Internal Revenue Service

Number: **201611003**
Release Date: 3/11/2016

Index Number: 105.00-00, 106.00-00, 401.27-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:HW
PLR-121608-15
Date: December 3, 2015

Legend:

Taxpayer =

Parent Company =

Retirement Plan A =

Retirement Plan B =

Health Plan for Retirees =

Reimbursement Arrangement Plan =

Medical Account Plan =

Year 1 =

Year 2 =

Year 3=

Year 4 =

Year 5=

Year 6 =

Year 7 =

Year 8 =

Amount 1 =

Date 1:

Dear :

This letter responds to your ruling request, submitted by your authorized representatives, as supplemented by correspondence dated and , requesting rulings on the Federal tax consequences of a proposed transaction under sections 105, 106, and 401(h) of the Internal Revenue Code (the "Code") and their accompanying regulations.

The following facts and representations are submitted under penalties of perjury in support of your request:

Taxpayer was formed in Year 1 as a subsidiary of Parent Company. Prior to Taxpayer's creation, Parent Company maintained Retirement Plan A, a defined benefit plan qualified under section 401(a) of the Code.

In Year 2, Retirement Plan A, sponsored by Parent Company, was amended to add a retiree health account described in section 401(h). No employee contributions were required to be made to the Retirement Plan A 401(h) account. Retirement Plan A received a favorable determination letter from the Internal Revenue Service following the amendment which added the 401(h) account.

In Years 3, 4, and 5, in accordance with a special transition rule set forth in Section 7311 of the Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239), all of the eligibility conditions for which Parent Company satisfied, Parent Company made direct contributions to the Retirement Plan A 401(h) account of approximately Amount 1. At no time did Parent Company transfer any assets from Retirement Plan A, including any transfer of assets pursuant to section 420, to the Retirement Plan A 401(h) account. Following Year 5, Parent Company made no further contributions to that 401(h) account.

In Year 1, at the time Parent Company formed Taxpayer as a subsidiary, Taxpayer adopted Retirement Plan B, identical in its terms to Retirement Plan A. At the same time, a portion of the assets of Retirement Plan A were transferred from Retirement Plan A to Retirement Plan B, including assets in the Retirement Plan A 401(h) account. Since Taxpayer's formation, no contributions have been made by Taxpayer to the Retirement Plan B 401(h) account.

In Year 6, Taxpayer became a separate, publicly-traded company. Thereafter, Taxpayer continued to maintain Retirement Plan B, including the section 401(h) account. No employee contributions were made to Retirement Plan B, and Taxpayer has not made any additional contributions to the Retirement Plan B 401(h) account. All retired employees of Taxpayer who are eligible to receive medical benefits under the Retirement Plan B 401(h) account are eligible to receive retirement benefits under Retirement Plan B, or are retired from employment with Taxpayer by reason of permanent disability.

In Year 7, the Retirement Plan B 401(h) account was closed to new entrants. In Year 8, Retirement Plan B was frozen and newly-hired employees were not eligible to participate in it.

Continuously since becoming a separate, publicly-traded company in Year 6, Taxpayer has maintained a traditional, major medical plan for its retirees under its Health Plan for Retirees. For a certain group of retirees (the “Grandfathered Group”), Taxpayer was obligated to maintain such medical benefits pursuant to the transactions that resulted in Taxpayer becoming a separate, publicly-traded company.

Commencing in Year 6, Taxpayer has used the Retirement Plan B 401(h) account to pay a portion of the monthly medical plan premiums under the Health Plan for Retirees for members of the Grandfathered Group, their spouses, and certain of their dependents up to age 65. For Taxpayer’s eligible retirees in the Grandfathered Group who turn age 65, and are enrolled in Medicare, the 401(h) account is used to provide reimbursement for premiums for Medicare and certain individual health insurance under the Reimbursement Arrangement Plan. The Reimbursement Arrangement Plan is an “employer-payment” plan (not a health reimbursement arrangement) that reimburses premiums for Medicare and certain individual health insurance (and not any other section 213(d) expenses) for those individuals who are in the Grandfathered Group, over age 65, and enrolled in Medicare.

In Year 7, at the same time that the 401(h) account was closed to new entrants, Taxpayer adopted the Medical Account Plan, which is a retiree-only health reimbursement account established in accordance with section 105 and unconnected to Retirement Plan B, its 401(h) account, or the Reimbursement Arrangement Plan. The Medical Account Plan is for the benefit of eligible retirees and totally disabled former employees not included in the Grandfathered Group (the “Non-Grandfathered Group”) who are eligible for the traditional, major medical plan for retirees that Taxpayer maintains.

Prior to age 65, former employees in the Non-Grandfathered Group are eligible to purchase coverage for themselves, their spouse, and their eligible dependents under

the Health Plan for Retirees, but receive no premium subsidy. No amount in the Retirement Plan B 401(h) account is used to provide any benefit to this group.

After age 65, amounts credited to a member of the Non-Grandfathered Group's Medical Account Plan (which is a notional account) can be used to pay the premiums for the traditional, major medical plan for retirees sponsored by Taxpayer or to purchase coverage on the open market. The Retirement Plan B 401(h) account is not used to provide any of the amounts credited under the Medical Account Plan. Taxpayer is under no obligation, contractual or otherwise, to provide any benefit to the Non-Grandfathered Group under the Medical Account Plan.

On Date 1, at the time Retirement Plan B was frozen, the Health Plan for Retirees, Reimbursement Arrangement Plan, and Medical Account Plan were closed to new entrants who did not meet certain age and service requirements prior to Date 1, or who had not become disabled prior to such date. Individuals falling into this category are referred to here as the "Excluded Group."

Although Taxpayer has made no contributions to the Retirement Plan B 401(h) account at any time after Year 6, the account has assets in excess of all current and reasonably anticipated future obligations to members of the Grandfathered Group. Taxpayer therefore proposes the following transaction ("Proposed Transaction"): Taxpayer will use the Retirement Plan B 401(h) account to also reimburse members of the Non-Grandfathered Group for premiums that are considered "sickness, accident, hospitalization, [or] medical expenses" under section 401(h) and Treas. Reg. § 1.401-14, eligible for reimbursement under the terms of the Medical Account Plan, and incurred by eligible individuals who meet the requirements to be considered "retired employees, their spouses, or their dependents" under section 401(h) of the Code and/or Treas. Reg. § 1.401-14.

Taxpayer proposes to amend Retirement Plan B, including the terms under which it established the 401(h) account, and the Medical Account Plan, to permit the Retirement Plan B 401(h) account to make reimbursements for amounts credited to members of the Non-Grandfathered Group's Medical Account Plan (the "Proposed Amendment"). All members of the Non-Grandfathered Group who receive the benefit of such reimbursements from the Retirement Plan B 401(h) account are also eligible to receive retirement benefits under Retirement Plan B, or have retired from employment with Taxpayer by reason of permanent disability. No portion of the 401(h) account will be used to provide any benefit or reimbursement to any member of the Excluded Group.

Taxpayer represents that:

(1) It does not have a contractual obligation to fund the Medical Account Plan and may amend or terminate its retiree health plans at any time;

(2) The Proposed Transaction will not affect benefits that are already being paid through the Retirement Plan B 401(h) account;

(3) The Medical Account Plan is currently and, at all times following the implementation of the Proposed Transaction, will remain unfunded and no retired employee will be entitled to any amount under the Medical Account Plan in excess of premiums requested to be reimbursed under the Retirement Plan B 401(h) account; and

(4) Until premium reimbursements are made under the Medical Account Plan, all Medical Account Plan-related funds will remain in the Retirement Plan B 401(h) account, and, in the event of termination of either Retirement Plan B or the Medical Account Plan, all such amounts remaining in the 401(h) account after satisfaction of all liabilities to provide medical benefits will be subject to 401(h) (including section 401(h)(5) and the excise tax on reversions pursuant to section 4980).

RULINGS REQUESTED

Taxpayer requests a ruling that the Proposed Transaction:

(1) Will not violate section 401(h) and Treas. Reg. § 1.401-14 or otherwise cause Retirement Plan B to lose it its tax-qualified status under section 401(a); and

(2) Will be excludable from the gross income of such “retired employees, their spouse, or their dependents” under sections 105 and 106, as applicable.

LAW

Section 61(a)(1) of the Code and Treas. Reg. § 1.61-21(a)(3) provide that, except as otherwise provided in Subtitle A, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 105(a) provides that, except as otherwise provided in this section, amounts received by an employee through accident or health insurance for personal injuries or sickness shall 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.

Section 105(b) provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care (as defined in section 213(d)) of the taxpayer, his spouse, his dependents (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof), and any

child (as defined in section 152(f)(1)) of the taxpayer who as of the end of the taxable year has not attained age 27. Any child to whom section 152(e) applies shall be treated as a dependent of both parents for purposes of this subsection.

Section 106 provides that gross income does not include contributions by the employer to accident or health plans for compensation (through insurance or otherwise) to his employees for personal injuries or sickness.

Section 401(a) describes requirements for a qualified trust that is created or organized in the United States and forms part of a pension plan of an employer that is for the exclusive benefit of the employer's employees or their beneficiaries. Section 501(a) provides in pertinent part that an organization described in section 401(a) is generally exempt from income tax.

In pertinent part, 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, and
> (5) notwithstanding the provisions of subsection (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.

Treas. Reg. § 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 this section to describe such payments.

Treas. Reg. § 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.

In Rev. Rul. 2002-41, 2002-2 C.B. 75, an employer sponsors a health reimbursement arrangement (HRA) that is paid for solely by the employer and not through salary reduction contributions. The HRA reimburses substantiated medical care expenses (as defined in section 213(d)) of participating employees and their spouses and dependents (as defined in section 152) up to a maximum annual reimbursement amount. Unused amounts from one coverage period are carried forward to subsequent coverage periods. Participating employees have no right to receive cash or any other benefit in lieu of medical expense reimbursements. In Situation 2 of Rev. Rul. 2002-41, the maximum reimbursement amount under the HRA that is not applied to reimburse medical care expenses before an employee retires or otherwise terminates employment continues to be available after retirement or termination for any medical care expense incurred by the former employee or the former employee's spouse and dependents. The ruling concludes that coverage and reimbursements made under the HRA are excludable from the gross income of participating employees under sections 106 and 105.

Notice 2002-45, 2002-2 C.B. 93, describes the tax treatment of 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.

CONCLUSION

Based on the facts and representations provided by Taxpayer, the use of the Retirement Plan B 401(h) account to reimburse premiums of eligible retirees in the Non-Grandfathered Group will not violate section 401(h) and Treas. Reg. § 1.401-14 or otherwise cause Retirement Plan B to lose it its tax-qualified status under section 401(a). In addition, contributions from the Retirement Plan B 401(h) account to the Medical Account Plan are excludable from a retired employee’s gross income under section 106 of the Code. Furthermore, amounts received by retired employees, their spouses, and their eligible dependents for medical care are excluded from the gross income of the retired employees, if such amounts are paid directly or indirectly to the retired employees to reimburse them for expenses incurred for the medical care of themselves, their spouses, and their dependents under section 105(b).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

These rulings are based on the assumption that Retirement Plan A and Retirement Plan B are qualified under section 401(a). The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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 representatives.

If you have any questions concerning this letter, please contact , Attorney, at .

Sincerely,

/S/

Janet A. Laufer
Senior Technician Reviewer
Health & Welfare Branch
Office of Associate Chief Counsel
(Tax Exempt & Government Entities)