Internal Revenue Service

Index Nos. 105.00-00; 3401.00-00;
3121.00-00; 3306.00-00

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

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Refer Reply to:

Date: CC:EBEO:Br 6 PLR-118382-98

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Taxpayer =

Dear

This is in reply to your letter dated September 16, 1998, requesting rulings, on behalf of Taxpayer, concerning the Federal income and employment tax treatment of certain rebate payments.

Taxpayer manages a Preferred Provider Organization (PPO) network. The network consists of hospitals, physicians and other health care providers who offer their services to Taxpayer's clients at negotiated discounted rates. Taxpayer offers access to its PPO network to self-insured employers and other health care payers. In exchange for the discounted rates for their employees, employers pay fees to Taxpayer to use the PPO network. The fees are generally based on a percentage of the savings realized through employees' utilization of contracted network providers for medical services versus non-contracted providers. Taxpayer also offers claims administration and other health, life and related services to its self-insured clients as an agent of the client in processing medical claims and making payments to medical service providers.

In order to increase employee usage of Taxpayer's contracted network providers for medical services, the Taxpayer proposed to administer an incentive "rebate" program under which Taxpayer will rebate to an employee a portion of that employee's out-of-pocket health care costs incurred from using Taxpayer's PPO network. All employees pay a portion of their health care costs in the form of co-insurance or deductibles, and each claim for a PPO visit within Taxpayer's PPO network for a covered service will be eligible for a rebate. The amount of the rebate for each eligible claim will not exceed the patient's actual out-of-pocket cost for that claim. Rebate payments for each employee will accumulate over the year but be paid out only once annually (after the end of the client-employer's medical plan year) with a maximum rebate equal to an employee's annual out-of-pocket expense maximum.

Taxpayer will offer employers two methods for financing the cost of its rebate program. First, rebate payments may be paid directly with employer funds. Second, rebate payments may be funded indirectly with employer funds. If paid with Taxpayer funds, the employer will pay an increased fee to reimburse Taxpayer.

Section 105(a) of the Internal Revenue Code provides that except as otherwise provided in section 105, amounts received by an employee through employer-provided accident or health insurance for personal injuries or sickness shall be included in gross income.

Section 105(b) of the Code provides an exception to the general rule of inclusion under section 105(a). Section 105(b) provides that except in the case of amounts attributable to deductions allowed under section 213 for any prior taxable year, gross income does not include amounts received by an employee for personal injuries or sickness if such amounts are paid directly or indirectly to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care of the taxpayer, his spouse or dependents.

Section 105(e) of the Code provides that, for purposes of section 105, amounts received under an accident or health plan for employees shall be treated as amounts received through accident or health insurance.

Section 1.105-5(a) of the Income Tax Regulations provides that, in general, an accident or health plan is an arrangement for the payment of amounts to employees in the event of personal injuries or sickness.

Accordingly, an employer-provided plan to reimburse a portion of an employee's out of pocket expenses for medical care constitutes accident and health insurance for purposes of sections 105(a) and (b) of the Code pursuant to section 105(e) of the Code.

Section 105(h) of the Code provides that section 105(b) shall not apply to excess reimbursements received by a highly compensated individual under a discriminatory self-insured medical expense reimbursement plan.

Section 3121(a)(2) of the Code provides that, for Federal Insurance Contribution Act (FICA) purposes, "wages" do not include the amount of any payment made to, or on behalf, of an employee or any of his dependents under an employer's plan on account of medical or hospitalization expenses in connection with sickness or accident disability. In addition, section 3306(b)(2) of the Code excepts such payments from the definition of "wages" for Federal Unemployment Tax Act (FUTA) purposes.

Section 3401(a)(20)of the Code provides that, for purposes of tax withholding, "wages" do not include remuneration paid for any medical care reimbursement made to or for the benefit of an employee under a self-insured medical reimbursement plan within the meaning of section 105(h)(6) of the Code.

Accordingly, based on the representations made and authorities cited above, we conclude as follows:

1. Rebate payments to an employee under the Taxpayer's rebate program are treated as reimbursements of medical expenses through an employer provided health plan and are excludable from the recipient's gross income under section 105(b) of the Code, except to the extent the rebates constitute discriminatory excess reimbursements to highly compensated individuals under section 105(h) or reimbursements of medical expenses that were deducted under section 213 for a prior taxable year.

2. Neither Taxpayer nor the employer has any information reporting, income tax withholding or employment tax obligation with respect to rebate amounts paid under Taxpayer's rebate program to the employees, except that, to the extent the rebates constitute discriminatory excess reimbursements to highly compensated individuals under section 105(h) of the Code, the rebates will be subject to reporting requirements under section 6041 of the Code.

No opinion is expressed or implied concerning the tax consequences of the Taxpayer's rebate program under any other provision of the Code or regulations other than those specifically stated above. In particular, no opinion is expressed or implied concerning whether any employer's self-insured medical expense reimbursement plan discriminates in favor of highly-compensated individuals under section 105(h) of the Code.

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

Sincerely yours,

Harry Beker
Chief, Branch No.6
Office of the Associate
Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosures:
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