



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

201022028

MAR 11 2010

Uniform Issue List: 419.00-00; 419.12-02; 419A.00-00

T: EP: RA: T2

Legend:

Company = ***

Trust = ***

Trust Holdcos = ***

OldCo = ***

Union = ***

Membership Interest = ***

Settlement Agreement 1 = ***

Settlement Agreement 2 = ***

Operating Agreement = ***

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Entity 1 = ***

Entity 2 = ***

Entity 3 = ***

Date 1 = ***

Date 2 = ***

Date 3 = ***

Date 4 = ***

Date 5 = ***

Date 6 = ***

Date 7 = ***

Date 8 = ***

Amount A = ***

Amount B = ***

Amount C = ***

Amount D = ***

Amount E = ***

Amount F = ***

Amount G = ***

Amount H = ***

Amount J = ***

Amount K = ***

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Dear * * * :

This letter is in response to your ruling request dated Date 1 concerning Trust and certain contributions thereto. Specifically, you requested a ruling with respect to whether Trust is maintained pursuant to a collective bargaining agreement within the meaning of section 419A(f)(5)(A) of the Internal Revenue Code (Code), and rulings with respect to contributions of Membership Interests and a Note to Trust.¹

Company, along with its subsidiaries, manufactures, assembles, and sells goods both in the United States and throughout the world. Company is a * * * limited liability company. Company is treated as a partnership for U.S. tax purposes. The initial members of Company were Entity 1, Entity 2, and Entity 3 (Initial Members).

According to your ruling request, OldCo previously agreed to provide certain medical benefits to its retirees for their lifetime as negotiated in various agreements with Union. The last of these agreements (Settlement Agreement 1) requires establishment of Trust to fund retiree medical benefits for certain bargaining unit employees and required OldCo to make certain deposits and remittances to Trust for the provision of retiree medical benefits. Trust is intended to qualify as a tax-exempt voluntary employees' beneficiary association (VEBA) under section 501(c)(9), and Trust has applied for a favorable determination letter from the Internal Revenue Service.

On Date 2, OldCo and several of its subsidiaries filed petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code (the Bankruptcy Proceeding). Pursuant to Bankruptcy Court approval granted on Date 3, Company purchased various assets from OldCo in the Bankruptcy Proceeding free and clear of claims from OldCo's creditors (the Sale).

During the Bankruptcy Proceeding, Company and Union disputed whether Company, as successor to OldCo, was responsible for providing the retiree medical benefits contemplated in Settlement Agreement 1. As a result of negotiations relating to the dispute and under the supervision of the Bankruptcy Court, Company and Union entered into a new settlement agreement (Settlement Agreement 2).

Under the terms of Settlement Agreement 2, Company agreed to (1) contribute Membership Interests to Trust, representing Amount A of the fully diluted ownership of Company as of the consummation of the sale, and (2) to contribute a new, senior, unsecured, negotiable note, due Date 4 and issued by Company with a principal amount of Amount B and an implied interest rate of Amount C

¹ You have also requested from the Department of Labor an exemption from certain prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974 (ERISA).

(the Note) payable in Amount D fixed annual installments on Date 5 of each year commencing Date 6, with each installment consisting of interest and amortized principal.

You represent that Union entered into Settlement Agreement 2 on its own behalf and as the authorized representative, as defined in section 1114(c)(1) of the U.S. Bankruptcy Code, of those persons receiving retiree benefits as defined in section 1114(a) of the U.S. Bankruptcy Code.

You represent that Settlement Agreement 2 resulted from arm's-length negotiation between Company and Union and represents part of a good faith bargained-for-exchange between Company and Union. You represent that Company viewed a skilled workforce as essential to its future operations, and as a consequence during the Bankruptcy Proceeding engaged in negotiations with Union representatives. Company believes that Union leadership would not have recommended that its members ratify the amended collective bargaining agreements unless Company agreed to fund Trust as set forth above. You represent that the consideration provided to Company by Union in exchange for Company's agreement to take over obligations under Trust constitutes unprecedented modifications to the agreement between Company and Union, including an Amount E-year no-strike clause.

On Date 7, Company and Trust entered into the Equity Subscription Agreement, under which Company was to issue and deliver to Trust Amount F Membership Interests, representing interests in the capital and profits of Company.

The Trust Holdcos were formed to hold Membership Interests to be delivered to Trust. Each of the Trust Holdcos made an election to be treated as an association taxable as a corporation for Federal income tax purposes. The Trust Holdcos were formed by Trust specifically for the purpose of holding Trust's Membership Interests and do not engage in any other business or activity other than activities related to holding Trust Membership Interests.

On Date 8, Company and Trust entered into an agreement under which Trust transferred and assigned its right to take delivery of the Membership Interests to the Trust Holdcos. Under the agreement, the delivery by Company of the Membership Interests to the Trust Holdcos was in satisfaction of Trust's right to acquire the Membership Interests under the Equity Subscription Agreement.

Also on Date 8, Company issued to Trust Amount F Membership Interests and delivered the Membership Interests to the Trust Holdcos. Hereinafter, the issuance of Membership Interests to Trust, and Trust's transfer and assignment to the Trust Holdcos are collectively referred to as the "Delivery Transaction".

The capital accounts of Entity 1, Entity 2, and Entity 3 were reduced by the aggregate amount of the Trust Holdcos' capital accounts resulting from owning the Amount F Membership Interests.

Ownership of Company consisted of Amount G Class A Membership Interests and Amount H Class B Membership Interests. Class A and Class B Membership Interests are generally identical except that the rights associated with Class B Membership Interests will increase upon the achievement of certain performance milestones. With respect to the Class A Membership Interests, Entity 1 owns Amount J, Entity 2 owns Amount K, and Trust, through the Trust Holdcos, owns Amount F. Entity 3 owns all of the Class B Membership Interests.

Operating Agreement provides that in the event of a liquidation proceeding, after payment or provision for payment of all of Company's liabilities had been made, and after all allocations have been made, all remaining assets of Company shall be distributed to the members in accordance with their positive capital account balances.

You represent that no amount contributed to date to Trust exceeded the unfunded present value of benefits to be provided through Trust, determined as of the date of the contribution. For the purposes of this representation, (1) the unfunded present value of benefits to be provided through Trust as of a date is equal to the present value of benefits to be provided through Trust as of that date less the fair market value of the assets held by Trust as of that date, and (2) the Note will not be treated as an asset held by Trust for purposes of calculating the unfunded present value of the benefits to be provided through Trust and instead any future cash payments Trust receives in respect of the Note will be treated as amounts contributed to Trust. No deduction will be taken for any future contribution to Trust to the extent that, as of the date of the future contribution, the amount of the contribution exceeds the unfunded present value of benefits to be provided through Trust.

Company requests the following rulings:

1. Trust is maintained pursuant to a collective bargaining agreement for purposes of section 419A(f)(5) of the Code.
2. The issuance of Membership Interests to Trust was a contribution to a welfare benefit fund for purposes of sections 419 and 419A of the Code in an amount equal to the value of the Membership Interests and, subject to any capitalization requirement generally applicable to such contributions under section 263A of the Code or otherwise, is deductible by Company pursuant to sections 419 and 419A of the Code for the taxable year in which such Membership Interests were issued.

3. The payments of the annual installments on the Note to the Trust are contributions to a welfare benefit fund for purposes of sections 419 and 419A of the Code, and, subject to any capitalization requirement generally applicable to such contributions under section 263A of the Code or otherwise, will be deductible by Company pursuant to sections 419 and 419A of the Code for the taxable year in which such payments are made to Trust.

LAW AND ANALYSIS

Section 162(a) of the Code provides for a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Section 1.162-10(a) of the Treasury Regulations (Regulations) provides in part that amounts paid or accrued within the taxable year for a sickness, accident, hospitalization, medical expense, welfare, or similar benefit plan, are deductible under 162(a) of the Code if they are ordinary and necessary expenses of the trade or business. However, section 1.162-10T, Q&A-2 of the Regulations provides that section 419 of the Code governs the deduction of contributions paid or accrued by an employer with respect to a "welfare benefit fund" within the meaning of section 419(e) of the Code.

Section 419(a) of the Code provides that contributions paid or accrued by an employer to a welfare benefit fund are not deductible under Chapter 1 of the Code, but if they would otherwise be deductible shall (subject to the limitation in section 419(b)) be deductible under section 419 of the Code for the taxable year when paid.

Section 419(b) of the Code provides that the amount of any deduction under section 419(a)(2) of the Code for any taxable year shall not exceed the welfare benefit fund's qualified cost for the taxable year, which is generally defined in section 419(c)(1) of the Code to be the sum of the "qualified direct cost" for the taxable year as well as any additions to a "qualified asset account" for the taxable year.

Section 419(c)(3)(A) of the Code provides that the term "qualified direct cost" means, with respect to any taxable year, the aggregate amount (including administrative expenses) that would have been allowable as a deduction by the employer with respect to benefits provided during the taxable year if such benefits were provided directly by the employer, and the employer used the cash receipts and disbursements method of accounting.

Section 419(e)(1) of the Code provides that, for purposes of section 419 of the Code, the term "welfare benefit fund" means any fund which is part of a plan of an employer, and through which the employer provides welfare benefits to employees or their beneficiaries.

Section 419(e)(2) of the Code provides that, for purposes of section 419 of the Code, the term "welfare benefit" means any benefit other than a benefit with respect to which section 83(h) of the Code applies, section 404 of the Code applies (determined without regard to section 404(b)(2)), or section 404A of the Code applies.

Section 419(e)(3) of the Code provides that for purposes of section 419 of the Code, the term "fund" includes any organization described in paragraph (7), (9), (17), or (20) of section 501(c) of the Code.

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

Section 419A(b) of the Code provides that no addition to any qualified asset account may be taken into account under section 419(c)(1)(B) of the Code to the extent such addition results in an amount exceeding the account limit. Under section 419A(c)(1) of the Code, except as otherwise provided in section 419A(c) of the Code, the account limit for any qualified asset account for any taxable years is the amount reasonably and actuarially necessary to fund the claims incurred but unpaid (as of the close of such taxable year) for disability benefits, medical benefits, SUB or severance benefits, or life insurance benefits, and administrative costs with respect to such claims. Under section 419A(c)(2)(A) of the Code, the account limit for a taxable year may include a reserve funded over the working lives of the covered employees and actuarially determined on a level basis (using assumptions that are reasonable in the aggregate) as necessary for post-retirement medical benefits to be provided to covered employees (determined on the basis of current medical costs).

Section 419A(f)(5)(A) of the Code provides that no account limits shall apply in the case of a qualified asset account under a separate welfare benefit fund under a collective bargaining agreement.

Section 7701(a)(46) of the Code provides that in determining whether there is a collective bargaining agreement between employee representatives and one or more employers, the term "employee representatives" shall not include any organization more than one-half of the members of which are employees who are owners, officers, or executives of the employer. An agreement shall not be treated as a collective bargaining agreement unless it is a bona fide agreement between bona fide employee representatives and one or more employers.

Section 1.419-1T, Q&A-10(a) of the Regulations states in part that contributions paid or accrued with respect to a welfare benefit fund are deductible only to the

extent that the contributions satisfy the requirements of section 162 or 212 of the Code.²

Section 1.419-1T, Q&A-10(d) of the Regulations provides that in determining the extent to which contributions paid or accrued with respect to a welfare benefit fund are deductible under section 419 of the Code, the rules of sections 263, 446(b), and 461(a) of the Code will be treated as having been satisfied to the extent the contributions satisfy the otherwise applicable rules of section 419 of the Code. Thus, for example, contributions to a welfare benefit fund will not fail to be deductible under section 419 of the Code merely because they create an asset with a useful life extending substantially beyond the close of the taxable year if such contributions satisfy the otherwise applicable requirements of section 419 of the Code.

Section 1.419A-2T, Q&A-1, of 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 sections 419(b), 419A(b), or 512(a)(3)(E) of the Code until the earlier of: (i) The date on which the last of the collective bargaining agreements relating to the fund in effect on, or ratified on or before, the date of issuance of final regulations concerning such limits for collectively bargained welfare benefit funds terminates (determined without regard to any extension thereof agreed to after the date of issuance of such final regulations), or (ii) the date 3 years after the issuance of such final regulations.

Section 1.419A-2T, Q&A-2, of the Regulations defines a welfare benefit fund pursuant to a collective bargaining agreement and states:

- (1) For purposes of Q&A-1, a collectively bargained welfare fund is a welfare benefit fund that is maintained pursuant to an agreement which the Secretary of Labor determines to be a collective bargaining agreement and which meets the requirements of the Secretary of Treasury as set forth in paragraph (2) below.
- (2) Notwithstanding a determination by the Secretary of Labor that an agreement is a collective bargaining agreement, a welfare benefit fund is considered to be maintained pursuant to a collective bargaining agreement only if the benefits provided through the fund were the subject of arms-length negotiations between employee representatives and one or more employers, and if such agreement between employee representatives and one or more employers satisfies section 7701(a)(46) of the Code. Moreover, the circumstances surrounding a collective bargaining agreement must evidence good faith bargaining between adverse parties over the welfare benefits to be provided through the fund. Finally, a welfare benefit fund is not considered to be maintained pursuant

² The Regulations refer to deductibility under sections 162 and 212 of the Code (rather than "otherwise" deductibility) because they were published before technical corrections of section 419(a) of the Code were enacted.

- 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.
- (3) In the case of a collectively bargained welfare benefit fund, only the portion of the fund (as determined under allocation rules to be provided by the Commissioner) attributable to employees covered by a collective bargaining agreement, and from which benefits for such employees are provided, is considered to be maintained pursuant to a collective bargaining agreement.
 - (4) Notwithstanding the preceding paragraphs and pending the issuance of regulations setting account limits for collectively bargained welfare benefit funds, a welfare benefit fund will not be treated as a collectively bargained welfare benefit fund for purposes of Q&A-1 if and when, after July , 19 , 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 such regulations, for purposes of applying the 50 percent test of paragraph (2) to a welfare benefit fund that is not in existence on July , 19 , "90 percent" shall be substituted for "50 percent".

Section 1.721-1(b)(1) of the Regulations provides in part that to the extent that any of the partners gives up any part of his right to be repaid his contributions (as distinguished from a share in partnership profits) in favor of another partner as compensation for services (or in satisfaction of an obligation), section 721 of the Code does not apply. The value of an interest in such partnership capital so transferred to a partner as compensation for services constitutes income to the partner under section 61 of the Code. The amount of the income is the fair market value of the interest in the capital so transferred.

Section 1114 of the U.S. Bankruptcy Code provides for an arms-length process through which a court-appointed employee representative may collectively bargain with respect to a Chapter 11 debtor's obligations to provide benefits to all of its retired employees.

It is assumed that Trust has received or will receive a favorable determination letter from the Service with respect to its tax-exempt status under section 501(c)(9) of the Code. Also, for purposes of this ruling, it is assumed that the Secretary of Labor has determined, or would determine, that Trust is maintained pursuant to a collective bargaining agreement.

The information furnished indicates that Union qualifies as an authorized employee representative under section 1114(c)(1) of the U.S. Bankruptcy Code of those persons receiving retiree benefits, as defined in section 1114(a) of the U.S. Bankruptcy Code, and that the negotiations and the compromises reached between Company and Union were carried out in an arm's-length fashion under

the supervision of the bankruptcy court. Moreover, the information furnished indicates that there was good faith bargaining between adverse parties over the welfare benefits.

All of the bargaining units negotiating with respect to Trust fall within the scope of Settlement Agreement 2 between Company and its employees. Because percent of the employees eligible to receive benefits under Trust are covered by the collective bargaining agreement, the 90 percent requirement of section 1.419A-2T, Q&A-2, of the Regulations is satisfied.

