

# [Exemptions]

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

## 26 U.S. Code § 501 (c)(17)



### 501(c)(17) — Supplemental Unemployment Benefit Trusts



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#### Part 7. Rulings and Agreements

#### Chapter 25. Exempt Organizations Determinations Manual

#### Section 17. Supplemental Unemployment Benefit Trusts

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##### 7.25.17 Supplemental Unemployment Benefit Trusts

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##### 7.25.17.1 (09-25-1997)

###### Statute

1. IRC 501(c)(17) exempts from Federal income tax a trust or trusts forming part of a plan providing for the payment of supplemental unemployment compensation benefits, if the requirements of IRC

501(c)(17)(A)(i), (ii), and (iii) are met. Subparagraphs (B), (C), (D), and (E) of IRC 501(c)(17) set out operational information and definitions used in implementing IRC 501(c)(17).

#### **7.25.17.1.1 (09-25-1997)**

##### **History**

1. IRC 501(c)(17) was enacted in 1960 and made applicable to all taxable years beginning after December 31, 1959. Regulations to implement IRC 501(c)(17) were adopted September 11, 1968.
  - A. Supplemental unemployment benefits (SUB) plans arose out of attempts by some labor unions to negotiate guaranteed annual wage plans. Their primary concern was the difference between the workers average weekly earnings received when employed, and the unemployment benefits received by workers when unemployed. Consequently, supplemental unemployment benefit plans developed instead of guaranteed annual wage plans.
  - B. The first of the main SUB plans were those negotiated with the automobile industry in 1955, and the bulk of the plans developed since that time have followed their general pattern. Under these plans a worker is eligible for SUB payments if laid off by the company, either in a reduction in force or in a temporary layoff. Usually these payments also depend on the concurrent receipt (at least during part of the period) of State unemployment benefits. In addition, an employee has no vested interest in amounts the employer pays into the fund, and if the employee leaves the company voluntarily or is discharged for misconduct, he/she is not eligible for a benefit. See Senate Report No. 1518, 1960-2 C.B. 753 at 754.
2. SUB plans are set up as separate trusts and are funded by payments by the employer to the trusts of a certain amount per hour per employee. These trusts generally qualified for exemption under IRC 501(c)(9).
  - A. Prior to the Tax Reform Act of 1969, IRC 501(c)(9) required that 85 percent or more of the income of a voluntary employees' beneficiary association consist of amounts collected from members or contributed by the employer of members. Some SUB trusts could not qualify for exemption under IRC 501(c)(9) because their investment income was more than 15 percent of their total income.
  - B. Because SUB funds are nonprofit in character, provide worthwhile benefits, and are not in competition with profit-making enterprises, Congress enacted IRC 501(c)(17) to exempt from tax trusts providing unemployment compensation benefits, even though investment and other income exceeded the 15 percent limit then existing under IRC 501(c)(9).
  - C. However, because of possible competition with private enterprise, SUB trusts that provide sickness and accident benefits may provide such benefits only as a subordinate part of the plan.
  - D. IRC 501(c)(17) does not cover retirement and death benefits since other Code provisions cover trusts providing such benefits.

#### **7.25.17.1.2 (09-25-1997)**

##### **Deficit Reduction Act of 1984**

1. The Deficit Reduction Act of 1984 (DEFRA) imposed new requirements and restrictions on employee welfare benefit funds, including IRC 501(c)(17) organizations. DEFRA provided for—
  - Mandatory filing requirements,
  - Limitation on employer deductions for contributions to the organizations,
  - Imposed IRC 512(a)(3) rules on IRC 501(c)(17) organizations,

- Imposed unrelated business income tax (UBIT) on amounts exceeding specified account limits, and
  - Excise tax on disqualified benefits.
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#### **7.25.17.2 (09-25-1997)**

##### **Filing Requirements**

1. A trust seeking recognition of exemption under IRC 501(c)(17) must file its application on Form 1024. IRC 505(c) provides that a trust will not be considered exempt unless Form 1024 is filed within time limits prescribed by regulations.
    - A. Reg. 1.505(c)-1T sets forth the filing requirements and time limits for trusts applying for exemption under IRC 501(c)(17).
    - B. A trust that was organized on or before July 18, 1984, had to apply before February 4, 1987. A trust organized after July 18, 1984, must apply for exemption within 15 months from the end of the month in which it was organized. A trust that files a timely notice and that otherwise meets the requirements of IRC 501(c)(17) will have its exemption recognized retroactively to the date it was organized. However, a trust that does not file a timely notice will not be recognized as exempt before the date on which its notice was filed.
  2. An extension of time for filing the required notice may be granted by the area manager if the request is submitted before the end of the applicable period and it is demonstrated that additional time is needed.
    - A. A trust that files a late notice may be granted an extension of time pursuant to Reg. 301.9100-1. Rev. Proc. 92-85, 1992-2 C.B. 490, sets forth the information and representations that must be furnished by the trust and some factors that will be taken into consideration in determining whether such an extension will be granted.
  3. 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).
    - A. Failure to file all of the information necessary to complete the notice will not in itself be sufficient to deny recognition of exemption from the date of organization to the date of submission.
    - B. If the notice filed 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, the original notice will be considered timely.
    - C. A full description of the supplemental unemployment benefits available to the participants must accompany the Form 1024, showing the amount, duration, eligibility requirements, and the circumstances that will cause payment of the benefit.
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#### **7.25.17.3 (09-25-1997)**

