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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

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Date:
March 28, 2019

Legend:

Taxpayer =

Trust A =

Trust B =

Plan A =

Plan B =

Plan C =

Date 1 =

Date 2 =

Date 3 =

$A =

$B =

$C =

$D =

Year 1 =

Year 2 =

Year 3 =

Dear :

This responds to your representative's letter, dated May 14, 2018, and later correspondence, requesting a ruling regarding the tax consequences under sections 419, and 419A, and 4976 of the Internal Revenue Code ("Code") of amendments to Trust A and Trust B. As described in greater detail below, the amendments would allow certain assets in Trust A and Trust B, to which Taxpayer contributed in order to provide postretirement medical benefits for Taxpayer's employees, to be used to provide current medical benefits for Taxpayer's employees.

FACTS

Taxpayer sponsors Trust A, which was established on Date 1 and holds assets that are used to provide postretirement medical benefits under Plan A for Taxpayer's retired, non-bargaining unit employees. Trust A received a determination letter, dated Date 2, stating that it is a voluntary employees' beneficiary association ("VEBA") under section 501(c)(9). Taxpayer represents that it contributed $A to Trust A between Year 1 and Year 2 and deducted the contributions in accordance with sections 419 and 419A, including section 419A(c)(2). Trust A holds $B as of Date 3. $B is more than $A. Taxpayer represents that current assets in Trust A greatly exceed the actuarial liability for postretirement medical benefits under Plan A for Taxpayer's retired, non-bargaining unit employees.[1]

Taxpayer also sponsors Trust B, which was established on Date 1 and holds assets that are used to provide postretirement medical benefits under Plan A for Taxpayer's retired, bargaining unit employees. Trust B received a determination letter, dated Date 2, stating that it is a VEBA under section 501(c)(9). Taxpayer represents that, at all times since its establishment, Trust B has been a separate welfare benefit fund under a collective bargaining agreement within the meaning of section 419A(f)(5) and section 1.419A-2T of the Income Tax Regulations ("Regulations"). Taxpayer represents that it contributed approximately $C to Trust B between Year 1 and Year 2 and deducted the contributions

[1] The assets in Trust A greatly exceed the actuarial liability for postretirement medical benefits under Plan A for Taxpayer's retired, non-bargaining unit employees due to Taxpayer's large initial contributions, a large settlement gain resulting from freezing benefits under Plan A, increased cost-shifting to participants, lower participation, and changes to the design of Plan A.

in accordance with sections 419 and 419A, including section 419A(f)(5). Trust B holds $D as of Date 3. $C is more than $D. Taxpayer represents that current assets in Trust B greatly exceed the actuarial liability for postretirement medical benefits under Plan A for Taxpayer's retired, bargaining unit employees.[2]

Plan B provides medical benefits for Taxpayer's active, non-bargaining and bargaining unit employees. Taxpayer currently funds benefits provided under Plan B from its general assets. Plan A and Plan B will be merged to form Plan C in Year 3. Plan C will provide: (1) postretirement medical benefits for Taxpayer's retired, non-bargaining and bargaining unit employees, and (2) medical benefits for Taxpayer's active, non-bargaining and bargaining unit employees. Following the merger, Taxpayer will amend Trust A in Year 3 to permit, as of the effective date of the amendment, $A of the assets in Trust A to be used to provide: (1) postretirement medical benefits for Taxpayer's retired, non-bargaining unit employees under Plan C, and (2) medical benefits for Taxpayer's active, non-bargaining unit employees under Plan C. Taxpayer also will amend Trust B in Year 3 to permit the value of assets in Trust B to be used to provide: (1) postretirement medical benefits for Taxpayer's retired, bargaining unit employees under Plan C, and (2) medical benefits for Taxpayer's active, non-bargaining unit employees under Plan C.

