[Exemptions]

[Federal income tax exempt status issued by IRS &/or as declared by Taxpayers]

26 U.S. Code § 501 (c)(9)

501(c)(9) — Voluntary Employee Beneficiary Associations

Part 7. Rulings and Agreements

Chapter 25. Exempt Organizations Determinations Manual

Section 9. Voluntary Employees' Beneficiary Associations

7.25.9 Voluntary Employees' Beneficiary Associations

- 7.25.9.9 Relation of IRC 501(c)(17) to IRC 501(c)(9)
- 7.25.9.10 Unrelated Business Taxable Income of VEBAs
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Manual Transmittal

September 12, 2014

Purpose

(1) This transmits revised IRM 7.25.9, Exempt Organizations Determinations Manual - Voluntary Employees' Beneficiary Associations.

Material Changes

(1) Changes have been made to reflect the amendment to IRC 501(c)(9) by the Patient Protection and Affordable Care Act of 2010, which provides that for sick and accident benefits, the term "dependent" shall include a child of a member under the age of 27 and to update cross-references, where appropriate.

(2) IRM 7.25.9.1.1(4), reference to IRC 89 which was enacted in the Tax Reform Act of 1986 (Public Law 99 514) discussed in Old IRM 7.25.9.1(4)(e) is deleted.

(3) Old IRM 7.25.9.2.1, that discussed Nondiscrimination Requirement is deleted and is now discussed in IRM 7.25.9.3.2.

(4) IRM 7.25.9.2.1(2) deletes references to IRC 501(c)(17) and IRC 501(c)(20) since focus of the IRM is IRC 501(c)(9).

(5) IRM 7.25.9.2.1(3)(a), deletes discussion of Revenue Procedure 92-85, 1992-2 C.B. 490 which is no longer required since the Treas. Reg. regulates "extension of time to file notice" request.

(6) Old IRM 7.25.9.3.1 that discussed Multiple Employer Trusts is deleted.

(7) IRM 7.25.9.3.2, now discusses Nondiscrimination Requirement with revisions specific to IRC 501(c)(9) organizations.

(8) Old IRM 7.25.9.3.3.1 that discussed Nondiscrimination Safe Harbor rules as it applies to Income Replacement Benefits is deleted.

(9) Old IRM 7.25.9.3.4.1 that discussed Supplemental Unemployment Compensation Benefits is deleted.

(10) Old IRM 7.25.9.3.4.2 that discussed Employer-provided Group term Life Insurance benefits is deleted.

(11) Old IRM 7.25.9.3.4.3 that discussed Non-Income Replacement Benefits is deleted.

(12) Old IRM 7.25.9.3.4.4 that discussed General Nondiscrimination Safe Harbor Requirement for Non-Income Replacement Benefits is deleted.

(13) Old IRM 7.25.9.3.4.5 that discussed Health and Accident Benefits is deleted.

(14) IRM 7.25.9.6.5, update to give discussion of the Labor Management Relations Act (LMRA) clarity.

(15) Old IRM 7.25.9.3.4.6 that discussed Group Legal Services Benefits is deleted.

(16) Old IRM 7.25.9.3.4.7 that discussed Educational Assistance Benefits is deleted.

(17) Old IRM 7.25.9.3.4.8 that discussed Dependent Care Assistance Benefits is deleted.

(18) IRM 7.25.9.4, update to give discussion of Employee Defined, a requirement for exemption under IRC 501(c)(9), clarity.

(19) IRM 7.25.9.5 that discussed "Voluntary Defined", citation of the Lima Surgical Associates v. U.S. case is deleted. Reference to Treas. Reg. 1.501(c)(9)-8 regarding control over a collective bargained VEBA is deleted also.

(20) Old IRM 7.25.9.6.6 that discussed Legal Benefits is deleted.

(21) Old IRM 7.25.9.6.8 that discussed Housing Assistance Benefits is deleted.

(22) IRM 7.25.9.8, update to give discussion of Records and Taxation of Benefits clarity , discussion of taxation of non-permissible benefits, not more than a de minimis benefits and payment to non-employee is deleted.

(23) IRM 7.25.9.8.1, update to give discussion of Taxable Benefits clarity. References to Revenue Ruling 67-351, 1967-2 C.B. 86, Revenue Ruling 57-316, 1957-2 C.B. 626, Revenue Ruling 77-347, 1977-2 C.B. 363, Revenue Ruling 70-51, 1970-1, C.B. 192 and Revenue Procedure 68-21, 1968-1 C.B. 817 are deleted.

(24) IRM 7.25.9.9, update to give discussion of Relation of IRC 501(c)(17) to IRC 501(c)(9) clarity.

(25) IRM 7.25.9.10, update to give discussion of Unrelated Business Taxable Income of VEBAs clarity. Deleted reference to the Deficit Reduction Act of 1984 (Public Law 98 369). Update made to reflect applicable IRC and Treas. Regs.

(26) IRM 7.25.9.11, update to give the discussion of Deductibility of Employer Contributions clarity.

(27) IRM 7.25.9.11.1, update to give discussion of IRC 419 clarity.

(28) IRM 7.25.9.12, update to give the discussion of IRC 419A clarity.

(29) IRM 7.25.9.13, update to give the discussion of IRC 4976 Excise Tax on Disqualified Benefits clarity and specific to IRC 501(c)(9).

(30) Old IRM 7.25.9.15, that discussed of Digests of Published Rulings and Procedures is deleted.

