

Internal Revenue Service

Department of the Treasury

Number: **200204021**
Release Date: 1/25/2002
Index Number: 104.01-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:HW;PLR-137250-01
Date:
10/22/2001

Employer =
Plan =

Dear

This responds to your letter of July 6, 2001, on behalf of Employer. You requested rulings concerning the federal income tax treatment of long-term disability benefits paid through the Plan under sections 104(a)(3) and 105 of the Internal Revenue Code (the Code).

You represent that the Plan is a fully non-contributory employee welfare benefit plan providing long-term disability coverage under a group insurance policy for all eligible employees. Under the plan as currently written, Employer pays the entire cost for each employee's long-term disability coverage. To enhance the long-term disability benefit for its' employees, Employer proposes to amend the Plan to provide non-taxable proceeds from the Plan for the participants (the Amended Plan). Under the Amended Plan, Employer will continue to make the premium payments for the disability insurance for each participant and then include the amount of the premium paid, in each participant's taxable wages in the year the payments are made. Additionally, Employer will provide each participant with a one-time cash payment equal to the approximate additional tax resulting from the inclusion of the amount of the premium payments in taxable wages.

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 1.104-1(d) of the Income Tax Regulations states 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). Conversely, 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, the exclusion provided under section 104(a)(3) does not apply to any

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amounts received by his employees through such fund or insurance.

Amounts received by an employee through accident or health insurance for personal injuries or sickness must be included in gross income under section 105(a) of the Code 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.

In *Bouquet v. Commissioner*, T.C. Memo. 1994-212, 67 T.C.M. 2959 (1994), the taxpayer's employer paid the premium for long-term disability insurance and the taxpayer reimbursed his employer. The insurance policy stated that the employer was "nothing more than an agent or conduit which paid the premiums nominally and then collected the premium payments from employees themselves." In addition, the employees signed agreements to recompense the corporation for these disbursements. The court in *Bouquet* concluded that the disability benefits received by the taxpayer were attributable to employee contributions and were thus excludable from the taxpayer's gross income under section 104(a)(3) of the Code.

Participants in the Amended Plan will have long-term disability benefits that are attributable to contributions by the employer which will be included in the gross income of participants. Effectively, therefore, Employer is acting as a conduit for the payment of premiums for the long-term disability coverage by the participants with after-tax dollars.

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

(1) Long-term disability coverage purchased under the Amended Plan will not be attributable to contributions by Employer for purposes of section 104(a)(3) and 105 of the Code.

(2) The long-term disability benefits received by participants covered under the Amended Plan will be excludable from the participants' gross income under section 104(a)(3) of the Code.

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 yours,
Felix Zech
Assistant Chief, Health and Welfare Branch
Office of Division Counsel/
Associate Chief Counsel
(Tax Exempt and Government Entities)