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CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

CC:EBO:Br.4EMadden
FREV-115539-98
JUN 29 1999

MEMORANDUM FOR DIRECTOR, EXEMPT ORGANIZATIONS DIVISION,
CP:E:EO
Attn: Bob Fontenrose

FROM: Assistant Chief Counsel
Office of the Associate Chief Counsel (Employee Benefits
and Exempt Organizations), CC:EBO

SUBJECT: [REDACTED] VEBA

This memorandum responds to your request for assistance dated June 22, 1998, relating to a change in the operation of the [REDACTED] VEBA Trust (Trust).

ISSUE

Whether workers' compensation benefits are permissible VEBA benefits if the employer voluntarily elects to purchase with VEBA assets, and state law does not require the employer to provide, workers' compensation insurance coverage for its employees.

CONCLUSION

If the employer elects to purchase with VEBA assets, and state law does not require the employer to provide, workers' compensation insurance coverage for its employees, workers' compensation benefits are permissible VEBA benefits.

FACTS

On [REDACTED] and its affiliates (Employer) established the [REDACTED] to fund medical and disability benefits for its employees. Trust was granted tax-exempt status under section 501(c)(9) of the Internal Revenue Code by the Service. Trust is not the result of collective bargaining.

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The [REDACTED] allows employers to choose whether or not to carry workers' compensation insurance coverage on their employees. Rather than carry workers' compensation insurance coverage on its employees, Employer initially elected to become a nonsubscriber to [REDACTED] workers' compensation and to provide medical and disability benefits for injured workers under Plan and through Trust.

Employer then elected to purchase, with Trust assets, a workers' compensation insurance policy covering its [REDACTED] employees. This policy became effective on [REDACTED]. Employer is not making further contributions to Trust and intends to terminate Trust, in accordance with its terms, after the exhaustion of Trust assets. After the assets of Trust are exhausted, workers' compensation benefits and insurance premiums will be paid from the general assets of Employer.

Prior to the exhaustion of Trust assets, Employer may decide (with appropriate notification to the Service) to amend Trust Agreement to contribute additional sums to Trust and to provide other welfare benefits from Trust.



LAW AND ANALYSIS

Section 501(a) of the Code exempts from federal income tax those organizations described in section 501(c). A voluntary employees beneficiary association (VEBA) is described by section 501(c)(9) of the Code as an association 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.

Section 1.501(c)(9)-3(d) of the regulations defines "other benefits" to include only benefits that are similar to life, sick, or accident benefits. A benefit is similar to a life, sick, or accident benefit if it is intended to safeguard or improve the health of a member or a member's dependent or if it protects against a contingency that interrupts or impairs a member's earning power.

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In Revenue Ruling 74-18, 1974-1 C.B. 139, the Service concluded that an association formed by an employer to provide workmen's compensation benefits, which were required under state law, did not qualify for exemption as a VEBA under section 501(c)(9) of the Code. The Service reasoned that the association did not provide any benefits to the employees other than those to which they were already entitled under state law. Instead, the association merely ensured that the employer would discharge its statutory obligation to the employees.

In GCM 38922 (August 20, 1982), Counsel examined whether a trust formed through collective bargaining to provide workers' compensation benefits required under state law is exempt under section 501(c)(9) of the Code. Counsel concluded that this type of benefit is an "other benefit" within the meaning of section 1.501(c)(9)-3(d) of the regulations because it is a benefit that protects against contingencies that impair the earning power of a member, serves as a form of wage replacement, and is permitted by section 302(c)(5) of the Labor Management Relations Act. After reaching this conclusion, Counsel considered whether the provision of those benefits was consistent with the basic principles of VEBA exemption. In a situation where a trust is formed through collective bargaining to provide workers' compensation benefits that are required by state law, Counsel indicated that the Service should defer to the judgment of the employees and conclude that the trust is formed for the benefit of the employees, and thus it can be a VEBA. However, in a situation where a trust is formed unilaterally by an employer to discharge its obligations under the workers' compensation laws of a state, the trust is formed for the benefit of the employer and cannot be exempt under section 501(c)(9) of the Code. According to Counsel, the rationale for the distinction between trusts formed unilaterally by employers and those formed through collective bargaining lies in the wider latitude granted throughout the regulations under section 501(c)(9) of the Code for trusts formed through collective bargaining. Although the trust in GCM 38922 was intended to supplement the basic statutory benefits if possible, that fact was not relied on in distinguishing the trust from the association described in Rev. Rul. 74-18.