Effect on Other Documents

IRM 7.25.9 dated May 24, 2002 is superseded.

Audience

TEGE (Exempt Organizations)

Effective Date

(09-12-2014)

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7.25.9.1 (09-12-2014)
The Statute

1. IRC 501(c)(9) exempts from Federal income tax voluntary employees' beneficiary associations (VEBAs) providing for the payment of life, sick, accident, or other benefits to their members (or their dependents or designated beneficiaries) if no part of the net earnings inures (other than through such payments) to the benefit of any private shareholder or individual. Effective March 30, 2010, for purposes of sick and accident benefits, the term dependent includes any individual who is a child (as defined in IRC 152(f)(1)) of a member who at the end of the calendar year has not reached age 27.

7.25.9.1.1 (09-12-2014)
History

1. The predecessors of IRC 501(c)(9) were IRC 103(16) of the Revenue Act of 1928 and 101(16) of the Internal Revenue Code of 1939.

    A. The law, prior to the Tax Reform Act of 1969, required that 85 percent or more of the income of VEBAs be derived from amounts collected from members and, as added with retroactive effect by the Revenue Act of 1942, amounts contributed by employer.

    B. Also, prior to the enactment of the Tax Reform Act of 1969, old IRC 501(c)(10) (IRC 101(19) of the Internal Revenue Code of 1939) provided for the exemption of voluntary beneficiary associations composed exclusively of Federal officers and employees. See H.R. Rep. No. 855, 87th Cong. 1939–2 C.B. 504 at 508. The exemption requirements under old IRC 501(c)(10) were identical to IRC 501(c)(9) except there was no 85 percent test and membership was restricted to Federal officers and employees.

2. With the imposition of unrelated business income tax on all VEBAs, Congress concluded that the 85 percent test was no longer necessary for tax-exempt status of IRC 501(c)(9) organizations and eliminated the requirement. See Senate Report No. 91–552, 91st Cong., 1st Sess. 69 (1969), 1969–3 C.B. 468. Recognizing that no substantive difference remained between IRC 501(c)(9) and old 501(c)(10), Congress combined the two categories of VEBAs into IRC 501(c)(9) effective January 1, 1970. Sec. 121, P.L. 91–172, 1969–3 C.B. 10, 40.

    A. Final regulations under IRC 501(c)(9) were published in the Federal Register on January 7, 1981 (T.D. 7750).

3. In the Tax Equity and Fiscal Responsibility Act of 1982 (Public Law 97–248), Congress lowered the limits on amounts that could be contributed to qualified pension plans and limited the benefits that could be paid out of the plans.

    A. As a result of these restrictions, some tax practitioners began recommending that employers use VEBAs and other non-pension employee benefit organizations in order to obtain tax sheltering advantages similar to those that had existed with pension plans before 1982, but with fewer restrictions.

4. Because Congress recognized that a potential for abuse existed, provisions of the Deficit Reduction Act of 1984 (Public Law 98–369) were enacted to provide restrictions on employee welfare benefit funds, including VEBAs in this legislation,

    A. IRC 505 established new nondiscrimination rules and mandatory filing requirements for organizations described in IRC 501(c)(9), effective for taxable years beginning after December 31, 1984.

    B. IRC 419 and IRC 419A provide for limits on deductibility of employer contributions to VEBAs and to other welfare benefit funds, effective for contributions made after December 31, 1985.

    C. IRC 512(a)(3)(E) subjects income to tax under IRC 511 to the extent the income exceeds the permissible set aside amount, which is based on certain account limits.

D. IRC 4976 provides for an excise tax on disqualified benefits provided by VEBAs and other welfare benefit funds. See IRM 7.25.9.12.

5. By way of an amendment, the Patient Protection and Affordable Care Act of 2010 ("PPACA")(Public Law 111-148) enacted a provision that pertains to employer-provided and self-insured health plans which includes plans, that use VEBAs.

    A. IRC 501(c)(9), as amended by PPACA, provides that, for purposes of providing for the payment of sick and accident benefits to VEBA members and their dependents, the term dependent includes any individual who is a members child (as defined in IRC 152(f)(1)) and who has not attained age 27 as of the end of the calendar year.

7.25.9.2 (09-12-2014)
Exemption Requirements

1. The regulations under IRC 501(c)(9) provide that for an organization to be a VEBA within the meaning of IRC 501(c)(9):

    A. the organization must be an association of employees;

    B. membership in the association must be voluntary;

    C. The organization's purpose must be to provide for the payment of life, sick, accident, or other benefits to its members or their dependents or designated beneficiaries, and substantially all of its operations are in furtherance of providing such benefits, and

    D. no part of the net earnings of the organization can inure, other than by payment of the benefits referred to in (c), to the benefit of any private shareholder or individual.

7.25.9.2.1 (09-12-2014)
Notice Requirements

1. Under IRC 505(c), all IRC 501(c)(9), organizations must file a *Form 1024, Application for Recognition of Exemption Under Section 501(a) or for Determination Under Section 120*, to be recognized as exempt.

    A. A full description of the benefits available to the participants must accompany the Form 1024, showing for each benefit the amount, duration, eligibility requirements, and the circumstances that will cause payment of the benefit. This information may be contained in a "plan document" , or in the creating document of the organization, such as the trust agreement or articles of incorporation.

