The following Comments are the individual views of the members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or the Section of Taxation.

These Comments were prepared by individual members of the Committee on Employee Benefits of the Section of Taxation and its Subcommittee on VEBAs, Retiree Health, and Other Funding Vehicles. Principal responsibility was exercised by George L. Whitfield. Substantive contributions were made by Randy Andreozzi, Russell Greenblatt, Nell Hennessy, Joyce Mader, and Carol Weiser. The Comments were reviewed by Taina Edlund and Greta Cowart of the Employee Benefits Committee of the Section of Taxation; by Mark S. Dray of the Quality Assurance Group of the Employee Benefits Committee, whose members are former chairs of the Committee; by Diane J. Fuchs of the Section’s Committee on Government Submissions; and by Thomas A. Jorgensen, Council Director for the Employee Benefits Committee.

Although some of the members of the Section of Taxation who participated in preparing these Comments have clients who would be affected by the federal tax principles addressed by Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Exhibit A
EXECUTIVE SUMMARY

These Comments respond to the request in Notice 2003-24 for input on the “separate” fund requirement for collectively bargained plans in §419A(f)(5). Section 419A(f)(5) provides a complete exemption from the deduction and reserve limits of §§419 and 419A for collectively bargained plans. As originally enacted in 1984, §419A(f)(5) directed Treasury and the IRS to provide for higher reserve limits for welfare benefit funds established under collective bargaining agreements. A temporary regulation issued on July 1, 1985 provided that the limits of §§419 and 419A would not apply to qualifying welfare benefit funds until the issuance of final regulations. The temporary regulation also provided guidance on qualified funds maintained under collective bargaining agreements. The standards were different and more liberal for plans in effect on or before July 1, 1985, requiring only 50% of the eligible employees to be covered by a collective bargaining agreement; while, for funds established after July 1, 1985, the requirement was 90%. In all cases, separate accounting for non-union employees was required.

The Tax Reform Act of 1986 amended §419A(f)(5) to specify that §§419 and 419A do not otherwise apply to a “separate” welfare fund under a collective bargaining agreement. The legislative history from both 1984 and 1986 reveals a strong congressional intent that the rules for welfare benefit funds maintained under collective bargaining agreements should be liberal.

The 1985 temporary regulation remains in effect and no additional regulations or guidance have been issued. Notice 2003-24 states that the IRS intends to issue proposed regulations on collectively bargained funds under §419A(f)(5). There is a growing concern about “sham” union plans attempting to take advantage of the exemption and it is anticipated that the proposed regulations will attempt to address and curtail these abuses. In addition, Notice 2003-24 designates certain arrangements purporting to be collectively bargained plans as listed transactions for tax shelter purposes and specifies other potential tax shelter consequences.

One case, the Sixth Circuit Parker-Hannifin case, has upheld the separate fund requirement in §419A(f)(5). We believe that case should be restricted to its facts and should not prevent coverage of formerly active participants, participants with a nexus or connection to the bargaining agreement, plan or union (referred to as “union-related” – see also Exhibit A), and even a reasonable percentage of participants who are not union or union-related, without requiring a separate fund or separate accounting.

Section 3(40)(A) of ERISA specifies certain consequences for multiple employer welfare arrangements but excludes any plan established under a collective bargaining agreement. On April 9, 2003, the Department of Labor issued a final regulation setting forth criteria for that exception for collectively bargained plans.
There are many valid reasons for reasonable and flexible rules that allow participation in a collectively bargained welfare fund, without separation or separate accounting, by alumni and union-related participants and even other employees of participating employers. Generally the benefits of the fund will not be available at all or will not be available at reasonable cost for these groups, which will often be small in size and represent a relatively small percentage of the total participants. In general, avoidance of separate funds and separate accounting will promote efficient and economical plan administration. Maintenance of separate funds or separate accounting will often be burdensome and impractical and, in some cases, impossible.

These Comments suggest that the proposed and final regulations under §419A(f)(5) should not impose undue burdens and restrictions on valid collectively bargained plans. They should deal with potentially abusive plans by means other than a prohibition against reasonable percentages of related and other participants. In that connection, the safeguards inherent in Taft-Hartley plans should be fully recognized in the proposed and final regulations. In addition, special treatment should be accorded plans that have been in compliance or substantially in compliance with the 1985 temporary regulation and those that have been in compliance with the DOL regulation since it was proposed in 2000.

Contributors to these Comments know from experience and information from others that there are many collectively bargained plans in existence that cover union-related and former participants as well as other employees of participating employers. We therefore confirm the understanding expressed in Notice 2003-24 that such plans exist without maintaining actual or notational separation of the funding for those who are not currently active union employees entitled to benefits under an applicable collective bargaining agreement. The existence of these plans and arrangements in significant numbers mandates a need for clear and flexible requirements under §419A(f)(5), assuming the existence of a bona fide collective bargaining agreement and assuming that benefits for the non-collectively bargained participants are no more favorable than those for similarly situated collectively bargaining participants.

Based upon the foregoing, we offer the following additional comments and recommendations, which we hope will inform and stimulate development of the proposed regulations:

1. We applaud and encourage the provisions of Notice 2003-24 that address illegal tax shelters and encourage the Treasury and the IRS to remain vigilant in their pursuit of such vehicles and the persons and entities that promote them.

2. The proposed and final regulations should limit the application of the Parker-Hannifin case and should not be unduly restricted by that case.

3. The proposed and final regulations concerning allowable participants should adopt verbatim or in substance the applicable provisions of the DOL regulation, subject to some suggested modifications and appropriate supplementation for single employer plans. Doing so
will enhance plan administration and avoid the burdens and risks of requiring compliance with two sets of rules. Consistent guidance from federal agencies having overlapping or concurrent jurisdiction of federal law or regulations should always be a singular objective of government. Such agencies should work out their differences in the context of any competing underlying policies before the promulgation of guidance.

4. In general, union-related and alumni (see Exhibit A) participants should be considered part of the collectively bargained population of a plan without limit and without requiring separation or separate accounting.

5. A reasonable percentage of non-nexus participants (see Exhibit A) should also be allowed. We recommend that non-nexus participation be permitted to range up to 15% of total plan participation. We have no intent, however, to be more restrictive than the DOL regulation.

6. We recommend a grandfathering rule for plans that have been in compliance or substantially in compliance with the 1985 temporary regulation. We also recommend grandfathering treatment of plans that have been in compliance with the DOL regulation.

7. We suggest that special treatment should be accorded Taft-Hartley plans because there is almost no possibility of abuse in those plans.

8. We recommend a special transitional rule for plans that continue to cover former employees after a corporate transaction for a period ranging up to the end of the following plan year.

9. To the extent the foregoing recommendations are not adopted, we urge that separate accounting should avoid the need for an actual separate fund for those plans that are able and choose to maintain separate accounting.

10. If any of the proposed and final rules are more restrictive than current guidance and practices and if grandfathering rules are not adopted, we recommend liberal transitional rules allowing plans reasonable procedures and adequate time to move into compliance with the final regulations.

11. The proposed and final regulations should be clear and comprehensive and should address all of the issues raised in these Comments.

12. Finally, the 1985 temporary regulation should be declared obsolete and superseded by the new regulations when final.
I. Background

On May 5, 2003, the IRS published Notice 2003-24. The notice expresses concern about certain arrangements purporting to qualify as collectively bargained welfare benefit funds exempt under §419A(f)(5) from the deduction and reserve limits of §§419 and 419A. The notice addresses arrangements that generally may be characterized as “sham” unions, although that term is not used in the notice. The notice also designates certain arrangements as listed transactions for tax shelter purposes and describes other tax shelter implications. The notice advises that the IRS will be issuing proposed regulations under §419A(f)(5) and requests comments on the “separate” fund requirement applicable to collectively bargained plans in the statutory language. In that connection, the notice references the probable existence of bona fide collectively bargained plans that provide benefits to one or more employees who are not union members so that a separate and distinct fund for only union and union represented employees has not been maintained. Informally, the IRS subsequently indicated that it is receptive to comments on any other aspect of the collectively bargained fund exception in §419A(f)(5). Comments are requested by August 3, 2003.

Introductory Notes on Terminology

The following notes on terminology used in these Comments are summarized in Exhibit A attached.

The core participants in a plan that qualifies for the collectively bargained exception in §419A(f)(5) are active employees covered by an applicable collectively bargained agreement. Some of those participants (generally in right-to-work states) are not union members, but the terms and conditions of their employment are subject to a collective bargaining agreement and they are represented by a union in the collective bargaining process. These participants will sometimes be referred to as “union-represented” employees or participants in these Comments. However, references to union members and union participants are intended to include union-represented employees. Union members and union-represented employees are also sometimes referred to in these Comments as “collectively bargained” or as “core” employees or participants.

