

APHIS inspectors will cut and inspect fruit that are randomly selected from throughout the shipment at a rate designated in this paragraph. If inspectors find a single live Mediterranean fruit fly in any stage of development during an inspection, the entire shipment of clementines will be

rejected. If a live Mediterranean fruit fly in any stage of development is found in any two shipments of fruit from the same orchard during the same shipping season, that orchard will be removed from the export program for the remainder of that shipping season.

(1) For the first clementine shipping season that occurs after the effective date of this rule, inspectors will cut 200 randomly selected fruit per shipment.

(2) For all further shipping seasons, inspectors will cut fruit according to the following table, except as noted in paragraph (f)(3) of this section:

If the sample size for a given season is—	. . . and the rejection rate during that season is—	. . . then the sample size for the next season is—
200	≤5 percent	100
	>5 percent	200
100	≤2 percent	76
	>2 percent but ≤5 percent	100
	>5 percent	200
76	≤2 percent	76
	>2 percent but ≤5 percent	100
	>5 percent	200

(3) If APHIS determines that fruit presented for inspection and treatment appear to be highly infested during a shipping season in which 100 or 76 fruit are cut per shipment, APHIS reserves the right to increase the required sample size during the shipping season. At no time will more than 200 fruit be required to be cut, but the sample size could be raised to that level at APHIS's discretion.

(g) *Cold treatment.* Clementines must be cold treated in accordance with the Plant Protection and Quarantine (PPQ) Treatment Manual, which is incorporated by reference at § 300.1 of this chapter. Upon arrival of clementines at a port of entry into the United States, APHIS inspectors will examine the cold treatment data for each shipment to ensure that the cold treatment was successfully completed. If the cold treatment has not been successfully completed, the shipment will be held until appropriate remedial actions have been implemented.

(h) *Port of entry sampling.* Clementines imported from Spain are subject to inspection by an inspector at the port of entry into the United States. At the port of first arrival, an inspector will sample and cut clementines from each shipment to detect pest infestation according to sampling rates determined by the Administrator. If a single live Mediterranean fruit fly in any stage of development is found, the shipment will be held until an investigation is completed and appropriate remedial actions have been implemented. If APHIS determines at any time that the safeguards contained in this section are not protecting against the introduction of Medflies into the United States, APHIS may suspend the importation of clementines and conduct an

investigation into the cause of the deficiency.

(i) *Shipping season.* For the purposes of this section, a shipping season is considered to include the period beginning approximately in mid-September and ending approximately in late February of the next calendar year.

Done in Washington, DC, this 8th day of July 2002.

Bill Hawks,

Under Secretary for Marketing and Regulatory Programs, USDA.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-165868-01]

RIN 1545-BA47

10 or More Employer Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that provide guidance regarding whether a welfare benefit fund is part of a 10 or more employer plan. The regulations reflect changes to the law made by the Deficit Reduction Act of 1984. The regulations will affect certain employers that provide welfare benefits to employees through a plan to which more than one employer contributes. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by October 9, 2002. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for Tuesday, November 5, 2002, must be received by Tuesday, October 15, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG-165868-01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:ITA:RU (REG-165868-01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments to the IRS Internet site at www.irs.gov/regs. The public hearing will be held in Room 4718, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Betty J. Clary, (202) 622-6080; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Regulations Unit Paralegal (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of

Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S Washington, DC 20224. Comments on the collections of information should be received by September 9, 2002. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collections of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collections of information in this proposed regulation are in § 1.419A(f)(6)-1(a)(2) and § 1.419A(f)(6)-1(e). These collections of information are authorized by section 419A(i) of the Internal Revenue Code. This information will be required by the Commissioner and by employers participating in a plan that is intended to be a 10 or more employer plan described in section 419A(f)(6) to verify the plan's compliance with section 419A(f)(6). This information will be used by the Commissioner and by the employers to determine whether the provisions of sections 419 and 419A, concerning the deductibility of employer contributions to a welfare benefit fund, are applicable to the employers participating in the plan. The respondents are administrators of plans that include certain taxable or tax-exempt welfare benefit funds.

Estimated total annual reporting and/or recordkeeping burden: 2500 hours.

Estimated average annual burden hours per respondent and/or recordkeeper: 25 hours.

Estimated number of respondents and/or recordkeepers: 100.

Estimated annual frequency of responses: On occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to the Income Tax Regulations under section 419A of the Internal Revenue Code. Sections 419 and 419A, which were added to the Code by section 511 of the Deficit Reduction Act of 1984, Public Law 98-369 (98 Stat. 494), set forth special rules for the deduction of contributions to a welfare benefit fund that would otherwise be deductible, including limitations on the amount of the deduction. Pursuant to section 419A(f)(6), the rules of sections 419 and 419A do not apply in the case of a welfare benefit fund that is part of a plan to which more than one employer contributes and to which no employer normally contributes more than 10 percent of the contributions of all employers under the plan. However, this exception for 10 or more employer plans does not apply to any plan that maintains experience-rating arrangements with respect to individual employers.

Section 419A(i) of the Code provides that the Secretary shall prescribe regulations as may be appropriate to carry out the purposes of sections 419 and 419A. Section 419A(i) further provides that the regulations may provide that the plan administrator of any welfare benefit fund to which more than one employer contributes shall submit such information to the employers contributing to the fund as may be necessary to enable the employers to comply with the provisions of section 419A.

The legislative history of sections 419 and 419A of the Code explains that the principal purpose of the deduction limits for contributions to welfare benefit funds "is to prevent employers from taking premature deductions, for expenses which have not yet been incurred, by interposing an intermediary organization which holds assets which are used to provide benefits to the employees of the employer." H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1155 (1984), 1984-3 C.B. (Vol. 2) 1, 409. The section 419(e)(3) definition of fund includes taxable trusts and organizations described in section 501(c)(9) and includes regulatory authority to encompass "any account held for an

employer by any person." The legislative history indicates that the regulatory definition of fund should be broad and should encompass situations "in which an employer may, in some cases, pay an insurance company more in a year than the benefit costs incurred in that year and the employer has an unconditional right in a later year to a refund or credit of the excess of payments over benefit costs." H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1155 (1984), 1984-3 C.B. (Vol. 2) 1, 409.¹

The legislative history of section 419A(f)(6) of the Code explains that the reason the deduction limits of sections 419 and 419A do not generally apply to a fund that is part of a 10 or more employer plan is that "the relationship of a participating employer to [such a] plan often is similar to the relationship of an insured to an insurer." H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1159 (1984), 1984-3 C.B. (Vol. 2) 1, 413. Thus, the premise underlying the exception is that no special limitation on deductions is necessary in situations where a payment by an employer in excess of the minimum necessary to currently provide for the benefits under the plan is effectively lost to that employer, because the economics of the plan will discourage excessive contributions.

The exception to the deduction limitation does not apply, however, where the plan maintains experience-rating arrangements with respect to individual employers. The reason for excluding these plans from the exception is that an experience-rating arrangement with respect to an individual employer changes the economics of the plan and allows an employer to contribute an amount in excess of the minimum amount necessary to provide for the current benefits with the confidence that the excess will inure to the benefit of that employer or its employees. The legislative history notes that making the exception to the deduction limits unavailable to plans that determine contributions on the basis of experience rating is consistent with the general

¹ Section 1851 of the Tax Reform Act of 1986, Public Law 99-514 (100 Stat. 2085), modified the definition of "fund" in section 419(e) to exclude amounts held pursuant to a specific type of insurance contract. While section 419(e)(4), as amended, clarifies that assets held by an insurance company under certain experience-rated contracts do not constitute a fund (so that premiums under those contracts are not subject to the deduction limitations of section 419), this amendment has no relevance in determining whether a plan intended to be described in section 419A(f)(6) has an experience-rating arrangement with respect to individual employers. Any insurance contracts purchased under a 10 or more employer plan are investments of the fund and are not the fund itself.

rules relating to the definition of fund because "the employer's interest with respect to such a plan is more similar to the relationship of an employer to a fund than an insured to an insurer." H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1159 (1984), 1984-3 C.B. (Vol. 2) 1, 413.

In Notice 95-34, 1995-1 C.B. 309, the IRS identified certain types of arrangements that do not satisfy the requirements of section 419A(f)(6). Those arrangements typically require large employer contributions relative to the cost of the coverage for the benefits to be provided under the plan. The plans identified in the Notice often maintain separate accounting of the assets attributable to the contributions made by each participating employer.² In some cases an employer's contributions are related to the claims experience of its employees, while in other cases benefits are reduced if assets derived from an employer's contributions are insufficient to fund the benefits to that employer's employees. Thus, a particular employer's contributions or its employees' benefits may be determined in a way that insulates the employer to a significant extent from the experience of other participating employers.

The arrangements described in Notice 95-34 and similar arrangements do not satisfy the requirements of section 419A(f)(6) of the Code and do not provide the tax deductions claimed by their promoters for any of several reasons. For example, such an arrangement may be providing deferred compensation; the arrangement may be separate plans maintained for each employer; or the plan may be maintaining, in form or in operation, experience-rating arrangements with respect to individual employers (e.g., where the employers have reason to expect that, at least for the most part, their contributions will benefit only their own employees). The Notice also states that even if an arrangement satisfies the requirements of section 419A(f)(6), so that the deduction limits of sections 419 and 419A do not apply to the arrangement, the employer contributions may represent expenses that are not deductible under other sections of the Code.

In Notice 2000-15, 2000-1 C.B. 826 (supplemented and superseded by Notice 2001-51, 2001-34 I.R.B. 190), the Service identified transactions that are the same as or substantially similar to

the transactions described in Notice 95-34 as *listed transactions* for purposes of § 1.6011-4T(b)(2) of the Temporary Income Tax Regulations and § 301.6111-2T(b)(2) of the Temporary Procedure and Administration Regulations. Independent of their classification as "listed transactions" for purposes of §§ 1.6011-4T(b)(2) and 301.6111-2T(b)(2), such transactions may also be subject to the disclosure requirements of section 6011, the tax shelter registration requirements of section 6111, or the list maintenance requirements of section 6112 under the regulations issued in February 2000 (§§ 1.6011-4T, 301.6111-2T and 301.6112-1T, A-4), as well as the regulations issued in 1984 and amended in 1986 (§§ 301.6111-1T and 301.6112-1T, A-3). Persons required to register these tax shelters who have failed to register the shelters may be subject to the penalty under section 6707(a), and to the penalty under section 6708(a) if the requirements of section 6112 are not satisfied.

Explanation of Provisions

These proposed regulations provide guidance under section 419A(f)(6) of the Code regarding the requirements that a welfare benefit fund must satisfy in order for an employer's contribution to the fund to be excepted from the rules of sections 419 and 419A. These regulations are consistent with the IRS's analysis of the arrangements described in Notice 95-34, discussed above and reproduced below.

Section 419A(f)(6) of the Code provides that sections 419 and 419A do not apply in the case of a welfare benefit fund that is part of a 10 or more employer plan that does not maintain experience-rating arrangements with respect to individual employers. A *10 or more employer plan* is a plan to which more than one employer contributes and to which no employer normally contributes more than 10 percent of the total contributions contributed under the plan by all employers.

Pursuant to the authority set forth in section 419A(i), the proposed regulations provide a special rule to assist participating employers and the Commissioner in verifying that the arrangement satisfies the section 419A(f)(6) requirements. Under that rule, an arrangement satisfies the requirements of section 419A(f)(6) and the regulations only if the plan is maintained pursuant to a written document that (1) requires the plan administrator to maintain records sufficient for the Commissioner or any participating employer to readily verify the plan's compliance with section

419A(f)(6) and (2) provides the Commissioner and each participating employer with the right to inspect and copy all such records.

In addition, the proposed regulations make clear that in order to be eligible for the exception from the deduction limits of sections 419 and 419A, a plan must satisfy the requirements of section 419A(f)(6) and these regulations both in form and operation. For purposes of these regulations, the term *plan* means the totality of the arrangement and all related facts and circumstances, including any related insurance contracts. Thus, all agreements and understandings (including promotional materials and policy illustrations) will be taken into account in determining whether the requirements of section 419A(f)(6) are satisfied in form and in operation. For example, if promotional materials indicate that an employer or its employees will receive a future benefit based on the employer's accumulated contributions, the plan will be treated as maintaining experience-rating arrangements with respect to individual employers, even if the formal plan does not specifically provide for experience rating.

The proposed regulations clarify the situations in which a plan maintains experience-rating arrangements with respect to individual employers for purposes of section 419A(f)(6). A plan maintains an experience-rating arrangement with respect to an employer if the employer's cost of coverage for any period is based, in whole or in part, either on the benefits experience or on the overall experience (or on any proxy for the benefits experience or overall experience) of that employer or one or more employees of that employer. The prohibition against experience rating with respect to individual employers applies under all circumstances, including employer withdrawals and plan terminations.

For purposes of the proposed regulations, an employer's *cost of coverage* is the relationship between that employer's contributions (including those of its employees) under the plan and the benefits or other amounts payable under the plan with respect to that employer. The term *benefits or other amounts payable* includes all amounts payable or distributable (or that will be otherwise provided), regardless of the form of the payment or distribution. *Benefits experience* refers, generally, to the benefits and other amounts incurred, paid, or distributed (or otherwise provided) in the past. The *overall experience* of an employer is the balance that would have accumulated in a welfare benefit fund if that employer

² See *Booth v. Commissioner*, 108 T.C. 524 (1997), for an arrangement using a separate accounting system that does not qualify under the 10 or more employer plan exception.

were the only employer providing benefits under the plan. The *overall experience* of an employee is the balance that would have accumulated in a welfare benefit fund if that employee were the only employee being provided benefits under the plan. *Overall experience* is defined similarly for a group of employers or a group of employees.

The proposed regulations illustrate various ways a plan can violate the prohibition against maintaining experience-rating arrangements with respect to individual employers: By adjusting an employer's contributions, by adjusting the benefits for its employees, or by adjusting both, based on the benefits experience or overall experience of the employees of that employer.

Thus, a plan maintains an experience-rating arrangement with respect to an individual employer if the current (or future) cost of coverage of the employer is (or will be) based on either the past benefits or other amounts paid with respect to one or more of that employer's employees (or any proxy therefor) or on the balance accumulated in the fund as a result of the employer's or its employees' past contributions (or any proxy therefor). Accordingly, the process for determining whether a plan maintains an experience-rating arrangement is to inquire whether the past experience of an individual employer or its employees is used, in whole or in part, to determine the employer's cost of coverage. This determination is not intended to be purely a computational one (although actual numbers often can be used to demonstrate the existence of an experience-rating arrangement).

The proposed regulations also include special rules that apply in certain situations. One rule applies where a plan specifies a minimum contribution required to maintain a benefit level, but permits an employer to contribute more, and the amount of benefits and duration of coverage are fixed. These plans commonly involve universal life insurance contracts with flexible premiums. When analyzing these arrangements, for purposes of determining whether an employer's cost of coverage is based on past experience, the Commissioner may treat the employer as contributing the minimum contribution amount needed to maintain that coverage. The relevant question would then be whether the relationship between the minimum amount the employer must contribute and the benefits or other amounts payable under the arrangement depends on the past

experience of that employer or its employees.

Another special rule is provided in the case of a plan maintaining an experience-rating arrangement with respect to a group of participating employers or a group of employees covered under the plan (a rating group). Under that rule, a plan will not be treated as maintaining an experience-rating arrangement with respect to an individual employer merely because the cost of coverage under a plan with respect to the employer is based, in whole or in part, on the benefits experience or the overall experience (or a proxy for either type of experience) of a rating group that includes the employer or one or more of its employees, provided that the employer does not normally contribute more than 10 percent of all contributions with respect to that rating group.

Other special rules relate to the treatment of insurance contracts. Under those rules, insurance contracts under an arrangement are treated as assets of the fund. Thus, any payments under an arrangement from an employer or its employees directly to an insurance company will be treated as contributions to the fund, and any amounts paid by the insurance company under the arrangement will be treated as paid by the fund. Further, as of any date, the fund will be treated as having either a gain or loss with respect to an insurance contract, depending upon the benefits paid under the contract, the value of the contract, and the premiums paid on the contract.

These special rules relating to insurance contracts recognize that if whole life insurance policies, or similar policies that generate a savings element, are purchased under an arrangement, the retained values of those policies (including cash values, reserves, and any other economic values, such as conversion credits or high dividend rates) reflect the past experience of the employees who participate under the plan. As a result, if the retained values associated with policies insuring an employer's employees under an arrangement are used to determine the current cost of coverage for that employer (as opposed to being shared among all of the employers participating in the plan), the employer can anticipate that its past contributions in excess of incurred losses for claims for its employees will inure to the benefit of the employer (as opposed to the other employers participating in the plan). This assurance that the employer will benefit from favorable past experience is the hallmark of an experience-rating arrangement. It is also the hallmark of

the type of welfare benefit fund that Congress intended to be subject to the deduction limitations of sections 419 and 419A.

Furthermore, Congress' expectation that employers participating in 10 or more employer plans would not have a financial incentive to over-contribute was the basis for providing the section 419A(f)(6) exception from the deduction limits of sections 419 and 419A. Allowing a 10 or more employer plan to use insurance contracts for an employer's employees with retained values would provide a financial incentive for the employer to over-contribute to the plan, contrary to the premise underlying the intent of Congress in providing the exception for 10 or more employer plans. If the retained values of life insurance contracts relating to an employer's employees are used to determine that employer's cost of coverage, the arrangement results in a prohibited experience-rating arrangement under these proposed regulations.

