200301047

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

UIL Numbers: 501.09-00
4976.00-00
512.00-00
420.00-00

Date: OCT 10 2002

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legends:

Corporation =
Life Trust =
Nonrepresented
Health Trust =

Represented
Health Trust =

Retiree Medical Plan =

Retiree Dental Plan =
Life Plan =
Prior Private Letter
Ruling =
B Corporation =
X Corporation =
Y Corporation =
m =
n =

Dear Sir or Madam:

This is in reference to your ruling request dated December 7, 2001, as supplemented by letter dated September 16, 2002, concerning issues under sections 61, 419, 419A, 420, 501, 512 and 4976 of the Internal Revenue Code ("Code").

Facts:

Corporation was formed from communication systems formerly part of B Corporation. Corporation became independent of B Corporation as part of a tax-free reorganization.

The Life Trust is a voluntary employees' beneficiary association ("VEBA") trust recognized as exempt under section 501(c)(9) that currently provides certain postretirement life insurance benefits to Corporation's eligible retired employees. The Life Trust holds a single asset, a group term life insurance contract (the "Life Insurance Policy"). Pursuant to the Life Insurance Policy, the insurance company maintains a retired lives reserve ("Retired Lives Reserve") for the purpose of funding postretirement life insurance benefits for both represented and nonrepresented employees. As of September 30, 2000, the amount of assets in the Life Trust in excess of the amount necessary to fully fund the present value of postretirement life insurance benefits under the Corporation's life insurance plan was approximately $1 billion.

The Nonrepresented Health Trust is a VEBA recognized as exempt under section 501(c)(9) of the Code that covers nonrepresented active and retired employees. The Represented Health Trust is a VEBA under section 501(c)(9) that covers represented active and retired employees. Represented employees are those covered by a collective bargaining agreement and nonrepresented employees are those not covered by a collected bargaining agreement. Both trusts provide medical benefits.

The Life Trust, the Nonrepresented Health Trust, and the Represented Health Trust were established in connection with a spin-off of assets and liabilities from the corresponding B Corporation welfare benefit funds as part of the Corporation spin-off. Corporation has not made any contributions to the Life Trust since its establishment. Thus, the source of all funds within the Life Trust are contributions originally made (and presumably deducted) by B Corporation.

X Corporation was formed as a result of the tax-free spin-off of the m business of Corporation in 2000.

Y Corporation comprises Corporation's former n group. Currently Y Corporation and Corporation are members of the same controlled group. Corporation anticipates subsequently distributing all of the remaining Y Corporation shares in a tax-free transaction. The Corporation received a private letter ruling that the spin-off of X Corporation constituted a tax-free reorganization. However, the Corporation has received no ruling concerning the proposed spin-off of Y Corporation.

Prior to the spin-offs of X Corporation and Y Corporation, Corporation entered into certain agreements (the "Employee Benefit Agreements") with X Corporation and Y Corporation for the purpose of governing the employee benefits aspects of the spin-offs of the respective companies. The Employee Benefit Agreements require that all assets transferred from Corporation's postretirement VEBA trusts will be transferred to corresponding postretirement VEBA trusts established by X Corporation and Y Corporation on a pro rata basis under FAS 106 assumptions.

Proposed Transactions

Corporation first proposed transaction is to apportion the Life Trust into two separate VEBAs (the "Represented Welfare Trust" and the "Nonrepresented Welfare Trust", collectively,

the "New VEBAs"), the former providing postretirement life insurance benefits to represented employees and the latter proving postretirement life insurance benefits to nonrepresented employees. In accordance with this division, the Life Insurance Policy will be apportioned into life insurance policies established to provide benefits to nonrepresented and represented employees (the "Represented Life Insurance Policy" and the "Nonrepresented Life Insurance Policy"). As part of the division the Retired Lives Reserves will be apportioned into two retired lives reserves (the "Nonrepresented Retired Lives Reserve" and the "Represented Retired Lives Reserve").

The allocation of assets between the Nonrepresented Retired Lives Reserve and the Represented Retired Lives Reserve will be on a pro rata allocation on the basis of the present values of the future benefit obligations of the Represented Life Insurance Policy and the Nonrepresented Life insurance Policy. The actuarial assumptions that will be applied for purposes of calculating the present value of future benefit obligations will be the actuarial assumptions utilized by the Corporation for its financial accounting purposes pursuant to FAS 87.