If a plan or fund covered only collectively bargained participants, the singular issue under §419A(f)(5) would be the validity of the collective bargaining parties and process and there would be no issue concerning the separate fund requirement. There are often many other actual or potential participants, however, and these Comments address the extent to which a plan that qualifies as collectively bargained under §419A(f)(5) may include others, with or without separate accounting. We have grouped other possible participants into three categories for purposes of discussion.
Those that have some relation to the fund through a union, union organization, employer organization, related or reciprocal plan, or other connection are referred to as “union-related” and also as “nexus” participants.

Individuals who were formerly participants, whether or not collectively bargained employees, are referred to as “alumni.” The term “alumni” does not include any active participant in a plan who transfers or moves to another employment status that is eligible for and allows continued active participation in the plan. Those individuals continue to be participants and are not former participants.

Finally, those who are not subject to the collective bargaining agreement and have no connection to the plan or fund other than employment by an employer that has other employees in the core group or has another significant connection to the plan are labeled as “non-nexus.” Non-nexus participants include owners or employees of an employer that is subject or connected to an applicable collective bargaining agreement but who are not themselves collectively bargained or union-related employees.

The terms “nexus” and “non-nexus” in these Comments do not always have the same meaning as in the DOL regulation.

The term “non-union” includes both nexus and non-nexus employees. In our normal use, it does not include alumni. However, the meaning of “non-union” also sometimes reflects everyday parlance or the context in which it is used.

All of these terms are limited to those who are accruing benefits or have remaining benefit rights under the applicable fund.

In these Comments, unless the context clearly indicates otherwise, references to a collectively bargained plan, fund or welfare benefit fund are intended to mean a welfare benefit plan or fund that qualifies (or should qualify in our view) for the collectively bargained exception under §419A(f)(5), whether or not portions of the fund may be subject to a requirement of separate accounting. References to a plan are generally intended to mean a welfare benefit fund which is the applicable terminology in the text of §419A(f)(5).

References in these Comments to a “Taft-Hartley plan” are to a plan contemplated by Section 302(c)(5)-(9) of the Labor Management Relations Act of 1947 (the “Taft-Hartley Act”), 29 U.S.C. 186(c)(5)-(9). A Taft-Hartley plan is a welfare or pension benefit trust that exists only for limited benefit purposes and must adhere to significant administrative restrictions and requirements. See I. G(4) below. “Taft-Hartley plans” can include both single employer and multiemployer plans.

References in these Comments to a “multiemployer” plan are intended to mean a Taft-Hartley plan in which more than one employer participates. The term “multiemployer” is intended to have substantially the same meaning as in Section 3(37) of ERISA and the very
similar definition for pension plan purposes in Section 414(f) of the Internal Revenue Code. While they may exist, we are not aware of any multiemployer plan that is not a Taft-Hartley plan. (However we are not very familiar with plan structures under the Railway Labor Act.)

Although there are undoubtedly a wide variety of plans, including plan types that we have not encountered, we are not aware of a collectively bargained plan or fund with multiple unrelated participating employers that is not a Taft-Hartley plan. We are aware of situations following an acquisition, disposition or other transaction, in which employees who are transferred to new employment as a result of the transaction may continue to participate for a brief transition period.

A. §§419 and 419A.

Sections 419 and 419A were added to the Code by the Deficit Reduction Act of 1984. Together these sections impose limits on the amount and timing of deductions for contributions to welfare benefit funds. Section 419 generally provides that contributions by an employer to a welfare benefit fund, if otherwise deductible, are deductible for the taxable year in which paid, provided that the deduction is limited to the fund’s qualified cost for the taxable year. Qualified cost is defined in §419 as the sum of the qualified direct cost plus any allowable addition to a qualified asset account, as defined, determined and limited by §419A, minus after-tax income, for the taxable year. Qualified direct cost is the amount actually paid for the year for benefits and related administrative expenses.

Subject to applicable limits §419A allows a deduction for amounts paid to a reserve or “qualified asset account” for payment of medical, life insurance, disability, supplemental unemployment or severance pay benefits. Subject to certain exceptions and additions, such as a reserve for retiree benefits, a qualified asset account is limited to a reasonable estimate of incurred but unpaid claims and related costs. The deductible contribution for a year to a qualified asset account is limited to an amount that does not cause the account to exceed the applicable limit.

There are two special exceptions to the reserve limits in §419A. The first, in §419A(f)(5), applies to welfare benefit funds under a collective bargaining agreement or an employee-pay-all plan under §501(c)(9). The second is for 10 or more employer plans described in §419A(f)(6). The Treasury and the IRS are concerned about potential abuses under the collective bargaining application of the first exception.

B. §419A(f)(5): Initial Language and Temporary Regulations.

As originally enacted in 1984, §419A(f)(5) read as follows:

(5) Higher limit in case of collectively bargained plans. Not later than July 1, 1985, the Secretary shall by regulations provide for special
account limits in the case of any qualified asset account under a welfare benefit fund established under a collective bargaining agreement.¹

Treasury Decision 8034, dated July 1, 1985, included temporary regulation §1.419A-2T (the “temporary regulation”) addressing the qualified asset account limitation for collectively bargained plans. The temporary regulation consisted of two questions and answers. The first postponed the application of §§419 and 419A (and also §512) to welfare benefit funds maintained pursuant to one or more collective bargaining agreements until final regulations are issued. The second, Q&A-2, defined a welfare benefit fund maintained pursuant to a collective bargaining agreement as follows:

**Q-2:** What is a welfare benefit fund maintained pursuant to a collective bargaining agreement for purposes of Q&A-1?

**A-2:** (1) For purposes of Q&A-1, a collectively bargained welfare benefit fund is a welfare benefit fund that is maintained pursuant to an agreement which the Secretary of Labor determines to be a collective bargaining agreement and which meets the requirements of the Secretary of the Treasury as set forth in paragraph 2 below.

(2) Notwithstanding a determination by the Secretary of Labor that an agreement is a collective bargaining agreement, 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. Finally, a welfare benefit fund is not considered to be maintained pursuant to a collective bargaining agreement unless at least 50 percent of the employees eligible to receive benefits under the fund are covered by the collective bargaining agreement.

(3) 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.

(4) Notwithstanding the preceding paragraphs and pending the issuance of regulations setting account limits for collectively bargained welfare benefit funds, a welfare benefit fund will not be treated as a

¹ All quoted text appears in bold font.
collectively bargained welfare benefit fund for purposes of Q&A-1 if and when, after July 1, 1985, the number of employees who are not covered by a collective bargaining agreement and are eligible to receive benefits under the fund increases by reason of an amendment, merger, or other action of the employer or the fund. In addition, pending the issuance of such regulations, for purposes of applying the 50 percent test of paragraph (2) to a welfare benefit fund that is not in existence on July 1, 1985, “90 percent” shall be substituted for “50 percent”.

The temporary regulation stated that it would remain in effect with respect to an employer until the earlier of three years following the issuance of final regulations or the expiration of the last applicable collective bargaining agreement in effect at the time of issuance of final regulations. No final regulations have been issued, and the temporary regulation remains in effect.

C. 1986 Amendment of §419A(f)(5).

The Tax Reform Act of 1986 completely restated §419A(f)(5) to read in relevant part as follows:

(5) Special rule for collective bargained and employee pay-all plans. No account limits shall apply in the case of any qualified asset account under a separate welfare benefit fund--

(A) under a collective bargaining agreement, or

(B) an employee pay-all plan under section 501(c)(9) . . .

At the time of original enactment in 1984, the Conference Committee Report directed the Treasury, in establishing limits for collectively bargained plans, to presume that the reserves in such plans are not excessive because of the arm’s-length negotiations between adversarial parties inherent in the collective bargaining process. The Conference Committee Report also noted that contributions under collectively bargained plans are often on a defined contribution basis over multiple years based on assumptions that often prove incorrect, suggesting that the limits for collectively bargained plans should allow substantial flexibility in applying the rules of §§419 and 419A. It also noted that these funds may be the only source of benefits during periods of labor strife and economic downturns.

