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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:TEGE:EB:HW  
PLR-154154-04

Date:  
February 17, 2005

Legend

Taxpayer:

Plan:

Fund:

Dear :

This responds to your letter of July 28, 2004 on behalf of Taxpayer, requesting rulings on the proper Federal income tax treatment of contributions to and benefits paid from the Fund and the Plan.

You state that Taxpayer maintains the Plan that reimburses eligible employees and retirees exclusively for medical care as defined in section 213 of the Internal Revenue Code (Code). In addition to covering active employees, retirees who satisfy certain eligibility criteria may also participate in the Plan. Generally, a retiree is eligible to participate in the Plan if he or she has accrued fifteen years of service with Taxpayer at retirement. The Plan has two coverage options: a health maintenance organization (HMO) type option and an indemnity type option.

The Taxpayer proposes to establish and contribute to the Fund which will be used to pay for a portion of the health care coverage of eligible retirees under the Plan. The Fund will be funded by Taxpayer contributions based on a fixed percentage of the total salaries of all active employees. The Fund will not be governed by an external trust agreement but will be held and administered by Taxpayer.

The Fund will be used exclusively for the purpose of paying the health coverage of retirees who participate in Taxpayer's Plan. Employees and retirees will not have individual accounts under the Fund and no portion of the Fund will be available in the form of cash or other benefits. Disbursements from the Fund will be limited to payments to the Plan for the health coverage of retirees.

The payment of annual retiree health coverage will be made from the following sources: (1) Taxpayer will pay either a certain percentage of the monthly cost of retiree health coverage that it pays for active employees or Taxpayer will subsidize coverage at a higher level for retirees receiving less than a designated monthly amount in retirement benefits; (2) after a cap amount is reached, Taxpayer will make the monthly payment for retiree health coverage from the Fund until the annual distribution amount is reached, provided that there are sufficient funds in the Fund; and (3) participating retirees will pay for their remaining cost of coverage on an after-tax basis.

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 104(a)(3) of the Code provides that except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 for any prior taxable year, gross income does not include amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness (other than amounts received by an employee to the extent such amounts are attributable to contributions by the employer which were not includible in the gross income of the employee, or are paid by the employer).

Section 106 of the Code provides that 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 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 or the employee's spouse or dependents. 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.

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 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).

Coverage provided under an accident or health plan to retired employees and their spouses and dependents is excludable from gross income under section 106. See, Rev. Rul. 62-199, 1962-2 C.B. 38; Rev. Rul. 75-539, 1975- 2 C.B. 45.

Based on the information submitted and the representations made, we conclude as follows:

(1) Contributions made to the Fund and disbursements from the Fund which are used exclusively to pay for the accident or health coverage of retired employees and their spouses and dependents are excludable from the gross income of active employees and retired employees under section 106 of the Code; and

(2) Payments and reimbursements of medical care expenses of retired employees and their spouses and dependents under the Plan are excludable from the gross income of retired employees under sections 104(a)(3) or 105(b) of the Code.

No opinion is expressed concerning the Federal tax consequences of the Fund or the Plan under any other provision of the Code or regulations other than those specifically stated.

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.

Sincerely,

Harry Beker  
Branch Chief,  
Health and Welfare (Employee Benefits)  
(Tax Exempt & Government Entities)

cc: