Internal Revenue Service

Number: **201844005**
Release Date: 11/2/2018

Index Number: 512.09-03

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:HW
PLR-105792-18

July 16, 2018

LEGEND

Taxpayer =

Association =

Date X =

Date Y =

Date Z =

State =

Industry =

Plan =

Dear :

This responds to your letter of February 16, 2018, and subsequent correspondence dated June 15, 2018, requesting a ruling regarding the computation of unrelated business taxable income (UBTI) of Taxpayer under section 512(a)(3) of the Internal Revenue Code (Code).

FACTS

Taxpayer received a letter dated Date Z from the Internal Revenue Service stating that it is a voluntary employees' beneficiary association (VEBA) under section 501(c)(9) of the Code.

Association has been in existence since Date X, and has been incorporated in State as a nonprofit corporation since Date Y. The purpose of Association is to offer forums, discussion groups and conferences to keep members of Industry current and to provide training in essential Industry principles, and to provide advocacy for Industry at the state and federal levels of government. Taxpayer represents that Association is a bona fide association as described in section 2791(d)(3) of the Public Health Service Act (42 U.S.C. 300gg-91(d)(3)) (PHSA).

The Association maintains Plan, which is a multiple employer welfare benefit plan that provides medical, dental, vision, life and disability benefits to all eligible employees of participating employers. All the voting members of Association and the Association itself are eligible to adopt Plan, regardless of any health status-related factor relating to the member or to individuals eligible for coverage through the member. Membership in the Association and participation in Plan are not conditioned on any health-related status factor relating to an individual, including an employee of an employer or the dependent of an employee.

Taxpayer is the funding mechanism for Plan.

RULINGS REQUESTED

Taxpayer requests the following rulings:

(1) Plan is maintained by a bona fide association, as that term is defined in section 419A(c)(6)(B), so the applicable account limit for Plan with respect to medical benefits is determined under section 419A(c)(6)(A); and

(2) For purposes of computing Taxpayer's UBTI under section 512(a)(3), the applicable account limit under section 419A(c)(6) may include insurance premiums for medical benefits as qualified direct costs.

LAW

Section 511 imposes tax on the unrelated business taxable income (as defined in section 512) of organizations described in section 501(c).

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

Section 512(a)(3)(B) provides that the term “exempt function income” means, for a section 501(c)(9) organization, the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing the members or their dependents goods, facilities, or services in furtherance of the organization to which such income is paid. Such term also includes all income (other than an amount equal to the gross income derived from any unrelated trade or business regularly carried on by the organization) which is set aside to provide for the payment of life, sick, accident, or other benefits, including reasonable costs of administration directly connected with the provisions of such benefits.

Section 512(a)(3)(B) further provides that, if during the taxable year, an amount that is attributable to income so set aside is used for a purpose other than to provide for the payment of life, sick, accident or other benefits, or for purposes specified in section 170(c)(4), such amount shall be included, under subparagraph (A), in the unrelated business taxable income for the taxable year.

Section 512(a)(3)(E) provides, in the case of a section 501(c)(9) organization, that the set-aside described in section 512(a)(3)(B) for a section 501(c)(9) organization 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 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 retirement medical benefits).

Section 419(a) provides that contributions paid or accrued by an employer to a welfare benefit fund are not deductible under Chapter 1, but if they would otherwise be deductible shall (subject to the limitation of subsection (b)) be deductible under section 419 for the taxable year in which paid.

Section 419(b) limits the employer’s deduction under section 419(a) to a welfare benefit fund’s qualified cost for the taxable year.

Section 419(c)(1) defines the qualified cost of a welfare benefit fund for a taxable year as the sum of the qualified direct cost for the taxable year and, subject to the limitation of section 419A(b), any addition to a qualified asset account for the taxable year.

Section 419(c)(2) provides that the qualified cost for any taxable year is reduced by the welfare benefit fund’s after-tax income for the taxable year.

Section 419(c)(3)(A provides that the term “qualified direct cost” means, with respect to any taxable year, the aggregate amount (including administrative expenses) that would have been allowable as a deduction by the employer with respect to benefits provided during the taxable year if such benefits were provided directly by the employer, and the employer used the cash receipts and disbursements method of accounting.

Section 1.419-1T Q&A-6(a) of the Income Tax Regulations provides that if a calendar year welfare benefit fund pays an insurance company in July 1986 the full premium for coverage of its current employees under a term health insurance policy for the twelve month period ending June 30, 1987, the insurance company will be treated as provided by the fund over such twelve month period. Accordingly, only the portion of the premium for coverage during 1986 will be treated as a "qualified direct cost" of the fund for 1987. Section 419A(a) of the Code provides that for purposes of sections 419, 419A and 512 the term "qualified asset account" means any account consisting of assets set aside to provide for the payment of disability benefits, medical benefits, SUB or severance pay benefits, or life insurance benefits.

Section 419A(b) provides that no addition to any qualified asset account may be taken into account under section 419(c)(1)(B) to the extent such addition results in the amount in such account exceeding the account limit.

Section 419A(c)(1) provides that, in general, the account limit for any qualified asset account for any taxable year is the amount reasonably and actuarially necessary to fund (A) claims incurred but unpaid (as of the close of such taxable year) for benefits referred to in subsection (a), and (B) administrative costs with respect to such claims.

Section 419A(c)(5)(A) provides that, in general, unless there is an actuarial certification of the account limit determined under subsection 419A(c) for any taxable year, the account limit for such taxable year shall not exceed the sum of the safe harbor limits for such taxable year.

Section 419A(c)(5)(B)(i) provides that, in the case of short-term disability benefits, the safe harbor limit for any taxable year is 17.5 percent of the qualified direct costs (other than insurance premiums) for the immediately preceding taxable year with respect to such benefits.

Section 419A(c)(5)(B)(ii) provides that, in the case of medical benefits, the safe harbor limit for any taxable year is 35 percent of the qualified direct costs (other than insurance premiums) for the immediately preceding taxable year with respect to medical benefits.

Section 419A(c)(6)(A) provides that an applicable account limit for any taxable year may include a reserve in an amount not to exceed 35 percent of the sum of the qualified direct costs and the change in claims incurred but unpaid, for such taxable year with respect to medical benefits (other than post-retirement medical benefits).

Section 419A(c)(6)(B) defines "applicable account limit" to mean an account limit for a qualified asset account with respect to medical benefits provided through a plan maintained by a bona fide association (as defined in section 2791(d)(3) of the PHSA (42 U.S.C. 300gg-91(d)(3)).

Section 2791(d)(3) of the PHSA (42 U.S.C. 300gg-91(d)(3)) defines "bona fide association" to mean, with respect to health insurance coverage offered in a state, an association which (A) has been actively in existence for at least 5 years; (B) has been formed and maintained in good faith for purposes other than obtaining insurance; (C) does not condition membership in the association on any health status-related factor relating to an individual (including an employee or an employer or a dependent of an employee); (D) makes health insurance coverage offered through the association available to all individuals regardless of any health status-related factor relating to such members (or individuals eligible for coverage through a member); (E) does not make health insurance coverage offered through the association available other than in connection with a member of the association; and (F) meets such additional requirements as may be imposed under state law.[1]

ANALYSIS AND CONCLUSION

Ruling Request 1: Applicable Account Limit

As a VEBA, Taxpayer's UBTI is determined in accordance with section 512(a)(3) of the Code, and its exempt function income is subject to the set aside limits of section 512(a)(3)(E). Section 512(a)(3)(E)(1) provides that a set-aside for the payment of medical benefits for employees may be taken into account as exempt function income of a VEBA under section 512(a)(3)(B)(ii) only to the extent that it does not result in an amount of assets in excess of the account limit determined under section 419A. Section 419A(c)(6)(B) defines the "applicable account limit" for purposes of section 419A(c)(6) as the account limit for a qualified asset account with respect to medical benefits provided through a plan maintained by a bona fide association (as defined in section 2791(d)(3) of the PHSA). Taxpayer represents that Association is a bona fide association as that term as described in section 2791(d)(3) of the PHSA, and that Association maintains Plan. Based upon these representations, we conclude that for purposes of computing Taxpayer's UBTI under section 512(a)(3), Taxpayer satisfies the requirements of section 419A(c)(6)(B) to include in its applicable account limit a reserve described in section 419A(c)(6)(A).

Ruling Request 2: Insurance Premiums under Section 419A(c)(6)

For a bona fide association plan described in section 419A(c)(6)(B), section 419A(c)(6)(A) provides that an applicable account limit for any taxable year may include a reserve in an amount not to exceed 35 percent of the sum of the qualified direct costs and the change in claims incurred but unpaid, for such taxable year with respect to medical benefits (other than post-retirement medical benefits).

---

[1] The PHSA is under the jurisdiction of the Department of Health and Human Services. We are not attempting to interpret it. Instead, in issuing this ruling we are relying upon Taxpayer's representation that Association is a bona fide association as described in section 2791(d)(3) of the PHSA.

The term “qualified direct cost” is defined in section 419(c)(3)(A) as the aggregate amount (including administrative expenses) that would have been allowable as a deduction by the employer with respect to benefits provided during the taxable year if such benefits were provided directly by the employer, and the employer used the cash receipts and disbursements method of accounting. In defining qualified direct cost, section 419(c)(3)(A) describes an aggregate amount that includes insurance premiums. Section 1.419-1T Q&A-6(a) of the Income Tax Regulations clarifies that insurance premiums are included in calculation of qualified direct cost.

Some provisions for permissible reserves to be included in the account limit for purposes of section 419A include specific language excluding insurance premiums. Both section 419A(c)(5)(B)(i) (with regard to short term disability benefits), and section 419(c)(5)(B)(ii) (with regard to medical benefits) provide that the account limit includes “qualified direct costs (other than insurance premiums).” Section 419(c)(6)(A), by contrast, refers to “qualified direct costs” with no such exclusionary language.

Accordingly, for purposes of computing UBTI and the set-aside under section 512(a)(3)(E)(i), the applicable account limit under section 419A(c)(6) may be computed by including insurance premiums for medical benefits as qualified direct costs.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Specifically, this ruling does not address Taxpayer’s qualification as a VEBA under section 501(c)(9), and it does not address the tax consequences to Association or employers contributing to Taxpayer.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Janet A. Laufer
Senior Technician Reviewer
Health & Welfare Branch
Office of Associate Chief Counsel
(Tax Exempt & Government Entities)