The Conference Committee Report for the Tax Reform Act of 1986 incorporated the Senate explanation, noting the temporary regulation issued on July 1, 1985, and stating that the bill “permanently exempts collectively bargained VEBAs from the account limits” of §§419 and 419A, so that “contributions to such VEBAs are deductible and earnings on assets of such VEBAs are tax exempt.” (Note that while the statutory language applicable to employee-pay-all plans refers to VEBAs under §501(c)(9), there is no statutory reference to VEBAs in the
language in §419A(f)(5) exempting collectively bargained plans from the applicable limits. The exemption for employee-pay-all plans is not relevant to these Comments.) The 1986 Senate report again referenced the 1984 admonition to the IRS to presume that excessive reserves in collectively bargained plans are precluded by arm’s-length negotiations between independent adversarial parties. This language in the report suggests that Congress intended the 1986 exemption for collectively bargained funds to be broad and liberal.

D. Parker-Hannifin.

The requirement of a “separate” welfare benefit fund in §419A(f)(5) was addressed in Parker-Hannifin Corp. v. Comm’r., 139 F.3d 1090 (6th Cir. 1998). In that case, only about 6.5% of the employees of the employer were represented by unions. In 1987, the employer established a VEBA trust as the funding medium for certain welfare benefits, and it funded reserves for those benefits, including future union medical benefits in the amount of $3.2 million, as well as very large post-retirement benefits for retirees and active employees, in a single total contribution in excess of $42 million. Due to a decrease in corporate tax rates there was a benefit to the employer to make the contribution by June 30 of that year, which it did.

In the recital of facts, the court points out that the employer never notified its union employees or any of the unions representing its employees of the existence of the trust. In addition, the total assets in the trust were commingled and applied to pay current benefits without any separate accounting. There was only one trust with no subtrusts.

The company deducted the entire $42 million contribution on its corporate income tax return for 1987. The IRS disallowed the entire deduction other than amounts attributable to incurred but unpaid claims and related expenses which totaled just under $10 million. While the primary issue in the case was the deduction of nearly $26 million for post-retirement benefits and failure to actually set aside funds in a reserve for that purpose, the opinion also addresses the $3.2 million contribution for medical benefits for union members. The employer argued that this portion of the contribution and the related deduction should be sustained under §419A(f)(5). The government argued that the company was not entitled to the deduction because it did not maintain a separate welfare benefit fund for the union employees. The Sixth Circuit affirmed the Tax Court decision agreeing with the IRS. The employer argued that the separate fund requirement meant only that there must be an obligation under a collective bargaining agreement and a deposit in a welfare fund. The employer also argued that the separate fund language only required separation from the general assets of the employer. Rejecting both arguments, the court concluded that the language of the statute mandates establishing a separate fund for union participants, distinct and apart from assets providing benefits to other employees.

E. DOL Regulation.

Section 3(40)(A) of ERISA defines the term “multiple employer welfare arrangement.” The definition states that the term does not include any plan or other arrangement established or maintained “under or pursuant to one or more agreements which the Secretary finds to be collective bargaining agreements.” On April 9, 2003, the Employee Benefits Security
Administration of the Department of Labor issued final regulation §2510.3-40 (the “DOL regulation”) setting forth criteria for determining whether a plan is established or maintained under or pursuant to one or more collective bargaining agreements (sometimes referred to as a “CBA”). The final DOL regulation followed publication of a proposed regulation on October 27, 2000. Both the proposed regulation and the final DOL regulation adhered to the recommendations of an advisory committee convened under the Negotiated Rulemaking Act. Therefore, the DOL regulation was developed with full input from all industry segments, as well as public comment.

In our judgment after much discussion, the DOL regulation is highly relevant to development of proposed and final regulations under §419A(f)(5), and the reasons for our conclusion are discussed in further detail below. Subsection (b)(2) of the DOL regulation specifies that at least 85% of the participants in the plan must be union, alumni and union-related participants and lists, in subsections (i) through (x), those who are counted as union, alumni and union-related participants in testing the 85% to 15% ratio, including some who would be clearly considered non-nexus in the ordinary context.

The following is the text of each component of subsection (b)(2) of the DOL regulation with brief summaries of or comments on the text:

(1) §2510.3-40(b)(2).

(2) At least 85% of the participants in the plan are:

The DOL regulation allows up to 15% of the participants to be non-nexus individuals who do not meet any of the additional criteria specified in subsection (b)(2) and who exceed the non-nexus limit specified in subsection (viii). Subsections (i) through (x) of subsection (b)(2) describe individuals who may be included in a plan without loss of collectively bargained status and who will count in determining the 85% to 15% ratio. Note in the discussion of subsection (viii) below, that 10% of the total participants can be non-nexus and still be part of the 85%.

(2) §2510.3-40(b)(2)(i).

(i) Individuals employed under one or more agreements meeting the criteria of paragraph (b)(3) of this section, under which contributions are made to the plan, or pursuant to which coverage under the plan is provided;

These are the core union participants in the plan.

(3) §2510.3-40(b)(2)(ii).

(ii) Retirees who either participated in the plan at least five of the last 10 years preceding their retirement, or

(A) Are receiving benefits as participants under a
multiemployer pension benefit plan that is maintained under the
same agreements referred to in paragraph (b)(3) of this section, and

(B) Have at least five years of service or the equivalent
under that multiemployer pension benefit plan;

This provision includes retirees but imposes minimum service requirements on
participating retirees. We suggest that the negotiated requirements for benefit accruals in an
applicable collective bargaining agreement should be sufficient and that the additional service
requirements for retirees in this component of the DOL regulation are not necessary. The basis
for the exemption in the first instance simply obviates the need for an additional service
requirement.

(4) §2510.3-40(b)(2)(iii).

(iii) Participants on extended coverage under the plan pursuant to
the requirements of a statute or court or administrative agency
decision, including but not limited to the continuation coverage
requirements of the Consolidated Omnibus Budget Reconciliation
Act of 1985, sections 601-609, 29 U.S.C. 1169, the Family and
Medical Leave Act, 29 U.S.C. 2601 et seq., the Uniformed Services
et seq., or the National Labor Relations Act, 29 U.S.C. 158(a)(5);

This is a detailed inclusion of those on extended coverage mandated by law, such as
through exercise of COBRA rights. We understand that individuals on COBRA coverage count
ward the 85% requirement regardless of whether they were nexus or non-nexus participants
during their active service.

(5) §2510.3-40(b)(2)(iv).

(iv) Participants who were active participants and whose coverage
is otherwise extended under the terms of the plan, including but not
limited to extension by reason of self-payment, hour bank, long or
short-term disability, furlough, or temporary unemployment,
provided that the charge to the individual for such extended
coverage is no more than the applicable premium under section 604
of the Act;

This provision includes formerly active participants who have other extended coverage,
such as those on disability or layoff, as long as any charge for extended coverage does not
exceed the allowable COBRA cost. As noted in E(4) above, we understand that individuals in
this classification count toward the 85% requirement regardless of whether they were nexus or
non-nexus participants in their active service.

(6) §2510.3-40(b)(2)(v).
(v) Participants whose coverage under the plan is maintained pursuant to a reciprocal agreement with one or more other employee welfare benefit plans that are established or maintained under or pursuant to one or more collective bargaining agreements and that are multiemployer plans;

This provision allows coverage, through reciprocal agreement, of participants under other multiemployer plans.

(7) §2510.3-40(b)(2)(vi).

(vi) Individuals employed by:

(A) An employee organization that sponsors, jointly sponsors, or is represented on the association, committee, joint board of trustees, or other similar group of representatives of the parties who sponsor the plan;

(B) The plan or associated trust fund;

(C) Other employee benefit plans or trust funds to which contributions are made pursuant to the same agreement described in paragraph (b)(3) of this section; or

(D) An employer association that is the authorized employer representative that actually engaged in the collective bargaining that led to the agreement that references the plan as described in paragraph (b)(3) of this section;

This is a description of union-related employees of employee organizations, union affiliated plans and other entities with sufficient nexus to be considered union members for purposes of evaluating the plan.

(8) §2510.3-40(b)(2)(vii).

(vii) Individuals who were employed under an agreement described in paragraph (b)(3) of this section, provided that they are employed by one or more employers that are parties to an agreement described in paragraph (b)(3) and are covered under the plan on terms that are generally no more favorable than those that apply to similarly situated individuals described in paragraph (b)(2)(i) of this section;

This provision includes former core union participants who have transferred to other employment with an employer that is a party to an applicable CBA, provided that their participation is no more favorable than the terms applicable to similarly situated active union employees described in §2510.3-40(b)(2)(i).
§2510.3-40(b)(2)(viii).

(viii) Individuals (other than individuals described in paragraph (b)(2)(i) of this section) who are employed by employers that are bound by the terms of an agreement described in paragraph (b)(3) of this section and that employ personnel covered by such agreement, and who are covered under the plan on terms that are generally no more favorable than those that apply to such covered personnel. For this purpose, such individuals in excess of 10% of the total population of participants in the plan are disregarded;

This provision includes non-nexus participants employed by an employer bound by, and having union members covered by, an applicable collective bargaining agreement, subject to two conditions. First, the coverage cannot be more favorable than that applicable to employees covered by the CBA; and second, up to but no more than 10% of the total number of participants in the plan can be included in this category and treated as nexus participants in determining the 85% to 15% limit even though they are and always have been non-nexus participants. See Example 1 in the DOL regulation. Any additional non-nexus participants in this category are counted in determining compliance with the 85% to 15% ratio.

§2510.3-40(b)(2)(ix)-(x).

(ix) Individuals who are, or were for a period of at least three years, employed under one or more agreements between or among one or more “carriers” (including “carriers by air”) and one or more “representatives” of employees for collective bargaining purposes and as defined by the Railway Labor Act, 45 U.S.C. 151 et seq., providing for such individuals’ current or subsequent participation in the plan, or providing for contributions to be made to the plan by such carriers; or

(x) Individuals who are licensed marine pilots operating in United States ports as a state-regulated enterprise and are covered under an employee welfare benefit plan that meets the definition of a qualified merchant marine plan, as defined in section 415(b)(2)(F) of the Internal Revenue Code (26 U.S.C.).

These are special provisions for inclusion of “carriers,” “representatives,” and “licensed marine pilots.”

F. Scope of Comments.

Based on the foregoing, these Comments address the “separate” fund requirement in §419A(f)(5), as requested in Notice 2003-24, both in terms of the extent to which individuals who are not currently active union members may be included and the extent to which an actual separate fund is required. These Comments also briefly address disposition of the existing
temporary regulation and suggest the need for clarity and appropriate transition rules. These Comments do not otherwise address guidelines for determining the validity of a collective bargaining arrangement, leaving that topic for possible treatment when the proposed regulations are issued.

G. **Underlying Policy Reasons Supporting Comments.**

These Comments are based on the premise that, assuming the existence of a bona fide collective bargaining arrangement, a welfare benefit fund under a collective bargaining agreement within the meaning of §419A(f)(5) should be permitted to include a variety of participants other than active union members without being required to have an actual separate fund or separate accounting, provided that those non-union participants fit within one or more selected categories and, in some cases, satisfy certain other conditions. The following are some of the policy reasons that support this premise and the specific comments and recommendations:

1. **Benefits Not Available.**

   In many cases, the benefits provided through a welfare benefit fund are simply not otherwise available for nexus employees who work with or provide services to the collectively bargained employees or previously worked with those employees, such as employees of the employee organization, the plan or a related plan, or to non-nexus employees of a participating employer. Participation in the welfare benefit fund is the only means of obtaining comparable benefits for those individuals.

2. **Unreasonable Cost.**

   Similarly, the benefits provided by a welfare benefit plan may be available for nexus or non-nexus employees but only at excessive and unreasonable cost and therefore, can be obtained at reasonable cost only through the plan.

3. **Separate Funds or Separate Accounting Burdensome and Impractical.**

   Rules that provide a reasonable opportunity to avoid separate plans or separate accounting will greatly facilitate plan administration and reduce administrative costs and burdens. In addition, maintenance of separate plans or separate accounting may defeat the underwriting economies that are achieved for union-related and non-nexus participants by inclusion in the same plan.

   While we advocate that separate accounting should be the equivalent of maintaining separate plans, as it is for purposes of §419A(f)(6), separate accounting appears to be difficult and costly, and perhaps even impossible in many situations. It will result in a need for separate and ongoing actuarial analysis. It will require difficult and costly monitoring and tracking as individuals shift between union and non-union status. Indeed, separate accounting may be impossible for the plan when shifts between union and non-union status occur many times during a year or in certain industries in which the plan must depend on employer reporting for necessary information.
(4) Taft-Hartley Plans.

The safeguards in the Taft-Hartley Act should qualify Taft-Hartley plans under §419A(f)(5) without the need for separate accounting or actual separation of funds for union-related and non-nexus participants. Taft-Hartley plans are structured in accordance with Section 302(c)(5)-(9) of the Taft-Hartley Act, 29 U.S.C. 186(c)(5)-(9). Under these requirements, the fund must be for the sole and exclusive benefit of the employees of the contributing employer or employers and their families and dependents and payments from the fund must be for specified welfare, pension and other benefits. Employers and employees must be equally represented in the administration of the fund. A written agreement must specify the detailed basis on which benefit payments are to be made. Annual audits are required. Employer contributions to the fund that are not compliant with the allowable purposes and restrictions are subject to criminal sanctions. Therefore, there is virtually no risk of excess contributions by any participating employer in a Taft-Hartley plan. In fact, we believe that the IRS’ concern is centered on bogus union plans, generally established by smaller employers, and not on Taft-Hartley plans.

(5) Reliance on Temporary Regulation and DOL Regulation.

As emphasized several times in these Comments, special consideration is needed for plans that have relied upon and substantially complied with the temporary regulation, some since 1985, or the DOL regulation since proposed in 2000.

(6) Other Restraints on Abuses.

The proposed and final regulations should deal with potentially abusive plans by means other than restrictive limitations on inclusion of nexus, alumni and non-nexus participants. While sham union plans may include non-union participants, it is more likely that all participants will be members of the purported union. On the other hand, bona fide collectively bargained plans would be unduly penalized by inflexible restrictions on inclusion of union-related, alumni and non-nexus participants.

II. Separate Fund: Who May Be Participants?

The proposed regulations under §419A(f)(5) must address whether individuals who were previously union members but who are no longer active union members whose employment and entitlement to or accrual of benefits is governed by an applicable collective bargaining agreement may be included in or must be excluded from a welfare benefit fund in order for the fund to qualify for the exemption. Also, the proposed regulations must address the extent to which individuals who have never been subject to an applicable collective bargaining agreement may be entitled to benefits provided through the welfare benefit fund. We believe on the basis of our own knowledge and reliable anecdotal evidence that there are many plans covering collectively bargained employees with additional participants who are no longer active union
participants and participants who have never been subject to a CBA. We also think that inclusion of union-related, alumni and non-nexus participants in a collectively bargained plan pursuant to reasonable standards and without the need for separate accounting is supported by the temporary regulation, the DOL regulation and other flexible rules such as the VEBA regulations treating nexus and alumni employees as union employees and allowing up to 10% of participants in a VEBA to be non-employees. We have also concluded that Parker-Hannifin does not prevent such inclusion. The discussion and recommendations with respect to coverage of individuals in this Section II (see II. B-H below) reflect our view that participation by such individuals should not require separate accounting. The discussion and recommendations concerning separate accounts in Section III below are intended to apply only to the degree that our views, as expressed in this Section are not adopted or, if adopted, are not met by the fund in question.

A. Additional Background and Discussion.

(1) Validation of Issue.

In addition to those contributing to these Comments, several other attorneys whose practices address collectively bargained plans provided background information. Based on the experience of the principal contributors and the information provided by others, the existence of welfare benefit funds providing benefits, not only to union but also to union-related and non-nexus participants is fairly common. We are aware of situations in which a welfare benefit fund established by a single employer (or related group) provides benefits for both union and other participants. In addition, we are aware of circumstances in which multiemployer collectively bargained welfare benefit funds allow inclusion of non-nexus employees on a basis equal to or not more favorable than for union participants. Multiemployer plans and large single employer plans also may provide benefits to employees of the union, staff of the plan or trust, and even staff of a related program such as a retirement plan, or other nexus employees. It has been confirmed to us by what we consider reliable sources that substantial numbers of these plans do not maintain separate funds or separate accounting.