Trust A and Trust B each provide that no amendment may be made that would cause any part of the income or corpus of the trust fund to be used for or diverted to purposes other than for the exclusive benefit of the participants or their eligible beneficiaries. Taxpayer represents that all amounts in Trust A and Trust B will at all times continue to be held for the exclusive benefit of the participants and beneficiaries of Trust A and Trust B, as applicable. Taxpayer further represents that the proposed amendments to Trust A and Trust B will be effective prospectively and will apply only with respect to active, non-bargaining unit employee medical benefits incurred on or after the effective date of the amendments to Trust A and Trust B (i.e., the amendments to Trust A and Trust B will only apply with respect to medical benefits newly payable on a prospective basis after the effective date of the amendments).

Taxpayer represents that its taxable year is the calendar year. With respect to Trust A, Taxpayer represents that it will include $A in gross income in Year 3 under the tax benefit rule. With respect to Trust B, Taxpayer represents that it will include the value of assets in Trust B on the effective date of the amendment in gross income in Year 3 under the tax benefit rule, Taxpayer represents that no portion of the tax benefit income

[2] The assets in Trust B greatly exceed the actuarial liability for postretirement medical benefits under Plan A for Taxpayer's retired, bargaining unit employees due to Taxpayer's large initial contributions, a large settlement gain resulting from freezing benefits under Plan A, increased cost-shifting to participants, lower participation, and changes to the design of Plan A.

with respect to the assets in Trust A or Trust B is excludable under the exclusionary part of the tax benefit rule.

Taxpayer represents that (a) Contributions have been made to Trust A and Trust B by retired employees, and the disbursements under each plan have exceeded the retired employee contributions to each respective trust on an annual basis; (b) no active employee contributions have been made to Trust A or Trust B; (c) the assets in Trust A to be used for medical benefits for active, non-bargaining unit employees will be limited to $A (d) the assets in Trust B to be used for medical benefits for active, non-bargaining unit employees will not be limited; and (e) neither Trust A nor Trust B have at any time since their establishment received a transfer of assets from another VEBA or another welfare benefit fund.

RULINGS REQUESTED

Taxpayer requests the following rulings:

Ruling Request 1: The amendment of Trust A and the use of Trust A assets to provide medical benefits to active, non-bargaining unit employees will not be treated as a disqualified benefit under section 4976(b)(1)(C), and will not, in and of itself, result in excise tax under section 4976.

Ruling Request 2: The amendment of Trust B and the use of Trust B assets to provide medical benefits to active, non-bargaining unit employees will not be treated as a disqualified benefit under section 4976(b)(1)(C), and will not, in and of itself, result in excise tax under section 4976.

Ruling Request 3: The amount of Trust A assets that will be used to provide medical benefits for active, non-bargaining unit employees under Plan C, and that will be included in Taxpayer's gross income in the tax year in which the Trust A amendment is effective, will be treated as a contribution (within the meaning of section 419(a)) to Trust A in that tax year, and Taxpayer will be permitted to take deductions with respect to such Trust A contributions used for medical benefits under Plan C for active, non-bargaining unit employees to the extent permitted by sections 419 and 419A.

Ruling Request 4: The amount of Trust B assets that will be used to provide medical benefits for active, non-bargaining unit employees under Plan C, and that will be included in Taxpayer's gross income in the tax year in which the Trust B amendment is effective, will be treated as a contribution (within the meaning of section 419(a)) to Trust B in that tax year, and Taxpayer will be permitted to take deductions with respect to such Trust B contributions used for medical benefits under Plan C for active, non-bargaining unit employees to the extent permitted by sections 419 and 419A.

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 that 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 rules 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 419A(a) defines the term “qualified asset account” to include any account consisting of assets set aside to provide for the payment of medical 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)(A) 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 post-retirement medical benefits to be provided to covered employees (determined on the basis of current medical costs).

