I. IRC 501(c)(9)

1. Introduction

IRC 501(c)(9) provides for the exemption from federal income tax of voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to their members and their members' dependents or designated beneficiaries, if no part of their net earnings inure to the benefit of any private shareholder or individual (other than through such payments). Proposed regulations under IRC 501(c)(9) were published in the Federal Register on July 17, 1980 and a copy appears at the end of this topic. These supersede the previous proposed regulations published on January 23, 1969.

The proposed regulations clarify the basic requirements that an organization must meet in order to be a "voluntary employees' beneficiary association" within the meaning of IRC 501(c)(9). They are not intended to describe "employees' beneficiary association" as that term is used in section 3(4) of the Employee Retirement Income Security Act of 1974 (ERISA). Generally, the basic requirements in order to be a "voluntary employees' beneficiary association" are that:

(a) The organization is an association of employees;

(b) Membership in the organization is voluntary;

(c) The purpose of the organization is to provide for the payment of life, sick, accident, or other benefits; and

(d) None of the organization's funds inures to the benefit of any private shareholder or individual other than as contemplated by (c) above.

The principal function of the proposed regulations is to clarify who may join the association and the kinds of benefits the association may provide. These provisions are supplemented with examples of both what is permitted and what is prohibited.

2. Procedures

IRM 7664.43 provides that key District Directors should issue determination letters under IRC 501(c)(9) where, from application of the statute and revenue rulings or revenue procedures published in the Internal Revenue Bulletin, it is clear that there is no inurement of net earnings, that the organization has an appropriate structure and membership, that benefits are provided to employees or their dependents, and that the only benefits provided are clearly permitted. Benefits clearly permitted by the statute, or by precedents published to date, are term life insurance, medical (or dental) care, accident and disability benefits, and supplemental unemployment benefits. Generally, key District Districts should not issue unfavorable determinations since the published precedent is not usually sufficient to make such determinations. Applications for exemption may be referred to the National Office where an adverse result is indicated.

IRM 7(10)62.4 provides that prior to the issuance of a proposed revocation or modification of a ruling or determination letter with respect to an organization' exempt status under IRC 501(c)(9), key District Directors shall forward the case to the National Office for technical advice.

These procedures remain in effect. The Notice of Proposed Rule Making published on July 17, 1980 should not be relied on in disposing of cases.

3. Discussion

Pertinent parts of each reg. section will be discussed below.

(a) 1.501(c)(9)-1.

The reg. provides that substantially all of a 501(c)(9) organization's operations must be in furtherance of providing permissible benefits. This test is explained in Reg. 1.501(c)(9)-3(a) as meaning that while an organization may provide some nonqualifying benefits, it will not qualify for exemption if it systematically and knowingly provides nonqualifying benefits of more than a *de minimis* amount.

(b) 1.501(c)(9)-2.

This section provides membership requirements. Persons eligible for membership must be defined by reference to objective standards that constitute an employment-related common bond among such individuals. This "bond" can be a common employer, common benefits under collective bargaining agreements, or a labor union affiliation. In addition, members may be employees of one or more employers engaged in the same line of business in the same geographic area. The geographic area limitation would appear to deny exemption to national or statewide multiple-employer trusts, unless established pursuant to collective bargaining. Additionally, up to ten percent of the members may be non-employees, but these persons must share an employment-related bond with the employee members.

Reg. 1.501(c)(9)-2(b) defines the term "employee" very broadly. The notice provides that a person is an "employee" if such person first becomes "entitled to participate in the association by reason of being an employee." Thus, a person and the dependents of a person may receive benefits even though the person is on leave of absence, working temporarily for another employer or as an independent contractor, or terminated from employment by reason of retirement, disability or layoff.

Reg. 1.501(c)(9)-2(c) requires that the association must be an entity having an existence independent of the member-employees or their employer(s), and that it be controlled by either its membership or by independent trustees, or by trustees or other fiduciaries at least some of whom are designated by the membership. These provisions are considered important to deal with arrangements which have proliferated in recent years and which are not considered to be voluntary employees' beneficiary associations. Among such arrangements are mere bookkeeping entries on an employer's books, and a fund which is established by a business league to meet various obligations of its employer-members. The control requirement have proved to be extremely controversial, with many employers arguing that ERISA provides sufficient guarantees against abuse by the employers where they control the funds.

(c) 1.501(c)(9)-3.

This section defines the permissible benefits a 501(c)(9) can provide to members and their dependents. Dependents always include a spouse and children. Also, any other individual meeting the dependency tests of IRC 152(a) can receive benefits. In determining if IRC 152(a) is met, the association may rely on good faith representations made by its members. A member's spouse and children do not have to satisfy IRC 152(a) to properly receive benefits.

(1) Life benefits. Life benefits are payable on the lives of a member or a member's dependents. The reg. specifically permits the payment of benefits that

are either (1) furnished pursuant to a contract of insurance with a life insurance company, or (2) paid directly by the association. The reg. does not indicate whether the provision of life benefits directly by an employer-funded organization are eligible for the exclusion from gross income of either IRC 79(b) or IRC 101(a), and is not intended to imply that they are. The reg. generally requires that "life benefits" consist of current protection only, and generally does not permit various forms of "permanent" life insurance contracts. There are three exceptions to this general rule. First, any organization may provide to a participant in a group life insurance contract a certificate of eligibility for individual coverage without evidence of insurability on termination of the member's relationship with the association. Second, "life benefits" generally include any "permanent benefit" provided in the manner prescribed in the regulations under IRC 79. This provision will be most relevant to employer-funded organizations and permits the provision of permanent benefits the cost of which is required to be included currently in the gross income of the employee. Finally, an organization that is funded with employee, rather than employer, contributions generally may offer "life benefits" that involve permanent protection. Like "permanent benefits" which are paid for with income on which the employee has been taxed under IRC 79, coverage purchased directly by an employee from an IRC 501(c)(9) organization also will be purchased with tax-paid dollars. Where "permanent benefits" are allowed, cash surrender value and policy loan benefits are permitted as these are commonly provided in permanent life insurance contracts. The regulations do not specifically say, but they clearly imply, that employer-funded organizations may not provide protection involving permanent insurance contracts other than "group insurance" contracts described in IRC 79.

(2) Sick and accident benefits. These are described in proposed Reg. 1.501(c)(9)-3(c), which is fairly self-explanatory.

(3) Other benefits. The 1969 notice provided that "other benefits" includes only benefits which are similar to life, sick, and accident benefits in the sense that they are "intended to safeguard or improve the health of the employee or to protect against a contingency which interrupts earning power." The same basic definition is used in the revised notice, except that it is expanded to include benefits which are intended to safeguard or improve the health of a member's spouse or dependents.

Both the 1969 notice and the revised notice expressly exclude from the definition of "other benefits" any benefit of the type provided by a stock bonus, pension, profit-sharing or annuity plan or similar plan providing substantially deferred compensation.

The proposed reg. gives a number of specific examples of "other benefits". These are generally self-explanatory. A few important items are discussed here.

(a) Loans. The 1969 notice makes no mention of this benefit. The revised notice provides that a section 501(c)(9) organization may provide benefits in the form of temporary living expense loans at times of disaster, such as fire or flood, but does not allow such organizations to provide loans to members in the ordinary course of a banking or financing business. See also loans on life insurance policies discussed above.

(b) Job readjustment allowances. The revised notice specifically provides that job readjustment allowances may be paid as an example of a benefit provided to protect against a contingency which interrupts earning power. Job readjustment is the sort of contingency which is an appropriate occasion for the payment of a benefit. It allows a worker to bridge the period between jobs without the loss of income.

(c) Severence and supplemental unemployment compensation benefits. Under the 1969 notice, severence payments and supplemental unemployment compensation could be paid in the event of a "reduction in force or temporary layoff," but severence payments at a time of mandatory or voluntary retirement were not permitted because their purpose was not "to protect in the event of an interruption of earning power."

Two changes have been effected in the revised notice. First, permissible supplemental unemployment compensation benefits have been defined by reference to IRC 501(c)(17)(D)(i). This takes into account IRC 501(c)(17)(E), which states that exemption as an IRC 501(c)(9) organization shall not be denied to any organization merely because such organization provides SUB benefits as defined by IRC 501(c)(17)(D)(i). In addition, permissible severence benefits are defined in the revised notice with reference to 29 CFR 2510.3-2(b). This is the labor law provision which distinguishes a severance pay plan from a pension plan for purposes of Title I of ERISA. General guidelines include a maximum amount of payment not to exceed twice the employee's most recent annual compensation, and payment being completed within two years after the termination of employment.