Once the Corporation apportions the Life Trust into the New VEBAs, the Corporation proposes to use the Excess Pre-DEFRA Reserves available in the New VEBAs to fund postretirement health care benefits. The Corporation will determine the amount of Excess Pre-DEFRA Reserves in the New VEBAs by first using the methodology set forth in section 1.512(a)-5T, Q & A 4 of the regulations, substituting the term "Pre-DEFRA Reserve" for "existing reserve for post-retirement medical or life insurance benefits" and the date "December 31, 1985" for the date "July 18, 1984" appearing in those regulations, to determine the amount of Pre-DEFRA Reserves in the VEBA. (Thus, to determine the Pre-DEFRA reserves, the Corporation will begin with the December 31, 1985, life insurance reserve, decrease it by subsequent benefit payments, and increase it with proportional (between Pre-DEFRA and other reserves) investment income. The Corporation will then allocate the Pre-DEFRA Reserves in the Life Trust to the New VEBAs in proportion to the assets within each of the New VEBAs.)

The Corporation will then determine the Excess Pre-DEFRA Reserve within each New VEBA as the lesser of the Pre-DEFRA Reserve and the Excess Assets held by that New VEBA. The Excess Assets of each New VEBA will be determined as the excess of the fair market value of assets held within each New VEBA over the present value of that VEBA's (adjusted as described in the following sentence) benefit obligations. For the purposes of determining each VEBA's (adjusted) benefit obligations, life insurance benefits will not be taken into account to the extent that the aggregate amount for any employee exceeds $50,000. The actuarial assumptions that will be applied for purposes of calculating the present value of future benefit obligations will be the actuarial assumptions utilized by the Corporation pursuant to FAS 87.

The amount of Excess Pre-DEFRA reserves that will be released to fund postretirement health benefits will be determined each year by Corporation's human resources and financial staff members. It is contemplated that the formal letter of instruction will be issued by the Corporation's Senior Vice President of Human Resources.

The Corporation has requested the following rulings:

1. The proposed transactions will not cause the Life Trust, or any of the other VEBA Trusts involved in the proposed transactions, to fail to be exempt from tax under section 501(a) of the Code as organizations described in section 501(c)(9).

2. The proposed transactions will not cause Corporation to include any amount in gross income.

3. The proposed transactions will not result in the provision of any "disqualified benefit" within the meaning of section 4976 of the Code and, consequently, will not cause Corporation to be liable for the tax imposed by section 4976.

4. The proposed transaction will not cause any of the VEBAs involved in the proposed transactions to recognize unrelated business taxable income.

5. As of the end of a plan year with respect to any plan included under the VEBAs, the assets then held in the retired lives reserves by the VEBAs will not be treated as assets "set aside to pay for the qualified current retiree health liability" for purposes of section 420(e)(1)(B) of the Code.

6. The proposed transaction will not be deemed inconsistent with, or violative of, any representations made by the Corporation for the purpose of obtaining the Prior Private Letter Ruling, and will not adversely affect such ruling.

LAW AND ANALYSIS

Ruling Request 1:

Section 501(a) of the Code provides an exemption from federal income tax for organizations described in section 501(c).

Section 501(c)(9) of the Code describes a "voluntary employees' beneficiary association" as an organization which provides 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.

Section 1.501(c)(9)-2(a)(2)(i) of regulations provides that in part, that eligibility for membership in a VEBA may be restricted by geographic proximity, or by objective conditions or limitations reasonably related to employment, such as a limitation to a reasonable classification of workers.

Section 1.501(c)(9)-2(a)(2)(ii)(B) of the regulations provides in the case of an employer funded-organization, a provision that excludes from membership, or limits the type or amount of benefits provided to, individuals who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that the benefit or benefits provided by the organization were the subject of good faith bargaining between such employee representatives and such employer or employers.

Section 1.501(c)(9)-3 of the regulations provides, in part, that life, sickness, accident or other similar benefits may be provided by a VEBA, so long as each type of benefit is a permissible VEBA benefit.

Section 1.501(c)(9)-4(a) of the regulations provides, in part, that no part of the net earnings of an employees' association may inure to the benefit of any private shareholder or individual other than through the payment of benefits permitted by section 1.501(c)(9)-3.

Section 1.501(c)(9)-2(a)(2)(i) of the regulations permits the coverage of a VEBA to be restricted to a specified class of employees. In particular, it is permissible to exclude from coverage groups of employees that are no longer employed within the VEBA sponsor's controlled group. Thus, Corporation may amend its VEBAs to exclude coverage of employees transferred to X Corporation or Y Corporation. Additionally, X Corporation and Y Corporation may establish and maintain VEBAs covering employees who have transferred from the Corporation. The coverage of the Represented Welfare Trust and Y Corporation Represented Welfare Trust to represented employees, and to restrict the coverage of the Nonrepresented Welfare Trust and Y Corporation Nonrepresented Welfare Trust to nonrepresented employees.

Additionally, the section 501(c)(9) requirements are not violated by the adoption of an amendment to an existing VEBA (or the establishment of a new VEBA) to provide health benefits in addition to life insurance benefits.

Also, the transfer of assets from one VEBA to another (e.g., from the current Life Trust to the corresponding Life Insurance Trust established for X Corporation, from the current Life Trust to the Nonrepresented Welfare Trust, or from the Represented Welfare Trust or Nonrepresented Welfare Trust to the corresponding welfare trust established for Y Corporation) will not result in prohibited inurement of the net earnings of any of the VEBAs involved in the transaction. Coverage for all of the employees currently covered by the Life Trust, Represented Health Trust, or Nonrepresented Health Trust will be retained by such VEBAs or assumed by one or more of the other VEBAs involved in the transactions (as applicable), and all current assets and liabilities of the Life Trust, Represented Health Trust, or Nonrepresented Health Trust will either be retained or transferred to another VEBA involved in the transaction. Therefore, there is no prohibited inurement.

Therefore, the proposed transactions will not cause the Life Trust, or any of the other VEBA Trusts involved in the proposed transactions, to fail to be exempt from tax under section 501(a) of the Code as organizations described in section 501(c)(9).

Ruling Request 2:

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

Section 111(a) of the Code 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 such amount did not reduce the amount of tax imposed by Chapter 1 of the Code. That section, in part, codifies the "tax benefit rule". Generally, the tax benefit rule requires the inclusion in income of certain amounts that were deducted in a prior year and that generated a tax benefit through a reduction in the amount of tax liability in the prior tax year. Estate of Block v. Comm'r, 39 B.T.A. 338 (1939), aff'd sub nom.; Union Trust Co. v. Comm'r, 111 F.2d 60 (7th Cir. 1939), cert. denied, 311 U.S. 658 (1940); Rev. Rul. 85-186, 1985-2 C.B. 84. In Hillsboro Nat'l Bank v. Comm'r, 460 U.S. 370 (1983), the Supreme Court held, in part, that income may arise under the tax benefit rule even though there is no actual recovery of funds that were previously deducted, if an event occurs that is "fundamentally inconsistent" with the premise on which a deduction was taken in a prior year.

Contributions to a welfare benefit fund are deductible when paid, but only if they qualify as ordinary and necessary business expenses under section 162 of the Code and only to the extent allowable under sections 419 and 419A. Those sections impose strict limits on the amount of tax-deductible prefunding permitted for contributions to a welfare benefit fund. The deduction limitations imposed by sections 419 and 419A apply to contributions paid or accrued with respect to a welfare benefit fund after December 31, 1985. Prior to this date deductions for contributions paid to a welfare benefit funds were controlled by section 162.

Section 1.162-10 of the regulations provides, in part, that amounts paid or accrued within the taxable year for a sickness, accident, hospitalization, medical expense, or similar benefit plan, are deductible under section 162(a) of the Code if they are ordinary and necessary expenses of the trade or business.

Rev. Rul. 69-478, 1969-2 C.B. 29, holds that a corporation's nonrefundable contribution to an employee's trust to provide group health and life insurance for both active and retired employees is deductible under section 162 of the Code, when contributions are actuarially determined and made by the employer on a level basis so that at the time of an employee's retirement there is enough money in the fund to enable the trustee to continue to make the premium payments on the contracted insurance.

Rev. Rul. 69-382, 1969-2 C.B. 28, holds that for taxable years ending on or before June 17, 1969, premiums paid or incurred by an employer policyholder under contracts providing group term life and health and accident coverage for its active and retired employees are deductible in full even though a portion of the premium is credited to a retired lives reserve if (1) the balance in the reserve is held by the insurance company solely for the purpose of providing insurance coverage on active or retired lives so long as any active or retired employees remain alive, and (2) the amount added to the retired lives reserve is not greater than an amount which would be required to fairly allocate the cost of the insurance coverage provided over the working

lives of the employees involved. This revenue ruling also stated that for taxable years ending after June 17, 1969, such premiums paid or incurred are deductible if in addition to the two requirements, the insurance contract states that the employer policyholder has no right to recapture any portion of the reserve so long as any active or retired employee remains alive.

Rev. Rul. 73-599, 1973-2 C.B. 40, holds that the annual contributions by the taxpayer to the fund maintained by the trustee for retired lives are business expenses deductible under section 162 of the Code in the taxable year paid or incurred but only to the extent that such contributions are actuarially determined and made on a level basis.

One proposed transaction involves funding postretirement health benefits for Corporation employees from amounts originally attributable to contributions made to fund postretirement life benefits for which deductions were previously taken pursuant to section 162 of the Code. Also, Corporation plans to transfer assets relating to nonrepresented employees from the insurance policy within the Life Trust (which will cover only represented employees once the transaction occurs), to a new substantially identical policy within the New VEBA providing benefits to the Corporation's nonrepresented employees. Additionally, the Corporation will transfer assets to new welfare benefit plans established to provide life insurance benefits by the two spun-off corporations, X Corporation and Y Corporation, in an amount proportionate to the accumulated postretirement benefit obligations of employees transferred to X Corporation and Y Corporation, respectively. When amounts were originally contributed to the Life Trust (or the trust that previously held the assets), deductions were taken in accordance with sections 162 and 419.

As stated 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 rule protects the Government and taxpayers from the adverse effects of reporting a transaction on the basis of assumptions that an unforeseen event in a subsequent year proves to have been erroneous. However, not every unforeseen event will require the taxpayer to report income in the amount of the prior deduction. Rather, the tax benefit rule will "cancel out" a prior deduction only when the subsequent event is indeed "fundamentally inconsistent with the premise on which the deduction was based. That is, if that event had occurred within the same taxable year [as the deduction], it would have foreclosed the deduction." Hillsboro, 460 U.S. at 383-84 [footnote omitted]. The facts and circumstances of each case must be considered "in light of the purpose and function of the provisions granting the deductions." Id. at 385.

The Corporation represents that all of the Excess Pre-DEFRA Reserves are amounts contributed or accruing prior to the enactment and applicability of section 419 of the Code. As such, all deductions for these contributions would have been taken under section 162 for ordinary and necessary business expenses limited by the rules set out in Rev. Rul. 69-382 and Rev. Rul 73-599. The transfer of funds from the Corporation's retired life reserves to the separate postretirement health account within the VEBA results in a transfer of assets from an account that provides welfare benefits to another that provides welfare benefits. For the deduction taken under section 162 for a contribution to a welfare benefit fund prior to the enactment of section 419, no distinction was made between the type of welfare benefit provided under the fund. However, the deduction taken under section 162 was not unlimited. Rather, when originally taken, the deduction under section 162 for contributions to B Corporation's

retired life reserves was limited to an amount actuarially determined to allocate the cost of the postretirement life insurance coverage provided over the working lives of the employees involved.

If the amounts in the B Corporation's retired life reserves that were set aside to fund postretirement life insurance benefits had been released to fund postretirement health benefits in the same years in which B Corporation took deductions under section162 of the Code for contributions to the retired life reserves, that release would not have, in and of itself, foreclosed the deductions. However, because the limit on the amount of the deduction in each of those years would have been different depending on whether the contributions were applied to fund postretirement life insurance benefits or postretirement health benefits, more information is needed from the Corporation in order to determine whether the application of the tax benefit rule results in gross income to the Corporation in this case. Specifically, the amount of the contribution in each year that would have been deductible for funding postretirement life benefits (i.e., up to the amount that would fairly allocate the cost of postretirement life insurance over the working lives of the employees involved) may have exceeded the amount that would have been deductible for funding postretirement health benefits over the working lives of the employees involved. If excess Pre-DEFRA Reserves are attributable to amounts deducted by B Corporation for contributions that did not exceed the amount that would have been deductible if used to fund postretirement health benefits over the working lives of the employees involved for the years in which the respective deductions were taken, the release to the separate accounts within each of the New VEBAs to provide postretirement health benefits is not fundamentally inconsistent with the deductions taken under section 162, and therefore, the application of the tax benefit rule would not result in gross income to the Corporation.

The Corporation has represented that it appears reasonable to conclude that all of the contributions toward the life insurance reserve would have been fully deductible under section 162 of the Code if the contributions to the postretirement life insurance reserve had in fact been made to the postretirement health reserve.

