OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DISTRICT COUNSEL, ILLINOIS DISTRICT

FROM: Michael J. Roach
Chief, Branch 7, Office of Associate Chief Counsel (EBEO)
CC:EBEO:BR7

SUBJECT:

This Field Service Advice responds to your memorandum dated March 2, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

TP1 =
TP2 =
Fund A =
Local B =

Group C =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
X =

ISSUE

Whether contributions to Fund A by TP2, a Subchapter S corporation wholly-owned by TP1, fall within the section 419A(f)(5) exception to the account limit rules of section 419A of the Code.

FACTS

TP1 owns TP2, a Subchapter S corporation, which apparently sold all of the assets comprising its principal line of business in Date 1[1] resulting in a large gain for tax purposes. TP1 claims that TP2 engaged in the business of being a sales representative after the sale of the assets.

Although not entirely clear, it appears that TP1 caused himself and two of his children to join Local B. Undated, but signed, union cards for TP1 and his two children were included with the incoming submission. On or about Date 3, TP1 caused TP2 to become a member of Group C, a master employers group that collectively bargained with Local B.

Also on or about Date 3, TP1, as president of TP2, signed a Subscription Agreement in which TP2 agreed to make certain contributions to Fund A, a tax-exempt entity under section 501(c)(9) of the Code, for the purpose of providing medical care, health and hospitalization insurance, and other benefits to its employees and eligible dependents of employees. Although the Subscription Agreement indicates that the amount of contributions, benefits, and other information about Fund A is included in the attachment to the Subscription Agreement, that information is not included in the attachment. The benefits provided by Fund A appear to include life insurance benefits. In Date 1, TP2 contributed $X to Fund A and claimed a deduction in this amount, indicating that this contribution was deductible under sections 419 and 419A of the Code. Because this deduction was claimed on a Subchapter S return, it ultimately flowed through to TP1's personal income tax return. On Date 4, a notice of deficiency was mailed to TP1 denying the flow-through loss of $X from TP2.

LAW AND ANALYSIS

Section 419(a) of the Code provides that contributions paid or accrued by an employer to a welfare benefit fund are deductible for the taxable year paid, subject

[1] This date may be inaccurate based on information in the written protest letter which indicates that the sale of assets occurred in Date 2 rather than Date 1.

to the limitation contained in section 419(b), and provided the contributions would otherwise be deductible.

Section 419(b) of the Code limits the amount of the deduction allowable under section 419(a) to the welfare benefit fund's qualified cost for the taxable year. Section 419(c) of the Code defines qualified cost as the sum of (1) the qualified direct cost for the taxable year, and (2) any addition to a qualified asset account, subject to the limitation of section 419A(b). Qualified cost is reduced by the welfare benefit fund's after-tax income for the taxable year.

According to section 419(c)(3) of the Code, the qualified direct cost of a welfare benefit fund for any taxable year of the fund is the aggregate amount (including administrative expenses) that would have been allowable as a deduction to the employer for benefits provided by the fund during the year if (1) the benefits were provided directly by the employer, and (2) the employer used the cash receipts and disbursements method of accounting.

Section 419A(a) defines a qualified asset account as any account consisting of assets set aside to provide for the payment of disability benefits, medical benefits, SUB or severance pay benefits, or life insurance benefits. Section 419A(b) provides that no addition to a qualified asset account may be taken into account under section 419(c)(1)(B) to the extent that the addition results in the amount of the qualified asset account exceeding the account limit. Under section 419A(c), the account limit for any qualified asset account for any taxable year is generally the amounts reasonably and actuarially necessary to fund the claims incurred but unpaid as of the close of the taxable year for the above benefits and the administrative costs of such claims. Section 419A(c)(2) permits an additional reserve for post-retirement medical and life insurance benefits if certain requirements are met.

Section 419A(f)(5) of the Code provides an exception from the account limit rules for collectively bargained plans. Under section 419A(f)(5), no account limits apply in the case of any qualified asset account under a separate welfare benefit fund under a collective bargaining agreement.

Section 1.419A-2T, Q&A-2(2) of the Income Tax Regulations explains that a welfare benefit fund is considered to be maintained pursuant to a collective bargaining agreement only if the benefits provided through the fund were the subject of arms-length negotiations between employee representatives and one or more employers, and if such agreement between employee representatives and one or more employers satisfies section 7701(a)(46) of the Code. Moreover, the circumstances surrounding a collective bargaining agreement must evidence good faith bargaining between adverse parties over the welfare benefits to be provided through the fund.

Under section 1.419A-2T, Q&A-2(3) of the regulations, in the case of a collectively bargained welfare benefit fund, only the portion of the fund (as determined under allocation rules to be provided by the Commissioner) attributable to employees covered by a collective bargaining agreement, and from which benefits for such employees are provided, is considered to be maintained pursuant to a collective bargaining agreement.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

[redacted]

[redacted]

If you have any further questions, please call the branch telephone number.

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