29 CFR 2510.3-2(b) is excerpted below:

> (b) Severence pay plans. (1) for purposes of Title I of the Act and this chapter, an arrangement shall not be deemed to constitute an employee pension benefit plan or pension plan solely by reason of the payment of severance benefits on account of the termination of an employee's service, provided that:
>
> (i) Such payments are not contingent, directly or indirectly, upon the employee's retiring;
>
> (ii) The total amount of such payments does not exceed the equivalent of twice the employee's annual compensation during the year immediately preceding the termination of his service; and
>
> (iii) All such payments to any employee are completed,
>
> (A) In the case of an employee whose service is terminated in connection with a limited program of terminations, within the later of 24 months after the termination of the employee's service, or 24 months after the employee reaches normal retirement age; and
>
> (B) In the case of all other employees, within 24 months after the termination of the employee's service.
>
> (2) For purposes of this paragraph (b),
>
> (i) "Annual compensation" means the total of all compensation, including wages, salary, and any other benefit of monetary value, whether paid in the form of cash or otherwise, which was paid as consideration for the employee's service during the year, or which would have been so paid at the employee's usual rate of compensation if the employee had worked a full year.

(ii) "Limited program of terminations" means a program of terminations:

(A) Which, when begun, was scheduled to be completed upon a date certain or upon the occurrence of one or more specific events;

(B) Under which the number, percentage or class or classes of employees whose services are to be terminated is specified in advance; and

(C) Which is described in a written document which is available to the Secretary upon request, and which contains information sufficient to demonstrate that the conditions set forth in paragraphs (b)(2)(ii)(A) and (B) of this section have been met.

(d) Vacation funds. "Vacation benefits" and "providing vacation facilities" were allowed in the 1969 notice because they protect against mental and physical fatigue and accidents or illness which may result therefrom. No mention was made of savings funds. In the revised notice savings funds are specifically not allowed. In addition, "vacation funds" which constitute deferred compensation are not permitted since such arrangements are not necessary to protect against a contingency, nor to protect the mental and physical health of the employees, and therefore are not similar to life, sick, or accident benefits. If the arrangement more closely resembles a "savings" facility than a "vacation benefit" it is not permitted. Examples of each are provided in Reg. 1.509(c)(9)-3(g) Example (1) and (2).

(e) Day care centers and legal aid. The earlier notice makes no mention of these benefits. These benefits are permitted under the revised notice. The provision of child-care facilities for preschool and school-age dependents is permitted as "safeguarding the health of a member's dependents." Personal legal service benefits are permitted, provided they consist solely of payments or credits to one or more organizations or trusts described in IRC 501(c)(20), because they come within contingencies which interrupt earning power. Also, both are specifically allowable under section 302 of the LMRA, discussed below. If Congress allows 501(c)(20) to lapse after 1981, as is presently scheduled, the Service will reconsider allowing the direct provision of personal legal service benefits via IRC 501(c)(9) organizations. If Congress amends or extends IRC

501(c)(20), the amendments would also be applicable to legal service benefits provided from funds supplied by IRC 501(c)(9) organizations.

(f) Section 302 of the Labor Management Relations Act. The notice provides that: "except to the extent otherwise provided in these regulations, as amended from time to time, "other benefits" also include any benefit provided in the manner permitted by paragraphs (5) et. seq. of section 302(c) of the Labor Management Relations Act of 1947".

Section 302(c)(5) et. seq. provides:

The provisions of this section [302] shall not be applicable:

