

The Jobs Act and Welfare Benefit Plans

The smaller deduction in 419(e) plans may make them more prudent than 419A(f)(6) plans.

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The enactment of the American Jobs Creation Act may impact all welfare benefit plans under Section 419A(f)(6). As an advisor, you need to know the effects of this act on these plans so that you will know what to recommend to your clients.

The Jobs Act includes new laws regarding listed transactions, reportable transactions and tax shelters. The act imposes significant penalties on taxpayers who do not disclose reportable transactions, including listed transactions and transactions substantially similar, which would apply to tax returns filed after the date of enactment.

Listed transactions

In 2000, the IRS identified Notice 95-34 as a listed transaction. The notice describes plans purporting to qualify as multiple employer plans under 419A(f)(6) (plans that, in fact, would be collections of separate plans with experience rating by individual employers). Other plans were actually deferred compensation arrangements, or the contributions represented prepaid expenses that were nondeductible under other sections of the code.

Any arrangement “substantially similar” is also a listed transaction. The notice describes 12 provisions, many of which are either required by 419A(f)(6) or are allowable. If a multiple employer plan is substantially similar to those de-

scribed in Notice 95-34, the IRS will contend these plans are subject to the listing and disclosure requirements. If the plan is substantially similar because it permits experience rating by employer or is more like deferred-compensation arrangements than a welfare plan, it will fail the requirements of 419A(f)(6).

Penalties

The penalty for failure to disclose a listed transaction is \$200,000. This penalty may be imposed regardless of whether or not

**IN A 419(e) PLAN,
SINGLE EMPLOYER
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the deduction is upheld. As an advisor, you are responsible for not placing any of your clients at risk without complete and informed disclosure. Any taxpayer participating in such a plan that was not disclosed to the IRS and was subsequently deemed to be a listed transaction would suffer the imposed penalty without recourse. Obviously, this is an unacceptable risk for you and your client.

The act not only imposes penalties on the actual plan participant, it also imposes reporting requirements for the material advisors who “organize, manage, promote, sell, implement, insure or carry out” the reportable transaction.

Reaction to the act

The passage of the Jobs Act has triggered different responses from the industry. In the defined-benefit arena, any policyholder who purchased life insurance coverage over the incidental 74-307 limits in a 412(i) plan in 2004 would be well advised to amend his tax return and not deduct the applicable amount, and pay the excise tax to avoid being classified as a listed transaction as prescribed in Revenue Ruling 2004-20. The IRS has not provided guidance as to whether or not amending the plan would avoid a listed-transaction status. Accordingly, as a precautionary measure, most advisors are filing Form 8264 to avoid these penalties. At this point, there is no requirement to list client names on Form 8264, and it is not clear what specifics the IRS will seek to obtain in the future.

Helping your clients choose

Assuming one of your clients is suitable for participating in a welfare benefit plan, the next step is to decide whether to consider a multiple employer plan under Section 419A(f)(6) or a single employer plan under Section 419(e). In light of the passage of the Jobs Act and the real risk that participating in a 419A(f)(6) plan could be considered a listed transaction, the smaller deduction found in 419(e) plans may be the more prudent course to recommend.

Until the IRS provides a definitive Private Letter Ruling on all aspects of a 419A(f)(6) plan, the risk of participating in this plan appears too great to undertake. Many firms have engaged lawyers who have spoken with various members of the IRS, the Treasury or Congress; however, informal discussions and assurances are only as good as the paper they are written on.

While the tax deductibility of participating in any welfare benefit plan should

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419A (f)(6) VS. 419(e) PLANS

419A(f)(6)

- No experience rating, multiple employers
- Higher deduction
- No separate accounts for retired employees
- Forfeitures revert to trust for benefit of all employers' participants
- One plan administrator for all employers
- Possible listed-transaction scrutiny
- No postretirement medical benefits
- Severance benefits deductible

419(e)

- Experience rating permitted, one employer
- Deduction limited to qualified direct cost
- Separate accounts for retired employees
- Forfeitures revert to single trust for benefit of single employer's participants
- Employer is its own plan administrator
- Not subject to 419A(f)(6) rules
- Postretirement medical benefits permitted
- Severance deductible only if employer had a severance plan and paid such benefits

tirement plans or whose pension plans no longer favor the business owners may find that now is the time to consider a properly designed 419(e) plan.

A business entity that adopts a 419(e) plan should have at least one participant who qualifies as a bona fide employee, in addition to the owner-employee. It is possible to have a plan that funds benefits for already-retired employees so long as the plan provisions provide for

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never be the sole consideration in deciding whether or not to adopt a nonqualified plan, it remains one of its compelling features.

Some commentators have suggested that similar to other regulators in the post-Enron and Sarbanes-Oxley world, the IRS may feel emboldened to notch up its scrutiny of any transaction that may appear to favor the more affluent. Unfortunately, a literal reading of the Jobs Act section on tax shelters paints an extremely broad brush.

419(e) plans

Unlike multiple employer welfare ben-

efit plans, single employer plan assets are kept separate from other employers' plan assets. Each employer's experience is looked at annually, with no commingling of assets or sharing of risk, unlike a 419A(f)(6) plan.

The types of welfare benefits that can be funded up to the account limit include death, disability, postretirement health (and any other welfare benefit the particular trust has adopted and had certified by its actuaries). The types of businesses that may be suitable for a 419(e) plan include LLCs, partnerships, and C and S corporations.

A profitable firm that is no longer able to make contributions to its qualified re-

lated to this feature. 419(e) plans can also fund postretirement medical benefits for dependents as long as dependents of all employees are included. In this instance, a spouse would not have to be employed to receive this particular benefit. On the other hand, to be eligible for the insured death benefit, spouses must be actively employed, which is extremely helpful in estate planning where one spouse is potentially uninsurable. **A1**

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