These proposed regulations also identify five characteristics that are indications that an employer's interest with respect to the plan is more similar to the relationship of an individual employer to a fund than an insured to an insurer. (See, H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1155 (1984), 1984-3 C.B. (Vol. 2) 1, 413.) The presence of some of these characteristics in a plan suggests that there are multiple plans present instead of a single plan. The presence of others tends to indicate that an employer's cost of coverage is (or will be) based on that employer's benefits experience. Others tend to indicate that the plan is expected to accumulate a surplus that ultimately will be used for the benefit of the individual employers (or their employees). One way this surplus might be used would be to reduce future contributions for the individual employers based on past contributions or claims of the employers. Another way would be to pay benefits to an employer's employees based on the employer's share of the surplus on the occasion of the withdrawal of the employer or at plan termination, thereby violating the rule that an employer's cost of coverage cannot be based on its overall experience. Accordingly, these regulations provide that a plan exhibiting any of these characteristics is not a 10 or more employer plan described in section 419A(f)(6) unless it is established to the satisfaction of the Commissioner that the plan satisfies the requirements of section 419A(f)(6) and these proposed regulations. It should be noted that the fact that a plan has none

of these characteristics does not create an inference that it is a 10 or more employer plan described in section 419A(f)(6).

The first characteristic indicating that a plan is not a 10 or more employer plan described in section 419A(f)(6) is that the assets of the plan are allocated among the participating employers through a separate accounting of contributions and expenditures for individual employers or otherwise. The second characteristic is that amounts charged under the plan differ among the employers in a manner that is not reflective of differences in risk or rating factors that are commonly taken into account in manual rates used by insurers (such as age, gender, dependents covered, geographic locale, or the benefit package). The third characteristic is that the plan does not provide for fixed welfare benefits for a fixed coverage period for a fixed price. The fourth characteristic is that the plan charges the participating employers an unreasonably high amount for the covered risk. The fifth characteristic is that the plan provides for payment of benefits upon triggering events other than the illness, personal injury, or death of an employee or family member, or the employee's involuntary termination of employment.

A number of examples are provided in the proposed regulations illustrating the application of the rules regarding experience-rating arrangements to specific fact situations. Many of these arrangements exhibit the characteristics of a fund that Congress intended to be subject to the deduction limitations of sections 419 and 419A. Each example illustrates only the application of the definition of experience-rating arrangements under section 419A(f)(6) and these regulations, and no inference should be drawn from the scope of the examples about whether these plans are otherwise described in section 419A(f)(6) or about any other provision of the Code. For example, no inference should be drawn about whether any plan described in the examples is a single plan. In addition, no inference should be drawn about the applicability or nonapplicability of any other Code provision, such as section 404, that might limit or preclude the deduction for contributions to the arrangement. For example, in *Neonatology Associates, P.A., v. Commissioner*, 115 T.C. 43 (2000), *appeal docketed*, No. 01-2862 (3d Cir.), the Tax Court held that the contributions were in large part constructive dividends to the employee/owners (and thus did not reach the government's alternative contention that the plan was maintaining experience-

rating arrangements with respect to individual employers). In *Booth v. Commissioner*, 108 T.C. 524 (1997), the Tax Court held that the arrangement was an aggregation of separate plans (and thus was not a single plan) and that there were experience-rating arrangements with respect to the individual employers.

Finally, these proposed regulations provide that the plan administrator of a plan that is intended to be a 10 or more employer plan shall maintain records sufficient to substantiate that the plan is described in section 419A(f)(6). An opinion letter stating the plan is described in section 419A(f)(6) does not constitute substantiation.

Proposed Effective Date

Except as explained below, these regulations—which generally clarify existing law—are proposed to be effective for contributions paid or incurred in taxable years of an employer beginning on or after the date of publication of this Notice of Proposed Rulemaking in the **Federal Register**. For contributions made before this proposed effective date, the IRS will continue applying existing law, including the analysis set forth in Notice 95-34 and relevant case law. Thus, taxpayers should not infer that a contribution that would be nondeductible under the regulations would be deductible if made before that date. In this regard, taxpayers are reminded that, as noted above, the IRS has already identified transactions that are the same as or substantially similar to the transactions described in Notice 95-34 as *listed transactions* for purposes of § 1.6011-4T(b)(2) of the Temporary Income Tax Regulations and § 301.6111-2T(b)(2) of the Temporary Procedure and Administration Regulations.

The requirement that written plan documents contain specified provisions relating to compliance information and the record maintenance requirement for plan administrators are proposed to be effective for taxable years of a welfare benefit fund beginning after the publication of final regulations. Existing record retention requirements and record production requirements under section 6001 continue to apply to employers and promoters.

For the convenience of taxpayers, Notice 95-34 is reproduced below.

Appendix—Notice 95-34

Taxpayers and their representatives have inquired as to whether certain trust arrangements qualify as multiple employer welfare benefit funds exempt from the limits of section 419 and section 419A of the Internal Revenue Code. The Service is

issuing this Notice to alert taxpayers and their representatives to some of the significant tax problems that may be raised by these arrangements.

In general, contributions to a welfare benefit fund are deductible when paid, but only if they qualify as ordinary and necessary business expenses of the taxpayer and only to the extent allowable under section 419 and section 419A of the Code. Those sections impose strict limits on the amount of tax-deductible prefunding permitted for contributions to a welfare benefit fund.

Section 419A(f)(6) provides an exemption from section 419 and section 419A for certain welfare benefit funds. In general, for this exemption to apply, an employer normally cannot contribute more than 10 percent of the total contributions, and the plan must not be experience rated with respect to individual employers. The legislative history states that the exemption under section 419A(f)(6) is provided because “the relationship of a participating employer to [such a] plan often is similar to the relationship of an insured to an insurer.” Even if the 10 percent contribution limit is satisfied, the exemption does not apply to a plan that is experience rated with respect to individual employers, because the “employer's interest with respect to such a plan is more similar to the relationship of an employer to a fund than an insured to an insurer.” H.R. Rep. No. 98-861, 98th Cong., 2d Sess., 1159 (1984-3 C.B. (Vol. 2) 1, 413).

In recent years a number of promoters have offered trust arrangements that they claim satisfy the requirements for the 10-or-more-employer plan exemption and that are used to provide benefits such as life insurance, disability, and severance pay benefits. Promoters of these arrangements claim that all employer contributions are tax-deductible when paid, relying on the 10-or-more-employer exemption from the section 419 limits and on the fact that they have enrolled at least 10 employers in their multiple employer trusts.

These arrangements typically are invested in variable life or universal life insurance contracts on the lives of the covered employees, but require large employer contributions relative to the cost of the amount of term insurance that would be required to provide the death benefits under the arrangement. The trust owns the insurance contracts. The trust administrator may obtain the cash to pay benefits, other than death benefits, by such means as cashing in or withdrawing the cash value of the insurance policies. Although, in some plans, benefits may appear to be contingent on the occurrence of unanticipated future events, in reality, most participants and their beneficiaries will receive their benefits.

The trusts often maintain separate accounting of the assets attributable to the contributions made by each subscribing employer. Benefits are sometimes related to the amounts allocated to the employees of the participant's employer. For example, severance and disability benefits may be subject to reduction if the assets derived from an employer's contributions are insufficient to fund all benefits promised to that employer's employees. In other cases, an

employer's contributions are related to the claims experience of its employees. Thus, pursuant to formal or informal arrangements or practices, a particular employer's contributions or its employees' benefits may be determined in a way that insulates the employer to a significant extent from the experience of other subscribing employers.

In general, these arrangements and other similar arrangements do not satisfy the requirements of the section 419A(f)(6) exemption and do not provide the tax deductions claimed by their promoters for any one of several reasons, including the following:

(1) The arrangements may actually be providing deferred compensation. This is an especially important consideration in arrangements similar to that in *Wellons v. Commissioner*, 31 F.3d 569 (7th Cir. 1994), affg, 64 T.C.M. (CCH) 1498 (1992), where the courts held that an arrangement purporting to be a severance pay plan was actually deferred compensation. If the plan is a nonqualified plan of deferred compensation, deductions for contributions will be governed by section 404(a)(5), and contributions to the trust may, in some cases, be includible in employees' income under section 402(b). Section 404(a)(5) provides that contributions to a nonqualified plan of deferred compensation are deductible when amounts attributable to the contributions are includible in the employees' income, and that deductions are allowed only if separate accounts are maintained for each employee.

(2) The arrangements may be, in fact, separate plans maintained for each employer. As separate plans, they do not qualify for the 10-or-more employer plan exemption in section 419A(f)(6).

(3) The arrangements may be experience rated with respect to individual employers in form or operation. This is because, among other things, the trust maintains, formally or informally, separate accounting for each employer and the employers have reason to expect that, at least for the most part, their contributions will benefit only their own employees. Arrangements that are experience rated with respect to individual employers do not qualify for the exemption in section 419A(f)(6).

(4) Even if the arrangements qualify for the exemption in section 419A(f)(6), employer contributions to the arrangements may represent prepaid expenses that are nondeductible under other sections of the Internal Revenue Code.

Taxpayers and their representatives should be aware that the Service has disallowed deductions for contributions to these arrangements and is asserting the positions discussed above in litigation.