> (5) with respect to money or other thing of value paid to a trust fund established by such representative [labor union], for the sole and exclusive benefit of the employees of such employer, and their families and dependents (or of such employees, families, and dependents jointly with the employers making similar payments, and their families and dependents): Provided, That (A) such payments are held in trust for the purpose of paying, either from principal or income or both, for the benefit of employees, their families and dependents, for medical or hospital care, pensions on retirement or death of employees, compensation for injuries or illness resulting from occupational activity or insurance to provide any of the foregoing, or unemployment benefits or life insurance, disability and sickness insurance, or accident insurance; (B) the detailed basis which such payments are to be made is specified in a written agreement with the employer, and employees and employers are equally represented in the administration of such fund, together with such neutral persons as the representatives of the employers and the representatives of employees may agree upon and in the event the employer and the employee groups deadlock on the administration of such fund and there are no neutral persons empowered to break such deadlock, such agreement provides that the two groups shall agree on an impartial umpire to decide such dispute, or in the event of

their failure to agree within a reasonable length of time, an impartial umpire to decide such dispute shall, on petition of either group, be appointed by the district court of the United States for the district where the trust fund has its principal office, and shall also contain provisions for an annual audit of the trust fund, a statement of the results of which shall be available for inspection by interested persons at the principal office of the trust fund and at such other places as may be designated in such written agreement; and (C) such payments as are intended to be used for the purpose of providing pensions or annuities for employees are made to a separate trust which provides that the funds held therein cannot be used for any purpose other than paying such pensions or annuities; (6) with respect to money or other thing of value paid by any employer to a trust fund established by such representative for the purpose of pooled vacation, holiday, severance or similar benefits, or defraying costs of apprenticeship, or other training programs: Provided, That the requirements of clause (B) of the proviso to clause (5) of this subsection shall apply to such trust funds; (7) with respect to money or other things of value paid by an employer to a pooled or individual trust fund established by such representative for the purpose of (A) scholarships for the benefit of employers, their families, and dependents for study at educational institutions, or (B) child care centers for preschool and school age dependents of employees: Provided, That no labor organization or employer shall be required to bargain on the establishment of any such trust fund, and refusal to do so shall not constitute an unfair labor practice: Provided further, That the requirements of clause (B) of the proviso to clause (5) of this subsection shall apply to such trust funds; (8) with respect to money or any other thing of value paid by any employer to a trust fund established by such representative for the purpose of defraying the costs of legal services for employees, their families, and dependents for counsel or plan of their choice: Provided, That the requirements of clause (B) of the proviso to clause (5) of this subsection shall apply to

> such trust funds: Provided further, That no such legal service shall be furnished: (A) to initiate any proceeding directed (i) against any such employer or its officers or agents except in workmen's compensation cases, or (ii) against such labor organization, or its parent or subordinate bodies, or their officers or agents, or (iii) against any other employer or labor organization, or their officers or agents, in any matter arising under subchapter II of this chapter or this chapter; and (B) in any proceeding where a labor organization would be prohibited from defraying the costs of legal services by the provisions of the Labor-Management Reporting and Disclosure Act of 1959; or (9) with respect to money or other things of value paid by an employer to a plant, area or industrywide labor management committee established for one or more of the purposes set forth in section 5(b) of the Labor Management Cooperation Act of 1978. (Emphasis Added.)

In applying this portion of the IRC 501(c)(9) regs. three points should be kept in mind:

1) Only those benefits allowed under sections 302(c)(5) et seq. are permitted. These sections are the only provisions relevant for purposes of IRC 501(c)(9) organizations. In addition, specific reference has been made to possible future amendment to the regulations to enable the Service to evaluate any new benefits provided by future amendments to section 302.

2) The revised notice permits benefits allowed by 302(c)(5) et seq., "except to the extent otherwise provided" in the IRC 501(c)(9) regulations. This exception resolves inconsistencies (such as pension benefits which are allowed under 302(c)(5) but which are expressly prohibited in Reg. 1.501(c)(9)-3), in favor of the tax regulations. For a second example, the provision of legal services under 302(c)(8) must be done as provided by the 501(c)(9) regs., through an IRC 501(c)(20) organization.

3) The benefits must be provided "in the manner permitted" by section 302. This includes the establishment of a trust by the employees' representative (i.e. labor union), the existence of a written agreement, employee-representation in the administration of the organization, etc. Consequently, this provision

incorporates certain safeguards into the regulations (which Congress in other contexts thought necessary) if the association intends to provide these particular benefits.

The only significant benefit that the reference to section 302 allows at this time is the provision of educational benefits to members' dependents. Scholarships and other educational and training benefits provided to the members are permitted under the revised notice as protecting against a contingency which interrupts or impairs the member's earning power, whereas educational benefits provided to the member's dependents would be permitted only as a benefit allowed by reference to section 302(c)(7).

