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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:HW
PLR-127873-04

Date:
09/14/2004

Legend

Employer:

Plan:

Dear :

This is in reply to your letter dated May 19, 2004, requesting rulings concerning the proper Federal tax treatment of a medical reimbursement plan.

You represent that Employer has established the Plan, which is an employer-provided medical reimbursement plan. The Plan provides that all employees of Employer who are either administrators or teachers are Members of the Plan. The Plan provides for the payment of or reimbursement for, qualified medical expenses incurred by Plan Members. Under Employer's Plan, the payment of, or reimbursement for, medical expenses is limited to those expenses that are incurred after retirement or other termination of employment.

Under the Plan, an individual account will be established for each employee who is a Member of the Plan. You represent that the accounts are held in a Trust, which is a voluntary employees' beneficiary association described in section 501(c)(9) of the Internal Revenue Code (the Code).

The amount of total payments or reimbursements to which a Member is entitled is determined by the balance of the individual account established for the Member. Employer makes contributions to the Trust on behalf of each Member. Members do not have the right to receive cash or any other taxable or non-taxable benefit under the Plan

other than the payment of, or reimbursement for medical expenses. You represent that Employer contributions allocated to each Member's account do not, directly or indirectly result from any form of salary reduction or employee election.

The Plan reimburses Members for medical expenses, as defined in § 213(d) of the Code (except for long-term care expenses). The Plan reimburses only those medical expenses that were incurred by the Member and the Member's spouse and dependents (as defined in § 152), and no medical expenses incurred by any individual who is not the Member or the Member's spouse or dependents (as defined in § 152) are eligible for payment or reimbursement under the Plan. The Plan will reimburse medical expenses only to the extent that the Member or the Member's spouse or dependents have not been reimbursed for the expense from any other plan. Employer requires Members to substantiate medical expenses before reimbursements or payments are made.

Upon the death of a Member who has an account balance, the Member's surviving spouse and dependents (as defined in § 152) are entitled to payment of, or reimbursement for medical expenses (as defined in § 213(d)) until the account balance is exhausted. The account balance of a deceased Member is not available for the payment of, or reimbursement for medical expenses of any individual, other than the deceased Member's surviving spouse or dependents (as defined in § 152). If a deceased Member does not have a surviving spouse or dependents (or if the surviving spouse or dependents die before the account is depleted), the Member's account balance is allocated among the accounts of the other Members.

Section 61(a)(1) of the Code and § 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 106 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 provides 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 (as defined in § 152). 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. However, if the insurance policy, trust or fund provides other benefits in addition to accident or health, § 106 applies only to the portion of the contributions allocable to accident or health benefits.

Section 105(a) provides that, except as otherwise provided in § 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 § 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 § 213(d)) of the taxpayer or the taxpayer's spouse or dependents (as defined in § 152). Section 1.105-2 of the regulations provides that only amounts that are paid specifically to reimburse the taxpayer for expenses incurred by the taxpayer for the prescribed medical care are excludable from gross income. Thus, § 105(b) does not apply to amounts that the taxpayer would be entitled to receive irrespective of whether or not the taxpayer incurs expenses for medical care.

In Rev. Rul. 2002-41, 2002-2 C.B. 75, an employer sponsors a health reimbursement arrangement (HRA) that is paid for solely by the employer and not through salary reduction contributions. The HRA reimburses substantiated medical care expenses (as defined in § 213(d)) of participating employees and their spouses and dependents (as defined in §152) up to a maximum annual reimbursement amount. Unused amounts from one coverage period are carried forward to subsequent coverage periods. Participating employees have no right to receive cash or any other benefit in lieu of medical expense reimbursements. In Situation 2 of Rev. Rul. 2002-41, the maximum reimbursement amount under the HRA that is not applied to reimburse medical care expenses before an employee retires or otherwise terminates employment continues to be available after retirement or termination for any medical care expense under § 213(d) incurred by the former employee or the former employee's spouse and dependents. The ruling concludes that coverage and reimbursements made under the HRA are excludable from the gross income of participating employees under §§ 106 and 105.

Notice 2002-45, 2002-2 C.B. 93, provides that an HRA is an arrangement that: (1) is paid for solely by the employer and not pursuant to salary reduction; (2) reimburses the employee for medical care expenses (as defined in § 213(d)) incurred by the employee and the employee's spouse and dependents (as defined in § 152); and (3) provides that any unused portion of the maximum dollar amount available during the coverage period is carried forward to subsequent periods. Notice 2002-45 also provides that benefits under an HRA must be limited to reimbursements of § 213(d) expenses and that all such expense reimbursements must be substantiated to be excludable under § 105. Notice 2002-45 further provides that medical care expense reimbursements under an HRA are excludable under § 105(b) if the reimbursements are provided to the following individuals: current and former employees (including retired employees), their spouses and dependents (as defined in § 152 as modified by the last sentence of § 105(b)), and the spouses and dependents of deceased employees.

The Plan is an employer-provided accident and health plan that is paid for solely by the Employer and amounts are used exclusively to reimburse Members (i.e., former employees) for expenses incurred for the medical care (as defined in § 213(d)) of the Member and the Member's spouse or dependents (as defined in § 152). Upon the death of a Member, amounts are used exclusively to reimburse the Member's surviving spouse or dependents (as defined in § 152) for medical care (as defined in § 213(d)). No benefits other than reimbursements for medical care expenses are available at any time to Members or the surviving spouses and dependents of Members either in the form of cash or other nontaxable or taxable benefits. Accordingly, the Plan meets the requirements as set forth in Rev. Rul. 2002-41 and Notice 2002-45.

Based on the information submitted and the representations made, we conclude as follows: (1) contributions and coverage under the Plan are excludable from the gross income of Members under § 106 of the Code; and (2) payments for, and reimbursements of medical care expenses to Members and the spouses and dependents of Members (as defined in §152) or the surviving spouses and dependents of Members (as defined in § 152) under the Plan are excludable from gross income under § 105(b) of the Code.

No opinion is expressed concerning whether the Plan satisfies the nondiscrimination requirements of § 105(h) of the Code and § 1.105-11 of the regulations. In addition, no opinion is expressed concerning whether the Trust is a voluntary employees' beneficiary association described in § 501(c)(9) of the Code. Moreover, we are specifically not ruling on whether contributions, coverage, and payments or reimbursements will be excludable from gross income under §§ 106 and 105 if any amounts may be provided under the Plan to anyone other than Members and the spouses and dependents of Members or the surviving spouses and dependents of Members. Finally, no opinion is expressed concerning the Federal tax consequences of the Plan under any other provision of the Code other than those specifically stated herein.

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)