Ivins, Phillips & Barker
Irregular Benefits Tax Flash

Relevance: This flash may be relevant to you if either of the following apply – - Your company:

- Sponsors a VEBA (Voluntary Employees' Beneficiary Association), *or*
- Has a vacation plan that covers employees in California

Flash: As a result of a recent decision by the 6th Circuit Court of Appeals, **VEBAs may not be required to pay UBIT on investment income** that is spent on benefits or administrative costs during the year, even if total assets held in the VEBA at year end exceed applicable Code section 419A account limits. *See Sherwin-Williams Co. Employee Health Plan Trust v. Comm'r*, 91 AFTR 2d 2003-2302 (6th Cir., May 23, 2003).

Potential Impact:

- VEBAs that have paid UBIT should consider whether they may be able to file refund claims for open years. There may be steps that VEBAs outside the 6th Circuit (Michigan, Ohio, Tennessee, Kentucky) can take to bolster the strength of their refund claims.
- Employers that have not adopted a VEBA to fund vacation benefits for California employees (to qualify for ERISA preemption) because of UBIT concerns may want to reconsider.
- *Sherwin-Williams* may extend the relevance of the recent *Wells Fargo* case to retiree medical benefits for former *salaried* employees. (*Wells Fargo* allowed immediate funding of VEBA medical reserves for retired employees but did not address the UBIT problem for salaried retirees.)

Caveats: The IRS is unlikely to follow this decision outside of the 6th Circuit, and it is impossible to predict whether other courts will agree with the 6th Circuit. It is possible that the IRS might request legislation to reverse the decision prospectively. The potential impact on deduction limits under Code section 419 should be considered. Finally, there may be a factual issue as to whether a VEBA can demonstrate that it spent investment income during the year (although this may not be necessary). Prospectively, it may be advisable to amend VEBA trust documents to instruct the trustee to spend investment income before employer or employee contributions.

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