

Revenue Ruling 75-539

Section 106. Contributions by Employer to Accident and Health Plans.

Medical insurance premiums paid for retired employee. Payments for a retired employee's continued participation in the employer's union-negotiated hospital, surgical, and medical group insurance plan, which provides that upon retirement the employee may receive a cash payment for accumulated sick leave or have the payment applied to the cost of insurance, are includible in the employee's gross income and are deductible as medical expenses under *section 213 of the Code*. Similar payments made under a plan with no option to receive a cash payment are excludable from gross income and not deductible.

Advice has been requested whether, under the circumstances described below, the amounts paid for health insurance are excludable from the gross income of retired employee-taxpayers under *section 106 of the Internal Revenue Code of 1954*.

During 1974, an employer negotiated two contracts with labor unions to guarantee the services of the union members as employees. Each contract provides that an employee [*2] can accumulate up to a maximum of 150 days of sick leave credits. Furthermore, each contract contains an article that stipulates the treatment to be accorded accumulated sick leave for retired employees.

In Contract A, the sick leave article provides that upon retirement an employee will receive a cash payment for one-half of the employee's accumulated unused sick leave credits in excess of 50 days or, at the option of the employee, this payment may be applied as the employee's payment of the full cost of the employee's continued participation in the employer's hospital, surgical and medical group insurance plan until such funds are exhausted.

In Contract B, the sick leave article provides that the value of three-fourths of a retiring employee's accumulated unused sick leave credits will be placed by the employer in an escrow account to pay the full premiums of continued participation by the retired employee in the employer's hospital, surgical and medical group insurance plan until such funds are exhausted. Under no circumstances may the retired employee, the retired employee's spouse, or dependents receive any of this escrow amount in cash. Any part of the escrow amount which, for [*3] any cause, is not expended for such premiums reverts to the employer.

Section 61 of the Code provides that, except as otherwise provided, gross income means all income from whatever source derived, including compensation for services.

Section 451 of the Code provides that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-1 of the Income Tax Regulations provides the general rule that gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer, unless includible for a different year in accordance with the taxpayer's method of accounting.

Section 1.451-2 of the regulations provides, in part, that income, although not actually reduced to the taxpayer's possession, is constructively received in the taxable year credited to the taxpayer's account, set apart, or otherwise made available so that the taxpayer may draw upon it at any time, or could have drawn upon it during [*4] the taxable year if notice of intention to withdraw had been given.

Section 106 of the Code provides that gross income does not include contributions by the employer to accident or health plans for compensation (through insurance or otherwise) to the employer's employees for personal injuries or sickness.

Section 1.106-1 of the regulations provides, in part, that the gross income of an employee does not include contributions that the employee's employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by the employee, the employee's spouse, or dependents, as defined in *section 152 of the Code*. The employer may contribute to an accident or health plan either by paying the premium (or a portion of the premium) on a policy of accident or health insurance covering one or more of the employer's employees, or by contributing to a separate trust or fund (including a fund referred to in *section 105(e)*) that provides accident or health benefits directly or through insurance to one or more of the employer's employees.

Rev. Rul. 62-199, 1962-2 C.B. 38, deals with an accident and health plan covering both [*5] active and retired employees. It holds that a retired employee may exclude from gross income under *section 106 of the Code* any amount paid by the company under the plan as its share of the cost of providing hospital, medical and surgical insurance coverage for the retired employee.

Section 213 (a) (2) of the Code provides the special rule that there will be allowed as a deduction an amount (not in excess of 150 dollars) equal to one-half of the expenses paid during the taxable year for insurance that constitutes medical care for the taxpayer, the taxpayer's spouse, and dependents. The balance of medical care insurance expenses is treated as a regular medical expense under, and subject to the limitation of, *section 213(a)(1)*.

Unused sick leave credits that are received in cash are includible in gross income under *section 61 of the Code* as compensation for services. The fact that a retiree, by option, may relinquish the right to the cash payment in order that it be used to make premium payments on the retiree's health insurance plan, does not alter the conclusion that such amount is constructively received by the retiree under the provisions of *section 451*, and thus is includible in the [*6] retiree's gross income. The amount of the premium payments is considered an employee contribution out of salary and not a contribution by the employer within the scope of *section 106*.

Accordingly, under *Contract A*, the value of unused accumulated sick leave credits, whether paid in cash to the retired employee or used under the plan to continue hospital, surgical and medical coverage for the employee, is includible in the retired employee's gross income. The retired employee may, however, deduct the retired employee's contributions to the instant health insurance premiums to the extent permitted under *section 213 of the Code*.

Under *Contract B*, the value of unused accumulated sick leave credits is placed in escrow by the employer solely for the payment of health insurance premiums and may not in any event be received in cash by the employee, the employee's spouse, or dependents. Accordingly, such amounts are not constructively received by the retiree under the provisions of *section 451 of the Code*, but rather are contributions by the employer to the employer's employees' accident or health plan, and thus are excludable from the retired employee's gross income under *section 106*

of the Code. [*7] Since the premiums are paid by contributions of the employer, the retired employee is not entitled to deduct such premiums as medical expenses under *section 213*.