##### **Exemption Requirements**

1. For a SUB trust to be exempt under IRC 501(c)(17), the trust must be a—
  - A. valid, existing trust under local law and be evidenced by an executed document. The trust instrument need not set out all the terms of the plan since it is only used to implement the SUB plan; therefore, it is sufficient if it merely binds the trustees to act in a manner consistent with plan provisions. See Rev. Rul. 58-442, 1958-2 C.B. 194, in re IRC 501(c)(9) trusts.

- B. plan which provides that the corpus and income of the trust cannot, before the satisfaction of all liabilities to employees covered by the plan, be used for, or diverted to, any purpose other than providing supplemental unemployment compensation benefits.

#### **7.25.17.3.1 (09-25-1997)**

##### **Sub Plan Requirements**

1. IRC 501(c)(17) requires that a written plan be established and maintained by an employer and/or his/her employees, for the purpose of providing supplemental unemployment compensation benefits. The Code defines supplemental unemployment benefits to include sick and accident benefits that are subordinate to the separation benefits.
  - A. If the facts and circumstances show that the real purpose of a plan is to provide sick and accident benefits, rather than unemployment benefits, the plan will not qualify because the sick and accident benefits are not subordinate to the separation benefits.
  - B. Sick and accident benefits cannot include a benefit paid upon the death of an employee because payments under a SUB plan must be made "to the employee." See Reg. 1.501(c)(17)-2(a).
  - C. A SUB plan must provide for supplemental unemployment benefits paid only because of an employee's involuntary separation from employment, whether temporary or permanent, (i) resulting directly from a reduction in work force, (ii) the discontinuance of a plant or operation, or (iii) other similar conditions.
  - D. A qualified plan cannot provide for the payment of benefits when the unemployment results from a voluntary decision by the employee. See Reg. 1.501(c)(17)-1(b)(3).
  - E. A qualified plan may provide for the payment of benefits either in installments or in a lump sum. If payments are made in other than cash, the fair market value of such payments at the date they are made will be used to determine whether the payments meet the nondiscrimination requirements of IRC 501(c)(17)(A)(iii).
  - F. The provision for paying any necessary or appropriate expenses in administering the plan will not disqualify it from exemption under IRC 501(c)(17).
2. Rev. Rul. 71-156, 1971-1 C.B. 153, holds that an amendment to a SUB trust, which provides for distribution to employees of funds representing contributions in excess of maximum funding of the trust, would adversely affect the trust's exempt status under IRC 501(c)(17). Such a distribution to employees does not constitute supplemental unemployment benefits within the meaning of IRC 501(c)(17)
  - A. Investing some of a SUB trust's funds in low yield investments that further projects providing community and social benefits will not adversely affect its exemption under IRC 501(c)(17) as long as sufficient safeguards insure that the trust's funds are not invested for the benefit of related parties or in a manner contrary to the interests of employees. Rev. Rul. 70-536, 1970-2 C.B. 120.
  - B. An amendment to a SUB trust permitting an employee to authorize the trustee to deduct and pay union dues from the employee's benefit payments will not adversely affect the exemption qualification of a plan under IRC 501(c)(17). Under this type of arrangement, no part of the corpus or income is used for, or diverted to, any purpose other than the providing of supplemental unemployment benefits. Rather, part of the employee's monthly benefits are used, at his/her request, to satisfy the employee's obligation to pay union dues. Rev. Rul. 73-307, 1973-2 C.B. 186.

