



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Release Number: **200638027**  
Release Date: 9/22/2006  
UIL: 501.09-00  
Date: June 29, 2006

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:  
1120

Tax Years:

Dear \_\_\_\_\_ :

This is our final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code section 501(a) as an organization described in Code section 501(c)(9).

We made this determination for the following reason(s):

Your activities include providing non-permissible benefits, discrimination in favor of highly compensated persons and inurement.

You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations  
Rulings & Agreements

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



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INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Date: JUL 19 2004

UIL. 501.09-00

Dear :

We have considered your application for recognition of exemption from federal income tax under section 501(c)(9) of the Internal Revenue Code. We issued you a proposed denial letter dated [redacted]. This letter supercedes that letter.

You were incorporated on [redacted] as a nonprofit mutual benefit corporation under the Nonprofit Mutual Benefit Corporation Law of the [redacted] State of [redacted]. You are formed for the purpose of providing post-retirement medical benefits for the employees of [redacted]. The Plan Administrator segregates the value of the retirees' accounts upon retirement of an employee. The retired employee then has the option of electing the following medical benefits:

1. Reimbursement for the cost of Medicare Part B.
2. The premium for a supplemental Medicare policy, other medical insurance policy, long term care insurance policy, etc.
3. Payment for out of pocket medical expenses.

The retiree may elect to redirect the distribution of his reimbursements any time during the Plan Year. In the event of any overfunding of the accounts when all participants are retired, the unneeded funds are distributed on a percentage ratio basis to the separate accounts of the retired participants. Retirees will never be entitled to cash payments. In the event that a retiree and the retiree's dependants die before the balance of his Postretirement Reimbursement Account is completely depleted, any balance will be distributed to his estate. Your minimum retirement age is 60 years with 5 years of participation. [redacted] and [redacted] are each 50% owners of [redacted].

The information submitted shows that Mr. [redacted] projected medical retirement costs are the dominant share of the total medical retirement costs.

Section 501(c)(9) of the Code exempts from federal income tax a voluntary employees' beneficiary association (VEBA) providing for the payment of life, sick, accident or other benefits to its members or their dependents or designated beneficiaries, and in which no part of its net

earnings inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-1(c) of the Income Tax Regulations provides that substantially all of the operations of a 501(c)(9) organization must be in furtherance of providing permissible benefits.

Section 1.501(c)(9)-3(a) of the Regulations provides that an organization is not described in section 501(c)(9) of the Code if it systematically and knowingly provides benefits (of more than a de minimis amount) that are not permitted by section 1.501(c)(9) of the regulations.

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. A "life benefit" may be provided directly or through insurance. 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. A "life benefit" also includes the benefit provided under any life insurance contract purchased directly from an employee-funded association by a member or provided by such an association to a member. The term "life benefit" does not include a pension, annuity or similar benefit, except that a benefit payable by reason of the death of an insured may be settled in the form of an annuity to the beneficiary in lieu of a lump-sum death benefit (whether or not the contract provides for settlement in a lump sum).

Section 1.501(c)(9)-3(c) of the Regulations provides that the term "sick and accident benefits" means amounts furnished to or on behalf of a member or a member's dependents in the event of illness or personal injury to a member or dependent. Such benefits may be provided through reimbursement to a member or a member's dependents for amounts expended because of illness or personal injury, or through the payment of premiums to a medical benefit or health insurance program. Similarly, a sick and accident benefit includes an amount paid to a member in lieu of income during a period in which the member is unable to work due to sickness or injury. Sick benefits also include benefits designed to safeguard or improve the health of members and their dependents. Sick and accident benefits may be provided directly by an association to or on behalf of members and their dependents, or may be provided indirectly by an association through the payment of premiums or fees to an insurance company, medical clinic, or other program under which members and their dependents are entitled to medical services or to other sick and accident benefits. Sick and accident benefits may also be furnished in noncash form, such as, for example, benefits in the nature of clinical care services by visiting nurses, and transportation furnished for medical care.

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(e) of the Regulations provides that paying vacation benefits, providing vacation facilities, reimbursing vacation expenses, and subsidizing recreational activities such as athletic leagues are considered "other benefits." The provision of child-care facilities for preschool and school-age dependents are also considered "other benefits." The provision of job readjustment allowances, income maintenance payments in the event of economic dislocation, temporary living expense loans and grants at times of disaster (such as fire or flood), supplemental unemployment compensation benefits (as defined in section 501(c)(17)(D)(i) of the Code), severance benefits (under a severance pay plan within the meaning of 29 CFR 2510.3-2(b)) and education or training benefits or courses (such as apprentice training programs) for members, are considered "other benefits" because they protect against a contingency that interrupts earning power. Personal legal service benefits which consist of payments or credits to one or more organizations or trusts described in section 501(c)(20) are considered "other benefits." Except to the extent otherwise provided in these regulations, as amended from time to time, "other benefits" also include any benefit provided in the manner permitted by paragraphs (5) et seq. of section 302(c) of the Labor Management Relations Act of 1947, 61 Stat. 136, as amended, 29 U.S.C. 186(c) (1979).

Section 1.501(c)(9)-3(f) of the Regulations provides that benefits that are not described in paragraphs (d) or (e) of this section are not "other benefits." Thus, "other benefits" do not include the payment of commuting expenses, such as bridge tolls or train fares, the provision of accident or homeowner's insurance benefits for damage to property, the provision of malpractice insurance, or the provision of loans to members except in times of distress (as permitted by Sec. 1.501(c)(9)-3(e)). "Other benefits" also do not include the provision of savings facilities for members. 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, or a benefit that is similar to the benefit provided under a stock bonus or profit-sharing plan. For purposes of section 501(c)(9) and these regulations, 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. Thus, for example, supplemental unemployment benefits, which generally become payable by reason of unanticipated layoff, are not, for purposes of these regulations, considered similar to the benefit provided under a pension, annuity, stock bonus or profit-sharing plan.

In Section 1.501(c)(9)-3(g), each covered employee of T is entitled, at his or discretion, to contribute up to an additional \$1,000 each year to V, which agrees in respect of such sum to pay interest at a stated rate from the time of contribution until the time at which the contributing employee's vacation benefit is distributed. In addition, each employee may elect to leave all or a portion of his/her distributable benefit on deposit past the time of distribution, in which case interest will continue to accrue. Because the plan more closely resembles a savings arrangement than a vacation plan, the benefit payable to the covered employees of T is not a "vacation benefit" and is not an eligible "other benefit" described in section 501(c)(9) and Sec. 1.501(c)(9)-3(d) or (e).

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

Section 1.501(c)(9)-4(b) of the Regulations provides that any payment to any member of disproportionate benefits, where such payment is not pursuant to objective and nondiscriminatory standards, will not be considered a benefit within the meaning of section 1.501(c)(9)-3 of the regulations even though the benefit otherwise is one of the type permitted by that section. For example, the payment to highly compensated personnel constitute prohibited inurement unless the different can be justified on the basis of objective and reasonable standards adopted by the association.

Section 4976(b)(1)(C) of the Code provides that it is a disqualified benefit for any portion of a welfare benefit fund to revert to the benefit of the employer.

Section 419A(c)(2) of the Code provides that post-retirement medical benefits may be provided to covered employees on a deferral basis upon an actuarially determined basis.

Based on the information submitted, we conclude that you are not a voluntary employees' beneficiary association as that term is used in section 501(c)(9) of the Code.

Section 1.501(c)(9)-1 of the regulations provides that to be described in section 501(c)(9) of the Code an organization must provide for the payment of life, sick, accident, or other benefits to its members or their designated beneficiaries, and substantially all its operations must be in furtherance of providing such benefits. In this case, medical benefits provided by the trust qualify as "sick and accident benefits" under section 1.501(c)(9)-3(c).

On the other hand, the payment of an employee's residual account balance to a designated beneficiary is not a permissible VEBA benefit. It is not a "life benefit" in that there is no current protection, no insurance-type protection, and no set death benefit. Section 1.501(c)(9)-3(b). For example, a retiree has no current or insurance-type life protection if his or her account can be exhausted through medical payments prior to death or if the payout is defined by how much money a person is able to save. It is not a "sick benefit," because it is not paid for health-related reasons.

The payment of a residual account balance also does not come within the description of "other benefits" in section 1.501(c)(9)-3(d) or (e). Section 1.501(c)(9)-3(f) provides that benefits that are not described in paragraphs (d) or (e) are not "other benefits," and generally provides that the provision of savings facilities for members or payments that are similar to a pension, annuity, stock bonus, or profit-sharing plan are not "other benefits." For these purposes, a benefit is 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.

The benefits are in all cases payable to members, their spouses or dependents, or their estates. Because you provide impermissible benefits, your earning inure to the benefit of members. See section 1.501(c)(9)-4(a) of the regulations, which prohibits such inurement. Further, all assets in a VEBA belong to the VEBA and not to the members. VEBA assets are not permitted to vest in members before the time they are paid as permissible benefits. The dedication of a portion of VEBA assets as a permanent account for members, that is vested and can be willed to a beneficiary by the member, is inurement of VEBA assets to the member. As such you do not qualify for exemption under section 501(c)(9) of the Code.

The information submitted shows that the present dominant cost of your plan is for your owners/participants in relationship to all employees. It appears that your owners/participants will be the only participants that will be receiving separate medical accounts upon retirement based on their age, minimum age retirement and the number of years for eligibility. Thus, you have not established that you are not violating the inurement proscription of section 1.501(c)(9)-4(b) of the Income Tax Regulations. In addition, you state that the estate of the employee is entitled to any overfunding of a participant's medical account upon his death. Such vested benefits are similar to a deferred compensation arrangement and thus are impermissible benefits in violation of section 1.501(c)(9)-3(f) of the Income Tax Regulations.

The post-retirement medical benefit is being funded proportionate to salary. Because medical expenses potentially affect all persons equally, there is no objective or nondiscriminatory basis for providing a larger medical benefit to highly compensated persons. While there is a rationale for providing benefits in proportion to salary for income replacement benefits like disability and life insurance, there is no rationale for providing a greater medical benefit to one class of employees over another. Thus, this arrangement would be in violation of section 1.501(c)(9)-4(b) of the Income Tax Regulations, because medical benefits that are provided unequally in favor of highly compensated personnel are disproportionate per se.

Accordingly, based on all the facts and circumstances, we conclude that you do not qualify for recognition of exemption from federal income tax under section 501(c)(9) of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio EP/EO key district office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, EP/EO Customer Service, P.O. Box 2508, Cincinnati, OH 45201.

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

**Internal Revenue Service**

**1111 Constitution Ave, N.W.  
Washington, D.C. 20224**

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

*Joseph Chasin*  
Joseph Chasin  
Manager, Exempt Organizations  
Technical Group 2