UIL
4976.01-00

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224 200003054

Date:
OCT 27 1999

Contact Person:

ID Number:

Telephone Number:

OP:E:EO:T:2

Employer Identification Number:

LEGEND: M =

Dear Sir or Madam:

This is in reply to your letter requesting several rulings regarding the transfer of the assets of a tax exempt health and welfare fund back to you.

You have been recognized as exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code and are a public charity within the meaning of section 509(a)(3) of the Code.

You previously operated a hospital. You stopped operating the hospital several years ago and, at that point in time, you entered into an operating agreement with several other unrelated health care providers to continue to provide health care in the area and transferred your operations to them. These entities have since merged and are now operating as M. M has been recognized as exempt under section 501(c)(3) of the Code and currently is an active medical care provider and a public charity for purposes of section 509(a). You continue to support M in carrying out its mission to provide health care in the region. Your responsibilities under the operating agreement include providing funding for capital expenditures and improvements needed for the existing health care facility, including capital equipment. Although you intend to continue to operate as a charity, you expect to ultimately need few or no employees to carry on your exempt charitable activities.

While you operated the hospital you established a voluntary employees' beneficiary association (VEBA) to provide for the payment of health and welfare benefits to your hospital employees. The VEBA has been recognized as exempt from Federal income tax under section 501(c)(9) of the Code. You intend to have the trustees of the VEBA trust amend its governing instruments to provide that the VEBA be terminated. After the payment of any outstanding claims, the remaining funds will be transferred to you and certain of your former employees. The amounts to be transferred are based on the amounts originally contributed to the VEBA by each party. You have represented that 67 percent of the funds were contributed by you and 33 percent were contributed by your former employees.

288

Re:

As represented in your letter of July 9, 1999, the VEBA will distribute 33 percent of the funds it is holding (representing the amount employees contributed to the VEBA in 1995) to M and M will distribute a lump sum payment on a pro rata basis to each eligible employee. The employees eligible to participate in this transaction are those individuals who were employed by you as of the last day of 1995, who are now on the payroll of M or any other organization related directly to M, which is still providing services to M. Your former employees who are not now on the payroll of the new hospital or a similarly situated related employer will not receive any benefit from this transfer. In addition, a former employee who does not currently have to contribute to their current health care plans will not receive any benefit.

You have represented that the new hospital will not receive any benefit from the distribution but will receive a nominal savings on its administrative fee. You also represent that the employees who shall benefit from the distribution of assets from the VEBA have been selected in a manner which does not provide for disproportionate benefits to officers, shareholders, or highly compensated employees.

You expect to use the remaining 67 percent of the fund (representing your contributions to the VEBA in 1995) to carry on your charitable program. As previously stated, under the operating agreement you have with M, among other responsibilities, you are required to provide the funding for capital expenditures and improvements needed for the healthcare facility, including capital equipment.

You have requested the following rulings:

1. whether the adoption of the proposed Amendment and subsequent transfer of assets to you and your former employees will cause a retroactive revocation of your VEBA's exempt section 501(c)(9) designation; and

2. whether the 100 percent excise tax allowed by section 4976 of the Code will apply to the proposed transfer of assets from the VEBA back to you.

Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c).

Section 501(c)(9) of the Code describes a voluntary employees' beneficiary association ("VEBA") providing for the payment of life, sick, accident or other benefits to its members or their dependents or designated beneficiaries, and in which no part of its net earnings inure (other than through such payments) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-4(a) of the Income Tax Regulations provides that no part of the net earnings of an employees' association may inure to the benefit of any private shareholder or individual other than through the payment of permissible benefits. Whether prohibited inurement has occurred is a question to be determined with regard to all the facts and circumstances.

Re:

Section I.501(c)(9)-4(d) of the regulations provides that a distribution to members upon the dissolution of the association will not constitute prohibited inurement if the amount distributed to members are [is] determined pursuant to the terms of a collective bargaining agreement or on the basis of objective and reasonable standards which do not result in either unequal payments to similarly situated members or in disproportionate payments to officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association. If the association's corporate charter, articles of association, trust instrument, or other written instrument by which the association was created, as amended from time to time, provides that on dissolution its assets will be distributed to its members' contributing employers, or in the absence of such provision the law of the state in which the association was created provides for such distribution to the contributing employers, the association is not described in section 501(c)(9).

Section 4976(a)(2) of the Code imposes an excise tax on an employer equal to 100 percent of any disqualified benefit provided by an employer-maintained welfare benefit fund.

