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

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No Third Party Contacts
Date:
JUN 27 1999

Contact Person:

ID Number:

Telephone Number:
Fax:

OP:E:EO:T3

Employer Identification Number:

Legend:

A =
B =
C =
X =
Y =

M =
N =

Dear Sir or Madam:

This refers to your ruling request under sections 501(c)(9) and 4976 of the Internal Revenue Code.

A is exempt under section 501(c)(3) of the Code. A owns and operates hospitals in M and surrounding states.

Prior to 1988, A and the predecessor to C, a private foundation, jointly operated a hospital in N, which is adjacent to M. B was created as a jointly owned corporation for the purpose of operating the hospital. A owned 51% of B and C's predecessor owned the remaining 49%. B is exempt under sections 501(c)(3), and because it is no longer operating the hospital, is classified as a private foundation.

X and Y are both exempt under section 501(c)(9) of the Code. X was established to fund the A Retiree Welfare Benefit Plan providing medical and life insurance benefits to eligible retired employees of A and their eligible dependents (the "A Retiree Health Plan"). X also provides funding for the A Disabled Employee Medical Benefit Plan. Y was established to fund the B Plan for Retiree Health and Life Insurance Benefits providing for medical and life insurance benefits to eligible retired employees of B, and their eligible dependents (the "B Retiree Health Plan"). The health and accident benefits under the A Retiree Health Plan are similar (but not identical) to those available to retirees of B under the B Health Plan. Participants in the A Health Plan make contributions to X. Participants in the B Health Plan make contributions to Y.

B has not had any active employees since the sale of its hospital operations and assets in 1988. The number of retirees and dependants eligible for benefits each year from the B Retiree Health Plan is diminishing and the cost per participant of administering the B Retiree Health Plan and maintaining funding for Y is increasing. While not yet the case, the Administrator and Trustee of Y have determined that the cost per participant of administering the B Retiree Health Plan and maintaining funding for Y could become unreasonably high in future years. In addition, as the number of eligible participants and beneficiaries decreases, the ability to predict accurately the annual funding cost of Y will become less certain. In order to reduce the costs of administration and to allow for accurate estimation of the amount necessary to fund benefits, Y proposes to transfer all of its funds to X. X would then be liable to provide benefits to the eligible retirees of B and their dependants.

Actuarial calculations and projections have been completed for both X and Y. These calculations show that presently X contains assets sufficient to pay existing claims, projected claims, and expenses. Y has assets sufficient to pay current and projected claims and expenses, however, long term funding requirements for health and accident benefits for a steadily diminishing, and closed group, of retirees are becoming increasing difficult to assess. The Board of Trustees of A and B have determined to merge the Y into X. The merger will also include assumption by A of all funding liabilities of X for continuing health and accident benefits to retirees of B under the B Retiree Health Plan.

It is represented that after the merger, the assets and liabilities of X and Y will be combined. Neither A nor B will receive any of the assets of either VEBA before, during or after the merger. X will assume and commence paying claims to retired employees of B consistent with the terms of the B Retiree Health Plan. X will also continue paying claims to retirees of A consistent with the terms of the A Retiree Health Plan and other benefits according to the terms of the respective plans. It is anticipated that benefits for retirees of B will eventually be amended to become uniform with those available to A retirees under X.

Section 501(a) of the Code provides exemption from federal income tax for organizations that include those described in section 501(c)(9).

Section 501(c)(9) of the Code describes voluntary employees' beneficiary associations which provide for the payment of life, sick, accident, or other benefits to the members of the association or their dependents, or designated beneficiaries, if no part of the net earnings of the association inures to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-2(a)(1) of the Income Tax Regulations provides that the membership of an organization described in section 501(c)(9) must consist of individuals who become entitled to participate by reason of their being employees and whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond among such individuals. Typically, those eligible for membership in an organization described in section 501(c)(9) are defined by reference to a common employer (or affiliated employers). In addition, employees of one or more employers engaged in the same line of business in the same geographic locale will be considered to share an employment-related bond for purposes of an organization through which their employers provide benefits.

Section 1.501(c)(9)-2(d)(1) of the Proposed Income Tax Regulations provides, as safe harbor, that an area is a single geographic locale if it does not exceed the boundaries of three contiguous states, i.e., three states each of which shares a land or river border with at least one of

the others.

Section 1.501(c)(9)-4(d) of the regulations provides that it will not constitute prohibited inurement if, on termination of a plan established by an employer and funded through an association described in section 501(c)(9), any assets remaining in the association, after satisfaction of all liabilities to existing beneficiaries of the plan, are applied to provide, either directly or through the purchase of insurance, life, sick, accident or other benefits pursuant to criteria that do not provide disproportionate benefits to officers, shareholders, or highly compensated employees of the employer.

Section 4976(a) of the Code imposes on an employer that maintains a welfare benefit fund a tax equal to 100% of the disqualified benefit provided during any taxable year.

Section 4976(b)(1)(C) of the Code defines a "disqualified benefit" to include any portion of a welfare benefit fund reverting to the benefit of the employer.

The committee reports on the Deficit Reduction Act of 1984, which added section 4976 to the Code, provide no guidance on the meaning of "reverting to the benefit of the employer." However, the Bluebook explaining the 1984 Act, although not authority, states that if an amount is paid by a fund to another fund for the purpose of providing welfare benefits to employees of the employer, then the payment is not to be considered a reversion.

The information submitted indicates that the assets transferred under the proposed merger will be used to provide eligible members with permissible benefits under section 501(c)(9) of the Code. The members of Y share an employment-related common bond with the members of X. Therefore, the proposed merger will not adversely affect the tax-exempt status under section 501(c)(9) of the involved VEBAs. In addition, neither of the sponsoring employers who have contributed to the two VEBAs will receive any of the assets of either VEBA before, during, or after the merger. Therefore, neither sponsoring employer will receive an impermissible economic benefit. As such, the proposed merger and transfer of assets should not create a reversion to either employer and will not constitute a "disqualified benefit" within the meaning of Code Section 4976(b)(1)(C).

Based on the foregoing, we rule as follows:

1. The proposed transfer of all assets and liabilities from Y and their assumption by X will not adversely affect the status of either VEBA as a tax exempt trust under sections 501(a) and 501(c)(9) of the Internal Revenue Code.

2. The proposed transfer of all assets and liabilities of Y and their assumption by X will not result in an asset reversion to either A or B as the employers who contribute to and sponsor either VEBA.

3. The proposed transfer of all assets and liabilities from Y and their assumption by X will not be subject to excise tax under sections 4976(a) and 4976(b)(1)(C) of the Code.

This ruling is based on the assumption that there is no material change in the submitted facts. Also, this ruling does not express or imply any opinion as to the federal tax consequences of the transactions under any other provisions 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.

We are informing your TE/GE EO Area office of this ruling. Please keep this letter in your permanent records.

Sincerely,

(signed) Robert C. Harper, Jr.

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

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