Internal Revenue Service

Number: **201625019**
Release Date: 6/17/2016

Index Number: 4976.00-00, 4976.01-00, 61.44-00, 111.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:TEGE:EB:HW
PLR-T-103511-15
Date: March 11, 2016

Legend:

Taxpayer =

Trust A =

Trust B =

Trust C =

Trust D =

Plan =

V =

$W =

$X =

$Y =

$Z =

Dear :

This responds to your letter dated October 29, 2014, and subsequent correspondence, requesting a ruling as to the federal tax consequences under section 4976 and section 61 of the Internal Revenue Code (Code) with respect to the merger of Trust A and Trust B into Trust C, and the transfer of assets from Trust D to Trust C.

FACTS

Taxpayer is a corporation that was formed through multiple business combinations. Taxpayer represents that Trust A, Trust B, Trust C, and Trust D are each maintained as a voluntary employees' beneficiary association under section 501(c)(9).

Taxpayer maintains Trust A, which currently provides medical benefits under Plan to eligible employees, eligible retirees, and their eligible dependents. Taxpayer represents that the contributions and related deductions for Trust A were calculated in accordance with the requirements of the Code, including sections 419A(c)(1) and 419A(c)(2).

Taxpayer maintains Trust B, which currently provides life insurance benefits under Plan to eligible employees, eligible retirees and their eligible dependents. Taxpayer represents that it has taken deductions for all employer contributions made to Trust B in accordance with the requirements of the Code, including section 419A(c)(2)(B).

Taxpayer maintains Trust C, which currently provides medical and long term disability benefits under Plan to eligible employees. Taxpayer represents that the contributions and related deductions for Trust C were calculated in accordance with the requirements of the Code, including section 419A(c)(1).

Taxpayer maintains Trust D, which currently provides medical benefits under Plan to certain eligible retirees and their eligible dependents. Taxpayer represents that Trust D has at all times qualified as a trust maintained pursuant to a collective bargaining agreement under § 1.419A-2T of the Income Tax Regulations.

MERGER OF TRUST A AND TRUST B INTO TRUST C

Trust A and Trust B will be merged into Trust C by no later than December 31, 2016. Trust C will be amended to provide that Trust C may be permitted to fund benefits for certain non-union retirees. Trust C will be renamed and new Trust C will contain three separate subtrusts including: a subtrust consisting of current Trust A, a subtrust consisting of current Trust B, and a subtrust consisting of current Trust C. Taxpayer represents that the assets of each subtrust will be used to provide medical and welfare benefits to eligible employees and retirees of Taxpayer and certain of its affiliates in the same manner as prior to the merger of the trusts. Taxpayer represents that each subtrust will continue to maintain separate books and records. Taxpayer represents that Trust C will provide that none of the assets in a subtrust in Trust C can be used as assets for any other subtrust and none of the assets in a subtrust in Trust C are available to pay any of the other subtrusts' benefits.

Trust C might provide other benefits under Plan which are permissible under section 501(c)(9). Taxpayer represents that any such benefits will be provided through a separate substrust and assets of the three subtrusts described above will not be used to pay for those benefits.

TRANSFER OF ASSETS FROM TRUST D TO TRUST C

Trust D will be amended to allow for a one-time transfer of (i) the Trust D balance on the date of the transfer less (ii) $Y. $Y is approximately (i) V% of the projected amount required to fund the $Z of annual benefits and claims of the Trust D and (ii) 15 times the projected retiree contributions to Trust D. The amendment will require the transferred amount to be transferred no earlier than January 1, , and be completed by December 31, , so that the transfer of the entire transferred amount will be completed in one taxable year of Taxpayer.

The transferred amount will be held in the general account of Trust C until able to fund each of the subtrusts. At such point, the funds held in the general account of Trust C will be transferred and allocated to each subtrust to be used during a year for the payment of health and welfare claims and expenses. None of the transferred amount will be used to fund benefits directly. Any portion of the transferred amount in excess of the amount needed to pay claims for that year will remain in the general account of Trust C and be used in subsequent years to provide benefits payable through the subtrusts.

Taxpayer represents that the contributions and related deductions for Trust D were calculated in accordance with the requirements of the Code, including section 419A(f)(5)(A). From the effective date of Trust D through the tax year ending December 31, , the total amount of contributions to Trust D that had been deducted was $W. Trust D had a balance of $X in assets as of December 31, . Taxpayer made no nondeductible contributions to Trust D, and there will be no amounts deducted after December 31, , and before the one-time transfer. The amount of the one-time transfer exceeds the total amount of previously deducted contributions to Trust D. The projected balance of Trust D, after the transfer of assets from Trust D to Trust C, will be $Y. Retiree contributions are less than the annual benefits payable by Trust D and are used to pay benefits in the year in which they are placed into Trust D.

Taxpayer represents that Trust D has become overfunded due to declining headcount, increased cost shifting to participants, the inability of Taxpayer to pay certain prescription drug expenses from Trust D, and limits on benefits that may be paid from Trust D.

Taxpayer represents that Trust A, Trust B, Trust C and Trust D each individually have specific provisions that prohibit the trust from distributing any portion of the trust to Taxpayer. Each trust has a specific provision to provide that: (i) the assets of the trust allocable to any plan shall be held for the exclusive purposes of providing benefits to participants of the plan and their beneficiaries and defraying the reasonable expenses of administering the plan and the trust; (ii) that trust assets may only be returned to Taxpayer if a contribution (less losses) was made by Taxpayer due to a mistake of fact, and (iii) upon the termination of the plan, the assets of the trust shall be used to provide benefits described in section 501(c)(9) to plan participants and their beneficiaries (or used as provided in § 1.501(c)(9)-4(d) of the Income Tax Regulations), except as otherwise provided in regulations of the Department of Labor promulgated under section 403(d)(2) of the Employee Retirement Income Security Act of 1974 (ERISA).

Taxpayer represents that in the context of this merger, Taxpayer will not divert or direct any Trust A, Trust B, Trust C, or Trust D assets to Taxpayer.

Taxpayer represents that it does not have any current or future legal obligations to provide benefits through Trust C, including without limitation, specifically (i) the benefits to be provided to certain non-union retirees under Trust C or (ii) any other benefits under Plan which are permissible under section 501(c)(9) of the Code.

Taxpayer represents that it will take the total amount of previously deducted contributions to Trust D ($W) into gross income under the tax benefit rule in the year of the one-time transfer, and no portion of that amount is excludable under section 111.

RULINGS REQUESTED

Taxpayer requests rulings that:

(1) The proposed merger of Trust A and Trust B into Trust C, and the transfer from Trust D to Trust C, will not result in a reversion of assets to Taxpayer and therefore will not result in an excise tax under section 4976 due to a reversion of assets to Taxpayer.

(2) The proposed merger of Trust A and Trust B into Trust C will not cause Taxpayer to include any amount in gross income under section 61, including the inclusionary part of the tax benefit rule.

(3) The proposed one-time transfer from Trust D to Trust C will not cause Taxpayer to include any amount in gross income under section 61 in excess of the amount included pursuant to the tax benefit rule.

LAW

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

Section 111(a) 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 the 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 419(c)(3)(A) provides that the term "qualified direct cost" means, with respect to any taxable year, the aggregate amount (including administrative expenses) that would have been allowable as a deduction to the employer with respect to the benefits provided during the taxable year, if those benefits were provided directly by the employer and the employer used the cash receipts and disbursements method of accounting.

Section 419(c)(3)(B) provides that, for purposes of section 419(c)(3)(A), a benefit is treated as provided when that benefit would be includible in the gross income of the employee if provided directly by the employer (or would be so includible but for any provision of Chapter 1 of the Code excluding that benefit from gross income).

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).

