

Audit Technique Guide - Voluntary Employees' Beneficiary IRC 501(c)(9)

Introduction

This audit technique has examination guidelines for an organization recognized as exempt from income tax under IRC Section 501(a) as an organization described in IRC Section 501(c)(9). It offers audit techniques effective in identifying and developing issues commonly met during the audit of an IRC Section 501(c)(9) organization.

These guidelines aren't all-inclusive. The intent isn't to restrict the auditor in identifying issues or using examination techniques not included here.

This guide doesn't have detailed technical information on IRC Section 501(c)(9) organizations. Review the technical information in [IRM 7.25.9](#).

Background Information

IRC Section 501(c)(9) exempts from federal income tax voluntary employees' beneficiary associations (VEBAs):

- Whose organization is an employees' association;
- Whose association's membership is voluntary;
- Whose purpose is to offer paying life, sick, accident, or other benefits to its members or their dependents or designated beneficiaries, and substantially all of its operations further offer such benefits; and
- Having no net earnings, other than paying permitted benefits, inuring to any private shareholder or individual.

Organizational Requirements

Most VEBAs are formally organized as trusts; therefore, these guidelines refer to trust documents. However, a VEBA can be a corporation or an unincorporated association.

VEBAs may also have a "plan document," which is a separate document and describes benefits available to participants.

Plan documents or the organizing documents of the VEBA (in the plan document's absence) must contain a full description of the benefits available to the participants, for each benefit offered, including:

- Amount
- Duration
- Eligibility requirements
- The circumstances that'll cause the benefit's payment

Audit Guidelines – Organizational Requirements

Review the trust agreement, or other organizational document, and get answers to the following questions:

- Is the VEBA a separate legal entity?
- What provision is for distributing remaining assets upon terminating the VEBA?
- Who controls the VEBA?
- What is the employment-related common bond?
- What are the eligibility requirements?
- What benefits are provided?

Review the summary plan description for consistency with the plan document and any additional limitations on eligibility or benefits.

Activities

Substantially all IRC Section 501(c)(9) organization's operations must be in furtherance of providing permissible benefits.

A VEBA may offer non-qualifying benefits, but it won't qualify for exemption if it systematically and knowingly offers more than a de minimus amount of nonqualifying benefits.

Audit Guidelines – Activities

Review the minute book to get an overview of the VEBA's activities. Note any comments on benefits, loans, reimbursements, and other items, that raise questions as to VEBA's activities.

Interview the trustee or the plan administrator or both to identify any changes in the VEBA's operations since it received exemption. Ask for:

- Any plan's and trust's amendments
- Current summary plan description
- Any rulings received subsequent to exemption
- Forms 5500's copies filed by the employer

Review any contracts with insurance companies that provide benefits to members to ensure:

- The insurance policy is in the VEBA's name and not in the employer's name.
- The contract provides only permitted benefits.

Review any other contracts to which the VEBA is a party, such as contracts for administrative services. Look for:

- Reasonableness of compensation and other contract terms (such as length)
- Indications of contracts with related parties

Membership

A VEBA's membership is restricted to employees with an employment-related common bond.

An employment-related common bond can be any of these:

- A common employer (including VEBA or union employees who are members of the VEBA)
- Coverage under a collective bargaining agreement
- Membership in a labor union affiliation

Audit Guidelines-Membership

Review membership records and enrollment forms to verify that:

- Membership is voluntary
- Ninety percent of the members are employees
- Members share the employment-related common bond specified in the organizing documents
- Non-employee members (if any) share an employment-related common bond with employee members

Benefits

See [IRM 7.25.9](#) for permissible and impermissible VEBA benefits.

Audit Guidelines-Benefits

Review the plan and trust documents to determine if there are:

- Otherwise impermissible benefits disguised as permissible benefits. The most common example is severance benefits that may be paid when an employee retires or voluntarily terminates. These benefits may be like pension benefits, deferred compensation arrangements or savings plans;
- Employee contributions that fund benefits, at least in part, in individual accounts. These benefits may be like the "savings arrangement" under Treas. Reg. 1.501(c)(9)-3(g);
- Employer contributions that maintain and fund benefits, at least in part, in individual accounts. If amounts in the account are vested with the employee with no possibility of forfeiture, the benefits may be like a pension or deferred compensation arrangement; and
- Benefits added to the plan since the VEBA received its exemption from the IRS.

Review brochures, forms, etc., relating to life, sick, accident, or other benefits to determine:

- Type of benefits
- Eligibility requirements
- Designated beneficiaries

Discrimination

IRC 505(b) requires IRC Section 501(c)(9) organizations that aren't collectively bargained to meet nondiscrimination requirements (unless some other IRC section has nondiscrimination rules for a type of benefit).

