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Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply to:
T:EP:RA:T:A1
Date:
OCT 24 2001

In re: Company =

Plan =

Unions =

Trust =

This letter is in response to a ruling request submitted on your behalf by your authorized representative concerning the tax treatment of contributions to the Trust, which is a welfare benefit fund, established by the Company.

The Company generally provides health insurance and post-retirement medical benefits for its employees represented by the Unions. The health insurance coverage for these Union employees is provided pursuant to the terms of collective bargaining agreements with the Unions. The Company provides health benefits to active employees and retirees. In general, the post-retirement medical benefits for Union retirees are provided pursuant to the above-referenced collective bargaining agreements, memoranda of agreement and plant closing agreements. The respective agreements do not require the Company to establish a welfare benefit fund to provide the post-retirement medical benefits.

The Company is funding retiree health benefit obligations through a trust under which Union and non-Union employee benefits are paid. The Company proposes to establish within the Trust a sub-trust designed to provide post-retirement medical and life insurance benefits for participants. This sub-trust is referred to as the "Retiree Benefits Reserve Account." The proposed Reserve Account will have separate accounting for assets of the Plan and any other plan that may use the Trust as a funding vehicle for benefits.

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Based upon the above, you have requested rulings on five issues. We are responding to:

- Issue 1 (whether the Reserve Account of the Trust is a qualified asset account under a separate welfare benefit fund under a collective bargaining agreement, as described in §§ 419A(a) and 419A(f)(5) of the Internal Revenue Code);
- Issue 2 (whether the Company's contributions to the Trust, or other Trust assets, which are credited to the Reserve Account under the Trust (the "Account Credits") are "qualified costs" under § 419(c)(1)(B) and therefore, the amount of the Account Credits for a taxable year, after the adjustments provided for in §§ 419(c)(2) and 419(c)(5) (the "Net Account Credit"), is allowable as a deduction under § 419(a), to the extent that the Net Account Credit for such taxable year otherwise satisfies the requirements of § 419(a));
- Issue 3 (whether a contribution to and an amount of the Trust which were credited to the Reserve Account under the Trust on December 29, 1998 were qualified costs under § 419(c)(1)(B) and after the adjustments provided for in §§ 419(c)(2) and 419(c)(5), and pursuant to § 419(a), such amounts are deductible by the Company for its tax year ending December 31, 1998); and
- Issue 4 (whether in taxable years after December 31, 1998, the Net Account Credit for each taxable year is deductible under § 419(a), except to the extent that the assets of the Reserve Account as of the end of the taxable year exceed the present value of all future post-retirement benefits that are to be provided from the Reserve Account for current and future retirees (from current active employees) of the Company.

We are forwarding a copy of our file to the Exempt Organizations Division (TEGE) to reply to Issue 5 (whether the limitations described in § 512(a)(3)(E)(i) apply to the amounts set aside in the Reserve Account).

Issue 1

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 Code but if they would otherwise be deductible such contributions shall (subject to the limitations of subsection (b)) be deductible under § 419 for the taxable year in which paid. Section 419(b) provides that the amount of the deduction allowable under subsection (a) for any 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 limitation of § 419A(b), any additions to a qualified asset account for the taxable year, minus (C) after-tax income.

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.

Section 1.419A-2T, Q&A-2, of the (temporary) 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 § 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) 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 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 fund 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 collective bargaining agreements with the Unions mandate that the Company provide the post-retirement benefits that will be funded through the Trust. More than 90% of the members in the Trust are covered by collective bargaining agreements. The members who will receive post-retirement medical and life insurance benefits from the Reserve Account in the Trust that will hold assets for the Plan will consist only of former Union employees of the Company. None of the company's Union employees are owners (other than of a de minimis number of shares of the Company), executives or officers of the Company.

The information provided concerning the negotiations between the Company and the Unions evidences the arm's-length nature of the collective bargaining process. The Company has represented that it believes that the Secretary of Labor would hold that the agreements are collective bargaining agreements.

