

Internal Revenue Service
Appeals Office
1375 E. Ninth Street
Cleveland, OH 44114-1739

Department of the Treasury

**Employer Identification
Number:**

Person to Contact:

Telephone:

Refer Reply to:

Release Number: 200950049
Release Date: 12/11/09
Date: September 15, 2009
UIL Code: 501.33-00
501.35-00

Dear :

We considered your appeal of the adverse action proposed by the Director, Exempt Organizations, Rulings and Agreements. The paragraph(s) check below indicate(s) our decision.

Your exemption from Federal income tax under Internal Revenue Code (IRC) section 501(c)(9) is:

- Confirmed.
 Modified. A new determination letter is enclosed.

Denied or Revoked. You are required to file Federal income tax returns on Form 1041 for the above years. You should file these returns within 30 days from the date of this letter, unless a request for extension of time is granted. File the returns in accordance with their instructions and do not send them to this office.

You are not a private foundation because you are described in IRC section(s) _____.

You are an operating foundation as described in IRC section 4942(j)(3).

You have no liability for excise taxes under IRC _____ for the above years.

Your liability for excise taxes under IRC _____ for the above year(s) was properly reported on your return(s).

There is no change to your unrelated business income tax liability as reported for the above years.

Your Form(s) 990-T for the above years are accepted as filed.

You may direct questions about the decision to the appeals officer whose name and telephone number are shown above.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Karen Skinder". The signature is fluid and cursive, with a long horizontal stroke at the end.

Karen Skinder
Appeals Team Manager

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

Date: NOV 05 2007

[REDACTED]

Contact Person:
[REDACTED]
Identification Number:
[REDACTED]
Contact Number:
[REDACTED]
FAX Number:
[REDACTED]
Employer Identification Number:
[REDACTED]

Dear

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(9). The basis for our conclusion is set forth below. This letter supersedes our previous letter dated [REDACTED].

ISSUE

Does the applicant qualify for federal income tax exemption under section 501(c)(9) of the Internal Revenue Code?

FACTS

You were formed on [REDACTED] pursuant to a Trust Agreement "Trust" made and entered into between the [REDACTED] and [REDACTED] as Trustee. The Trust states that [REDACTED] has adopted one or more employee welfare benefit plans, the purpose of which is to provide welfare benefits for those employees of the Corporation and their eligible dependents covered by the Plan. According to the Form 1120S filed by [REDACTED] for tax year 200[REDACTED] was incorporated on [REDACTED] and the return was marked "Initial return."

At the time the application was submitted to the Internal Revenue Service the Plan consisted of all four employees of the [REDACTED] President, CEO and sole shareholder, his wife, [REDACTED], Secretary, his father, [REDACTED], Treasurer and Chief Financial officer, and [REDACTED] marketing contact. [REDACTED] and [REDACTED] reside in [REDACTED], [REDACTED] resided in [REDACTED] and [REDACTED] resides in [REDACTED]. All four participants are listed as Trustees. On [REDACTED], [REDACTED] two part-time employees were added to the Plan: [REDACTED], a long-time friend of the [REDACTED] and [REDACTED]. We requested you provide the number of hours per week each of these employees worked but this information was not provided. You state there is no employee contract for either individual.

██████████ age ██████████ in ██████████ did not receive a Form W-2 from ██████████ for tax year ██████████. He received a salary of \$ ██████████ during ██████████. He died on ██████████. Due to his age and health he was not accepted for disability or life insurance.

Effective ██████████ and ██████████ resigned as Trustees of the Plan and appointed ██████████, CPA, as successor trustee. ██████████ provides accounting and individual income tax services for the ██████████. He is also the accountant and income tax preparer for ██████████.

Your application states that the Plan will provide death benefits in the amount of twenty times the annual compensation on the life of each participant. Pre-retirement disability will be 100 percent of salary (\$ ██████████ maximum) for up to 5 years. Post-retirement health benefits will be funded in an amount necessary to fund a reserve over the working lives of covered employees using reasonable actuarial assumptions. Insurance premiums are paid from contributions from ██████████; no employee contributions are contemplated.

