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New Industrywide VEBA Relies on HCTC Expansion

Paul M. Hamburger

December 12, 2011 — As has been widely reported, the establishment of a new so-called Auto Retiree VEBA Trust — a voluntary employees' beneficiary association (VEBA) — was approved by the U.S. Bankruptcy Court for the Southern District of New York. This VEBA is designed to provide certain retirees in the automotive part manufacturing industry with retiree health coverage. The VEBA, which will cover eligible retirees in Ohio, Michigan and Wisconsin, is reported to be the first industrywide VEBA designed to take advantage of the federal Health Coverage Tax Credit (HCTC) program.

A VEBA is a tax exempt trust that is funded to provide certain specified health and welfare benefits. In the case of the auto-related retiree VEBA, the VEBA provides for retiree health coverage. There are several technical tax rules that apply for a VEBA to obtain IRS approval for tax exemption. (One of those requirements is why this VEBA is limited to a tri-state area.) Those technical requirements are beyond the scope of this column and employers interested in pursuing a VEBA strategy should consult with expert tax counsel.

Putting the VEBA in Context

To put this new industry-wide VEBA in context, consider the recent history of the use of similar retiree-only VEBAs.

In several recent bankruptcy proceedings, VEBAs figured prominently as vehicles to take over employers' liability for retiree health coverage. By creating a stand-alone VEBA, an employer could emerge from a bankruptcy reorganization without significant retiree liabilities. At the same time, those retiree health liabilities could still be satisfied thereafter through a separate VEBA that was funded through a single one-time contribution from the employer. Thereafter, no further employer contributions or involvement takes place.

VEBAs and the HCTC

One economic benefit that really makes the VEBA strategy useful is the HCTC program. As explained in ¶1284 of the *Guide*, the HCTC program was originally enacted as part of the Trade Act of 2002. As originally enacted, it provided a 65-percent tax credit for COBRA coverage (as well as 10 other specified types of qualifying health coverage) to benefit certain workers. The specific workers who could benefit from the HCTC are:

1. individuals who receive a benefit through one of the Trade Adjustment Assistance (TAA) programs;
2. Pension Benefit Guaranty Corporation (PBGC) pension payees who are between age 55 and 64; and
3. qualified family members of TAA recipients and PBGC payees.

Eligible individuals cannot be enrolled in certain other health coverage such as Medicaid or Medicare. The IRS administers the HCTC program. In looking for guidance on HCTC, employers and administrators should bear in mind that, aside from the statutory rules, there are no official "regulations" as such. Instead, information is available and updated regularly at the IRS website for the HCTC program at http://www.irs.gov/individuals/article/0,,id=187948,00.html.

Over time, the HCTC was amended and expanded to include broader definitions and expanded coverage opportunities. For example, the original list of 10 types of qualifying coverage, which included COBRA coverage, was expanded to add coverage under a VEBA created through a bankruptcy court proceeding. So now there are 11 types of coverage that could qualify for the HCTC tax benefit. Also, on Oct. 21, 2011, President Obama signed legislation that:

1. increased the tax credit to 72.5 percent of the applicable premium for qualifying coverage;
2. continued to allow for the VEBA-related coverage to qualify for the credit (whether or not it is COBRA coverage); and
3. enacted a cut-off rule so that the HCTC provisions expire at the end of 2013.

The original stand-alone VEBAs took advantage of the HCTC program by taking on the COBRA liability that arose through the bankruptcy. Under COBRA, if retirees lose coverage through a Chapter 11 bankruptcy reorganization, they would be entitled to lifetime COBRA coverage from the employer. (See ¶1125.) At the same time, in many bankruptcy situations, the retirees might also be covered by an underfunded pension plan that is taken over by the PBGC. In that case, the retirees of the bankrupt employer could become PBGC-eligible individuals entitled to the HCTC to help pay for their COBRA coverage.

Thus, the original stand-alone VEBAs for single employer bankruptcy situations were designed to: (1) take over the employer's retiree health/lifetime COBRA obligation (thereby relieving it of this significant liability); and (2) use the HCTC as a way to help retirees pay for the lifetime COBRA obligation taken on by the new VEBA.

This type of coverage was limited to COBRA coverage however and, as such, was not completely applicable for every type of retiree who might be a PBGC-eligible retiree. After the statute was expanded to allow for VEBA coverage to qualify as HCTC-eligible coverage, that opened the door to a VEBA-based design that provided coverage for PBGC-eligible individuals even if it was not COBRA coverage.

As long as this type of VEBA charges retirees at least 50 percent of the cost of coverage, the VEBA coverage could qualify for the tax credit and therefore obtain funding from the federal government through the HCTC program.

The New Twist

What is new about the reported industry-wide VEBA is that it is an attempt to take advantage of the availability of the HCTC on a broad scale to make coverage available to as wide a group of retirees as possible. Essentially, any retirees from auto parts companies who are PBGC-eligible will be allowed to purchase coverage through the VEBA. (It is estimated that there could be as many as 40,000 potential individuals.) They will be charged the full cost of coverage as a pass through; however, with the federal government subsidizing 72.5 percent of the cost, this type of VEBA presents an attractive opportunity for early retirees who qualify to purchase affordable health coverage. Importantly, there will be no employer-based contributions to the VEBAs from any of the auto parts companies.