    B. For benefits provided through policies of insurance, all such policies must be included. Where individual policies are provided to the participants, typical examples of the policies issued to participants are acceptable, provided that they adequately describe all forms of insurance available to participants.

    C. If an insurance policy has cash value, it must be owned in the name of the IRC 501(c)(9) organization.

2. Organizations that fail to file the required notice within time limits prescribed in the regulations will not be recognized as exempt for any period prior to the filing of the notice. Treas. Reg. 1.505(c)–1T sets forth the filing requirements and time limits for organizations applying for exemption under IRC 501(c)(9).

    A. IRC 501(c)(9) applicants that were organized on or before July 18, 1984, must apply before February 4, 1987. An organization organized after July 18, 1984, must apply for exemption within 15 months from the end of the month in which the organization was organized, or by February 4, 1987, whichever is later.

B. An organization that files a timely notice and that otherwise meets the requirements of IRC 501(c)(9), will have its exemption recognized retroactively to the date it was organized. However, an organization that does not file a timely notice will not be recognized as exempt before the date on which its notice was filed.

C. The notice may be filed by either the plan administrator (as defined in IRC 414(g)) or trustee. The Service will not accept a Form 1024 for any organization or trust before such entity has been organized.

3. An organization that files a late notice may be granted an automatic extension of time pursuant to Treas. Reg. 301.9100–2. Under Treas. Reg. 301.9100-2, an automatic extension of 12 months from the due date for making a regulatory election is granted to make elections described in (a)(2) of this section provided the taxpayer takes corrective action as defined in paragraph (c) of this section within that 12-month extension period. The 15-month rule for filing an exemption application for a IRC 501(c)(9) is one of the elections described in paragraph (a)(2) of Treas. Reg. 301.9100-2.

4. Although a properly completed and executed Form 1024, together with the required additional information, must be submitted to satisfy the notice required by IRC 505(c), failure to file all of the information necessary to complete the notice will not alone be sufficient to deny recognition of exemption from the date of organization to the date of submission.

A. If the notice filed by the organization within the required time is substantially complete, and the additional information requested by the Service to complete the notice is furnished within the time allowed by the Service, the original notice will be considered timely.

7.25.9.3 (09-12-2014)
Membership Requirements

1. Pursuant to Treas. Reg.1.501(c)(9)-2, generally, only employees are entitled to become members of a VEBA. In addition, eligibility for membership must be defined by reference to objective standards that constitute an employment-related common bond among such individuals.

A. This "bond" can be a common employer, coverage under a collective bargaining agreement, a labor union affiliation. In addition, employees of the VEBA and employees of the union whose members are members of the VEBA will be considered to share an employment related common bond.

B. Exemption will not be denied merely because the membership includes some individuals who are not employees, provided that such individuals share an employment-related common bond with the employee members (for example, the proprietor of a business whose employees are members of the VEBA) and do not comprise more than 10% of the total membership of the VEBA on one day of each quarter of the VEBA's taxable year.

2. Employees of one or more unaffiliated employers engaged in the same line of business "in the same geographic locale" also share an employment-related common bond.

3. A notice of proposed rule making was published in the Federal Register Vol. 57, 153 on August 7, 1992, in which Treas. Reg.1.501(c)(9)–2(a)(1) was proposed to be revised by adding a paragraph (d) which further defines the term "geographic locale" .

A. Proposed Treas. Reg. 1.501(c)(9)–2(d) provides for a three-state safe harbor. An area is considered a single geographic locale if it does not exceed the boundaries of three contiguous states.

B. The three-state safe harbor includes three states which share a land or river border with at least one of the others, such as South Carolina, North Carolina, and Virginia. Also, Alaska and Hawaii are considered contiguous to California, Oregon, and Washington for purpose of these regulations.

4. In addition, the Service has authority to recognize an area that exceeds the three-state safe harbor as the same geographic locale if:

    A. It would not be economically feasible to establish two or more VEBAs to cover employees of employers engaged in the same line of business in fewer than three states and still be able to offer VEBA membership to employees of employers in the covered states, and

    B. Employment characteristics in that line of business, population characteristics, or other regional factors support the particular states included. This is deemed satisfied if the states included are contiguous.

7.25.9.3.1 (09-12-2014)
Membership and Eligibility Restrictions

1. Treas. Reg. 1.501(c)(9)–2(a)(2)(i) provides that eligibility for membership may be restricted by geographic proximity, or by objective conditions or limitations reasonably related to employment, such as a limitation to a reasonable classification of workers, a limitation based on a reasonable minimum period of service, a limitation based on maximum compensation, or a requirement that a member be employed on a full-time basis.

    A. Eligibility for benefits may be restricted by objective conditions relating to the type or amount of benefits offered. Any objective criteria used to restrict eligibility for membership or benefits may not be selected or administered in a manner that limits membership or benefits to officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the VEBA.

2. Eligibility for benefits may not be subject to conditions or limitations that have the effect of entitling officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association to benefits that are disproportionate in relation to benefits to which other members of the association are entitled. For example:

    A. In the case of an employer-funded organization, a provision that excludes or effectively excludes certain employees, who are members of another organization or are covered by a different plan funded by the employer, to the extent that such other organization or plan offers similar benefits on comparable terms, will be considered a reasonable restriction.

    B. The provision of life benefits in amounts that are a uniform percentage of the compensation received by the individual whose life is covered will be considered a reasonable restriction. (See Treas. Reg. 1.501(c)(9) –2(a)(2)(ii) for other examples of reasonable restrictions).