Section 4976(b)(1)(C) of the Code defines "disqualified benefit" to include any portion of a welfare benefit fund reverting to the benefit of the employer.

Section 4976(b)(3) of the Code provides that section 4976(b)(1)(C) does not apply to any amount attributable to a contribution to the fund that is not allowable as a deduction under section 419 for the taxable year or any prior taxable year.

The information submitted establishes that you intend to terminate the VEBA you had established to provide for the payment of health and welfare benefits to the employees who worked for you while you operated a hospital. You intend to have the VEBA transfer 33 percent of the funds, through M, to certain of your former employees and transfer the remaining 67 percent to you to be used to carry on your charitable program. You have represented that the employees benefitting from the distribution of assets from the VEBA have been selected in a manner which does not provide for disproportionate benefits to officers, shareholders, or highly compensated employees of the employer.

Section 1.501(c)(9)-4(d) of the regulations recognizes that distributing funds to the participants in a terminating VEBA is an accepted manner of terminating a section 501(c)(9) VEBA. The eligible employees have been selected in a reasonable manner and the transfer will not provide for the payment of disproportionate benefits to the owners or highly compensated employees. Accordingly, it is clear that the transfer of 33 percent of the funds held by the VEBA to the eligible employees is permissible upon termination of this VEBA. Therefore, based on the submitted information, we have concluded that this aspect of the proposed termination of your VEBA does not constitute inurement and will not affect, in any manner, the tax-exempt status of the VEBA prior to the transfer.

240

Re:

Because the proposed Amendment will provide that on dissolution of the trust, trust assets will be distributed to you, the VEBA will be disqualified under section 501(c)(9) when the proposed Amendment is adopted. See section I.501(c)(9)-4(d) of the regulations. Additionally, when the assets are transferred to you, the VEBA will be disqualified under section 501(c)(9). Although the adoption of the proposed Amendment and transfer of assets will affect the tax-exempt status of the VEBA, they will not affect, in any manner, the tax-exempt status of the VEBA prior to the adoption of the proposed Amendment and subsequent transfer of assets.

You also intend to have the VEBA transfer the remaining 67 percent of the funds in the trust back to yourself. This 67 percent represents the contributions you made into the VEBA on behalf of your employees when you operated a hospital. These funds are to be used by you to carry on your current charitable programs which support the operations of M. When you transferred these funds to the VEBA you were acting as an employer and were making contributions to the VEBA to provide for the payment of health and welfare benefits to your employees. As a general rule the return of any portion of a welfare benefit fund for the benefit of an employer is a disqualified benefit and subject to the 4976(a)(2) excise tax.

However, under section 4976(b)(3), the excise tax does not apply if the amount reverting to the employer is attributable to contributions that were not allowable as a deduction under section 419 for any tax year. In considering how this provision applies to a tax-exempt employer, we note that the section 4976 excise tax was enacted to establish a meaningful sanction that would prohibit an employer from deducting contributions to a qualifying trust, accumulating the assets in the trust on a tax free basis, and subsequently distributing the assets to itself or otherwise misapplying them. It was felt that the previously existing sanctions, loss of exemption or deductions for future contributions, were an insufficient deterrent. But no tax deduction is possible for an exempt organization for a contribution to a VEBA (other than in connection with an unrelated trade or business), and earnings on amounts held by the tax-exempt employer are not taxed whether or not transferred to a VEBA. In the case of a tax-exempt employer, therefore, we conclude that amounts contributed to a fund, unless directly connected with an unrelated trade or business are "not allowable as a deduction under section 419" within the meaning of section 4976(b)(3). Accordingly, section 4976(b)(1)(C) does not apply to any assets that may revert to you.

Similarly, any savings M could realize by reason of this transfer are not inconsistent with the accomplishment of its exempt purposes.

Accordingly, based on the information you have submitted we have concluded that:

1. The adoption of the proposed Amendment and subsequent transfer of assets to you by the VEBA and your former employees will not cause a retroactive revocation of the VEBA's exempt status under section 501(c)(9) of the Code; and

2. the 100 percent excise tax allowed by section 4976 of the Code will not apply to the proposed transfer of assets from the VEBA back to you.

This ruling is directed only to the organization that requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

291

200003054

Re:

We are informing your key District Director of this ruling. Because this letter could help resolve any question about your exempt status, you should keep it in your permanent records.

If you have any question about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter. For other matters, including questions concerning reporting requirements, please contact your key District Director.

Sincerely Yours,

(signed) Garland A. Carter

Garland A. Carter
Chief, Exempt Organizations
Technical Branch 2