Internal Revenue Service
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Department of the Treasury
Washington, DC 20

200133047

Contact Person:

Telephone Number:

In Reference to:
T:EP:RA:T:A1
Date:
SEP 08 2000

In re:

This is in response to your request (dated December 30, 1997) for a ruling regarding the above-named trust (the "Trust"). Specifically, you asked that we rule as to whether the Trust satisfies certain requirements under section 419A(f)(6) of the Internal Revenue Code ("Code").

FACTS

The version of the Trust described herein is the "Third Amended and Restated" version (dated September 15, 1997). The Trust by its terms provides death and severance benefits to employees who are specified in the adoption agreement signed by those employers who have chosen to participate in the Trust. Death benefits are provided to all participants in the Trust. Severance benefits are provided only to those participants whose employers elected in the adoption agreement to provide such benefits.

Each participating employer is declared to be a "plan administrator" and is given "all discretionary and other authority to control and manage the operation and administration of the Trust". However, the Trust requires each plan administrator to delegate various duties and responsibilities to a "contract administrator" specified in the Trust document. Amongst the delegated duties and responsibilities are (i) directing the Trust's trustee as to the crediting and distribution of funds, (ii) making claims decisions, and (iii) maintaining accounting records.

282

Death benefits are equal to a specified percentage of compensation (but no less than a minimum dollar amount specified in the Trust). The specified percentage is chosen by the employer at the time the Trust is adopted by the employer. The death benefit provided to each participant is based on compensation at the time the Trust is adopted by the employer (and, thus, does not become automatically adjusted for subsequent changes in compensation). The Trust provides that a participant's right to receive death benefits is forfeited upon a "termination of employment" or a "discharge for cause". Also, if the employer has elected to provide severance benefits in addition to the death benefits, owners of a significant amount of the total combined voting power or value of all classes of stock in the employer forfeit their right to receive death benefits upon the attainment of the later of (i) age 70 ½ or (ii) ten years of participation.

If death benefits are forfeited by a participant, the participant has the option of purchasing the insurance policy that was providing the death benefit.

Severance benefits are payable upon a "termination of employment". Under the provisions of the Trust, a termination of employment occurs when the participant becomes totally disabled, resigns or is discharged "without cause". A participant who is discharged "for cause" or voluntarily terminates "without good cause" forfeits severance benefits. A participant's right to receive severance benefits is forfeited upon death or actual retirement. For participants who own at least 5% of the employer, severance benefits are forfeited upon the attainment of the later of (i) age 70 ½ or (ii) ten years of participation.

The amount of an employee's severance benefit is determined under one of several formulas set forth in the Trust's adoption agreement. There are four such formulas; the particular formula that applies to the employees of an employer is chosen by the employer at the time the Trust is adopted. Each formula sets the employee's severance benefit equal to a specified percentage of average compensation multiplied by years of service as a participant in the Trust (but subject to a maximum number of creditable years).[1] In addition, the Trust provides a graded vesting schedule that calls for the total forfeiture of all severance benefits by any employee who has fewer than four years of service with the employer. For employees with at least four years of service, but less than ten years, the graded vesting schedule calls for a partial forfeiture of severance benefits. Under this graded schedule, employees with four years of service receive 40% of the benefit that would otherwise have been payable to them. This percentage increases by ten percentage points for each additional year of service. After ten years of service with the employer, the employee is fully vested in the severance benefit.

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[1] Each of the potential formulas is structured so that the maximum severance benefit will be either 100% or 200% of average annual compensation.

An employer can withdraw from the Trust. This action gives rise to "termination distributions" that are received by those participants who are employed by the withdrawing employer. The termination distribution made to a participant is equal to a pro-rated portion of the withdrawing employer's "excess assets". The value of the "excess assets" is equal to the portion of the employer's "allocable share" (as described in the next paragraph) of the Trust's assets in excess of the amounts required to pay the benefits earned under the Trust (as well as any fees, costs and other amounts accrued by the employer).[2] Termination distributions are also payable upon termination of the Trust itself.

The Trust's assets are invested in individual insurance contracts, tax-exempt securities and cash. Each participating employer has an "allocable share" of the Trust's assets, generally equal to the amounts held under the individual insurance contracts covering the employees of that employer, plus the value of any additional assets being held in the employer's "side fund".

The Trust also provides that some of its assets will be held in certain special-purpose accounts. As described in the Trust, these special-purpose accounts are as follows:

> Tax reserve account: This account is funded by amounts withheld (at the discretion of the Trust's contract administrator) from termination distributions (i.e., those that are made on account of either the termination of the Trust or the withdrawal from the Trust by an employer). Funds in the tax reserve account are used to pay various tax liabilities of the Trust.
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> Professional fee reserve account: This account holds funds that are used to retain professionals on behalf of the Trust. It is funded by amounts withheld (at the discretion of the contract administrator) from termination distributions. The contract administrator has the authority to require employers to make annual contributions into this account.
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> Reserve account: This account is used to pay benefits to participants, but only to the extent that such benefits have not been funded by the employer of that participant. It is funded by one-time contributions made by the employer at the time the employer

[2] The Trust document contained conflicting statements as to whether the participants would receive payment of their vested severance benefits prior to the calculation of the "excess assets".

adopts the Trust. The amount of the contribution is determined under a formula established by the contract administrator.[3]

Surplus account: This account is used to pay benefits to participants, but only to the extent that such benefits have not been funded by the employer of the participant and only to the further extent that the funds in the Reserve Account have been exhausted. It is funded by the "experience gains" of those employers who have achieved "full funding" of their benefit obligations.[4] Neither of the terms "experience gain" and "full funding" are defined in the Trust document. However, the Trust document does describe two situations that might give rise to an experience gain. First, the non-vested portion of a severance benefit that was otherwise payable to a participant will be forfeited to the Surplus Account (but, as just noted, only if the employer had already fully funded its benefit obligations). Second, the Trust document provides the contract administrator with the authority to withhold a portion of the excess assets that would otherwise be distributed to participants as part of a "termination distribution" and to forfeit this portion to the Surplus Account. The Trust document does not indicate the circumstances under which the contract administrator may take this action.

The sample insurance policies provided along with your request are self-described as "flexible premium adjustable life" policies (i.e., a type of policy commonly known as "universal life insurance"). The policy permits the payment of additional premiums at any time during the life of the insured (subject to any maximums or other restrictions that might be imposed by the insurer). The policies pay annual dividends (which are either paid to the policyholder in cash or added to the policy's account value).

Section 8.1 of the Trust document requires each employer to make contributions in amounts sufficient to pay the severance benefits for its employees. If the employer fails to make such required contributions, the contract administrator must take "whatever actions are necessary" to collect the contributions from the employer. The contract administrator also may unilaterally terminate the employer's participation in the Trust for failure to make required

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[3] The formula varies depending on whether the employer elects to provide death benefits only, or death benefits and severance benefits. For the "death benefit only" employers, the contribution to the reserve account is equal to one-fourth of 1% of the employer's deposit (subject to a minimum amount equal to the greater of $250 or one-twelfth of the term cost of insurance attributable to the employees of that employer). For the employers that provide both death benefits and severance benefits, the contribution to the reserve account is equal to 1% of the employer's deposit (subject to a minimum amount of $1,000).

[4] If an employer has not fully funded its benefit obligations, then none of its "experience gains" are forfeited to the Surplus Account.

contributions and may offset the value of such unpaid contributions against any benefit distributions (including termination distributions) or roll-over payments.[5] Furthermore, if an owner or highly-compensated employee terminates employment at a time when the employer's allocable share of the Trust assets is not sufficient to pay the full severance benefits for all of the employer's employees, then the contract administrator shall limit the severance benefit payable to the amount that can be paid from his or her employer's "allocable share" of the Trust's assets (as reduced by the amount of severance benefit earned by employees of that employer who are not owners or highly-compensated).

In the case of employers that have chosen to provide death benefits only (and these are the majority of the employers), section 8.2 of the Trust document requires the employers to make contributions that the insurer determines to be necessary to fund the death benefits. Nonetheless, certain marketing material used by the Trust (described in more detail below) states that the funding of "Death Benefit Only plans" is "flexible" and further states that "there is no maximum contribution" under such plans. In operation, the individual insurance policies purchased under the "Death Benefit Only plans" have developed substantial cash values (thus indicating that contributions under these policies have been in excess of the amounts needed to provide current insurance protection).

