TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Number: **201024068**
Release Date: 6/18/2010

Date: March 26, 2010

Contact Person:

Identification Number:

Telephone Number:
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Employer Identification Number:

UIL: 416.07-01. 501.09-00, 512.01-00

Legend:

M =
N =
VEBA =

Dear :

We have considered your request dated November 1, 2006, for a ruling concerning the federal income and excise tax consequences of a proposed transfer of assets from one account to another within a voluntary employees' beneficiary association (VEBA).

Facts:

You are an independent labor union, recognized as tax-exempt under section 501(c)(5) of the Internal Revenue Code (Code), that sponsors a voluntary employees' beneficiary association trust recognized as tax-exempt under section 501(c)(9) of the Code. You state that you have been exempt from income tax throughout the preceding five years and that you have made substantially all of the contributions to the VEBA. Your sole source of income is dues from union members. M, the employer of the union members has no relationship to the VEBA, and, therefore has never taken a tax deduction or contributed to the VEBA. An uncompensated board of directors consisting of your members, but not your employees, governs the VEBA.

Currently, the VEBA holds, in separate accounts, the assets of four self-insured welfare benefit plans. Three of the plans are contributory plans covering members and employees. The fourth plan is a non-contributory plan, N, that provides catastrophic major medical benefits to VEBA members. You also maintain, outside the VEBA, a self-insured group health plan that is governed by a collective bargaining agreement between you and your employees. You represent that all of the plans, including the health plan, provide benefits based on criteria that do not provide for disproportionate benefits to officers, shareholders or highly compensated employees. Your board of directors proposes to transfer excess assets from N to an account

within the VEBA to provide a reserve for retiree health benefits for union employees that participate in your separate group health plan.

A few years ago, you negotiated improvements to the members' employer-provided health benefit plan. To encourage members to sign up for the improved plan, you amended the health plan that you offer through the VEBA by eliminating some benefits and raising the deductibles, which substantially reduced the amount of reserves necessary for the plan. Afterward, the actuary certified an annual valuation of N's assets that reported excess funds projected to increase through the next four years. You decided to establish a new account in the VEBA and transfer N's excess funds to the new account to provide additional security for employees whose post-retirement health benefits would otherwise depend upon your available cash flow. Although the VEBA will hold the assets in the reserve, you will use the reserve to provide benefits offered by your existing employee health plan outside the VEBA.

You operate in accordance with your constitution and bylaws that vest ultimate decision-making power regarding union affairs in a group of union members (national officers) who are not employed by the union. You have between 40 and 45 employees. Of those employees, the highest ranking is the executive administrator. Article VIII of your bylaws provides that the executive administrator shall:

1. Supervise all departments consistent with the Union Employee Handbook and the agreement between the union and the union staff employees association.
2. Present a report at all regularly scheduled board meetings concerning the operations of the union departments that are subject to the administrator's direction and supervision.
3. Ensure that all laws, provisions of the union constitution and bylaws, and the resolutions of the board are faithfully executed as delegated by the board.
4. Operate the union within the budget as prepared by the secretary-treasurer and approved by the board.
5. Conduct regular staff meetings for the purpose of coordinating the efforts of the union.
6. Provide any other reports the board may require.
7. Have the ability to hire and fire employees from the director level on down, with concurrence of the president of the union. In the event of a disagreement between the president and the executive administrator regarding the termination of an employee, the case will be decided by a majority vote of the board on a one man, one vote basis.

You provided job descriptions for each type of employee:

The director of representation provides legal counsel to the national officers, board of directors, and all union committees involving policy and institutional matters, grievance, arbitration, and negotiating strategy, contractual issues, internal and external administration of the collective bargaining agreement, and other legal matters involving the union or individual union members.

The director of industry analysis provides economic and business analysis of M and competitors' current and historical operational performance and examines industry trends, competitive positions, and competing business models. The director also provides economic and contractual impact analysis of the components of the union/M contract as well as competitors' collective bargaining agreements.

The director of finance oversees financial strategy and planning, monitors and reports results, advises the national officers and the board of directors with respect to financial reporting, financial stability, liquidity and financial growth, including representation of financial information at all regular board of director meetings and reviews financial results with the national officers on a regular monthly basis.

The director of benefits identifies, analyzes and resolves with appropriate parties any non-negotiated benefits or policy changes made by M for compliance with M/union contract provisions and applicable benefits laws and regulations. The director also identifies, analyzes, recommends and participates in negotiations of benefit issues on behalf of the union with M primarily during contract negotiations.

You, the union, compensate the executive administrator, director of representation, director of industry analysis, director of finance, and the director of benefits at levels that exceed the threshold for classification as a "key employee" under section 416(i) of the Code.

