



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

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Contact Person:

Identification Number:

Telephone Number:

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501.09-01  
501.09-03  
4976.01-00

Legend:

M =  
N =  
P =  
Q =  
b =

Dear \_\_\_\_\_ :

This responds to a letter from the authorized representatives of M and P, who request rulings under section 501(c)(9) and 4976 of the Internal Revenue Code on behalf of M and P.

Facts:

M, a b, sponsors a collectively-bargained disability plan, N. N benefits are paid from P. P is a voluntary employees' beneficiary association which is recognized exempt from federal income taxation as an organization described in section 501(c)(9) of the Code.

Presently, N pays temporary disability ("TD") benefits at 50% of pre-disability earnings to eligible employees. TD benefits begin upon expiration of employer-funded sick pay ("Sick Pay") benefits and end after 26 weeks of disability when a disabled employee may qualify for long-term disability ("LTD") benefits at 50% of pre-disability earnings. In addition to disability benefits, N provides monthly survivor income benefits to family members of deceased covered employees and former employees.

Sick Pay is a payroll practice funded by M from its general assets and is paid at 100% of pre-disability earnings. The duration of Sick Pay varies with the employee's years of service.

Due to changes in M's competitive environment and financial circumstances, M intends to seek Q's approval to eliminate Sick Pay and to amend N's disability benefit arrangements. Q is a union that represents employees of M that are eligible for Sick Pay and N benefits.

Subject to Q's approval, M contemplates no longer providing Sick Pay. Instead, N will be amended so that sickness and disability benefits under N begin sooner. While the specific terms of the amended N are subject to the collective bargaining process, the amended N benefit structure is expected to pay sickness and disability benefits at 100% of pre-disability earnings for a set number of hours after which benefits will be reduced to a lower level (e.g., 60%) and then to 50% for the remainder of the 26-week period. At the end of 26 weeks, LTD benefits may begin. Additional qualifying benefits, as agreed to by Q, may also be paid from N and P.

Rulings Requested:

M and P request the following rulings contingent on Q's approval of the changes to N and P:

1. The use of P's assets to pay expanded collectively-bargained benefit obligations for disability and sick pay benefits and other permissible benefits under an amended N will not adversely affect P's tax exempt status under section 501(c)(9) of the Code and will not be considered prohibited private inurement to M.
2. The use of P's assets to pay expanded collectively-bargained benefit obligations for disability and sick pay benefits and other permissible benefits under an amended N will not be a prohibited reversion that is subject to the excise tax under section 4976(a) of the Code.

Law:

Section 501(a) of the Code exempts organizations described in section 501(c) from federal income taxation.

Section 501(c)(9) of the Code describes voluntary employees' beneficiary associations 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(a) of the Income Tax Regulations provides that the life, sick, accident, or other benefits provided by a voluntary employees' beneficiary association must be payable to its members, their dependents, or their designated beneficiaries. A voluntary employees' beneficiary association is not operated for the purpose of providing life, sick, accident, or other benefits unless substantially all of its operations are in furtherance of the provision of such benefits. Further, an organization is not described in section 501(c)(9) if it systematically and knowingly provides benefits of more than a de minimis amount that are not permitted life, sick, accident, or other benefits.

Section 1.501(c)(9)-3(c) of the regulations provides that the term "sick and accident benefits" means amounts furnished to or on behalf of a member or a member's dependents in the event of illness or personal injury to the member or dependent. A sick and accident benefit includes

an amount paid to a member in lieu of income during a period in which the member is unable to work due to sickness or injury.

Section 1.501(c)(9)-4(a) of the 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 benefits permitted by section 1.501(c)(9)-3. The disposition of property to, or the performance of services for, a person for less than the greater of fair market value or cost (including indirect costs) to the association, other than as a life, sick, accident or other permissible benefit, constitutes prohibited inurement.

Section 4976(a) of the Code imposes an excise tax on an employer that maintains a welfare benefit fund if the fund provides a disqualified benefit. The tax is equal to 100 percent of the disqualified benefit.

Section 419(e)(3) of the Code explains that a welfare benefit fund includes any organization described in section 501(c)(9).

Under section 4976(b)(1)(C) of the Code, a "disqualified benefit" includes any portion of a welfare benefit fund reverting to the benefit of the employer.

Analysis:

If Q agrees, M will no longer provide Sick Pay. Rather, if approved through collective bargaining, benefits under N for sickness and disability will begin earlier. These collectively-bargained expanded benefits will be paid under N from P. It is possible that other qualifying benefits may be offered through the amended N and P as a result of the collective bargaining process. M will amend N only upon receiving approval from Q.

The sickness and disability benefits that M intends to provide through N and P with Q's approval are benefits described in section 1.501(c)(9)-3(a) and (c) of the regulations that an organization described in section 501(c)(9) of the Code is allowed to provide its members. The payment of benefits permitted under section 1.501(c)(9)-3 does not constitute prohibited inurement for purposes of section 1.501(c)(9)-4(a). Therefore, the use of P's assets to fund collectively-bargained sickness, disability, and other permissible benefits would not adversely affect P's status as an organization described in section 501(c)(9) of the Code, and would not result in prohibited inurement. Furthermore, the use of P's assets to provide disability, sickness, and other permissible benefits to members and their dependents would not be considered a reversion of P's assets to M within the meaning of section 4976.

Conclusion:

Accordingly, based on the information submitted, and contingent upon Q's approval of the sickness, disability, and other permissible benefits provided through N and P as described above, we rule as follows:

1. The use of P's assets to fund disability, sickness, and other benefits permitted under section 1.501(c)(9)-3 of the regulations will not adversely affect the status of P as an organization described in section 501(c)(9) of the Code.

2. The use of P's assets to fund disability, sickness, and other benefits permitted under section 1.501(c)(9)-3 of the regulations will not result in inurement that is prohibited under section 1.501(c)(9)-4 of the regulations.

3. The use of P's assets to fund disability, sickness, and other benefits permitted under section 1.501(c)(9)-3 of the regulations will not result in any portion of P's assets reverting to the benefit of M, and M will not be considered to have provided a disqualified benefit under section 4976 of the Code.

These rulings are made on the understanding that there will be no material changes in the facts upon which they are based.

Except as specifically ruled on above, no opinion is expressed concerning the federal income tax consequences of the transactions described above under any other provision of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to the authorized representatives of M and P. A copy of this letter should be kept in the permanent records of M and P.

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.

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.

Sincerely,

Robert Fontenrose

Michael Seto  
Manager, Exempt Organizations  
Technical Guidance Group 1

Enclosure  
Notice 437