GROOM
LAW GROUP
CHARTERED

BENEFITS BRIEF

September 29, 2015 www.groom.com

If you have questions, please contact your regular Groom attorney or one of the attorneys listed below:

Kathryn Bjornstad Amin
kamin@groom.com
(202) 861-2604

Christine L. Keller
ckeller@groom.com
(202) 861-9371

Louis T. Mazawey
lmazawey@groom.com
(202) 861-6608

Recent IRS Letter Rulings Shine Helpful Light on Reallocation of VEBA Assets

Background

Ever since the restrictive and complex rules for VEBA funding were enacted over 30 years ago (Code secs. 419, 419A, 512(a)(3) and 4976), there still is no official IRS guidance on when assets held by an Internal Revenue Code section 501(c)(9) voluntary employees' beneficiary association ("VEBA") to pay one type of benefit may be reallocated to fund other welfare benefits under that plan for the same or other employees. For example, this situation may arise when retiree health liabilities are reduced – or LTD benefits are paid down – and there may be "surplus" assets in the VEBA.

Over the years, the IRS has issued a number of non-precedential letter rulings confirming that the 100% excise tax of Code section 4976 on "employer reversions" does not apply to a transfer of benefits between VEBAs. (*See*, *e.g.*, PLR 200111046 and GCM 39774 (Jan. 24, 1989)). However, these and other letter rulings also indicate that –

- the use of amounts contributed to a VEBA to fund benefit A that are used to pay benefit B may trigger the "tax benefit" rule if the new use is "fundamentally inconsistent" with the original use (and such a "fundamental inconsistency" is triggered where different Code section 419A deduction rules apply to benefits A and B);
- the reallocation might be deemed a "reversion" subjecting the employer to a 100% excise tax on the amount used for benefit B.

As a result, advisers have generally cautioned against any reallocation of VEBA assets except where all of the VEBA's beneficiaries are collectively bargained employees (because such VEBAs are totally exempt from the section 419A account limits under IRC § 419A(f)(5) and thus, different Code section 419A deduction rules do not apply to benefits A and B).

The New Rulings

Two recent companion private letter rulings (PLR 201530022, July 24, 2015, and PLR 201532037, Aug. 7, 2015) address an amendment to a VEBA trust that "would permit some assets, now dedicated to post-retirement medical benefits, to be used to provide health benefits to active employees." The taxpayer in PLR 201530022 (i.e., the employer who sponsored the trust) represented that it would segregate the reallocated amount in a "separate subpart of the trust" for use in paying active health benefits, and that it would recognize that amount as income under the "tax benefit" rule. *Hillsboro National Bank*, 460 US 370 (1983). Interestingly, the facts do not indicate that the retiree medical benefits were overfunded or being terminated.

PLR 201530022 confirms that the "tax benefit" rule – generally resulting in an income item for the employer in the amount being reallocated – would apply to the use of retiree medical funds for active medical benefits. (While the IRS did not address it here, the impact of this income item typically will be softened by the amount of any current 419A deduction.) The Service then clearly states that the reallocation will not cause the taxpayer to be liable for the 100% excise tax on "reversions" under Code section 4976(b)(1)(C). And PLR 201532037 (issued to the VEBA) confirms that the reallocation will not result in "prohibited inurement," which otherwise could disqualify the VEBA under Code section 501(c)(9).

Observations

These new PLRs suggest that employers who would like to reallocate some of their VEBA assets to fund other "permissible benefits" should take a fresh look at the situation. While the income tax impact of the "tax benefit" rule needs to be evaluated, the cash flow savings to the company may outweigh any tax cost as long as the reversion tax would not apply (and there are very strong arguments that it shouldn't).

Employers interested in this strategy also should keep in mind the following –

- private letter rulings may only be relied upon by the recipient (IRC § 6110(k)(3)),
- for ERISA-covered benefits, all affected benefits generally must be provided under the same ERISA plan (and the plan may need to be amended to permit reallocation) to satisfy ERISA's exclusive benefit rule, and
- any accounting implications of such reallocations need to be considered.

Groom Law Group's "VEBA" team has substantial experience in this area and would be pleased to help interested companies explore these and other options.