



Tax Reduction Letter

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Private Letter Ruling 200709007

Accident and Health Plans; Health Plan Contributions.

Index Number: 0105.00-00, 0106.00-00

Release Date: 3/2/2007

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Refer Reply To: CC:TEGE:EB:HW PLR-119471-06

LEGEND:

Employer = * * *

Trust = * * *

* * * = * * *

Dear * * *:

This responds to your letter of January 31, 2006 and subsequent correspondence, requesting rulings concerning the proper Federal income tax treatment under *sections 105* and *106 of the Internal Revenue Code* (Code) of retiree health benefits provided to management employees, their spouses and dependents.

You represent that Employer established the Trust for the benefit of eligible management employees, their spouses and dependents. Trust funds are used to pay for retiree health benefits payable under the Employer's Retiree Health Care Policy (the Policy). Under the Policy, retiree health benefits are limited to management employees who meet certain service requirements, retire on a voluntary basis and are covered by the Employer's health plan at anytime in the 12 months preceding retirement ("eligible management employee"). Upon reaching retirement, an [*2] eligible management employee's accumulated and unused sick and vacation leave accrued on the date of retirement is paid into the Trust and used for the payment of the premiums for the Employer's health policy and other health insurance covering the retiree, his or her spouse and dependents, including premiums under Medicare.

You represent that once an eligible management employee reaches retirement, retiree health coverage is automatic and mandatory for the retiree, his or her spouse and dependents and that an eligible management employee cannot elect in or out of coverage. If an eligible management employee dies before retirement and is survived by a spouse or dependents, retiree health insurance coverage is extended to a surviving spouse and any dependents at the time of the employee's death. After the death of the surviving spouse or dependents, the remaining value of the accumulated and unused sick and vacation leave will be applied to any unreimbursed medical expenses of the employee's spouse or dependents incurred at any time in the 36 months prior to the death of the employee's spouse or dependents, with any remaining balance being forfeited. If the eligible management employee [*3] dies before retirement and is not survived by a spouse or any dependents, then the accumulated and unused sick and vacation leave will be applied to any unreimbursed medical expenses of the employee incurred at any time in the 36 months prior to the death of the employee, with any remaining balance being forfeited. You represent that

under no circumstance may the retired eligible management employee or the retired eligible management employee's spouse or dependents receive any unused amounts at any time in cash or other benefits. Any amounts not applied to health insurance or to reimburse medical expenses will be forfeited.

Section 61(a)(1) of the Code and *section 1.61-21(a)(3) of the Income Tax Regulations* provide that, except as otherwise provided in Subtitle A, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 106(a) of the Code provides that the gross income of an employee does not include employer-provided coverage under an accident or health plan. *Section 1.106-1 of the regulations* states that the gross income of an employee does not include contributions which his employer makes to an accident or health plan [*4] for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by the employee, the employee's spouse, or the employee's dependents as defined in *section 152 of the Code*. The employer may contribute to an accident or health plan either by paying the premium on a policy of accident or health insurance covering one or more of the employees, or by contributing to a separate trust or fund which provides accident or health benefits directly or through insurance to one or more of the employees. However, if the insurance policy, trust or fund provides other benefits in addition to accident or health, *section 106* applies only to the portion of the contributions allocable to accident or health benefits.

Section 105(a) provides that, except as otherwise provided in *section 105*, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

Section 105(b) states that except in the case of amounts attributable [*5] to (and not in excess of) deductions allowed under *section 213* (relating to medical expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by the taxpayer for the medical care (as defined in *section 213(d)*) of the taxpayer or the taxpayer's spouse or dependents (as defined in *section 152*). *Section 1.105-2 of the regulations* provides that only amounts that are paid specifically to reimburse the taxpayer for expenses incurred by the taxpayer for the prescribed medical care are excludable from gross income. Thus, *section 105(b)* does not apply to amounts that the taxpayer would be entitled to receive irrespective of whether or not the taxpayer incurs expenses for medical care.

In Situation 1 of *Rev. Rul. 2005-24, 2005-16 I.R.B. 892*, an employer sponsors a reimbursement plan that reimburses the substantiated medical care expenses of both current and former employees (including retired employees), their spouses and dependents. Under no circumstances may an employee receive taxable or nontaxable benefits under the plan, other the [*6] reimbursement of medical care expenses incurred by the employee and his or her spouse and dependents. When an employee retires, the employer automatically and on a mandatory basis (as determined under the plan) contributes an amount to the reimbursement plan equal to the value of all or a portion of the retired employee's accumulated unused vacation and sick leave. Under no circumstances may the retired employee or the retired employee's spouse or dependents receive any of the designated amount in cash or other benefits. The ruling concludes that coverage and reimbursements made under the plan described in Situation 1 are excludable from gross income under *section 106*.

Based on the information submitted and the representations made, we conclude that for periods on or after September 1, 2006:

Amounts paid to the Trust and amounts paid from the Trust which are used exclusively to pay for health insurance premiums and other medical expenses of retired eligible management employees and retired eligible management employees' spouses and dependents as defined in *section 152* (determined without regard to *section 152(b)(1)*, *(b)(2)*, and *(d)(1)(B)*) are excludable from gross income under *sections 105* [*7] and *106 of the Code*.

The Trust will be classified as a trust within the meaning of *Treas. Reg. section 301.7701-4(a)*. Because the principal and income of the Trust may be applied in discharge of legal obligations of the Employer under *section 677*, Employer shall be treated as the owner of the Trust. Accordingly, under *section 677*, there shall be included in computing Employer's taxable income and credits, those items of income, deductions, and credits against tax of the Trust, subject to the provisions of the Code applicable to *section 501(c)(3)* organizations.

No opinion is expressed concerning whether the Policy satisfies the nondiscrimination requirements of *section 105(h) of the Code* and *section 1.105-11 of the regulations*. In addition, no opinion is expressed concerning the Federal tax consequences of the Policy under *sections 83, 409A, 457* or any other provision of the Code other than those specifically stated herein.

This ruling is directed only to the Taxpayer requesting it. *Section 6110(k)(3) of the Code* provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized [*8] representative.

Sincerely,

Harry Beker, Chief
Health and Welfare Branch
Office of Division Counsel/
Associate Chief Counsel (Tax
Exempt & Government Entities)