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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
PLR-116517-15

Date: November 2, 2015

Legend:

Taxpayer =

Department =

M =

State =

Plan =

Date X =

Date Y =

Date Z =

Dear :

This responds to your letter dated May 8, 2015, and subsequent correspondence, requesting rulings under the Internal Revenue Code ("Code") as to the Federal tax consequences of proposed distributions of Taxpayer's assets upon termination. Specifically, you requested rulings concerning (1) whether the distributions comply with section 501(c)(9) of the Code; (2) whether the distributions are wages subject to Federal Insurance Contributions Act ("FICA") taxes, Federal Unemployment Tax Act ("FUTA") tax, and Federal income tax withholding; and (3) whether the distributions must be reported to each of Taxpayer's members who receives a distribution on a Form W-2.

FACTS

Taxpayer, a trust, received a letter from the Internal Revenue Service, dated Date X, stating that it is a voluntary employees' beneficiary association under section 501(c)(9) of the Code. Taxpayer was established by employees and former employees of Department for the purpose of providing post-retirement health insurance coverage to its members. Department is a department of M, which is a political subdivision of State. M is the common law employer of each of Taxpayer's members.

Pursuant to section 4.1 of Plan, Taxpayer will pay a monthly amount: (a) to reimburse an eligible member for medical, dental, or vision plan premiums incurred by the member (or the member's spouse or dependents), so long as the member provides Taxpayer's Board of Trustees ("Board") with sufficient proof that such expenses have been incurred; or (b) directly to the insurer with whom the member (or the member's spouse or dependents) has medical, dental, or vision insurance. The maximum monthly benefit amount is determined by the Board.

Taxpayer's assets consist solely of mandatory contributions that were deducted from employee members' paychecks. The Board is responsible for making all decisions regarding Taxpayer. Pursuant to section 8.2 of the trust agreement governing Taxpayer, the Board has the authority to terminate Taxpayer after a majority of the voting eligible employees vote to terminate. Section 8.3 of the trust agreement provides that, upon termination, Taxpayer's assets will be distributed: (a) towards the payment of administrative expenses, and (b) towards the payment of benefits or return of contributions to eligible current and former employees pursuant to objective criteria which do not result in a disproportionate amount of the distribution being provided to officers or highly compensated employees of M.

On Date Y, a vote of the eligible employees concluded with a majority voting to terminate Taxpayer. On Date Z, the Board executed a resolution to terminate Taxpayer based on the Date Y vote and to distribute Taxpayer's assets as soon as reasonably practicable based on a uniform, nondiscriminatory, and objective allocation method. Taxpayer represents that any outstanding liabilities, including incurred but unpaid benefit claims owed to members, will be paid before Taxpayer's assets are distributed to members.

The Board proposes to distribute Taxpayer's remaining assets as follows ("Distribution Methodology"):

(1) First, the assets will be used to pay all outstanding administrative expenses.

(2) Second, the remaining assets will be divided pro rata amongst members based on each member's contributions to Taxpayer. Members who have already received benefits equaling or exceeding the amount they contributed will receive no distribution. No member will receive a distribution of more than the amount he or she contributed.

Taxpayer represents that assets will be distributed in accordance with the following formula ("Distribution Formula"):

> ((Included Member's contributions/total contributions of all Included Members) x (remaining assets in Taxpayer + amount of benefits already received by all Included Members)) – amount of benefits already received by the Included Member

For purposes of the Distribution Formula, the term "Included Members" means members who have received benefits equaling less than the amount of their contributions (including those who have received zero benefits). Only Included Members will receive distributions from Taxpayer. Taxpayer represents that, after distributions are made using the Distribution Formula, members who are not Included Members will have received at least 100% of their contributions, and Included Members will have received the same percentage of their contributions as other Included Members, regardless of whether they began receiving benefits or not. Taxpayer further represents that the Distribution Formula does not discriminate in favor of highly compensated employees and that the distributions upon Taxpayer's termination will not result in either unequal payments to similarly situated members or in disproportionate payments to officers, shareholders, or highly compensated employees.