Finally, in response to questions raised by taxpayers and their representatives, we note that the Service has never issued a letter ruling approving the deductibility of contributions to a welfare benefit fund under section 419A(f)(6). Although a trust used to provide benefits under an arrangement of the type discussed in this Notice may have received a determination letter stating that the trust is exempt under section 501(c)(9), a letter of this type does not address the tax deductibility of contributions to such a trust.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collections of information in these regulations will not have a significant economic impact on a substantial number of small entities. The collections of information in the regulation are in § 1.419A(f)(6)-1(a)(2) and § 1.419A(f)(6)-1(e) and consist of the requirements that a plan administrator maintain certain information and that it provide that information upon request to the Commissioner and to employers participating in the plan. This certification is based on the fact that requests for such information are likely to be made, on average, less than once per year per employer and that the costs of maintaining and providing this information are small. In addition, relatively few small entities are plan administrators. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

A public hearing has been scheduled for November 5, 2002 at 10 a.m., in room 4718 of the Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Because of access restrictions, visitors must enter at the main entrance, located at 1111 Constitution Ave, NW. All visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend hearing, see the **FOR FURTHER INFORMATION CONTACT** portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of topics to be discussed and time to be devoted to each topic (preferably a signed original and eight (8) copies) by October 15,

2002. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Betty J. Clary, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *.

Section 1.419A(f)(6)-1 is also issued under 26 U.S.C. 419A(i). * * *

Par. 2. Section 1.419A(f)(6)-1 is added to read as follows:

§ 1.419A(f)(6)-1 Exception for 10 or more employer plan.

(a) *Requirements*—(1) *In general.* Sections 419 and 419A do not apply in the case of a welfare benefit fund that is part of a 10 or more employer plan described in section 419A(f)(6). A plan is a 10 or more employer plan described in section 419A(f)(6) only if it is a single plan—

(i) To which more than one employer contributes;

(ii) To which no employer normally contributes more than 10 percent of the total contributions contributed under the plan by all employers;

(iii) That does not maintain an experience-rating arrangement with respect to any individual employer; and

(iv) That satisfies the requirements of paragraph (a)(2) of this section.

(2) *Compliance information.* A plan satisfies the requirements of this paragraph (a)(2) if the plan is maintained pursuant to a written document that requires the plan administrator to maintain records sufficient for the Commissioner or any participating employer to readily verify that the plan satisfies the requirements of section 419A(f)(6) and this section

and that provides the Commissioner and each participating employer (or a person acting on the participating employer's behalf) with the right, upon written request to the plan administrator, to inspect and copy all such records. See § 1.414(g)-1 for the definition of plan administrator.

(3) *Application of rules*—(i) *In general.* The requirements described in paragraph (a)(1) and (a)(2) of this section must be satisfied both in form and in operation.

(ii) *Plan includes totality of arrangement.* For purposes of this section, the term plan includes the totality of the arrangement and all related facts and circumstances, including any related insurance contracts. Accordingly, all agreements and understandings (including promotional materials and policy illustrations) and the terms of any insurance contract will be taken into account in determining whether the requirements are satisfied in form and in operation.

(b) *Experience-rating arrangements*—

(1) *General rule.* A plan maintains an experience-rating arrangement with respect to an individual employer and thus does not satisfy the requirement of paragraph (a)(1)(iii) of this section if, with respect to that employer, there is any period for which the relationship of contributions under the plan to the benefits or other amounts payable under the plan (the *cost of coverage*) is or can be expected to be based, in whole or in part, on the benefits experience or overall experience (or a proxy for either type of experience) of that employer or one or more employees of that employer. For purposes of this paragraph (b)(1), an employer's contributions include all contributions made by or on behalf of the employer or the employer's employees. See paragraph (d) of this section for the definitions of *benefits experience*, *overall experience*, and *benefits or other amounts payable*. The rules of this paragraph (b) apply under all circumstances, including employer withdrawals and plan terminations.

(2) *Adjustment of contributions.* An example of a plan that maintains an experience-rating arrangement with respect to an individual employer is a plan that entitles an employer to (or for which the employer can expect) a reduction in future contributions if that employer's overall experience is positive. Similarly, a plan maintains an experience-rating arrangement with respect to an individual employer where an employer can expect its future contributions to be increased if the employer's overall experience is

negative. A plan also maintains an experience-rating arrangement with respect to an individual employer where an employer is entitled to receive (or can expect to receive) a rebate of all or a portion of its contributions if that employer's overall experience is positive or, conversely, where an employer is liable to make additional contributions if its overall experience is negative.

(3) *Adjustment of benefits.* An example of a plan that maintains an experience-rating arrangement with respect to an individual employer is a plan under which benefits for an employer's employees are (or can be expected to be) increased if that employer's overall experience is positive or, conversely, under which benefits are (or can be expected to be) decreased if that employer's overall experience is negative. A plan also maintains an experience-rating arrangement with respect to an individual employer if benefits for an employer's employees are limited by reference, directly or indirectly, to the overall experience of the employer (rather than having all the plan assets available to provide the benefits).

(4) *Special rules*—(i) *Treatment of insurance contracts*—(A) *In general.* For purposes of this section, insurance contracts under the arrangement will be treated as assets of the fund. Accordingly, the value of the insurance contracts (including non-guaranteed elements) is included in the value of the fund, and amounts paid between the fund and the insurance company are disregarded, except to the extent they generate gains or losses as described in paragraph (b)(4)(i)(c) of this section.

(B) *Payments to and from an insurance company.* Payments from a participating employer or its employees to an insurance company pursuant to insurance contracts under the arrangement will be treated as contributions made to the fund, and amounts paid under the arrangement from an insurance company will be treated as payments from the fund.

(C) *Gains and losses from insurance contracts.* As of any date, if the sum of the benefits paid by the insurer and the value of the insurance contract (including non-guaranteed elements) is greater than the cumulative premiums paid to the insurer, the excess is treated as a gain to the fund. As of any date, if the cumulative premiums paid to the insurer are greater than the sum of the benefits paid by the insurer and the value of the insurance contract (including non-guaranteed elements), the excess is treated as a loss to the fund.

(ii) *Treatment of flexible contribution arrangements.* Solely for purposes of determining the cost of coverage under a plan, if contributions for any period can vary with respect to a benefit package, the Commissioner may treat the employer as contributing the minimum amount that would maintain the coverage for that period.

(iii) *Experience rating by group of employers or group of employees.* A plan will not be treated as maintaining an experience-rating arrangement with respect to an individual employer merely because the cost of coverage under the plan with respect to the employer is based, in whole or in part, on the benefits experience or the overall experience (or a proxy for either type of experience) of a rating group, provided that no employer normally contributes more than 10 percent of all contributions with respect to that rating group. For this purpose, a *rating group* means a group of participating employers that includes the employer or a group of employees covered under the plan that includes one or more employees of the employer.

(iv) *Family members, etc.* For purposes of this section, contributions with respect to an employee include contributions with respect to any other person (e.g., a family member) who may be covered by reason of the employee's coverage under the plan and amounts provided with respect to an employee include amounts provided with respect to such a person.

(c) *Characteristics indicating a plan is not a 10 or more employer plan*—(1) *In general.* The presence of any of the characteristics described in paragraphs (c)(2) through (c)(6) of this section generally indicates that the plan is not a 10 or more employer plan described in section 419A(f)(6). Accordingly, unless established to the satisfaction of the Commissioner that the plan satisfies the requirements of section 419A(f)(6) and this section, a plan having any of the following characteristics is not a 10 or more employer plan described in section 419A(f)(6). A plan's lack of all the following characteristics does not create any inference that the plan is a 10 or more employer plan described in section 419A(f)(6).

(2) *Allocation of plan assets.* Assets of the plan or fund are allocated to a specific employer or employers through separate accounting of contributions and expenditures for individual employers, or otherwise.

(3) *Differential pricing.* The amount charged under the plan is not the same for all the participating employers, and those differences are not reflective of differences in risk or rating factors that

are commonly taken into account in manual rates used by insurers (such as age, gender, geographic locale, number of covered dependents, and benefit terms) for the particular benefit or benefits being provided.

(4) *No fixed welfare benefit package.* The plan does not provide for fixed welfare benefits for a fixed coverage period for a fixed cost, within the meaning of paragraph (d)(5) of this section.

(5) *Unreasonably high cost.* The plan provides for fixed welfare benefits for a fixed coverage period for a fixed cost, but that cost is unreasonably high for the covered risk for the plan as a whole.

(6) *Nonstandard benefit triggers.* Benefits or other amounts payable can be paid, distributed, transferred, or otherwise provided from a fund that is part of the plan by reason of any event other than the illness, personal injury, or death of an employee or family member, or the employee's involuntary separation from employment. Thus, for example, a plan exhibits this characteristic if the plan provides for the payment of benefits to an employer's employees on the occasion of the employer's withdrawal from the plan.

(d) *Definitions.* For purposes of this section:

(1) *Benefits or other amounts payable.* The term *benefits or other amounts payable* includes all amounts that are payable or distributable (or that will be otherwise provided) directly or indirectly to employers, to employees or their beneficiaries, or to another fund as a result of a spinoff or transfer, and without regard to whether payable or distributable as welfare benefits, cash, dividends, rebates of contributions, property, promises to pay, or otherwise.

(2) *Benefits experience.* The *benefits experience* of an employer (or of an employee or a group of employers or employees) means the benefits and other amounts incurred, paid, or distributed (or otherwise provided) directly or indirectly, including to another fund as a result of a spinoff or transfer, with respect to the employer (or employee or group of employers or employees), and without regard to whether provided as welfare benefits, cash, dividends, credits, rebates of contributions, property, promises to pay, or otherwise.

(3) *Overall experience—(i) Employers.* The term *overall experience* means, with respect to an employer (or group of employers), the balance that would have accumulated in a welfare benefit fund if that employer (or those employers) were the only employer (or employers) providing welfare benefits under the plan. Thus, the overall experience is

credited with the sum of the contributions under the plan with respect to that employer (or group of employers), less the benefits and other amounts paid or distributed (or otherwise provided) with respect to that employer (or group of employers) or the employees of that employer (or group of employers), and adjusted for gain or loss from insurance contracts (as described in paragraph (b)(4)(i) of this section), investment return, and expenses. Overall experience as of any date may be either a positive or a negative number.

(ii) *Employees.* The term *overall experience* means, with respect to an employee (or group of employees, whether or not employed by the same employer), the balance that would have accumulated in a welfare benefit fund if the employee (or group of employees) were the only employee (or employees) being provided welfare benefits under the plan. Thus, the overall experience is credited with the sum of the contributions under the plan with respect to that employee (or group of employees), less the benefits and other amounts paid or distributed (or otherwise provided) with respect to that employee (or group of employees), and adjusted for gain or loss from insurance contracts (as described in paragraph (b)(4)(i) of this section), investment return, and expenses. Overall experience as of any date may be either a positive or a negative number.

(4) *Employer.* The term *employer* means the employer whose employees are participating in the plan and those employers required to be aggregated with the employer under section 414(b), (c), or (m). In the case of an employer that is the recipient of services performed by a leased employee described in section 414(n) who participates in the plan, the leased employee is treated as an employee of the recipient and contributions made by the leasing organization attributable to service performed with the recipient are treated as made by the recipient.

(5) *Fixed welfare benefit package—(i) In general.* A plan provides for fixed welfare benefits for a fixed coverage period for a fixed cost, if it—

(A) Defines one or more welfare benefits, each of which has a fixed amount that does not depend on the amount or type of assets held by the fund,

(B) Specifies fixed contributions to provide for those welfare benefits, and

(C) Specifies a coverage period during which the plan agrees to provide specified welfare benefits, subject to the payment of the specified contributions by the employer.

(ii) *Treatment of actuarial gains or losses.* A plan will not be treated as failing to provide for fixed welfare benefits for a fixed coverage period for a fixed cost merely because the plan does not pay the promised benefits (or requires all participating employers to make proportionate additional contributions based on the fund's shortfall) when there are insufficient assets under the plan to pay the promised benefits. Similarly, a plan will not be treated as failing to provide for fixed welfare benefits for a fixed coverage period for a fixed cost merely because the plan provides a period of extended coverage after the end of the coverage period to all participating employers at no cost to the employers (or provides a proportionate refund of contributions to all participating employers) because of the plan-wide favorable actuarial experience during the coverage period.

(e) *Maintenance of records.* The plan administrator of a plan that is intended to be a 10 or more employer plan described in section 419A(f)(6) shall maintain permanent records and other documentary evidence sufficient to substantiate that the plan satisfies the requirements of section 419A(f)(6) and this section. (See § 1.414(g)-1 for the definition of plan administrator.)

(f) *Examples.* The provisions of paragraph (c) of this section and the provisions of section 419A(f)(6) and this section relating to experience-rating arrangements may be illustrated by the following examples. Unless stated otherwise, it should be assumed that any life insurance contract described in an example is non-participating and has no value other than the value of the policy's current life insurance protection plus its cash value. Paragraph (ii) of each example applies the characteristics listed in paragraph (c) of this section to the facts described in that example. Paragraphs (iii) and (iv) of each example analyze the facts described in the example to determine whether the plan maintains experience-rating arrangements with respect to individual employers. Paragraphs (iii) and (iv) of each example illustrate only the meaning of *experience-rating arrangements*. No inference should be drawn from these examples about whether these plans are otherwise described in section 419A(f)(6) or about the applicability or nonapplicability of any other Internal Revenue Code provision that may limit or deny the deduction of contributions to the arrangements. Further, no inference should be drawn from the examples concerning the tax treatment of employees as a result of the employer

contributions or the provision of the benefits.

Example 1. (i) An arrangement provides welfare benefits to employees of participating employers. Each year a participating employer is required to contribute an amount equal to the claims and other expenses expected with respect to that employer for the year (based on age, gender, geographic locale, number of participating employees, benefit terms, and other risk or rating factors commonly taken into account in manual rates used by insurers for the benefits being provided), multiplied by the ratio of actual claims with respect to that employer for the previous year over the expected claims with respect to that employer for the previous year. No employer participating in the arrangement contributes more than 10 percent of the total contributions made under the arrangement by all the employers.

(ii) This arrangement exhibits at least one of the characteristics listed in paragraph (c) of this section generally indicating that the arrangement is not a 10 or more employer plan described in section 419A(f)(6). Differential pricing exists under this arrangement because the amount charged under the plan is not the same for all the participating employers, and those differences are not reflective of differences in risk or rating factors that are commonly taken into account in manual rates used by insurers for the particular benefit or benefits being provided.

(iii) This arrangement does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. Under the arrangement, an employer's cost of coverage for each year is based, in part, on that employer's benefits experience (i.e., the benefits and other amounts provided in the past with respect to one or more employees of that employer). Accordingly, pursuant to paragraph (b)(1) of this section, the arrangement maintains experience-rating arrangements with respect to individual employers.

Example 2. (i) The facts are the same as in Example 1, except that the amount charged to an employer each year is equal to claims and other expenses expected with respect to that employer for the year (determined the same as in Example 1), multiplied by the ratio of actual claims for the previous year (determined on a plan-wide basis) over the expected claims for the previous year (determined on a plan-wide basis).

(ii) Based on the limited facts described above, this arrangement exhibits none of the characteristics listed in paragraph (c) of this section generally indicating that the arrangement is not a 10 or more employer plan described in section 419A(f)(6). Unlike the arrangement discussed in Example 1, there is no differential pricing under the arrangement because the only differences in the amounts charged to the employers are solely reflective of differences in risk or rating factors that are commonly taken into account in manual rates used by insurers for the particular benefit or benefits being provided.

(iii) Nothing in the facts described in this Example 2 indicates that the arrangement maintains experience-rating arrangements prohibited under section 419A(f)(6) and this section. An employer's cost of coverage under the arrangement is based, in part, on the benefits experience of that employer (as well as of all the other participating employers). However, pursuant to paragraph (b)(4)(iii) of this section, the arrangement will not be treated as maintaining experience-rating arrangements with respect to the individual employers merely because the employers' cost of coverage is based on the benefits experience of a group of employees eligible under the plan, provided no employer normally contributes more than 10 percent of all contributions with respect to the rating group that includes the employees of an individual employer. Under the arrangement described in this Example 2, the rating group includes all the participating employers (or all of their employees), and no employer normally contributes more than 10 percent of the contributions made under the arrangement by all the employers. Accordingly, absent other facts, the arrangement will not be treated as maintaining experience-rating arrangements with respect to individual employers.

Example 3. (i) Arrangement A provides welfare benefits to employees of participating employers. Each year an employer is required to contribute an amount equal to the claims and other expenses expected with respect to that employer for the year (based on risk or rating factors commonly taken into account in manual rates used by insurers for the benefits being provided), adjusted based on the employer's notional account. An employer's notional account is determined as follows. The account is credited with the sum of the employer's contributions previously paid under the plan less the benefit claims for that employer's employees. The notional account is further increased by a fixed five percent investment return (regardless of the actual investment return earned on the funds). If an employer's notional account is positive, the employer's contributions are reduced by a specified percentage of the notional account. If an employer's notional account is negative, the employer's contributions are increased by a specified percentage of the notional account.

(ii) Arrangement A exhibits at least two of the characteristics listed in paragraph (c) of this section generally indicating that the arrangement is not a 10 or more employer plan described in section 419A(f)(6). First, assets under the plan are allocated to specific employers. Second, differential pricing exists because the amount charged under the plan is not the same for all the participating employers, and those differences are not reflective of differences in risk or rating factors that are commonly taken into account in manual rates used by insurers for the particular benefit or benefits being provided.

(iii) Arrangement A does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. Under the arrangement, a participating employer's cost of coverage for each year is based on a proxy

for that employer's *overall experience*. An employer's *overall experience*, as that term is defined in paragraph (d)(3) of this section, includes the balance that would have accumulated in the fund if that employer's employees were the only employees being provided benefits under the plan. Under that definition, the overall experience is credited with the sum of the contributions paid under the plan by or on behalf of that employer less the benefits or other amounts provided to with respect to that employer's employees, and adjusted for gain or loss from insurance contracts, expenses, and investment return. Under the formula used by the arrangement in this example to determine employer contributions, expenses are disregarded and a fixed investment return of five percent is used instead of actual investment return. The disregard of expenses and substitution of the fixed investment return for the actual investment return merely results in an employer's notional account that is a proxy for the overall experience of that employer. Accordingly, the arrangement maintains experience-rating arrangements with respect to individual employers.

