



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Dear :

This is in response to a ruling request from F's (the "Trust") authorized representative, who has requested certain rulings relating to the federal tax consequences of a proposed transaction.

The information submitted shows that the Trust is exempt from federal income tax as a voluntary employee's beneficiary association (VEBA) pursuant to section 501(c)(9) of the Internal Revenue Code. Trustee is a G not-for-profit corporation which serves as the Trustee of the Trust.

Trust exists to provide

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The Trust utilizes the funds collected to pay for its costs of operation, including payment to the Trustee of an amount sufficient to fund its cost to provide the foregoing services to Taxpayer.

The Trustee is licensed by the State of G as a third party administrator in order to solicit its services to employers who are not Participating Employers of Taxpayer ("Other Employers"). No license is necessary under G law for Trustee to provide services solely to Taxpayer. In addition, Trustee will earn sales commissions from those contracts where the Participating Employer does not have an insurance agent. Trustee will administer _____ for Other Employees. G law prohibits Trustee from distributing profits to its members or returning such profits to Taxpayer.

The Trust does not want to accumulate excess funds as it may utilize those funds solely to provide nondiscriminatory benefits for members or to credit excesses to the person or persons whose contributions were applied to such premiums. Different employer groups have different premium levels based upon mortality, morbidity and claims history. Different employers choose to participate in one or more of the benefit programs and may be insured by different Carriers on the programs they select. Participating Employers have constant turn over of employees and dependants insured through these programs. Participating Employers policies differ with respect to which benefits will be paid by the employer, which benefits will be optional to the employees and whether any benefits are provided through a cafeteria plan. Based upon all of these factors it is not practical for the Trust to credit excess funds to the person or persons whose contributions were applied to such premiums in compliance with section 1.501(c)(9)-4(c) of the regulations. If such funds were to be utilized by the Trust to provide benefits, it would also be difficult to determine which participants are entitled to additional benefits.

The Participating Employers of the Trust propose to form a limited liability company organized under the laws of the State of G ("Newco"). Initially, interests in Newco will be offered to all of the Participating Employers of the Trust. It is anticipated most of the Participating Employers will choose to become members of Newco. Initially, all of the members of Newco will be Participating Employers of the Trust, however, a small membership interest not exceeding 25% of the total membership interests may be set aside for potential incentive compensation to key employees of Newco. It is anticipated that on a periodic basis, new Participating Employers of the Trust will be offered an interest in Newco while members of Newco who cease to be

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Participating Employers of the Trust would have their interest in Newco retired. Each of the initial members of Newco will make a capital contribution to Newco in proportion to their current interest in the Trust, the aggregate of which will be the amount necessary to fund the start up of Newco's operations. Additionally, a majority of the initial board of directors of Newco will also be on the board of directors of the Trustee. It is also possible that interests in Newco will be offered to Other Employers in order to induce them to purchase benefits through Newco. Newco's business purposes shall be limited to providing administrative services relating to employee benefit plans maintained by Participating Employers and Other Employers, and members of Newco will be allowed to withdraw their investment in Newco if that purpose is changed.

Once formed, Newco will make application to the State of G to be licensed as a third party administrator. Once licensed, Trustee shall assign to Newco its rights and obligations with respect to the administration of insurance contracts for Other Employers. The Trust will enter into a contract with Newco to perform all of the Trust's administrative responsibilities to the Participating Employers and Carriers. In return, Newco shall receive all of the fees paid by the Carriers for administration services and commissions. In addition, the Trust will pay to Newco the administrative fees currently collected by the Trust on the life, disability and dental programs where no fees are paid by the Carrier. The contract between Newco and Trustee shall be substantially similar to the contracts currently in place by and between Trustee and the Other Employers. All amounts that will be paid by the Trust to Newco for its services are commercially reasonable and comparable to amounts that will be paid to Newco by Other Employers for comparable services.

Any profits realized by Newco will be distributed to the owners of Newco in proportion to their ownership interest in Newco.

The following rulings have been requested:

1. The proposed transactions will not adversely affect the tax-exempt status of the VEBA trust under section 509(c)(9) of the Code.
2. Distributions by Newco to its members who are also Participating Employers of the Trust will not result in the imposition of excise tax on the Participating Employers pursuant to section 4976 of the Code.

Ruling Request 1:

Section 501(c)(9) of the Code provides for the exemption from federal income tax of 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 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.

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Section 1.501(c)(9)-1 of the Income Tax Regulations provides that for an organization to be described in section 501(c)(9), it must be an employees' association; membership in the association must be voluntary; the organization must provide for the payment of life, sick, accident, or other benefits to its members; and there can be no inurement (other than by payment of permitted benefits) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-3(a) of the regulations provides that whether prohibited inurement has occurred is a question to be determined with regard to all of the facts and circumstances. Specifically, cited as examples of prohibited inurement are (i) the disposition of property to or the performance of services for, a person for less than the greater of fair market value or cost to the association; (ii) the payment of unreasonable compensation to the trustees or employees of the association; or (iii) the purchase of insurance or services for amounts in excess of the fair market value from a company in which one or more of the association's trustees, officers or fiduciaries has an interest.

Section 1.501(c)(9)-4(a) of the regulations provides, in part, that whether prohibited inurement has occurred is a question to be determined with regard to all of the facts and circumstances, taking into account the guidelines set forth in this section.

Section 1.501(c)(9)-4(b) of the regulations provides that whether benefits are paid pursuant to standards that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees is determined under section 1.501(c)(9)-2(a)(2) and (3).

Section 1.501(c)(9)-4(d) of the regulations provides that it will not constitute prohibited inurement if, on termination of a plan funded through a VEBA, any assets remaining after satisfying all liabilities to existing plan beneficiaries are applied to provide life, sick, accident or other appropriate welfare benefits pursuant to criteria that do not provide for disproportionate benefits to officers, shareholders or highly compensated employees.

The regulations provide that it does not constitute prohibited inurement, if on termination of a plan, any assets remaining, after satisfaction of all liabilities to existing beneficiaries, are applied to provide benefits described in section 501(c)(9) of the Code pursuant to criteria that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees of the employer

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Therefore, Trustee will transfer its business to Newco, which will transfer any profits back to Participating Employers. Newco is far enough removed from an unlawful rebate because of its nature as an independent business. Newco will perform the Trust's administrative responsibilities to Participating Employers and Carriers. Newco will receive all fees paid by Carriers for administrative services and commissions.

The fees and commissions that Newco receives from Carriers will not constitute prohibited inurement so long as the premiums paid by the Participating Employers for such policies of insurance are reasonable based upon the mortality, morbidity in health risk factors for such Participating Employers.

The administrative fees paid by Trustee to Newco will not be considered as inurement so long as such administrative fees do not exceed the administrative fees paid by the Carriers to Newco for comparable services.

Ruling Request 2:

Section 4976(a) of the Code imposes a 100% excise tax if an employer maintains a welfare benefit fund, and there is a disqualified benefit provided during any taxable year.

Section 4976(b)(1)(C) of the Code provides that for purposes of subsection (a), the term "disqualified benefit" means any portion of a welfare benefit fund reverting to the benefit of the employer.

Section 4976(b)(3) of the Code provides that paragraph (1)(C) shall not apply to any amount attributable to a contribution to the fund which is not allowable as a deduction under section 419 for the taxable year or any prior year taxable year.

None of the distributions by Newco of profits to Participating Employers should be determined to be subject to the excise tax on welfare benefit plans pursuant to section 4976 of the Code so long as: (i) the administrative fees paid by the Trust to Newco are reasonable for the services rendered; (ii) the premiums charged by the Carriers are reasonable and based upon actuarial mortality, morbidity and health experience; and (iii) the administrative fees and commissions paid to Newco by the Carriers are reasonable.

As long as all such payments are comparable to similar amounts charged by Newco to Other Employers for similar services, then the funds utilized to pay administrative fees or premiums on policies should no longer be considered part of the Trust fund. If the profits of Newco are not considered assets of the Trust fund, then the distribution of such profits to Participating Employers does not violate section 4976 of the Code.

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.

Private Letter Ruling

If there are any questions about this ruling, please contact the person whose name and telephone are shown in the heading of this letter.

Sincerely,

Robert C. Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3