Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

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Date:
May 10, 2018

Legend

Taxpayer =

Trust =

Trust A =

Plan A =

Plan B =

Date 1 =

Date 2 =

$A =

$B =

$C =

$D =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Dear :

This responds to your representative's letter, dated October 31, 2017, and later correspondence, requesting a ruling regarding the tax consequences under the tax benefit rule and under section 4976 of the Internal Revenue Code ("Code") of an amendment to Trust. The amendment would permit assets of Trust, currently a separate welfare benefit fund under a collective bargaining agreement as described in section 419A(f)(5), to be used to provide for the payment of active collectively bargained employees' health benefits through a newly established subaccount within Trust.

FACTS

Taxpayer is a subsidiary of a public utility holding company. Taxpayer sponsors Trust, which holds assets used to provide for the payment of postretirement health benefits under Plan A to collectively bargained employees who retire from Taxpayer. Plan B provides for health benefits to Taxpayer's active collectively bargained employees. Plan B is not currently funded by Trust. Trust received a determination letter dated Date 1, stating it is a voluntary employees' beneficiary association under section 501(c)(9).

Taxpayer represents that it has deducted the amounts of all of its contributions to Trust. Taxpayer contributed a total of $A to Trust for Year 1, Year 2, Year 3, and Year 4 and deducted a total of $A on its tax returns for those years. Taxpayer has made deductible contributions in years other than Year 1, Year 2, Year 3, and Year 4. Trust holds $B as of Date 2.

Taxpayer represents that $B, the assets in Trust as of Date 2, exceeds the present value of the benefit obligations for current participants under Trust, which as of Date 2 was $C. Taxpayer represents that Trust has become overfunded due to collectively bargained changes in plan design that modified benefit obligations.

Trust will be amended after the issuance of this private letter ruling to include, as an additional class of participants and beneficiaries under Trust, active collectively bargained employees. Taxpayer represents that the amendment will require Trustee to create a separate subaccount within Trust to provide for the payment of health benefits under Plan B to active collectively bargained employees and their eligible dependents. By end of Year 5, Trustee will make a one-time transfer of approximately $D to the subaccount. $D is less than $A. The subaccount will fund health benefits currently provided under Plan B to active collectively bargained employees and their eligible dependents. Only amounts in the subaccount can be used by Trust to provide for the payment of health benefits to active collectively bargained employees and their eligible dependents. Taxpayer represents that the amendment of Trust will include language to rename it and it will thereafter be known as Trust A.

Taxpayer represents that at all times since the establishment of Trust, and at all times after the transfer of assets to the subaccount within Trust, Trust has been and will continue to be, a separate welfare benefit fund under a collective bargaining agreement within the meaning of section 419A(f)(5) and section 1.419A-2T of the Income Tax Regulations ("Regulations"). Taxpayer further represents that it deducted contributions to Trust in accordance with section 419A(f)(5), and that, pursuant to the amendment, the amount of Trust assets to be made available to active collectively bargained employees is less than the total amount contributed to Trust.

Taxpayer represents that all amendments made to Trust in conjunction with this ruling will be effective prospectively and will apply only with respect to health benefits newly payable on a prospective basis (for example, no reimbursements will be made with respect to claims for medical expenses that have already been incurred).

Taxpayer estimates that the subaccount's assets of approximately $D will be exhausted in approximately three years. Trust provides that no termination, modification or amendment may be made that permits any part of the corpus or income of Trust to be used for or diverted to purposes other than for the exclusive benefit of the participants or their beneficiaries. Trust provides that neither the income nor other assets of the Trust will inure to any person other than by payment of the benefits.

Taxpayer represents that although it operates as a public utility company, approval from the Federal Energy Regulatory Commission is not required for the transfer of assets to the subaccount within Trust, due to the nature of the funds that comprise its assets.

RULINGS REQUESTED

Taxpayer requests the following rulings:

(1) The transfer of assets to subaccount within Trust will not cause Taxpayer to recognize any income under the tax benefit rule.

(2) The transfer of assets to subaccount within Trust, and future use of the assets for purposes of providing health benefits to active collectively bargained employees, will not be treated as a disqualified benefit under section 4976(b)(1)(C) of the Code, and will not result in an excise tax under section 4976.

LAW

Section 61(a) of the Code provides that, unless otherwise excepted, gross income includes all income from whatever source derived.

Section 111(a) provides that gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent that the amount did not reduce the amount of tax imposed by Chapter 1 of the Code.

Generally, the tax benefit rule requires a taxpayer who received a tax benefit from a deduction in an earlier year to recognize income in a later year if an event occurs that is fundamentally inconsistent with the premise on which the deduction was initially based. Hillsboro National Bank v. Commissioner, 460 U.S. 370 (1983); see also Hughes & Luce, LLP v. Commissioner, 70 F.3d 16 (5th Cir. 1995), cert. denied, 517 U.S. 1208 (1996). The term "tax benefit rule" encompasses two concepts, an inclusionary part and an exclusionary part. Frederick v. Commissioner, 101 T.C. 35, 40-41 (1993). The inclusionary part has been developed in the courts and requires a taxpayer to include a previously deducted amount in the current year's income when a fundamentally inconsistent event has occurred. The exclusionary part is partially codified at section 111(a) and permits a taxpayer to exclude an amount that did not previously provide a tax benefit when it was deducted; the exclusionary part cannot apply unless the inclusionary part applies.

The tax benefit rule allays some of the inflexibilities of the annual accounting system under specific circumstances. Hillsboro National Bank, 460 U.S. at 377. The general purpose of the tax benefit rule is to approximate the results produced by a tax system based on transactional rather than annual accounting. Id. at 381. The tax benefit rule will "cancel out" an earlier deduction when a later event is "fundamentally inconsistent" with the premise on which the deduction was initially based, even in situations where there is no actual recovery of funds. Id. at 381-383. One must consider the facts and circumstances of each case in light of the purpose and function of the provisions granting the deductions. Id. at 385. Although it is usually helpful to determine whether the later event would have foreclosed the deduction if it had occurred within the same tax year, that inquiry is not an exclusive test. See American Mutual Life Insurance Co. v. United States, 267 F.3d 1344, 1350 (Fed. Cir. 2001).

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

Section 419(b) limits the employer's deduction under section 419(a) to a welfare benefit fund's qualified cost for the taxable year. The qualified cost of a welfare benefit fund for a taxable year is defined in section 419(c)(1) as the sum of the qualified direct cost for the taxable year and, subject to the limitation of section 419A(b), any addition to a qualified asset account for the taxable year. Under section 419(c)(2), the qualified cost for any taxable year is reduced by the welfare benefit fund's after-tax income for the taxable year.

Section 419(c)(3)(A) provides that the term "qualified direct cost" means, with respect to any taxable year, the aggregate amount (including administrative expenses) that would have been allowable as a deduction to the employer with respect to the benefits provided during the taxable year, if those benefits were provided directly by the employer and the employer used the cash receipts and disbursements method of accounting.

Section 419(c)(3)(B) provides that, for purposes of section 419(c)(3)(A), a benefit is treated as provided when that benefit would be includible in the gross income of the employee if provided directly by the employer (or would be so includible but for any provision of Chapter 1 of the Code excluding that benefit from gross income). Section 419A(a) defines the term "qualified asset account" to include any account consisting of assets set aside to provide for the payment of medical or life insurance benefits.

Section 419(e)(1) 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 an organization described in section 501(c)(9).

Section 419A(a) provides that the term "qualified asset account" means any account consisting of assets set aside to provide for the payment of (1) disability benefits, (2) medical benefits, (3) SUB or severance pay benefits, or (4) life insurance benefits.

Section 419A(b) provides that no addition to any qualified asset account may be taken into account under section 419(c)(1)(B) to the extent the addition results in the amount of the account exceeding the account limit.

Section 419A(f)(5)(A) 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 1.419A-2T, Q&A-1, of the Regulations provides that contributions to a welfare benefit fund maintained pursuant to one or more collective bargaining agreements and the reserves of such a fund generally are subject to the rules of sections 419, 419A, and 512 of the Code. However, neither contributions to nor reserves of such a collectively bargained welfare benefit fund shall be treated as exceeding the otherwise applicable limits of section 419(b), 419A(b), or 512(a)(3)(E) until the earlier of: (i) the date on which the last of the collective bargaining agreements relating to the fund in effect on, or ratified on or before, the date of issuance of final regulations concerning such limits for collectively bargained welfare benefit funds terminates (determined without regard to any extension thereof agreed to after the date of issuance of such final regulations), or (ii) the date 3 years after the issuance of such final regulations.

Section 4976(a) imposes a 100 percent 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) defines “disqualified benefit” to include any portion of a welfare benefit fund reverting to the benefit of the employer.

ANALYSIS AND CONCLUSION

As explained above, the tax benefit rule is implicated when a taxpayer has taken a deduction in a prior year, and in a subsequent year an event occurs that is fundamentally inconsistent with the premise of the deduction. The facts and circumstances of each case must be considered “in light of the purpose and function of the provisions granting the deductions.” Hillsboro National Bank, 460 U.S. at 385.

Taxpayer took deductions in previous years for contributions to Trust which Taxpayer represents is a separate welfare benefit fund under a collective bargaining agreement within sections 419A(f)(5) of the Code and 1.419A-2T, Q&A-1, of the Regulations. The amendment of Trust will require amounts that were originally contributed to provide for the payment of postretirement health benefits to collectively bargained retirees to be used instead to provide for the payment of health benefits to active collectively bargained employees. The amendment of Trust to transfer assets to a separate subaccount to provide for the payment of health benefits to active collectively bargained employees is not fundamentally inconsistent with the premise on which the Taxpayer’s earlier deduction was based because Trust continues to be a separate welfare benefit fund under a collective bargaining agreement within the meaning of section 419A(f)(5) of the Code. Therefore, the tax benefit rule does not apply.

As explained above, section 4976(a) imposes a 100 percent excise tax if an employer maintains a welfare benefit fund and there is a disqualified benefit provided during any taxable year. A “disqualified benefit” is defined in section 4976(b)(1)(C) to include any portion of a welfare benefit fund reverting to the benefit of the employer. Based on the information submitted by Taxpayer, the amendment of Trust to include a subaccount to provide for the payment of health benefits to active collectively bargained employees will not result in any portion of Trust reverting to the benefit of Taxpayer. Thus, the amendment of Trust and the use of Trust assets to provide for the payment of health benefits to active collectively bargained employees will not result in a “disqualified benefit” within the meaning of section 4976(b)(1)(C), and the transaction will not, in and of itself, cause Taxpayer to be liable for the excise tax imposed by section 4976.

We assume, without expressing an opinion, for purposes of this ruling, that Trust may be amended as described and that the amendment can otherwise be effectuated and does not fail to meet the requirements of other applicable federal and state law. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Specifically, no opinion is expressed regarding the tax consequences of the described amendment to Trust or Trust's status under section 501(c)(9). Section 6110(k)(3) provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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,

Janet A. Laufer
Senior Technician Reviewer, Health and Welfare
(Employee Benefits)
(Tax Exempt & Government Entities)

cc: