

## Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:TEGE:EB:HW PLR 149613-02

Date:

10/18/2002

Employer:

Plan:

Dear \_\_\_\_\_ :

This responds to your letter of September 5, 2002, requesting rulings on behalf of Employer concerning the Federal income tax treatment of long-term disability benefits paid through the Plan under sections 104 and 105 of the Internal Revenue Code (the Code).

You represent that Employer provides long-term disability coverage to its eligible employees through the Plan. Eligible employees are designated as Tier I or Tier II employees. Disability benefits for Tier I employees are provided through a group insurance policy and individual insurance policies with third-party insurance carriers. Disability benefits for Tier II employees are provided through a group insurance policy with a third-party insurance carrier. Under the current terms of the Plan, Employer pays the premiums for coverage for each Tier I and Tier II employee and the cost of coverage is not included in the gross income of the employee. An employee, however, may elect to pay all or a portion of the premiums through payroll deductions.

Employer intends to amend the Plan (the Amended Plan) to provide that it will continue to make premium payments for the group and individual policies for each Tier I employee and then include such premiums in the taxable wages of each Tier I employee in the year in which the payments are made. A Tier I employee may not elect to have Employer pay premiums on his or her behalf on a pre-tax basis. In addition, while Employer will continue to meet, in full, the premium payments for the group policy for each Tier II employee, such premiums will be allocated to each Tier II employee who elects to meet the cost of coverage on an after-tax basis which will be included in his or her taxable wages for the year. A Tier II employee may also elect to have Employer pay the premiums on his or her behalf on a pre-tax basis.

Under the Amended Plan, a Tier II employee may make an irrevocable election to pay for the cost of coverage on an after-tax or on a pre-tax basis prior to the commencement of the Plan year in which the election becomes effective. Tier II employees will be permitted to make a new election for each Plan year prior to the beginning of that Plan year. Each Tier II employee who becomes eligible for long-term disability coverage during a Plan year may make an election for the remainder of the Plan year during the first thirty days after he or she becomes eligible to participate in the Amended Plan.

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

Section 1.104 -1(d) of the Income Tax Regulations states that if an individual purchases a policy of accident or health insurance out of his own funds, amounts received thereunder for personal injuries or sickness are excludable from his gross income under section 104(a)(3). Conversely, if an employer is either the sole contributor to such a fund, or is the sole purchaser of a policy of accident or health insurance for his employees (on either a group or individual basis), the exclusion provided under section 104(a)(3) does not apply to any amounts received by his employees through such fund or insurance. The regulation refers to section 1.105-1 of the regulations for rules relating to the determination of the amount attributable to employer contributions.

Section 1.105-1(b) of the regulations provides that all amounts received by employees through an accident or health plan which is financed solely by their employer are subject to the provisions of section 105(a).

Section 105(a) of the Code provides that amounts received by an employee through accident or health insurance for personal injuries or sickness must 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, unless paid as reimbursement of medical expenses under section 105(b) or for the loss of use of a member or function of the body and without regard to absence from work under section 105(c).

Section 1.105-1(c) of the regulations provides that in the case of amounts received by an employee through an accident or health plan which is financed partially by his employer and partially by contributions of the employee, section 105(a) of the Code applies to the extent that such payments are attributable to contributions of the employer that were not includible in the employee's gross income. The portion of such

amounts which is attributable to such contributions of the employer shall be determined in accordance with section 1.105-1(d) in the case of insured plans.

With respect to each Tier I and Tier II employee, the Amended Plan is financed either solely by the Employer or solely by the employee. At no time is the coverage under the Amended Plan financed by both Employer and employee contributions. Accordingly, the Amended Plan is not a contributory plan within the meaning of section 1.105-1(c)(1) of the regulations.

Based on the information submitted and the representations made, we conclude as follows:

- (1) Long-term disability benefits paid to a Tier I employee whose premiums were paid, under the Amended Plan, on an after-tax basis for the Plan year in which he or she becomes disabled, are attributable solely to after-tax employee contributions and excludable from the employee's gross income under section 104(a)(3) of the Code.
- (2) Long-term disability benefits paid to a Tier II employee who has elected, under the Amended Plan, to have his or her premiums paid on an after-tax basis for the Plan year in which he or she becomes disabled, are attributable solely to after-tax employee contributions and excludable from the employee's gross income under section 104(a)(3) of the Code.
- (3) Long-term disability benefits paid to a Tier II employee, who has elected, under the Amended Plan, to exclude the premiums paid by Employer from his or her gross income for the Plan year in which he or she becomes disabled, are attributable solely to Employer contributions and includible in the employee's gross income under section 105(a) of the Code.

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, Chief  
Health and Welfare Branch  
Office of Division Counsel/  
Associate Chief Counsel  
(Tax Exempt & Government Entities)

Enclosures:  
Copy of Letter  
Copy for Section 6110 purposes