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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: **201121028**
Release Date: 5/27/2011
Date: March 1, 2011

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Uniform Issue List
501.09-00
511.00-00
4976.00-00

Legend:
A =
B =
Z =

Dear

This is in response to your ruling requests as to the federal tax consequences of the proposed transactions under the Internal Revenue Code and Federal Tax Regulations.

FACTS:

You are an organization recognized as exempt under section 501(a) of the Internal Revenue Code ("Code"), and an organization described in section 501(c)(9) as a Voluntary Employees' Beneficiary Association ("VEBA"). You represent that you received a favorable tax-exempt status under section 501(c)(9) of the Code on June 29, 1989.

You provide medical, life, dental, and sickness benefits to employees of your participating members/employers (individually as the "Employer" and collectively as the "Employers"). The Employers are in the A industry, located in the northern part of State Z. Your participating Employers are members of the sponsoring trade association known as B.

You represent that in the summer of 2006, B sent you notice that it plans to end its sponsorship. B also required the Employers to seek alternate insurance arrangements, and as of December 2006, all of the Employers had arranged alternative healthcare coverage for their employees. As a result, there are no remaining Employers in the VEBA. You now plan to wind up and terminate the VEBA. Pursuant to Article IX, Section 2(d) of your trust document ("Trust"), upon the VEBA's termination, the trustee shall "Apply any remaining assets toward keeping in force

the plan, policy or policies held at termination for such a period as the contributions shall serve, or toward such other purposes as, in the opinion of the trustees, shall be consistent with the purpose of this Trust". You represent that the Trust assets (the "Fund Balance") that you will transfer to the Employers upon your termination were derived from exempt function income.

You represent that you do not plan to distribute to the Employers any of the Fund Balance remaining after payment of administrative expenses. Rather, you will require each Employer to enter into a written agreement ("Agreement"). Under the Agreement, you will determine how much of the Fund Balance is allocable to each Employer. The Agreement will stipulate that Employers shall use any portion of the Fund Balance allocable to them to provide VEBA benefits as provided under section 501(c)(9) of the Code.

You submitted a copy of the Agreement. Pursuant to the Agreement:

a. Each Employer understands that after you terminate the VEBA and pay expenses resulting thereof, you are permitted solely to use Fund Balance to continue to provide their employees with section 501(c)(9) of the Code benefits until the Fund Balance is exhausted. The Employers have no legal right to a reversion of assets under the Code or the Agreement.

b. You will use the Fund Balance to pre-pay employee benefits permitted under section 501(c)(9). Each Employer must represent that it has in place a plan that will provide its employees with the benefits permitted within the perimeters of section 501(c)(9) of the Code and section 1.501(c)(9)-3 of the Income Tax Regulations ("regulations"). Each Employer must submit proof of such plan. Each Employer must also consent that either you or the Internal Revenue Service ("Service") may require such Employer to produce copies of such plan.

c. To enable you to pre-pay the group plans the Employers will set up, each Employer must submit information about the group plan and the cost of the group plan. Upon your receipt and verification of the group plan's information, you will draw a check in the name of the group plan and mail the check to the Employer who will then forward the check to the group plan.

d. Each Employer shall not administer benefit(s) payment arrangements that will bestow disproportionate benefit(s) to officers, shareholders, or other highly paid employees of the Employer.

e. If an Employer's contribution to the VEBA included contributions by an Employer's employees, the Employer agrees that during the successor coverage period represented by your distribution, no further contribution shall be required of the employees. The Employer may also reimburse the employees any amount(s) attributable to employee premium payments as far as the Employer still has records reasonably accounting for such employee contributions and the employee expenditures for medical benefits described in section 213 of the Code, if possible.

f. Each Employer understands that the Service can audit any Employer to make certain that the Employer applied its share of the Fund Balance to pay benefit(s) consistent

with the terms and provisions of the Agreement, the Internal Revenue Code, and this Private Letter Ruling.

g. Each Employer understands that you plan to terminate and wind up by December 31, 2010, and if any Employer fails to comply with the Agreement, such an Employer will forfeit any claim to the Fund Balance.

