Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Significant Index No. 419A.00-00

Contact Person:

Telephone Number:

T:EP:RA:T:A2

In Reference to:

Date:

FEB 15 2001

In re: Request for rulings on behalf of

Legend:

M =
N =
0 =
P =
Q =
R =
S =

This is in response to a letter from your authorized representative (Form 2848), dated March 10, 1999, in which six rulings were requested, all of which related to one or more of the trusts named above as "Q", "R", and "S".

The first five of the requested rulings were answered by Technical Branch 4 of the Exempt Organizations Division (now known as Exempt Organizations Technical Group 4, Tax Exempt and Government Entities Division). The sixth requested ruling was referred to Employee Plans Actuarial Group 2, and that is the only ruling request that this letter will address. The sixth requested ruling was amended by your authorized representative in a telephone call with of our office on August 17, 2000, to replace all references to Internal Revenue Code (Code) section 419(e)(1) with Code section 419A(e)(1), and on February 12, 2001, to modify the wording of the sixth requested ruling.

FACTS

According to the facts submitted, "M" is a holding company created in conjunction with the merger, as of March 1, 1998, of "N" and its subsidiaries and affiliates with "0" and its

subsidiaries and affiliates. A substantial number of N's employees are represented by one of two local unions affiliated with "P", and approximately 42 percent of O's employees are represented by a third local union affiliated with P. None of the represented employees are employees who are owners, officers, or executives of the employer.

Prior to the merger, N maintained trust Q which received a favorable determination letter from the Internal Revenue Service (Service) as a voluntary employees' beneficiary association (VEBA) described in section 501(c)(9) of the Code, dated December 15, 1994. Trust Q consisted of five sub-trusts and, although assets were pooled for investment, separate accounting was maintained for each sub-trust. None of the sub-trusts benefited any key employee within the meaning of section 416(i) of the Code. Assets of each sub-trust were available only to pay benefits as follows.

1. One sub-trust provided post-retirement medical benefits for current and retired union-represented employees and their dependents, where such benefits were the product of good-faith labor negotiations.

2. One sub-trust provided post-retirement life insurance benefits for current and retired union-represented employees and their dependents, where such benefits were the product of good-faith labor negotiations.

(You have identified the two foregoing sub-trusts (1, 2) as sub-trusts "DU".)

3. One sub-trust provided post-retirement medical benefits for current and retired non-union ("management") employees and their dependents.

4. One sub-trust provided post-retirement life insurance benefits (not in excess of $50,000 per retiree) for current and retired management employees.

5. One sub-trust provided post-retirement life insurance benefits (in excess of $50,000 per retiree) for some current and retired management employees.

(You have identified the three foregoing sub-trusts (3, 4, and 5) as sub-trusts "DM".)

Prior to the merger, 0 maintained trust R, which received a favorable determination letter from the Service as a VEBA, dated December 18, 1989. Trust R consisted of two sub-trusts, one for post-retirement medical benefits and the other for post-retirement life insurance benefits.

364

Although approximately 42 percent of O's employees were and are represented by a labor organization, and post-retirement welfare benefits for current and retired employees of 0 and their dependents were the product of good-faith labor negotiations, 0 did not segregate the assets of trust R attributable to such negotiated benefits.

When trust S was created on June 17, 1998, after the merger of N and 0, the seven sub-trusts of trust Q and trust R were maintained as separate accounts within trust S. M now wants to establish five sub-trusts within trust S, with the same purposes as those maintained within trust N. That is, assets of each sub-trust will be available only to pay benefits as follows.

1. One sub-trust will provide post-retirement medical benefits for current and retired union-represented employees and their dependents, where such benefits are the product of good-faith labor negotiations;

2. One sub-trust will provide post-retirement life insurance benefits for current and retired union-represented employees and their dependents, where such benefits are the product of good-faith labor negotiations;

(You have identified the two foregoing sub-trusts (1, 2) as sub-trust "CU".)

3. One sub-trust will provide post-retirement medical benefits for current and retired non-union ("management") employees and their dependents;

4. One sub-trust will provide post-retirement life insurance benefits (not in excess of $50,000 per retiree) for current and retired management employees; and

5. One sub-trust will provide post-retirement life insurance benefits (in excess of $50,000 per retiree) for some current and retired management employees.

(You have identified the three foregoing sub-trusts (3, 4, and 5) as sub-trust "CM".)

The sub-trusts providing post-retirement medical and life insurance benefits to union-represented employees and retirees of M's subsidiaries and affiliates, and their dependents (CU) will contain the assets of sub-trusts DU, along with a proportional amount of the sub-trusts of trust R. Such proportional amount of the sub-trusts of trust R was actuarially calculated to bear a relation to the entire amount of trust R (prior to such transfer) equal to the relation that the actuarial present value of the collectively-bargained post-retirement benefits earned by the 0 union-represented employees and retirees (and payable from trust R), bears to the total actuarial present value of all such benefits earned by all employees of 0 (and payable from trust R). The amount will be allocated to the two sub-trusts of R on the basis of trust R's obligations for post-

retirement medical and life insurance benefits for such union-represented employees and retirees. The other three sub-trusts (CM) will contain the assets of sub-trusts DM, along with the remainder of the trust 0, allocated on the basis of that trust's respective obligations for medical, life insurance under $50,000, and life insurance over $50,000.

Under no circumstances may the assets of sub-trusts CU be used for any purpose other than the provision of welfare benefits to union-represented employees and former employees (retirees) and their dependents. Under no circumstances may the assets of sub-trusts CM be used for any purpose other than the provision of post-retirement welfare benefits to non-union employees and former employees (retirees) and their dependents. No key employees (within the meaning of Code section 416(i)), or individuals who are owners of M, its affiliates or subsidiaries (other than through shares held by qualified retirement plans or de minimis shares held personally by retirees), officers, or executives will be eligible to receive benefits from any of the sub-trusts of trust S.

Ruling Requested

Based on the facts as stated, you have requested the following ruling:

Sub-trusts CU do not have to meet the requirements for medical reserves set out in section 419A(e)(1) of the Code.

Applicable Law

Section 419(a) of the Code provides that contributions paid or accrued by an employer to a welfare benefit fund shall not be deductible under Chapter 1 of the Code but if they would otherwise be deductible, such contributions shall (subject to the limitations of subsection (b)) be deductible under section 419 of the Code for the taxable year in which paid. Section 419(b) provides that the amount of the deduction allowable under subsection (a) for any taxable year shall not exceed the welfare benefit fund's qualified cost for the taxable year. Section 419(c) provides that the term "qualified cost" means the sum of (A) the qualified direct cost for such taxable year, and (B) subject to the limitation of section 419A(b), any addition to a qualified asset account for the taxable year, minus (C) after-tax income.

Section 419A of the Code gives limitations on additions to a qualified asset account. A qualified asset account is defined in section 419A(a) as 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. Sections 419A(b) and (c) provide rules and limitations related to additions to qualified asset accounts. Section 419A(c)(2) of the Code provides that the account limit for any taxable year may include a reserve funded over the working lives of the covered

366

employees and actuarially determined on a level basis (using assumptions that are reasonable in the aggregate) as necessary to provide post-retirement medical benefits and post-retirement life insurance benefits for covered employees.

Section 419A(e)(1) provides that no reserve may be taken into account under subsection 419A(c)(2) for post-retirement medical benefits or life insurance benefits to be provided to covered employees unless the plan satisfies the nondiscrimination requirements of Code section 505(b) with respect to such benefits (whether or not such requirements apply to such plan). Section 419A(e)(1) further states that the requirement to satisfy section 505(b) does not apply to any 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 post-retirement medical benefits or life insurance benefits were the subject of good faith bargaining between such employee representatives and such employer(s).

Section 419A(f)(5) 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 501(c)(9) of the Code describes a voluntary employees' beneficiary association (VEBA) as 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 1.419A-2T, Q&A-2, of the (temporary) Income Tax Regulations defines a welfare benefit fund maintained pursuant to a collective bargaining agreement and states:

> (1) For purposes of Q&A-l, a collectively bargained welfare fund is a welfare benefit fund that is maintained pursuant to an agreement which the Secretary of Labor determines to be a collective bargaining agreement and which meets the requirements of the Secretary of the Treasury as set forth in paragraph (2) below.
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> (2) Notwithstanding a determination by the Secretary of Labor that an agreement is a collective bargaining agreement, a welfare benefit fund is considered to be maintained pursuant to a collective bargaining agreement only if the benefits provided through the fund were the subject of arms-length negotiations between the employee representatives and one or more employers, and if such agreement between employee representatives and one or more employers satisfies section 7701(a)(46) of the Code. Moreover, the circumstances surrounding a collective bargaining agreement must evidence good faith bargaining between adverse parties over the welfare benefits to be provided through the fund. Finally, a welfare benefit fund is not considered to be maintained pursuant to a

collective bargaining agreement unless at least 50 percent of the employees eligible to receive benefits under the fund are covered by the collective bargaining agreement.

(3) In the case of a collectively bargained welfare benefit fund, only the portion of the fund (as determined under allocation rules to be provided by the Commissioner) attributable to employees covered by a collective bargaining agreement, and from which benefits for such employees are provided, is considered to be maintained pursuant to a collective bargained agreement.

(4) Notwithstanding the preceding paragraphs and pending the issuance of regulations setting account limits for collectively bargained welfare benefit funds, a welfare benefit fund will not be treated as a collectively bargained welfare benefit fund for purposes of Q&A-l if and when, after July 1, 1985, the number of employees who are not covered by a collective bargaining agreement and are eligible to receive benefits under the fund increases by reason of an amendment, merger, or other action of the employer or the fund. In addition, pending the issuance of such regulations, for purposes of applying the 50 percent test of paragraph (2) to a welfare benefit fund that is not in existence on July 1, 1985, "90 percent" shall be substituted for "50 percent".

Analysis

The employees who will receive benefits from the two sub-trusts designated CU will consist only of union-represented employees and retirees of M's subsidiaries and affiliates, and their dependents. Furthermore, under no circumstances may the assets of sub-trusts CU be used for any purpose other than the provision of welfare benefits to union-represented employees and former employees (retirees) and their dependents. None of the represented employees are employees who are owners (other than of a de minimis number of shares of the Company), executives or officers of the Company, and none of the sub-trusts of S benefit any key employee within the meaning of section 416(i) of the Code.

Because the benefits provided through the CU sub-trusts (established with the allocation to them of sub-trusts DU and the actuarially determined proportional share of R) were the subject of arms-length negotiations between employee representatives (the three local unions) and the employers, and none of the represented employees are executives, officers, or owners of more than a de minimis amount of employer stock, sub-trusts CU are maintained pursuant to a collective bargaining agreement within the meaning of section 1.419A-2T of the regulations. The sub-trusts CU constitute separate welfare benefit funds maintained pursuant to a collective bargaining agreement within the meaning of section 419A(f)(5) of the Code and, therefore, no account limits will apply as long as the assets of each sub-trust are not available to pay any benefits provided by the other sub-trusts.

368

Additionally, because the benefits provided through the sub-trusts CU were the subject of good faith bargaining between employee representatives (the three local unions) and the employers, the reserves for post-retirement medical benefits and life insurance benefits under sub-trusts CU will not be subject to the nondiscrimination requirements of Code section 419A(e)(1) or Code section 505(b).

Holding

Sub-trusts CU do not have to meet the requirements for medical reserves set out in section 419A(e)(1) of the Code.

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.

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 by others as precedent.

Sincerely yours,

Martin L. Pippins, Manager
Employee Plans Actuarial Group 2
Tax Exempt and Government Entities Division

369