Except as noted below for the director of finance, no union employee has actual, exercised, or implied authority to bind the union to any agreement with third parties, or to sign checks or authorize disbursement of funds on behalf of the union without prior approval of one or more national officers. With regard to authorization for the disbursement of funds, one national officer must approve projects for amounts exceeding $2,000 and two national officers must sign projects exceeding $5,000. With regard to the VEBA, all disbursements from the VEBA require approval from the director of benefits (or alternatively the director of finance) and a national officer. Finally, no union employee has the independent ability to hire or fire any other union employee without the national officer or board of directors' approval.

You requested the following rulings:

1. The proposed transfer of the excess assets to a separate account under the VEBA trust will not adversely affect the VEBA's tax exempt status,
2. The VEBA will not have to report unrelated business taxable income (UBTI) under section 511 and 512 of the Code for amounts that are set-aside (including contributions and earnings) in the reserve in excess of the deduction limitations, for taxable entities, described in sections 419 and 419A, and
3. That particular employees will not be considered "officers" and therefore not "key employees" within the meaning of section 416(i) of the Code.

Law:

Section 414(q)(5) of the Internal Revenue Code (Code) provides that for purposes of subsection (r) and for purposes of determining the number of employees in the top-paid group, the following employees shall be excluded –

A. Employees who have not completed 6 months of service,
B. Employees who normally work less than 17 1/2 hours per week,
C. Employees who normally work during not more than 6 months during the year,

D. Employees who have not attained age 21, and
E. Except to the extent provided in the regulations, employees who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and the employer.

Except as provided by the Secretary, the employer may elect to apply subparagraph A, B,C, or D by substituting a shorter period of service, smaller number of hours, or months, or lower age for the period of service, number of hours or months, or age (as the case may be) than that specified in such paragraph.

Section 416(i)(1)(A) of the Code provides that the term "key employee" means an employee who, at any time during the plan year, is:

(i). An officer of the employer having an annual compensation greater than $130,000,
(ii). A five-percent owner of the employer, or
(iii).A one-percent owner of the employer having an annual compensation from the employer of more than $150,000.

For purposes of clause (i), no more than 50 employees (or, if lesser, the greater of 3 or 10 percent of the employees) shall be treated as officers. In the case of plan years beginning after December 31, 2002, the $130,000 amount in clause (i) shall be adjusted at the same time and in the same amount as under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2001, and any increase under that sentence which is not a multiple of $5,000 shall be rounded to the next lower multiple of $5,000. Such term shall not include any officer or employee of an entity referred to in section 414(d) (relating to governmental plans). For purposes of determining the number of officers taken into account under clause (i), employees described in section 414(q)(5) shall be excluded.

Section 501(c)(9) of the Code provides exemption from federal tax for voluntary employee 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 and certain other requirements are satisfied.

Sections 511(a)(1) and (2) of the Code imposes a tax for each taxable year on the unrelated business taxable income (as defined in section 512) of every organization described in sections 401(a) and 501(c).

Section 512(a)(3) of the Code states that for an organization described in section 501(c)(9), the term unrelated business taxable income means the gross income (excluding any exempt function income) less the deductions allowed which are directly connected with the production of the gross income (excluding exempt function income), computed with the modifications provided in paragraphs (6), (10), (11), and (12) of subsection (b).

Section 512(a)(3)(B)(ii) of the Code states that the term "exempt function income" means all income which is set aside, in the case of an organization described in section 501(c)(9), for the payment of life, sick, accident, or other benefits.

Section 512(a)(3)(E)(i) of the Code states that in the case of any organization described in section 501(c)(9), a set-aside for any purpose specified in clause (ii) of subparagraph (B) may be taken into account under subparagraph (B) 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 (without regard to subsection (f)(6) thereof) for the taxable year (not taking into account any reserve described in 419A(c)(2)(A) for post-retirement medical benefits).

Section 512(a)(3)(E)(iii) of the Code states that this subsection shall not apply to any organization if substantially all the contributions to such organization are made by employers who were exempt from tax under this chapter throughout the 5-taxable year period ending with the taxable year in which the contributions are made.

Section 1.416-1, Q&A T-13 of the Income Tax Regulations (regulations) states that whether an individual is an officer shall be determined upon the basis of all the facts, including, for example, the source of his authority, the term for which elected or appointed, and the nature or extent of his or her duties. Generally, the term officer means an administrative executive who is in regular and continued service. The term officer implies continuity of service and excludes those employed for a special transaction. An employee who merely has the title of officer but not the authority of an officer is not considered an officer for purposes of the key employee test. Similarly, an employee who does not have the title of an officer but has the authority of an officer is an officer for purpose of the key employee test. In the case of one or more employers treated as a single employer under sections 414(b), (c), or (m), whether or not an individual is an officer shall be determined based upon his or her responsibilities with respect to the employer or employers for which he or she is directly employed, and not with respect to the controlled group of corporations, employers under common control or affiliated service group. A partner or partnership will not be treated as an officer for purposes of the key employee test merely because he or she owns a capital or profit interest in the partnership, exercises his or her voting rights as a partner, and may, for limited purposes, be authorized and does in fact act as an agent of the partnership.

