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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

UIL Numbers: 501.09-00
419A.00-00

Date:
DEC 11 2002

Contact Person:

Identification Number:

Telephone Number:

T:EO:B3

Employer Identification Number:

Legends:

Company =
VEBA =

Unions =
Plan =

1 =

Dear Sir or Madam:

This is in reference to your ruling request dated August 17, 1999, concerning the tax treatment of certain set asides and contributions to the VEBA, 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 VEBA is exempt from federal income tax as an organization described in section 501(c)(9) of the Internal Revenue Code ("Code"). The VEBA has been determined to be maintained under a collective bargaining agreement within the meaning of section 419A(f)(5).

The Company is funding retiree health benefit obligations through the VEBA under which Union employee benefits are paid. The Company proposed to establish within the VEBA an account designed to provide post-retirement medical and life insurance benefits for participants. This account is referred to as the "Retiree Benefits Reserve Account." The proposed Retiree

Benefits Reserve Account will have separate accounting for assets of the Plan and any other plan that may use the VEBA as a funding vehicle for benefits.

The purpose of the VEBA is to provide benefits pursuant to the terms of the Plan, including medical and life insurance benefits for retirees.

You requested five rulings, and ruling request number five asked whether the limitations described in section 512(a)(3)(E)(i) of the Code apply to the amounts set-aside in the Retiree Benefits Reserve Account.

The Actuarial Branch of the Employee Plans Division responded to ruling requests one through four in a ruling letter dated October 24, 2001. This letter responds to ruling request number five.

Section 501(a) of the Code exempts from federal income tax organizations described in section 501(c)(9). Section 501(c)(9) describes voluntary employees' beneficiary associations that provide for the payment of life, sick, accident, or other benefits to members of the association or their dependents or designated beneficiaries, if no part of the earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 511(a) of the Code imposes a tax for each taxable year on the unrelated business taxable income of organizations exempt from taxation under section 501(a).

Section 419A(f)(5) of the Code provides, in pertinent part, 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&A1 of the Income Tax Regulations asks: "what account limits apply to welfare benefit funds that are maintained pursuant to a collective bargaining agreement?" The response to section 1.419A-2T, Q&A1 provides, in part, that "neither contributions to nor reserves of a welfare benefit fund maintained pursuant to a collective bargaining agreement . . . shall be treated as exceeding the otherwise applicable limits of section 419(b), 419A(b), or 512(a)(3)(E) . . . until the date 3 years after the issuance of . . . final regulations concerning limits for collectively bargained welfare benefit funds."

Section 512(a)(3)(A) of the Code provides, in part, that in the case of an organization described in section 501(c)(9), the term "unrelated business income" means the gross income (excluding exempt function income), less the deductions allowed which are directly connected with the production of gross income (excluding exempt function income).

Section 512(a)(3)(B) of the Code provides, in relevant part, that for the 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 constituting the basis for the exemption of the organization to which such income is paid. Exempt function income also means all income (other than an amount equal to the gross

income derived from any unrelated trade or business regularly carried on by such organization computed as if the organization were subject to paragraph (1)), which is set aside –

> "(ii) in the case of an organization described in section 501(c)(9), to provide for the payment of life, sick, accident, or other benefits, including reasonable costs of administration directly connected with a purpose described in this paragraph."

Section 512(a)(3)(E)(i) of the Code provides, in part, that in the case of an organization described in paragraph (9) of section 501(c), a set-aside for any purpose specified in clause (ii) of subparagraph (B) may be taken into account under subparagraph (B) only to the extent that such set-aside does not result in an amount of assets set aside for such purposes in excess of the account limit under section 419A.

Section 511(a) of the Code imposes a tax on unrelated business taxable income. Unrelated business income does not include exempt function income; any amounts set aside to provide benefits under section 501(c)(9) are exempt function income to the extent that the amounts set aside do not exceed certain limits. However, these limits are inapplicable to qualified asset accounts under a separate welfare benefit fund maintained under a collective bargaining agreement.

Here, the VEBA is an organization described in section 501(c)(9) of the Code and the Retiree Benefits Reserve Account only provides for the payment of post-retirement medical and life insurance benefits; and all amounts credited to the Retiree Benefits Reserve Account are considered to be additions to a qualified asset account under section 419A(a), without being subject to the account limit of section 419A(c), pursuant to the provisions of section 419A(f)(5)(A). Furthermore, in a separate ruling the Service has ruled that the VEBA is maintained under a collective bargaining agreement within the meaning of section 419A(f)(5)(A). Therefore, under section 419A(f)(5)(A), no account limits apply to any accounts that the VEBA set aside to provide health benefits to the Company's retired employees.

Since account limits are not applicable in the case of accounts set aside to provide health benefits to the Company's retired employees, all amounts set aside for these section 501(c)(9) of the Code purposes are exempt function income. Unrelated business taxable income does not include exempt function income; therefore, any amounts set aside to provide health benefits to the Company's retired employees are not subject to the unrelated business income tax imposed under section 511(a).

Therefore, we rule that the limitations described in section 512(a)(3)(E)(i) of the Code do not apply to the amounts set aside in the Retiree Benefits Reserve Account.

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