(d) 1.501(c)(9)-4.

Generally, dispositions of property by an IRC 501(c)(9) organization, except to pay permitted benefits and reasonable administrative expenses, may constitute inurement. Experience rated insurance rebates are permitted. Also, upon dissolution assets may be distributed to the members but not to the contributing employers.

It is important to note that many instances of inurement, such as the payment of unreasonable compensation to the trustees or employees of the association, or the purchase of insurance or services for amounts in excess of their fair market value from a company in which one or more of the association's trustees, officers, or fiduciaries has an interest, may constitute violations of the fiduciary responsibility rules of ERISA. If such a case arises during an examination, the procedures for coordination with the Department of Labor must be followed. See IRM 7(11)90. The DOL-IRS agreement to exchange examination information is contained in IRM Exhibit 7(11)90-2.

(e) 1.501(c)(9)-5.

IRC 501(c)(9) organizations maybe required by IRC 6041 to file annual information returns with respect to benefits paid to members. This will occur where the employer has not included the contributions to the 501(c)(9) in the employee's gross income. Generally, payments in excess of $600 constituting taxable benefits must be reported on Forms 1096 and 1099. See Reg. 1.6041-1(a)(2).

Supplemental unemployment compensation benefits, which are treated as if they were wages for purposes of income tax withholding under IRC 3402(0), must be reported on Forms W-3 and W-2. See Reg. 1.6041-2(b)(1)(ii). Other forms of wages, as defined in IRC 3401, are also required to be reported on Form W-2. The term "wages" does not include remuneration paid in the form of group-term life insurance on the life of an employee, his spouse, or children [IRC 3401(a)(14)]; any payment, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under IRC 127, referring to certain educational assistance programs for employees, [IRC 3401(a)(19)]; and any medical care reimbursement made to or for the benefit of an employee under a self-insured medical reimbursement plan under a self-insured medical reimbursement plan under IRC 105(h)(6) [IRC 3401(a)(20)]. Vacation benefits generally constitute wages [Reg. 31.3401(a)-1(b)(3)]. Dismissal or severence payments generally constitute wages [Reg. 31.3401(a)-1(b)(4)].

Payments that constitute wages are generally subject to income tax withholding, FICA and FUTA. An IRC 501(c)(9) organization may be responsible for income tax withholding, while the employer is directly responsible for FICA and FUTA taxes. See Rev. Rul. 57-316, 1957-2 C.B. 626. Under Reg. 31.3504-1 the IRC 501(c)(9) organization may receive authorization from the District Director or director of a service center to pay over FICA and FUTA taxes on behalf of the employer. See Rev. Rul. 70-51, 1970-1 C.B. 192, and

Rev. Proc. 68-21, 1968-1 C.B. 817. 80 IRC 6052 provides special rules for returns regarding payment of wages in the form of group-term life insurance. Such payments must be included in a separate Form W-2, but only to the extent that such cost is taxable to the employee under IRC 79(a).

(f) 1.501(c)(9)-6.

Benefits realized by an employee may constitute taxable income to the employee to the extent provided in the Code including, but not limited to, IRC 61, 72, 101, 104, and 105. See also other appropriate sections of the Code such as IRC 79, 106, 120, and 127.

Benefits may be "realized" when the employer contributes money to the 501(c)(9) organization. See Rev. Rul. 67-351, 67-2 C.B. 86. In other circumstances, benefits may not be realized until payments are made from the

501(c)(9) trust to the employee. See Rev. Rul. 57-316, 1957-2 C.B. 626, Rev. Rul. 70-51, 1970-1 C.B. 192, and Rev. Rul. 77-347, 1977-2 C.B. 363.

Benefits will generally be considered "realized" when the employer makes contributions to the trust if they are definable and nonforfeitable at that time. In these cases, the employer must report the contributions as wages paid to the employee unless excludable under IRC 106 or other applicable code section. If benefits are forfeitable, that is, contingent on some event not within the employee's control, such as involuntary unemployment, income will not be realized until payments are made by the IRC 501(c)(9) trust. In such cases, the discussion of Reg. 1.501(c)(9)-5 above is particularly appropriate, as the IRC 501(c)(9) trust will be responsible for filing appropriate information returns.