With regard to the transfer of assets from the Life Trust to the life insurance policy in the New VEBA covering only the nonrepresented employees, the life insurance benefits in the New VEBAs will maintain the provision that trust amounts will only be used to provide postretirement life insurance benefits and to pay related administrative expenses (with the exception of the amendment to allow the release of Excess Pre-DEFRA amounts to pay for retiree health benefits as discussed above). Additionally, these trusts and the life insurance policies thereunder contain provisions prohibiting the reversion of any amount held in the retirement funding account to the Corporation as long as any employee or retiree of the Corporation remains alive. These provisions are effective to preserve the integrity of the assets transferred to the New VEBA covering nonrepresented employees. Accordingly, this transaction will not be fundamentally inconsistent with the deductions taken in previous years with respect to those assets, and the application of the tax benefit rule would not result in gross income to the Corporation. Similarly, the transfer of the proportionate assets to the New VEBA that provides retiree life benefits to nonrepresented employees, from the Life Trust, subject to the limitation that funds in those trusts be used exclusively to provide postretirement life insurance benefits, and to pay related administrative expenses, except to the extent that Excess Pre-DEFRA Reserves are released to pay postretirement health benefits and related administrative

expenses, will not result in a reversion to the benefit of the Corporation that is subject to the excise tax imposed by section 4976.

In the case of the transfer of assets to the X Corporation and Y Corporation VEBAs, a similar analysis as that described in the previous paragraph is appropriate to determine the applicability of the tax benefit rule and any inclusion in gross income. The Employee Benefits Agreements require certain assets to be transferred from the Represented Health Trust to corresponding postretirement health benefit VEBA trusts established by X Corporation and Y Corporation. Neither the terms of these agreements, nor the events that have occurred subsequent to the effectuation of these agreements, give us any reason to believe that these transferred assets will in fact be utilized for any purpose other than providing postretirement health benefits and paying related expenses.

Ruling Request 3:

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 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 taxable year.

Corporation represents that only amounts attributable to the Pre-DEFRA Reserve will be used to pay postretirement health benefits under the proposed transactions. The Pre-DEFRA Reserve is solely attributable to contributions that were not allowable as deductions under section 419 of the Code. Therefore, the transferred amounts are not subject to the section 4976 excise tax. Corporation represents that it has no right to any transferred funds, and all of the assets held by the various welfare benefit funds will be used for the exclusive purpose of providing welfare benefits to Corporation's retired employees (and eligible beneficiaries), as applicable.

Therefore, the proposed transactions will not result in the provision of any "disqualified benefit" within the meaning of section 4976 of the Code and, consequently, will not cause Corporation to be liable for the tax imposed by section 4976.

Ruling Request 4:

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

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 proposed transactions will not create unrelated business taxable income. The transfer of Excess Pre-DEFRA Reserves from a retired lives reserve to the VEBA that is the policyholder of the life insurance contract is simply a transfer from one welfare benefit fund to another welfare benefit fund. The transfer of Excess Pre-DEFRA Reserves will instead represent merely a reallocation of assets between different welfare benefit funds.

Therefore, the proposed transaction will not cause any of the VEBAs involved in the proposed transactions to recognize unrelated business taxable income.

However, no opinion is expressed about the implications of past computation of the account limit under section 419A(c) of the Code for purposes of computing the unrelated business income under section 512(a)(3) of the Life Trusts or any prior trusts to which assets now in the Life Trust were originally contributed.

For purposes of calculating the amount of unrelated business taxable income of the New VEBAs for any taxable year, an "existing reserve for post-retirement medical and life insurance benefits" described in section 512(a)(3)(E)(iii)(I) of the Code must be calculated using the greater of two amounts as set forth in section 512(a)(3)(E)(iii)(II). Both of these amounts are keyed to the date July 18, 1984, and not to December 31, 1985. Consequently, for purposes of calculating UBTI, the relevant reserve shall be the reserve attributable to amounts set aside as of July 18, 1984 (and not as of December 31, 1985).

Ruling Request 5:

Section 420 of the Code permits, subject to specified conditions and limitations, a qualified transfer of excess pension assets of a defined benefit plan (other than a multiemployer plan) to a health benefits account (under section 401(h)) that is part of the plan. Section 420(b)(3) limits the amount that may be transferred to the amount that is reasonably estimated to be the amount the employer maintaining the plan will pay (whether directly or through reimbursement) out of the account during the taxable year of the transfer for qualified current retiree health liabilities.

Section 420(e)(1)(A) of the Code provides that, generally, the term "qualified current retiree health liabilities" means, with respect to any taxable year, the aggregate amounts (including administrative expenses) that would have been allowable as a deduction to the employer for the taxable year with respect to applicable health 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 420(e)(3)(B) of the Code provides that the amount determined under section 420(e)(1)(A) shall be reduced by amounts in health benefits accounts or welfare benefit funds set aside to pay for the qualified current retiree health liability. This reduction is based on the ratio of (i) the value, as of the close of the plan year preceding the section 420 transfer, of the assets in all health benefits accounts or welfare benefit funds set aside to pay for qualified current retiree health liabilities, to (ii) the present value of the qualified current retiree health liabilities for all plan years.

During any taxable year, once the Corporation has determined an amount of Excess Pre-DEFRA Reserves in the New VEBAs that may be released to be applied to fund postretirement health benefits and related expenses in a taxable year, those amounts are committed to pay current retiree health liabilities for that year. Accordingly, once the Corporation determines an amount of Excess Pre-DEFRA Reserves is to be released to be applied to fund postretirement health benefits, the amounts so designated become assets "set aside to pay the qualified

current retiree health liability". It is the determination to release the amounts, and not the actual release and deposit of these amounts in separate accounts within the New VEBAs, that is the relevant event for purposes of section 420(e)(3)(B). When the Corporation makes a determination, whether by board action or other managerial decision making process, that certain funds will be released to fund postretirement health benefits, the amounts are committed to fund such benefits. Thus, as of the end of any plan year, assets "set aside to pay the qualified current retiree health liability" under section 420(e)(1)(B) includes any portion of the Excess Pre-DEFRA Reserves that the Corporation has determined will be released in that plan year to pay postretirement health benefits whether or not the funds have actually been set aside into a separate retiree health account. In contrast, however, the ruling request indicates that any amount of the Excess Pre-DEFRA Reserve the Corporation does not determine it will release for postretirement health benefits remaining in the retired lives reserve will be applied only to pay retiree life insurance liabilities. Thus, those remaining assets are not assets "set aside to pay the qualified current retiree health liability" under section 420(e)(1)(B).

Ruling Request 6:

Section 4976(a) of the Code imposes an excise tax in the amount of 100 percent of the amount of any disqualified benefit provided by a welfare benefit plan.

Section 4976(b)(1)(C) of the Code indicates that the term "disqualified benefit" includes "any portion of a welfare benefit fund reverting to the benefit of the employer."

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

The issue of whether the use of funds set aside to fund postretirement life benefits under section 419(c)(2) of the Code to provide postretirement health benefits is a "disqualified benefit" under section 4976(b), thus triggering the 4976 excise tax is not being addressed in this ruling. Section 1.419-1T, Q&A-2, of the regulations provides that section 419 applies only to contributions paid or accrued with respect to a welfare benefit fund (such as the B Corporation and the Corporation retired life reserves and VEBAs) after December 31, 1985, in taxable years of employers ending after that date. Assuming the Corporation is correct in its statement that all the entire excess amount represents contributions made and accruals occurring prior to December 31, 1985, only Excess Pre-DEFRA Reserves will be applied to provide postretirement health benefits. The Excess Pre-DEFRA Reserves are attributable only to contributions that were not "allowable as a deduction under section 419 for the taxable year or any prior taxable year" within the meaning of section 4976(b)(3) of the Code. Accordingly, pursuant to section 4976(b)(3), section 4976(b)(1)(C) does not apply with respect to the use of the Excess Pre-DEFRA Reserves.

The Service previously issued the Prior Private Letter Ruling regarding the transfer of amounts from B Corporation's welfare benefit funds to similar welfare benefit funds established by the Corporation. The rulings in that Prior Private Letter Ruling were based, in part, upon representations by the Corporation that the amounts transferred to the retired life reserves

would be used exclusively to provide postretirement life insurance benefits and to pay related administrative expenses. The Corporation now represents that the life insurance policies held by the New VEBAs will provide that the retired life reserve assets will be used exclusively to provide postretirement life insurance benefits and to pay related administrative expenses, except to the extent that Excess Pre-DEFRA Reserves are released to pay postretirement health insurance benefits and related administrative expenses as described above. Because, as indicated above, section 4976 is not applicable with respect to the use of Excess Pre-DEFRA reserves, we conclude that the proposed transactions will not adversely affect the determinations in the Prior Private Letter Ruling.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

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

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,

(signed) Robert C. Harper, Jr.

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