Section 1.416-1, Q&A T-15 of the regulations states that for purposes of the top-heavy rules, sole proprietorships, partnerships, associations, trusts, and labor organizations may have officers. The rule is effective for purposes of determining whether a plan is top-heavy for plan years that begin after February 28, 1985.

Section 1.501(c)(9)-2(a) of the regulations states that employees of a labor union also will be considered to share an employment-related common bond with members of the union.

Analysis:

You propose to create a reserve by transferring excess assets from the catastrophic medical benefit account for union members to a separate account to create a reserve for post-retirement medical benefits for union employees. Union members who participated in the catastrophic medical plan will now receive their benefits from the more favorable employer-provided health benefit plan. Since union employees share an employment-related common

bond with union members under section 1.501(c)(9)-2(a) of the regulations, the use of the excess funds to pay their post-retirement benefits is a permissible payment for the VEBA. The information you provided shows that the VEBA will continue to use the excess funds for the purpose and for eligible participants for which the VEBA was established. Therefore, the transfer of excess funds within the VEBA will not have an adverse impact on the VEBA's exempt status.

Generally, an organization that is described in section 501(c)(9) of the Code must pay tax on its unrelated business taxable income (UBTI) each year. Although section 512(a)(3)(B)(ii) exempts all income set aside for the payment of permissible benefits from UBTI, section 512(a)(3)(E)(i) sets limits on the amount of assets that may be set aside for that purpose. However, section 512(a)(3)(E)(iii) states that the set-aside limits in section 512(a)(3)(E)(i) do not apply to an organization if substantially all of its contributions are made by tax-exempt employers who were exempt from tax throughout the 5-year taxable period ending with the year in which the contributions are made. You plan to transfer the excess funds in N to a reserve for the provision of permissible benefits to eligible employees. You state that you are a tax-exempt organization which made substantially all of the contributions to the VEBA, excluding member contributions, for the preceding five years. Even though you made contributions to N on behalf of your members as a labor union and not on behalf of your employees as their employer, the income of the VEBA that is used to provide benefits to the union employees as described herein will be exempt function income not subject to the limitation under section 512(a)(3)(E)(i) and thus the income may be excluded from the VEBA's UBTI under section 512(a)(3).

Section 416(i)(1)(A)(i) of the Code states that a key employee is an employee who is an officer of the employer having an annual compensation greater than $130,000 (adjusted for inflation for plan years beginning after December 31, 2002). Section 1.416(i)-1, Q & A T-13 of the regulations states that whether an individual is an officer is determined upon the basis of all the facts, including the source of his or her authority, the term for which elected or appointed, and the nature or extent of his or her duties. Q & A T-13 states further that the term officer generally means an administrative executive who is in regular and continued service and that an employee who merely has the title of an officer but not the authority of an officer is not considered an officer for purposes of the key employee test. Similarly, an employee who does not have the title of an officer but has the authority of an officer is considered an officer for purposes of the key employee test.

In the instant case, each of the particular employees has the title of an officer. However, their duties are generally not those of officers. In brief, the executive administrator supervises union employees, the director of representation provides legal counsel to national officers, and other union members, and the directors of industry analysis, finance, and benefits provide information to the national officers and the board of directors.

Moreover, none of the particular employees has the authority of an officer. Specifically, none of the particular employees can bind the union to any agreement or sign any report required by law, or, without the concurrence of a national officer, authorize the expenditure of more than $2,000, sign a check for more than $5,000, or hire or fire any employee of the union.

Accordingly, because neither the duties nor the authorities of the particular employees are those

of officers, the particular employees are not officers within the meaning of section 416(i) of the Code.

Conclusion:

Based on the foregoing, we rule as follows:

1. The proposed transfer of the excess assets to a separate account within the VEBA will not adversely affect the VEBA's tax exempt status,
2. The VEBA will not have to report unrelated business income tax under sections 511 and 512 of the Code for amounts that are set-aside (including contributions and earnings) in the reserve in excess of the limitations described in sections 419 and 419A of the Code, and
3. That particular employees will not be considered "officers" and therefore not "key employees" within the meaning of section 416(i) 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.

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.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolved questions concerning your federal income tax status, this ruling should be kept in your permanent records.

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. In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Manager, Exempt Organizations
Technical Group 2

Enclosure
Notice 437