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
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Date: June 15, 2015

Legend:

Taxpayer =

Company A =

Company B =

Company C =

Trust =

Bankruptcy Court =

Plan =

Year 1 =

Year 2 =

Year 3 =

$X =

Dear :

This responds to your letter dated May 9, 2014, and subsequent correspondence, requesting a ruling under section 4976 of the Internal Revenue Code (Code) regarding the termination of Trust and the transfer of Trust assets to various charitable organizations.

FACTS

Taxpayer is a business trust established pursuant to an order of the Bankruptcy Court in connection with the insolvency of Company A. Company A was formed after its former parent company, Company B, went bankrupt in Year 1. Company A and its affiliates, including Company C, filed for Chapter 11 protection in Bankruptcy Court in Year 2. In Year 3, Taxpayer took over the Company A bankruptcy estate.

Company B provided welfare benefits to its employees through Plan, including medical benefits, group term life insurance benefits, severance benefits, and disability benefits ("Plan Benefits"). Company B established Trust to hold and invest the contributions it made and to pay or provide Plan Benefits to employees. Taxpayer is the successor in interest and assignee of certain assets and obligations of Company A, including those relating to Plan.

Trust intends to terminate and transfer all remaining Trust assets, after payment of administrative expenses related to the termination, to various unrelated charitable organizations.

Taxpayer represents as follows:

1. Trust is a voluntary employees' beneficiary association under section 501(c)(9) of the Code.

2. There are no remaining participants in Plan, all benefits owed under Plan have been paid, and there are no outstanding benefit claims or liabilities.

3. All of the remaining assets in Trust are derived from contributions made after December 31, 1985.

4. All contributions to Trust were deducted by Company A, Company B, or Company C.

5. The total amount of the previously deducted contributions exceeds the amount of the remaining assets in Trust as of December 31, 2014.

6. The amount of remaining assets in Trust as of December 31, 2014, is approximately $X.

7. Taxpayer acknowledges that the transfer of the remaining assets in Trust to the charitable organizations will be subject to the tax benefit rule.

8. Taxpayer will take the fair market value of the remaining assets in Trust that are transferred to the charitable organizations into income under the tax benefit rule, and no portion of that amount is excludable under section 111.

9. Taxpayer will not take a charitable deduction for the amount transferred to the charitable organizations.

RULING REQUESTED

Taxpayer has requested a ruling that the termination of Trust and the transfer of the remaining assets in Trust to various charitable organizations will not result in a reversion to Taxpayer within the meaning of section 4976(b)(1)(C), and, therefore, will not cause Taxpayer to be subject to the excise tax under section 4976.

LAW

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

Section 111(a) of the Code 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 such 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 rule 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 511 of the Code imposes a tax on the unrelated business taxable income of exempt organizations, including organizations described in section 501(c)(9).

Section 512(a)(1) provides, generally, that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by Chapter 1 which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in section 512(b).

Section 512(a)(3)(A) 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 Chapter 1 which are directly connected with the production of the gross income (excluding exempt function income), both computed with modifications.

Section 512(a)(3)(B) provides that the term "exempt function income" means the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing the members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid. The term also means 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 paragraph (1)), which is set aside—

(i) for a purpose specified in section 170(c)(4), or

(ii) in the case of an organization described in paragraph (9), (17), or (20) of section 501(c), to provide for the payment of life, sick, accident, or other benefits,

including reasonable costs of administration directly connected with a purpose described in clause (i) or (ii). If during the taxable year, an amount which is attributable to income so set aside is used for a purpose other than that described in clause (i) or (ii), such amount shall be included, under subparagraph (A), in unrelated business taxable income for the taxable year.

Section 512(a)(3)(E) limits amounts set aside to provide benefits described in section 512(a)(3)(B)(ii) that can be treated as exempt function income.

Section 170(c)(4) provides that the term "charitable contribution" includes a contribution or gift by an individual to or for the use of a domestic fraternal society, order, or association, operating under the lodge system, but only if such contribution or gift is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

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 CONCLUSION

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.

The proposed transfer of the remaining assets in Trust to charitable organizations will allow amounts attributable to contributions made for the purpose of providing Plan Benefits to be transferred and used for charitable purposes. Thus, the transfer will implicate the tax benefit rule because Taxpayer deducted the amount of the contributions for Plan Benefits in a prior year, but now plans to transfer the assets to charitable organizations, which is fundamentally inconsistent with the premise of the deduction. Taxpayer has therefore represented that it will include the fair market value of the assets in income under the tax benefit rule.

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. Furthermore, section 512(a)(3)(B)(i) contemplates that a voluntary employees' beneficiary association may make a contribution to a charitable organization. Based on the information submitted by Taxpayer, it does not appear that the transfer of assets to the unrelated charitable organizations will result in any portion of Trust reverting to the benefit of Taxpayer. Thus, the termination of Trust and the transfer of Trust assets to charitable organizations will not result in a "disqualified benefit" within the meaning of section 4976(b)(1)(C), and will not, in and of itself, cause Taxpayer to be liable for the excise tax imposed by section 4976.

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.

This ruling is directed only to the taxpayer requesting it. Specifically, this ruling does not address the tax consequences to Trust.

Section 6110(k)(3) of the Code 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,

/S/

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