The nondiscrimination requirements were enacted to ensure that highly compensated employees aren't favored over other employees.

In general, plans must be nondiscriminatory as to eligibility and benefits. Both tests must be satisfied or the VEBA won't be exempt from taxation.

Only discrimination in favor of highly compensated employees is prohibited; differences in benefits among non-highly compensated employees are irrelevant.

[IRM 7.25.9](#) describes how the nondiscrimination rules apply. This subsection specifies the information you need to perform a discrimination test analysis.

Discrimination Test Guidelines

To test a plan for discrimination, you need a complete employee census, which includes, for each employee:

- Name
- Annual compensation
- Length of service
- Whether full-time or part-time
- Whether an officer or shareholder of the employer
- Any required employee contributions
- Any other information, which may affect benefits' eligibility, such as job classification or location.

For plans offering group-term life insurance under the rules of IRC Section 79, identify the key employees per IRC Section 416(i).

- You index the dollar amount for inflation per IRC Section 415(b)(1)(A), which is published annually in a notice in the Internal Revenue Bulletin. Effective January 1, 2017, the IRC Section 415(b)(1)(A) limit is \$215,000, and the IRC Section 415(c)(1)(A) limit is \$54,000.

- Key employees must be the employer's officers or shareholders; high compensation isn't enough.

Per IRC Section 105(h), for plans offering self-funded medical coverage, identify the highly compensated employees. The definition includes the highest paid 25 percent of all employees. Therefore, an employer will always have some highly compensated employees.

Recordkeeping

VEBAs must maintain records showing the amount:

- Each member and employer contributes
- And type of benefits paid to or on behalf of each member

Audit Guidelines – Recordkeeping

Analyze the cash:

- Receipts journal and related documents to determine whether the records show the amount each member and employer contributes.
- Disbursements journal and supporting documents to determine whether the records show the amount and type of benefits paid to or on behalf of each member.

Specific Audit Guidelines

The following subsections offer additional examination techniques that apply to:

- Multiple employer plans,
- Collectively bargained plans, and
- Limited membership plans.

Multiple Employer Plans

Multiple employer plan participants are employees of unaffiliated employers engaged in the same line of business “in the same geographic locale” who also share an employment-related common bond.

See [IRM 7.25.9](#) to define multiple employer plans and “geographic locale.”

Audit Guidelines-Multiple Employer Plans

Analyze the VEBA's records of the participating employers to determine:

- If the employment-related common bond in the plan and trust documents exists
- The legal organization's form of the participating employers. If some are partnerships or sole proprietorships, the VEBA may not meet the 90 percent test as partners and sole proprietors aren't employees for this test
- Whether each employer, tested individually, complies with the discrimination rules

- Whether membership is voluntary for benefits that are at least in part employee funded, as insurers may require 100 percent participation for small employers

Secure copies of any brochures or similar documents to market the VEBA to participating employers.

Determine what happens to plan assets if an employer terminates participation. If assets could possibly revert to the employer, or its employees, consider applying the examination techniques of limited membership VEBAs.

Collectively Bargained Plans

Collectively bargained plans or agreements are negotiated between two parties, employers and workers, labor organizations, employees' associations, unions, etc., and usually about wages, working conditions, benefits, etc.

Examination Guidelines-Collectively Bargained Plans

Review the collective bargaining agreements to determine whether this is a:

- Legitimate union
- A bona fide collective bargaining agreement.

Signs, which may show a sham union or lack of a bona fide collective bargaining agreement, include:

- A substantial degree of employer control retained, such as unilaterally terminating the collective bargaining agreement or any of its significant provisions
- A large number of small employers participating in many industries
- Promotional materials directed toward employers
- Union membership such as executives or business owners (see IRC Section 7701(a)(46))
- A union that isn't affiliated with other labor organizations such as the AFL-CIO.

Determine whether the VEBA's benefits were the subject of the bargaining process. If the benefits aren't in the agreement, it's questionable whether the benefits were of good faith bargaining and the various rules and exceptions for collectively bargained plans won't apply.

Limited Membership VEBAs

See [IRM 7.25.9](#) for discussing legal issues arising in cases where a dominant share of the benefits is payable to the individuals who exercise control over the VEBA. Keep in mind that:

- These issues arise in cases where a small, closely held corporation is providing self-funded benefits or whole-life benefits

- Similar issues are sometimes in multiple employer plans where most of the participating employers are very small (fewer than 20 employees) and are closely held corporations such as professional corporations.

Audit Guidelines-Limited Membership VEBAs

Review the VEBA's records to establish the number of actual participants.

Determine whether any benefits are self-funded or create an asset that could be disposed of upon termination, as with whole-life insurance policies.