In a memorandum to your office dated July 5, 1995, regarding this subject, we concluded that a noncollectively bargained fund, which was formed unilaterally by the employer to satisfy the employer's obligation under state law to provide workers' compensation benefits, did not qualify for exemption under section 501(c)(9) of the Code as a VEBA. Although the benefits provided were above the level required by state law, this fact did not affect our conclusion. Moreover, we concluded that in a situation where workers' compensation benefits are provided by a trust (not formed through collective bargaining) and where workers' compensation benefits are required by state law, the workers' compensation benefits must

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constitute a de minimis amount of the total benefits provided by the trust to be a permissible VEBA benefit.

In the present situation, Employer, a Texas employer, may elect to obtain workers' compensation insurance coverage. An employer who elects to obtain coverage is subject to the [REDACTED] Workers' Compensation Act. [REDACTED]

[REDACTED] An employer can obtain workers' compensation insurance through a licensed insurance company or through self insurance. [REDACTED]
[REDACTED]

If an employee is injured in the course and scope of employment, the employer, through its insurance carrier or self insurance, is liable for compensation to the employee without regard to fault or negligence. [REDACTED]

[REDACTED] Benefits under the [REDACTED] Workers' Compensation Act are intended to be the exclusive remedy for an injured employee. An employee cannot sue an employer for negligence unless the employee gives notice to the employer, at the time of hiring, that the employee reserves his or her rights under common law. [REDACTED]
[REDACTED]

If an employee is injured in the course and scope of employment and the employer elected not to obtain workers' compensation insurance coverage (i.e. the employer is a nonsubscriber), the employee must prove that the injury was caused by the negligence of the employer. [REDACTED] Also, in an action against an employer who is a nonsubscriber, the employer cannot assert certain common law defenses such as contributory negligence, assumption of risk, or the fellow-servant rule. [REDACTED]

Initially, Employer was a nonsubscriber under the [REDACTED] Workers' Compensation Act, but Employer established Trust to provide medical and disability benefits to its injured employees. In [REDACTED] Employer voluntarily elected to purchase, with Trust assets, a workers' compensation insurance policy covering its [REDACTED] employees that would provide workers' compensation benefits for any injured employees, and Employer is currently a subscriber to the [REDACTED] Workers' Compensation Act. In the present situation, we believe the provision of workers' compensation benefits by Employer is a permissible VEBA benefit.

The present situation differs from the ones described in Rev. Rul. 74-18 and the memorandum we previously provided your office. [REDACTED] law does not require Employer to provide workers' compensation insurance coverage for its employees. Thus, by providing workers' compensation insurance coverage for the employees, Trust is not discharging an obligation imposed on Employer by the [REDACTED]
The fact that Trust was not established through collective bargaining does

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not alter this conclusion. As previously indicated in Rev. Rul. 74-18, workers' compensation benefits are permissible VEBA benefits because they fall within the definition of "other benefits" in section 1.501(c)(9)-3(d) of the regulations. Because Trust continues to provide employee benefits in the form of workers' compensation coverage and no obligation of Employer is discharged by the provision of these benefits, the change in operation of Trust should not affect its tax-exempt status. Accordingly, no audit should be opened at this time.

Based on this conclusion, there is no need to address the application of section 4976 of the Code or the basis of Rev. Rul. 74-18.

Finally, we note that although the above analysis may appear to apply also to multiemployer plans, our conclusion here is limited to single-employer VEBAs. We believe there may be additional considerations for situations involving multiemployer plans. If you receive a case involving a multiemployer plan, we would appreciate the opportunity to review the case file.

If you have any questions regarding this memorandum, please contact Erinn Madden in my office. Ms. Madden can be reached at 622-6060.

MARY OPPENHEIMER
Assistant Chief Counsel

BY:



Mark Schwimmer
Chief, Branch 4