We therefore believe, as suggested in Notice 2003-24, that there are a substantial number of existing welfare plans that cover union, union-related and non-nexus employees without separate funding or accounting. Accordingly, there is a critical need for guidance in this area that is clear and flexible and accommodates existing arrangements and, to the extent the proposed and final rules are more restrictive than current practices, provides reasonable transition rules. We also understand that there are plans that have operated for years in substantial compliance with the temporary regulation and/or with the proposed DOL regulation. This history should be accorded full consideration in developing proposed regulations, and the potential disruption in plan structure and administration that would result from sudden imposition of significantly more restrictive rules should be recognized.
The temporary regulation quoted above, issued long before the decision in Parker-Hannifin, stated that, pending issuance of final regulations, an existing welfare benefit fund would be considered to be maintained pursuant to a collective bargaining agreement if at least 50% of the employees eligible to receive benefits under the fund were covered by an applicable collective bargaining agreement. However, the temporary regulation also specified that a plan would cease to be treated as a collectively bargained welfare benefit fund if and when, after July 1, 1985, the number of non-collectively bargained participants eligible to receive benefits increases due to amendment, merger or other action of the employer or the fund. Moreover, welfare benefit funds established after July 1, 1985 are treated in the temporary regulation as maintained pursuant to a collective bargaining agreement only if at least 90% of the employees eligible to receive benefits from the fund are covered by an applicable collective bargaining agreement. Finally, in all cases, the temporary regulation treats only the portion of the fund (determined under allocation rules to be provided by the IRS) attributable to employees covered by a collective bargaining agreement as being maintained pursuant to a CBA.

We believe, again on the basis of direct experience and reliable information, that most plans purporting or attempting to comply with the temporary regulation actually fail some element of compliance. Literally applied, the rules in the temporary regulation, at least for plans in effect before July 1, 1985, and perhaps for all plans subject to the rule, result in failure if a single additional employee not covered by a collective bargaining agreement becomes eligible to receive benefits from the fund by reason of an amendment, merger or other action of the employer or the fund. This appears to be true for plans in existence on or before July 1, 1985, even if after the increase in non-collectively bargained participation the plan nevertheless complies with the 90% threshold for plans not in existence on July 1, 1985. It is probable that increases in non-collectively bargained participation have occurred without realization that this rule was violated or without any practical means of avoiding it.

In addition, the separate accounting rule of the temporary regulation has not been followed by many funds simply because it is extremely difficult or impossible to follow for the reasons set forth in I. G(3) above.

(3) **Distinguish Parker-Hannifin.**

In connection with the following discussion in this Section II and the discussion in Section III, we suggest that the Parker-Hannifin case does not mandate establishment of a separate fund or separate accounting simply because the fund covers some who are not active union participants. The court notes at the outset that the applicable bargaining agreements did not require the establishment of a welfare benefit fund for providing the benefits and that the employer never notified any of the unions or the union employees of the existence of the fund or of its contributions to the trust for union medical benefits. Moreover, the court in Parker-Hannifin addressed only the facts before it and the arguments presented by the parties. In that case, union employees represented only about 6.5% of the total covered employees. The employer argued that it was sufficient that the benefits for union employees were required under
the applicable collectively bargained agreements and that the employer elected to provide those benefits through the use of a welfare benefit fund. The court rejected that argument as completely obviating the word “separate” in the statute. The employer also argued that the separate fund language required only that assets be set aside from the employer’s general assets and beyond the reach of its creditors. The court rebuffed that argument as also rendering the separate fund requirement mere surplusage.

The court in Parker-Hannifin was not presented with a situation in which the number of union employees was predominant or participation by non-union employees was subordinate to the collectively bargained arrangement. It was not presented with a situation in which a separate accounting or separate subtrusts had been maintained. In fact, the court could have avoided the separate fund issue altogether by simply extending its primary conclusion in the case that no separate reserves were established or maintained and that all dollars contributed were part of a pool of funds for payment of current benefits of all participants. In other words, the court in Parker-Hannifin was not challenged to consider whether either a relatively small participation by non-union employees or separate accounting could be consistent with the requirement of maintaining a separate fund. The court certainly did not address coverage of alumni and others with and without significant union nexus. We conclude, therefore, that the IRS and Treasury have considerable latitude in interpreting the statute beyond the narrow context of Parker-Hannifin and should not be unduly constrained by that case. The impact of the decision should be limited to its facts.

(4) **DOL Regulation.**

The DOL regulation addresses at length participants who should be treated as collectively bargained employees. While we see some relatively minor disadvantages in doing so, those contributing to these Comments strongly argue that the advantages of adopting the DOL regulation or a high degree of consistency with the applicable components of the DOL regulation, as the standards for the regulations under §419A(f)(5), outweigh the disadvantages. Before addressing the DOL regulation and providing some commentary on that guidance, however, we have elected to first provide comments and recommendations that we would make in the absence of the DOL regulation. The DOL regulation is addressed in II. F below.

(5) **Union Participants.**

In making these Comments, it is assumed that participation by employees covered by and entitled to benefits or benefit accruals pursuant to an applicable collective bargaining agreement, and their covered dependents and beneficiaries, are the basic or core population of union participants supporting the determination that the plan or fund is collectively bargained. These Comments primarily address the extent to which others may be participants without causing loss of collectively bargained status for purposes of §419A(f)(5). All references to other individuals also include their eligible dependents. As in the DOL regulation (see Example 1 in the DOL regulation), dependents and beneficiaries should not be counted in applying any percentage or other numerical limits or tests.
These Comments assume and do not discuss the presence of bona fide collective bargaining and a valid collective bargaining agreement. We assume that all issues related to those requirements will be addressed in the proposed regulations independently of the matters in these Comments. The issues concerning inclusion of non-core participants, separate accounting and separate and distinct funds are discussed in these Comments on the assumption that it has been determined that all applicable collective bargaining agreements are valid and arise from a bona fide collective bargaining process. To the extent that the proposed and final regulations under §419A(f)(5) include bright line tests relating to coverage of non-core participants or reference such coverage as an indicator that the plan does not meet the requirements of §419A(f)(5), there should be consistency and coordination with the rules discussed in these Comments that apply when the validity of the collective bargaining process and the resulting agreement is not in question.

We advocate that the final rules can and should tolerate significant percentages of nexus, alumni and non-nexus participants as long as their benefits cannot be more favorable in any respect than those provided to similarly situated union participants. This condition should be coupled with adequate safeguards preventing benefits ostensibly available to all participants but having more favorable criteria applicable or more likely to be applicable only to participants who are not collectively bargained employees.

We encourage the IRS to address this issue, and we assume in this connection that the proposed and final regulations will prohibit benefits that favor owners and other management and highly compensated participants. We believe that such regulations will address the heart of the Treasury and IRS concerns and encourage the Service to continue to address truly abusive situations.

B. Nexus Participants.

(1) Issue.

Beyond core participants, large single employer plans and multiemployer plans often provide coverage to an extended group of individuals who are not covered by an applicable CBA, but instead are employed by an employee or employer organization or a similar related association or entity, or by the plan or trust or a related plan or trust, such as a qualified retirement plan. Typically, these union-related or nexus individuals participate in the plan on the same basis as similarly situated union participants.

(2) Comment.

Nexus participants should not be distinguished from collectively bargained participants who are covered by an applicable CBA and should be treated as part of the collective bargaining population of the plan or fund if they participate in the plan on a basis that is not more favorable than for collectively bargained employees.
With respect to qualified retirement plans, §413(b)(8) provides that employees of the employee representative (i.e., the union) who are retirement plan participants are treated as being covered under the retirement plan pursuant to a CBA if the group of employees of the union who are covered under the plan satisfy the requirements of §§401(a)(4) and 410(b). Treas. Reg. §1.413-1(i) further provides that the applicable retirement plan and any affiliated health or welfare plan are deemed to be employee representatives for purposes of these rules; that is, employees of these entities may participate in the plan on the same basis as employees of the union. In addition, the regulations specify that an affiliated health or welfare plan includes any plan maintained pursuant to the same CBA as the relevant retirement plan and covering the same membership. These rules recognize that employees of the union and of related plans should be treated in the same manner as union members for purposes of coverage under a retirement plan if they are covered under the retirement plan on a basis that is no more favorable than for similarly situated union members. The same standard should apply with respect to a welfare benefit fund. There is no reasonable policy or legal basis for a distinction between qualified and welfare plans. While the pension regulations do not address employer representatives, we believe, consistent with the DOL regulation, that allowable coverage also should extend to employees of any related employer association or organization that represents employers in the collective bargaining process. The DOL regulation is much more recent than the regulations under §413 and is more analogous to the collective bargaining exemption under §419A(f)(5). See II. F below.

Another similar analogy is found in the membership rules in the VEBA regulations. Treas. Reg. §1.501(c)(9)-2(a)(1) defines eligible employees in that context as including employees of a union or VEBA.

(3) **Recommendation.**

We recommend that the proposed regulations liberally permit, without requiring establishment of a separate account or fund, participation by individuals who have nexus to the welfare benefit fund through an employee organization or other related organization or entity, a plan or trust fund established and maintained under the same or a related CBA, or a related employer association or organization, provided that they participate in the plan on terms that are not more favorable than the terms for similarly situated participants covered by a CBA or on terms that are otherwise demonstrated to be nondiscriminatory with respect to other employees of the union or the applicable fund or organization.

C. **Alumni.**

(1) **Issue.**

Employees covered by a collective bargaining agreement frequently move from current, active employment covered by the CBA to another status. In some cases, these “alumni” remain eligible for one or more benefits provided through the welfare benefit fund or perhaps even continue to accrue benefits. The most common of these situations may be union members who retire and are eligible for retiree benefits. Other common examples include termination of employment prior to normal or early retirement age, perhaps with continuation of benefits
available through COBRA or otherwise for a limited period, or transfer to employment not covered by the collective bargaining agreement. The latter includes promotion to foreman, supervisor or other status specifically excluded in the CBA, promotion or transfer to other non-union employment within the company that is not addressed in the CBA or transfer to employment with the union, the welfare benefit fund or a retirement plan or another welfare benefit fund affiliated with the union. In some cases, individuals may transfer back and forth, sometimes frequently, between union and non-union status. When a participant moves from one covered classification to another – e.g., from core to nexus employment eligible to continue participation – we do not consider that individual to be an alumnus, just a continuing participant.

In addition to former collectively bargained participants, we have defined the term “alumni” to include any individual who was formerly an allowable participant in the plan or fund and has retired or otherwise terminated employment or transitioned to employment not covered by the plan and who either continues to accrue benefits or remains entitled to benefits. This includes those who are no longer in the employment status that initially entitled them to participation but who have a right to extended coverage under an applicable law, such as COBRA coverage, or on some other basis or under a bargaining agreement provision.

The issue, therefore, is whether former participants who continue to accrue or remain eligible for benefits from the welfare benefit fund even though in an alumni status give rise to the need for a separate fund or separate accounting within a fund in order to qualify for the exception of §419A(f)(5). We don’t think so.

(2) **Comment.**

Alumni who are continuing to earn benefits or are entitled to benefits from the collectively bargained welfare benefit fund solely by reason of their former participation should not be distinguished from collectively bargained participants and their coverage should not require the establishment of a distinct fund or separate accounting. We find no reason why alumni should be impacted by or should affect the requirement of a separate collectively bargained fund. This result is also supported by Treas. Reg. §1.501(c)(9)-2(b) of the VEBA regulations which broadly include various alumni as employees for VEBA purposes, and by the DOL regulation.

(3) **Recommendation.**

Accordingly, we recommend that the proposed regulation should define categories of participants for whom no separate fund or separate accounting is required to include all alumni, as we have defined that term, who are entitled to current or future benefits from the fund, even if subject to some reasonable conditions and limitations.
D. Non-Nexus Participants.

(1) **Issue.**

As noted, it is clear that there are and will continue to be substantial numbers of collectively bargained welfare plans that cover some participants who have never been union members or even in a union-related status. For example, an employer with a large collectively bargained workforce that also employs some non-union salaried and hourly-paid employees, may find it most cost efficient to provide welfare benefits for all employees under one plan. Therefore, there is a critical issue, distinct from the nexus and alumni issues, of whether some non-nexus participation will cause a welfare benefit fund to cease to be “separate” and maintained “under” a CBA.

(2) **Comment.**

We advocate allowing a significant level of non-nexus participation and favor a broad and flexible tolerance for non-nexus participation if reasonable conditions and limits are met. The allowable ratio of non-nexus participants should be up to 15% to coordinate with the level permitted in the DOL regulation.

While we urge, as discussed in Section III below, that separate accounting for two or more portions of a fund should qualify each part as a separate fund, we believe that if there is a reasonable tolerance threshold for non-nexus participants, such as up to 15%, and if the benefits for non-nexus participants are the same or not more favorable than for similarly situated union participants, then there should be no requirement of a separate accounting or allocation.

We suggest that a reasonable inclusion of non-nexus participants is not only supported by compelling reasons and by the DOL regulation but is also supported by the analogous VEBA rules cited in the two preceding sections. See II. B, C.

In connection with the foregoing, we note that in the context of a multiemployer qualified plan and identification of excludable collectively bargained employees under §410(b), there is a 5% limit on nexus, alumni and non-nexus employees. See Treas. Reg. §1.410(b)-6(d)(2)(ii)(D). However, in view of the history of §419A(f)(5), including the temporary regulation, and the DOL regulation, we think that the allowable tolerance of non-nexus employees in the first instance, and without regard to alumni status, should be substantially higher than 5% for §419A(f)(5).

(3) **Recommendation.**

We strongly recommend allowing a significant level of non-nexus participation. We further recommend that the level should be up to 15% of plan participants. Moreover, we urge the IRS and Treasury to consider that as long as the benefit and/or cost structures for non-nexus participants are identical or not more favorable than for similarly situated union members, there should be no need for a separate accounting for non-nexus participants. We contend that non-
nexus participation up to 15%, coupled with a requirement that non-nexus participants receive no more favorable benefits than those provided to similarly situated union participants, establishes reasonable conditions obviating the need for requiring a separate welfare benefit fund under a collective bargaining agreement. (Note: In choosing the 15% level we are aware that the DOL regulation allows up to 10% of non-nexus participants to be counted as nexus participants in applying the 15% limit on non-nexus participants. It is not our intent to be more restrictive in our recommendation than the DOL regulation. See also I. E(9) and II. F(2)).

E. Grandfathering Under Temporary Regulation.

(1) **Issue.**

If the requirements for collective bargaining status under §419A(f)(5) are ultimately more restrictive than the requirements in the temporary regulation, plans in effect on or before July 1, 1985 that have maintained compliance with the 50% requirement in the temporary regulation, and perhaps even plans established after July 1, 1985 that have maintained compliance with the 90% standard in the temporary regulation, will cease to qualify unless there is an exception or an extension of the applicable rule of the temporary regulation.

(2) **Comment.**

Although phased transition rules and forced separation or separate accounting can address this situation, we believe it is a better solution to allow plans in existence prior to publication of Notice 2003-24 on May 5, 2003, that have at all times complied with the applicable requirements of the temporary regulation, to continue to qualify as collectively bargained plans. As noted in A(2) above however, it is very likely that many plans have inadvertently failed to comply with the requirements of the temporary regulation, or have complied with all of the requirements of the temporary regulation other than separate accounting. Recognizing that widespread loss of collectively bargained status for these purposes would be undesirable, one possible approach could be a “fresh start” under the new regulations for relatively minor violations of percentage limits and limits on any subsequent increase in the number of non-union participants due to merger or other employer or fund action. At the same time, we do not believe the failures justify the adoption of expensive or complicated solutions. To the extent that separate accounting is not required in the proposed and final regulations under §419A(f)(5), past separate accounting failures could be ignored or at least the plans could also be given the opportunity for prospective validation notwithstanding prior noncompliance.

(3) **Recommendation.**

The proposed and final regulations should incorporate and continue the 50% grandfathering rule in the temporary regulation for plans in existence on or before July 1, 1985 and should similarly extend and continue, if necessary, the 90% rule in the temporary regulation for plans established after July 1, 1985 and before May 5, 2003. In addition, we strongly recommend some reasonable flexibility and accommodation of past noncompliance with the temporary regulation. Finally, we recommend a reasonable transition rule for any plan that
qualifies for this grandfathering treatment when the final regulations are issued and subsequently fails to meet the applicable limitation.

F. **DOL Regulation.**

As noted above, while the exception for collectively bargained plans in §3(40)(A) of ERISA is not directly related to the exception in §419A(f)(5), there are substantial advantages to the administration of collectively bargained plans if the standards for each of these exceptions are the same or very closely coordinated. In addition, there are striking symmetries between the rules in that both provide exceptions for collectively bargained plans from otherwise significant consequences and both are intended to recognize and validate the restraints that derive from bona fide adversarial bargaining between independent parties. Both have the purpose, expressly stated in the preamble to the DOL regulation, of excluding bogus and sham unions. Moreover, the DOL regulation has the added strength of negotiated rulemaking in addition to public comment.

(1) **Issue.**

In formulating proposed regulations, the IRS and Treasury must consider whether to adopt the DOL regulation verbatim or to a very substantial extent or whether differences in the statutory purpose and language, as well as the complexities and negotiated special provisions of the DOL regulation mandate a substantial departure from the DOL regulation for the regulations under §419A(f)(5). This decision must be made with respect to the entire DOL regulation but can be made separately with respect to components of it, including subsection (b)(2) relating to participation requirements.