The application for universal life insurance for ██████████ lists ██████████ Trustee for the ██████████ Revocable Living Trust, as the beneficiary. The application for ██████████ lists ██████████ Living Trust as the beneficiary. The application for all the remaining employees lists ██████████ VEBA Plan as the beneficiary. The VEBA Plan owns all five universal life insurance policies.

Each Life Insurance Policy contains provisions for net cash value surrender and partial withdrawals before the death of the insured. The Policy allows the insured to borrow money from the policy up to the net cash surrender value at the time of the loan. Payout options for individuals include: interest payment; fixed amount payable; fixed period payment; limited payment; and joint lifetime payment.

You submitted three documents entitled (1) ██████████ Voluntary Employee Welfare Plan Trust Agreement "Trust", (2) ██████████ Voluntary Employee Benefit Association "Plan" and (3) ██████████ Voluntary Employee Welfare Benefit Plan Adoption Agreement "Adoption Agreement". ██████████ signed the Trust Agreement and Adoption Agreement as President of the Corporation, as Trustee, and as Secretary for attestation purposes. The Adoption Agreement lists ██████████ as the acting Plan Administrator pending IRS approval of the Plan. You subsequently provided a copy of the agreement from ██████████, Inc. to act as Plan Administrator effective ██████████. ██████████ is a broker with ██████████, the company that provides life insurance for Plan participants.

██████████ was the initial Trustee of the Plan. It wasn't until ██████████ that ██████████ and ██████████ resigned as Trustees and appointed ██████████. In your letter dated ██████████ you stated that negotiations were under way to replace ██████████ with ██████████ and ██████████. We subsequently requested a copy of the agreement with the Bank. In your letter dated ██████████ you state that no agreement had been reached with ██████████ and ██████████ and that a verbal agreement had been reached with ██████████ to act as Plan Trustee. In response to our request for a written copy of the agreement with ██████████ you provided a copy of an e-mail from a representative of the ██████████ Department stating they were moving forward to act as Trustee of the Plan provided:

1. The Trust plan was updated to current law and IRS and Treasury requirements.
2. That an IRS determination be obtained.
3. That [REDACTED], [REDACTED] (Plan Administrator) and [REDACTED], Power of Attorney for the Plan, work out a funding agreement set forth within the Trust for accepted investments.

Based on the unmet requirements listed above, [REDACTED] continues to act as Trustee of the Plan. In regards to the "independence" of [REDACTED], you state you were advised that as long as it is "properly disclosed" that he is "independent." You also state he is independent because he is not a relative of the [REDACTED] or their employee.

Article I, Sec. 1.1 of the Trust states that the Trustee shall hold the Trust Fund in trust and shall manage and administer the same in accordance with the terms and for the purpose of the Trust.

Article I, section 1.4 states that the Plan Administrator shall have full responsibility for and control of the administration of the Plan and, except as specifically provided otherwise herein, and the powers necessary to carry out the provisions of the Trust.

Article III, Section 3.1 states that "The Trustee shall invest and reinvest the principal and income of the Trust Fund and keep the Trust Fund invested, without distinction between principal and income, in such securities or in such property, real or personal, tangible or intangible, as the Trustee shall deem advisable..."

Article III, Section 3.2 states that "The Plan Administrator shall, pursuant to the Plan, establish and carry out a funding policy consistent with the purposes of the Plan and the requirements of applicable law, as may be appropriate from time to time."

Article IV, Section 4.1, states in part, that the Trustee is authorized and empowered, in part, (a) to sell, exchange, convey, transfer, or dispose of, and grant options with respect to any property held by the Trust; (b) to acquire, hold, dispose of any real estate, at such time, in a manner and upon such terms as the Trustee may deem advisable; to remain, manage, operate, repair, improve, partition, mortgage or lease for any term or years any such real estate, or to exchange all or part of thereof for other real estate, upon such terms as the Trustee deems proper, (c) to compromise, compound and settle any debt or obligation due to or from it as the Trustee, (d) to vote any stocks or other securities at any time held in the Trust Fund and exercise any options appurtenant to any stocks, bonds or other securities, (e) to accept and hold any securities or other property received by the Plan, (f) to borrow or raise money for the purpose of the Trust Fund, (g) to enforce any right, obligation or claim in its discretion to protect the interests of the Trust, (h) to make and deliver deeds or any other instruments necessary, (i) to cause any investments held by it to be registered in, or transferred into, its name as Trustee, (j) to hold any part or all of the Trust Fund uninvested; and (k) to do all acts which the Trustee may deem necessary or proper to exercise the powers of the Trustee.

Article IV, Section 4.4 states that the Trustee may be paid such reasonable compensation as agreed upon in writing by the Corporation and the Trustee.

Article VI, Section 6.2 states the Corporation may remove the Trustee at any time upon 30 days notice in writing to the Trustee.

Article VI, Section 6.3 allows the Corporation to appoint a successor Trustee, upon the resignation or removal of the Trustee.

Article VII, Section 7.2 states that the Trust Agreement may be terminated at any time by the Corporation and upon termination, dissolution, or liquidation of the Corporation, the Trust Fund shall be paid out by the Trustee as and when directed by the Plan Administrator or the Corporation in accordance with the provisions of Article II of the Plan. You provided an Amendment to this section of the Trust that was adopted on [REDACTED]. The Amendment states the Agreement may be terminated at any time upon the agreement of the Corporation and the Trustee or in the event of the dissolution or liquidation of the Corporation. The Trust Fund will be paid out to the participants by the Trustee upon the directive of the Plan Administrator. In the event of the termination or dissolution of the Trust, all funds will be distributed to Plan participants; no assets will be returned to or inure to the benefit of the Corporation.

Article I, Section 1.6 of the Plan Agreement defines "Board" as the Board of Directors of the Company or the officer or officers of the Company to whom such Board of Directors may delegate any of its rights, duties or powers.

Article III, Section 3.2(b) of the Plan Agreement states that all monies contributed by the Company, as well as all earnings, shall be returned to the Company in the event the IRS determines the Plan and Trust does not qualify for exemption under section 501(c)(9) of the Code.

Article IV, Section 4.1 of the Plan states the Trustee shall have the authority and discretion to manage and control the Trust Fund Assets.

Article V, Section 5.1 of the Plan describes the Governing Employee Board. It states that the Board shall consist of at least two Participants, only one of whom may own stock in the Company (Corporation). Section 5.2 of the Plan states that the Board has the power and authority to designate, remove, or replace the Plan Administrator and approve of, overrule or revise any rules, regulations or interpretations adopted by the Plan Administrator.

Article X, Section 10.1 of the Plan states that the Board and the Governing Employee Board, acting jointly, have the right to amend the Plan and Trust at any time. Section 10.2 states the Company reserves the right to permanently discontinue contributions to the Trust at any time by written notification to the Plan Administrator, the Governing Employee Board and the Trustee. The Plan defines the "Board" as the Board of Directors of the Company.

The Adoption Agreement provides that the Plan will cover all employees of [REDACTED] who are (1) at least 21 years of age, (2) completed 1,000 or more hours of service within a fiscal year, (3) part-

time employees working less than 20 hours a week, (4) seasonal employees (less than 6 months of service or temporary), (5) unionized employees, and (6) employees who are insurable at standard rates. The Participation Commencement Date is the first day of the Plan year following the completion of 2 years of service but no more than 3 years. After [redacted] and [redacted] were hired in [redacted] the Plan was amended on [redacted] to waive the two year waiting period.

You included a copy of the First Amendment to the Adoption Agreement, dated [redacted]. Section 1 of the Amendment states the Governing Employee Board shall include [redacted] and [redacted]. You provided a second amendment, dated [redacted], which lists [redacted], [redacted] and [redacted] as members of the Board.

The financial information you provided shows you received the following payments from [redacted]
200 [redacted]
200 [redacted]
200 [redacted]

*Includes \$ [redacted] for [redacted] who was not approved for disability or life insurance and thus ineligible to participate in the Plan)

You provided the following information for tax year 200:

<u>NAME</u>	<u>SALARY</u>	<u>BENEFITS</u>	<u>PREMIUMS</u>
[redacted]	\$ [redacted]	\$ [redacted]	\$ [redacted]
[redacted]	\$ [redacted]	\$ [redacted]	\$ [redacted]
[redacted]	\$ [redacted]	\$ [redacted]	\$ [redacted]
[redacted]	\$ [redacted]	[redacted]	* see above reference

The amount of benefits attributable to the [redacted] for [redacted] totals \$ [redacted] or 1% of all benefits. The amount of premiums paid on behalf of the [redacted] for 200 is \$ [redacted] or of the total premiums for all employees.

You provided the following information for tax year 2006:

<u>NAME</u>	<u>SALARY</u>	<u>BENEFITS</u>	<u>PREMIUMS</u>
[redacted]	\$ [redacted]	\$ [redacted]	\$ [redacted]
[redacted]	\$ [redacted]	\$ [redacted]	\$ [redacted]
[redacted]	\$ [redacted]	\$ [redacted]	\$ [redacted]

██████████	\$ ██████████	\$ ██████████	\$ ██████████
██████████	\$ ██████████	\$ ██████████	\$ ██████████

The amount of benefits attributable to the ██████████ totals \$██████████ or ██████████% of all benefits. The amount of premiums paid on behalf of the ██████████ for 2006 is \$██████████ or ██████████% of the total premiums for all employees.

LAW

Section 501(c)(9) of the Code provides for the exemption of voluntary employees' beneficiary associations that provide 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)-1 of the Income Tax Regulations provides that for an organization to be described in section 501(c)(9) an organization must meet all the following requirements:

- (a) the organization must be an association of employees;
- (b) membership in the association must be voluntary;
- (c) the organization's purpose is to provide for the payment of life, sick, accident, or other benefits to its members or their dependents or designated beneficiaries, and substantially all of its operations are in furtherance of providing such benefits, and
- (d) no part of the net earnings of the organization inures, other than by payment of the benefits referred to in (c), to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-2(a)(i) of the regulations states that the determination whether the selection or administration of objective conditions has the effect of providing disproportionate benefits to officers, shareholders, or highly compensated employees generally is to be determined on the basis of all the facts and circumstances.

Section 1.501(c)(9)-2(a)(2)(ii)(F) of the regulations states that, a uniform percentage of compensation is a permissible restriction on the amount of life benefits received by the individual whose life is covered.

Section 1.501(c)(9)-2(c)(1) of the regulations provides, in effect, that a voluntary employee beneficiary association must be an entity, such as a corporation or trust established under applicable local law, having an existence independent of the member-employees or their employer.

Section 1.501(c)(9)-2(c)(3) of the regulations states that in order to be described in section 501(c)(9) an organization must be controlled--

- (i) By its membership
- (ii) By independent trustee(s) (such as a bank), or
- (iii) By trustees or other fiduciaries at least some of whom are designated by, or on behalf of, the membership.

Section 1.501(c)(9)-3(f) of the regulations describes nonqualifying benefits from a VEBA to include: the provision of loans to members, except in times of distress; the provision of savings facilities for members; any benefit that is similar to a pension or annuity payable at the time of mandatory or voluntary retirement

Section 1.501(c)(9)-4(a) of the regulations provides that no part of the net earnings of a VEBA inure to the benefit of any shareholder or individual other than through the payment of permitted types of life, sick, accident, or other benefit. Prohibited inurement will be determined with regard to all of the facts and circumstances.

Section 1.501(c)(9)-4(b) of the regulations states, "For purposes of subsection (a), the payment to any member of disproportionate benefits, where such payment is not pursuant to objective and nondiscriminatory standards, will not be considered a benefit within the meaning of Section 1.501(c)(9)-3." As an example, the payment to highly compensated personnel of benefits that are disproportionate in relation to benefits received by other members of a plan will constitute prohibited inurement.

Section 1.501(a)-1(c) of the Regulations provides that the words "private shareholder" or "individual" in section 501 refers to persons having a private interest in the activities of an organization.

Revenue Ruling 81-94, 1981-1 C.B. 330 holds that the inurement prohibition precludes the tax exemption of an organization operated to promote the private interests of an individual or individuals standing in relation to the organization as an investor for private gain.

Section 414(q) of the Code provides that "highly compensated employee" means any employee who (A) was a 5-percent owner at any time during the year or the preceding years, or (B) for the preceding year, had compensation from the employer in excess of \$80,000, and was in the top-paid group of employees for any preceding year, as the employer elects.

In Lima Surgical Associates, Inc. Voluntary Employees' Beneficiary Plan Trust, Huntington National Bank, Trustee v. United States, 20 Cl. Ct. 674 (1990), aff'd 944 F.2d 885 (Fed. Cir. 1991) the Claims Court held that a VEBA plan, formed and controlled by three surgeons that provided non-qualifying retirement benefits and that limited the authority of the Trustee, did not qualify for exemption under section 501(c)(9) of the Code. The Court held the plan did not meet three of the four mandatory requirements for a qualified VEBA as stated in Regulations 1.509(c)(9)-1 because it is not a "voluntary association of employees because it is not controlled by an independent trustee within the meaning of Regulations 1.501(c)(9)-2(c)(3), it does not provide for the payment of life, sick, accident or other permissible benefits and the Trust

provides disproportionate benefits to its officers, shareholders, and highly compensated in a manner prohibited under Regulations 1.501(c)(9)-4(b) and because the Trust violates the proscription against private inurement by providing disproportionate benefits to its officers, shareholders, and highly compensated employees in a manner prohibited under Regulations 1.501(c)(9)-4(b)."

In Wade L. Moser v. Commissioner, 56 TCM 1604, T.C. Memo, 1989-142 (1989) aff'd as to other issues, 914F.2d 1040, 90-2USTC ¶50,498 (8th Cir. 1990) the IRS disallowed a \$200,000 deduction by the taxpayer to a VEBA Plan. The Tax Court allowed the deduction in full as a section 162 business expense. The tax-exempt status for the VEBA plan was not an issue decided by the Court. The VEBA was subsequently revoked by the IRS.

In Joel A. Schneider, M.D., 63 TCM 1787, T.C. Memo 1992-24 (1992) a doctor was allowed to deduct VEBA contributions in excess of \$1.1 million over three years where 95% of the benefit was for the doctor and his children. The trust applied for tax-exempt status under section 501(c)(9) but was denied, and this was not an issue in the case.

APPLICATION OF LAW

Inurement

Section 501(c)(9), in conjunction with section 501(a), exempts from Federal income tax a voluntary employees' beneficiary association (VEBA) providing for the payment of life, sick, accident, or other benefit to its members or their dependents, or designated beneficiaries, if no part of the net earnings of the association inures (other than through such payments) to the benefit of any private shareholder or individual.

You were organized pursuant to a Trust Agreement executed on [REDACTED]. [REDACTED] signed the Agreement in his capacity as the 100 percent shareholder of the Corporation and as one of the two Trustees. Until his resignation on [REDACTED] he was one of two members of the Governing Employee Board of the Plan. On [REDACTED], [REDACTED] and [REDACTED] resigned as Trustees and [REDACTED], CPA, was appointed the sole Trustee of the Plan. Article VI of the Trust Agreement states [REDACTED] may remove the Trustee at any time.

[REDACTED] is the sole owner of [REDACTED], the company that funds the Plan. He and [REDACTED] received 94 percent and 88 percent of the benefits of the Plan for 2005 and 2006 respectively. They are each insured for \$[REDACTED]. Their applications for life insurance list each other as the beneficiary whereas the Plan is listed as the beneficiary for the remaining employees.

The Plan is subject to a degree of direct control by [REDACTED], the owner-member, since he is the sole owner of the contributing employer, has ultimate control over the Plan by determining the level of contributions and benefits, and reserves the right to appoint, remove and control the activities of trustees. As contributing employer, he also controls the right to terminate the Plan at any time.

During your operation and upon your termination, you provide a dominant share of aggregate benefits to [REDACTED], the highly compensated owner-employee, and his wife. In addition, by reason of having direct control over [REDACTED], [REDACTED] maintains effective control over your operation, administration, and termination. These circumstances indicate that you operate primarily for the benefit of [REDACTED] and [REDACTED], rather than primarily for the benefit of an employee group. You accumulate funds predominantly for the current benefit of [REDACTED] and [REDACTED]. Because you are subject to termination at the discretion of [REDACTED], he is able to direct the distribution of his allocable share of trust assets. In this manner, you function substantially as an investment fund for the direct and private benefit of [REDACTED] and [REDACTED].