At this point, it is expected that the new VEBA would be up and running by Jan. 1, 2012. In the meantime, the administrators are in the process of securing insurance bids.

Issues to Consider

In considering this new VEBA arrangement (and perhaps others like it that might arise in the future), there are several interesting issues to consider:

1. **What happens in 2014?** As part of the recent HCTC increase and extension, Congress provided that the HCTC expires in 2014. So what will happen in 2014 when the credit is no longer available and retirees have to foot the bill for the entire premium with no subsidy? Reported stories do not address this issue.

Perhaps the HCTC will be extended again. Or perhaps those who have promoted these VEBA ideas are anticipating that health insurance exchanges created as part of the new health care reform law will be available in 2014 and provide other options for affordable coverage to the age 55 and older category of qualifying individuals. If that does not happen, then it would seem that the retirees would have to pay the full cost of coverage thereafter (subject to any further HCTC extension).

Excerpt From Press Release Announcing VEBA Trust
On Oct. 18, the San-Francisco law firm of Farella Braun + Martel, LLP announced the establishment of the Auto retiree VEBA Trust. An excerpt from its press release is below:
The U.S. Bankruptcy Court for the Southern District of New York authorized creation of the Auto Retiree VEBA Trust — a Voluntary Employee Benefit Association (VEBA) that will provide thousands of retirees of auto part manufacturers access to subsidized health care benefits thanks to a substantial federal tax credit made available through VEBA participation. This is the first ever industry-wide VEBA created to provide Health Coverage Tax Credit eligible benefits, as most VEBAs to date are associated with a single company.
The Auto Retiree VEBA Trust benefits retirees, between the ages of 55 and 65, of Metaldyne and all other auto part manufacturing companies whose headquarters were, or presently remain, in the states of Ohio, Michigan or Wisconsin and with pensions currently trusted by the federal Pension Benefit Guaranty Corporation. Retirees of these companies, which also include Allis-Chalmers, Amcast, Collins & Aikman, Delphi, Hayes-Lemmerz International and dozens of others are eligible regardless of current state residency.
Auto Retiree VEBA Trust participants, many of whom were forced into early retirement, have the ability to take advantage of the federal Health Coverage Tax Credit.

The firm has a fact sheet on the VEBA that is available at http://tinyurl.com/VEBAfactsheet.

2. **What happens if a VEBA-covered individual experiences a COBRA qualifying event (such as death, divorce, legal separation, or cessation of dependent child status)?** This is one of the big potential differences between the traditional stand-alone VEBAs created by single employers and the new industrywide VEBA concept. When a single employer creates a stand-alone VEBA, that VEBA is an employer-sponsored plan for COBRA purposes. Admittedly, the VEBA might effectively relieve the employer of all liability for retiree health and COBRA obligations for the retiree group from an accounting perspective. Nevertheless, according to IRS regulations, that type of VEBA is still going to be an employer-sponsored group health plan. Specifically, the regulations define a group health plan to include a plan to which the employer does not even contribute as long as the coverage would not be available at the same cost to an individual but for the individual's employment-related connection to the employer. (See IRS final COBRA regulations, Section 54.4980B-2, Question 1(a).) In the VEBA scenarios, employers typically contribute to the VEBAs an initial funding amount. In addition, the fact is that the coverage would not be available to the retirees at the same cost but for their employment by the prior employer. Therefore, the VEBA coverage could constitute group health plan coverage for COBRA purposes regarding future qualifying events.

   By contrast, the new industrywide VEBA concept works differently. First, there are not intended to be *any* employer contributions. Second, it is less clear that the general regulatory standard would be met. That is, it is not clear that coverage would not be available at the same cost but for employment by a particular employer. The cost of coverage will be determined by the insurance company or companies willing to offer coverage to the group of retirees who are PBGC-eligible and between ages 55 and 64. Admittedly, employment in the industry is a trigger to being eligible for the coverage; however, given the reported structure of the industrywide VEBA, it is not clear that future COBRA qualifying events would be recognized. This is an issue that will have to be addressed once the new coverage is put in place.

Be Aware of the Risk
VEBAs have existed for decades and over that time, their popularity as a funding vehicle has gone up and down. At this point, the use of VEBAs is definitely on the rise and well-publicized. Yet VEBAs are not without risk in this area, particularly the stand-alone VEBAs. It has been reported that some of the stand-alone

employer-created VEBAs have had trouble maintaining the funding levels without ongoing employer contributions. This underfunding could cause them to cut back benefits unless other sources of funding are found. Another area of uncertainty — particularly for VEBA designs relying on the use of the HCTC as a way of enticing participation among retirees — is to plan for the eventual expiration of that tax credit. Perhaps health care reform insurance exchanges will step in and provide alternatives.

In all likelihood, we have not heard the last of industrywide VEBAs or other stand-alone VEBAs created to take advantage of the HCTC through 2013. Employers interested in taking advantage of these strategies should monitor the ongoing developments closely and consult with expert benefits counsel.

Paul M. Hamburger, Esq., is a partner in the Washington, D.C., office of the law firm Proskauer Rose LLP. He is a member of Thompson's Health Plan Advisory Board, and is author and contributing editor of the COBRA Guide, *the* Pension Plan Fix-It Handbook *and the* Guide to Assigning and Loaning Benefit Plan Money, *all published by Thompson Publishing Group.*
