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Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:FIP:B04 - PLR-106568-03
Date:
June 17, 2003

In Re:

Individual A =

Company X =

Company Y =

State Z =

Dear :

This is in response to the January 30, 2003 letter submitted by you on behalf of company X requesting a ruling concerning the federal income tax treatment of benefits received under certain life insurance contract riders.

FACTS

Company X is a stock life insurance company organized under the laws of State Z and is subject to tax under section 801 of the Internal Revenue Code. Company X is a wholly-owned subsidiary of company Y. Companies X and Y file a consolidated income tax return on a calendar year basis.

Individual A is considering purchasing a cash value life insurance contract ("Contract") with attached riders issued by company X. Company X represents that the Contract qualifies as a "life insurance contract" within the meaning of section 7702. The

attached riders consist of four separate riders: (1) Death of Spouse or Child Rider; (2) Chronic Illness Accelerated Benefits Rider; (3) Disability Income Rider; and (4) Critical Illness Rider. A Contract holder has the option of purchasing the riders, but the riders are available only as a group. Company X requests a ruling with respect only to the Disability Income Rider and the Critical Illness Rider.

Charges for each of the riders will be imposed against the cash value of the Contract. Charges will depend on the age, risk classification, and gender of the insured. The riders will not be underwritten separately from the Contract and do not have a cash value.

The aggregate amount of benefits payable under all of the riders will be established at issuance as the initial face amount of the Contract and will decrease as rider benefits are paid. Benefits paid under the riders will not reduce the Contract's death benefit or cash value.

The Disability Income Rider will pay a monthly benefit equal to a percentage of the aggregate amount of benefits payable under the riders if the insured has not reached the age of 65, is receiving Social Security Disability payments, and is totally disabled (because of injury or sickness is unable to engage in any occupation for which the insured is reasonably qualified by education, training, or prior experience). If the insured is not a participant in the Social Security program, benefits will be paid if the insured has not reached the age of 65, is totally disabled with a disability that is expected to last at least a continuous period of 12 consecutive months or is expected to result in death, and was continuously actively at work during the three month period immediately prior to the commencement of total disability. The Disability Income Rider terminates when the insured reaches age 65.

The Critical Illness Rider will pay a lump-sum benefit equal to a percentage of the aggregate amount of benefits payable under the riders upon the occurrence or diagnosis of Amyotrophic lateral sclerosis, blindness, cancer, end stage renal failure, loss of hearing, heart attack, organ or bone transplant, paralysis, loss of limbs, or stroke.

Both the Disability Income Rider and the Critical Illness Rider have a waiver of premium benefit under which the premium on the Contract will be waived while the insured is eligible for benefits under the rider.

LAW AND ANALYSIS

Section 104(a)(3) provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc. expenses) 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 (A) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (B) are paid by the employer).

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) provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 for any prior year, gross income does not include amounts referred to in section 105(a) if such amounts are paid to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care of the taxpayer, his spouse and dependents.

Section 105(c) provides that gross income does not include amounts referred to in section 105(a) to the extent such amounts constitute payments for the permanent loss or loss of use of a member or function of the body or the permanent disfigurement, of the taxpayer, his spouse, or a dependent and are computed with reference to the nature of the injury without regard to the period the employee is absent from work.

The Disability Income Rider specifically conditions the payment of benefits upon total disability "because of injury or sickness" and all of the conditions for which payment will be made under the Critical Illness Rider constitute illnesses or bodily infirmities.

Accordingly, we conclude:

- A. Benefits received under the Disability Income and Critical Illness Riders will be excludable from the recipient's gross income under section 104(a)(3), unless the benefits are attributable to contributions of the recipient's employer that were not includible in the recipient's gross income.
- B. Benefits attributable to contributions of the recipient's employer that were not includible in the recipient's gross income that are received under the Critical Illness Rider will be includible in the recipient's gross income under section 105(a) except to the extent they qualify for exclusion under sections 105(b) or 105(c),
- C. Benefits payable under the Disability Income Rider are not reimbursements of medical expenses of the recipient nor are they computed with reference to the nature of the recipient's injury without regard to the period the recipient is absent from work. Accordingly, benefits received by an employee under the Disability Income Rider are includible in the employee's gross income under section 105(a) to the extent that they are attributable to contributions of his or her employer that were not includible in his or

her gross income.

Except as expressly provided herein, no opinion is expressed concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed concerning whether the benefits provided under the riders, either individually or as a group, are considered qualified additional benefits for purposes of section 7702.

The rulings contained in this letter are based upon information and representations submitted by company X and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

DONALD J. DREES, JR.
Senior Technician Reviewer
Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)