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INTERNAL REVENUE SERVICE

NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

APR 7 1999 OP:E:EO:T2

Taxpayer's Name:

Taxpayer's Address:

Years involved:

Date of Conference:

LEGEND:

A =

Issues:

1. Is the payment of self-funded paid-up life and/or the payment of self-funded term life insurance a qualifying benefit for the purposes of section 501(c)(9) of the Code?

2. Is the refund of contributions to an employer which were paid after the collective bargaining agreement had ended and during the pendency of a labor dispute with a union a disqualified benefit, inurement or a taxable reversion to the employer?

3. If the Fund's status as an organization described in section 501(c)(9) of the Code were revoked is the Fund entitled to section 7805(b) relief?

Facts:

The Fund has been recognized as exempt from Federal income tax under section 501(c)(9) of the Code. It is a multi-employer benefit trust and was established pursuant to a collective bargaining agreement between a group of employers and the union which represented employees of the employers.

The benefits provided employee/members through the Fund include two self-funded life insurance benefits programs. The life insurance benefits provided are a so-called "paid up life"

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Re:

and a term life benefit. The amount of term insurance is the same for every participant. The amount of paid-up life insurance is based, in large part, on how long a participant has been making contributions to the Fund. In both situations benefits are only payable upon the demise of the covered employee. X, the authority within the state which is responsible for insurance matters, does not consider "paid up life insurance" life insurance for the purposes of the state statutes governing insurance.

Prior to the end of the term of the collective bargaining agreement several of the contributing employers became involved in what became a long running dispute with the union regarding the proper interpretation of certain terms in the terms of the collective bargaining agreement. During this continuing dispute the collective bargaining agreement(s) between the affected contributing employers and the union expired. After the expiration of the collective bargaining agreement the employers had no obligation to continue to make contributions to the Fund. It appears that after the term of the first collective bargaining agreement had ended and before the new collective bargaining agreement was signed, a period of time which exceeded one year, a small number of employers erroneously continued to make contributions to the Fund. When these employers recognized their error, they requested that the contributions made after the termination of the collective bargaining agreement be returned to them and the Fund returned the monies in question. It appears that such a repayment is permitted under the provisions of the trust agreement.

Law:

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.

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.

Re:

Section 1.501(c)(9)-3(b) of the regulations provides that the term 'life benefits' means a benefit (including a burial benefit or a wreath) payable by reason of the death of a member or dependent. It generally must consist of current protection, but also may include a right to convert to individual coverage on termination of eligibility for coverage through the association, or a permanent benefit as defined in, and subject to the conditions in, the regulations under section 79.

Section 1.501(c)(9)-3(d) of the regulations provides that the term 'other benefits' includes only benefits that are similar to life, sick, or accident benefits. A benefit is similar to a life, sick, or accident benefit if:

(1) It is intended to safeguard or improve the health of a member or a member's dependents, or

(2) It protects against a contingency that interrupts or impairs a member's earning power.

Section 1.501(c)(9)-3(f) of the regulations provides that the term "other benefits" does not include any benefit that is similar to a pension or annuity payable at the time of mandatory or voluntary retirement. For the purposes of section 501(c)(9) a benefit will be considered similar to that provided under a pension, annuity, stock bonus or profit sharing-plan if it provides for deferred compensation that becomes payable by reason of the passage of time rather than as the result of an unanticipated event.

Section 1.501(c)(9)-4(a) of the regulations provides 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 permissible benefits. Whether prohibited inurement has occurred is a question to be determined with regard to all the facts and circumstances.

Section 4976 of the Code imposes an excise tax on an employer equal to 100 percent of any disqualified benefit provided by an employer-maintained welfare benefit fund.

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

Section 111 of the Code provides the so-called "tax benefit rules". In particular it 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 this chapter.

William H. Block v. Commissioner, 39 B.T.A. 338, at 341 (1939), affirmed Sub Nom., Union Trust Co. of Indianapolis v. Commissioner, 111 F. 2d 60 (1940), cert. den. 311 U.S. 658 (1940), explains the tax benefit rule as being when either recovery of a previously deducted item or some other event that is inconsistent with what has been done in the past occurs, an adjustment must be made in reporting income for the year in which the change occurs.

Rev. Rul. 68-223, 1968-1 C.B. 154 provides that the transfer of funds from a non-exempt employees' welfare fund to an employees' trust forming part of a pension plan will not, of itself, disqualify the plan and trust under the provision of section 401(a) of the Code nor affect the exempt status of the trust under section 501(a).

The Revenue Ruling notes that subject to the tax benefit rule, that part of the funds transferred which was properly taken by the employer as deductions for payments to the welfare fund should be included in the employer's gross income, under the provision of section 61(a) of the Code, in the year transferred and taken as a deduction by the employer in that year, to the extent allowed by section 404(a) of the Code.

Rationale:

Issue 1. Benefits

Term life insurance is a typical type of life insurance benefit recognized in section 1.501(c)(9)-3(b) of the regulations. Therefore, the sole benefit provided through the Fund which remains in question is the self-funded paid-up life insurance benefit.

As previously indicated X does not consider self-funded paid-up life insurance to be insurance for state tax purposes. However, it is clear that the payment of this benefit only comes due upon the occurrence of an unanticipated event, the death of the insured, and protects a member and his or her family or beneficiary against a contingency that interrupts or impairs the member's earning power. Furthermore, it is clear that unlike an annuity or a retirement benefit this benefit is not payable merely by reason of the passage of time. Accordingly, we have concluded that no matter how self-funded paid-up life insurance is characterized under state law, it is a qualifying benefit for the purposes of section 501(c)(9) of the Code.

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Issue 2. The repayment of contributions to contributing employers.

It is clear that a transfer or reversion of assets took place when the Fund repaid certain of the participating employers a portion of the amount of funds previously contributed by them. As a general rule such an action would subject the Fund to the excise tax imposed by section 4976 of the Code.

However, the submitted information does not indicate that the employer received any monetary benefit through this transaction. All that has occurred in this situation is that monies erroneously paid by an employer to provide benefits to its employees were returned to the employer. Because the collective bargaining agreement had terminated and was not renewed on a retroactive basis the employers were not required by the collective bargaining agreement to continue to provide these benefits to their employees and were under no obligation to continue to make contributions to the Fund on behalf of these employees until the new collective bargaining agreement became effective. Therefore, the repayment was not a disqualified benefit and the excise tax imposed by section 4976(a)(2) is not applicable.

Conclusion:

1. The payment this self-funded paid-up life insurance is a qualifying benefit for the purposes of section 501(c)(9) of the Code.

2. The refund of contributions to an employer which were paid after the collective bargaining agreement had ended and during the pendency of a labor dispute with the union is not a disqualified benefit, inurement or a taxable reversion.

3. Inasmuch as the answer to questions number 1 and 2 are in favor of the taxpayer there are no grounds for possible revocation of the organization's section 501(c)(9) status and the question of section 7805(b) relief does not arise.

A copy of the technical advice memorandum is to be given to the organization. Section 6110(j)(3) of the Internal Revenue Code provides that it may not be used or cited by others as precedent.

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