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Department of the Treasury
Washington, DC 20224

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Person To Contact:
_____, ID No.
Telephone Number:

Refer Reply To:
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Date:
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Legend

- Taxpayer =
- Pension Plan =
- Welfare Benefit Plan =
- Entity 1 =
- Date 1 =
- Date 2 =
- Date 3 =
- Date 4 =
- Date 5 =
- Year A =

Dear _____ :

This is in response to your letter, dated _____, submitted on your behalf by your authorized representative. The letter requests a ruling regarding the qualified status under Internal Revenue Code section 401(a) and (h) with respect to a plan amendment to the Pension Plan, expanding employee eligibility for benefits under the Pension Plan's section 401(h) retiree medical account to include certain active employees eligible to commence retirement benefits under the Pension Plan upon attainment of age 59½ pursuant to section 401(a)(36).

Facts

The following facts and representations have been submitted under penalties of perjury in support of the rulings requested:

Taxpayer has a calendar year accounting period and files its tax returns under the accrual method.

Taxpayer maintains the Pension Plan, a defined benefit pension plan. The Pension Plan was established on Date 1. The Pension Plan was most recently restated on Date 2. The Pension Plan provided a traditional average pay formula with a Social Security offset until it converted to a cash balance plan formula in Year A for all participants. The Pension Plan was frozen to new participants on Date 3.

Effective Date 4, Taxpayer amended the Pension Plan to include a section 401(h) retiree medical account ("401(h) Account") used for payment of medical benefits provided to certain retired employees, and their spouses and dependents. The Pension Plan has received multiple favorable determination letters since it was amended to add the 401(h) Account, the most recent being dated Date 5.

Taxpayer is not required to fund the 401(h) Account on an annual or regular basis, although the 401(h) Account has been funded by Taxpayer from time to time, with the last contribution being made in 2012.

Taxpayer represents that the 401(h) Account was not funded, directly or indirectly, by a section 420 transfer. The Pension Plan does not allow for or permit contributions from employees.

In order to participate in the Pension Plan, an individual must be an "Eligible Employee," subject to completing one year of service. An Eligible Employee is any individual who renders service to the "Company"¹ in the status of an employee, as defined under section 3121(d). Certain types of employees, including those whose collective bargaining or other agreement with the Company does not provide for coverage under the Pension Plan, are excluded.

A participant becomes 100% vested in the Pension Plan's benefits upon completion of one of the following: (a) reaching the normal retirement age of 65 while an employee at the Company, (b) termination or partial termination of the Pension Plan by the Company, or (c) five years of service.

Pension Plan participants are generally eligible for benefits under the 401(h) Account provided that the participants retire under the terms of the Pension Plan and, at the time of retirement, are employees of the Taxpayer or Entity 1. A participant is considered to have retired under the Pension Plan when the participant terminates employment from the Company for any reason (other than death) on or after their earliest retirement date (when the participant has attained age 55 and completed five years of service).

¹ The Company comprises the Taxpayer, its parent company, and other member of the parent company's controlled or affiliated service groups. For purposes of specific articles and sections of the Pension Plan, the Company also means any trade or business (whether or not incorporated) which is under common control with Taxpayer within the meaning of section 414(b), (c), (m), or (o).

Participants who are key employees or represented by a collective bargaining agreement are not eligible for benefits under the 401(h) Account.

The 401(h) Account provides funding and payment of retiree health benefits for Pension Plan participants who are eligible to receive such benefits under the Welfare Benefit Plan, which is sponsored by Taxpayer. Retiree health benefits under the Welfare Benefit Plan are available to former employees and their dependents provided one or more eligibility requirements is met.

Although the Welfare Benefit Plan provides retiree health benefits to eligible represented and non-represented employees, the 401(h) Account only provides funding and payment for retiree health benefits under the Welfare Benefit Plan for former non-represented and non-key employees.

