Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

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Date:
09/30/2002

Key

M =

N =

P =

Q =

R =

date a =

date b =

date c =

x dollars =

y dollars =

Dear :

This is in response to letters dated December 8, 2000 and March 19, 2001 requesting rulings concerning the transaction described below.

FACTS

M is an organization described in section 501(c)(6) of the Internal Revenue Code. N is a wholly-owned subsidiary of M. M's membership includes businesses with employees and businesses without employees. Among other activities, M sponsors trade shows and educational seminars for its members, collects industry data and publishes survey results, and provides assistance with government lobbying. In addition, through N, M offers medical, dental, life insurance, and disability benefits coverage for purchase by M's members. P, a business with one or more employees, is a member of M participating in the health and life insurance programs sponsored by M.

During the 1970's and 1980's, M received payments of excess reserve funds from insurance companies based on favorable claims experience with health and group term life insurance. The premiums to which the refunds related were premiums paid over a number of years by all group members for the health and life coverage. The experience rating for the refunds was on a group-wide basis.

On date a, Q was established by M to ensure that the excess reserve funds received and developed would be available for the benefit of the insured persons in M's insurance programs and the members of M. Q is not exempt under section 501(c)(9) of the Code.

Q's stated purpose is to provide group employee welfare benefit programs that can benefit employees of members of M. The trust document specifies that the trustee may use trust assets to fund the employee welfare benefit programs for members of M through any one or a combination of the following: insurance policies; a wholly-owned insurance company for the purpose of providing insurance for the benefit of the members; a multiple employer welfare arrangement; or any other insurance or other arrangement authorized by state or federal law which would benefit the members. A member's rights and interest in Q terminate when the member doesn't make the required contributions under the welfare benefit programs or when it is no longer a member of M. Pursuant to the trust document, no part of the Q's earnings may inure to the benefit of any member of M or any individual other than through payments to provide benefits.

Q is administered by M, acting through its board of directors, which includes members of various types and sizes as well as certain officers of M. No particular employer is able to control Q. Rather, Q is controlled by M for the benefit of those who are participating in M's insurance programs.

Q was initially funded with the excess reserve funds mentioned above, as well as with an equity share distribution in connection with a life insurance company's conversion from a mutual company to a stock company. The trust document contemplates that participating members will make contributions to Q as provided under

the employee welfare benefit program maintained under Q. Disbursements from Q in the form of benefit or insurance premium payments and other expenses must be made only in accordance with the employee welfare benefit program.

It is represented that neither post-retirement medical benefits nor post-retirement life insurance benefits have been provided under any of Q's benefit programs, and that all benefit obligations have been met. It is further represented that neither M nor any of its members has ever contributed more than ten percent of the total contributions of all participating members under any of the benefit programs available to M's members, and at no time was coverage for any member experience-rated on an individual basis. Finally, it is represented that Q is and has always been part of a ten or more employer plan described in section 419A(f)(6) of the Code.

As of date b, Q had assets valued at approximately x dollars. M, as trustee of Q, has now authorized the transfer of y dollars from Q to R. It is represented that R is an organization described in section 501(c)(3) of the Code.

Rulings are requested that (1) the transfer of funds from Q to R will not result in the imposition of the 100% excise tax under section 4976 of the Code; and (2) the transfer will not result in taxable income or unrelated business taxable income to M, to R, or to P and other members of M. You are not requesting a ruling on the issue of whether Q satisfies the section 419A(f)(6) exception for ten or more employer plans, and we are not ruling on that issue. Rather, in addressing the issue raised in request (1), we are relying on the representation that Q satisfies the section 419A(f)(6) exception. With respect to request (2), your application indicates that you are not requesting a ruling on the issue of whether the transfer of funds from Q to R will result in taxable income to Q, and we are not ruling on that issue. Further, as explained in a telephone conversation with your authorized representative, we decline to rule on whether the transfer of funds from Q to R will result in income to P and other members of M.

Ruling #1

Sections 419 and 419A of the Code provide rules with respect to the deductiblity of contributions paid or accrued by an employer to a welfare benefit fund.