#### **7.25.17.3.2 (09-25-1997)**

##### **Permissible Benefits**

1. The term "supplemental unemployment benefits" means only benefits paid to an employee because of involuntary separation from the employment of the employer, whether or not the separation is temporary, but only when the separation is one resulting:
  - directly from a reduction in force,
  - the discontinuance of a plant or operation, or
  - other similar conditions.
2. Sick and accident benefits that are subordinate to supplemental unemployment benefits are also permissible. The Service has clarified the type of permissible benefit described in Reg. 1.501(c)(17)-1(b)(1).
3. Rev. Rul. 70-188, 1970-1 C.B. 134, holds that relocation allowances paid to employees who were involuntarily separated from their employment in one city, but offered employment in another city where they were needed, constituted supplemental unemployment compensation benefits within the meaning of IRC 501(c)(17).
4. Short work week benefits paid by a SUB plan to employees not wholly separated from employment will be treated as supplemental unemployment benefits. Even though employees whose hours of employment have been reduced are not wholly separated from their employment, their employment situation has been changed in a way equivalent to a partial separation. Accordingly, short work week benefits will be treated as supplemental unemployment compensation benefits within the meaning of IRC 501(c)(17). Rev. Rul. 70-189, 1970-1 C.B. 134.
5. However, a SUB plan that pays compensation benefits to employees, because technological changes have reduced the number of working hours in the industry, does not qualify for exemption under IRC 501(c)(17). Eligibility for benefits in this case was not limited to employees who suffered an actual reduction in working hours. See Rev. Rul. 77-43, 1977-1 C.B. 151.

#### **7.25.17.3.3 (09-25-1997)**

##### **Non-Discrimination Provisions**

1. SUB plans that qualify for exemption under IRC 501(c)(17) must meet certain nondiscrimination conditions. These requirements provide that neither the classification under which benefits are paid nor the benefits themselves may discriminate in favor of highly compensated employees.
  - A. Benefits based on a uniform relationship to total compensation are not considered discriminatory. Accordingly, the benefits provided for highly compensated employees may be greater than those provided for lower paid employees if the benefits are determined by reference to their compensation. However, a plan will not qualify if the benefits paid to the highly compensated employees bear a larger ratio to their compensation than the benefits paid to the lower paid employees bear to the latter's compensation. See Reg. 1.501(c)(17)-1(a)(5).
2. The Tax Reform Act of 1986 (TRA '86) revised IRC 501(c)(17) to prohibit discrimination in favor of "highly compensated employees (within the meaning of IRC 414(q))." For taxable years beginning before January 1, 1997, IRC 414(q) defines "highly compensated employee" to mean an employee who, during the taxable year (or preceding year):
  - was at any time a 5-percent owner;
  - received compensation from the employer in excess of \$75,000 (indexed for inflation);
  - received compensation from the employer in excess of \$50,000 (indexed for inflation) and was in the top 20 percent of the employees in compensation; or

- was an officer of the employer and received compensation in excess of 150 percent of the amount in effect under IRC 415(c)(1)(A) for the taxable year (or preceding year).
3. For taxable years beginning after December 31, 1996, IRC 414(q) defines "highly compensated employee" to mean an employee who, during the taxable year (or preceding year):
    - was a 5-percent owner at any time during the year or preceding year, or
    - for the preceding year, (i) had compensation from the employer in excess of \$80,000 (indexed for inflation); and (ii) 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.
  4. The eligibility requirements and the benefits must be set forth in the plan. The fact that a plan specifies nondiscriminatory eligibility requirements and benefits is not sufficient; the plan must actually be nondiscriminatory in operation.
  5. SUB plans may be combined with other plans that provide similar benefits. Generally, benefits provided under some other plan are not considered when determining whether a SUB plan satisfies the requirements of nondiscrimination. If the SUB plan is not discriminatory, it will not be necessary to look further in allowing exemption for the SUB trust. However, if the SUB plan appears discriminatory on its face because of some variation in the manner in which benefits are allocated, it may be necessary to look to related plans to see if the combined effect of all the plans is nondiscriminatory. A plan used in correlation with another is not discriminatory where the benefits under the plan are determined in accordance with Reg. 1.501(c)(17)-2(c).
  6. IRC 501(c)(17)(C) states that a SUB plan will satisfy the nondiscrimination requirements if on at least one day in each quarter of the taxable year of the trust it satisfies the IRC 501(c)(17)(A) requirements.

#### **7.25.17.3.4 (09-25-1997)**

##### **Sick and Accident Benefits**

1. IRC 501(c)(17) provides that only supplemental unemployment compensation benefits may be paid under an exempt plan, but defines these benefits as including sick and accident benefits subordinate to the separation benefits. Whether sick and accident benefits are subordinate to supplemental unemployment benefits is a matter of facts and circumstances.
  - A. Sick and accident benefits may be provided only for employees who are eligible to receive separation benefits under the SUB plan; but it is not necessary to provide sick and accident benefits to all employees for whom separation benefits are available. However, the plan must be careful not to discriminate against those groups specified in IRC 501(c)(17)(A)(ii) and (iii). The portion of the plan providing sick and accident benefits must satisfy the requirements against discrimination on its own merits, apart from the portion providing separation benefits.

