

Rev. Rul. 69-154

Section 104. - Compensation for Injuries or Sickness

26 CFR 1.104-1: Compensation for injuries or sickness.

(Also Section 105; 1.105-1.)

1969-1 C.B. 46

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That portion of excess indemnification received under medical insurance policies or plans attributable to a taxpayer's contributions is not includible in gross income but that attributable to an employer's contributions is includible.

The Internal Revenue Service has been asked to state its position concerning the taxability of "excess indemnification" received through medical insurance in certain situations where the taxpayer has more than one health insurance policy.

Section 104(a)(3) of the Internal Revenue Code of 1954 provides, in pertinent part, that, except in the cases of amounts attributable to (and not in excess of) deductions allowed under section 213 of the Code for any prior taxable years, gross income does not include amounts received through 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 that were not includible in the gross income of the employee, or are paid by the employer).

Section 1.104-1(d) of the Income Tax Regulations provides, in pertinent part, that if an individual purchases a policy of accident or health insurance out of his own funds, amounts received thereunder for personal injuries or sickness are excludable from his gross income under section 104(a)(3) of the Code. However, if an employer is either the sole contributor to such a fund, or is the sole purchaser of a policy of accident or health insurance for his employees (on either a group or individual basis), the exclusion provided under section 104(a)(3) of the Code does not apply to any amounts received by his employees through such fund or insurance.

The regulations further provide that if the employer and his employees contribute to a fund or purchase insurance that pays accident or health benefits to employees, section 104(a)(3) of the Code does not apply to amounts received thereunder by employees to the extent that such amounts are attributable to the employer's contributions. Although amounts paid by or on behalf of an employer to an employee for personal injuries or sickness are not excludable from the employee's gross income under section 104(a)(3) of the Code, they may be excludable therefrom under section 105 of the Code.

Section 105(a) of the Code states that except as otherwise provided in section 105 of the Code, 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 are attributable to contributions by the employer that were not includible in the gross income of the employee, or are paid by the employer.

The provisions of section 1.105-1 of the regulations, to the extent pertinent, apply in determining the extent to which amounts received for personal injuries or sickness by employees through an accident or health plan are subject to the provisions of section 105(a) of the Code, rather than section 104(a)(3) of the Code.

Section 105(b) 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 referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care of the taxpayer, his spouse, and his dependents.

However, section 1.105-2 of the regulations provides that section 105(b) of the Code is not applicable to the extent that such amounts exceed the amount of the actual expenses for such medical care.

The foregoing provisions are illustrated in the situations discussed below.

Situation 1. A paid the annual premiums of \$240 and \$120 respectively for two personal health insurance policies. During the year, A had only one illness and incurred and paid total medical expenses, as defined in section 213 of the Code, of \$900. In the same year as a result of this illness, A was indemnified \$700 and \$500 under the respective insurance policies.

Since A paid the entire premium for both policies, the \$300 excess indemnification (\$1,200-\$900) is not includible in A's gross income.

Situation 2. B is covered by his employer's general health insurance policy. In addition, B is covered by his employer's comprehensive supplemental health insurance policy. B's employer paid the entire annual premiums of \$240 and \$120, respectively, and these amounts were not included in B's gross income.

During the year B had only one illness and incurred and paid total medical expenses, as defined in section 213 of the Code, of \$900. In the same year as a result of this illness, B was indemnified \$700 and \$500 under the respective insurance policies.

Since B's employer paid the entire premium for both policies, the \$300 excess indemnification (\$1,200-\$900) is the amount includible in B's gross income.

Situation 3. C is covered by his employer's health insurance policy. C's employer pays the annual premium of \$240. In addition, C paid the entire premium (\$120) for a personal health insurance policy.

During the year, C had only one illness and incurred and paid total medical expenses, as defined in section 213 of the Code, of \$900. In the same year as a result of this illness, C was indemnified \$700 under his employer's insurance policy and \$500 under his personal insurance policy.

The portion of any excess indemnification received by C attributable to his employer's contribution is determined as follows:

Indemnification from employer's policy	\$700
Indemnification from employee's policy	500
Total indemnification received	1,200
Amount of medical expenses attributable to employee's policy $5/12 \times \$900 =$	375
Amount of medical expenses attributable to employer's policy $7/12 \times 900 =$	525
Total medical expenses incurred	900
Excess indemnification attributable to the employer's policy $\$700 - 525 =$	175

Since C's employer paid the entire premium on this policy, the \$175 excess indemnification is the amount includible in C's gross income.

Situation 4. D is covered by his employer's health insurance policy. The annual premium is \$240, of which the employer pays \$90 and \$150 is deducted from D's wages. In addition, D paid the entire premium (\$120) for a personal health insurance policy.

During the year, D had only one illness and incurred and paid total medical expenses, as defined in section 213 of the Code, of \$900. In the same year as a result of this illness, D was indemnified \$700 under his employer's insurance policy and \$500 under his personal insurance policy.

The portion of any excess indemnification received by D attributable to his employer's contribution is determined as follows:

Indemnification from employer's policy	\$700
Indemnification from employee's policy	500
Total indemnification received	1,200
Amount of medical expenses attributable to employee's policy $5/12 \times \$900 =$	375
Amount of medical expenses attributable to employer's policy $7/12 \times 900 =$	525
Total medical expenses incurred	900
Excess indemnification attributable to the employer's policy	175

Since both D and his employer contributed to the payment of the cost of this policy, a further allocation must be made to ascertain the excess indemnification 48 attributable to the employer's contribution.

Employee's contribution	\$150
Employer's contribution	90
Total cost of policy	240
Ratio of employer's contribution to the annual cost of the policy ($\$90/\240)	9/24

Thus, 9/24 of the excess indemnification of \$175 (or \$65.62) is attributable to the employer's contribution and, accordingly, is the amount includible by D in his gross income.

In situations involving indemnification by more than one policy for a specific portion of the expenses of medical care, the aggregate amounts expended for medical care must, in accordance with Revenue Ruling 56-18, C.B. 1956-1, 135, be reduced by the aggregate indemnities received under the insurance policies in arriving at the net deductible medical expense allowable under section 213 of the Code.