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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

JUN 25 2003

Date:

Contact Person:

Significant Index Nos.: 501.09-04
4976.01-00

Identification Number:

Telephone Number:

T:EO:B3

Employer Identification Number:

Legend:

Company =
X =
Y =
Z =
B =
M =
N =
The Group Benefits Trust =
The Employees' Trust =
The Retiree Life Insurance Trust =
The Retiree Medical Trust =
The Retiree Medical Union Trust =

Dear Sir or Madam:

This is in reference to a ruling request dated February 12, 2002, submitted by representatives of the Company concerning the federal tax consequences of the transfer of various assets from a trust described in section 501(c)(9) of the Internal Revenue Code to a similar trust and the allocation of assets in one trust to subtrusts in the other trust.

Facts:

Company is a subsidiary of X. On June 15, 2000, X merged with Y. The merged company is known as Z.

The Company maintains a trust fund (the Group Benefits Trust) to provide for payment of various benefits to active and retired employees of both Company and other subsidiaries of X. The Group Benefits Trust is a voluntary employees beneficiary association (VEBA) exempt from federal income tax under section 501(a) of the Code as an organization described in

section 501(c)(9). The VEBA has various sub-accounts, including a Retiree Medical Account, which funds benefits for both union-represented and non-union-represented employees. The union and non-union employees have identical benefit rights, so there is no segregation of the assets of the Retiree Medical Account between the two groups.

Y maintained several trust funds to provide in part for the payment of benefits to its active and retired employees and their dependents. Y maintained an Agreement of Trust by and between itself and B (Agreement of Trust). The Agreement of Trust funded benefits for active employees only. The Agreement of Trust was amended to provide that the Company, rather than Y will be the sponsor of the trust, and that the trust will fund benefits for employees of the Company and its affiliates, including Y. For purposes of this ruling request, this trust will be referred to as "The Employees' Trust."

Y also maintained several trusts for retiree benefits. These trusts included the following (and assets of each trust were available only to pay benefits under the following groupings):

1. The Retiree Life Insurance Trust, a trust to provide post-retirement life insurance benefits for retired employees and their dependents.

2. The Retiree Medical Trust, a trust to provide post-retirement medical benefits for retired non-union employees and their dependents.

3. The Retiree Medical Union Trust, a trust to provide post-retirement medical benefits for retired union-represented employees and their dependents, where such benefits were the product of good-faith labor negotiations.

The Retiree Life Insurance Trust has been amended to provide that the Company, rather than Y will be the sponsor of the trust and that the trust will fund group life insurance benefits for both current and future retired employees of the Company and its affiliates, including Y.

The Employees' Trust, the Retiree Life Insurance Trust, the Retiree Medical Trust, and the Retiree Medical Union Trust have all been recognized as exempt from federal income tax under section 501(a) of the Code as VEBAs described in section 501(c)(9).

The Company proposes to merge the Retiree Medical Account with the Retiree Medical Trust, including all assets and liabilities. The value of the assets attributable to union-represented employees will be calculated and assets of that value will then be transferred to the Retiree Medical Union Trust. The transfer will not be pro rata, as several insurance policies currently owned by the Retiree Medical Account will remain with the Retiree Medical Trust. Other assets of equal value to the portion of the insurance policies attributable to the union-represented employees will be transferred to the Retiree Medical Union Trust along with the liability for the benefits to those employees.

The instrument establishing The Group Benefits Trust was amended on December 28, 2001, to authorize the Company to direct the trustee to transfer trust assets to another qualified VEBA trust on a pro rata or non-pro rata basis. No particular assets are required to be transferred with respect to any particular liability.

The Group Benefits Trust holds two group life policies that are used as funding vehicles for the retiree medical benefits provided by the Group Benefits Trust. One of the policies (Policy A) is issued by M and the other (Policy B) is issued by N. Both M and N have represented to the Company that the group policies they issued to the Company are designed to meet the definition of "a life insurance contract" under section 7702 of the Code. Additionally, the Company represents that neither Policy A nor Policy B is encumbered by a loan.

