Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Significant Index No.: 501.09-01

199902016

Contact Person:

Telephone Number:

In Reference to: OP:E:EO:T:3

Date: OCT 16 1998

Legend:

X =
Y =

Dear Sir or Madam:

This is in reference to a letter dated April 20, 1998, submitted on your behalf by your authorized representative, requesting a private letter ruling with respect to the proposed transactions described below.

The information provided indicates that X, a labor organization, established Y (the "Trust") to provide benefits to its members who are employees of police departments statewide. The Trust is exempt from federal income tax under section 501(c)(9) of the Internal Revenue Code as a voluntary employees beneficiary association (VEBA).

X wishes to implement a collectively bargained "Retiree Premium Reimbursement Plan" (the "Plan") which would provide reimbursement for health care coverage premiums after termination of employment, including retirement. The Plan will provide benefits through either the Trust or a new VEBA. The organization's members can only join the plan as a group through the collective bargaining process. There is no individual election into the Plan. Employers will make contributions to the Plan on behalf of all members of the bargaining unit while they are actively employed. There is no individual election on the amount of the contributions. The Plan will be funded by mandatory pre-tax contributions in one of two methods. Under the first method, the employers will contribute to the Plan a percentage of all employees' pay. Under the second method, the employer will contribute to the Plan an amount equal to a certain portion of unused sick leave for all employees. The Plan will maintain a separate account for each employee. An employee may not elect to receive cash in lieu of the contributions to the Plan.

The Plan will pay benefits consisting of reimbursement of health insurance premiums. When an employee incurs an expense

92

for health insurance premiums, the employee will submit a voucher to the Plan for reimbursement. Proof of expenses shall be at least, but not limited to, canceled checks drawn to the name of the medical insurance provider or receipt for payment from the medical insurance provider, subject to verification by the Plan. The Plan will provide reimbursement of benefits to retirees until the retirees' account balances reach zero. Upon the death of a retiree, the retirees' surviving spouse and other dependents may continue eligibility for the reimbursement benefits.

Section 501(c)(9) of the Code provides exemption from federal income tax for voluntary employees' beneficiary associations providing for the payment of life, sick, accident or other benefits to the members of such association or their dependents or beneficiaries, if no part of the net earnings of such association inures to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-(3)(c) of the Income Tax Regulations provides that the term "sick and accident benefits" means amounts furnished to or on behalf of a member or a member's dependents in the event of illness or personal injury to a member or dependent. Such benefits may be provided through reimbursement to a member or a member's dependents for amounts expended because of illness or personal injury, or through the payment of premiums to a medical benefit or health insurance program. Similarly, a sick and accident benefit includes an amount paid to a member in lieu of income during a period in which the member is unable to work due to sickness or injury. Sick benefits also include benefits designed to safeguard or improve the health of members and their dependents. Sick and accident benefits may be provided directly by an association to or on behalf of members and their dependents, or may be provided indirectly by an association through the payment of premiums or fees to an insurance company, medical clinic, or other program under which members and their dependents are entitled to medical services or to other sick and accident benefits.

Section 106(a) of the Code provides that gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.106(a)-1 of the regulations states that gross income of an employee does not include contributions which his employer makes to an accident or health plan either by paying the premium (or a portion of the premium) on a policy covering one or more employees or by contributing to a separate trust or fund which provides accident and health benefits directly or through insurance to one or more employees. If such trust provides other

benefits in addition to accident and health benefits, section 106 applies only to the portion of the employer's contribution which is allocable to accident or health benefits.

Rev. Rul. 61-146, 1961-2 C.B. 25, considered a situation in which employers paid a share of employees' premiums for hospital and medical insurance. For those employees who were covered by an employer's group policy, the employer paid his share of the premium directly to the insurance company. For those employees not covered by an employer's group policy but who had other types of hospital and medical insurance for which the employees paid premiums directly to the insurers, the employer paid a part of the premiums upon proof that the insurance was in force and was being paid by the employees. The employer used one of three methods to pay his share of the premiums. Under one method, the employer reimbursed each employee directly once or twice a year upon proof of prior payments of the premiums by the employee. Under the second method, the employer issued to each employee a check payable to the particular employee's insurance company, the employee being obligated to turn over the check to the insurance company. Finally, the employer issued a check as in the second method except that the check was made payable jointly to the insurance company and the employees. Rev. Rul. 61-146 concluded that the reimbursements constituted employer payments of accident or health insurance premiums for employees and, therefore, were excludable from the gross income of the employees under section 106 of the Code.

Rev. Rul. 75-539, 1975-2 C.B. 45, concerned two contracts that provided that employees could accumulate up to a maximum of 150 days of sick leave credits. The contracts also stipulated the treatment to be accorded accumulated sick leave for retired employees. In Contract A, an employee received a cash payment for one-half of the employee's accumulated sick leave credits in excess of 50 days or, at the option of the employee, the payment applied to the cost of the employee's continued participation in the employer's hospital, surgical and medical group insurance plan. In Contract B, the employer placed the value of three-fourths of a retiring employee's accumulated sick leave credits in an escrow account to pay the premiums of continued participation by the retired employee in the employers' hospital, surgical and medical group insurance plan. Under this contract, the retired employee, his spouse or his dependents could not receive any of the escrow amount in cash. The revenue ruling held that the payments made under Contract A were includible in the employee's income. The payments made under Contract B were excludable pursuant to section 106 of the Code.

X's reimbursement of members' health care coverage premiums through contribtions to Y is a permitted benefit under section 501(c)(9) of the Code. Benefits will be paid only as reimbursement for health premiums. Under no circumstances can employees take the contributions as unrestricted cash. Accordingly, we rule as follows:

1. The Plan does not jeopardize the tax-exempt status of the Trust under section 501(c)(9) of the Code; and,

2. Reimbursement of health insurance premiums under the Plan will be excludable from the gross income of members under section 106 of the Code.

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

We are informing your key District Director of this ruling. Because this letter could help resolve any questions about your exempt status and foundation status, you should keep it 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.

Sincerely,

Edward K. Karcher

Edward K. Karcher
Chief, Exempt Organizations
Technical Branch 3

95