Example 4. (i) Under Arrangement B, death benefits are provided for eligible employees of each participating employer. Individual level premium life insurance policies are purchased to provide the death benefits. Each policy has a face amount equal to the death benefit payable with respect to the individual employee. Each year, a participating employer is charged an amount equal to the level premiums payable with respect to the employees of that employer. One participating employer, F, has an employee, P, whose coverage under the arrangement commenced at the beginning of 2000, when P was age 50. P is covered under the arrangement for \$1 million of death benefits, and a life insurance policy with a face amount of \$1 million has been purchased on P's life. The level annual premium on the policy is \$23,000. At the beginning of 2005, when P is age 55, the \$23,000 premium amount has been paid for five years and the policy, which continues to have a face amount of \$1 million, has a cash value of \$92,000. Another employer, G, has an employee, R, who is also 55 years old at the beginning of 2005 and is covered under Arrangement B for \$1 million, for which a level premium life insurance policy with a face amount of \$1 million has been purchased. However, R did not become covered under Arrangement B until the beginning of 2005. Because R's coverage began at age 55, the level annual premium charged for the policy on R's life is \$30,000, or \$7,000 more than the premiums payable on the policy in effect on P's life. Employer F is charged \$23,000 and employer G is charged \$30,000 for the death benefit for employees P and R, respectively. Assume that employees P and R are the only covered employees of their respective employers and that they are identical with respect to any risk and rating factors used by the insurer (other than age at policy issuance).

(ii) Arrangement B exhibits at least three of the characteristics listed in paragraph (c) of this section generally indicating that the arrangement is not a 10 or more employer

plan described in section 419A(f)(6). First, assets of the plan are effectively allocated to specific employers. Second, there is differential pricing under the arrangement. That is, the amount charged under the plan during the year for a specific amount of death benefit coverage is not the same for all the employers (employer F is charged \$23,000 each year for \$1 million of death benefit coverage while employer G is charged \$30,000 each year for the same coverage), and the difference is not reflective of differences in risk or rating factors that are commonly taken into account in manual rates used by insurers for the death benefit being provided (employees P and R are the same age). Third, there is unreasonably high cost, at least during the early years of coverage under the arrangement when the amounts charged to an employer for that employee's death benefit coverage are unreasonably high for the covered risk for the plan as a whole.

(iii) Arrangement B does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. Arrangement B maintains experience-rating arrangements with respect to individual employers because the cost of coverage for each year for any employer participating in the arrangement is based on a proxy for the overall experience of that employer. Under Arrangement B, employer F's cost of coverage for 2005 is \$23,000 for \$1 million of coverage. The \$92,000 cash value at the beginning of 2005 in the policy insuring P's life is a proxy for employer F's overall experience. (The \$92,000 is essentially the balance that would have accumulated in the fund if employer F were the only employer providing welfare benefits under Arrangement B.) Further, the \$23,000 charged to F for the \$1 million of coverage in 2005 is based on the \$92,000 since, in the absence of the \$92,000, employer F would have been charged \$30,000 for P's \$1 million death benefit coverage. (Note that the conclusion that the \$92,000 balance is the basis for the lower premium charged to employer F is consistent with the fact that a \$92,000 balance, if converted to a life annuity using the same actuarial assumptions as were used to calculate the cash value amount, would be sufficient to provide for annual annuity payments of \$7,000 for the life of P—an amount equal to the \$7,000 difference from the premium charged in 2005 to employer G for the \$1 million of coverage on employee R's life.) Thus, F's cost of coverage for 2005 is based on a proxy for F's overall experience. Accordingly, Arrangement B maintains an experience-rating arrangement with respect to employer F.

(iv) Arrangement B also maintains an experience-rating arrangement with respect to employer G because it can be expected that each year G will be charged \$30,000 for the \$1 million of coverage on R's life. Each year, G's cost of coverage will reflect G's prior contributions and allocable earnings, so that G's cost of coverage will be based on a proxy for G's overall experience. Accordingly, Arrangement B maintains an experience-rating arrangement with respect to employer G. Similarly, Arrangement B maintains an

experience-rating arrangement with respect to each other participating employer. Accordingly, Arrangement B maintains experience-rating arrangements with respect to individual employers. This would also be the result if Arrangement B maintained an experience-rating arrangement with respect to only one individual employer.

Example 5. (i) Under Arrangement C, death benefits are provided for eligible employees of each participating employer. Flexible premium universal life insurance policies are purchased to provide the death benefits. Each policy has a face amount equal to the death benefit payable with respect to the individual employee. Each participating employer can make any contributions to the arrangement provided that the amount paid for each employee is at least the amount needed to prevent the lapse of the policy. The amount needed to prevent the lapse of the universal life insurance policy is the excess, if any, of the mortality and expense charges for the year over the policy balance. All contributions made by an employer are paid as premiums to the universal life insurance policies purchased on the lives of the covered employees of that employer. Participating employers H and J each have a 50-year-old employee covered under Arrangement C for death benefits of \$1 million, which is the face amount of the respective universal life insurance policies on the lives of the employees. In the first year of coverage employer H makes a contribution of \$23,000 (the amount of a level premium) while employer J contributes only \$6,000, which is the amount of the mortality and expense charges for the first year. At the beginning of year two, the balance in employer H's policy (including earnings) is \$18,000, but the balance in J's policy is zero. Although H is not required to contribute anything in the second year of coverage, H contributes an additional \$15,000 in the second year. Employer J contributes \$7,000 in the second year.

(ii) Arrangement C exhibits at least two of the characteristics listed in paragraph (c) of this section generally indicating that the arrangement is not a 10 or more employer plan described in section 419A(f)(6). First, assets of the plan are effectively allocated to specific employers. Second, the arrangement does not provide for fixed welfare benefits for a fixed coverage period for a fixed cost.

(iii) Arrangement C does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. Arrangement C maintains experience-rating arrangements with respect to individual employers because the cost of coverage of an employer participating in the arrangement is based on a proxy for the overall experience of that employer. Pursuant to paragraph (b)(4)(ii) of this section (concerning treatment of flexible contribution arrangements), solely for purposes of determining an employer's cost of coverage, the Commissioner may treat an employer as contributing the minimum amount needed to maintain the coverage. Applying this treatment, H's cost of coverage for the first year of coverage under Arrangement C is \$6,000 for \$1 million of

death benefit coverage, but for the second year it is zero for the same amount of coverage because that is the minimum amount needed to keep the insurance policy from lapsing. Employer H's overall experience at the beginning of the second year of coverage is \$18,000, because that is the balance that would have accumulated in the fund if H were the only employer providing benefits under Arrangement C. (The special rule of paragraph (b)(4)(ii) of this section only applies to determine cost of coverage; it does not apply in determining overall experience.) The \$18,000 balance in the policy insuring the life of employer H's employee is a proxy for H's overall experience. Employer H can choose not to make any contributions in the second year of coverage due to the \$18,000 policy balance. Thus, H's cost of coverage for the second year is based on a proxy for H's overall experience. Accordingly, Arrangement C maintains an experience-rating arrangement with respect to employer H.

(iv) Arrangement C also maintains an experience-rating arrangement with respect to employer J because in each year J can contribute more than the amount needed to prevent a lapse of the policy on the life of its employee and can expect that its cost of coverage for subsequent years will reflect its prior contributions and allocable earnings. Accordingly, Arrangement C maintains an experience-rating arrangement with respect to employer J.

Example 6. (i) Arrangement D provides death benefits for eligible employees of each participating employer. Each employer can choose to provide a death benefit of either one, two, or three times the annual compensation of the covered employees, provided that no employer contributes more than 10 percent of the total contributions under the plan by all employers. Under Arrangement D, the death benefit is payable only if the employee dies while employed by the employer. If an employee terminates employment with the employer or if the employer withdraws from the arrangement, the death benefit is no longer payable, no refund or other credit is payable to the employer or to the employees, and no policy or other property is transferrable to the employer or the employees. Furthermore, other than any conversion rights the employees may have under state law, the employees have no right under Arrangement D to coverage under any other arrangement and no right to purchase or to convert to an individual insurance policy. Arrangement D determines the amount required to be contributed by each employer for each month of coverage by aggregating the amount required to be contributed for each covered employee of the employer. The amount required to be contributed for each covered employee is determined by multiplying the amount of the death benefit coverage (in thousands) for the employee by five-year age bracket rates in a table specified by the plan. The rates in the specified table do not exceed the rates set forth in Table I of § 1.79-3(d)(2). The table is used uniformly for all covered employees of all employers participating in Arrangement D. Arrangement D uses the amount contributed by each employer to

purchase one-year term insurance coverage on the lives of the covered employees with a face amount equal to the death benefit provided by the plan. No employer is entitled to any rebates or refunds provided under the insurance contract.

(ii) Arrangement D does not exhibit any of the characteristics listed in paragraph (c) of this section generally indicating that the arrangement is not a 10 or more employer plan described in section 419A(f)(6). Under Arrangement D, assets are not allocated to a specific employer or employers. Differences in the amounts charged to the employers are solely reflective of differences in risk or rating factors that are commonly taken into account in manual rates used by insurers for the particular benefit or benefits being provided. The arrangement provides for fixed welfare benefits for a fixed coverage period for a fixed cost, within the meaning of paragraph (d)(5) of this section. The cost charged under the arrangement is not unreasonably high for the covered risk of the plan as a whole. Finally, benefits and other amounts payable can be paid, distributed, transferred, or otherwise made available only by reason of the death of the employee, so that there is no nonstandard benefit trigger under the arrangement.

(iii) Nothing in the facts of this Example 6 indicates that Arrangement D fails to satisfy the requirements of section 419A(f)(6) or this section by reason of maintaining experience-rating arrangements with respect to individual employers. Based solely on the facts described above, Arrangement D does not maintain an experience rating-arrangement with respect to any individual employer because for each participating employer there is no period for which the employer's cost of coverage under the arrangement is based, in whole or in part, on either the benefits experience or the overall experience (or a proxy for either type of experience) of that employer or its employees.

Example 7. (i) The facts are the same as in Example 6, except that under the arrangement, any refund or rebate provided under that year's insurance contract is allocated among all the employers participating in the arrangement in proportion to their contributions, and is used to reduce the employers' contributions for the next year.

(ii) This arrangement exhibits at least one of the characteristics listed in paragraph (c) of this section generally indicating that the arrangement is not a 10 or more employer plan described in section 419A(f)(6). The arrangement includes nonstandard benefit triggers because amounts are made available to an employer by reason of the insurer providing a refund or rebate to the plan, an event that is other than the illness, personal injury, or death of an employee or family member, or an employee's involuntary separation from employment.

(iii) Based on the limited and specific facts described in this Example 7, an employer participating in this arrangement should be able to establish to the satisfaction of the Commissioner that the plan does not maintain experience-rating arrangements with respect to individual employers. A

participating employer's cost of coverage is the relationship of its contributions to the death benefit coverage or other amounts payable with respect to that employer, including the employer's portion of the insurance company rebate and refund amounts. The rebate and refund amounts are allocated to an employer based on that employer's contribution for the prior year. However, even though an employer's overall experience includes its past contributions, contributions alone are not a proxy for an employer's overall experience under the particular facts described in this Example 7. As a result, a participating employer's cost of coverage under the arrangement for each year (or any other period) is not based on that employer's benefits experience or its overall experience (or a proxy for either type of experience), except as follows: If the total of the insurance company refund or rebate amounts is a proxy for the overall experience of all participating employers, a participating employer's cost of coverage will be based in part on that employer's overall experience (or a proxy therefor) by reason of that employer's overall experience being a portion of the overall experience of all participating employers. Under the special rule of paragraph (b)(2)(iii) of this section, however, that fact alone will not cause the arrangement to be treated as maintaining an experience-rating arrangement with respect to an individual employer because no employer normally contributes more than 10 percent of the total contributions under the plan by all employers (the rating group). Accordingly, the arrangement will not be treated as maintaining experience-rating arrangements with respect to individual employers.

Example 8. (i) Arrangement E provides medical benefits for covered employees of 90 participating employers. The level of medical benefits is determined by a schedule set forth in the trust document and does not vary by employer. Other than any rights an employee may have to COBRA continuation coverage, the medical benefits cease when an employee terminates employment with the employer. If an employer withdraws from the arrangement, there is no refund of any contributions and there is no transfer of anything of value to employees of the withdrawing employer. Arrangement E determines the amount required to be contributed by each employer for each year of coverage. To determine the amount to be contributed for each employer, Arrangement E classifies an employer based on the employer's location. These geographic areas are not changed once established under the arrangement. The amount charged for the coverage under the arrangement to the employers in a geographic area is initially determined from a rate-setting manual based on the benefit package, but adjusted to reflect the claims experience of the employers in that classification as a whole. Arrangement E does not have any geographic area classification for which one of the employers in the classification contributes more than 10 percent of the contributions made by all the employers in that classification.

(ii) Arrangement E exhibits at least one of the characteristics listed in paragraph (c) of this section generally indicating that the

arrangement is not a 10 or more employer plan described in section 419A(f)(6). The amount charged under the arrangement to an employer in one geographic area can be expected to differ from that charged to an employer in another geographic area (and the differences are not merely reflective of risk or rating factors for those geographic areas), resulting in differential pricing.

(iii) Based on the facts described in this Example 8, an employer participating in Arrangement E should be able to establish to the satisfaction of the Commissioner that the plan does not maintain experience-rating arrangements with respect to individual employers even though there is differential pricing. Although an employer's cost of coverage for each year is based, in part, on its benefits experience (as well as the benefits experience of the other employers in its geographic area), that does not result in experience-rating arrangements with respect to any individual employer because the employers in each geographic area are a rating group and no employer normally contributes more than 10 percent of the contributions made by all the employers in its rating group. (See paragraph (b)(4)(iii) of this section.)

Example 9. (i) The facts of Arrangement F are the same as those described in Example 8 for Arrangement E, except that K, an employer in one of Arrangement F's geographic areas, contributes more than 10 percent of the contributions made by the employers in that geographic area.

(ii) For the same reasons as described in Example 8, Arrangement F results in differential pricing.

(iii) Arrangement F does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. An employer's cost of coverage for each year is based, in part, on its benefits experience (as well as the benefits experience of the other employers in its geographic area) and the special rule for experience-rating by a rating group does not apply to Arrangement F because employer K contributes more than 10 percent of the contributions made by the employers in its rating group. Accordingly, Arrangement F maintains experience-rating arrangements with respect to individual employers.

Example 10. (i) The facts of Arrangement G are the same as those described in Example 8 for Arrangement E, except for the way that the arrangement classifies the employers. Under Arrangement G, the experience of each employer for the prior year is reviewed and then the employer is assigned to one of three classifications (low cost, intermediate cost, or high cost) based on the ratio of actual claims with respect to that employer to expected claims with respect to that employer. No employer in any classification contributes more than 10 percent of the contributions of all employers in that classification.

(ii) For the same reasons as described in Example 8, Arrangement G results in differential pricing.

(iii) Arrangement G does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this

section is not satisfied. The special rule in paragraph (b)(4)(iii) of this section for rating groups can prevent a plan from being treated as maintaining experience-rating arrangements with respect to individual employers if the mere use of a rating group is the only reason a plan would be so treated. Under Arrangement G, however, an employer's cost of coverage for each year is based on the employer's benefits experience in two ways: the employer's benefits experience is part of the benefits experience of a rating group that is otherwise permitted under the special rule of paragraph (b)(4)(iii) of this section, and the employer's benefits experience is considered annually in redetermining the rating group to which the employer is assigned. Accordingly, Arrangement G maintains experience-rating arrangements with respect to individual employers.

Example 11. (i) Arrangement H provides a death benefit equal to a multiple of one, two, or three times compensation as elected by the participating employer for all of its covered employees. Universal life insurance contracts are purchased on the lives of the covered employees. The face amount of each contract is the amount of the death benefit payable upon the death of the covered employee. Under the arrangement, each employer is charged annually an amount equal to 200 percent of the mortality and expense charges under the contracts for that year covering the lives of the covered employees of that employer. Arrangement H pays the amount charged each employer to the insurance company. Thus, the insurance company receives an amount equal to 200 percent of the mortality and expense charges under the policies. The excess amounts charged and paid to the insurance company increase the policy value of the universal life insurance contracts. When an employer ceases to participate in Arrangement H, the insurance policies are distributed to each of the covered employees of the withdrawing employer.

(ii) Arrangement H exhibits at least three of the characteristics listed in paragraph (c) of this section generally indicating that the arrangement is not a 10 or more employer plan described in section 419A(f)(6). First, assets are effectively allocated to specific employers. Second, because the amount of the withdrawal benefit (*i.e.*, the value of the life insurance policies to be distributed) is unknown, the arrangement does not provide for fixed welfare benefits for a fixed coverage period for a fixed cost. Finally, Arrangement H includes nonstandard benefit triggers because amounts can be distributed under the arrangement for a reason other than the illness, personal injury, or death of an employee or family member, or an employee's involuntary separation from employment.

(iii) Arrangement H does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. Pursuant to paragraph (b)(1) of this section, the prohibition against maintaining experience-rating arrangements applies under all circumstances, including employer withdrawals. Arrangement H maintains experience-rating arrangements

with respect to individual employers because the cost of coverage for a participating employer is based on a proxy for the overall experience of that employer. Under Arrangement H, the contributions of a participating employer are fixed. The benefits or other amounts payable with respect to an employer include the value of the life insurance policies that are distributable to the employees of that employer upon the withdrawal of that employer from the plan. Thus, the cost of coverage for any period of an employer's participation in Arrangement H is the relationship between the fixed contributions for that period and the variable benefits payable under the arrangement. The value of those variable benefits depends on the value of the policies that would be distributed if the employer were to withdraw at the end of the period. (Each year the insurance policies to be distributed to the employees in the event of the employer's withdrawal will increase in value due to the premium amounts paid on the policy in excess of current mortality and expense charges.) For reasons similar to those discussed above in Example 5, the aggregate value of the life insurance policies on the lives of an employer's employees is a proxy for that employer's overall experience. Thus, a participating employer's cost of coverage for any period is based on a proxy for the overall experience of that employer. Accordingly, Arrangement H maintains experience-rating arrangements with respect to individual employers.