3. The regulations provide that an employer-funded VEBA may not restrict membership or eligibility for benefits to officers, shareholders, or highly compensated employees of the employer. Additional nondiscrimination rules in IRC 505(b) apply to plans that are not collectively bargained.

4. Treas. Reg. 1.501(c)(9)–4(b) dealing with inurement and Treas. Reg. 1.501(c)(9)–2(a)(2) dealing with membership restrictions should be considered together in dealing with disproportionate benefit problems.

7.25.9.3.2 (09-12-2014)
Nondiscrimination Requirements

1. Under IRC 505(a), VEBAs must meet nondiscrimination requirements unless they are subject to the exception in IRC 505(a)(2) for VEBAs maintained pursuant to collective bargaining agreements.

2. The 505(b) nondiscrimination requirements were enacted to ensure that highly compensated employees are not favored over other employees. Under IRC 505(b) (1), a plan will meet the requirements of IRC 505(b) only if:

A. each class of benefits under the plan is provided under a classification of employees that is set forth in the plan and that does not discriminate in favor of highly compensated individuals; and

B. In the case of each class of benefits, such benefits do not discriminate in favor of highly compensated individuals.

3. While Treas. Reg. 1.501(c)(9)–2(a)(2)(i) permits an employer to use its own objective criteria under 1.501(c)(9)–2(a)(2)(i) to exclude certain employees from participation, IRC 505(b) seeks to ensure that the result of these exclusions is not discriminatory in favor of highly compensated individuals. In testing to determine whether a benefit is provided on a nondiscriminatory basis, IRC 505(b)(2) permits the exclusion of certain employees from consideration for purposes of the test. These employees that need not be taken into account include:

   A. employees with less than three years of service,

   B. employees under the age of 21,

   C. seasonal or less than half-time employees,

   D. employees not included in the plan who are covered by a collective bargaining agreement, and,

   E. certain nonresident alien employees.

4. Under IRC 505(b)(5), the determination as to whether an individual is a highly compensated individual shall be made under rules similar to those under IRC 414(q).

5. IRC 414(q) defines "highly compensated employee" to mean an employee who,

   A. was a 5-percent owner at any time during the year or preceding year, or

   B. For the preceding year, (1) had compensation from the employer in excess of $80,000 (adjusted for inflation); and (2) if the employer elects the application of this clause for such preceding year, was in the top paid group of employees for such preceding year. The top-paid group consists of the top 20 percent of employees ranked on the basis of compensation paid during the year.

   C. Inflation adjustments for the above compensation levels are published annually in the Internal Revenue Bulletin. For example, see Notice 2011-90, 2011-47 I.R.B. 791 for 2012 adjustments.

6. IRC 505(b)(3) provides that if a particular benefit is subject to the nondiscrimination requirements of another Code provision, that benefit must be tested under the requirements of the other provision rather than under IRC 505(b)(1). For example, the following benefits must be tested under the IRC provisions noted below:

   A. Group term life insurance benefits under IRC 79;

   B. Self-insured medical benefits under IRC 105;

   C. Educational assistance benefits under IRC 127; and

   D. Dependent care assistance benefits under IRC 129.

7.25.9.4 (09-12-2014)
Employee Defined

1. Under Treas. Reg. 1.501(c)(9)–2(b)(1)), whether an individual is an “employee” is determined by reference to the legal and bona fide relationship between an employer and an employee. As such, an employee includes:

   A. An individual who is considered an employee for employment tax purposes.

B. An individual who is considered an employee for purposes of a collective bargaining agreement, or

C. An individual who became entitled to membership in the VEBA by reason of being or having been an employee, such as an individual who is on a leave of absence, working as an independent contractor, or has been terminated on account of retirement.

2. Because it is consistent with exemption for a VEBA to provide benefits to retired employees, a VEBA will not be disqualified from exemption merely because it provides benefits only to retirees, if such benefits are merely a continuation of benefits that have been provided to those employees while they were actively employed.

3. The surviving spouse and dependents of an employee are "employees" if they are considered to be members of the VEBA. Thus, if the surviving spouse and dependents meet this condition they will not be subject to the 10 percent limitation on non-employees.

7.25.9.5 (09-12-2014)
Voluntary Association of Employees Defined

1. Under Treas. Reg. 1.501(c)(9)-2(c)(2), membership in a VEBA is "voluntary" if an affirmative act by an employee is required to become a member of a VEBA. Thus, an employee does not become a member of a VEBA just by being an employee. However, a VEBA is considered voluntary although membership is required to all employees, provided that the employees do not incur a detriment. Membership in a VEBA is considered voluntary if required as a result of collective bargaining agreement or as a result of membership in a labor organization.

2. Treas. Reg. 1.501(c)(9)-2(c)(1) requires that a VEBA must be an entity, such as a corporation or trust established under applicable local law, having an existence independent of the member-employees or their employer(s). Under Treas. Reg. 1.501(c)(9)-3, a VEBA must be controlled by either its membership, by independent trustees, or by trustees or other fiduciaries some of whom are designated by, or on behalf of, the membership.

   A. A bank generally will be considered to be an independent trustee.

   B. A VEBA will also be considered to be controlled by independent trustees if it provides benefits through an employee benefit plan as defined in section 3 (1) of the Employee Retirement Income Security Act of 1974 (ERISA) and, as such, is subject to the requirements of ERISA. The Department of Labor has jurisdiction of Title 1 of ERISA.

   C. An association will be considered to be controlled by its membership if it is controlled by one or more trustees designated pursuant to a collective bargaining agreement (whether or not the bargaining agent of the represented employees bargained for and obtained the right to participate in selecting the trustees.

3. Under section 3 (1) of ERISA, the term "employee welfare benefit plan" means any plan, fund, or program established or maintained by an employer or by an employee organization, or by both to the extent that such plan, fund, or program was established or maintained, for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise:

   A. Medical, surgical, or hospital care or benefits, or benefits in the event of sickness, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services, or;

   B. Any benefit described in section 302(c) of the Labor Management Relations Act of 1947 (other than pensions on retirement or death, and insurance to provide such pensions).

4. Section 302(c) of the Labor Management Relations Act of 1947 does not apply to any employee welfare benefit plan if:

    A. such plan is a governmental plan (as defined in section 3(32) of ERISA);

    B. such plan is a church plan (as defined in section 3(33)) with respect to which no election has been made under IRC 410(d);

    C. such plan is maintained solely for the purpose of complying with applicable workmen's compensation laws or unemployment compensation or disability insurance laws;

    D. such plan is maintained outside of the United States primarily for the benefit of persons substantially all of whom are nonresident aliens; or

    E. such plan is an excess benefit plan (as defined in section 3(36) of ERISA and is unfunded.

7.25.9.6 (09-12-2014)
Permissible Benefits

1. VEBA must provide life, sick, accident, or other benefits to members, their dependents, or their designated beneficiaries. Dependents include a member's spouse, any child of the member or member's spouse who is a minor or student (within the meaning of IRC 152(f)(1)) or other minor child residing with the member. Dependents also include any other individual who an association, relying on information furnished to it by a member, in good faith believes is a person described in IRC 152(a). For purposes of sick and accident benefits, the term dependent includes any individual who is a child (as defined in IRC 152(f)(1)) of a member who at the end of the calendar year has not attained age 27.

2. Treas. Reg. 1.501(c)(9)-3(a) provides that substantially all of a VEBA's operations must be in furtherance of providing permissible benefits. This means that a VEBA will not qualify for exemption if it systematically and knowingly provides nonqualifying benefits of more than a de minimis amount. Examples of nonqualifying benefits are shown in IRM 7.25.9.6.8.

7.25.9.6.1 (09-12-2014)
Life Benefits

1. Treas. Reg. 1.501(c)(9)-3(b) provides that life benefits are benefits payable on the lives of a member or a member's dependents death. Life benefits include burial and wreath benefits. The payment of benefits can either be furnished pursuant to a contract of insurance with a life insurance company paid directly by the VEBA.

2. The regulations generally require that "life benefits" consist of current protection only. There are three exceptions to this general rule.

    A. A VEBA may provide to a participant in a group life insurance contract the right to convert to individual coverage on termination of the member's relationship with the VEBA.

    B. "Life benefits" generally include any "permanent benefit" as defined in, and subject to the conditions in, provided in the regulations under IRC 79. To the extent provided in the regulations under IRC 79, the cost of the permanent benefits required to be included currently in the gross income of the employee.

    C. A VEBA that is funded with employee, rather than employer, contributions generally may offer "life benefits" that involve permanent protection or other permanent benefits provided under a life insurance contract purchased by a member directly from the VEBA or provided by the VEBA to the member.

3. Life benefits do not include a pension, annuity or similar benefit. However, the regulations permit settlement/payment of death benefits under a life insurance policy in the form of an annuity to the beneficiary in lieu of a lump-sum death benefit.

4. The Joint Committee on Taxation Explanation to the Deficit Reduction Act of 1984 indicates that life insurance benefits may not be integrated with social security benefits for purposes of meeting nondiscrimination requirements.

7.25.9.6.2 (09-12-2014)
Sick and Accident Benefits

1. 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. These benefits may be provided through reimbursement for amounts paid by a member or through the payment of premiums to a medical benefit or health insurance program. (See Treas. Reg. 1.501(c)(9)–3(c)).

7.25.9.6.3 (09-12-2014)
"Other Benefits" Defined

1. Treas. Reg. 1.501(c)(9)-3(d) provides that "other benefits" are those that are similar to life, sick, or accident benefits. A benefit is similar if:

    A. It is intended to safeguard or improve the health of a member or a member's dependents, or

    B. It protects against a contingency that interrupts or impairs a member's earning power.

7.25.9.6.4 (09-12-2014)
Specific Other Benefits

1. Examples of other benefits include vacation pay and facilities, child care payments and facilities, and subsidizing recreational activities.

    A. Treas. Reg. 1.501(c)(9)-3(e) permits benefits in the form of temporary living expense loans at times of disaster, such as fire or flood, but do not allow such organizations to provide loans to members in the ordinary course of a banking or financing business.

    B. The regulations provide that job readjustment allowances may be paid as an example of a benefit provided to protect against a contingency which interrupts earning power, as it allows a worker to bridge the period between jobs without the loss of income.

    C. Supplemental unemployment compensation benefits are permitted and are defined in IRC 501(c)(17)(D)(i).

    D. Permissible severance benefits are defined by reference to 29 CFR 2510.3–2(b), a regulatory labor provision which distinguishes a severance pay plan from a pension plan for purposes of Title I of ERISA. General guidelines include a maximum amount of payment not to exceed twice the employee's most recent annual compensation, payment being completed within two years after the termination of employment, and payments not directly or indirectly contingent upon retirement.

7.25.9.6.5 (09-12-2014)
Benefits under the Labor Management Relations Act (LMRA)

1. Treas. Reg. 1.501(c)(9)–3(e) provides that "other benefits" also includes any benefit provided in the manner permitted by paragraph (5) *et. seq*. of section 302(c) of the LMRA.

A. The VEBA regulations permit these benefits " except to the extent otherwise provided" in the VEBA regulations. This resolves the apparent inconsistency of pension benefits that are allowed under LMRA 302(c)(5) but which are expressly prohibited in Treas. Reg. 1.501(c)(9)–3.

B. The benefits must be provided "in the manner permitted" by section 302 of the LMRA. This includes the establishment of a trust by the employees representative (i.e. labor union), the existence of a written collective bargaining agreement, and employer-representation in the administration of the organization, etc.

C. Examples of benefits permitted by sections 302(c)(5)-(7) of the LMRA are the provision of scholarship's for members' dependents and personal legal service benefits.

7.25.9.6.6 (09-12-2014)
Education Benefits

1. Education or training benefits or courses, such as apprenticeship training programs for members, are permissible other benefits. In addition, because collectively bargained trusts may provide certain benefits described in section 302(c) of the LMRA, these organizations can provide educational benefits, such as scholarships, to dependents of members.

7.25.9.6.7 (09-12-2014)
Non-Qualifying Benefits

1. Under Treas. Reg. 1.501(c)(9)-3(f), the following categories of benefits are not permitted:

    A. Benefits similar to those provided by a pension, stock bonus or profit-sharing plan;

    B. Deferred compensation benefits, defined as being payable by reason of passage of time rather than as the result of an unanticipated event;

    C. Property and malpractice insurance;

    D. Loans (other than loans at times of disaster);

    E. Savings plans; and

    F. Commuting expenses.

7.25.9.7 (09-12-2014)
Inurement of Earnings

1. Treas. Reg. 1.501(c)(9)-4 provides that no part of the net earnings of a VEBA may inure to the benefit of any private shareholder or individual other than through the payment of permitted benefits. "Private shareholder or individual" refers to persons having a personal or private interest in the activities of the organization and includes the members, officers, trustees, employees and fiduciaries of the organization and contributing employers.

    A. The payment of disproportionate benefits to members who are officers, shareholders or highly compensated employees of a contributing employer constitutes prohibited inurement. Inurement under Treas. Reg. 1.501(c)(9)–4(b), and membership restrictions under Treas. Reg. 1.501(c)(9)-2(a)(2) should be considered together in considering problems involving disproportionate benefits.

    B. Generally, the payment of unreasonable compensation to the trustees or employees of the VEBA, or the purchase of insurance or services for amounts in excess of their fair market value from a company in which one or more of the VEBA's trustees, officers or fiduciaries has an interest, will constitute prohibited inurement.

2. Prohibited Inurement can also consist of the disposition of property to, or the performance of services for, a person for less than the greater of fair market value or cost to the VEBA.

3. Experience-rated insurance rebates to employers are allowed. An insurance policy that has a continuing residual cash value must be owned in the name of the VEBA.

4. On dissolution, assets may be distributed to members, or used for benefits until depleted, but may not return to the contributing employers. If any of the VEBA's creating documents e.g., articles of incorporation, trust documents, etc., provide that upon dissolution the assets of the VEBA can revert back to the contributing employer(s), or the state law in which the VEBA was created provides that upon dissolution, the assets of the VEBA can revert back to the contributing employer(s), then the VEBA cannot qualify for exemption as an organization described in IRC 501(c)(9). Inurement to an employer may also be:

    A. a reversion subject to the IRC 4976 excise tax, or

    B. a prohibited transaction under ERISA Title 1 fiduciary rules, in which case a referral to DOL may be appropriate.

7.25.9.8 (09-12-2014)
Records and Taxation of Benefits

1. Every VEBA must maintain records indicating the amount contributed by each member and contributing employers, and the amount and type of benefits paid by the VEBA to or on behalf of each member.

2. Cash and noncash benefits received by a person from a VEBA must be included in the gross income of the recipient to the extent provided in the Code.

3. Many of the benefits received by members of a VEBA are excluded from the gross income of the recipient. For example, the following benefits are excluded if they meet the statutory requirements of the sections provided:

    - health and accident benefits under IRC 105 and 106,
    - compensation for injuries under IRC 104,
    - certain death benefits under IRC 101, and
    - certain educational assistance under IRC 127.

4. The above statutes govern the taxability of benefits to the individual. It is irrelevant:

A. whether an individual is eligible for membership in the VEBA,

B. whether the benefit paid is permissible, or

C. whether the VEBA is in fact tax-exempt.

7.25.9.8.1 (09-12-2014)
Taxable Benefits

1. If a benefit payment is taxable as wages, it will be subject to income tax withholding, FICA and FUTA taxes, and reported on Form W-2 and Form W-3. Under IRC 6041, payments in excess of $600 that are not wages must be reported on Form 1096 and Form 1099.

    A. Generally, vacation benefits constitute wages under Treas. Reg. 31.3401(a)–1(b)(3), except as noted above, as do supplemental unemployment compensation payments.

B. Dismissal or severance payments generally constitute wages (Treas. Reg. 31.3401(a)–1(b)(4)). If a benefit is taxable when the employer pays it, and the benefit is in the form of wages, the employer is responsible for income tax withholding paying FICA and FUTA taxes, and the reporting requirements. If the benefit is taxable when the VEBA pays it, the VEBA is responsible for the payment of these taxes and the reporting requirements.

C. The trust can act as agent on behalf of the employer when the employer has the tax and reporting obligations.

2. Cases indicating that an employer is not properly withholding or paying employment taxes should be referred to EO Examinations under existing procedures. For example, an employer may be treating payments to an a VEBA as being made solely to an accident and health plan under IRC 106, when in reality these payments are also payments for a severance benefits plan. The employer must instead make an allocation between the two plans as the employer is required to withhold on the portion allocable to the severance plan. Under such circumstances the information should be referred to EO Examinations.

A. Exempt Organizations specialists are responsible for determining whether VEBA's are meeting their responsibilities with respect to income tax withholding, FICA and FUTA, and reporting on W–2s and W–3s in the case of wages, and the reporting requirements of IRC 6041 in the case of other taxable benefits.

7.25.9.9 (09-12-2014)
Relation of IRC 501(c)(17) to IRC 501(c)(9)

1. A supplemental unemployment benefit (SUB) plan has the option to qualify for exemption under IRC 501(c)(9) or IRC 501(c)(17). See Treas. Reg. 1.501(c)(17)–3(b). However, differences in the treatment of these organizations could affect the decision.

A. An IRC 501(c)(17) SUBs can provide only SUB benefits and subordinate sick and accident benefits, while a VEBA can provide a much broader range of benefits.

B. Also IRC 501(c)(17) are the subject to the prohibited transaction rules of IRC 503.

7.25.9.10 (09-12-2014)
Unrelated Business Taxable Income of VEBAs

1. IRC 512(a)(3) provides special rules for determining the unrelated business taxable income of VEBAs.

2. Generally, all income (less permitted deductions) of a VEBA is taxable unless it constitutes exempt function income under IRC 512(a)(3)(B). Under Treas. Reg. 1.512(a)-5T, employer contributions are treated as member contributions.

A. Exempt function income generally includes all contributions paid by members of a VEBA. In addition, it includes investment income which is set aside under IRC 512(a)(3)(B) for the payment of life, sick, accident, or other benefits, subject to certain limits;

B. Income from an unrelated trade or business (under the general rule of IRC 512(a)(1)) is not exempt function income. Thus, like other exempt organizations, a VEBA is taxed on income from an unrelated trade or business as defined in IRC 513.

3. IRC 512(a)(3)(E) set limits on the permitted set aside in IRC 512(a)(3)(B).

A. IRC 512(a)(3)(E) provides that the amounts in excess of the IRC 419A(c) account limit (the otherwise applicable IRC 419A account limit is adjusted because it is calculated without regard to a reserve for post-retirement medical benefits) will not be considered exempt function income.

B. IRC 512(a)(3)(E) does not apply to VEBAs that receive substantially all of their contributions from organizations that have been tax-exempt organizations throughout a five-year period ending with the taxable year in which contributions are made.

C. Under Treas. Reg. 1.512(a)-5T, the unrelated business taxable income of a VEBA generally equals the lesser of: (1) the income of the VEBA for the taxable year (excluding member contributions), or (2) the excess of the total amount set aside as of the close of the taxable year over the qualified asset account limit (calculated without regard to the otherwise permitted reserve for post-retirement medical benefits) for the taxable year

4. Under Treas. Reg. 1.419A-2T, neither contributions to, nor reserves of, a collectively bargained welfare benefit fund are treated as exceeding the otherwise applicable limits of IRC 419(b) (relating to fund's qualified cost for the taxable year), IRC 419A(b) (relating to additions to qualified asset accounts), or IRC 512(a)(3)(E) (relating to set aside amounts for organizations described in IRC 501(c)(9), (17), or (20)." See Treas. Reg. 1.419A-2T for a definition of collectively bargained welfare benefit fund.

7.25.9.11 (09-12-2014)
Deductibility of Employer Contributions

1. Congress enacted IRC 419 and IRC 419A to provide limits on the deductibility of employer contributions. Generally, for contributions paid or accrued to a welfare benefit fund, if they would otherwise be deductible, IRC 419 and 419A operate to allow a deductions for contributions in the year the employee includes the benefit in income (or would have be included it but for another provision of the Code).

   A. However, IRC 419 and IRC 419A also allow deductions for amounts used to fund accounts set aside for certain benefits up to limits specified in IRC 419A(c).

   B. The rules of IRC 419 and IRC 419A apply to both VEBAs and welfare benefit finds. Under IRC 419A(f)(6), the rules of IRC 419 and 419A do not apply to contributions to a welfare benefit fund which is part of a 10 or more employer plan is a plan that does not maintain experience-rating arrangements with respect to individual employers. A 10 or more employer plan to which more than one employer contributes and to which no employer normally contributes more than 10% of the total contributions contributed under the plan by all employers. Plans described in IRC 419A(f)(6) are subject to the general deduction rules under the Code.

   C. Under IRC 419A(f)(5), there is no account limit for welfare benefits fund maintained pursuant to a collective bargaining agreement or an employee pay-all VEBA.

7.25.9.11.1 (09-12-2014)
IRC 419

1. IRC 419 provides that contributions paid or accrued by an employer to a welfare benefits fund, if otherwise deductible, are deductible, subject to certain limitations, in the taxable year in which paid. The deduction is limited to the employer’s qualified cost for the taxable year, reduced by the fund’s after-tax income.

   A. The term "welfare benefit fund" is defined in IRC 419(e) to include a fund through which an employer provides benefits (other than pension and other deferred compensation benefits. Welfare benefit funds include employer-funded organizations described in IRC 501(c)(7), IRC 501(c)(9), IRC 501(c)(17) and certain accounts, in addition to nonexempt employer-funded organizations.

2. The employer’s "qualified cost" is defined in IRC 419(c) to mean the sum of the amounts in (a) and (b) below:

   A. The employer’s qualified direct cost for the taxable year. The employer’s qualified direct cost is the aggregate amount (including administrative expenses) that would have been allowable as a deduction to a cash-basis employer directly providing benefits to employees. For these purposes, a

benefit is treated as provided only in the year the benefit is includible in the gross income of the employee (or would be includible but for a provision of the Code.)

B. The employer's additions to qualified asset accounts for disability, medical, life, supplemental unemployment, or severance benefits described in IRC 419A (as limited by IRC 419A(b)) for the taxable year.

3. In establishing the allowable deduction under IRC 419, the employer's qualified cost is reduced by the fund's "after tax income." "After tax income" is the fund's gross income, reduced by any income taxes paid and by expenses directly connected with the production of gross income. Gross income does not include employer contributions, but does include employee contributions. The effect of these rules is to reduce otherwise allowable employer deductions by the amount of net investment income of the fund and by the amount of employee contributions to the fund.

4. Employer contributions in excess of the IRC 419 deductibility limits are carried forward to succeeding taxable years.

5. A ruling on VEBA qualification is issued to the VEBA, which is a separate taxpayer. A VEBA ruling does not address the application of IRC 419 or the deductibility of employer contributions. Accordingly, the following caveat should be used: No opinion is expressed or implied as to whether employer contributions to you are deductible under the Code.

7.25.9.12 (09-12-2014)
IRC 419A

1. IRC 419A defines "qualified asset account " as an accounts set aside to provide for disability, medical, life, supplemental unemployment, or severance benefits. Deductions under IRC 419 are limited to contributions that do not cause the account limit of IRC 419A(c) to be exceeded.

   A. IRC 419A(c)(1) provides that the account limit for any qualified asset account is the amount reasonably and actuarially necessary to fund claims incurred but unpaid as of the close of the taxable year, and administrative costs for such claims. However, IRC 419A(c)(2) through (5) provide other limits for particular benefits.

   B. An additional reserve is allowed for post-retirement medical and life insurance benefits, but only if the plan meets the nondiscrimination requirements of IRC 505(b).

   C. A separate account must be maintained for each key employee for whom a post-retirement medical or life insurance benefit is provided.

7.25.9.13 (09-12-2014)
IRC 4976 Excise Tax on Disqualified Benefits

1. IRC 4976(a) imposes a 100% excise tax on an employer for disqualified benefits provided by an employer-maintained welfare benefit fund, including a VEBA.

2. Disqualified benefits are defined in IRC 4976(b) as:

   A. Post-retirement medical or life insurance benefits provided with respect to a key employee if a separate account is required to be established for such employee under IRC 419A(a) and such payment is not from such account,

   B. Any post-retirement medical or life insurance benefits provided with respect to an individual in whose favor discrimination is prohibited unless the plan meets the requirements of IRC 505(b) with respect to such benefit whether or not such requirements apply to such plan; and

C. Amounts for which a deduction is allowable under IRC 419 that revert from the fund to the benefit of the employer.

7.25.9.14 (09-12-2014)
VEBA Funded Cafeteria Plan Benefits

1. The provision of IRC 125 benefits, such as health insurance, disability, life insurance, child care through a VEBA trust is not necessarily inconsistent with exempt status under IRC 501(c)(9).

    A. IRC 505(b)(3) provides that if a benefit is subject to nondiscrimination rules under some other section of the Internal Revenue Code, those rules must be satisfied and not the nondiscrimination requirements of IRC 505(b)(1).

2. Benefits that are provided through a VEBA and a related cafeteria plan can be viewed as meeting the nondiscrimination requirements of IRC 501(c)(9) if the following standards are met:

    A. The nondiscrimination rules applicable to a specific benefit must be met so that the specific benefit is treated as nontaxable. For example, a dependent care assistance program must meet the rules in IRC 129(d), a self-insured medical expense reimbursement plan must meet the rules in IRC 105(h), and group-term life insurance must meet the rules in IRC 79(d).

    B. In addition to the nondiscrimination rules which determine whether specific benefits are nontaxable, the cafeteria plan itself must also meet the nondiscrimination requirements set forth in IRC 125(b).

3. Because the Service will not rule on the qualification of IRC 125 plans, the following caveat should be used in these situations:

    A. We are not making a determination directly or indirectly, on whether the arrangement which you describe as a "cafeteria plan" meets the requirements of IRC 125 and other related sections of the Internal Revenue Code. Further, this determination is not to be construed by inference or otherwise as approving, for purposes of exemption under IRC 501(c)(9), any other arrangement which purports to be a "cafeteria plan" .

4. Since cash or deferred savings arrangements can be provided through a cafeteria plan, but are not permissible benefits under IRC 501(c)(9), any exemption ruling or determination under IRC 501(c)(9) should clearly only cover permissible IRC 501(c)(9) benefits.

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