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

Section 1.419A-2T, Q&A-1, of the Regulations provides that contributions to a welfare benefit fund maintained pursuant to one or more collective bargaining agreements and the reserves of such a fund generally are subject to the rules of sections 419, 419A, and 512 of the Code. However, neither contributions to nor reserves of such a collectively bargained welfare benefit fund shall be treated as exceeding the otherwise applicable limits of section 419(b), 419A(b), or 512(a)(3)(E) until the earlier of: (i) the date on which the last of the collective bargaining agreements relating to the fund in effect on, or ratified on or before, the date of issuance of final regulations concerning such limits for collectively bargained welfare benefit funds terminates (determined without regard to any extension thereof agreed to after the date of issuance of such final regulations), or (ii) the date 3 years after the issuance of such final regulations.

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 the term “disqualified benefit” to include any portion of a welfare benefit fund reverting to the benefit of the employer.

ANALYSIS AND CONCLUSIONS

Tax Benefit Rule: 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. Taxpayer made contributions to Trust A for the purpose of providing postretirement medical benefits for Taxpayer’s retired, non-bargaining unit employees. Taxpayer deducted the contributions in accordance with sections 419 and 419A, including section 419A(c)(2). The proposed amendment to Trust A will allow, as of the effective date of the amendment, $A of the assets in Trust A to be used to provide medical benefits to Taxpayer’s active, non-bargaining unit employees. This use is fundamentally inconsistent with the premise of the previously taken deductions. The amendment of Trust A therefore will implicate the tax benefit rule. Taxpayer represents that it will include $A in gross income in Year 3 under the tax benefit rule. Furthermore, Taxpayer represents that no portion of the tax benefit income with respect to the assets in Trust A is excludable under the exclusionary part of the tax benefit rule.

Taxpayer made contributions to Trust B for the purpose of providing postretirement medical benefits for Taxpayer’s retired, bargaining unit employees. Taxpayer deducted the amount of those contributions in accordance with section 419A(f)(5). The proposed amendment to Trust B will allow the assets in Trust B to be used to provide current medical benefits to Taxpayer’s active, non-bargaining unit employees. This use is fundamentally inconsistent with the premise of the previously taken deductions. The amendment of Trust B therefore will implicate the tax benefit rule. Taxpayer represents that it will include the value of assets in Trust B on the effective date of the amendment

in gross income in Year 3 under the tax benefit rule. Furthermore, Taxpayer represents that no portion of the tax benefit income with respect to the assets in Trust B is excludable under the exclusionary part of the tax benefit rule.

Ruling Requests 1 and 2: 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 submitted by Taxpayer, the amendment of Trust A and Trust B, or the use of Trust A and Trust B assets to provide medical benefits to active, non-bargaining unit employees will not result in any portion of either Trust A or Trust B reverting to the benefit of Taxpayer. Thus, the amendment of Trust A and Trust B, and the use of Trust A and Trust B assets to provide medical benefits to active, non-bargaining unit employees, 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.

Ruling Requests 3 and 4: The amount of Trust A and Trust B assets that are used to provide medical benefits under Plan C, and that will be included in Taxpayer's gross income in Year 3, will be treated as a contribution (within the meaning of section 419(a)) to Trust A and Trust B, respectively, in that tax year, and Taxpayer may take deductions with respect to such contribution to the extent permitted by sections 419 and 419A. Taxpayer will not be considered to have contributed to Trust A or Trust B any amount that exceeds the amount that Taxpayer is taking into income under the tax benefit rule pursuant to this ruling. Accordingly, the total amount that Taxpayer may deduct under sections 419 and 419A as a result of the amendments of Trust A and Trust B cannot exceed the amount taken into income under the tax benefit rule as a result of the amendments.

We assume, without expressing an opinion, for purposes of this ruling, that Trust A and Trust B may be amended as described and that the proposed amendments otherwise can 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.

This ruling is directed only to the taxpayer requesting it. Specifically, no opinion is expressed regarding the tax consequences to Trust A and Trust B of the proposed amendments (including, for example, under section 1001), nor is any opinion expressed regarding the status under section 501(c)(9) of Trust A or Trust B.

Section 6110(k)(3) provides that this ruling 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,

Janet A. Laufer
Senior Technician Reviewer
Health & Welfare Branch
Office of Associate Chief Counsel
(Employee Benefits, Exempt Organizations, and Employment Taxes)

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