Section 1.419-1T, Q&A-2(a) of the Income Tax Regulations, provides that section 419 of the Code 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 419A(a) provides that the term "qualified asset account" means any account consisting of assets set aside to provide for the payment of (1) disability benefits, (2) medical benefits, (3) SUB or severance pay benefits, or (4) life insurance benefits. Section 419A(b) provides that no addition to any qualified asset account may be taken into account under section 419(c)(1)(B) to the extent the addition results in the amount of the account exceeding the account limit.

Section 419A(c)(1) provides that, except as otherwise provided in this subsection, the account limit for any qualified asset account for any taxable year is the amount reasonably and actuarially necessary to fund (A) claims incurred but unpaid (as of the close of the taxable year) for benefits referred to in subsection (a), and (B) administrative costs with respect to the claims.

Section 419A(a) provides that the term "qualified asset account" means any account consisting of assets set aside to provide for the payment of (1) disability benefits, (2) medical benefits, (3) SUB or severance pay benefits, or (4) life insurance benefits. Section 419A(b) provides that no addition to any qualified asset account may be taken into account under section 419(c)(1)(B) to the extent the addition results in the amount of the account exceeding the account limit.

Section 419A(c)(1) provides that, except as otherwise provided in this subsection, the account limit for any qualified asset account for any taxable year is the amount reasonably and actuarially necessary to fund (A) claims incurred but unpaid (as of the close of the taxable year) for benefits referred to in subsection (a), and (B) administrative costs with respect to the claims.

Section 419A(c)(2) provides that the account limit for any taxable year may include a reserve funded over the working lives of the covered employees and actuarially determined on a level basis (using assumptions that are reasonable in the aggregate) as necessary for (A) post-retirement medical benefits to be provided to covered employees (determined on the basis of current medical costs), or (B) post-retirement life insurance benefits to be provided to covered employees.

Section 419A(f)(5)(A) provides that no account limits apply in the case of any qualified asset account under a separate welfare benefit fund under a collective bargaining agreement.

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.

Section 4976(b)(1)(C) defines "disqualified benefit" to include any portion of a welfare benefit fund reverting to the benefit of the employer.

In Revenue Ruling 73-599, 1973-2 C.B. 40, modified by Rev. Rul. 77-92, 1977-1 C.B. 41, 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. The ruling also holds that, in those cases in which the tax benefit rule under section 111 applies, the rule applies only to that part of the balance that was accumulated out of premiums; it does not apply to that part of the accumulated balance that is the interest increments.

Similarly, in Revenue Ruling 77-92, 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 basic federal income tax rules apply to the transfers in the two cases. The ruling also states that the portion of the transferred reserve accumulated out of premiums paid or incurred in taxable years ending after June 17, 1969, is not includible in the employer's income because such premiums were not deducted since the employer retained the right of recapture.

ANALYSIS AND CONCLUSIONS

MERGER OF TRUST A AND TRUST B INTO TRUST C

Taxpayer represents that following the merger of Trust A and Trust B into Trust C, the assets of each subtrust will be used to provide medical and welfare benefits to eligible employees and retirees of Taxpayer and certain of its affiliates in the same manner as prior to merger. Each subtrust will continue to maintain separate books and records, and Trust C will provide that none of the assets in a subtrust in Trust C can be used as assets for any other subtrust and none of the assets in a subtrust are available to pay any of the other subtrusts' benefits.

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. We conclude that the merger of Trust A and Trust B into Trust C is not fundamentally inconsistent with the premise on which the deductions for contributions to Trust A and Trust B were based, and, therefore, the tax benefit rule does not require Taxpayer to include any amount in income as a result of that merger.

Furthermore, based on the information provided by Taxpayer, the merger of Trust A and Trust B into Trust C will not be an accession to wealth for Taxpayer and, therefore, does not result in gross income under section 61. In this case, with regard to the merger of Trust A and Trust B into Trust C, there are provisions requiring the assets of Trust A and Trust B to be used for providing benefits and prohibiting those trusts from distributing any portion 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. Moreover, Taxpayer has no right to any sort of reversion of Trust C's assets and has no current or future obligations to provide benefits through Trust C . Therefore, Taxpayer will not realize any income under section 61 due to the merger of Trust A and Trust B into Trust C.

