

(1984), 1984-3 C.B. (Vol. 2) 1, 413. Thus, the premise underlying the exception is that no special limitation on deductions is necessary in situations where a payment by an employer in excess of the minimum necessary to currently provide for the benefits under the plan is effectively lost to that employer, because the economics of the plan will discourage excessive contributions.

The 10 or more employer plan exception to the deduction limitation does not apply, however, where the plan maintains experience-rating arrangements with respect to individual employers. The reason for excluding these plans from the exception is that an experience-rating arrangement with respect to an individual employer changes the economics of the plan and allows an employer to contribute an amount in excess of the minimum amount necessary to provide for the current benefits with the confidence that the excess will inure to the benefit of that employer as the excess is used to provide benefits to its employees. The legislative history notes that making the exception to the deduction limits unavailable to plans that determine contributions on the basis of experience rating is consistent with the general rules relating to the definition of fund because "the employer's interest with respect to such a plan is more similar to the relationship of an employer to a fund than an insured to an insurer." H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1159 (1984), 1984-3 C.B. (Vol. 2) 1, 413.

In Notice 95-34 (1995-1 C.B. 309), the IRS identified certain types of arrangements that do not satisfy the requirements of section 419A(f)(6). Those arrangements typically require large employer contributions relative to the cost of the coverage for the benefits to be provided under the plan. The plans identified in the Notice often maintain separate accounting of the assets attributable to the contributions made by each participating employer.¹ In some cases an employer's contributions are related to the claims experience of its employees, while in other cases benefits are reduced if assets derived from an employer's contributions are insufficient to fund the benefits to that employer's employees. Thus, a particular employer's contributions or its employees' benefits may be determined in a way that insulates the employer to

a significant extent from the experience of other participating employers.

The arrangements described in Notice 95-34 and similar arrangements do not satisfy the requirements of section 419A(f)(6) of the Code and do not provide the tax deductions claimed by their promoters for any of several reasons. For example, such an arrangement may be providing deferred compensation; the arrangement may be separate plans maintained for each employer; or the plan may be maintaining, in form or in operation, experience-rating arrangements with respect to individual employers (e.g., where the employers have reason to expect that, at least for the most part, their contributions will benefit only their own employees). The Notice also states that even if an arrangement satisfies the requirements of section 419A(f)(6), so that the deduction limits of sections 419 and 419A do not apply to the arrangement, the employer contributions may represent expenses that are not deductible under other sections of the Code.

Transactions that are the same as or substantially similar to the transactions described in Notice 95-34 are listed transactions for purposes of the tax shelter disclosure, registration, and list maintenance requirements. See Notice 2000-15 (2000-1 C.B. 826) (supplemented and superseded by Notice 2001-51 (2001-2 C.B. 190)), § 1.6011-4(b)(2) of the Income Tax Regulations, and §§ 301.6111-2(b)(2) and 301.6112-1(b)(2) of the Procedure and Administration Regulations.

On July 11, 2002, a notice of proposed rulemaking (REG-165868-01) relating to whether a welfare benefit fund is part of a 10 or more employer plan (as defined in section 419A(f)(6) of the Internal Revenue Code) was published in the **Federal Register** (67 FR 45933). Written and electronic comments responding to the notice of proposed rulemaking were received. A public hearing was held on November 14, 2002. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The revisions are discussed below.

Explanation of Provisions

Overview of Rules

These regulations provide guidance under section 419A(f)(6) of the Code regarding the requirements that a welfare benefit fund must satisfy in order for an employer's contribution to the fund to be excepted from the rules of sections 419 and 419A.

Section 419A(f)(6) of the Code provides that sections 419 and 419A do

not apply in the case of a welfare benefit fund that is part of a 10 or more employer plan that does not maintain experience-rating arrangements with respect to individual employers. A *10 or more employer plan* is a plan to which more than one employer contributes and to which no employer normally contributes more than 10 percent of the total contributions contributed under the plan by all employers. The regulations provide that an employer is determined by aggregating all of the entities required to be aggregated under the rules under section 414(b), (c), or (m). This is particularly relevant for purposes of determining how many employers contribute, whether an employer normally contributes more than 10 percent of the total contributions under the plan, and whether the plan maintains experience-rating arrangements with respect to individual employers.

In addition, the regulations make clear that in order to be eligible for the exception from the deduction limits of sections 419 and 419A, a plan must satisfy the requirements of section 419A(f)(6) and these regulations both in form and operation. The determination of whether a plan is described in section 419A(f)(6) is based on the totality of the arrangement and all related facts and circumstances, including any related insurance contracts. Thus, all agreements and understandings (including promotional materials and policy illustrations) will be taken into account in determining whether the requirements of section 419A(f)(6) are satisfied in form and in operation. For example, if promotional materials indicate that an employer or its employees can be expected to receive a future benefit based on the employer's accumulated contributions, the plan will be treated as maintaining experience-rating arrangements with respect to individual employers, even if the formal plan does not specifically provide for experience rating.

The regulations provide generally that a plan maintains an experience-rating arrangement with respect to an employer—making the plan ineligible for the section 419A(f)(6) exception—if any employer's cost of coverage for any period is based, in whole or in part, either on the benefits experience or on the overall experience of that employer or one or more employees of that employer. For purposes of the regulations, an employer's *cost of coverage* is the relationship between that employer's contributions (including those of its employees) under the plan and the benefits or other amounts payable under the plan with respect to

¹ See *Booth v. Commissioner*, 108 T.C. 524 (1997), for an arrangement using a separate accounting system that does not qualify under the 10 or more employer plan exception.