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**Internal Revenue Service** | **Department of the Treasury**

Washington, DC 20224

Person to Contact: [redacted]

Telephone Number: [redacted]

Refer Reply to: CP:E:EO:T:5

Date: AUG 26 1996

[redacted]

Employer Identification Number: [redacted]
Key District: Midstates (Dallas TX)
Tax Years Ending: 12/31/1993 and Subsequent

Dear Applicant:

This is in reply to your Form 1024, Application for Recognition of Exemption under Section 501(a), dated [redacted], and postmarked [redacted], requesting your exemption from federal income tax as a "voluntary employees' beneficiary association" (VEBA) under section 501(c)(9) of the Internal Revenue Code.

Additional information is provided by your letter of [redacted], in response to our letter of [redacted].

You, the "Trust", provide health and medical insurance coverages for the dues-paying members (and their employees) of the [redacted], (the "Association"). The Association is a nonexempt association of "small business" employers and self-employed persons. Your operations are controlled by a "Benefits Review Committee" as "Plan Administrator", whose members are appointed by, and from, the Association.

The Trust provides that it is created under the laws of the State of [redacted], but with venue for legal actions to be in Washington, DC. The locations of the employers and their employees are not described, but are not limited to any State or geographical area.

You allow membership to any employers and their employees in the nation whose businesses are "small" in size. As confirmed in your letter of [redacted], in reply to our information request letter of [redacted], you do not create separate trust entities according to any common bond restriction such as specific employer, or specific union, or specific line of industry within a particular limited geographic locale. You serve the Association whose member employers are any "small" businesses who join it to seek the health coverages and other discount services and merchandise items offered by the Association.

[redacted]

The "Plan", for which you are the Trust, is known as the [redacted] Plan. The nonexempt [redacted] the Association, is based in [redacted]

The "Trustee", for you as the Trust, is a bank: [redacted], also in [redacted], the successor to [redacted].

Your Trust activity is effective and operational beginning [redacted]. Your annual accounting periods and tax years end on December 31.

Your Form 1024 indicates that you have restated the Trust to combine the earlier seven separate general industry trusts for the employer categories of: Agriculture, Construction, Manufacturing, Retail, Service, Transportation, and Wholesale. Such categories are now known as your subtrusts, used for cost purposes. Such trusts, and now subtrusts, are only generally specified as to the actual specific industry common bond and, also, are not limited to a specific industry that is within a particular limited geographic locale. We note that the earlier seven separate trusts each filed Form 1024, and were the subjects of our letters of [redacted], requesting additional information, and your reply letters of [redacted], withdrawing each Form 1024.

You employ, as your "Plan Supervisor", the services of the for-profit [redacted] corporation is [redacted], whose parent also has agreed, in return for remuneration, to provide some financial back-up for your health coverages. Your [redacted] letter indicates that the Plan Supervisor's owners are independent of your Association and its principals.

Your Form 1024, Schedule F, item 1, indicates that the employees' participation in this plan is "subject to any valid participation requirements of the participating employer." Your application does not explain these requirements, if any.

Your Form 1024, Schedule F, at items 3 and 4, indicates that, as of [redacted], there were [redacted] individuals in this plan, of whom not a single one was "highly compensated" pursuant to the relevant Code section 414(q). Your application does not explain this situation further.

Your Independent Auditors' Report dated [redacted] indicates that the U.S. Department of Labor issued an advisory opinion in which it was unable to conclude, on the basis of information presented, that the Plan was an employee welfare benefit plan for purposes of Title I of ERISA.

[redacted]

Section 501(c)(9) of the Code, which originated in the Revenue Act of May 29, 1928, allows, in pertinent part, exemption from federal income tax for "voluntary employees' beneficiary associations" (VEBA's) that provide health insurance benefits for their member employees.

The applicable final income tax regulations under section 501(c)(9) of the Code were adopted and published in the Federal Register, at 46 FR 1719, on January 7, 1981.

The Supplementary Information to the final income tax regulations stated, in part, at 46 FR 1720: "First, section 501(c)(9) provides for the exemption of associations of employees who enjoy some employment related bond. Allowing section 501(c)(9) to be used as a tax-exempt vehicle for offering insurance products to unrelated individuals scattered throughout the country would undermine those provisions of the Internal Revenue Code that prescribe the income tax treatment of insurance companies."

Section 1.501(c)(9)-2(a)(1) of the Income Tax Regulations requires that the eligibility for membership must be defined by reference to an "employment-related common bond" among the member individuals. Whether such a common bond exists is a question to be determined by all of the facts and circumstances. However, the Regulation allows employees of one or more different employers and their employees who are in the same line of business and in the same geographic locale to qualify as sharing an employment-related common bond.

In Water Quality Association Employees' Benefit Corporation v. United States, 795 F.2d 1303 (U.S. Court of Appeals for the 7th Circuit, including Wisconsin, decided on July 8, 1986), the Court, even though it disagreed with the Service's view on the facts of that case as to geographic limits, still recognized that the membership of an employees' association (VEBA) must be defined by reference to an employment-related common bond among the employees.

The above Court stated, on page 1310, "That the quintessential element of a Section 501(c)(9) tax-exempt VEBA is the commonality of interests among its employee members is not disputed. An association of unrelated individuals scattered throughout the country plainly would not fall within the scope of Section 501(c)(9) though its membership is comprised entirely of employees because there is no "employment-related common bond" among such individuals. See Treas. Reg. 1.501(c)(9)-2(a)(1)."

[redacted]

Section 1.501(c)(9)-2(a)(1) of the regulations also provides that exemption will not be denied merely because the membership of an association includes some individuals who are not employees, provided that such individuals share an employment-related bond with the employee-members. Such individuals may include, for example, the proprietor of a business whose employees are members of the association. An association will be considered to be composed of employees if 90% of the total membership of the association on one day of each quarter of the association's taxable year consists of employees.

Section 1.501(c)(9)-2(b) of the regulations defines "employees" as including individuals who are employees for employment tax purposes under Subtitle C of the Internal Revenue Code.

Section 1.501(c)(9)-2(a)(2) of the regulations provides that any objective criteria used to restrict eligibility for membership or benefits may not be selected or administered in a manner that limits membership or benefits to officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association. Similarly, eligibility for benefits may not be subject to conditions or limitations that have the effect of entitling officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association to benefits that are disproportionate in relation to benefits to which other members of the association are entitled.

Section 1.501(c)(9)-2(c)(3) of the regulations requires that a voluntary employees' beneficiary association must be controlled by its membership, independent trustee(s) (such as a bank), or fiduciaries at least some of whom are designated by, or on behalf of, the membership. Whether control by or on behalf of the membership exists is a question to be determined with regard to all of the facts and circumstances, but generally such control will be deemed to be present when the membership (either directly or through its representative) elects, appoints or otherwise designates a person or persons to serve as chief operating officer(s), administrator(s), or trustee(s) of the organization. An organization will be considered to be controlled by independent trustees if it is an "employee welfare benefit plan", as defined in section 3(1) of the Employee Retirement Income Security Act of 1974 (ERISA), and, as such, is subject to the requirements of Parts 1 and 4 of Subtitle B, Title I of ERISA.

[redacted]

Section 1.501(c)(9)-4(b) of the regulations provides that 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 section 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 members 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 your case, based upon the information submitted, we find, first, that you have failed to establish that the employees and their employers served by your Trust have the "employment-related common bond" that is a long-standing quintessential requirement for exemption as a voluntary employees' beneficiary association (VEBA) under section 501(c)(9) of the Code and section 1.501(c)(9)-2(a)(1) of the regulations. The bond that you state, namely, the relatively small sizes of the participating businesses, is not a common bond of the type recognized under section 501(c)(9) of the Code.

Second, your application states that you are controlled by the Benefits Review Committee appointed by the Association, which is controlled by employers and self-employed persons. You have not demonstrated that you are controlled by independent trustees, such as an employee welfare benefit plan as defined by ERISA is. Thus, you appear to be controlled by employers, rather than by or on behalf of your employee members as required by section 1.501(c)(9)-2(c)(3) of the regulations.

Third, your application fails to explain "the valid participation requirements of the participating employers", if any, as to the eligibility of each employer's employees to participate, resulting in no information as to whether such requirements disproportionately favor officers, shareholders, or highly compensated employees in violation of sections 1.501(c)(9)-2(a)(2) and -4(b) of the regulations.

Fourth, your application fails to sufficiently describe the percentage of members who are "employees" to establish that employees, as distinguished from self-employed people, shareholders, and others, constitute at least 90% of the total membership, as required by section 1.501(c)(9)-2(a)(1) of the regulations.

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[redacted]

Accordingly, we rule that you do not qualify for exemption from federal income tax under section 501(c)(9) of the Code. Thus, you remain subject to the applicable requirements for filing federal income tax returns.

You have a right to protest this ruling if you believe that it is incorrect. To protest, you should submit a statement of your views with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person must have on file a proper power of attorney, such as Form 2848, and otherwise qualify under our Conference and Practice Procedures.

If you submit a protest statement with respect to this case, please address your envelope to:

Internal Revenue Service
Exempt Organizations Technical Branch 5
CP:E:EO:T:5, Room 6539, Mr. [redacted]
1111 Constitution Ave., N.W.
Washington, DC 20224

If we do not hear from you within 30 days, this ruling will remain in effect, and a copy will be forwarded to your key district office for exempt organizations. Thereafter, any questions about this federal income tax matter or the filing of federal tax returns should be addressed to that key district office.

Sincerely,

(signed) [redacted]

[redacted]
Chief, Exempt Organizations
Technical Branch 5

cc: DD, Midstates (Dallas, TX)
Attn: EO Group

Initiator
CP:E:EO:T:5
[redacted]
8/22/96

Reviewer
CP:E:EO:T:5
8/23/96

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