You represent that you plan to use an objective method to determine the amount of the Fund Balance allocable to each Employer. Pursuant to this objective method, you shall:

a. Determine the Fund Balance after payment of administrative expenses;

b. Allocate the Fund Balance by line of coverage (i.e., medical, life, dental, sickness and accident) using the 2002-6 total contributions to VEBA as the denominator, and the 2002-6 contributions by line of coverage as the numerator and;

c. Determine the Employers' share of the Fund Balance per line of coverage using total 2002-6 contributions as the denominator and the Employers' respective 2002-6 contributions as the numerator.

Finally, in a draft letter that you plan to send to the Employers, you stated to the Employers "the Trust cannot make payment to your company directly. However, the letter ruling obtained by the Trust allows the Trust to pre-pay your insurance/plan obligations for up to the amount of the identified rebate amount."

You represent that if you are unable to locate an Employer or an Employer fails to respond or timely agree to the Agreement, you reserve the right to allocate the share of the Fund Balance allocable to a nonresponsive Employer to the other Employers.

RULINGS REQUESTED:

1. The proposed transactions will not adversely affect your tax-exempt status as an organization described under section 501(c)(9) of the Code.

2. The proposed transactions will not result in the imposition of tax on the Employers under section 4976 of the Code.

3. Transfers will not result in your incurring unrelated business taxable income under section 511 of the Code.

LAW:

Section 501(c)(9) of the Code provides for the exemption from federal income tax of voluntary employees' beneficiary associations providing 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 1.501(c)(9)-1 of the regulations provides that for an organization to be described in section 501(c)(9) of the Code, it must be an employees' association; membership in the association must be voluntary; the organization must provide for the payment of life, sick, accident, or other benefits to its members; and there can be no inurement (other than by payment of permitted benefits) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-4(a) of the regulations provides, generally, that no part of the net earnings of an employees' association may inure to the benefit of any private shareholder or individual other than through the payment of benefits permitted by section 1.501(c)(9)-3.

Section 1.501(c)(9)-4(d) of the regulations provides that it will not constitute prohibited inurement if, on termination of a plan established by an employer and funded through an association described in section 501(c)(9), any assets remaining in the association, after satisfaction of all liabilities to existing beneficiaries of the plan, are applied to provide, either directly or through the purchase of insurance, life, sick, accident or other benefits within the meaning of section 1.501(c)(9)-3 pursuant to criteria that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees of the employer.

Section 4976(a) of the Code imposes a 100% 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) of the Code provides that for purposes of subsection (a), the term "disqualified benefit" means any portion of a welfare benefit fund reverting to the benefit of the employer.

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c)(9).

Section 512(a)(3)(A) of the Code 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 modifications.

Section 512(a)(3)(B)(ii) of the Code provides that in the case of an organization described in paragraph (9), (17) or (20) of section 501(c), "exempt function income" includes all income (other than an amount equal to the gross income derived from any unrelated trade or business regularly carried on by such organization computed as if the organization were subject to section 512(a)(1)), which is set-aside to provide for the payment of life, sick, accident, or other benefits, including reasonable costs of administration directly connected with its exempt purpose.

Section 512(a)(3)(E) of the Code provides that, generally, for organizations described in paragraph (9), (17) or (20) of section 501(c), a set-aside may be taken into account under subparagraph (B) only to the extent that such set-aside does not result in an amount of assets set aside in excess of the account limit determined under section 419A (without regard to subsection (f)(6) thereof) for the taxable year (not taking into account any reserve described in section 419A(c)(2)(A) for post-retirement medical benefits).

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ANALYSIS:

You have requested a ruling on whether the proposed transactions will adversely affect your tax-exempt status as an organization described under section 501(c)(9) of the Code. Pursuant to section 1.501(c)(9)-4(d) of the regulations, it will not constitute prohibited inurement if, on termination of a plan established by an employer and funded through an association described in section 501(c)(9), any assets remaining in the association, after satisfaction of all liabilities to existing beneficiaries of the plan, are applied to provide, either directly or through the purchase of insurance, life, sick, accident or other benefits within the meaning of section 1.501(c)(9)-3 pursuant to criteria that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees of the employer.

You represent that after you terminate the VEBA and pay administrative expenses and liabilities, the remaining Fund Balance of the VEBA will be used to pre-pay group plans that will benefit the employees. Each Employer must provide to you information about the group plan it has secured for its employees and the group plan's costs. Upon your receipt and verification of the information regarding an Employer's group plan and its cost, you will draw a check in the group plan's name, not that of the Employer, and mail the check to the Employer. The Employer upon receipt of the check will forward the check to the group plan.

In order for an Employer to receive an allocable share of the Fund Balance, it must enter into the Agreement with you. The Agreement provides that no assets of the VEBA will revert back to any Employer, and each Employer must make certain that the group plan can only provide benefits permitted under section 501(c)(9) of the Code and section 1.501(c)(9)-3 of the regulations. Each Employer must also agree that there will be no disproportionate benefits to officers, shareholders, or other highly compensated employees of the Employers. Thus, because you will use the Fund Balance to pre-pay the group plans the Employers secured to provide VEBA benefits permitted under section 501(c)(9) of the Code with no disproportionate benefit inuring to any person, and because none of the VEBA's assets will revert back to any Employer, we conclude that this transaction will not adversely jeopardize your tax-exempt status under section 501(c)(9).

Second, you have requested a ruling on whether the proposed transactions will result in the imposition of tax on the Employers under section 4976 of the Code. Pursuant to section 4976(a) of the Code, a 100% excise tax shall be imposed if an employer maintains a welfare benefit fund, and there is a disqualified benefit provided during any taxable year. Further, section 4976(b)(1)(C) of the Code provides that for purposes of subsection (a), the term "disqualified benefit" means any portion of a welfare benefit fund reverting to the benefit of the employer.

You represent that each Employer must obtain a group plan that will provide solely benefits permitted under section 501(c)(9) of the Code. The Employers will submit information including costs of maintaining the group plans to you. After your verification of the group plans' information and costs, you will draw checks in the name of the group plans, not the Employers, to cover the costs of the group plans. You will mail the checks to the Employers and the Employers will forward the checks to the group plans. You will follow this procedure until the Fund Balance allocable to each Employer is exhausted. You represent that as a result of this procedure, you will pay no money directly to the Employers. You further represent that no

assets will revert to any Employer. Thus, because no Employer will receive a disqualified benefit, the proposed transactions will not result in the imposition of tax on the Employers under section 4976.

Finally, you have requested a ruling on whether the transfers will result in your incurring unrelated business taxable income under section 511 of the Code. You represent that the Fund Balance, after payment of administrative expenses, is exempt function income and does not constitute unrelated trade or business income. Pursuant to section 512(a)(3)(A) of the Code, in the case of an organization described in section 501(c)(9), unrelated business taxable income does not include any exempt function income, computed with modifications. Because the Fund Balance is exempt function income and not unrelated business taxable income under section 512(a)(3)(A) of the Code, it would not be subject to unrelated business income taxation under section 511.

RULINGS:

Based on the information submitted, we rule as follows:

1. The proposed transactions will not adversely affect your tax-exempt status as an organization described under section 501(c)(9) of the Code.

2. The proposed transactions will not result in the imposition of tax on the Employers under section 4976 of the Code.

3. Transfers will not result in your incurring unrelated business taxable income under section 511 of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose.* A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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 by others as precedent.

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.

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

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In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Theodore R. Lieber
Manager, Exempt Organizations
Technical Group 3

Enclosure
Notice 437