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. Based on the information provided by Taxpayer, it does not appear that the merger of Trust A and Trust B into Trust C will result in any portion of Trust A, Trust B or Trust C reverting to the benefit of Taxpayer. Thus, the merger will not result in a "disqualified benefit" within the meaning of section 4976(b)(1)(C), and the merger will not, in and of itself, cause Taxpayer to be liable for the excise tax imposed by section 4976.

TRANSFER OF ASSETS FROM TRUST D TO TRUST C

The amendment of Trust D, a separate welfare benefit fund under a collective bargaining agreement within the meaning of section 419A(f)(5)(A), will allow amounts that were originally set aside to provide retiree health benefits for union retirees to be transferred to Trust C and used to provide health and other welfare benefits to Taxpayer's active employees and other retirees. Therefore, the amendment of Trust D will implicate the tax benefit rule because Taxpayer deducted its contributions to Trust D in accordance with section 419A(f)(5)(A) in prior years, but after the amendment the amount of the one-time transfer will be available to provide benefits under Trust C, which is not a separate welfare benefit fund under a collective bargaining agreement as described in section 419A(f)(5)(A). Thus, the amendment is fundamentally inconsistent with the premise of the prior deductions. Taxpayer has therefore represented that it will take the total amount of previously deducted contributions to Trust D ($W) into gross income under the tax benefit rule in the year of the amendment and one-time transfer, and no portion of that amount is excludable under section 111.

Because the amount of the one-time transfer exceeds the total amount of previously deducted contributions to Trust D, it is necessary to consider whether Taxpayer will have an accession to wealth under section 61. In this case, with regard to the transfer of assets from Trust D to Trust C, there are provisions requiring the assets of Trust D to be used for providing benefits and prohibiting Trust D from distributing any portion of Trust D to Taxpayer. Although Trust D is being amended to allow the transfer of assets to Trust C, Trust D provisions prohibit Trust D assets from reverting 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. Moreover, Taxpayer has no right to any sort of reversion of Trust C's assets. Furthermore, Taxpayer has represented that it does not have any current or future legal obligations to provide benefits through Trust C. Therefore, because Taxpayer does not have any right to a reversion of Trust D assets or a relief from a liability, it will not realize any income under section 61 of the Code on the amount transferred from Trust D to Trust C that exceeds the $W to be included in Taxpayer's income under the tax benefit rule.

Based on the information submitted by Taxpayer, it does not appear that the transfer of Trust D assets to Trust C will result in any portion of Trust D reverting to the benefit of Taxpayer. Thus, the transfer from Trust D to Trust C will not result in a "disqualified benefit" within the meaning of section 4976(b)(1)(C), and the transaction will not, in and of itself, cause Taxpayer to be liable for the excise tax imposed by section 4976.

We assume, without expressing an opinion, for purposes of this ruling, that Taxpayer has the authority to complete the transactions described and that these transactions can otherwise be effectuated and do not fail to meet the requirements of other applicable federal and state law.

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 regarding the amount of any deductions under sections 419 and 419A. We note, however, that Taxpayer will not be considered to have contributed to Trust C any amount transferred from Trust D to Trust C that exceeds the amount that Taxpayer is taking into income under the tax benefit rule as described above. Accordingly, the total amount deductible by Taxpayer under sections 419 and 419A with respect to any amounts transferred from Trust D to Trust C cannot exceed $W.

This ruling is directed only to the taxpayer requesting it. Specifically, no opinion is expressed regarding the tax consequences of the described transactions to Trust A, Trust B, Trust C, or Trust D, nor is any opinion expressed regarding the status under section 501(c)(9) of any trust (including any subtrust). 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,

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