In support of your requested rulings, you provided us with copies of marketing material developed by the Trust. This material included a brochure entitled "Increase Benefits / Reduce Taxes", which contained descriptions of the Trust and its operations in question-and-answer format. You also provided a document entitled "Answers to Commonly-Asked Questions".

The Trust is currently in operation. You provided us with account summaries and billing invoices for approximately 200 participating employers. Of these participating employers, approximately 30 were providing severance-pay benefits in addition to death benefits.

Most of the billing invoices were dated at various points in the twelve-month period starting in the second quarter of 1997 and ending in the first quarter of 1998 (inclusive).[6] The aggregate amount billed on the invoices was approximately $19,800,000. You also provided us with a copy of the Trust's 1996 Form 5500 filing. This filing indicates that contributions received by the Trust during 1996 were in the amount of approximately $20,500,000.

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[5] Section 12.3(d) of the Trust document permits the roll-over to another welfare benefit plan of amounts that would otherwise have been paid as termination distributions.

[6] A few invoices were dated earlier than the second quarter of 1997.

Regarding the charge for the Reserve Account, the invoices provided to us showed a charge only for invoices dated December 1997 or later (although a few invoices with such dates did not show a charge). In all cases, the charge was $250, even though the formula described in our earlier footnote would have produced a larger amount in some cases.

One of the invoices called for an insurance premium of (approximately) $3,000,000. This amount is in excess of 10% of the aggregate amount billed on the invoices provided to us. It is also in excess of 10% of the annual contributions reported on the Trust's 1995 Form 5500 filing.

The account summaries are provided to the sponsoring employers under the title "Annual Company Report" (hereinafter, "company report" or "report"). These reports do not provide any information about the total amount of assets held in the Trust. Rather, they contain information on the value of assets allocable to that particular employer. For employers who offer severance benefits in addition to death benefits, the company report also indicates whether the severance benefits are "overfunded" or "underfunded".

Each company report also lists the amounts being held in the Reserve Account and the Professional Fee Reserve Account. The reports provided to us indicated that the Reserve Account held assets of approximately $60,000. They also indicated that the Professional Fee Reserve Account held approximately $20,000. The reports did not indicate that there were any amounts being held in the Surplus Account and the Tax Reserve Account.

Other than the Trust's 1996 Form 5500 filing, you did not provide any comprehensive financial statement relating to the Trust.

REQUESTED RULINGS

You asked us to rule that:

1. The Trust provides welfare benefits and is not a plan of deferred compensation,

2. The Trust is a single plan and not an aggregation of individual plans; and,

3. The Trust maintains no arrangements for experience rating.

On the basis of such findings, you further asked that we rule that the Trust satisfies the requirements of Code section 419A(f)(6) and, as a consequence, that all contributions made to the Trust by sponsoring employers would be currently deductible.

LAW

Section 404(a) of the Code provides that if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such compensation shall not be deductible under Chapter 1 of the Code but, if it would otherwise be deductible, it shall be deductible under Code section 404(a), subject to various limitations.

Section 404(a)(5) of the Code provides that if contributions are paid to a plan that is not described in paragraphs (1), (2) or (3) of Code section 404(a), then such contributions shall be deductible in the taxable year in which an amount attributable to the contribution is includible in the gross income of the employees participating in the plan (but, in the case of a plan in which more than one employee participates, only if separate accounts are maintained for each employee).

Section 404(b)(2)(A) of the Code provides that any plan providing for deferred benefits (other than compensation) for employees, their spouses, or their dependents shall be treated as a plan deferring the receipt of compensation. Section 404(b)(2)(B) provides that section 404(b)(2)(A) shall not apply to any benefit provided through a welfare benefit fund (as defined in section 419(e)).

Section 419(a) of the Code provides that contributions paid or accrued by an employer to a welfare benefit fund shall not be deductible under Chapter 1 of Subtitle A of the Internal Revenue Code but, if they would otherwise be deductible, shall be deductible under Code section 419 for the taxable year in which paid, subject to the limitation of Code section 419(b).

Section 419(b) of the Code provides that the amount of the deduction allowable under Code section 419(a) shall be limited to the welfare benefit fund's "qualified cost" for the taxable year. The term "qualified cost" is defined in Code section 419(c).

Section 419(e)(2) of the Code defines the term "welfare benefit" to mean any benefit other than a benefit to which Code section 83(h), Code section 404 (determined without regard to section 404(b)(2)), or Code section 404A applies.

Section 419A(f)(6)(A) of the Code provides that Subpart D of Chapter 1 of Subtitle A of the Internal Revenue Code shall not apply to any welfare benefit fund which is part of ten or more employer plan. (Subpart D consists of sections 419 and 419A.) However, section 419A(f)(6)(A) further provides that this exception shall not apply to any plan which maintains experience-rating arrangements with respect to individual employers.

Section 419A(f)(6)(B) of the Code provides that the term "ten or more employer plan" means a plan to which more than one employer contributes and to which no employer normally contributes more than ten percent of the total contributions contributed under the plan by all employers.

Section 1.162-10(a) of the Income Tax Regulations (the "regulations") provides that amounts paid or accrued within a taxable year for dismissal wages, unemployment benefits, or a welfare or similar benefit plan are deductible under Code section 162(a) if they are ordinary and necessary expenses of the trade or business. However, except in the case of certain negotiated plans, such amounts shall not be deductible under Code section 162(a) if they may be used to provide benefits under a plan of deferred compensation of the type referred to in Code section 404(a). In such event, the extent to which these amounts are deductible shall be governed by the provision of Code section 404 and the regulations issued thereunder. However, regulation section 1.162-10T, Q&A-2 provides that section 419 governs the deduction of contributions paid or accrued by an employer with respect to a "welfare benefit fund" (within the meaning of section 419(e)).

Section 1.404(a)-1(a)(2) of the regulations provides that Code section 404(a) does not apply to contributions to a plan which is solely a dismissal wage or unemployment benefit plan, welfare or similar benefit plan, or a combination thereof.

Section 1.404(a)-1(a)(3) of the regulations provides that, if contributions to a plan of deferred compensation can be used to provide any of the benefits described in section 1.404(a)-1(a)(2) of the regulations, then Code section 404(a) applies to the entire contribution to the plan (except as provided under Code section 404(c), relating to certain negotiated plans established before January 1, 1954).

Section 1.404(b)-1T, Q&A-2(a), of the regulations provides that, for purposes of section 404(a), (b), and (d), a plan defers the receipt of compensation or benefits to the extent it is one under which an employee receives compensation or benefits more than a brief period of time after the end of the employer's taxable year in which the services creating the right to such compensation or benefits are performed.

Section 1.404(b)-1T, Q&A-2(b)(1), of the temporary regulations provides that a plan shall be presumed to be one deferring the receipt of compensation for more than a brief period of time after the end of an employer's taxable year to the extent that compensation is received after the 15th day of the 3rd calendar month after the end of the employer's taxable year in which the related services are rendered.

ANALYSIS

As a preliminary matter, we note that nondeductible constructive distributions to employee/owners can take place under arrangements whereby contributions to a trust are used to pay insurance premiums in amounts that are in excess of those needed to provided current insurance protection for the employee/owners. See Neonatology Associates P.A., et al. vs. Commissioner (115 T.C., No. 5, issued July 31, 2000). In the instant case, most of the employers have made contributions well in excess of the amounts needed to provide current protection. As we have not been asked to rule as to whether the Trust provides for constructive distributions to owner/employees, we do not consider this question. However, we note that, to the extent the Trust provides constructive distributions, the issues that you raise and we address below would not need to be considered.

(1) Whether the Trust is a plan of deferred compensation

You take the position that the Trust is a welfare benefit fund within the meaning of section 419(e)(1) on the basis that death and severance benefits provided through the trust are welfare benefits within the meaning of section 419(e)(2). If those death or severance benefits are "deferred benefits (other than compensation)" that would be treated as deferred compensation under section 404(b)(2)(A), they would nevertheless be treated as welfare benefits under section 419(e)(2) because they are not within the exception under section 419(e)(2)(B) for benefits to which section 404 applies. They would not be within that exception because the reference in section 419(e)(2)(B) to section 404 is to "section 404 (determined without regard to section 404(b)(2))".

However, here the Trust, in effect, provides deferred compensation, because of the virtual certainty that the benefits will be provided in one form or another. See, Wellons v. Comm'r, 31 F.3d 569 (7th Cir. 1994) (holding that a severance pay benefit was actually deferred compensation because it was payable upon termination for any reason except dishonesty or fraud or if the employee took a leave of absence or converted to part time employment). Because the Trust provides deferred compensation, section 404(a) governs the deductibility of the entire contribution to the Trust. Regulation section 1.404(a)-1(a)(3).

In the remainder of this section, we discuss our finding that the Trust is providing deferred compensation. We provide separate analyses for those plans that provide only death benefits and those that also provide severance benefits.

Plans providing only death benefits

In addition to providing benefits on account of death, the Trust also provides benefits on account of employer withdrawal from the Trust and on account of termination of the Trust itself. In this regard, the information furnished by you shows that even those employers who have elected to provide only death benefits have made contributions substantially in excess of the cost of current insurance protection. It appears that these excess amounts, to the extent that they are not used to provide insurance protection, will become available to participants, because the participants will be able to receive "termination distributions" (either in cash or in kind). Indeed, the Trust's marketing material states that one of the benefits provided by the Trust is a "post retirement income stream from your paid up life insurance policy – tax free".[7]

The owners of the participating employers generally possess the ability to cause the employer to withdraw from the Trust at will. Because the Trust provides for termination distributions, there is not a realistic risk that the excess contributions described above will be forfeited. As a result, the "death benefit only" plans do not operate to provide insurance in the case of a contingent event. Rather, because of the virtual certainty that the excess contributions will be provided to the participants in one form or another, the plans provide deferred compensation.

Plans providing severance benefits

The severance benefits provided under the Trust are payable if a participant becomes totally disabled, resigns (for "good cause"), or is discharged "without cause." Severance benefits also appear to be available under circumstances that cause the benefits to be provided not as insurance against a contingent event but, rather, as an expected source of income. The marketing material distributed by the Trust (in particular, the "Answers to Commonly Asked Questions") provides two examples of such circumstances. First, when discussing the possibility that severance benefits might be forfeited on account of retirement, the marketing material states:

> There is no reason for [forfeiture due to retirement] to occur. This is an event controlled by the employee. He/she should delay receiving social security and other retirement benefits until his/her severance benefits expire.

[7] See the brochure entitled "Increase Benefits / Reduce Taxes".

Second, in its discussion of the definition of severance benefits, the marketing material states that such benefits will be paid to owners upon the sale of the business.[8]

In addition to its provisions for severance benefits, the Trust also provides benefits on account of employer withdrawal from the Trust and on account of termination of the Trust itself. An owner, in particular, would have control over withdrawal from the Trust.

On the basis of the above, there is little realistic potential for the forfeiture of benefits. Accordingly, the plans providing severance benefits are providing deferred compensation.

We also note that, because the termination distributions are payable when the insured is alive and still working for the employer, they are not either death or severance benefits, but rather constitute a form of deferred compensation.

(2) Whether the Trust is an aggregation of individual plans and is not a single plan[9]

Pursuant to its section 11.1 (entitled "Accounting"), the Trust maintains a separate accounting of each employer's "allocable share" of the Trust's assets. The Trust further requires that the severance benefit for an owner or highly-compensated employee be limited to the amount that can be paid from his or her employer's "allocable share" of the Trust's assets (as reduced by the amount of severance benefit earned by employees of that employer who are not owners or highly-compensated).