Prior to the proposed establishment of the Reserve Account, the assets of the Trust have been commingled for investment purposes. There has been and will continue to be separate accounting for the Union and non-Union assets in the Trust. The Trust document permits contributions for other Union welfare benefit plans. The Trust provides for separate accounting of assets for benefits under the Plan and any other plan that may use the Trust as a funding vehicle for benefits. The funds transferred to the Reserve Account for benefits provided under the Plan will be available to provide only benefits under the Plan. Similarly, contributions to the Reserve Account in the Trust for benefits provided for in the Plan will be available to provide benefits only to those retirees who were members of the Union immediately prior to retirement.

Based on the information furnished, the Reserve Account is maintained pursuant to a collective bargaining agreement under § 419A(f)(5) of the Code. In addition, the portion of the Trust designated as the Reserve Account that will hold assets for the Plan will constitute a qualified asset account under a separate welfare benefit fund maintained pursuant to a collective bargaining agreement within the meaning of § 419A(f)(5).

Issues 2, 3 and 4

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 but if they would otherwise be deductible such contributions shall (subject to the limitations of subsection (b)) be deductible under § 419 of the for the taxable year in which paid.

Section 419(c)(2) of the Code provides that the qualified cost for a welfare benefit fund for any taxable year shall be reduced by such fund's after-tax income for the taxable year. Section 419(c)(5) provides that no item may be taken into account more than once in determining the qualified cost of any welfare benefit fund.

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 § 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 § 419 of the Code, the rules of §§ 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 § 419. Thus, for example, contributions to a welfare benefit fund will not fail to be deductible under § 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 § 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 § 461(h) for any taxable year for which § 461(h) is effective, pursuant to the authority under § 461(h)(2), economic performance occurs as contributions to the welfare benefit fund are made.

Revenue Ruling 69-382, 1969-2 C.B. 28, Revenue Ruling 69-478, 1969-2 C.B. 29, and Revenue Ruling 73-599, 1973-2 C.B. 40, held, in effect, that employer contributions to a reserve for post-retirement benefits were deductible under § 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 contractual 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 § 419A are not exceeded. In general, in order for an amount to be deductible under § 419, the rules of §§ 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 §§ 162 and 263.

The three enumerated revenue rulings are concerned with the amount of deduction that meets the requirements of § 162 of the Code but do not necessarily provide the exclusive rule as to whether an amount satisfies the requirements of § 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 § 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 § 419. Thus, if the amount of contribution to a welfare benefit fund does not exceed the limits of § 419, the deduction of such amount is not limited by § 263. Thus, if the amount of the contribution satisfies the requirements of § 419, the deduction of such amount is generally not limited by § 162. 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 § 162.

As we ruled in Issue 1, the Reserve Account is a qualified asset account under a separate welfare benefit fund under a collective bargaining agreement, as described in §§ 419A(a) and 419A(f)(5)(A) of the Code. Accordingly, contributions by the Company to the Trust that are credited to the Reserve Account are qualified costs within the meaning of § 419(c)(1)(B). Therefore, the Net Account Credit is allowable as a deduction under § 419(a), to the extent that the Net Account Credit for such taxable year otherwise satisfies the requirements of § 419(a). Also, contributions to the Trust and the crediting to the Reserve Account are qualified costs under § 419(c)(1)(B).

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

This ruling is directed only to the taxpayer 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 being given with the understanding that the proposed trust agreement, as provided to us, is adopted. Failure to adopt the proposed trust as stated would cause the retroactive revocation of this ruling letter. In addition, if the representations made pursuant to this request are not accurate, the Company may not rely upon this ruling letter. A copy of this letter is being sent to your authorized representative pursuant to a Form 2848 (Power of Attorney) on file with our office.

Sincerely,

James E. Holland, Jr., Manager
Employee Plans Actuarial Group 1
Tax Exempt and Government Entities
Division

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