Rulings Requested:

1. The merger and transfer of assets and liabilities attributable to both union-represented and non-union represented employees from the Retiree Medical sub-account of the Group Benefits Trust to the Retiree Medical Trust will not adversely affect the tax-exempt status of the Group Benefits Trust or the Retiree Medical Trust under section 501(c)(9) of the Code.

2. The merger and transfer of assets and liabilities in the Retiree Medical sub-account of the Group Benefits Trust attributable to union -represented employees to the Retiree Medical Trust and then to the Retiree Medical Union Trust will not adversely affect the tax-exempt status of the Group Benefits Trust, the Retiree Medical Trust, or the Retiree Medical Union Trust, under section 501(c)(9) of the Code.

3. The merger and transfer of assets and liabilities in the Group Benefits Trust that are not attributable to the Company Retiree Medical sub-account to the appropriate sub-accounts of the trust created pursuant to the Agreement of Trust will not adversely affect the tax-exempt status of the Group Benefits Trust or The Employees' Trust under section 501(c)(9) of the Code.

4. The merger and transfer of assets in the Group Benefits Trust described in Rulings (1) through (3) and the allocation used by the actuarial consultant to determine the amount to be transferred to the Retiree Medical Union Trust and the Retiree Medical Trust, will not result in any portion of a welfare benefit fund reverting to the benefit of the Company and, therefore, will not be subject to the imposition of any excise tax under section 4976 of the Code.

5. The Retiree Medical Union Trust will remain a separate welfare benefit fund maintained under a collective-bargaining agreement within the meaning of section 419A(f)(5) of the Code after the transfer of assets attributable to union-represented employees under the Company Retiree Medical sub-account, and therefore the account limits of section 419A shall not apply, so long as the assets of the Retiree Medical Union Trust are not available to pay any benefits to be provided by any other trust;

6. The income of the Retiree Medical Union Trust set aside to provide post-retirement medical benefits for union-represented employees and their dependents is exempt function income and is not treated as unrelated business taxable income under section 512(a)(3) of the Code.

7. The non-discrimination rules of section 505(b) of the Code will not be applicable to benefits provided through the assets set aside in the Retiree Medical Union Trust.

8. The amendment of the Retiree Life Insurance Trust to include the liabilities of the Company will not affect the tax-exempt status of the Retiree Life Insurance Trust.

9. Neither the Group Benefits Trust, the Retiree Medical Trust nor the Retiree Medical Union Trust will recognize a gain or loss under section 1001 due to the division of trust assets described above.

10. The transfer of the group policies from the Group Benefits Trust to the Retiree Medical Trust is not a "transfer for valuable consideration" under section 101(a)(2) of the Code.

LAW:

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

Section 1.501(c)(9)-4(a) of the Income Tax Regulations (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 benefits permitted by that section.

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 for disproportionate benefits to officers, shareholders, or highly compensated employees of the employer.

Section 505(a)(1) of the Code provides that an organization described in paragraph (9) of subsection (c) of section 501 which is part of a plan shall not be exempt from tax under section 501(a) unless such plan meets the nondiscrimination requirements of Code section 505(b).

Section 505(a)(2) of the Code provides that paragraph (1) shall not apply to any organization which is part of a plan maintained pursuant to an agreement between employee representatives and one or more employers if the Secretary finds that such agreement is a collective bargaining agreement and that such plan was the subject of good faith bargaining between such employee representatives and such employer or employers.

Section 511 of the Code imposes a tax upon the unrelated business taxable income of an organization exempt from federal income tax under section 501(c)(9).

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

directly connected with the production of gross income (excluding exempt function income), both computed with the modifications set forth herein.

Section 512(a)(3)(B) of the Code provides that in the case of an organization described in section 501(c)(9), the term "exempt function income" includes all income (other than an amount equal to gross income derived from any unrelated trade or business carried on by the organization) which is set aside to provide for the payment of life, sick, accident or other benefits. If during the taxable year, an amount which is attributable to income so set aside is used for a purpose other than that described above, such amount shall be included under section 512(a)(3)(A) in unrelated business taxable income for the taxable year.

Section 512(a)(3)(E) of the Code provides that in the case of an organization described in section 501(c)(9), a set-aside can be taken into account in determining exempt function income 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 419(A) (not taking into account any reserve described in section 419(a)(c)(2)(A) for post-retirement medical benefits).

Section 419 of the Code provides rules with respect to the tax treatment of funded welfare benefit plans. A plan that is determined to be a voluntary employees beneficiary association under section 501(c)(9) is a welfare benefit fund within the meaning of section 419.

Section 419A(a) of the Code provides that for purposes of Code section 512 the term "qualified asset account" means any account consisting of assets set aside to provide for the payment of disability benefits, medical benefits, supplemental unemployment benefits or severance pay benefits, or life insurance benefits.

Section 419A(f)(5)(A) of the Code provides 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 of the regulations, Q&A 1 provides that contributions to a welfare benefit fund maintained pursuant to one or more collectively bargained agreements and the reserves of such a fund generally are subject to the rules of sections 419, 419(A), and 512. However, neither contributions to nor reserves of such a collectively bargained welfare benefit fund shall be treated as exceeding the otherwise applicable limits of section 419(b), 419A(b), or 512(a)(3)(E) until the earlier of: (i) the date on which the last of the collective bargaining agreements relating to the fund in effect on, or ratified on or before, the date of issuance of final regulations concerning such limits for collectively bargained welfare benefit funds terminates (determined without regard to any extension thereof agreed to after the date of issuance of such final regulations), or (ii) the date 3 years after the issuance of such final regulations.

Section 4976 of the Code generally provides that any portion of a welfare benefit fund (including a VEBA) reverting to the benefit of the employer is a disqualified benefit and will be subject to a 100 per cent excise tax.

Section 61(a)(3) of the Code provides that gross income includes gains derived from dealings in property.

Section 1001(a) of the Code provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss will be the excess of the adjusted basis provided in such section for determining loss over the amount realized. Section 1001(c) states that, except as otherwise provided in Subtitle A of the Code, the entire amount of the gain or loss, determined under section 1001, on the sale or exchange or property, shall be recognized.

Section 1.1001-1(a) of the regulations provides that except as otherwise provided in subtitle A of the Code, the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

A partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests, but do not acquire a new or additional interest as a result of the transaction. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

Thus, in order for a transaction to result in a section 1001 taxable event, the transaction must be a sale, exchange or other disposition. In Rev. Rul. 69-486, 1969-2 C.B. 159, distinguished by Rev. Rul. 83-61, 1983-1 C.B. 78, a trustee made a non-pro rata distribution of trust property pursuant to an agreement of the beneficiaries, although neither the trust instrument nor local law authorized the trustee to make non-pro rata distributions. The ruling holds that the transaction was equivalent to a pro rata distribution of the trust assets followed by an exchange of properties between the beneficiaries.

Section 101(a)(1) of the Code provides that, except as otherwise provided in section 101(a)(2), 101(d) and 101(f), gross income does not include amounts received under a life insurance contract, if such amounts are paid by reason of the death of the insured.

Section 101(a)(2) of the Code provides, generally, that if a life insurance contract, or any interest therein, is transferred for a valuable consideration, by assignment or otherwise, the exclusion from gross income provided by section 101(a)(1) is limited to an amount equal to the sum of the actual value of the consideration and the premiums and other amounts subsequently paid by the transferee.

The term "transfer for a valuable consideration" is defined for purposes of section 101(a)(2) of the Code in section 1.101-1(b)(4) of the regulations as "any absolute transfer for value of a right to receive all or a part of the proceeds of a life insurance policy."

Discussion

Rulings 1-3, 8

The transferred assets will be used only to provide permissible benefits to members who share an employment-related bond, pursuant to criteria that do not provide disproportionate benefits to officers, shareholders, or highly compensated employees. In addition, the methodology described in this ruling that will be used to calculate the amount of assets to be transferred is consistent with the requirements of section 501(c)(9). Therefore, the proposed merger and transfer of assets and liabilities will not affect the tax-exempt status of the Group Benefits Trust, the Retiree Medical Trust, the Retiree Medical Union Trust, the Retiree Life Insurance Trust or The Employees' Trust under section 501(c)(9) of the Code.

Ruling 4

The assets currently in the Trusts will not be used to benefit the Company in any manner other than through any incidental cost savings it may enjoy when the benefit structure is simplified. The Company will have no right to receive any funds that are transferred from one trust to another trust. All of the assets will be used for the exclusive purpose of providing welfare benefits (and paying related expenses) to Company's active or retired employees, spouses and eligible dependents in accordance with the underlying welfare benefit plans. Therefore, there is no reversion for purposes of section 4976.

Rulings 5-7

The assets of the Retiree Medical Union Trust, after the transfer of assets from the Medical sub-account of the Group Benefits Trust to the Retiree Medical Trust and then to the Retiree Medical Union Trust, will be used only to provide post-retirement benefits to retired employees of Company, its affiliates and subsidiaries, and their dependents, whose benefits have been the subject of good-faith collective-bargaining. Under no circumstances may the assets of the Retiree Medical Union Trust be used for any purpose other than the provision of medical benefits to union-represented retired employees and their dependents, although the Trust could be amended to provide other welfare benefits to such individuals. Because the Retiree Medical Union Trust funds plans whose benefits were the subject of good faith bargaining under a collective-bargaining agreement, it is a separate welfare benefit fund maintained under a collective bargaining agreement within the meaning of section 419A(f)(5) of the Code

Since the Retiree Medical Union Trust is maintained pursuant to a collective bargaining agreement, it is not subject to the account limits provided in section 419(A) or the nondiscrimination rules of section 505(b). See, section 1.419(A)-2T of the regulations and section 505(a)(2) of the Code. Because the income of the trust will be set aside to provide permissible benefits, it will not be treated as unrelated business taxable income under section 512(a)(3) of the Code.

Ruling 9

This case does not fall under the holding of Rev. Rul. 69-486. In substance, the Group Benefits Trust is distributing assets and liabilities to the Retiree Medical Trust and the Retiree Union Medical Trust based on the value of the assets attributable to the share of the union-represented and non-union-represented employees who will receive benefits from each trust. Unlike Rev. Rul. 69-486, the Company is authorized under the December 28, 2001 amendment to the governing instrument to direct the trustee to distribute the assets to another qualified VEBA trust on a pro rata or non-pro rata basis. Accordingly, the proposed non-pro rata distribution will not be treated as a pro rata distribution of the assets and liabilities followed by an exchange of the assets.

In addition, the Company, in a supplemental submission dated October 22, 2002, has stated that at the time of the partition, the interests of the trust beneficiaries are no different before than after the partition, and consequently, there is no material difference in the kind or extent of legal entitlements enjoyed by the beneficiaries. See generally, Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), where the United States Supreme Court stated, at 499 U.S. at 560-61, that an exchange of property is a realization event under section 1001(a) of the Code if the properties exchanged are "materially different" for purposes of section 1.1001-1(a); and, in defining what constitutes a "material difference" for purposes of that section, stated, at 499 U.S. at 564-65, that properties are "different" in the sense that is "material" to the Code so long as they embody legal entitlements that are different in kind or extent.

Based upon the discussion contained in the Company's supplemental submission, we agree that because of the particular nature of VEBA trusts, the interests of the trust beneficiaries after the proposed transaction will not differ materially from their interests prior to such transaction. Thus, the proposed transaction will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries. We, therefore, conclude that the proposed transaction will not result in the realization of any gain or loss under section 1001 of the Code.

Ruling 10

One could argue that the proposed transfer of Policy A and Policy B from the Retiree Medical Account to the Retiree Medical Trust as part of the merger of the two VEBAs is a transfer for a valuable consideration for purposes of section 101(a)(2), the valuable consideration being the Retirement Medical Trusts' assumption of the Retirement Medical Account's liabilities; however, acceptance of this analysis is predicated on the merger of the two VEBAs being a realization event under section 1001 of the Code. We have concluded above concerning Requested Ruling 9, to the contrary, that the Company's proposed transaction concerning the three VEBAs does not result in the realization of any gain or loss under section 1001 of the Code.

Therefore, we conclude that the proposed transfers of Policy A and Policy B from the Group Benefits Trust to the Retiree Medical Trust will not be transfers for a valuable consideration under section 101(a)(2) of Code.

Conclusions:

Based on the above, we conclude as follows:

1. The merger and transfer of assets and liabilities attributable to both union-represented and non-union represented employees from the Retiree Medical sub-account of the Group Benefits Trust to the Retiree Medical Trust will not adversely affect the tax-exempt status of the Group Benefits Trust or the Retiree Medical Trust under section 501(c)(9) of the Code.

2. The merger and transfer of assets and liabilities in the Retiree Medical sub-account of the Group Benefits Trust attributable to union -represented employees to the Retiree Medical Trust and then to the Retiree Medical Union Trust will not adversely affect the tax-exempt status of the Group Benefits Trust, the Retiree Medical Trust, or the Retiree Medical Union Trust, under section 501(c)(9) of the Code.

3. The merger and transfer of assets and liabilities in the Group Benefits Trust that are not attributable to the Company Retiree Medical sub-account to the appropriate sub-accounts of the trust created pursuant to the Agreement of Trust will not adversely affect the tax-exempt status of the Group Benefits Trust or The Employees' Trust under section 501(c)(9) of the Code.

4. The merger and transfer of assets in the Group Benefits Trust described in Rulings (1) through (3) and the allocation used by the actuarial consultant to determine the amount to be transferred to the Retiree Medical Union Trust and the Retiree Medical Trust, will not result in any portion of a welfare benefit fund reverting to the benefit of the Company and, therefore, will not be subject to the imposition of any excise tax under section 4976 of the Code.

5. The Retiree Medical Union Trust will remain a separate welfare benefit fund maintained under a collective-bargaining agreement within the meaning of section 419A(f)(5) of the Code after the transfer of assets attributable to union-represented employees under the Company Retiree Medical sub-account, and therefore the account limits of section 419A shall not apply, so long as the assets of the Retiree Medical Union Trust are not available to pay any benefits to be provided by any other trust.

6. The income of the Retiree Medical Union Trust set aside to provide post-retirement medical benefits for union-represented employees and their dependents is exempt function income and is not treated as unrelated business taxable income under section 512(a)(3) of the Code.

7. The non-discrimination rules of section 505(b) of the Code will not be applicable to benefits provided through the assets set aside in the Retiree Medical Union Trust

8. The amendment of the Retiree Life Insurance Trust to include the liabilities of the Company will not affect the tax-exempt status of the Retiree Life Insurance Trust.

9. Neither the Group Benefits Trust, the Retiree Medical Trust nor the Retiree Medical Union Trust will recognize a gain or loss under section 1001 due to the division of trust assets described above.

10. The transfer of the group policies from the Group Benefits Trust to the Retiree Medical Trust is not a "transfer for valuable consideration" under section 101(a)(2) of the Code.

These rulings are based on the understanding that there will be no material changes in the facts upon which they are based. No opinion is expressed concerning whether the December 28, 2001, Amendment to the governing instrument results in a realization event under section 1001 in that taxable year. No opinion is expressed on whether Policy A and Policy B are "life insurance contracts," as defined in section 7702.

Also, 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