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Date FEB 24, 1997

Signature [redacted]

[redacted]

CP:E:EO:T:3

EIN: [redacted]

JAN 7 1996

Dear Applicant:

This refers to your application for recognition of exemption from federal income tax as an organization described in section 501(c)(9) of the Internal Revenue Code.

Facts:

You were formed by [redacted] employers who signed a participation agreement (hereafter Participating Employers) on [redacted]. Your trust instrument is governed by the laws of [redacted]. Your trust document was formed to fund a self-funded medical, dental, and prescription plan. The information furnished shows there are [redacted] different plans that may be selected by Participating Employers. Also, the information furnished indicates that the medical plan includes $[redacted] in group term life coverage.

The information furnished shows that [redacted] entities are Participating Employers. These entities include hospitals, clinics, doctors, and a rural nursing home. It appears that each of the Participating Employer select the plan or plans they wish to provide to their employees.

However, if a Participating Employer elects to offer two or more plans to its employees, the information furnished does not indicate whether the employee may choose between the plans, or is restricted to one plan because of his/her job classification.

The information shows that [redacted] of the [redacted] Participating Employers only provide benefits to 1 employee. It appears that all 11 of these Participating Employers are medical doctors. It is not clear whether 9 of these Participating Employers had more than one employee or not. However, in the case of Participating Employer, [redacted] the application only covers [redacted] and specifically excludes all other

employees. Further the Participating Employer, [redacted], application only covers lab technicians and excludes all others.

Further, the application for [redacted] of the [redacted] Participating Employers do not show how many employees are participating. Of the remaining [redacted] Participating Employers, the [redacted] only provides benefits to persons who work 40 hours per week.

Also, in the case of [redacted], exempt employees are immediately covered for benefits, while all others must wait 90 days to participate. The term "exempt employee" is not defined.

Also, in the case of [redacted], all permanent employees are covered for benefits. The term "permanent employee" is not defined.

In question [redacted] of our information letter dated [redacted], we asked you to furnish information concerning the number of participating employees. Specifically we asked you to:

> " [f]urnish an updated VEBA census (Question 3 of Schedule F) showing the current number of employees participating in Plan benefits. Also, furnish the following:
>
> (i) This information should identify highly compensated, owners, directors, and partners, if any.
>
> (ii) This information should indicate the number of employees participating and the number of employees not participating.
>
> (iii) The information should reflect why the employees are not participating.
>
> (iv) Furnish the above information with respect to (a) each employer and to (b) each benefit you fund (life, medical, disability, sickness, and accident benefits)."

In response to this question, you state that your administrator does not maintain census information. Also, you state that because you terminated [redacted], "it is not practical to obtain [census information] from each employer."

Law:

Section 501(c)(9) of the Code provides for the exemption of voluntary employees' beneficiary associations that provide 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 105(h)(2) of the Code states that a self-insured medical reimbursement plan satisfies the requirements of section 105(h) of the Code only if-

> (A) the plan does not discriminate in favor of highly compensated individuals as to eligibility to participate, and
>
> (B) the benefits provided under the plan do not discriminate in favor of participants who are highly compensated individuals.

Section 105(h)(3)(A) of the Code states, in effect, that a self-insured medical reimbursement plan does not satisfy the requirements of subparagraph (A) of paragraph 2 unless such plan benefits 70 percent or more of all employees, or 80 percent of all employees eligible to participate.

Section 105(h)(3)(B) of the Code states, in pertinent part, that for purposes of subparagraph (A) there may be excluded (i) employees who have not completed 3 years of service, (ii) employees who are under 25 years old, and (iii) part-time or seasonal employees.

Section 105(h)(4) of the Code states, in effect, that a self-insured medical reimbursement plan does not satisfy the requirements of subparagraph (B) of paragraph 2 unless all benefits provided for participants who are highly compensated are provided for all other participants.

Section 1.105-11(c)(2)(iii)(C) of the Income Tax Regulations defines the term "part-time employee" to mean an employee who works less than 35 hours per week.

Section 1.501(c)(9)-2(a)(1) of the regulations provides, in pertinent part, 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 among such individuals.... Exemption will not be denied

merely because the membership of an association includes some individuals who are not employees (within the meaning of paragraph (b) of this section), provided that such individuals 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. For purposes of the preceding two sentences, an association will be considered to be composed of employees if 90 percent of the total membership of the association on one day of each quarter of the association's taxable year consists of employees (within the meaning of paragraph (b) of this section)."

Section 1.501(c)(9)-2(a)(2)(i) of the regulations provides, in effect, that membership may be restricted by geographic proximity, or by objective conditions or limitations reasonably related to employment, such as a reasonable classification of workers, a minimum period of service, maximum compensation, or full-time employment status. On the other hand, eligibility for benefits may be restricted by objective conditions relating to the type or amount of benefits offered. However, objective criteria may not be selected or administered in a manner that limits membership or benefits to prohibited group members. Moreover, eligibility for benefits may not be subject to conditions or limitations that have the effect, based on all the facts and circumstances, of entitling members of the prohibited group to benefits that are disproportionate in relation to benefits to which other members of the organization are entitled.

