

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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3306.00-00, 3401.00-00

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:TEGE:EB:HW  
PLR-103146-15

Date:  
April 06, 2015

Legend:  
Taxpayer =

Resolution =

Dear :

This responds to the letter from your authorized representative, dated December 29, 2014, and subsequent correspondence of February 12, 2015, requesting rulings on behalf of Taxpayer concerning the Federal income tax treatment under sections 106, 3121, 3306 and 3401 of the Internal Revenue Code (the Code) of contributions made to a retiree health plan on behalf of eligible retirees.

Taxpayer currently provides health coverage to eligible retirees, their spouses, their registered domestic partners and their dependents through a choice of health plans. Upon retirement, eligible retirees generally pay premiums for the health coverage with their own after-tax funds. Some retirees are also eligible to have a portion of their accumulated unused sick leave at retirement mandatorily converted to a contribution from the employer to pay for the health insurance premiums. Contributions are uniform and based on hours of sick leave available for conversion and the class of retiree coverage (e.g., retiree-only coverage, retiree-plus-dependent, retiree-plus-family).

Taxpayer proposes, pursuant to Resolution, to establish a new retiree medical benefit structure in the form of a health reimbursement arrangement for the benefit of eligible retirees, their spouses, their registered domestic partners and their dependents (retiree HRA). Eligible employees hired before a certain date will make an election at retirement to participate in either (1) the existing health plans with premiums funded, in part, by

mandatory sick leave conversion, or (2) a retiree HRA funded by mandatory conversion of accumulated unused sick leave at retirement. Retiree HRA amounts are uniform and based on hours of sick leave available for conversion, class of retiree coverage, and Medicare eligibility. The election to waive coverage under the existing health plans may not generally be changed. No other contributions, other than the sick leave conversion, are made to the retiree HRA.

Taxpayer represents that amounts in the retiree HRA may only be used to reimburse health insurance premiums and medical expenses as defined in section 213 of the Code. The retiree HRA will not pay claims for registered domestic partner's medical expenses. Nor will the retiree HRA reimburse spouse's group health insurance that has been paid with pre-tax dollars.

Taxpayer represents that under no circumstance may the eligible retiree or any beneficiary receive any conversion amounts at any time in cash or other benefits. Following the retiree's death, unused amounts continue for the benefit of the retiree's spouse, registered domestic partner and eligible dependents (children under 26). The benefits continue until all eligible sick leave has been converted, the death of the surviving spouse, registered domestic partner and eligible dependents, or an election to not continue the program at which time any amounts not applied to reimburse medical expenses are forfeited. If the eligible retiree dies and has no dependents, the sick leave amounts are forfeited. There is no option to receive the value of the unused sick leave in any form other than as reimbursement of medical expenses.

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 1.61-21(a)(3) of the regulations provides that a fringe benefit provided in connection with the performance of services shall be considered to have been provided as compensation for such services.

Section 1.61-21(a)(4) of the regulations provides that, in general, a taxable fringe benefit is included in the income of the person performing the services in connection with which the fringe benefit is furnished. If a fringe benefit is furnished to someone other than the service provider, such benefit is considered as furnished to the service provider.

Section 1.61-21(b)(1) of the regulations provides that an employee must include in gross income the fair market value of the fringe benefit.

Section 106(a) of the Code provides that the 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 his 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, the employee's spouse, or the employee's dependents as defined in section 152 of the Code. 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, section 106 applies only to the portion of the contributions allocable to accident or health benefits.

Coverage provided under an accident and health plan to former employees and their spouses and dependents is excluded from gross income under section 106. See, Rev. Rul. 62-199, 1962-2 C.B. 38.

Notice 2002-45, 2002-2 C.B. 93, describes the tax treatment of health reimbursement arrangements (HRAs). The notice explains that a tax-favored HRA is an arrangement that (1) is paid for solely by the employer and not pursuant to a salary reduction election or otherwise under a section 125 cafeteria plan; (2) reimburses the employee for medical care expenses (as defined in section 213(d)) incurred by the employee or by the employee's spouse or dependents; and (3) provides reimbursements up to a maximum dollar amount with any unused portion of that amount at the end of the coverage period carried forward to subsequent coverage periods.

Notice 2002-45 emphasizes that employer contributions to an HRA may not be attributable to salary reduction or otherwise provided under a section 125 cafeteria plan. An accident and health plan funded pursuant to salary reduction is not an HRA and is subject to the rules under section 125.

Rev. Rul. 2005-24, 2002-2 C.B. 93, describes a health reimbursement arrangement. Situation 1 of the ruling states that when an employee retires, the employer automatically and on a mandatory basis (as determined under the Plan) contributes an amount to the reimbursement plan equal to the value of all or a portion of the retired employee's accumulated unused vacation and sick leave. The ruling concludes that the reimbursement plan described in Situation 1 is an HRA that meets the requirements for tax-favored treatment.

Section 3101 imposes taxes under the Federal Insurance Contributions Act (FICA) "on the income of every individual" in an amount equal to a percentage "of the wages received by him with respect to employment." Section 3111 provides that the employer portion of FICA tax is imposed directly upon the employer as "an excise tax, with respect to having individuals in his employ." Similarly, section 3301 provides that FUTA tax is imposed on every employer as an excise tax with respect to individuals in his

employ equal to a percentage of wages paid by the employer with respect to employment.

Section 3121(a) provides for FICA purposes and section 3306(b) provides for FUTA purposes, with certain exceptions, that the term “wages” means “all remuneration for employment.” However, sections 3121(a)(2) and 3306(b)(2) provide that the term “wages” does not include any payment made to or on behalf of an employee, or any of his dependents, for medical or hospitalization expenses. Section 3401(a) provides that for purposes of federal income tax withholding, “wages” means all remuneration for services performed by an employee for his employer, including the cash value of any benefits. However, Rev. Rul. 56-632, 1956-2 C.B. 101, holds that when premiums paid by an employer under policies providing hospital and surgical services are excludable from employees’ gross income under section 106, the amounts paid by the employer are not subject to federal income tax withholding.

Accordingly, based on the information submitted, representations made and authorities cited above, we conclude that:

- (1) Taxpayer contributions made to the retiree HRA on behalf of eligible retirees, spouses, and eligible dependents which are used exclusively to pay for eligible medical expenses are excludable from the gross income of eligible retirees under section 106 of the Code
- (2) Taxpayer contributions made to the retiree HRA on behalf of eligible retirees, spouse and eligible dependents are not “wages” and are not subject to FICA taxes under section 3121(a), FUTA taxes under section 3306(b) or income tax withholding under section 3401(a).
- (3) Taxpayer contributions made to the retiree HRA that are used to provide medical coverage for registered domestic partners of eligible retirees (e.g., health insurance premiums) are included in the gross income of eligible retirees under section 61 of the Code.

No opinion is expressed as to the federal tax consequences of the transaction under any other section of the Code other than those specifically stated above.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

/S/

Harry Beker  
Chief, Health and Welfare Branch  
Office of Associate Chief Counsel  
(Tax Exempt and Government Entities)

cc: