

IRC § 419 WELFARE BENEFITS & DEFERRED COMPENSATION

A welfare benefit plan is any plan, fund or program which is established or maintained by an employer to provide employees, through insurance or another method, with:

- Medical, hospital care, sickness, accident, disability, or death benefits.
- Unemployment, vacation or training benefits.
- Daycare, scholarship or prepaid legal expenses.
- Severance, housing and related benefits, **other than pension benefits.**

These plans are authorized under Section 419 of the Internal Revenue Code (IRC) and sponsoring employers are subject to limits on deductibility and contribution amounts. When used correctly, these plans allow employers a current tax deduction for contributions made to a fund established to provide future welfare benefits to employees. However, there are penalties and excise taxes if these plans are used inappropriately.

REVIEW OF RELEVANT TAX CASES AND REGULATIONS

The IRS has prevailed several times in Tax Court on this issue over the past six years and, in February 2000, issued proposed regulations (IRS Notice 2000-12) for the registration and reporting of corporate tax shelters. One of the “tax shelters” identified by the IRS in those regulations is Sec. 419 Welfare Benefit Plans.

- *Wellons v. Comm.*, 31 F.3d 569 (7th Cir. 1994), the IRS successfully challenged a severance pay plan that was determined to be more like deferred compensation (a retirement benefit NOT eligible for treatment under § 419) than a welfare benefit.
- In **Notice 95-34**, the IRS put taxpayers on notice that it would attack deductions for deferred compensation plans that were camouflaged as § 419 Welfare Benefit Plans.
- *Booth v. Comm.*, 108 T.C. 524 (1997), the IRS won a case in which a multiple employer plan, purported to be exempt from the limitations of deductibility under § 419, was found to NOT be exempt because the plan failed the definition of a multiple employer plan.
- *Neonatology Assoc. v. Comm.*, 115 T.C. 5 (July 31, 2000), the IRS again won a case in which the taxpayers had attempted to enter into a § 419 Multiple Employer Welfare Benefit Plan, which was supposed to provide term insurance benefits. However, there were large up-front tax deductions and long-term values that resulted for the Company and the participants. The Court determined that these were NOT welfare benefits, but merely deferred compensation again under the § 419 disguise.

SUMMARY

If it seems too good to be true, it probably is. The IRS does NOT approve of plans that provide even a hint of deferred compensation under the guise of a § 419 Welfare Benefit Plan. No amount of supporting documentation or legal opinions from the promoter of the idea has insulated recent purchasers of these products from negative tax consequences upon audit.

These plans are risky and they violate the intent of existing tax law (if not the letter of the law). **We strongly recommend against the adoption of any so-called 419 plan by our clients in conjunction with any form of deferred compensation or retirement benefits.**

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