Uniform Issue List
419.03-00
419.12-02
501.09-00
512.10-00

200043049

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

OP:E:EO:T4

Contact Person:

ID Number:

Telephone Number:

7/25/2000

Employer Identification Number:

Legend:

M =

N =
O =
P1 =
P2 =
P3 =
P4 =
P5 =
P6 =
P7 =
P8 =
P9 =
P10=
P11=
P12=
Q =
R =
S =

T =
U =

Dear Applicant:

This is in response to your letter dated July 29, 1999, wherein you requested three rulings as follows:

(1) The Trust, M, constitutes a voluntary employees' beneficiary association ("VEBA") within the meaning of section 501(c)(9) of the Internal Revenue Code which is maintained pursuant to a collective bargaining agreement within the meaning of section 419A(f)(5) of the Code.

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(2) Contributions by N and its subsidiaries (collectively referred to as the Employers or O) to M in an amount (s) which, when added to the assets already in M, if any, does not exceed the present value of the post-retirement benefits under the Plans (as described below) shall be deductible by N and O under sections 162 and 419 of the Code in the taxable years in which paid to M.

(3) M's earnings shall not constitute unrelated business taxable income within the meaning of section 512 of the Code.

You have furnished the following background information:

N is the parent company of the following wholly-owned subsidiaries: P1 through P13 (thirteen companies). Collectively, these Employers, or O herein, have been members of an identified trade industry association, Q herein. Since 1950, Q has negotiated a series of collective bargaining agreements with an identified national labor union, R herein. N and O were signatories to these agreements, which covered union members who were employees of N and O. The collective bargaining agreements negotiated between Q and R required signatory employers to provide life and health insurance benefits for both active and retired R mineworkers and their dependents.

Prior to 1978, life and health insurance benefits for both active and retired R mineworkers and their dependents were provided through the R 1974 Benefit Plan & Trust (the "1974 Plan"). The 1974 Plan was a multi-employer welfare benefit fund.

A collective bargaining agreement between the Employers (O) and R was reached in 1978. The Employers were signatory parties to the 1978 agreement. Under this agreement, members of Q were permitted to provide the same benefits as provided for through the 1974 Plan through individual welfare benefit funds. The bargaining agreement required that such individual plans provide substantially the same benefits and coverage as the 1974 Plan.

After the expiration of the 1984 Q agreement with R, the Employers (O) ceased to be a signatory to those agreements and began to bargain with R on their own and not as members of Q. O entered into a separate collective bargaining agreement with R that provided for a single-employer welfare benefit plan for R members employed by O. O and R have renegotiated the terms of the welfare benefit plan in 1994 and 1998.

N entered a trust agreement with a trustee on July 28, 1999. In a determination letter dated September 22, 1999, the Service held that M is an employee welfare benefit plan under section 501(c) (9) of the Code.

M will fund welfare benefits provided by three plans (the "Plans"). The first plan is referred to herein as the S plan. The second plan is the T Plan. The third plan is the U Plan. The second plan and the third plan were established pursuant to sections 9702 and 9712 of the Code, respectively. These two plans are multi-employer employee welfare benefit plans.

Eligibility to participate in the Plans is restricted to retirees who were formerly members of R. Non-union employees and retirees are not eligible to receive benefits under the Plan. Key employees and former key employees are excluded from eligibility. N and O have provided historical information concerning the collective bargaining that led to the establishment of the Plans.

The participants consist only of former R employees of N and/or O. None of the R employees are owners (other than of a de minimis number of shares) of N or O, executives or officers of N or O.

In addition, N has represented that, upon issuance of a favorable ruling letter, N shall formally notify R of all contributions for the 1999 and 2000 Trust years that have been made during 1999 or through the period within 30 days after the date of this letter. Further, N will inform R that future contributions can be determined from Form 5500 or Form 990 (to be filed by M) and that interested parties may request Form 5500 from either the plan administrator or from the Department of Labor and may request Form 990 from the plan administrator.

The following law applies with respect to the first issue presented:

Section 419 (a) of the Internal Revenue Code provides that contributions paid or accrued by an employer to a welfare benefit fund shall not be deductible under Chapter 1 of the Code but if they would otherwise be deductible such contributions shall (subject to the limitations of subsection (b) be deductible under section 419 for the taxable year in which paid. Section 419(b) provides that the amount of the deduction allowable under subsection (a) for the taxable year shall not exceed the welfare benefit fund's qualified cost for the taxable year. Section 419(c) provides that the term "qualified cost" means the sum of (A) the qualified direct cost for such taxable year, and (B) subject to the limitations of Section 419A(b), any addition to a qualified asset account for the taxable year, minus (C) after-tax income.

Section 419(a)(2) of the Code defines a qualified asset account as an account consisting of assets set aside to provide for the payment of certain benefits, including medical benefits and life insurance benefits. Section 419A(b) provides that no addition to any qualified asset account may be taken into account to the extent such addition results in the amount in such account exceeding the account limit.

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

Section 7701(a)(46) of the Code states 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.

In 1992, Congress enacted the Coal Industry Retiree Health Benefit Act of 1992 (the "Coal Act"). The Coal Act established a basis and mechanism for funding retiree health benefits for members and former members of the Union (R).

Section 9702(a)(1) of the Code provides for the establishment of the United Mine Workers of America Combined Benefit Fund. Section 9702(a)(2) provides for the merger of the 1950 UMWA Benefit Plan and the 1974 Plan into the Combined Fund.

Section 9703(a)(1) of the Code provides that each eligible beneficiary of the Combined Fund shall receive health benefits described in subsection (b). Section 9703(b)(1) provides that the Combined Fund shall provide health care benefits to the maximum extent possible as substantially the same as the coverage provided by the 1950 Plan and the 1974 Plan as of January 1, 1992.

Section 9703(c)(1) of the Code provides that each eligible beneficiary of the Combined Fund shall receive death benefits identical to the ones described in the 1950 Plan and the 1974 Plan.

Section 9703(f) of the Code defines the term "eligible beneficiary" as a coal industry retiree or relation who is receiving benefits from the 1950 Plan or the 1974 Plan, as of July 20, 1992.

Section 9711(a) of the Code provides that the last signatory operator (and any related person) of the individual who, as of February 1, 1993, is receiving retiree health benefits from an individual employer plan, maintained pursuant to a 1978 or subsequent coal wage agreement, shall continue to provide health benefits coverage to such individual and eligible beneficiaries which is substantially the same as the coverage provided by such plan as of January 1, 1992. Such coverage shall continue to be provided for as long as the last signatory operator (and any related person) remains in business. This section applies to any individual that retired prior to October 1, 1994.

Section 1.419A-2T, Q&A-2, of the Income Tax Regulations defines a welfare benefit fund maintained 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 the 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 arm's-length negotiations between the 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 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) attritutable 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 bargained 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 for purposes of Q&A-1 if and when, after July 1, 1985, 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 1, 1985, "90 percent" shall be substituted for "50 percent".

The Plan herein was established pursuant to collective bargaining. The information submitted regarding the bargaining process was not comprehensive. However, the information submitted, along with N's representation about providing notice to participants regarding contributions to M, lead us to conclude that the negotiations between N, O, and R were at arm's length. N and O have also represented that they believe the Secretary of Labor would hold that the bargaining agreements are collective bargaining agreements.

Based on the foregoing, we rule that M constitutes a voluntary employees' beneficiary association that is maintained pursuant to a collective bargaining agreement within the meaning of section 419A (f) (5) of the Code.

The following law applies with respect to the second issue presented:

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

Section 1.419-1T, Q&A-10(a), of the regulations states in part that contributions to a welfare benefit fund are deductible only to the extent that the requirements of section 162 of the Code are met.

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, the rules of section 263, 446 (b), and 461(a) will be treated as having been satisfied to the extent that such contributions satisfy the otherwise applicable rules of section 419. Thus, for example, contributions to a welfare benefit fund will not fail to be deductible under section 419 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.

Section 1.419-1T, Q&A-10(e) of the regulations provides that in determining the extent to which contributions with respect to a welfare benefit fund satisfy the requirements of section 461(h) for any taxable year for which section 461(h) is in effect, pursuant to the authority under section 461(h)(2), economic performance occurs as contributions to the welfare benefit fund are made.

Revenue Rulings 69-382, 69-478, and 73-599 held, in effect, that employer contributions to a reserve for post-retirement benefits were deductible under section 162 of the Code if (1) the reserve was held for the sole purpose of providing benefits to covered employees; (2) the employer had no contractural right to recapture any part of the reserve as long as any active or retired employee remains alive; and (3) the contribution did not exceed the amount necessary to fairly allocate the cost of post-retirement benefits over the working lives of covered employees.

Section 419 of the Code limits the deduction that may be taken for contributions to a welfare benefit fund to the qualified cost for the year. One element of the qualified cost is the amount that may be added to the qualified asset account of the fund to the extent the limits of section 419A are not exceeded. In general, in order for an amount to be deductible under section 419, the rules of section 162 and 263 (among other requirements) must be satisfied. Therefore, the addition to a qualified asset account would be required to satisfy the requirements of section 162 and 263.

The three enumerated revenue rulings are concerned with the amount of deduction that meets the requirements of section 162 of the Code but do not necessarily provide the exclusive rule as to whether an amount satisfies the requirements of section 162. Section 263 is also concerned with the amount of the deduction allowable for a year. Section 1.419-1T, Q&A-10 (d) of the regulations provides, however, that section 263 of the Code will be treated as having been satisfied to the extent that the contributions to a welfare benefit fund satisfy the otherwise applicable rules of section 419 of the Code. Thus, if the amount of the contribution to a welfare benefit fund does not exceed the limits of section 419 of the Code, the deduction of such amount is not limited by section 263 of the Code. Thus, if the amount of the contribution satisfies the requirements of section 419 of the Code, the deduction of such amount is generally not limited by section 162 of the Code. Note, however, that if the contribution is such that the assets exceed the amount needed to provide post-retirement benefits to all current and future retirees (from current active employees) (i.e., the present value of future benefits), then the contribution would fail to satisfy the requirements of section 162 of the Code.

