provides that contributions paid or accrued by an employer to a welfare benefit fund are not deductible under Chapter 1, but if they would otherwise be deductible, are (subject to the limitation of section 419(b)) deductible under section 419 for the taxable year in which paid.

Section 419(b) limits the employer's deduction under section 419(a) to a welfare benefit fund's qualified cost for the taxable year. The qualified cost of a welfare benefit fund for a taxable year is defined in section 419(c)(1) as the sum of the qualified direct cost for the taxable year and, subject to the limitation of section 419A(b), any addition to a qualified asset account for the taxable year. Under section 419(c)(2), the qualified cost for any taxable year is reduced by the welfare benefit fund's after-tax income for the taxable year.

Section 419(c)(3)(A) provides that the term "qualified direct cost" means, with respect to any taxable year, the aggregate amount (including administrative expenses) that would have been allowable as a deduction to the employer with respect to the benefits provided during the taxable year, if those benefits were provided directly by the employer and the employer used the cash receipts and disbursements method of accounting.

Section 419(c)(3)(B) provides that, for purposes of section 419(c)(3)(A), a benefit is treated as provided when that benefit would be includible in the gross income of the employee if provided directly by the employer (or would be so includible but for any provision of Chapter 1 of the Code excluding that benefit from gross income). Section 419A(a) defines the term “qualified asset account” to include any account consisting of assets set aside to provide for the payment of medical or life insurance benefits.

Section 419(e)(1) defines the term “welfare benefit fund” to include any fund through which the employer provides welfare benefits to employees or their beneficiaries. The term “fund” is defined in section 419(e)(3) to include an organization described in section 501(c)(9).

Section 419A(a) provides that the term “qualified asset account” means any account consisting of assets set aside to provide for the payment of (1) disability benefits, (2) medical benefits, (3) SUB or severance pay benefits, or (4) life insurance benefits.

Section 419A(b) provides that no addition to any qualified asset account may be taken into account under section 419(c)(1)(B) to the extent the addition results in the amount of the account exceeding the account limit.

Section 419A(c)(1) provides that, except as otherwise provided in this subsection, the account limit for any qualified asset account for any taxable year is the amount reasonably and actuarially necessary to fund (A) claims incurred but unpaid (as of the close of the taxable year) for benefits referred to in subsection (a), and (B) administrative costs with respect to the claims.

Section 419A(f)(5)(A) provides that no account limits shall apply in the case of any qualified asset account under a separate welfare benefit fund under a collective bargaining agreement.

Section 1.419A-2T, Q&A-1, of the Regulations provides that contributions to a welfare benefit fund maintained pursuant to one or more collective bargaining agreements and the reserves of such a fund generally are subject to the rules of sections 419, 419A, and 512. However, neither contributions to nor reserves of such a collectively bargained welfare benefit fund shall be treated as exceeding the otherwise applicable limits of section 419(b), 419A(b), or 512(a)(3)(E) until the earlier of: (i) the date on which the last of the collective bargaining agreements relating to the fund in effect on, or ratified on or before, the date of issuance of final regulations concerning such limits for collectively bargained welfare benefit funds terminates (determined without regard to any extension thereof agreed to after the date of issuance of such final regulations), or (ii) the date 3 years after the issuance of such final regulations.

Section 4976(a) of the Code imposes a 100 percent excise tax if an employer maintains a welfare benefit fund and there is a disqualified benefit provided during any taxable year.

Section 4976(b)(1)(C) defines “disqualified benefit” to include any portion of a welfare benefit fund reverting to the benefit of the employer.

ANALYSIS AND CONCLUSIONS

As explained above, the tax benefit rule is implicated when a taxpayer has taken a deduction in a prior year, and in a subsequent year an event occurs that is fundamentally inconsistent with the premise of the deduction. The facts and circumstances of each case must be considered “in light of the purpose and function of the provisions granting the deductions.” Hillsboro National Bank, 460 U.S. at 385.

Taxpayer took a deduction in Year 1 for its contributions to Trust, which Taxpayer represents has been a separate welfare benefit fund under a collective bargaining agreement within the meaning of section 419A(f)(5) and section 1.419A-2T of the Regulations. The amendment will allow Trust assets to be used to provide benefits for active, non-collectively bargained employees, and Trust will no longer qualify as a separate welfare benefit fund under a collective bargaining agreement within the meaning of section 419A(f)(5) of the Code and section 1.419A-2T of the Regulations. Thus, the amendment of Trust will implicate the tax benefit rule because, after the amendment, the amounts attributable to the contributions will be available for a purpose which is fundamentally inconsistent with the premise of the deduction taken in Year 1 in accordance with section 419A(f)(5) of the Code. Taxpayer has therefore represented that it will include in gross income under the tax benefit rule in Year 2 the value of assets held by Trust. Furthermore, Taxpayer has represented that it is not asserting that any portion of the assets is excludable under the exclusionary part of the tax benefit rule.

The amendment of Trust will not, in and of itself, affect the status of Trust as a separate welfare benefit fund under a collective bargaining agreement within the meaning of section 419A(f)(5) or section 1.419A-2T of the Regulations for periods prior to the amendment.

As explained above, section 4976(a) imposes a 100 percent excise tax if an employer maintains a welfare benefit fund and there is a disqualified benefit provided during any taxable year. A “disqualified benefit” is defined in section 4976(b)(1)(C) to include any portion of a welfare benefit fund reverting to the benefit of the employer. Based on the information submitted by Taxpayer, it does not appear that the amendment of Trust or use of Trust assets to provide health benefits for active, non-collectively bargained employees will result in any portion of Trust reverting to the benefit of Taxpayer. Thus, the amendment of Trust and the use of Trust assets to provide health benefits to active, non-collectively bargained employees will not result in a “disqualified benefit” within the meaning of section 4976(b)(1)(C), and the transaction will not, in and of itself, cause Taxpayer to be liable for the excise tax imposed by section 4976.

Furthermore, the amount of Trust assets that are included in Taxpayer's income in Year 2 will be treated as a contribution to Trust in Year 2 (within the meaning of section 419(a)), and Taxpayer may take deductions with respect to such contributions for active, non-collectively bargained employees Plan health benefits to the extent permitted by sections 419 and 419A.

We assume, without expressing an opinion, for purposes of this ruling, that Trust may be amended as described and that the amendment can otherwise be effectuated and does not fail to meet the requirements of other applicable federal and state law. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed regarding the amount of any deductions under sections 419 and 419A. We note, however, that Taxpayer will not be considered to have contributed to Trust any amount involved in the amendment that exceeds the amount that Taxpayer is taking into income under the tax benefit rule as described above. Accordingly, the total amount deductible by Taxpayer under sections 419 and 419A cannot exceed the amount taken into income under the tax benefit rule.

This ruling is directed only to the taxpayer requesting it. Specifically, no opinion is expressed regarding the tax consequences of the described amendment to Trust, nor is any opinion expressed regarding the status under section 501(c)(9) of any trust. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Janet A. Laufer
Senior Technician Reviewer
Health & Welfare Branch
Office of Associate Chief Counsel
(Tax Exempt & Government Entities)

cc: