PRIVATE RULING 9612008

"This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code."

Section 106
Health Plan Contributions

0106.00-00

DATE: December 18, 1995

Refer Reply to: CC:EBEO:Br 6 TR-31-2314-95

LEGEND:
Employer = * * *

Dear * * *

This is in reply to your letter dated October 6, 1995, concerning the federal income tax treatment of medical coverage provided to terminated employees.

The information submitted indicates that the Employer is the sponsor and administrator of an employees' medical expense plan (Medical Plan). The Medical Plan is a welfare benefit plan and provides hospital and medical expense benefits for certain employees and retired employees of Employer and certain affiliated companies.

It is represented that the Medical Plan is a health plan described in sections 105 and 106 of the Internal Revenue Code and that the cost of coverage under the Medical Plan is funded through employer and employee premium contributions to Voluntary Employees' Beneficiary Associations as described in section 501(c)(9) of the Code.

Employer has established a severance plan that provides medical coverage, severance pay and other benefits to eligible terminated employees. With respect to medical coverage provided under the Medical Plan, the severance plan provides as follows: "A participant shall be entitled, pursuant to any continuation coverage rights under the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended ("COBRA"), to continue individual and dependent coverage under the Company's medical plan during the 18 months following termination of employment or until the participant or dependents fail to be eligible for continuation coverage under COBRA, if earlier. If such coverage is continued, the Company will pay the same portion of the cost of coverage that it pays for active employees (currently 82% during the first 12 months following termination of employment), and the participant will pay the balance. The participant shall be charged the full expense of coverage (102% of the cost of coverage) during the remainder of the 18 month period."

The issue presented is whether terminated employees who are receiving medical coverage under the Medical Plan and pursuant to the Employer's severance plan, are "employees" for purposes of sections 105 and 106 of the Code.

Section 106 of the Code provides that gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.106-1 of the Income Tax Regulations provides that the gross income of an employee does not include contributions that an employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by the employee, the employee's spouse, or the employee's dependents, as defined in section 152 of the Code.

Section 106 of the Code operates in conjunction with section 105, which provides that amounts an employee receives through accident or health insurance for personal injuries or sickness are includible in gross income to the extent the amounts (1) are attributable to contributions by the employer that were not includible in the gross income of the employee, or (2) are paid by the employer, except as specifically provided in sections 105(b) and (c).

Rev. Rul. 82-196, 1982-2 CB 53, holds that employer contributions to an accident or health plan that provides coverage for an employee and the employee's spouse and dependents before and after the employee's retirement and that also provides benefits for a deceased employee's surviving spouse and dependents are excludable from the gross income of the employee and the survivors under section 106 of the Code. Rev. Rul. 82-196 also holds that the taxation of health benefits paid to survivors of a deceased employee-participant in such a plan is determined under section 105. The ruling in effect considers an employee-participant in an employer-funded accident or health plan to continue to be an "employee" for purposes of sections 105 and 106 even after termination of employment. See also, Rev. Rul. 62-199, 1962-2 CB 38 and Rev. Rul. 75-539, 1975-2 CB 45 which hold that an employer's contributions to an accident and health plan that provides benefits for a retired employee are excludable from the retired employee's gross income.

In Rev. Rul. 85-121, 1985-2 CB 56, an employee was laid-off for a period of time. During the period of layoff, the employer made contributions to its accident and health plan on behalf of the laid-off worker and the worker received health benefit payments from the plan. The ruling states that, as in the case of retired or deceased employees, the employer's contributions to the accident and health plan on behalf of the laid-off worker were based solely upon the employment relationship and the laid-off worker's treatment should, therefore, be the same as that of the retired or deceased employees in Rev. Rul. 82-196. Accordingly, the ruling holds that during the period of layoff, the laid-off worker is an "employee" for purposes of sections 105 and 106 of the Code.

In the instant case, the Employer's contributions under the severance plan for medical coverage on behalf of terminated employees is related solely to and based solely upon the terminated employee's prior employment relationship with the Employer. Thus, the basis for the payments in this case is the same as the basis for the

payments on behalf of the laid-off employee in Rev. Rul. 85-121 and on behalf of the retired or deceased employee in Rev. Rul. 82-196.

Accordingly, we conclude that terminated employees who are receiving medical coverage under the Medical Plan pursuant to the Employer's severance plan are "employees" for purposes of sections 105 and 106 of the Code. Employer contributions for medical coverage on behalf of the terminated employees are, therefore, excludable from the terminated employees' gross incomes under section 106 of the Code.

Except as specifically ruled on above, no opinion is expressed as to the federal tax consequences of the transactions described under any other provision of the Code. Specifically, no opinion is expressed as to whether any benefit received under the Medical Plan is excludable from gross income under section 105(b) of the Code or whether the Medical Plan satisfies the nondiscrimination requirements of section 105(h) of the Code, if applicable.

This ruling is directed only to the taxpayer that requested it. Section 6110(j)(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 Assistant
Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosures:
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