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#### **7.25.17.4 (09-25-1997)**

##### **Relation to Other IRC sections**

1. Other code provisions that apply to SUB Plans are described below.

#### **7.25.17.4.1 (09-25-1997)**

##### **Prohibited Transactions**

1. IRC 503 denies exemption to an IRC 501(c)(17) organization that engages in a prohibited transaction. IRC 503(b) prohibited transactions generally relate to preferential treatment accorded to the creators of the trust or to related parties. The restriction is designed to prevent misuse of trust funds.

**7.25.17.4.2 (09-25-1997)**  
**IRC 501(c)(9)**

1. An organization will not be denied exemption under IRC 501(c)(9) merely because it pays supplemental unemployment benefits, if it otherwise meets the requirements of that section. See IRC 501(c)(17)(E).

**7.25.17.4.3 (09-25-1997)**  
**IRC 419 and IRC 419A**

1. Under IRC 419 and IRC 419A, employer contributions after December 31, 1985 are subject to limits set forth in those sections. No deduction is allowed in a taxable year to the extent the IRC 419 and IRC 419A limits are exceeded, although excess contributions may be carried forward to subsequent years. See IRM 7.25.9 on IRC 501(c)(9) organizations for an explanation of the operation of IRC 419 and IRC 419A.

**7.25.17.4.4 (09-25-1997)**  
**IRC 512(a)(3)**

1. Trusts exempt under IRC 501(c)(17) are subject to the unrelated business income tax provisions described in IRC 512(a)(3). Any trade or business regularly carried on by a trust exempt under IRC 501(c)(17) is an unrelated trade or business, and is taxable as such. IRC 513(b).
  - A. To the extent the IRC 419A(c)(3) account limit is exceeded at the end of the taxable year, the excess is subject to tax under IRC 512(a)(3)(E).

**7.25.17.4.5 (09-25-1997)**  
**IRC 4976**

1. Under IRC 4976, the reversion of funds from an IRC 501(c)(17) organization to the employer subjects the employer to a 100% excise tax on the amount of the reversion.

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**7.25.17.5 (09-25-1997)**  
**Digests of Published Rulings**

1. Relocation payments—Relocation allowances paid by an IRC 501(c)(17) trust to employees who would be involuntarily separated from employment if they were not relocated will be considered supplemental unemployment compensation benefits. See Rev. Rul. 70-188, 1970-1 C.B. 134.
2. Short work week benefits—An IRC 501(c)(17) trust partially compensated employees for wages lost when the company reduced the hours that each employee worked each week rather than reduce the number of its employees. This arrangement was equivalent to a partial separation and the payments were treated as "supplemental unemployment compensation benefits." See Rev. Rul. 70-189, 1970-1 C.B. 134.
3. Investments—An amendment to a supplemental unemployment benefit trust permitting low-yield income-producing investments that serve social purposes, that do not accrue for the benefit of related parties and are not contrary to employees' interests, will not affect the exempt status of the trust. See Rev. Rul. 70-536, 1970-2 C.B. 120.
4. Excess funding—An amendment to a supplemental unemployment benefit plan providing for distribution to employees of funds representing contributions in excess of maximum funding adversely affects the trust's exempt status under IRC 501(c)(17). See Rev. Rul. 71-156, 1971-1 C.B. 153.
5. Payment of union dues—An amendment to a supplemental unemployment benefit plan trust permitting an employee to authorize the trustee to deduct and pay union dues from his/her benefit payments will not adversely affect the qualification of the plan under IRC 501(c)(17). See Rev. Rul. 73-307, 1973-2 C.B. 185.

6. Compensation for lost wages—A trust established pursuant to a collective bargaining agreement between an association of employers and a labor union to compensate union members for anticipated lost wages because of the adoption of a new loading process in the shipping industry, with eligibility for benefits not limited to those union members suffering a loss of hours worked or wages, does not qualify for exemption under IRC 501(c)(17). See Rev. Rul. 77-43, 1977-1 C.B. 151.
7. Termination—A provision in a new collective bargaining agreement that calls for the termination of a supplemental unemployment benefit plan and the distribution of residuary assets to employees covered by the plan will not affect the exempt status of a trust created to administer the plan, if the plan has been in effect long enough to satisfy the requirements of Reg. 1.501(c)(17)-2(d) and satisfaction of all liabilities to employees is guaranteed. See Rev. Rul. 81-68, 1981-1 C.B. 349.

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