INTERNAL REVENUE SERVICE

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February 4, 2000

Employer =

Plan =

Dear

This is in reply to your letter dated September 8, 1999, and subsequent correspondence, requesting rulings on behalf of Employer concerning the federal income tax treatment under sections 104 and 105 of the Internal Revenue Code (the Code) of long term disability benefits paid through the Plan.

You represent that Employer sponsors the Plan for all of its employees. The Plan is a fully non-contributory employee welfare benefit plan providing long-term disability coverage under a group insurance policy for all of its eligible employees. Under the Plan as it is currently written, the Employer pays the entire cost for each employee's long-term disability coverage. To reduce its costs, Employer proposes to amend the Plan to provide that each eligible employee, including individuals hired in the future, may pay the full cost of his or her long-term disability coverage on an after-tax basis (the Amended Plan). Employer will continue to pay the long term disability coverage premium for any eligible employee who does not elect to pay for his or her long-term disability coverage on an after-tax basis. You represent that the election to pay insurance premiums on an after-tax basis under the Amended Plan must be made prior to the beginning of the plan year during which the employee will be paying for his or her long-term disability coverage on an after-tax basis and the election will be irrevocable for the plan year once the plan year begins. The employee 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 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, 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).

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 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 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 representations made, we conclude as follows:

(1) Long-term disability benefits paid to an employee who has elected, under the Amended Plan, to pay his or her own premiums 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 such employee's gross income under section 104(a)(3) of the Code.

(2) Long-term disability benefits paid to an employee who has elected, under the Amended Plan, to allow the Employer to pay his or her premiums for the plan year in which he or she becomes disabled are attributable solely to Employer contributions and includible in such employee's gross income under section 105(a) 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:
Copy of this letter
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