RULINGS REQUESTED

Taxpayer requests the following rulings:

Ruling Request 1: That the Distribution Methodology and Distribution Formula comply with section 501(c)(9) of the Code and will not cause any earnings to inure to the benefit of any private shareholder or individual or otherwise adversely affect the tax-exempt status of Taxpayer.

Ruling Request 2: Whether the distributions from Taxpayer determined in accordance with the Distribution Methodology and Distribution Formula are wages subject to FICA taxes, FUTA tax, and Federal income tax withholding.

Ruling Request 3: Whether Taxpayer must report on a Form W-2 any distribution made to a Taxpayer's member.

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.

Treas. Reg. § 1.501(c)(9)-4(a) provides 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 Treas. Reg. § 1.501(c)(9)-3. The disposition of property to, or the performance of services for, a person for less than the greater of fair market value or cost (including indirect costs) to the association, other than as a life, sick, accident or other permissible benefit, constitutes prohibited inurement. Generally, the payment of unreasonable compensation to the trustees or employees of the association, or the purchase of insurance or services for amounts in excess of their fair market value from a company in which one or more of the association's trustees, officers, or fiduciaries has an interest, will constitute prohibited inurement. Whether prohibited inurement has occurred is a question to be determined with regard to all of the facts and circumstances, taking into account the guidelines set forth in this section. The guidelines and examples contained in this section are not an exhaustive list of the activities that may constitute prohibited inurement, or the persons to whom the association's earnings could impermissibly inure. See Treas. Reg. § 1.501(a)-1(c).

Treas. Reg. § 1.501(c)(9)-4(b) provides that, for purposes of subsection (a), the payment to any member of disproportionate benefits, where such payment is not pursuant to objective and nondiscriminatory standards, will not be considered a benefit within the meaning of Treas. Reg. § 1.501(c)(9)-3 even though the benefit otherwise is one of the type permitted by that section. For example, the payment to highly compensated personnel of benefits that are disproportionate in relation to benefits received by other participants of the association will constitute prohibited inurement. 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. In general, benefits paid pursuant to standards or subject to conditions that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees will not be considered disproportionate. See Treas. Reg. § 1.501(c)(9)-2(a)(2) and (3).

Treas. Reg. § 1.501(c)(9)-4(d) 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 Treas. Reg. § 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. See Treas. Reg. § 1.501(c)(9)-2(a)(2). Similarly, a distribution to members upon the dissolution of the association will not constitute prohibited inurement if the amount distributed to members are determined pursuant to the terms of a collective bargaining agreement or on the basis of objective and reasonable standards which do not result in either unequal payments to similarly situated members or in disproportionate payments to officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association. Except as otherwise provided in the first sentence of this paragraph, if the association's corporate charter, articles of association, trust instrument, or other written instrument by which the association was created, as amended from time to time, provides that on dissolution its assets will be distributed to its members' contributing employers, or if in the absence of such provision the law of the state in which the association was created provides for such distribution to the contributing employers, the association is not described in section 501(c)(9).

Sections 3101 and 3111 of the Code provide for a tax (on employees and employers, respectively) which is a percentage of wages (as defined in section 3121(a)) paid by an employer with respect to employment for FICA purposes.

Section 3102(a) provides that the tax on employees imposed by section 3101 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid for FICA purposes.

Section 3102(b) generally provides that every employer required to deduct the tax on employees imposed by section 3101 shall be liable for the payment of such tax for FICA purposes.

Section 3301 imposes on every employer an excise tax, with respect to individuals in his employ, equal to a percentage of wages (as defined in section 3306(b)) paid by the employer during the calendar year with respect to employment for FUTA purposes.

Section 3402 generally provides for Federal income tax purposes that every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary.

Sections 3121(a) and 3306(b) provide that, with certain exceptions, the term “wages” means all remuneration for employment for FICA and FUTA purposes, respectively.

Similarly, section 3401 provides that, with certain exceptions, the term “wages” means all remuneration for services performed by an employee for his employer for Federal

income tax withholding purposes.

Generally 3121(b) and 3306(c) provide that "employment" means any service of whatever nature performed by an employee for the person employing him for FICA and FUTA purposes, respectively.

Section 3306(c)(7) provides that services performed in the employ of a state or any political subdivision thereof are excepted from the definition of employment for FUTA purposes.

Section 3401(d)(1) provides that if the common law employer does not have control of the payment of wages, the term "employer" means the person having control of the payment of such wages. The Code imposes Federal income tax withholding obligations upon the section 3401(d)(1) employer. Case law has extended the section 3401(d)(1) employer's obligations to include withholding and payment of FICA and FUTA taxes. See Otte v. United States, 419 U.S. 43 (1974); In re Armadillo Corp. v. United States, 561 F.2d 1382 (10th Cir. 1977); Lane Processing Trust v. United States, 25 F.3d 662 (8th Cir. 1994). A section 3401(d)(1) employer is responsible for reporting obligations. See Blue Lake Rancheria v. United States, 653 F.3d 1112, 1118 (9th Cir. 2011).

Section 6051(a) generally provides that every person required to deduct and withhold from an employee a tax under section 3101 (FICA) or section 3402 (Federal income tax withholding), or who would have been required to deduct and withhold a tax under section 3402 if the employee had claimed no more than one withholding exemption, or every employer engaged in a trade or business who pays remuneration for services performed by an employee, shall furnish to each such employee a written statement showing certain specific items, including the name of such person and the total amount of wages.

Section 6051(c) further provides that the statement required to be furnished shall contain such other information and be in such form as the Secretary may by regulations prescribe.

Treas. Reg. § 31.6051-1 generally provides that if an employer pays wages subject to Federal income tax withholding or FICA tax to an employee during the calendar year, the employer is to provide the employee a tax return copy and an employee's copy of a statement on a Form W-2.

ANALYSIS AND CONCLUSION

Ruling Request 1: As stated above, Treas. Reg. § 1.501(c)(9)-4(d) of the regulations provides, in part, that "… a distribution to members upon the dissolution of the association will not constitute prohibited inurement if the amount distributed to members [is] determined … on the basis of objective and reasonable standards which do not

result in either unequal payments to similarly situated members or in disproportionate payments to officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association." The Distribution Methodology and Distribution Formula appear to be consistent with Treas. Reg. § 1.501(c)(9)-4(d). Accordingly, the Distribution Methodology and Distribution Formula comply with section 501(c)(9) of the Code and will not cause any earnings to inure to the benefit of any private shareholder or individual or otherwise adversely affect the tax-exempt status of Taxpayer prior to the distribution.

Ruling Request 2: As a general matter, the distributions from Taxpayer determined in accordance with the Distribution Methodology and Distribution Formula are wages subject to FICA taxes and Federal income tax withholding. The distributions are not wages (remuneration for employment) for FUTA tax purposes, as section 3306(c)(7) provides that services performed in the employ of a state or any political subdivision thereof are excepted from the definition of employment for purposes of FUTA. The services in this case were performed in the employ of M, a political subdivision of State and the common law employer of the Taxpayer's members.

Additionally, M does not have control over the payment of wages, but Taxpayer does have control over these wage payments. Taxpayer is thus the section 3401(d)(1) employer liable for the withholding and payment of FICA taxes and Federal income tax withholding on these wage payments.

Ruling Request 3: Any distribution constituting wages must be reported on a Form W-2 and provided to the Taxpayer's member who receives such distribution. Taxpayer, as the section 3401(d) employer, is responsible for this reporting obligation.

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 concerning the tax consequences to Taxpayer under sections 511 or 512 of the distributions to Taxpayer's members under the Distribution Methodology.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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 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)