(g) <u>1.501(c)(9)-8</u>.

The proposed regs. will generally apply to tax years beginning after December 31, 1954. However, this section provides transitional rules for the application of the proposed regulations to existing IRC 501(c)(9) organizations. Generally, the membership and control requirements of proposed Reg. 1.501(c)(9)-2, which are more strict than similar provisions in the 1969 proposed regulations, apply only to taxable years beginning after December 31, 1980. The new regs. will not apply to trusts created pursuant to collective bargaining agreements in effect on December 31, 1980 until such agreement terminates. However, any 501(c)(9) organization may, at its option, subject itself to the proposed regs. prior to these effective dates. In cases where, under the transitional rules, the regulations do not apply, the clear meaning of the statute should be applied to determine qualification for exempt status.

4. <u>IRC 512(a)(3)</u>.

IRC 512(a)(3) provides special rules for determining the unrelated business taxable income of IRC 501(c)(9) organizations. Proposed regulations were published on May 31, 1971, but have not yet been finalized.

Generally, all income of an IRC 501(c)(9) organization is taxable, unless it constitutes <u>exempt function income</u> under IRC 512(a)(3)(B). Exempt function income generally includes all dues paid by members of a 501(c)(9) organization. In addition, it includes all other income, such as investment income which is set aside under IRC 512(a)(3)(B)(ii) for the payment of life, sick, accident, or other benefits. However, income from an unrelated trade or business cannot be set aside. Thus, a

501(c)(9) organization is taxed on income from an unrelated trade or business under IRC 513 or 514 in the same manner as other exempt organizations.

A number of interesting questions have arisen in recent years dealing with the application of IRC 512(a)(3) to IRC 501(c)(9) organizations. First, employer contributions to a IRC 501(c)(9) organization generally do not constitute gross income to the IRC 501(c)(9) organization. This is fairly clear in the usual case where the IRC 501(c)(9) organization is a trust. In Frazier v. Commissioner, 157 F.2d 282, 284 (6th Cir. 1946), cert. denied 329 U.S. 807 (1947) the court determined that employer contributions to a nonexempt employees' trust were not taxable to the trust. A similar result was reached in Hubble v. Commissioner, 150 F. 2d 516 (6th Cir. 1945). See also IRC 118 with respect to contributions to the capital of a corporation. If employer contributions do not constitute "income", they will not be taxed under IRC 512(a)(3), regardless of whether they are "set aside" under IRC 512(a)(3)(B)(iii).

Another question that has arisen in a number of Technical Advice cases deals with the mechanism for "setting aside" income for the payment of permissible benefits. The legislative history of IRC 512(a)(3)(B) indicates that investment income is an integral part of the exempt insurance function of an organization exempt from Federal income tax under IRC 501(c)(9). IRC 512(a)(3)(B) serves to remove from the unrelated business income tax an organization's investment income where that income is committed to provide for the payment of life, sick, accident, or other benefits permitted by IRC 501(c)(9). See S. Rep. No. 91-552, 91st Cong., 1st Sess. 72 (1969), 1969-3 C.B. 470.

Generally, income that is to be set aside for the purposes specified in IRC 512(a)(3)(B) must be specifically earmarked as such or placed in a separate account or fund. However, in the case of a 501(c)(9) organization which, by the terms of its governing instrument, must use its net investment income for life, sick, accident, or other benefits, the income and assets of the organization can be considered as committed to purposes within IRC 512(a)(3)(B) without any additional action by the organization's governing body. Additional actions, such as a trust amendment or resolution stating that investment income is committed to purposes under IRC 512(a)(3)(B) would merely make explicit the existing fact that the income and assets of the organization are already committed to purposes within IRC 501(c)(9) and 512(a)(3)(B) as a requirement of the organization's exemption under IRC 501(c)(9). Accordingly, in the case of a voluntary employee's beneficiary association which by the terms of its governing instrument may use its net investment income only for life, sick, accident, or other benefits, net investment income need not be otherwise designated by the organization to be considered properly set aside. See PLR 8023007, 8023009, 8023010, 8023013, 8023014, 8023015, and 8023016.