(iv) The result would be the same if, rather than distributing the policies, Arrangement H distributed cash amounts equal to the cash values of the policies. The result would also be the same if the distribution of policies or cash values is triggered by employees terminating their employment rather than by employers ceasing to participate in the arrangement.

Example 12. (i) The facts of Arrangement J are the same as those described in Example 11 for Arrangement H, except that (1) Arrangement J purchases a special term insurance policy on the life of each covered employee with a face amount equal to the death benefit payable upon the death of the covered employee, and (2) there is no benefit distributable upon an employer's withdrawal. The special term policy includes a rider that extends the term protection for a period of time beyond the term provided on the policy's face. The length of the extended term is not guaranteed, but is based on the excess of premiums over mortality and expense charges during the period of original term protection, increased by any investment return credited to the policies.

(ii) Arrangement J exhibits two of the characteristics listed in paragraph (c) of this section generally indicating that the arrangement is not a 10 or more employer plan described in section 419A(f)(6). First, assets of the plan are effectively allocated to specific employers. Second, the plan does not provide for fixed welfare benefits for a fixed coverage period for a fixed cost because the coverage period is not fixed.

(iii) Arrangement J does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the

requirement of paragraph (a)(1)(iii) of this section is not satisfied. Arrangement J maintains experience-rating arrangements with respect to individual employers because the cost of coverage for a participating employer is based on a proxy for the overall experience of that employer. Under Arrangement J, the contributions of a participating employer are fixed. The benefits or other amounts payable with respect to an employer are the one-, two-, or three-times-compensation death benefit for each employee of the employer for the current year, plus the extended term protection coverage for future years. Thus, for any period extending to or beyond the end of the original term of one or more of the policies on the lives of an employer's employees, the employer's cost of coverage is the relationship between the fixed contributions for that period and the variable benefits payable under the arrangement. The value of those variable benefits depends on the aggregate value of the policies insuring the employer's employees (*i.e.*, the total of the premiums paid on the policies by Arrangement J to the insurance company, reduced by the mortality and expense charges that were needed to provide the original term protection, and increased by any investment return credited to the policies). The aggregate value of the policies insuring an employer's employees is, at any time, a proxy for the employer's overall experience. Thus, a participating employer's cost of coverage for any period described above is based on a proxy for the overall experience of that employer. Accordingly, Arrangement J maintains experience-rating arrangements with respect to individual employers.

Example 13. (i) Arrangement K provides a death benefit to employees of participating employers equal to a specified multiple of compensation. Under the arrangement, a flexible-premium universal life insurance policy is purchased on the life of each covered employee in the amount of that employee's death benefit. Each policy has a face amount equal to the employee's death benefit under the arrangement. Each participating employer is charged annually with the aggregate amount (if any) needed to maintain the policies covering the lives of its employees. However, each employer is permitted to make additional contributions to the arrangement and, upon doing so, the additional contributions are paid to the insurance company and allocated to one or more contracts covering the lives of the employer's employees. In the event that any policy covering the life of an employee would lapse in the absence of new contributions from that employee's employer, and if at the same time there are policies covering the lives of other employees of the employer that have cash values in excess of the amounts needed to prevent their lapse, the employer has the option of reducing its otherwise-required contribution by amounts withdrawn from those other policies.

(ii) Arrangement K exhibits at least two of the characteristics listed in paragraph (c) of this section generally indicating that the arrangement is not a 10 or more employer plan described in section 419A(f)(6). First,

assets of the plan are allocated to specific employers. Second, because the plan allows an employer to choose to contribute an amount that is different than that contributed by another employer for the same benefit, the amount charged under the plan is not the same for all participating employers (and the differences in the amounts are not reflective of differences in risk or rating factors that are commonly taken into account in manual rates used by insurers for the particular benefit or benefits being provided), resulting in differential pricing.

(iii) Arrangement K does not satisfy the requirements of section 419A(f)(6) and this section because, at a minimum, the requirement of paragraph (a)(1)(iii) of this section is not satisfied. Arrangement K maintains experience-rating arrangements with respect to individual employers because the cost of coverage for any employer participating in the arrangement is based on a proxy for the overall experience of that employer. Under Arrangement K the benefits with respect to an employer for any year are a fixed amount. For purposes of determining the employer's cost of coverage for that year, the Commissioner may treat the employer's contribution under the special rule of paragraph (b)(4)(ii) of this section (concerning treatment of flexible contribution arrangements) as being the minimum contribution amount needed to maintain the universal life policies with respect to that employer for the death benefit coverage for that year. Because the employer has the option to prevent the lapse of one policy by having amounts withdrawn from other policies, that minimum contribution amount will be based in part on the aggregate value of the policies on the lives of that employer's employees. That aggregate value is a proxy for the employer's overall experience. Accordingly, Arrangement K maintains experience-rating arrangements with respect to individual employers.

(g) *Effective date*—(1) *In general.* Except as set forth in paragraph (g)(2) of this section, this section applies to contributions paid or incurred in taxable years of an employer beginning on or after July 11, 2002.

(2) *Compliance information and recordkeeping.* Paragraphs (a)(1)(iv), (a)(2), and (e) of this section apply for taxable years of a welfare benefit fund beginning after the date of publication of final regulations in the **Federal Register**.

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.
[FR Doc. 02-17469 Filed 7-10-02; 8:45 am]

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DEPARTMENT OF TRANSPORTATION

Coast Guard

33 CFR Part 165

[CGD01-02-063]

RIN 2115-AA97

Safety and Security Zones: USCGC EAGLE Port Visit—Salem Harbor, Massachusetts

AGENCY: Coast Guard, DOT.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard proposes to establish temporary safety and security zones for the United States Coast Guard Cutter (USCGC) EAGLE's port visit to the PG & E Power Plant in Salem, MA, from August 9, 2002, to August 12, 2002. The safety and security zones would temporarily close all waters within a 100 yard radius of the USCGC EAGLE while underway off the coast of Massachusetts in United States territorial seas, and while moored at the PG & E Pier in Salem Harbor, Salem, MA. The safety and security zones would prohibit entry into or movement within this portion of Salem Harbor during the effective periods.

DATES: Comments and related material must reach the Coast Guard on or before 29 July 2002.

ADDRESSES: You may mail comments and related material to Marine Safety Office Boston, 455 Commercial Street, Boston, MA. Marine Safety Office Boston maintains the public docket for this rulemaking. Comments and material received from the public, as well as documents indicated in this preamble as being available in the docket, will become part of the docket and will be available for inspection or copying at Marine Safety Office Boston between 8 A.M. and 3 P.M., Monday through Friday, except Federal holidays.

FOR FURTHER INFORMATION CONTACT: Lieutenant Dave Sherry, Marine Safety Office Boston, Waterways Safety and Response Division, at (617) 223-3000.

SUPPLEMENTARY INFORMATION:

Request for Information

We encourage you to participate in this rulemaking by submitting comments and related material. If you do so, please include your name and address, identify the docket number for this rulemaking (CGD01-02-063), indicate the specific section of this document to which each comment applies, and give the reason for each comment. Please submit all comments and related material in an unbound format, no larger than 8½ by 11 inches,

suitable for copying. If you would like to know your comments reached us, please enclose a stamped, self addressed postcard or envelope. We will consider all comments and material received during the comment period. We may change this proposed rule in view of them.

Public Meeting

We do not plan to hold a public meeting. However, you may submit a request for a meeting by writing to Marine Safety Office Boston at the address under **ADDRESSES** explaining why one would be beneficial. If we determine that a public meeting would aid in this rulemaking, we will hold one at a time and place announced by a separate notice in the **Federal Register**.

Background and Purpose

In light of terrorist attacks on New York City and Washington D.C. on September 11, 2001, temporary safety and security zones are proposed to safeguard the United States Coast Guard Cutter (USCGC) EAGLE (a training vessel for the U. S. Coast Guard Academy), persons on the vessel, the public, and surrounding communities from sabotage or other subversive acts, accidents, or other events of a similar nature. The USCGC EAGLE presents a possible target of terrorist attack, because it is a prominent and highly visible public vessel. These proposed safety and security zones, having identical boundaries, prohibit entry into or movement within the specified areas.

This regulation proposes to establish safety and security zones within a 100 yard radius of the USCGC EAGLE while it is moored at the PG & E Pier in Salem Harbor, Salem, MA and while the vessel is transiting within navigable waters of the United States in the Captain of the Port (COTP) Boston zone, as defined in 33 CFR 3.05-10. Under the Ports and Waterways Safety Act, (33 U.S.C.S. 1221 et. seq.) navigable waters of the United States include all waters of the territorial sea of the United States as described in Presidential Proclamation No. 5928 of December 27, 1988 (103 Stat. 2981; 54 FR 777, January 9, 1989). This Presidential Proclamation declared that the territorial sea of the United States extends to 12 nautical miles from the baseline of the United States determined in accordance with international law.

The safety and security zones would be in effect while the USCGC EAGLE is transiting within the navigable waters of the United States and while moored at the PG & E Pier from August 9, 2002, to August 12, 2002.