

MEMORANDUM

The IRS released attached Notice 2011-02 earlier today. The Notice provides very helpful guidance on certain issues raised under Internal Revenue Code section 162(m)(6) (the \$500,000 deduction limit on certain remuneration paid by covered health insurance providers (CHIPs)).

CHIP DEFINITION: The Notice clarifies that the 162(m)(6) deduction limit applies to deferred compensation attributable to services performed in 2010, 2011 or 2012, only if: (1) the employer was a CHIP in the year the services were performed to which the deferred compensation is related, and (2) the employer is a CHIP in the year such deferred compensation is paid.

DE MINIMIS RULE: The Notice clarifies that an entity will not be a CHIP in 2010, 2011 or 2012 if the premiums it receives from health insurance are less than 2% of gross revenues for the year in question. For years after 2012, an entity will not be a CHIP if the premiums it receives from health insurance that is "minimum essential coverage" are less than 2% of gross revenues. The Notice says that the broad controlled group rule applies for purposes of section 162(m)(6) and an example confirms that the de minimis rule is also applied on a controlled group basis.

DEFINITION OF APPLICABLE INDIVIDUAL: Section 162(m)(6) only applies to remuneration paid to "applicable individuals". The Notice provides that the term applicable individual does not include an independent contractor with respect to whom a compensation arrangement would not be subject to Code section 409A (generally excepting arrangements with independent contractors providing substantial services to multiple unrelated customers).

TREATMENT OF REINSURANCE: The Notice provides that in determining whether a taxpayer is a CHIP, premiums received under an indemnity reinsurance contract are not treated as premiums from providing health insurance coverage.

EFFECTIVE DATE: The Notice is effective beginning in 2010. Treasury anticipates including this guidance in upcoming regulations, but if any changes are made that would expand the reach of 162(m)(6), those changes would be made prospectively.

REQUEST FOR COMMENT: The Treasury Department and the IRS request comment by March 23, 2011, on the content of the Notice and on application of section 162(m)(6) generally. Comment is specifically requested on:

- The treatment of captive insurance companies.
- Stop loss insurance (including whether there is an attachment point that is so low the policy may constitute direct health insurance).
- The de minimis rule provided and possible alternative de minimis rules.
- The application of the CHIP definition in mergers, acquisitions, or reorganizations.
- Whether rules similar to Notice 2008-94, Q & A-9 (dealing with remuneration by TARP recipients) should be applied for purposes of allocating deferred compensation to a particular year.