TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

200137062

Date: JUN 18 2001

Contact Person:

Identification Number:

Telephone Number:

T:EO:B2

UIL: 419.11-00
419.12-02
512.09-03

Employer Identification Number:

LEGEND: L =
M =
N =

Dear Sir or Madam:

This is in reply to your request for a ruling on the proper treatment of your income under section 512(a)(3)(B) of the Internal Revenue Code and section 512(a)(3)(E) of the Code by reason of your status as a separate welfare benefit fund established under a collective bargaining agreement.

You have been recognized as exempt from Federal Income Tax as a voluntary employees' beneficiary association (VEBA) described in section 501(c)(9) of the Code.

L had entered into collective bargaining agreements with the forerunner to N which covered retiree health benefits for represented employees retiring from L. [For the purposes of this letter, the involved union shall be generally referred to as N.] L was dissolved and liquidated several years ago. M, a subsidiary of L survived the liquidation and assumed various post-liquidation liabilities of L. One of these liabilities was the postretirement health care benefits payable through medical welfare plans which had been established pursuant to a collective bargaining agreement between L and N.

In order to control costs M decided to make certain changes to the existing benefit plans. After a series of negotiations with N, a compromise concerning changes to the original collective bargaining agreement was agreed to between the parties. As a result of this new agreement, M eventually established two VEBAs both of which covered certain non-union retirees of L. These trusts sought and obtained tax exemption under section 501(c)(9) of the Code. A third VEBA was subsequently established exclusively for other retirees who were not union members. This VEBA also sought exemption and has been recognized as exempt under section 501(c)(9). The last group of retired employees who remained were the retirees who had been represented by

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Re:

N. M and N entered into negotiations and you were established to provide for the payment of medical benefits to this last group of employees. As previously noted you sought and obtained tax exempt status as an organization described in section 501(c)(9) of the Code.

You have represented that the Secretary of Labor would hold that the letter agreement between the M and N is a collective bargaining agreement. The information provided concerning the negotiations between M and the Union evidences the arm's length nature of the process. All of the beneficiaries you provide benefits to are former union employees (and dependents of such former employees) of L or its subsidiaries . Therefore, at least 90 percent of the employees eligible to receive benefits under the Trust are covered by the collective bargaining agreement.

You have requested the following rulings:

1. You are a separate welfare benefit fund under a collective bargaining agreement, within the meaning of section 419A(f)(5), and therefore exempt from the account limit requirement.

2. Your investment income is not taxable under section 511(a) as unrelated business taxable income because such income is exempt function income under section 512(a)(3)(B), as a set aside for life, health, accident, or other benefits, which is not in excess of the account limited of section 419A, within the meaning of section 512(a)(3)(E)(i).

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 earning inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-2(a)(l) of the Federal Income Tax Regulations provides that the membership of an organization described in section 501(c)(9) must consist of individuals who become entitled to participate by reason of their being employees and whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond among such individuals. 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.

Section 511(a) of the Code imposes a tax upon the unrelated business taxable income of organizations exempt from federal income tax under section 501(c).

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Section 512(a)(3)(A) of the Code provides, in relevant part, that in the case of an organization described in section 501(c)(9) of the Code, the term "unrelated business taxable income" means gross income, excluding any exempt function income, less the deductions which are directly connected with the production of the gross income (excluding exempt function income), both computed with the modifications set forth herein.

Section 512(a)(3)(B) of the Code provides that in the case of an organization described in section 501(c)(9) the term "exempt function income" includes all income (other than an amount equal to the gross income derived from any unrelated trade or business regularly carried on by the organization) which is set aside to provide for the payment of life, sick, accident or other benefits. If during the taxable year, an amount which is attributable to income so set aside is used for a purpose other than that described above, such amount shall be included under section 512(a)(3)(A) in unrelated business taxable income for the taxable year.

