

INTERNAL REVENUE SERVICE
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May 14, 1999

Company =

Companies =

Date A =

Date B =

Policy =

Fund =

Insurance Company =

Trust =

Trustee =

Dear

This is in response to your ruling request dated January 27, 1999, requesting rulings with respect to the transfer of assets held in Fund, which provides post-retirement life insurance benefits for active and retired employees of Company, to Trust.

FACTS

Company is the common parent of a group of affiliated corporations (Companies) that file a consolidated federal income tax return under Section 1501. Companies file their tax return on the basis of a December 31 fiscal year and use the accrual method of accounting.

Companies maintain group life insurance policies for their qualifying employees and retirees through Insurance Company, including Policy. Under the agreement between Companies and Insurance Company, each employer pays an advance premium monthly to Insurance Company to cover the full cost of basic insurance coverage for its employees. Insurance Company accumulates these advance premiums in Fund, a retired lives reserve it maintains for the Companies, and credits Fund with interest. Companies have the right to have any amount in the reserve applied against their future years' benefit costs or insurance premiums.

The insurance agreement provides that in the event of discontinuance of Policy by the employer or Insurance Company for any reason other than replacement by one or more group policies underwritten by Insurance Company, the insurance program shall be immediately discontinued and no further premiums paid. In the event of discontinuance of the insurance program, Insurance Company must use any remaining balance standing to the credit of Fund to continue insurance, if any, on retired employees covered under Policy for as long as Fund is sufficient to do so. If no insurance is in force for retired employees under Policy, any balance remaining in Fund is to be applied in a manner designated by Company to pay premiums for other Insurance Company group insurance policies covering active or retired employees of Companies. If no such policies are in force, the balance of Fund, upon six months advance written notice from Company, is to be transferred to a trustee, or another insurance company, and used for the sole benefit of active or retired employees of Company.

Company established Trust, effective on Date A, as a funding vehicle for benefits under its employee benefit plans. Trust has received a determination letter from the Service to the effect that it is a voluntary employees beneficiary association (VEBA) exempt from federal income tax under section 501(a) as an organization described in section 501(c)(9). Under the terms of Trust, all contributions and commitments to fund Trust are irrevocable when made.

For the fiscal year ending Date B, Companies propose to amend the agreement with Insurance Company to transfer all the moneys held in Fund to the Trustee of Trust. The amendment would prohibit transfer of any Fund amounts to any of the Companies. The Trust documents will be amended to include life insurance for retirees as a function

of the Trust. All amounts transferred to Trust from Fund will be credited to a separate account for post-retirement life insurance benefits and used exclusively for the payment of post-retirement life insurance benefits.

RULINGS REQUESTED

You have requested the following rulings:

1. The transfer of amounts in Fund from Insurance Company to Trust will not result in any portion of Fund reverting to the benefit of Companies under section 4976(b)(1)(C).

2. The transfer of amounts in Fund from Insurance Company to Trust will not result in the realization or recognition of gross income or gain to the Companies under section 61(a).

LAW AND ANALYSIS

Section 61(a) of the Code provides that, unless otherwise excepted, gross income includes all income from whatever source derived, including income from life insurance and endowment contracts.

Section 419 (a) of the Code provides that contributions paid or accrued by an employer to a welfare benefit fund, if they would otherwise be deductible, shall be deductible (subject to limitations) under section 419 for the taxable year in which paid.

Section 419(e) of the Code defines the term "welfare benefit fund" to include any fund through which the employer provides welfare benefits to employees or their beneficiaries. The term "fund" is defined in section 419(e)(3) to include, to the extent provided in regulations, any account held for an employer by any person. Paragraph (c) of regulation §1.419-1T, Q&A-3 states that a retired lives reserve maintained by an insurance company is a "fund," or part of a "fund," if it is maintained for a particular employer and the employer has the right to have any amount in the reserve applied against its future years' benefit costs or insurance premiums.

Section 4976(a) of the Code imposes an excise tax in the amount of 100 percent of the amount of any disqualified benefit provided by a welfare benefit plan.

Section 4976(b)(1)(C) defines the term "disqualified benefit" to include any portion of a welfare benefit fund reverting to the benefit of the employer.