Another issue considered in the seven Technical Advice Memoranda cited above is the extent to which set aside income may be accumulated. Although set-aside income may be accumulated, any accumulation which is unreasonable in amount or duration is evidence that the income was not accumulated for the purposes set forth in IRC 512(a)(3)(B)(ii). In the case of IRC 501(c)(9) organizations, accumulations which are reasonably necessary for the purpose of providing life, sick, accident, or other benefits to members, are not unreasonable even though such accumulations may be quite large and the time between the date of receipt by the organization of such amounts and the date of payment of the benefits is quite long. On the other hand, if an accumulation has become unreasonable in amount or duration, through continual additions to it over a period of years, it would no longer be reasonably necessary to set aside additional amounts to be added to the accumulated reserve. There is no specific statutory language or published precedent concerning the reasonableness of the amounts of funding of a 501(c)(9) organization. Whether or not an accumulation of funds is unreasonable in light of the exempt insurance function of a 501(c)(9) organization is a question requiring consideration of the detailed facts and circumstances of a particular case.

There are many valid purposes for which a 501(c)(9) organization may accumulate reserve funds. The existence of reserves allows such an organization to conduct its activities without interruption during financially adverse periods, such as, for example, strikes, lock-outs, and economic recessions. In many cases, a voluntary employees' beneficiary association is almost totally dependent on employer contributions for its funds. Therefore, it would of necessity be forced to suspend or substantially reduce its operations if those employer contributions were to be totally cut off or substantially reduced unless it retained a reasonably large reserve fund.

Many 501(c)(9) organizations are created and operated pursuant to a collective bargaining agreement between participating employers and labor unions representing the members of the employee's association. In these cases, the specific financial details of the employee's association's operations, including the amount of the employer contributions, the amount of the benefits to be paid to the members, and the amount of reserves the employee's association may accumulate, have been determined as a result of arm's-length negotiations between adversary parties. In this manner, the collective bargaining process acts as a control against the unreasonable accumulation of funds. Thus, barring any unusual circumstances, where a 501(c)(9) organization has been created and is operated pursuant to a collective bargaining agreement between participating employers and labor unions representing the members of the employees' association, it is appropriate to conclude that the reserves accumulated by such a 501(c)(9) organization are reasonable in amount and duration.

Where the 501(c)(9) organization is not established pursuant to collective bargaining, all the facts and circumstances of the case should be considered to determine if the accumulations are reasonable. For an example of such a case see PLR 8023007.

In any case where it is determined that a 501(c)(9)'s reserves are excessive, consideration should be given as to whether employer contributions are properly deductible by the employer. Generally, employer contributions to a 501(c)(9) organization are deductible as ordinary and necessary expenses under IRC 162 and Reg. 1.162-10. See Rev. Rul. 77-406, 1977-2 C.B. 56. Where a 501(c)(9)'s reserves are truly excessive, it can be argued that additional employer contributions are not an "ordinary and necessary" expense and thus are not deductible under IRC 162. Such contributions might also be viewed as contributions to a deferred compensation plan of the type referred to in IRC 404, with deductibility thus governed by the provision of IRC 404 and the regulations thereunder.

5. Relation of IRC 501(c)(17) to IRC 501(c)(9).

Generally, a supplemental unemployment benefit (SUB) plan can, at its option, qualify for exemption under IRC 501(c)(9) or IRC 501(c)(17). See Reg. 1.501(c)(17)-3(b). However, there are some important differences in treatment of 501(c)(9) and 501(c)(17) organizations that could affect such a decision.

First, 501(c)(9) organizations are subject to the special rules of IRC 512(a)(3), discussed above, while 501(c)(17) organizations are subject to the ordinary unrelated business income rules. Secondly, 501(c)(17) organizations are subject to the prohibited transaction rules of IRC 503 while 501(c)(9) organizations are not. Further, upon dissolution, a 501(c)(9) organization cannot return its corpus to a contributing employer. (Proposed Reg. 1.501(c)(9)-4(d)). On the other hand, employer contributions may be returned to the employer upon the dissolution of a 501(c)(17) organization after the satisfaction of all liabilities under the SUB plan. (Reg. 1.501(c)(17)-2(d)). Finally, a 501(c)(17) organization can provide only SUB benefits and subordinate sick and accident benefits, while a 501(c)(9) organization can provide the broad range of benefits discussed above.

[Proposed regulations not shown here]