The 401(h) Account pays for medical, dental, vision, behavioral health, and Medicare Part B premium reimbursement benefits under the Welfare Benefit Plan for eligible retirees and their dependents. The specific retiree health benefits available to retirees depends on which Welfare Benefit Plan eligibility requirements they satisfied.

The amounts available to Pension Plan participants and their dependents for benefits funded by the 401(h) Account as provided under the Welfare Benefit Plan depend on which of three categories of beneficiary they fall into.

The 401(h) Account has significantly more assets than needed to satisfy liabilities for post-retirement medical benefits. The surplus assets in the 401(h) Account are a result of several factors affecting Taxpayer and the post-retirement health benefits paid by Taxpayer, including: unexpectedly high investment returns, reductions in staffing, and government expansion of Medicare Part D.

Taxpayer wishes to amend the Pension Plan ("Proposed Transaction") in accordance with section 401(a)(36) to allow eligible participants who have not yet separated from service to begin receipt of pension benefits beginning the first month after attainment of age 59½. Key employees and collectively bargained employees will be excluded from eligibility for the new in-service distribution feature. In addition, the Pension Plan would be amended to treat active participants who have attained age 59½ as retirees for 401(h) Account purposes, and permit the payment from the 401(h) Account to such active participants (and their spouses and dependents) for health benefits under the Welfare Benefit Plan for active employees.

Post-age-59½ in-service distributions from the Pension plan would permit an eligible participant to obtain the participant's full accrued benefit as a Single Life Annuity or, if married, a 50% Qualified Joint and Survivor Annuity. Lump-sum distributions would not be permitted. Eligible participants who request in-service distributions would continue to accrue future benefits under the Pension Plan in accordance with plan terms.

Taxpayer represents that the 401(h) Account assets would not be used to pay for any medical benefits which Taxpayer has a contractual obligation to fund.

Taxpayer represents that collectively bargained Pension Plan participants and key employees would continue to be ineligible for retiree health benefits paid from the 401(h) Account.

Ruling Requested

Taxpayer requests a ruling that the payment of health benefits from the Pension Plan's 401(h) Account for Pension Plan participants who are eligible to take pension distributions in accordance with section 401(a)(36), does not violate section 401(h) or § 1.401-14 or otherwise affect the Pension Plan's tax-qualified status under section 401(a).

Law

Section 401(a) describes the requirements for a qualified trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of the employer's employees or their beneficiaries.

Section 501(a) provides that an organization described in section 401(a) is generally exempt from federal income tax.

Section 401(a)(36) provides that a trust forming part of a pension plan shall not be treated as failing to constitute a qualified trust under section 401 solely because the plan provides that a distribution may be made from the trust to an employee who has attained age 59½ and who is not separated from employment at the time of the distribution.

Section 401(h) provides that, under regulations prescribed by the Secretary, and subject to the provisions of section 420, a pension or annuity plan may provide for the payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees, their spouses, and their dependents, but only if—

- (1) such benefits are subordinate to the retirement benefits provided by the plan;
- (2) a separate account is established and maintained for such benefits;
- (3) the employer's contributions to such separate account are reasonable and ascertainable;
- (4) it is impossible, at any time prior to the satisfaction of all liabilities under the plan to provide such benefits, for any part of the corpus or income of such separate

account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits;

- (5) notwithstanding the provisions of section 401(a)(2), upon the satisfaction of all liabilities under the plan to provide such benefits, any amount remaining in such separate account must, under the terms of the plan, be returned to the employer; and
- (6) in the case of an employee who is a key employee, a separate account is established and maintained for such benefits payable to such employee (and his spouse and dependents) and such benefits (to the extent attributable to plan years beginning after March 31, 1984, for which the employee is a key employee) are only payable to such employee (and his spouse and dependents) from such separate account.

Section 1.401-14(a) provides that, under section 401(h), a qualified pension or annuity plan may make provision for the payment of sickness, accident, hospitalization, and medical expenses for retired employees, their spouses, and their dependents. The term "medical benefits described in section 401(h)" is used in § 1.401-14 to describe such payments.

Section 1.401-14(b)(1) provides that, under section 401(h), a qualified pension or annuity plan may provide for the payment of medical benefits described in section 401(h) only for retired employees, their spouses, or their dependents. To be "retired" for purposes of eligibility to receive medical benefits described in section 401(h), an employee must be eligible to receive retirement benefits provided under the pension plan, or else be retired by an employer providing such medical benefits by reason of permanent disability. For purposes of the preceding sentence, an employee is not considered to be eligible to receive retirement benefits provided under the plan if he is still employed by the employer and a separation from employment is a condition to receiving the retirement benefits.

Section 1.401-14(c) sets forth requirements which must be met for a qualified pension or annuity plan to provide medical benefits described in section 401(h):

- (1) The plan must specify the medical benefits described in section 401(h) which will be available and must contain provisions for determining the amount which will be paid. Such benefits, when added to any life insurance protection provided for under the plan, must be subordinate to the retirement benefits provided by such plan.
- (2) A separate account must be maintained with respect to contributions to fund medical benefits described in section 401(h).

- (3) Amounts contributed to fund medical benefits, as described in section 401(h), must be reasonable and ascertainable.
- (4) It must be impossible, at any time prior to the satisfaction of all liabilities under the plan to provide for the payment of medical benefits described in section 401(h), for any part of the corpus or income of the medical benefits account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits.
- (5) The plan must provide that any amounts which are contributed to fund medical benefits described in section 401(h) and which remain in the medical benefits account upon the satisfaction of all liabilities arising out of the operation of the medical benefits portion of the plan are to be returned to the employer.

Analysis

The second sentence of § 1.401-14(b)(1) provides that an employee is eligible to receive medical benefits from a 401(h) account as a “retired employee” if the employee is eligible to receive retirement benefits under the associated pension plan. Under the Taxpayer’s proposed amendment, certain participants will be eligible to receive retirement benefits under the terms of Pension Plan upon attainment of age 59½, thereby satisfying the definition of a “retired employee” as described in the second sentence of § 1.401-14(b)(1).

The third sentence of § 1.401-14(b)(1) provides that an employee is not considered to be eligible to receive retirement benefits under the plan if he is still employed by the employer and a separation from employment is a condition to receiving the retirement benefits. Because certain Pension Plan participants will be eligible to receive retirement benefits prior to their separation from employment once they attain age 59½, separation from employment would not be a condition to receiving retirement benefits under the Pension Plan for those participants. Accordingly, the participants covered by the proposed plan amendment who are at least 59½ and still actively employed would not be excluded from being considered eligible to receive retirement benefits under the third sentence of § 1.401-14(b)(1).

Ruling

We conclude that adoption of Taxpayer’s Proposed Transaction, allowing the use of payments from the Pension Plan’s 401(h) Account to fund health benefits for participants who are eligible to take pension distributions in accordance with section 401(a)(36), would not violate section 401(h) or § 1.401-14 or otherwise cause the Pension Plan to lose its tax-qualified status under section 401(a).

The ruling contained in this letter is based upon information and representations submitted by Taxpayer and accompanied by penalties of perjury statement executed by

an appropriate party, as specified in Rev. Proc. 2024-1, 2024-1 I.R.B. 1, section 7.01(16). This office has not verified any of the material submitted in support of the request for rulings. This material is subject to verification upon examination. The Associate Office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts, the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based, or—in the case of a transaction involving a continuing action or series of actions—the controlling facts change during the course of the transaction. See Rev. Proc. 2024-1, section 11.05.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter ruling. Specifically, no opinion is provided on any income tax consequences to Taxpayer as a result of the use of the Pension Plan's 401(h) Account to provide health benefits to the employees who have not separated from employment. In addition, no opinion is expressed as to whether the Pension Plan satisfies any requirements of section 401(a) not expressly discussed.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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,

Jeremy D. Lamb
Senior Counsel
Qualified Plans Branch 2
Office of Associate Chief Counsel
(Employee Benefits, Exempt Organizations, and
Employment Taxes)

cc: