

Office of Chief Counsel
Internal Revenue Service
memorandum

Number: **202534004**

Release Date: 8/22/2025

CC:EEE:EB:HW

PRESP-122872-21

UILC: 419A.00-00, 419.11-00

date: July 24, 2025

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subject: Qualified Asset Account; Limitation on Additions to Account

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

Under the facts described below, does the additional reserve for post-retirement medical benefits, as described in section 419A(c)(2) of the Internal Revenue Code (Code), include either (1) the expected cost of providing medical benefits with respect to employees for periods of coverage before the employees are expected to sever from employment, or (2) amounts funded over the working lives of the employees under which the working lives are defined as ending at a specified “retirement age” without regard to whether employees are expected to sever from employment at that date?

CONCLUSION

The additional reserve for post-retirement medical benefits under section 419A(c)(2) does not include (1) the expected cost of providing medical benefits with respect to employees for periods of coverage before the employees are expected to sever from employment, or (2) amounts funded over the working lives of the employees to the extent that the working lives are defined as ending at a specified “retirement age” without regard to whether the employees are expected to sever from employment at that date.

FACTS

Company X maintains Plan A to provide medical benefits as defined in section 419A(f)(2) to certain of its employees and former employees (and their spouses). Plan A provides that a covered employee will be eligible to receive medical benefits upon attainment of a specified age, which Plan A refers to as the employee’s “retirement age” (Retirement Age). These medical benefits are available upon attainment of that age without regard to severance from employment with Company X. Company X contributes to a welfare benefit fund to pay for the benefits to be provided by Plan A, and deducts, under section 419(a)(2), its contributions as an addition to a reserve for post-retirement medical benefits under section 419A(c)(2). A portion of the addition to the reserve is attributable to the expected cost of providing future benefits under Plan A for employees (and their spouses) during the period of time before the employees are expected to sever from employment. Company X’s actuarial calculations for the contributions and the deduction use Retirement Age as the end of the

employees' working lives (and the start of their "post-retirement" coverage), even though some employees are expected to work past that age.

LAW AND ANALYSIS

Section 419 prescribes limits on the amount of deductions for contributions paid or accrued by an employer to a welfare benefit fund. Under section 419(a) and (b), an employer's contributions to a welfare benefit fund are deductible in the taxable year in which paid, but only if they would otherwise be deductible under Chapter 1 of the Code, and the amount of the deduction is limited to the welfare benefit fund's qualified cost for the taxable year.

The term "qualified cost" for the taxable year is defined in section 419(c)(1) and (2) as the sum of (A) the qualified direct cost for that taxable year, and (B) any addition to a qualified asset account for the taxable year (but only to the extent the addition does not exceed the limit on the additions to the account under section 419A(b)), reduced by the fund's after-tax income for the taxable year.

The term "qualified direct cost" is generally defined in section 419(c)(3)(A) to mean, with respect to any taxable year, the aggregate amount (including administrative expenses) that would have been allowable as a deduction to the employer with respect to the benefits provided during the taxable year if (i) such benefits were provided directly by the employer, and (ii) the employer used the cash receipts and disbursements method of accounting. For this purpose, section 419(c)(3)(B) specifies that a benefit is treated as provided when that benefit would be includible in the gross income of the employee if provided directly by the employer (or would be so includible but for a provision of chapter 1 of the Code excluding the benefit from gross income).

Under section 419(c)(5), no item may be taken into account more than once in determining the qualified cost of any welfare benefit fund.

The term “qualified asset account” is defined in section 419A(a) to mean any account consisting of assets set aside to provide for the payment of disability benefits, medical benefits, supplemental unemployment benefits or severance pay benefits, or life insurance benefits. Pursuant to section 419A(b), no addition to any qualified asset account may be taken into account under section 419(c)(1)(B) to the extent that the addition would result in the amount in the account exceeding the account limit specified in section 419A(c).

Section 419A(c)(1) provides that the account limit for any qualified asset account for any taxable year is generally the amount reasonably and actuarially necessary to fund claims incurred but unpaid (as of the close of the taxable year) for benefits referred to in section 419A(a), and administrative costs with respect to those claims.

Section 419A(c)(2) provides that the account limit for any taxable year may also include a reserve funded over the working lives of the covered employees and actuarially determined on a level basis (using assumptions that are reasonable in the aggregate) as necessary for post-retirement medical benefits to be provided to covered employees (determined on the basis of current medical costs), or post-retirement life insurance benefits to be provided to covered employees.