Revenue Ruling 69-382, 1969-2 C.B. 28, holds, in part, that for taxable years ending on or before June 17, 1969, premiums paid or incurred by an employer

policyholder under contracts providing group term life and health and accident coverage for its active and retired employees were deductible in full even though a portion of the premium was credited to a retired lives reserve if (1) the balance in the reserve was held by the insurance company solely for the purpose of providing insurance coverage on active and retired lives so long as any active or retired employees remained alive, and (2) the amount added to the retired lives reserve was not greater than an amount that would be required to fairly allocate the cost of the insurance coverage provided over the working lives of the employees involved. Further, the ruling holds, in pertinent part, that these conclusions would be applicable to taxable years ending after June 17, 1969, provided that the employer policyholder promptly amended the contract to provide that it did not retain any right to recapture any portion of the reserve so long as any active or retired employee remains alive.

In Revenue Ruling 73-599, 1973-2 C.B. 40, the issue was whether the balance in a retired lives reserve had to be included in the gross income of the employer in the taxable year in which the employer terminated the insurance contract. At the time it terminated the insurance contract, the employer directed that the insurance carrier should transfer the balance in the retired lives reserve to a trust qualified as a VEBA under section 501(c)(9). The employer had deducted the premiums paid into the retired lives reserve during the years when it was maintaining the insurance contract for the benefit of its employees. The insurance contract provided that, upon cancellation or other termination of the contract, any balance in the retired lives reserve could be distributed to the employer as a dividend, or, at the employer's option, transferred to a trust qualified under section 501(c)(9) for the purpose of providing insurance coverage for retired employees. Under these facts, the ruling holds that the balance in the retired lives reserve was includable in the employer's gross income under section 61(a) in the year of the transfer. The ruling states that, because the insurance contract gave the employer a fixed right to receive the balance in the retired lives reserve in the year in which it terminated its coverage under the policy, that balance was includable in the employer's gross income for the year of the termination, notwithstanding the fact that the employer directed the insurance company to transfer the money to a section 501(c)(9) trust.

Similarly, in Revenue Ruling 77-92, 1977-1 C.B. 41, a corporate employer with a group term insurance program that included a retired lives reserve had the option to discontinue the insurance coverage and to direct the insurance carrier to use the amount in the retired lives reserve either to pay premiums for insurance on the lives of retired employees or to pay a dividend to the employer. The employer terminated the insurance contract and directed the insurance carrier to transfer the balance in the retired lives reserve to another insurance company to purchase insurance for retired employees. The ruling states that the facts presented are in substance the same as those contained in Rev. Rul. 73-599, except that the right reserved to the employer in Rev. Rul. 77-92 to transfer the funds remaining in the retired lives reserve consisted of the right to direct payment of those funds to another insurance company rather than to a trust that qualified for exemption under section 501(c)(9). However, this difference

was not considered material, because the Taxpayer's right of control over the retired lives reserve was substantially the same in both cases. Accordingly, the ruling concludes that the same federal income tax rules apply to the transfers in the two cases.

Fund is a retired lives reserve established to provide group life insurance to retirees of Companies. Companies have the right to have any amount in the reserve applied against their future years' benefit costs or insurance premiums. Consequently, Fund is a "welfare benefit fund" under section 419(e) of the Code.

All amounts transferred to Trust from Fund will be credited to a separate account for post-retirement life insurance benefits and used exclusively for the payment of post-retirement life insurance benefits. That distinguishes this case from the situation considered in Revenue Rulings 73-599 and 77-92, and preserves the integrity of Fund as a retirement funding account after the transfer of assets from Fund to Trust. The use of transferred assets is consistent with the purpose for which employer contributions to Fund were made and deducted. Therefore, the transaction will not result in the inclusion of amounts so paid in Company's gross income. Also, as there is no reversion of funds to or for the benefit of Company, the transaction will not result in a disqualified benefit and the imposition of tax on Company under section 4976 of the Code.

CONCLUSION

1. The transfer of amounts in Fund from Insurance Company to Trust will not result in any portion of Fund reverting to the benefit of Companies under section 4976(b)(1)(C).

2. The transfer of amounts in Fund from Insurance Company to Trust will not result in the realization or recognition of gross income or gain to Companies under section 61(a).

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the transaction described above under any provision of the Code. Moreover, if Fund or Trust is amended, this ruling may not remain in effect.

Sincerely,

Mark Schwimmer
Chief, Branch 4
Office of the Associate
Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosure: Copy for section 6110 purposes