You assert that the existence of the Reserve Account and the Surplus Account causes the Trust to become a single plan. You have not provided any support for this assertion. Moreover, the provisions of the Trust that serve to limit the severance benefits that might otherwise be payable to owners and highly-compensated employees (on account of insufficient funds in the employer's "allocable share" of the Trust's assets) make it very unlikely that either the Reserve Account or the Surplus Account will ever be called upon to provide substantial amounts of funding. This point is stated clearly in the marketing material provided by you in support of your request. A brochure entitled

[8] In this regard, we note that the same marketing material advises potential participating employers that employees "with many years of service" will "gain the most from a establishing a severance pay plan".

[9] In Ruling #1 we determine that the Trust is a plan of deferred compensation to which section 404 deduction rules apply, rather than the deduction rules of section 419. Given that determination, the other issues you raise, are arguably moot. Because the ultimate issue presented is the application of section 419A(f)(6), we are addressing the alternative reasons that that section does not apply.

292

"Increase Benefits / Reduce Taxes" (the "brochure") contains the questions: "Are participating employers liable to meet employee claims if both the Reserve Account and Surplus Account are exhausted?". The answer is "Yes", but the answer goes on to state that:

> [the] Contract Administrator annually reviews all employer groups to determine if their funding is adequate. If a group is underfunded and unable to increase funding, the Contract Administrator has the authority to modify the group's Adoption Agreement to decrease their benefits, thereby insuring the group is funded appropriately.

Also, it is unclear whether the Reserve Account represents funds that are separate from the "allocable shares" of the individual employers. When describing the Reserve Account, the brochure states: "It's funded by a one-time fee from each participating group. The fee is deducted from their contribution but remains an asset of their plan."

Even if the Reserve Account does consist of funds that are separate from the "allocable shares" of the individual employers, the amount of assets in the account is relatively insignificant. According to the individual company reports provided to us, the funds in the Reserve Account (as of the end of February 1998) comprised only about 0.15% of the total funds held by the Trust.

We have a similar concern about the materiality of the Surplus Account. The financial records provided by you did not reflect any funds being held in the Surplus Account.

Under the terms of the Trust, (i) individual employers are given the authority to select many of the relevant terms under which their employees might collect benefits, (ii) each employer's contributions serve to benefit primarily its own employees (and not the employees of other employers), (iii) a severed prohibited group member (owner or highly compensated employee) might receive less the full promised benefit even though the plan, as a whole, has sufficient assets for paying the full benefit, and (iv) the Trust maintains a separate accounting of the funds contributed by, and credited to, each employer. Also, the adoption agreement signed by each employer is very similar to adoption agreements used to establish separate plans under the terms of a master plan.

In summary, there does not appear to be a substantive mechanism whereby assets or liabilities are pooled, shared or distributed among the plans of the various individual employers. Also, the Trust has several characteristics that are typical of arrangements in which separate plans share a common administrator. Consequently, the Trust is an aggregation of separate plans with a common administrator (the "contract administrator"). It is not a single plan.

(3) Whether the Trust maintains an arrangement for experience rating with respect to individual sponsors

The exception under Code section 419A(f)(6) is not available to plans that maintain experience-rating arrangements with respect to individual employers. In the instant case, we are asked to rule whether the Trust maintains any arrangement for experience rating.

The term "experience-rating arrangements" is not defined in the Code. The term "experience rating" is used in the Conference Report accompanying the Deficit Reduction Act of 1984 (1984-3 C.B., Vol. 2, at 413). Although the term is not defined there, the Conference Report states that, under plans that use experience rating, the "employer's interest with respect to the plan is more similar to the relationship of an employer to a fund than an insured to an insurer".

With regard to owners and highly-compensated employees, the Trust maintains an arrangement whereby benefits are adjusted to reflect the amounts credited to each employer's account, and, accordingly, maintains an experience rating arrangement. See, Booth v. Comm'r 108 T.C. 524 (1997). As described earlier in this letter, Article Four of the Trust (entitled "Severance Benefits") provides that participants who are either owners or highly-compensated employees do not necessarily receive the severance benefits called for under the employer's adoption agreement, even if such participants would otherwise be eligible for those benefits. Instead, the Trust requires the contract administrator to limit severance benefits to the lesser of (i) the amount called for under the adoption agreement and (ii) the amount of assets that constitutes the employer's "allocable share" of the trust (reduced by the amount of severance benefit that might have been earned by employees who are not owners or highly compensated).[10]

This limiting of severance benefits is reinforced in Trust section 8.1 (entitled "Funding of Severance Benefits"), which authorizes the contract administrator to offset the amount of any benefit distribution by the amount of any unpaid employer contributions. Furthermore, this Trust section clarifies the aforementioned provisions of Article Four, stating that the limitation of severance benefits to owners and highly-compensated employees shall take place whenever "there are not sufficient assets allocable to the [employer] to pay all participant employees' full severance pay benefits at the time of a [participant's] termination of employment".