Unrelated Business Taxable Income (UBTI)

IRC Section 512(a)(3) gives special rules for determining the unrelated business taxable income (UBI) of IRC Section 501(c)(9) organizations.

See [IRM 7.25.9](#) for defining unrelated business income (UBI) of organizations which are VEBAs.

Generally, a VEBA is taxed on income from an unrelated trade or business that is regularly carried on per IRC Section 513 or 514 in the same way as other exempt organizations.

Audit Guidelines-UBTI

Determine if the organization's activities, cash receipts books, cash disbursement books, and balance sheet accounts has any unrelated business taxable income.

Distinguish between:

- Investment income, which can be set aside
- Income from an unrelated trade or business that's regularly carried on, which can't be set aside.

If the VEBA has investment income:

- Identify total trust assets at the end of the taxable year, other than buildings and similar capital items
- Determine the IRC Section 419(A)(c) account limit, which is the sum of the possible reserves for benefits per IRC Section 419A(c).

Note: The amount is "0" for benefits not listed in IRC Section 419A(c), such as child care, vacation benefits or any benefits to the funded by premium payments to commercial insurers. Also, to determine UBI, the amount is "0" for any post-retirement medical reserve per IRC Section 419A(c)(2)(A).

- If the IRC Section 419A(c) account limit equals or exceeds total assets, the VEBA has no tax liability on its investment income.
- If assets exceed the IRC Section 419A(c) account limit, determine the amount of the difference.

- Compare investment income to excess assets. Impose tax on the lesser of the two amounts.

Request the calculation of any amounts identified as a reserve for incurred but unpaid claims.

If any amount is claimed as a reserve for post-retirement medical or life insurance benefits, verify that funds are being held for that purpose and not expended for active employees.

If there is UBI, analyze the overhead, administrative and other expenses and review the basis for allocating the expenditures.

Required Compliance Checks

Many of the benefits received by members of a VEBA are excluded from the gross income of the recipient if they meet:

- Health and accident plans per IRC Section 105
- Compensation for injuries per IRC Section 104
- Certain death benefits per IRC Section 101
- Employer contributions to accident and health plans per IRC Section 106
- Certain educational assistance benefits per IRC Section 127.

You don't normally determine whether an employer is correctly reporting for employment tax purposes and payments made to VEBAs. Refer cases showing that employer problems exist to Compliance Planning and Classification, if warranted, by preparing and sending Form 5666, TE/GE Information Report and forward.

Example: An employer is treating payments to a VEBA as an accident or health plan per IRC Section 106 when these payments are also for a severance benefits plan. Since the employer must allocate the payment portion of a health plan account (because the employer must withhold the portion allocated to the severance plan), prepare Form 5666, TE/GE Information Report and send it to Compliance Planning and Classification.

You determine whether IRC Section 501(c)(9) organizations are meeting their responsibilities for income tax withholding, FICA and FUTA and reporting on Forms W-2 and W-3 for wages, and IRC Section 6041 reporting requirements for other taxable benefits.

If a benefit is taxable, it'll either be:

- Wages subject to income tax withholding, FICA and FUTA, and reported on Forms [W-2](#) and [W-3](#) (see IRC Section 3401 and regulations)

- Subject to IRC Section 6041 information return requirements. Generally, payments by an IRC Section 501(c)(9) organization in excess of \$600 constituting taxable benefits (other than wages) must be reported on [Forms 1096](#) and 1099. See Treas. Reg. 1.6041-1(a)(2).

Examination Guidelines-Required Filing Checks

In addition to the general guidelines for required filing checks per [IRM 4.75.4](#), you'll:

- Review the plan document to determine the nature of the benefits.
- Review benefit disbursement accounts, correspondence and other supporting documents to determine whether the VEBA pays any benefits other than those detailed in the plan document.
- Determine whether the benefits are taxable for FICA, FUTA or income tax purposes.
- Determine whether taxable benefits, if any, were correctly reported on Forms [W-2](#), [W-3](#), [940](#), [941](#) or [1099](#).
- Determine if the employer's payments are deductible on its income tax return.

If taxable benefits weren't correctly reported, you'll:

- Consider expanding the examination scope to include the employment tax returns.
- Secure delinquent information returns if they apply.
- Consider whether you should make discrepancy adjustments. If the employer made payments that aren't deductible, determine if the employer deducted the benefits from the income tax return. If you can't determine this by inspecting the employer's income tax return or determine if the benefits were deducted incorrectly, prepare Form 5666, TE/GE Information Report and forward a referral to Compliance Planning and Classification.

Note: Consider a discrepancy adjustment to the employer's income tax return, but in most cases a referral will do.