Section 512(a)(3)(E) of the Code provides that in the case of an organization described in section 501(c)(9),a set-aside can be taken into account in determining exempt function income only to the extent that such set-aside does not result in an amount of assets set aside for such purpose in excess of the account limit determined under section 419A of the Code. This amount is referred to as a qualified asset account.

Section 419 of the Code provides rules with respect to the tax treatment of funded welfare benefit plans. A plan which is determined by the Service to be a voluntary employee beneficiary association under section 501(c)(9) is a welfare benefit fund within the meaning of section 419.

Section 419A(a) of the Code provides that for the purposes of section 512 the term qualified asset account means any account consisting of assets set aside to provide for the payment of disability, medical, SUB or severance pay benefits, or life insurance benefits.

Section 419A(c)(1) of the Code describes the account limit, in general, as being the amount reasonably and actuarially necessary to fund claims incurred but unpaid (as of the close of such taxable year) and administrative costs with respect to such claims.

Section 1.419A-2T, Q&A-1of the regulations provides that neither contributions to nor reserves of a collectively bargained welfare benefit fund shall be treated as exceeding the otherwise applicable limits of section, 419(b), 419A(b), or 512(a)(3)(E).

Section I.419A-2T, Q&A-2(2) of the regulations provides that a welfare benefit fund maintained pursuant to a collective bargaining agreement between employee representatives and one or more employers shall not be treated as a collective bargaining agreement unless it is a bona fide agreement between bona fide employees and one or more employers. A welfare benefit fund is not considered to be maintained pursuant to a collective bargaining agreement unless at least 50 percent of the employees eligible to receive benefits under the fund are covered by the collective bargaining agreement.

Section 1.419-2T, Q&A -4 of the regulations provides that a welfare benefit fund will not be treated as a collectively bargained welfare benefit fun for purpose of Q&A-1 if and when after July 1, 1985, the number of employees who are not covered by a collective bargaining agreement and are eligible to receive benefits under the fund increases by reason of an amendment, merger, or other action of the employer or the fund. In addition, pending the issuance of these regulations for the purposes of applying the 50 percent test of Q&A(2) to a welfare benefit fund that is not in existence on July 1, 1985, "90 percent" shall be substituted for "50 percent".

The submitted information establishes that you are exempt under section 501(c)(9) of the Code. The information provided concerning the negotiations between M and N evidences the arm's length nature of the process and the bona fides of this agreement. Therefore, we have concluded that you were established pursuant to a collectively bargained agreement. All of your beneficiaries are former union employees (and their dependents) of L or its subsidiaries. Therefore, at least 90 percent of the employees eligible to receive benefits under you are covered by the collective bargaining agreement. The benefits provided appear to be limited to those allowable under section 419A.

Section 419A sets an account limit on the amount of certain reserves that can be maintained by a welfare benefit plan. The account limit is described in section 419A(c)(1) as the amount estimated to be necessary to fund plan liabilities for the amount of claims incurred but unpaid as of the close of the taxable year of the fund. It also takes into account administrative costs and section 419A(c)(2) provides for an additional reserve for post-retirement medical and life insurance benefits. The account limit of section 419A does not include other amounts, notwithstanding that they are intended to fund permissible benefits in future years. However, section 1.419A-2T, Q&A-1 of the regulations provides that no account limits shall apply in the case of any qualified asset account under a separate welfare benefit fund established pursuant to a collective bargaining agreement. Because this plan has been established pursuant to a collective bargaining agreement, the account limits of section 419A account limits are not applicable.

Therefore, based on the submitted information we have concluded that:

1. You are a separate welfare benefit fund under a collective bargaining agreement, within the meaning of section 419A(f)(5), and therefore exempt from the account limit requirement.

2. Your investment income is not taxable under section 511(a) as unrelated business taxable income because such income is exempt function income under section 512(a)(3)(B), as a set aside for life, health, accident, or other benefits, because as a collectively bargained plan you are not subject to the account limits.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent. A copy of this ruling should be maintained in your permanent records.

Re:

If you have any questions 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 the Ohio TE/GE Customer Service Office.

Sincerely Yours,

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2