Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

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Legend

Taxpayer =

Plan =

Dear :

This is in reply to your request dated July 10, 2002, for a ruling concerning the federal tax treatment under sections 104 and 105 of the Internal Revenue Code (the Code) of long term disability benefits paid under the Plan.

The Taxpayer sponsors the Plan, an employee welfare benefit plan that provides long term disability coverage for all of its eligible employees under a group insurance policy issued by a third-party insurance carrier. Under the Plan, employees may pay the premium for coverage on an after-tax basis or the Taxpayer will pay the premium for coverage (which is not included in the gross income of the employees). The Taxpayer amended the Plan, effective April 1, 2002, to enhance the long term disability benefits for its employees (the "Amended Plan"). Under the Amended Plan, employees must decide each year whether to have the Taxpayer pay the group disability insurance premiums charged by the third-party carrier or to pay the insurance premium themselves, with after-tax dollars. It is represented that, under the Amended Plan, employees decide, in writing or through electronic delivery prior to the beginning of each plan year during which the payments are made to either have the Taxpayer pay for the long-term disability coverage or to have the premium amounts included in their gross income. An election is irrevocable for the plan year once the plan year begins. Eligible employees will be able to make a new premium payment election for the following plan year prior to the beginning of the next plan year.

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 includable 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, 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 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).

Amounts received by an employee through accident or health insurance for personal injuries or sickness must be included in gross income under section 105(a) of the Code 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 reimbursements of medical expenses under section 105(b) or for the loss or 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)(1) of the regulations provides that in the case of amounts received by an employee through a contributory 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 the employees, the Amended Plan is financed either solely by the Taxpayer or solely by the employee. At no time is the coverage under the Amended Plan financed by both Taxpayer 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, representations made and authorities cited, we conclude as follows:

(1) Long-term disability benefits paid to an employee who has decided, under the Amended Plan, to have the premiums included in gross income for the plan year in which he or she becomes disabled, are attributable solely to after-tax employee contributions and are excludable from the employee's gross income under section 104(a)(3) of the Code.

(2) Long-term disability benefits paid to an employee who has decided, under the Amended Plan, to have the Taxpayer pay the premiums for the plan year in which he or she becomes disabled, are attributable solely to Taxpayer contributions and are 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 and Government Entities)

Enclosure (1)
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