In order for contributions to a reserve to be deductible as within the account limit of section 419A(b), those contributions must be intended actually to accumulate for the purpose of funding post-retirement benefits. General Signal Corp. v. Commissioner, 103 T.C. 216 at 239 (1994), aff'd, 142 F.3d 546 (2d Cir. 1998). Sections 419 and 419A were

enacted by the Deficit Reduction Act of 1984 (DEFRA). The legislative history of DEFRA explains that, under section 419A(c)(2), the qualified asset account limits allow amounts reasonably necessary to accumulate reserves in a welfare benefit fund so that the medical benefits payable to retired employees during retirement are fully funded upon retirement. These amounts may be accumulated no more rapidly than on a level basis over the working lives of the employees with the employer. Each year's computation of contributions with respect to retiree medical benefits is also limited to the assumption that the medical benefits provided to retirees in the future will cost the same as medical benefits currently provided to retirees (*i.e.*, projected inflation in the cost of medical benefits is not to be taken into account). The legislative history states that it is "intend[ed] that the Treasury Department prescribe rules requiring that the funding of retiree benefits be based on reasonable and consistently applied actuarial cost methods, which take into account experience gains and losses, changes in assumptions, and other similar items, and be no more rapid than on a level basis over the remaining working lifetimes of the current participants (reduced on the basis of reasonable turnover and mortality assumptions)." H.R. Rep. No. 98-861 at 1157 (1984) (Conf. Rep.).

Thus, in describing the section 419A(c)(2) reserves for post-retirement benefits, the DEFRA legislative history uses the terms "retired employees," "during retirement," "upon retirement," "retiree medical benefits," and "retirees." Neither section 419A nor the regulations thereunder expressly provide that, for purposes of section 419A(c)(2), the term "retirement" may include a period of time before employees have severed employment, or that "retirement" otherwise is to be defined in a way that differs from its

ordinary, everyday use.¹ The ordinary, everyday sense of the words “retired,” “retiree,” and “retirement” includes, at minimum, a severance from employment with an employer.² See, e.g., New Oxford American Dictionary (3rd ed. 2010) (defining “retire” as leave one’s job and cease to work, typically upon reaching the normal retirement age for leaving employment).³

Under Plan A, a portion of the contributions are intended to provide medical benefits to some employees for periods of time before they have severed from employment with Company X. Those amounts are not part of a reserve to provide “post-retirement” benefits and, thus, are not deductible as an addition to a reserve for post-retirement benefits.

Further, the actuarial calculations for Plan A use the Plan’s Retirement Age as the end of the employees’ working lives, even though it is expected that some covered employees will continue working beyond that age. Section 419A(c)(2) requires that the “working lives” of an employer’s employees be used as the period for the level funding of a reserve for post-retirement benefits. Section 419A(c)(2) also requires that reasonable assumptions be used to actuarially determine the addition to the reserve. It is not a reasonable assumption that the expected working lives of the covered

¹ Gonzales v. Carhart, 550 U.S. 124, 152 (2007) (“In interpreting statutory texts courts use the ordinary meaning of terms unless context requires a different result.”). See also F.D.I.C. v. Meyer, 510 U.S. 471, 476 (1994) (“In the absence of such a definition [in the statute], we construe a statutory term in accordance with its ordinary or natural meaning.”).

² Wisconsin Central Ltd. v. U.S., 585 U.S. 274, 284, (2018) (“[I]t’s a ‘fundamental canon of statutory construction’ that words generally should be ‘interpreted as taking their ordinary, contemporary, common meaning . . . at the time Congress enacted the statute.’”) (quoting Perrin v. U.S., 444 U.S. 37, 42 (1979)).

³ See also Black’s Law Dictionary (12th ed. 2024) (defining “retire” as “[t]o stop working at a job, usu[ally] upon reaching the normal age for leaving employment”).

employees ends before the covered employees are expected to sever employment, because this would result in amounts being funded more rapidly than over the covered employees' working lives.

The section 419A(c)(2) addition to a reserve for post-retirement medical benefits does not include amounts for benefits expected to be provided with respect to an employee prior to the employee's severance from employment with the employer maintaining the plan. Moreover, the addition to the reserve does not include amounts funded more rapidly than on a level basis over the covered employees' working lives. Thus, Company X's contributions to the welfare benefit fund are not deductible under section 419A(c)(2) to the extent they include such amounts.⁴

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⁴ In addition, the tax benefit rule generally requires a taxpayer who received a tax benefit from a deduction in an earlier year to recognize income in a later year if an event occurs that is fundamentally inconsistent with the premise on which the deduction was initially based. Hillsboro National Bank v. Commissioner, 460 U.S. 370, 383 (1983). Therefore, even if amounts are correctly deducted by Company X as a reserve for post-retirement benefits in one year, but in a later year amounts are used to provide benefits for employees who have not yet severed employment, that event is fundamentally inconsistent with the premise on which the deduction was initially based, thereby triggering the tax benefit rule.