You have represented that this is not the case with respect to the contributions that will be made to the Trust. Based on the foregoing, we rule that contributions by N and O to M in an amount(s) which, when added to the assets already in M, does not exceed the present value of the post-retirement benefits under the Plan, shall be deductible by N and O under sections 162 and 419 of the Code in the taxable years in which paid to M.

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the contributions to M under any provision of the Code. Specifically, no opinion is expressed regarding whether part or all of the contributions to M must be capitalized or included in inventory costs because they are allocable to the cost of property produced by the taxpayer to which section 263 of the Code applies.

With respect to the third issue presented, the following law applies:

Section 501(c)(9) of the Code describes a voluntary employees' beneficiary association ("VEBA") providing for the payment of life, sick, accident or other benefits to its members or their dependents or designated beneficiaries, and in which no part of its net earnings inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 511 of the Code imposes a tax on the unrelated business taxable income (defined in section 512) of organizations exempt from tax under section 501(c).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" to mean the gross income derived by any organization from any unrelated trade or business (defined in section 513) regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

Section 513(a) of the Code provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income). Further, it is "substantially related", for purposes of section 513 of the Code, only if the causal relationship is a substantial one. For this relationship to exist, the production or the performance of the service from which the gross income is derived must contribute importantly to the accomplishment of exempt purposes. Whether the activities productive of gross income contribute importantly to such purposes, depends, in each case, upon the facts and circumstances involved.

Section 512(a)(3)(A) of the Code provides that in the case of an organization described in section 501(c)(9), the term "unrelated business income" means the gross income (excluding any exempt function income), less the deductions allowed by Chapter 1 which are directly connected with the production of the gross income (excluding exempt function income), both computed with the modifications set forth in certain paragraphs of section 512(b).

Section 512 (a)(3)(B) of the Code provides that for purposes of subparagraph (A), the term "exempt function income" means the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes for which the organization is tax exempt. Such term also means all income (other than an amount equal to the gross income derived from any related trade or business regularly carried on by such organization computed as if the organization were subject to section 512(a)(1)), which is set aside, in the case of a section 501(c)(9) organization, to provide for the payment of life, sick, accident, or other benefits. If during the taxable year, an amount which is attributable

to income so set aside is used for a purpose other than that just described, such amount shall be included under subparagraph (A), in unrelated business taxable income for the taxable year.

Section 512(a)(3)(E)(i) of the Code provides that in the case of an organization described in section 501(c)(9), a set aside for the payment of life, sick, accident, or other benefits may be taken in account under section 512(a)(3)(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 for the taxable year (not taking into account any reserve described in section 419A(c)(2)(A) for post-retirement medical bills).

Section 1.512(a)-5T, Q&A-3(a) of the regulations provides, in part, that the amounts set aside in a VEBA as of the close of a taxable year of the VEBA to provide for payment of life, sick, accident, or other benefits may not be taken into account for purposes of determining "exempt function income" to the extent that such amounts exceed the qualified asset account limit, determined under Code sections 419A(c) and 419A(f)(7), for such taxable year of the VEBA.

Section 1.512(a)-5T, Q&A-3(b) of the regulations provides, in part, that the unrelated business taxable income of a VEBA for a taxable year of such organization generally will equal the lesser of two amounts: the income of the VEBA for the taxable year (excluding member contributions); or, the excess of the total amount set aside as of the close of the taxable year (including member contributions and excluding certain assets with a useful life extending beyond the end of the taxable year to the extent they are used in provision of welfare benefits) over the qualified asset account limit (calculated without regard to the otherwise permitted reserve for post-retirement medical benefits) for the taxable year.

The gross income of M will be set aside to provide for life, sick, accident, or other benefits, and as a result will constitute exempt function income within the meaning of section 512(a)(3)(B). The amount of such set aside will not be in excess of the maximum amount permitted by section 1.512(a)-5T, Q&A-3(b) of the regulations, such amount being determined by reference to the account limit, because M's qualified asset account will not have an account limit. In accordance with section 1.512-5T, Q&A-3(b), M's unrelated business taxable income will be the lesser of (1) the income of M and (2) the excess of the total amount set aside as of the close of the taxable year over the qualified asset account limit for the taxable year. Based upon these facts, we rule that M will not have unrelated business taxable income within the meaning of section 512(a)(3)(A) of the Code.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon your tax status should be reported to the Ohio Tax Exempt and Government Entities (TE/GE) Customer Service Office. The mailing address is: Internal Revenue Service,TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The telephone number there is 877-829-5500 (a toll free number.)

We are sending a copy of this ruling to the Ohio TE/GE Customer Service Office. Because this letter could help resolve any questions about your tax status, you should keep it with 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.

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 as precedent.

Thank you for your cooperation.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Chief, Exempt Organizations
Technical Branch 4

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