Furthermore, the Trust's provision for crediting its Surplus Account with experience gains will take effect with respect to any particular employer only after

[10] Also, see Trust section 11.1 (entitled "Accounting"), which requires the contract administrator to maintain accounting records that reflect each employer's share of the Plan's assets.

that employer has achieved full funding of its benefits. Prior to such full funding, any experience gains that are attributable to the employees of an employer remain within that employer's allocable share of the Trust's assets.

Based upon the information you have provided, it appears that the net effect of the various Trust provisions is to limit the use of an employer's "allocable share" of the Trust's assets essentially to providing benefits for its own employees.

With respect to death benefits, we note that section 5.2(a) of the Trust document provides that death benefits shall be funded primarily through the purchase of life insurance contracts from the Insurer. Section 5.2(c) provides that "the Insurer or Contract Administrator shall provide each employer annually with the amount of the minimum premium payments that must be paid to keep the policies in force on the lives of the Employer's Employee Group." This section further provides that if the employer does not make the required payments, the Trustee makes the payments from the side fund assets allocable to the employer's employee group, and places a lien on the policy equal to the payments made from the side fund, plus interest. When such a lien has been placed on the policy, the actual death benefit provided to the beneficiary by the policy will be reduced by the amount of the lien (Section 5.3(c)). Thus, the lien provides a mechanism whereby beneficiaries do not necessarily receive the death benefits called for under the employer's adoption agreement, even if such beneficiaries would otherwise be eligible for those benefits. Thus, the Trust maintains an arrangement whereby death benefits might be adjusted to reflect the amounts paid into each employer's account, and, accordingly, maintains an experience rating arrangement with respect to those benefits.

The Trust's provision for termination distributions also indicates that there is experience rating with respect to individual employers. The funds used to make such distributions to the employees of any particular employer represent the excess of contributions made by that employer (plus investment earnings allocated to that employer's "allocable share" of the Trust's assets) over the amounts needed to provide for benefits attributable to the employees of that employer (plus related expenses). As such, the termination distributions function as experience refunds. Consequently, the Trust's provision for the payment of such refunds can be viewed as an arrangement for experience rating.

You assert that the Plan does not maintain any arrangement for experience rating because the Reserve Account and the Surplus Account serve to supplement losses of the individual employers. As noted above, it is very unlikely that any employer would sustain such losses. Furthermore, as discussed in the previous section, neither the Reserve Account not the Surplus Account appear to contain significant amounts of funds and it is unlikely that they would materially affect the amount of benefits provided to participants.

295

Based on the above, the Trust maintains an experience-rating arrangement with respect to individual employers.

Finally, as noted above, from the information we have, it appears that one of the participating employers contributed in excess of ten percent of the total contributions contributed under the plan by all employers. If one employer normally contributes more than ten percent of the total contributions, the Plan fails to satisfy the definition of "10 or more employer plan" under section 419A(f)(6)(B).

CONCLUSION

Based on the material provided, we find that (1) the Trust (assuming that it is not an arrangement that provides constructive distributions to employee/owners) is a plan of deferred compensation, (2) the Trust is an aggregation of individual plans and is not a single plan; and (3) the Trust maintains an arrangement for experience rating with respect to individual employers. As a consequence of these findings, we further find that the Trust does not satisfy the requirements of Code section 419A(f)(6).

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited by others as precedent.

A copy of this letter is being sent to your authorized representative pursuant to a power-of-attorney (Form 2848) on file with us.

Sincerely,

James E. Holland, Jr.

James E. Holland, Jr., Manager
Employee Plans Actuarial Group 1
Tax Exempt and Government Entities
Division