IRS Warns Taxpayers About Certain Trust Arrangements Sold As Welfare Benefit Funds

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WASHINGTON – The Internal Revenue Service and the Treasury Department cautioned taxpayers about participating in certain trust arrangements being sold to professional corporations and other small businesses as welfare benefit funds and identified some of the arrangements as listed transactions.

There are many legitimate welfare benefit funds that provide benefits, such as health insurance and life insurance, to employees and retirees. However, the arrangements the IRS is cautioning employers about primarily benefit the owners or other key employees of businesses, sometimes in the form of distributions of cash, loans, or life insurance policies.

"The guidance targets specific abuses involving a limited group of arrangements that claim to be welfare benefit funds," said Donald L. Korb, Chief Counsel for the IRS. "Today's action sends a strong signal that these abusive schemes must stop."

The guidance explains that, depending on the facts and circumstances, a particular arrangement could be providing dividends to the owners of a business that are includible in the owners' income and not deductible by the business. The arrangement could also be a plan of nonqualified deferred compensation. Even some arrangements providing welfare benefits may have tax consequences different than what is claimed.

In Notice 2007-83, the IRS identified certain trust arrangements involving cash value life insurance policies, and substantially similar arrangements, as listed transactions. If a transaction is designated as a listed transaction, affected persons have disclosure obligations and may be subject to applicable penalties. Taxpayers who otherwise would be required to file a disclosure statement prior to Jan. 15, 2008, as a result of Notice 2007-83 have until Jan. 15, 2008, to make the disclosure.

In Notice 2007-84, the IRS cautioned taxpayers that the tax treatment of trusts that, in form, provide post-retirement medical and life insurance benefits to owners and other key employees may vary from the treatment claimed. The IRS may issue further guidance to address these arrangements, and taxpayers should not assume that the guidance will be applied prospectively only.

Today, the IRS also issued related Revenue Ruling 2007-65 to address situations where an arrangement is considered a welfare benefit fund but the employer's deduction for its contributions to the fund is denied in whole or part for premiums paid by the trust on cash value life insurance policies.

Related Items:

- Revenue Ruling 2007-65
- Notice 2007-83
- Notice 2007-84

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