

of these characteristics does not create an inference that it is a 10 or more employer plan described in section 419A(f)(6).

The first, third and fourth characteristics under the proposed regulations indicating that a plan is not a 10 or more employer plan described in section 419A(f)(6) (*i.e.*, the assets of the plan are allocated among the participating employers through a separate accounting of contributions and expenditures for individual employers or otherwise, the plan does not provide for fixed welfare benefits for a fixed coverage period for a fixed price or the plan charges the participating employers an unreasonably high amount for the covered risk) have been retained without change.

The second characteristic under the proposed regulations indicating that a plan is not a 10 or more employer plan described in section 419A(f)(6) is that amounts charged under the plan differ among the employers in a manner that is not reflective of differences in risk or rating factors that are commonly taken into account in manual rates used by insurers (such as age, gender, dependents covered, geographic locale, or benefit terms). In response to comments, this second characteristic has been clarified so that the exception for reflection of differences in risk or rating factors commonly taken into account in manual rates is limited to differences in charges that are merely reflective of differences in current risk (such as current age, gender, dependents covered, geographic locale, or benefit terms). Accordingly, an arrangement that charges different amounts for life insurance based on issue age would exhibit this second characteristic, unless the differences in amount charged are merely reflective of differences in risk or rating factors at the current age (*e.g.*, reflecting select and ultimate mortality).

The fifth characteristic under the proposed regulation indicating that a plan is not a 10 or more employer plan described in section 419A(f)(6) is that benefits or other amounts payable can be provided upon triggering events other than the illness, personal injury, or death of an employee or family member, or the employee's involuntary termination of employment. A number of commentators expressed concern that this fifth characteristic effectively prohibits a termination of a welfare benefit arrangement or otherwise redefines what is a welfare benefit arrangement. This concern reflects a misreading of the regulations, as this fifth characteristic does not prohibit the payment of benefits upon termination of the arrangement or withdrawal of an

employer from the arrangement³ or in any other way seek to redefine what is a permitted welfare benefit. Instead the characteristic reflects the inherent difficulty an insurer would have in determining an actuarially appropriate price for providing fixed benefits on the occasion of these non-standard benefit triggers and the associated likelihood that the amount of the benefits payable on such an occasion is being determined based on the overall experience of the employee or employer. The fact that some commentators have suggested that an employer be able to "spin-off" the employer's "share" of a fund is further indication that many plans that purport to fit within the section 419A(f)(6) exception are engaging in prohibited experience rating.

Taxpayers are reminded that a plan that exhibits one of these characteristics may still establish that the plan satisfies the requirements of section 419A(f)(6). For example, in the case of a plan that provides for a benefit to be provided on the occasion of an employer's withdrawal from the plan, the plan would have to demonstrate that the amount provided to an employee is not based on the benefits experience or the overall experience of the employee or the employer. In addition, in response to comments, the final regulations clarify that a plan does not exhibit this fifth characteristic merely because, upon cessation of participation in the plan, an employee is provided with the right to convert coverage under a group life insurance contract to coverage under an individual life insurance contract without demonstrating evidence of insurability, but only if there is no additional economic value associated with the conversion right.

The examples in the proposed regulations illustrating the application of the rules regarding experience-rating arrangements to specific fact situations are included in the final regulations, with minor changes, and two additional examples have been included. The facts described in some of the examples illustrate arrangements that do not maintain experience-rating arrangements with respect to individual employers. Other examples, however, describe arrangements that exhibit the characteristics of a fund that Congress intended to be subject to the deduction limitations of sections 419 and 419A. Each example illustrates only the application of the definition of experience-rating arrangements under section 419A(f)(6) and these regulations,

³ A withdrawal of an employer merely terminates the arrangement for that employer, but it continues for the other employers.

and no inference should be drawn from the scope of the examples about whether these plans are otherwise described in section 419A(f)(6) or about any other provision of the Code.⁴

Pursuant to the authority set forth in section 419A(i), the regulations provide a special rule to assist participating employers and the Commissioner in verifying that the arrangement satisfies the section 419A(f)(6) requirements. Under that rule, an arrangement satisfies the requirements of section 419A(f)(6) and the regulations only if the plan is maintained pursuant to a written document that (1) requires the plan administrator to maintain records sufficient for the Commissioner or any participating employer to readily verify the plan's compliance with section 419A(f)(6) and (2) provides the Commissioner and each participating employer with the right to inspect and copy all such records.

Effective Date

Except as explained below, these regulations—which generally clarify existing law—are effective for contributions paid or incurred in taxable years of an employer beginning on or after July 11, 2002. For contributions made before this effective date, the IRS will continue applying existing law, including the analysis set forth in Notice 95-34 and relevant case law. Thus, taxpayers should not infer that a contribution that would be nondeductible under the regulations would be deductible if made before that date. In this regard, taxpayers are reminded that the IRS has already identified transactions that are the same as or substantially similar to the transactions described in Notice 95-34 as *listed transactions* for purposes of § 1.6011-4T(b)(2) of the Temporary Income Tax Regulations and § 301.6111-2T(b)(2) of the Temporary Procedure and Administration Regulations.

The requirement that written plan documents contain specified provisions relating to compliance information and the record maintenance requirement for plan administrators are effective for

⁴ For example, in *Neonatology Associates, P.A., v. Commissioner*, 299 F.3d 221 (3d Cir. 2002), affirming 115 T.C. 43 (2000), the Court held that the contributions were in a large part constructive dividends to the employee/owners (and thus did not reach the government's alternative contention that the plan was maintaining experience-rating arrangements with respect to individual employers). In *Booth v. Commissioner*, 108 T.C. 524 (1997), the Tax Court held that the arrangement was an aggregation of separate plans (and thus was not a single plan) and that there were experience-rating arrangements with respect to the individual employers.