(2) **Comment.**

As also noted above, we generally conclude that the advantages of identical standards, which manifest primarily in reduced administrative burdens and confusion for affected funds, as well as coverage at affordable cost for those who otherwise might not be covered, strongly favor adoption of at least the participation requirements and tolerances of subsection (b)(2) of the DOL regulation. If adoption of that portion of the DOL regulation verbatim is not acceptable to the IRS and Treasury, then as much as possible should be adopted with utilization of identical terminology to the extent possible. If verbatim or substantial adoption of subsection (b)(2) of the DOL regulation is not possible as the general standard for the proposed and final regulations under §419A(f)(5), compliance with subsection (b)(2) of the DOL regulation, to the extent applicable, subject to any additional conditions imposed by the IRS and minus any part the IRS deems objectionable, should be considered as a possible safe harbor, or at least creating a rebuttable presumption that the plan will qualify without requiring separation or separate accounting.

In making these Comments and the following recommendation, we are mindful that the purpose here is to determine the boundaries of plans that will qualify for exemption from tax deduction limitations and we fully understand that the exception in §3(40)(A) of ERISA does not include the word “separate.” Nevertheless, we believe that the purpose and intent of each of
these provisions – to exclude collectively bargained plans from certain limits or requirements – is substantially the same and that virtually identical parameters are therefore justified. If there is an omission, error or shortcoming in the DOL regulation that becomes apparent, then that problem should be addressed and resolved in the proposed and final regulations under §419A(f)(5) even though a difference from the DOL regulation results. As noted at the outset, we view some parts of subsection (b)(2) of the DOL regulation as more restrictive than necessary for §419A(f)(5) (see II. E(3)), and we recognize that the DOL regulation applies only to plans covering employees of two or more unrelated employers. But overall, we believe that there is a substantial benefit from parallel rules and that there should be as much identity as possible.

Like the temporary regulation, it is probable that many plans have conformed to the DOL regulation as initially proposed and continue to comply with the final DOL regulation. To impose a new and more stringent standard under §419A(f)(5) will result in unnecessary confusion and add undue complexity to plan administration with no significant gain in compliance or curtailment of improper plans. It may mean that coverage is not otherwise available at a reasonable cost or even at any cost for excluded nexus and non-nexus participants. If more restrictive rules are imposed, both grandfathering and liberal transition guidance should be considered.

Our recommendation of verbatim adoption or adoption of the substance of the DOL regulation recognizes that there are some minor drawbacks to the DOL rule. It may be more lengthy and complex than necessary. On the other hand, in the MEWA context, it necessarily addresses plans covering employees of multiple unrelated employers to the exclusion of plans of single employers and related employers. Adaptation of the DOL rules to those plans may be necessary and may require additional rules or limitations. The service requirements for retirees appear unduly restrictive. If subsection (b)(2)(vii) set forth on page 12 above limits non-nexus participants to persons who once were covered by an applicable CBA, we disagree with that limitation. Finally, we note again the mechanism of allowing non-nexus participants up to 10% of the total participants to be counted as nexus participants in applying the 85% to 15% limitation. The result is that the acceptable level of non-nexus participation is actually higher than 15%, and we recommend a tolerance level for non-nexus participants that is at least as high as is permitted in the DOL regulation. See also I. E(9) and II. D(3).

(3) **Recommendation.**

We strongly recommend adoption of subsection (b)(2) of the DOL regulation as the standard for collectively bargained funds that will not require a separate fund or separate accounting with respect to any participants. If that recommendation is not acceptable, we recommend adoption of as much as possible, with identical terminology, of subsection (b)(2) of the DOL regulation or inclusion of the DOL regulation with appropriate modifications as an alternative safe harbor or as at least creating a favorable but rebuttable presumption. Finally both grandfathering and transition rules should be provided, if necessary.
G. Taft-Hartley Plans.

(1) **Issue.**

We recognize that there are very significant differences between Taft-Hartley plans and others. In Taft-Hartley arrangements, which can be single employer or multiemployer, the plan is not just negotiated but is an entity in itself and subject to joint labor-management administration and control. See I. G(4) above. On the other hand, a welfare benefit plan or fund of a single employer (or related group) may be entirely subject to management, control and administration by the employer with no input or oversight by union participants or managers, as long as it provides the benefits agreed to in the CBA. In formulating proposed and final regulations under §419A(f)(5), the IRS and Treasury will have to determine whether different or additional rules should be imposed on such employer-controlled plans and whether fewer, more liberal rules will suffice for Taft-Hartley plans in which the validity of the collective bargaining process is not in doubt and in which there is ongoing joint control and administration, including approval and control of participation and the terms and conditions of that participation.

(2) **Comment.**

In Taft-Hartley plans, there are so many required features and controls present and so many safeguards resulting from joint management and control that it would seem highly appropriate to have both fewer and more liberal guidelines for concluding that those plans qualify under §419A(f)(5). Indeed, it may be appropriate to identify Taft-Hartley plans as automatically qualifying under §419A(f)(5). In addition, we note again that the DOL regulation resulted from negotiated rule making with strong participation by Taft-Hartley plans, as well as public comments. However, the DOL regulation was developed entirely in the context of multiple participating employers (i.e., part of the definition of a MEWA), and may not fully address issues arising in single employer plans.

(3) **Recommendation.**

Therefore, we strongly recommend that all of the preceding recommendations be made applicable to Taft-Hartley plans and any other plans that have similar controls and protections. Even if some of the foregoing recommendations are deemed too liberal for plans that do not conform to Taft-Hartley or similar requirements, we recommend that more restrictive rules should not apply to Taft-Hartley arrangements and any other arrangements that are similarly structured. (Note: We conceded at the beginning that we do not have much experience with plans under the Railway Labor Act. Similar considerations may apply to those plans as well.)

H. Post-Transaction Transitional Coverage.

(1) **Issue.**

Following a corporate transaction, such as an acquisition, disposition or merger, where employees transfer employment in connection with the transaction, it is not uncommon that the employer of the transferred employees will wish to leave certain existing employee benefits
arrangements in place for a period of time. This decision may be driven by employee relations concerns, e.g., the desire not to interrupt coverage mid-year, cost or administrative concerns, e.g., the need for additional time to arrange for a transfer of coverage to the new employer’s plan(s), or both.

Typically, the parties to the corporate transaction agree that the transferred employees may continue to be covered under the plan for a transition period on the same basis as they were covered before the transaction or taking into account any changes implemented by the transferor for non-transferred participants. The transition period may extend until the end of the plan year in which the corporate transaction occurs or the end of the subsequent year. For a welfare benefit plan, it would be extremely unlikely for the transition period to be longer, since a longer period would result in being a “Multiple Employer Welfare Arrangement” under ERISA, with all the related requirements and loss of ERISA preemption, and would require the plan to file a Form M-1, Annual Report for Multiple Employer Welfare Arrangement, with the Department of Labor.

In addition, the parties to the transaction generally agree that the transferee employer will bear the cost of the continued coverage for the transferred employees. The accounting for these costs, however, may not be sufficiently formal to be considered a separate accounting.

In the case of a single employer plan that was considered collectively bargained under general rules prior to the corporate transaction and that covers transferred employees for a transition period after the transaction, most often the plan will continue to be considered collectively bargained under the general rules even during the transition period. In limited cases, however, such as where the group of transferred employees consists disproportionately of non-union, hourly paid employees, any general rules may not be satisfied with respect to all or a portion of the transferred employees if they are considered on their own.

(2) Comment

Section 410(b)(6)(C) and regulations thereunder recognize that there is a need for a transition period following a corporate transaction in which the nondiscrimination rules for qualified retirement plans will not apply in the usual manner, provided that there is no significant change in coverage or benefits (other than as a result of the transaction) under the plans that utilize the transition rule. Similarly, Form M-1 and its instructions provide that an M-1 need not be filed when, following a corporate transaction that occurred for business purposes, the employees of two or more employers are covered under a welfare plan as a result of the transaction for a temporary period extending no longer than the end of the plan year following the plan year in which the transaction occurred. Both of these rules acknowledge that employers that transfer employees pursuant to a corporate transaction may need time, for bona fide business reasons, to arrange alternative coverage for the transferred employees, and that these situations generally do not provide significant opportunities for abuse. Similar transition rules are needed for proposed regulations under §419A(f)(5).
(3) **Recommendation.**

Assuming that the proposed regulations include rules similar to those we have advocated above that would allow collectively bargained participants and certain classes of nexus and non-nexus participants to be covered under a collectively bargained welfare benefit plan without the need for separate accounting, we further recommend that the regulations should set forth a reasonable transition rule that would not require separate accounting for transferred employees for limited periods following a corporate transaction. The transition rule should apply to participants affected by the transaction for whom no separate accounting was required before the corporate transaction but for whom separate accounting would be required post-transaction absent the transition rule. The transition period should be permitted to continue until the end of the plan year subsequent to the year of the transaction, provided that the benefits for the affected participants remain the same as before the transaction or are the same as for similarly situated participants who were not affected by the transaction.

### III. Separate Fund: Separate Accounting or Allocations

#### A. Additional Background

The temporary regulation under the original version of §419A(f)(5) allowed only the portion of the fund attributable to union employees (determined under allocation rules to be provided by the IRS) to qualify for the exemption. Assuming that alumni and others described in Section II above are considered to be allowable participants in a fund, the comments and recommendations in Section II above urge establishment of an acceptable level of nexus, alumni, and non-nexus participants that may be included in a welfare benefit fund without the need for a separate fund or separate accounting. Those recommendations assume that the benefits provided through the welfare benefit fund derive from bona fide collective bargaining by adversarial parties and that the fund does not provide more favorable benefits for nexus, alumni and non-nexus employees than for similarly situated union participants. If a fund fails those requirements or exceeds a maximum allowable level of participants other than collectively bargained participants, the temporary regulation appears to support a concept of separate accounting or separate allocation as an adequate separation under §419A(f)(5).

The term “welfare benefit fund” is defined in §419(e) as any fund that is a medium for providing welfare benefits. “Fund” is broadly defined to include any organization described in paragraphs (7), (9), (17), or (20) of §501(c); any taxable trust, corporation or other organization; and, to the extent provided in regulations, any account held for an employer by any person. Temporary regulation §1.419-1T, Q&A-3 reflects this broad statutory definition.

There are many employee benefits arrangements in which a single trust or other funding vehicle serves multiple plans as long as adequate separate accounting is maintained. One example of this is a master trust for qualified plans under which multiple unrelated plans pool assets for investment but maintain separate accounting by plan. Also in the qualified plan...
context, regulations under §414(l) specify that a plan will not fail to be a single plan if all plan assets are available for benefits to employees and beneficiaries covered by the plan and separate accounting is not maintained for benefit payment purposes. See §1.414(l)-1(b)(1) and §1.414(l)-1(c)(1)(ii). Separate accounting for benefit purposes, therefore, connotes that there are separate plans. Similarly, a key feature of the proposed regulations under §419A(f)(6) is that separate accounting can establish that there are separate plans.

B. **Issue.**

The issue, therefore, is whether a fund can qualify as a “separate welfare benefit fund” for purposes of §419A(f)(5) through separate accounting even though maintained in a single trust or other funding vehicle, and even though assets are commingled for investment and administrative purposes, as long as separate accounting or allocation is maintained for the portion of the fund attributable to the collective bargaining agreement or agreements.

C. **Comment.**

If a welfare benefit fund does not comply, or subsequently fails to comply, with ultimate guidance allowing participation by nexus, alumni and non-nexus employees pursuant to reasonable standards without separation or separate accounting, separate accounting within a single trust or funding medium or through a master trust should satisfy the “separate” requirement of §419A(f)(5). In the employee benefits area, sufficient separate accounting should enable a plan, fund or program to be treated as distinct and separate while still achieving the benefits and economies of commingling for investment and administrative purposes. We believe that this view is validated by Q&A-2 of the temporary regulation. Furthermore, we believe that it is entirely consistent with the purpose of §419A(f)(5) and we know of no reason beyond the most narrow interpretation of the word “separate” that suggests separate accounting should not be sufficient. As noted in Section II. C above, the issue of separate accounting was not addressed in *Parker-Hannifin* and, therefore, should not be considered inconsistent with that decision.

D. **Recommendation.**

The temporary regulation references determination of the portion of a fund that is collectively bargained pursuant to allocation rules to be issued by the IRS. In that connection, we believe and recommend that the separate accounting requirements that would qualify under §419A(f)(5) should require a level of separate accounting sufficient to identify the separate percentage and dollar amount of the total assets of a fund attributable to the portion of the fund maintained pursuant to one or more collective bargaining agreements as of each valuation date for the assets of the fund.

To reiterate, we advocate that a fund that includes benefits for nexus, alumni and non-nexus employees subject to reasonable conditions such as those described in Section II above should qualify as a separate welfare benefit fund under a collective bargaining agreement without separate accounting. There are also potential burdens, costs and underwriting issues that
may result from mandated separate accounting as well as the impossibility of accurate separate accounting when participants frequently change status or when the fund must rely on the employer to identify participants in union-related and non-nexus categories. However, to the extent a fund fails the standard established in the proposed and final regulations, or if the IRS and Treasury ultimately determine that there is no tolerance for some nexus, alumni or non-nexus participation in a collectively bargained welfare benefit fund under §419A(f)(5), we strongly advocate that separate accounting should qualify as the establishment of a separate fund.

IV. Transition Rules

If proposed and final regulations under §419A(f)(5) are more restrictive than the requirements in the temporary regulation and do not include the grandfathering or safe harbor recommended in Section II, adequate transition rules should be provided. Transition rules also should be provided for any subsequent failure to satisfy either the general or any grandfathering or safe harbor requirements of the proposed and final regulations.

A. Issue

When and what transition rules should apply to funds and portions of funds intended to qualify under §419A(f)(5) but failing to meet final guidance when issued?

B. Comment and Recommendation

Nonconforming funds should be able to conform to the requirements of §419A(f)(5) by instituting separate accounting. Nevertheless, this will take some time. We therefore, believe that such funds should be allowed at least until the beginning of the second plan year following the year in which the final regulations under §419A(f)(5) are issued to implement the required separate accounting. Where separate accounting has not been maintained in the past, the transition rules also should allow any reasonable initial allocation of assets to the collectively bargained portion of the fund.

If separate accounting is not recognized as sufficient under §419A(f)(5), or is not the solution desired by the affected employers or fund, transition rules should provide an even longer period of time in which to physically separate an existing fund into separate and distinct funds. In this case we recommend a standard not unlike the standard in the temporary regulation, §1.419A-2T Q&A-1, which would require compliance as of the beginning of the third plan year following the issuance of final regulations or, if earlier, the beginning of the first plan year following termination of the last of the collective bargaining agreements relating to the particular fund that is in effect on, or ratified on or before, the date of issuance of final regulations.

We urge these fairly liberal transition rules in recognition of the probability that there are substantial numbers of potentially nonconforming welfare benefits funds, with the percentage of
nonconforming funds increasing if the final regulations are ultimately more restrictive than the separate fund requirements advocated by these Comments.

V. Clarity of Guidance

While clarity of any guidance under the Internal Revenue Code is always an objective, the collective bargaining exception in §419A(f)(5) offers the opportunity to achieve that goal without difficulty and also requires such clarity. We believe that the proposed and final regulations should be constructed with substantial efforts to avoid generalities and ambiguity and to establish clear standards to the greatest extent possible. In that connection, directly and possibly through examples, we urge the IRS to specify both what will and what will not constitute a “separate” fund under §419A(f)(5).

VI. Disposition of Temporary Regulation

Finally, we believe that continued existence of temporary regulation §1.419A-2T will result in confusion and that it should be superceded by the new guidance under §419A(f)(5) and withdrawn. If the IRS and Treasury determine that there is a valid reason for retention of the temporary regulation, then we recommend that a detailed statement distinguishing and limiting the application of the temporary regulation should be included in the proposed and final regulations under §419A(f)(5) and appended to the temporary regulation.
**EXHIBIT A**

**TERMINOLOGY**

<table>
<thead>
<tr>
<th>EMPLOYEE CLASSIFICATION</th>
<th>DESCRIPTIVE TERMS IN COMMENTS</th>
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</thead>
<tbody>
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<td></td>
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<tr>
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<td>Non-union employee or owner of participating employer</td>
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<tr>
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<tr>
<td>Retired – entitled to or receiving benefits</td>
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<tr>
<td>Terminated – COBRA or other rights</td>
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<td>In nonqualifying employment</td>
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<tr>
<td>Former* participant: not union or union-represented:</td>
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<tr>
<td>Retired</td>
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<tr>
<td>Terminated – COBRA or other rights</td>
<td></td>
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<tr>
<td>In nonqualifying employment</td>
<td></td>
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</tbody>
</table>

*A participant who transfers or moves from one covered classification (e.g., coll. barg’d to another) (e.g., employment by union/union org/related plan/employer org or non-union employee or owner of participating employer) is not considered to be a former participant.*