Section 1.501(c)(9)-4(a) of the regulations provides that, based on a determination with regard to all the facts and circumstances, no part of the net earnings of a voluntary employees' beneficiary association may inure to the benefit of any private shareholder or individual other than through the payment of permissible benefits. Thus, while an organization may provide permissible benefits to promote the common welfare of an association of employees in a manner consistent with the requirements of section 501(c)(9), the inurement proscription precludes the tax exemption of an organization predominantly operated to promote the interests of an individual standing in relationship to the organization as an investor for private gain. Cf., Rev. Rul. 81-94, 1981-1 C.B. 330; Church of the Transfiguring Spirit, Inc. v. Commissioner, 76 T.C. 1 (1981).

Section 1.501(c)(9)-4(b) of the regulations provide that the payment to any member of disproportionate benefits, where such payment is not pursuant to objective and nondiscriminatory standards, will not be considered a qualifying benefit for purposes of section 1.501(c)(9)-4(a) of the regulations. Also, the payment to similarly situated employees of benefits that differ in kind or amount will constitute prohibited inurement unless the difference can be justified on the basis of objective

and reasonable standards adopted by the association or on the basis of standards adopted pursuant to the terms of a collective bargaining agreement.

Rationale:

Discrimination can be a function of restrictions on either eligibility for membership or eligibility for benefits. Thus, eligibility for membership may be restricted by objective conditions reasonably related to employment (e.g., geographic location, classification of workers, reasonable minimum period of service). In contrast, eligibility for benefits may be restricted by objective conditions relating to the type or amount of benefits offered. However, the regulations provide that benefits may vary in both kind and amount as to employees who are similarly situated if such differences can be justified on the basis of objective and reasonable standards.

The regulations require that the criteria used to determine eligibility for membership and benefits, may not be selected, established or administered in a manner that has the overall effect of limiting membership or benefits to officers, shareholders or highly compensated employees, or has the effect of entitling members of the prohibited group to disproportionate benefits.

Thus, a VEBA may provide different kinds and amounts of benefits to employees of unaffiliated employers. Also, such variations in benefits may be based upon the election of participating employers. However, when the VEBA provides benefits to employees of unaffiliated employers, we conclude that the requirements of the regulations are separately applicable to each employer. Thus, in determining whether a plan is nondiscriminatory, each employer must separately satisfy the antidiscrimination requirements of the regulations. Thus, if one of the unrelated employers fails to satisfy the antidiscrimination provisions, the VEBA fails to qualify as exempt under section 501(c)(9) of the Code.

Because you fund a self-funded medical plan, you must satisfy the non-discriminatory requirements of section 105 of the Code. Because you have not furnished the employee census information we requested in our letter of [redacted], we are unable to determine whether all of the [redacted] employers meet the antidiscrimination provisions of section 105.

Even though you have not furnished the requested census information, some of the information furnished reflects that some of your Participating Employers fail to satisfy the antidiscrimination provisions of section 105. The information on

[redacted]

the application, which [redacted] submitted to participate in your self-funded medical plan, excludes all employees other than [redacted] (owner) who is a highly compensated employee. Also, the information on the application, which [redacted] submitted to participate in your self-funded medical plan, excludes all employees other than one laboratory technician.

In addition, the application submitted by the [redacted] to participate in your self-funded medical plan, only covers employees who work 40 hours per week. Thus, part-time employees who work 35 or more hours per week are excluded. Thus, we conclude that the [redacted] is in violation of section 105(h)(3)(B)(iii) of the Code because the [redacted] definition of the term "full-time employee" excludes a class of employees that are not part-time employees as defined by section 1.105-11(c)(2)(iii)(C) of the regulations (individuals who work between 35 and 39 hours per week).

Also, the application submitted by the [redacted] (hereafter [redacted]) to participate in your self-funded medical plan, does not define the term part-time employee. The application says that this will be determined by the Executive Committee. Further, the application says the exempt employees get immediate coverage, while all other employees have a 90 day waiting period. The application does not define the term "exempt employee". In addition, the application submitted by the [redacted]al (hereafter [redacted]) to participate in your self-funded medical plan, provides that all permanent employees are covered, however, there is no definition of the term permanent employee." Thus, we conclude that we have insufficient information to establish whether [redacted] and [redacted] comply with section 105(h)(4) of the Code.

Therefore, based on the above we conclude that you provide discriminatory benefits to one or more of the [redacted] unrelated employers who participate in your self-funded medical reimbursement plan.

Therefore, based on the above, we conclude that you do not qualify for recognition of exemption from federal income tax under section 501(c)(9) of the Code. You are required to file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days of the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your

protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director in Dallas, Texas. Thereafter, any question about your federal income status should be addressed to that office.

Sincerely yours,

Edward K. Karcher

Edward K. Karcher
Chief, Exempt Organizations
Rulings Branch 3