Section 419(e) provides that for purposes of section 419 the term "welfare benefit fund" means any fund that is part of a plan of an employer, and through which the employer provides welfare benefits to employees or their beneficiaries. The term "welfare benefit" means any benefit other than a benefit with respect to which section 83(h), section 404, or section 404A applies. The term "fund" means any organization described in section 501(c)(7), (9), (17), or (20); any trust, corporation, or other non-exempt organization; and, to the extent provided in regulations, any account held for an employer by any person.

Section 419A(f)(6) of the Code provides that sections 419 and 419A shall not apply in the case of any welfare benefit fund which is part of a ten or more employer plan that does not maintain experience-rating arrangements with respect to individual employers. The term “ten or more employer plan” means a plan to which more than one employer contributes, and to which no employer normally contributes more than ten percent of the total contributions contributed under the plan by all employers.

Section 4976(a) of the Code imposes an excise tax on an employer equal to 100% of any disqualified benefit provided by an employer-maintained welfare benefit fund. Pursuant to section 4976(b)(1)(A) and (B), the term "disqualified benefit" includes certain post-retirement medical or life insurance benefits. Section 4976(b)(1)(C) provides that the term “disqualified benefit” also includes any portion of a welfare benefit fund reverting to the benefit of the employer. Section 4976(b)(3) provides that paragraph (1)(C) of section 4976(b) shall not apply to any amount attributable to a contribution to a welfare benefit fund that is not allowable as a deduction under section 419 for the taxable year or any prior taxable year.

We conclude that Q is a fund that is part of a plan through which M’s employer-members provide welfare benefits to their employees. Accordingly, Q is a “welfare benefit fund” as that term is defined in section 419(e) of the Code. Additionally, for purposes of section 4976 we conclude that Q is a welfare benefit fund maintained by P and the other participating employers because M maintains Q on behalf of its member-employers.

Section 4976 of the Code imposes a 100% excise tax on an employer if a disqualified benefit is provided during the taxable year. Section 4976(b)(1)(A) through (C) describe “disqualified benefits.” The transfer of assets from Q to R cannot be a disqualified benefit under sections 4976(b)(1)(A) or (B) of the Code since no post-retirement medical or life insurance benefits are provided under Q’s benefit programs. Further, it is represented that Q is part of a ten or more employer plan to which the exception provided by section 419A(f)(6) applies. Based on that representation, employer contributions to Q were not “allowable as a deduction under section 419 for the taxable year or any prior taxable year” within the meaning of section 4976(b)(3). Thus, pursuant to section 4976(b)(3), the transfer of funds is not a disqualified benefit under section 4976(b)(1)(C).

Accordingly, we conclude that the transfer of funds from Q to R is not a “disqualified benefit” for purposes section 4976 of the Code and, therefore, will not result in the imposition of the 100% excise tax under that Code section.

Ruling #2

Section 511 of the Code generally imposes a tax on the unrelated business taxable income of organizations described in section 501(c).

Section 512 of the Code, in general, defines “unrelated business taxable income” as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the allowable deductions directly connected with the carrying on of such trade or business.

Section 513 of the Code, in general, defines “unrelated trade or business” as any trade or business the conduct of which is not substantially related to the exercise or performance of the purpose or function constituting the basis for the organizations exemption.

We conclude that the transfer of funds from Q to R is not income derived by M from any unrelated trade or business regularly carried on by it. We also conclude that the transfer of funds from Q to R is not income derived by R from any unrelated trade or business regularly carried on by it. Accordingly, the transfer will not result in taxable income to M or to R.

The rulings contained in this letter are based on 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.

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 or implied herein concerning whether Q is, as represented, a part of a ten-or-more employer plan that does not maintain experience rating arrangements with respect to individual employers. Additionally, no opinion is expressed concerning the tax consequences to N or to Q with respect to the proposed transaction or any past transactions. Further, we express no opinion as to whether the proposed transaction will cause the status of R to be that of a private foundation, as defined in section 509(a) of the Code, nor as to the tax consequences (if any) to any other parties if that is the result.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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Sincerely,

MARK SCHWIMMER
Senior Technician Reviewer
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)