The accumulation of investment funds for the private benefit of [REDACTED] and [REDACTED] does not fall within the ambit of permissible benefits as described in section 1.501(c)(9)-3(d) of the regulations. Under these circumstances, notwithstanding that current benefits are subject to a restriction that is generally permissible under section 1.501(c)(9)-2(a)(2)(ii)(F) of the regulations, you are organized and operated to promote the private interests of [REDACTED] and [REDACTED].

The holding of Rev. Rul. 81-94 is applicable to your Plan in that the Plan promotes the private interests of the [REDACTED] by providing a large percentage of benefits to them and by not using the services of an independent Trustee to oversee the Plan and its investment. This inurement precludes the Plan from qualifying for exemption under section 501(c)(9).

Your Plan is similar to the Plan discussed in Lima Surgical Associates, Inc. VEBA in that your Trust covers a small number of employees and provides a dominant share of the aggregate benefits to the [REDACTED].

Other Impermissible Benefits

Universal life insurance policies are not eligible for inclusion in a 501(c)(9). Since the policies have provisions for period payments to the insured as a settlement option, it is not an eligible benefit based on section 1.509(c)(9)-3(f) of the regulations. Also, the life insurance policies allow loans, which are impermissible benefits under section 501(c)(9).

Independent Trustee

Section 1.501(c)(9)-2(c)(3) of the regulations states that in order to be described in section 501(c)(9) an organization must be controlled by its membership, or independent trustee(s) (such as a bank), or by trustees or other fiduciaries at least some of whom are designated by, or on behalf of, the membership.

Although the [REDACTED] resigned as Trustees on [REDACTED], three years after the adoption of the Plan, they appointed [REDACTED], CPA, their personal and business accountant to act as a temporary "independent" Trustee. Although [REDACTED] has resigned as Trustee he is still able to exert significant control over the operation of the Plan because he controls the company that provides the funding for the Plan and he has authority to remove the Trustee at any time. He indirectly exhibits control over the Trustee in that he uses the Trustee as the accountant for [REDACTED], the company he owns as well as for his own personal accounting

and income tax services. [REDACTED] cannot be described as an "independent" trustee as he wears many hats for the [REDACTED].

You attempted to secure the services of a bank to act as permanent Trustee. You gave assurances that negotiations were underway to have [REDACTED] to act as Trustee for the Plan. Upon our request for a copy of the written agreement you stated that you could not reach an agreement with the Bank but that a verbal agreement had been reached with [REDACTED]. Upon our request for a copy of a written agreement you provided a copy of an e-mail from a representative of [REDACTED] that they are willing to act as a Trustee as long as the Plan has secured tax-exempt status from the IRS. The Plan has been in existence since [REDACTED] and it still has not secured the services of an independent Trustee. This allows the [REDACTED] to maintain too much control over the assets of the Plan.

APPLICANT'S POSITION

You state the Courts have not generally upheld the Internal Revenue Service's position with regard to VEBAs, as to private inurement, impermissible control by owner, and failure to observe non-discriminatory rules and prepaid expenses. You cite Wade L. Moser vs. Commissioner which ruled that a \$200,000 deduction claimed by the taxpayer to a VEBA plan to pre-fund a severance benefit, was deductible as a section 162 business expense. The Court rejected the IRS assertion that the plan was nothing more than a private investment fund created and operated for the benefit of the principal shareholders. You note that over 90 percent of the insurance premiums and the cost of funding the severance benefit were for benefits attributable to the principal shareholders. From the Court ruling you quote ... Thus, we hold that the fact that the plan benefits are skewed in favor of the [REDACTED] is not a determinative factor in deciding the issue of deductibility of Inland's VEBA contribution."

As to the issue of control you quote, in part, "Although [REDACTED] as the committee, had significant input into the management of the VEBA's assets, the independent trustee was the actual titleholder of those assets, and it retained possession and exerted day-to-day control over the assets."

You cite Joel A. Schneider, M.D. as another Tax Court Memo which followed Moser in holding that an employer does not necessarily retain too much control when it retains the right to alter or terminate a plan as long as the funds in the plan never revert to or inure to the benefit of the employer. In this case the plan benefits attributed to one participant were in excess of 95% of the aggregate benefits.

You conclude that the Tax Court rejected in both cases the difference in cost of benefits as a basis for denial of tax benefit and that the Trustee is now independent and is expected to shortly be replaced by an independent contractor.

You distinguish the findings in Lima from your case on several grounds including a finding that it was created to replace a terminated retirement plan and that the corporation retained too much control over the VEBA. You state in Lima the court approved the uniform percentage of the

compensation method which is the same basis used to determine benefits in the Meter Management VEBA.

SERVICE RESPONSE TO APPLICANT'S POSITION

In Moser the Court began their opinion by stating the question of whether the VEBA plan qualified for exemption under section 501(c)(9) was not an issue in their ruling. However, the Plan was subsequently revoked by the IRS. The Court was asked to rule on whether the funding corporation to the Plan was entitled to a \$200,000 business deduction under section 162 as an ordinary and necessary business expense. The IRS disallowed the deduction, in part, because 90 percent of the deduction was attributable to one individual. Of note is the fact that the Trustee of the VEBA Plan was an independent trust company. The Court determined the contribution was a section 162 business deduction and that there wasn't a statutory or regulatory provision prohibiting a deduction to an employee benefit plan because a large portion of the benefits were attributable to one employee. The Court made its ruling, in part, because an independent Trustee exerted day-to-day control over the assets.

In Schneider the issue was also the deductibility of contributions to a VEBA plan by a corporation as a section 162 business expense. The Service had already denied the application for tax-exempt status for the VEBA Plan that received the contributions that were being challenged. In Schneider, an independent bank served as trustee which gave the Court the assurance that the employer did not retain too much control over the Plan. Also, Schneider was decided prior to the section 419 and 419A of the Code which, in effect, allowed deductions only for the costs of current benefit plus and actuarially determined allowance for certain reserves and benefits accounts. The Schneider case has no relevance to qualification for exemption under section 501(c)(9) and little relevance to current issues of deductibility.

In Lima, the only court case cited where the primary issue was whether a Trust qualified for tax-exempt status under section 501(c)(9), the Court held the plan did not qualify for exemption as it did not meet three of the four mandatory requirements listed in Regulations 1.501(c)(9)-1. The Court held the Trust was not a voluntary association of employees because it was not controlled by an independent trustee; it did not provide for the payment of life, sick, accident, or other benefits; and the Trust violated the proscriptions against private inurement because it provides disproportionate benefits to its officers, shareholders, and highly compensated employees in a way prohibited under Regulations 1.501(c)(9)-4(b). Your Plan can be compared to Lima in that you do not have an independent trustee and you are providing disproportionate benefits to the [REDACTED]. These two factors together form the basis for our opinion that you do not qualify for exemption under section 501(c)(9).

Throughout the process of reviewing your request for tax-exempt status under section 501(c)(9) you have promised that you will obtain the services of an independent trustee on a number of occasions. In response to our questioning [REDACTED] as a Trustee to the Plan he resigned in [REDACTED]. He was temporarily replaced by [REDACTED] CPA, who you claim is an "independent" trustee even though he is the accountant for [REDACTED] and the personal accountant in income tax preparer for the [REDACTED]. You are now in negotiations with [REDACTED] who require you to have tax-exempt status before they will agree to act as the

Trustee. It is now three years after the plan was adopted and you still do not have an independent trustee.

CONCLUSION

The Trust is organized and operated in a way that violates the inurement proscriptions of Section 1.501(c)(9)-4 of the Income Tax Regulations. The Trust was established for the personal and private benefit of [REDACTED] and [REDACTED] and initially for [REDACTED], the father of [REDACTED]. The lack of an independent trustee in combination with the allocation of a dominant share of aggregate benefits to the [REDACTED] indicates that the Trust is organized and operated for their benefit and not for any employee group. Therefore the net earnings of the Trust improperly inure to the benefit of the [REDACTED].

The universal life policies in the plan are not eligible for inclusion in a 501(c)(9) because they allow for periodic payments and loans.

The Trust is not controlled by an independent trustee as required in Section 1.501(c)(9)-2(c)(3) of the Income Tax Regulations.

Therefore, the Trust does not qualify for tax-exempt status under section 501(c)(9) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street
Room 7-008
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert Choi". The signature is written in a cursive style with a large, prominent "C" at the end.

Robert Choi
Director, Exempt Organizations
Rulings & Agreements