Accordingly, we conclude that Trust is maintained pursuant to a collective bargaining agreement within the meaning of section 419A(f)(5)(A) of the Code.

With respect to the Delivery Transaction, under section 419(a) of the Code contributions paid by an employer to a welfare benefit fund are deductible under section 419 of the Code (subject to the limitation of section 419(b)) for the taxable year in which paid, if they would otherwise be deductible. Section 1.419-1T, Q&A-10(d) of the Regulations provides that in determining the extent to which contributions paid or accrued with respect to a welfare benefit fund are deductible under section 419 of the Code, the rules of section 263 of the Code are treated as having been satisfied to the extent the contributions satisfy the otherwise applicable rules of section 419 of the Code. You represent that no amount contributed to date to Trust exceeded the unfunded present value of the benefits to be provided through Trust determined as of the date of the contribution. Accordingly, the contributions to Trust satisfy the otherwise applicable requirements for deductibility under section 162 of the Code and section 1.162-10T of the Regulations. Moreover, contributions to Trust satisfy the requirements for deductibility under section 419 of the Code, including the limitation in section 419(b), as they do not exceed Trust's qualified cost as defined in section 419(c) of the Code. They do not exceed the qualified cost, because pursuant to section 1.419A-2T, Q&A-1, of the Regulations, contributions to a collectively bargained welfare benefit fund are not treated as exceeding the otherwise applicable limits of sections 419 and 419A of the Code. Therefore, the capitalization requirements of section 263 of the Code do not apply to Company's contribution to Trust of the Membership Interests.

We conclude that, subject to any capitalization requirement generally applicable to such contributions under section 263A of the Code or otherwise, the issuance of the Membership Interests to Trust was a contribution to Trust, and Company is entitled to a deduction in accordance with sections 419 and 419A of the Code for that contribution, in the taxable year in which the Delivery Transaction occurred. That deduction, however, can in no event be for more than an amount that, as of the date of the Delivery Transaction, equals the unfunded present value of benefits to be provided through Trust.

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With respect to deductibility of payments to Trust of annual installments on the Note, the Note itself is only a promise to pay and does not represent the paying out or reduction of Company's assets. Consequently, the note is not a contribution "paid" to Trust within the meaning of section 419(a) of the Code. See, Don E. Williams Co. v. Comm'r, 429 U.S. 569 (1977) (delivery of a promissory demand note to a qualified profit-sharing plan was not a contribution "paid" to the plan within the meaning of section 404(a) of the Code). As each annual installment payment on the Note is made, it is a contribution "paid" to Trust for purposes of section 419(a) of the Code. Accordingly, each annual installment on the Note paid to Trust is a contribution to Trust. Each such contribution is deductible by Company, subject to any capitalization requirement generally applicable to such contributions under section 263A of the Code or otherwise, pursuant to sections 419 and 419A of the Code for the taxable year in which the installment payment is made to Trust, and only to the extent that, as of the date of the contribution, the amount of the contribution does not exceed the unfunded present value of benefits to be provided through Trust.

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Internal Revenue Code or of Title I of ERISA. Specifically, no opinion is expressed regarding any of the following: (1) whether part or all of the contributions to Trust must be capitalized under section 263A of the Code; (2) the amount of the contribution and the corresponding deduction with respect to the Membership Interests contributed to Trust and transferred and assigned to the Trust Holdcos; and (3) whether any income realization event results to Company and the Initial Members from the contribution of the Membership Interests to Trust. Moreover, if Trust is amended or if the representations made pursuant to this request are not accurate, these rulings may not remain in effect.

Pursuant to a power of attorney on file with this office, a copy of this letter ruling is being sent to your authorized representative.

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

If you have any questions about this ruling, please contact *** (ID
 ***) at *** . Please address all correspondence to
 SE:T:EP:RA:T2.

Sincerely yours,

for 

Donzell H. Littlejohn, Manager,
 Employee Plans Technical Group 2

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Enclosures:

Deleted copy of ruling letter
Notice of Intention to Disclose

cc. ***
