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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Date:
December 05, 2013

Legend:

Taxpayer =

Union =

Group Policy =

Insurance Company =

Company A =

Company B =

Company C =

Plan A =

Plan B =

Plan C =

Plan D =

Plan E =

Union VEBA =

Management VEBA =

Dear :

This responds to your letter dated December 30, 2011, requesting rulings regarding the tax consequences of proposed transactions involving welfare benefit fund assets under sections 61 and 4976 of the Internal Revenue Code (Code). Specifically, you have asked how sections 61 and 4976 apply to a transfer of assets from a retired lives reserve under a group-term life insurance policy to voluntary employees' beneficiary associations (VEBAs) described in section 501(c)(9) of the Code.

FACTS

Taxpayer is organized as a Delaware corporation and was formed through the merger of several companies. Taxpayer is the successor of Company A, Company B, and Company C.

Taxpayer provides life insurance, health, and other welfare benefits to its active and retired employees (and their eligible spouses and dependents) through several welfare benefit plans, including Plan A. Plan A is an umbrella welfare benefit plan that provides medical, dental, vision, and life insurance benefits to certain active and retired union-represented employees of Taxpayer and its affiliates through several component plans. Plan B, a component plan under Plan A, provides group term life insurance to retired employees of Company A who were, before their retirement, represented by Union. Plan C, consisting of two component plans under Plan A, provides retiree medical and dental benefits to retired employees of Company A who were, before their retirement, represented by Union.

Plan D is a welfare benefit plan that provides medical, dental, vision, and life insurance benefits to active and retired employees of Taxpayer and its affiliates. Plan D primarily covers employees and retirees who are not union-represented, although some union-represented employees and retirees whose collective bargaining units have bargained for management benefits also participate in Plan D.

Plan E provides medical and dental benefits to management and non-union hourly retirees, including some disability retirees (collectively, management retirees), who retired from Taxpayer or its predecessor companies, including Companies A, B, and C. The management retirees and their eligible spouses and dependents who are covered by Plan E formerly participated in Plan D.

Retired employees covered by Plans B and D receive basic term life insurance benefits under Group Policy with Insurance Company. Taxpayer is the current policyholder, as successor to Company A and its predecessor companies. Group Policy establishes a retirement funding account (RFA) that is a retired lives reserve. Taxpayer represents that the RFA is a welfare benefit fund under section 419(e). The assets held in the RFA are used to pay life insurance premiums for retired employees.

Taxpayer sponsors a number of VEBAs, two of which are involved in the proposed transfers at issue in this ruling. Union VEBA provides funding for collectively bargained retiree health benefits for participants in Plan B and their eligible spouses and dependents. Management VEBA provides funding for medical and dental benefits for retired employees covered by Plan E.

Taxpayer proposes to transfer all or a portion of the RFA assets allocated to Plan A from Group Policy to Union VEBA, where the assets will be used to provide retiree health benefits under Plan C. Taxpayer represents that, after the transfer, the transferred assets will be used exclusively to provide medical benefits to eligible retired employees covered by Plan C.

Taxpayer proposes to transfer all or a portion of the RFA assets allocated to Plan D to Management VEBA, where the assets will be used to provide retiree health benefits under Plan E. Taxpayer represents that, after the transfer, the transferred assets will be used exclusively to provide medical benefits to eligible retired employees covered by Plan E.

Taxpayer represents that:

(1) All of the assets in the RFA are attributable to contributions made before 1986, and investment earnings on those contributions;

(2) Amounts contributed to the RFA were deductible when made under section 162 of the Code;

(3) Group Policy does not permit Taxpayer to recover any assets credited to the RFA, or to transfer those assets to an alternate funding medium where they will be used for any purpose other than to provide benefits to eligible employees of Taxpayer or its affiliates;

(4) If the RFA is no longer needed to pay life insurance premiums under Group Policy, the assets credited to the RFA must be used to provide other retiree welfare benefits; and

(5) Under the terms of Union VEBA and Management VEBA, and consistent with the prohibited inurement rules of section 501(c)(9),Taxpayer is prevented from recovering the RFA assets after they are transferred to the VEBAs.

RULINGS REQUESTED

You have requested the following rulings:

1. The transfer of assets from the RFA to Union VEBA and Management VEBA will not cause Taxpayer to include any amount in gross income under section 61.

2. The use of transferred RFA assets to provide medical benefits to retired employees through Union VEBA and Management VEBA will not cause Taxpayer to include any amount in gross income under section 61.

3. The transfer of assets from the RFA to Union VEBA and Management VEBA, and the use of the transferred assets to provide retiree health benefits, will not result in any portion of the RFA reverting to the benefit of Taxpayer within the meaning of section 4976(b)(1)(C) and will not cause the employer to be liable for the excise tax imposed by section 4976.

LAW

Section 61(a) provides that, unless otherwise excepted, gross income includes all income from whatever source derived, including income from life insurance and endowment contracts.

Section 162(a) provides, in part, that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 1.162-10 provides, in part, that amounts paid or accrued within the taxable year for a sickness, accident, hospitalization, medical expense, or similar benefit plan, are deductible under section 162(a) if they are ordinary and necessary expenses of the trade or business.

Section 1.162-10T, Q&A-2, provides that section 419 generally applies to contributions paid or accrued with respect to a welfare benefit fund after December 31, 1985, in taxable years of employers ending after that date.

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(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), and also, to the extent provided in regulations, any account held for an employer by any person.

Section 1.419-1T, Q&A-2(a) of the regulations, provides that section 419 generally applies to contributions paid or accrued with respect to a welfare benefit fund after December 31, 1985, in taxable years of employers ending after that date.

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.
Section 4976(b)(3) provides that section 4976(b)(1)(C) does not apply to any amount attributable to a contribution to the fund that is not allowable as a deduction under section 419 for the taxable year or any prior taxable year.

In Revenue Ruling 73-599, 1973-2 C.B. 40, the issue was whether the balance in a retired lives reserve had to be included in the gross income of the employer in the taxable year in which the employer terminated the insurance contract. At the time it terminated the insurance contract, the employer directed that the insurance carrier should transfer the balance in the retired lives reserve to a trust qualified as a VEBA under section 501(c)(9). The employer had deducted the premiums paid into a retired lives reserve during the years when it was maintaining the insurance contract for the benefit of its employees. The insurance contract provided that, upon cancellation or other termination of the contract, any balance in the retired lives reserve could be distributed to the employer as a dividend or, at the employer's option, transferred to a trust qualified under section 501(c)(9) for the purpose of providing insurance coverage for retired employees. Under these facts, the ruling holds that the balance in the retired lives reserve was includable in the employer's gross income under section 61(a) in the year of the transfer. The ruling states that, because the insurance contract gave the employer a fixed right to receive the balance in the retired lives reserve in the year in which it terminated its coverage under the policy, that balance was includable in the employer's gross income for the year of the termination, notwithstanding the fact that the employer directed the insurance company to transfer the money to a section 501(c)(9) trust.

Similarly, in Revenue Ruling 77-92, 1977-1 C.B. 41, a corporate employer with a group term insurance program that included a retired lives reserve had the option to discontinue the insurance coverage and to direct the insurance carrier to use the amount in the retired lives reserve either to pay premiums for insurance on the lives of retired employees or to pay a dividend to the employer. The employer terminated the insurance contract and directed the insurance carrier to transfer the balance in the retired lives reserve to another insurance company to purchase insurance for retired employees. The ruling states that the facts presented are in substance the same as those contained in Rev. Rul. 73-599, except that the right reserved to the employer in Rev. Rul. 77-92 to transfer the funds remaining in the retired lives reserve consisted of the right to direct payment to those funds to another insurance company rather than to a trust that qualified for exemption under section 501(c)(9) of the Code. However, this difference was not considered material because the taxpayer's right of control over the retired lives reserve was substantially the same in both cases. Accordingly, the ruling concludes that the same federal income tax rules apply to the transfers in the two cases.

ANALYSIS AND CONCLUSION

RULING REQUEST 1

In this case, with regard to the transfer of assets from the RFA to Union VEBA and Management VEBA, Taxpayer represents that there are provisions prohibiting the reversion of any assets to Taxpayer. The provisions precluding Taxpayer from receiving a reversion distinguishes this case from the situations considered in Rev. Ruls. 73-599 and 77-92. Therefore, because Taxpayer does not have any right to a reversion of the RFA assets, it will not realize any income under section 61 on the transfer of all or a portion of the RFA assets allocated to Plan A from Group Policy to Union VEBA and all or a portion of the RFA assets allocated to Plan D to Management VEBA.

RULING REQUEST 2

Taxpayer represents that all of the assets in the RFA are derived from contributions made before 1986. Accordingly, the deductibility of the contributions was governed by section 162, without regard to deduction limits of section 419. Taxpayer represents that the amounts contributed to the RFA were deductible when made under section 162. Therefore, the use of transferred RFA assets to provide medical benefits to retired employees through Union VEBA and Management VEBA will not cause Taxpayer to include any amount in gross income under section 61.[1]

RULING REQUEST 3

Under section 4976(b)(3), section 4976(b)(1)(C) does not apply to amounts attributable to contributions to a fund that were not allowable as a deduction under section 419. Accordingly, amounts attributable to contributions made prior to the effective date of section 419 are not subject to the section 4976(b)(1)(C) excise tax. Taxpayer represents that all of the assets in the RFA are attributable to contributions made before 1986 and investment earnings on those contributions. Accordingly, the transfer of assets from the RFA to Union VEBA and Management VEBA, and the use of the transferred assets to provide retiree health benefits, will not result in a “disqualified benefit” within the meaning of section 4976(b)(1)(C), and accordingly, will not in and of itself cause Taxpayer to be liable for the excise tax imposed by section 4976.

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[1] We have also considered the possible application of the tax benefit rule, which requires a taxpayer who received a tax benefit from a deduction in an earlier year to recognize income in a later year if there occurs an event that is fundamentally inconsistent with the premise on which the deduction was initially based. Hillsboro National Bank v. Commissioner, 460 U.S. 370, 383 (1983). Because the amounts at issue are attributable to contributions that were made prior to the effective date of section 419 and were deducted under section 162, it is not fundamentally inconsistent to transfer the funds between the retirement funding account and the retiree health plans. Consequently, the tax benefit rule does not apply.

The above rulings are directed only to the taxpayer who requested them. Section 6110(k)(3) of the Code provides that they may not be used or cited as precedent.

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the transaction described above under any provision of the Code.

Sincerely,

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

cc: