Office of Chief Counsel
Internal Revenue Service
Memorandum

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subject:

This is in response to the request for reconsideration of a memorandum dated August 4, 2015, prepared by you for Amy Myers, FSLG Mid-Atlantic Area Group Manager, and reviewed by this office in 2015. The memorandum relies upon Rev. Rul. 75-539, 1975-2 C.B. 45, and advises FSLG to deny refund claims filed by the school district relating to contributions made by public school employees under
. As explained below, after further consideration of this matter, we question the reliance on Rev. Rul. 75-539 as the basis for the position taken in the memorandum, and have concluded that the IRS should not rely upon the memorandum's analysis related to the application of the revenue ruling to the particular facts at issue.

Rev. Rul. 75-539 considers whether amounts paid for health insurance are excludible from gross income of retired employees under § 106. The ruling describes two labor contracts. Contract A provides that, upon retirement, an employee will receive a cash payment for one-half of the employee's unused sick leave credits in excess of 50 days or, at the option of the employee, that payment may be applied as the employee's payment of premiums for continued participation in the employer's health plan until the funds are exhausted. Contract B provides that the value of three-fourths of a retiring

employee's unused sick leave credits will be placed by the employer in an escrow account to pay the premiums of continued participation by the retired employee in the employer's health plan until the funds are exhausted. Contract B further provides that the retired employee, the retired employee's spouse, or dependents may not receive any of this escrow amount in cash. Furthermore, any part of the escrow amount which, for any cause, is not expended for premiums reverts to the employer.

With respect to Contract A, Rev. Rul. 75-539 finds that a retiree's option to relinquish the right to the cash payment so that it may be used to pay premiums for continued participation in the employer's health plan, does not alter the conclusion that the amount is constructively received by the retiree under § 451, and thus is includible in the retiree's gross income. Rev. Rul. 75-539 further provides that the amount of the premium payments is considered an employee contribution out of salary and not a contribution by the employer within the scope of § 106. Accordingly, under Contract A, Rev. Rul. 75-539 holds that the value of unused sick leave credits, whether paid in cash to the retired employee or used under the plan to continue health coverage for the employee, is includible in the retired employee's gross income.

With respect to Contract B, Rev. Rul. 75-539 notes that the value of unused sick leave credits is placed in escrow by the employer solely for the payment of health insurance premiums and may not be received in cash by the employee, the employee's spouse, or dependents. Accordingly, Rev. Rul. 75-539 holds that the amounts are not constructively received by the retiree under § 451, but rather are contributions by the employer to the employer's health plan, and thus are excludible from the retired employee's gross income under § 106.

Under , public school employees who earned service credit in the ending , or were on an approved leave of absence on that date, were provided a brief, one-time irrevocable election window to opt out of the future right to receive retiree health benefits under the state system. The election window opened in late and closed in early . Under , employees who elected to opt out of the future right to receive retiree health benefits under the state system would not be subject to a in their future compensation. Those who did not opt out would have a applied to their compensation and would retain the future right to receive retiree health benefits under the state system.

The August 2015 memorandum concludes that the election under is analogous to the choice offered to employees under Contract A in Rev. Rul. 75-539. The conclusion that the two elections are analogous is not correct. Under the facts described in Rev. Rul. 75-539, Contract A provided the employee a choice between a current cash payment and the application of the payment to premiums for continued coverage under the employer's health plan. In contrast, the election provided in accordance with is distinguishable because it provides employees a choice between future salary not yet earned (*not* a current cash payment) and a future right to receive retiree health benefits. Accordingly, the facts described in Rev. Rul. 75-539 are

distinguishable, and the IRS should not rely upon the application of its conclusions to the facts at issue in the August 2015 memorandum.

After further consideration of this matter, we have concluded that there is not explicit or analogous guidance addressing the federal tax consequences under these particular facts. In addition, analysis of these particular facts raises issues not only concerning the application of §§ 105 and 106, but also the application of the constructive receipt doctrine, the definition of a cafeteria plan, the application of § 125, the application of § 3121(a), and, by analogy, the definition of a cash or deferred arrangement (CODA) under § 401(k) and the potential relevance of the concept of a one-time irrevocable election contained in § 1.401(k)-1(a)(3)(v).

We will continue to analyze these and similar facts to determine the federal tax consequences, including whether published guidance may be appropriate to address the series of issues raised.