Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:EBEO:Br.4-PLR-109487-99
Date:
November 19, 1999

Trust =

Supplemental Plan =

Union =

Association =

Date A =

Date B =

Date C =

$X =

Dear

This is in response to the letter dated May 14, 1999, and subsequent correspondence, submitted by your authorized representative requesting rulings under sections 79, 83, 105, 106, 125, 129, and 501(c)(9) of the Internal Revenue Code. Specifically, the rulings requested are that the Supplemental Plan is not a cafeteria plan under section 125; that employer contributions to and coverage under the Supplemental Plan will not result in immediate income taxation to participants; that certain benefits are excludible under either section 79, 105(b), 106, or 129 of the Code; and that Supplemental Plan does not affect the tax-exempt status of Trust under section 501(c)(9).

The facts, as submitted, are as follows. Trust was established by Union and Association pursuant to a written agreement to provide health and welfare benefits to

workers covered by collective bargaining agreements (Agreement) between Union and Association. Trust was previously granted tax-exempt status under section 501(c)(9) of the Code.

Effective on Date A, Supplemental Plan was implemented to provide additional benefits to individuals covered by Agreement. All common law employees of a contributing employer who perform an hour of contributory service under Agreement after Date B are eligible to participate in Supplemental Plan. Individuals who are sole proprietors, partners, or two-percent or greater shareholders in Subchapter S corporations are excluded from participation. Participation in Supplemental Plan will begin on Date C for those individuals who have had 400 or more hours of contributions made on their behalves since Date B. For those individuals who are not participants on Date C, participation will begin once the individual has 400 hours of contributions made on his or her behalf to Supplemental Plan. Once an individual meets the 400 hour requirement and subject to certain unclaimed account rules, the individual will remain a participant as long as there is a balance in his or her account.

Signatory employers to Agreement will be required to make contributions to Supplemental Plan on behalf of all bargaining unit employees in an amount equal to $X for each hour worked under Agreement. Contributions may also be made for certain non-bargaining-unit employees who are eligible to participate. No individual will be able to elect to receive cash in lieu of contributions. An account will be maintained for each participant in Supplemental Plan. The account will be credited with an amount based on the employer contributions and interest accrued, and administrative expenses will be deducted.

Supplemental Plan will provide the following additional benefits: wage replacement benefits, health benefits, group-term life insurance benefits, and dependent care reimbursement benefits. Wage replacement benefits include supplemental short-term disability, supplemental workers' compensation, supplement unemployment, and dislocation benefits. These benefits are available to a participant who has incurred a loss of wages due to an inability to work that is outside of the participant's control. Health benefits include a premium payment plan and medical expense reimbursement plan.

Individuals who are eligible to participate in Supplemental Plan are required to make an election during an initial election period to direct all or a portion of the contributions to be made on their behalf to either a "Wage Replacement Account" or a "Premium Account." An annual election period will be held to allow eligible individuals and participants to make an election or modify a previous election. Certain semiannual elections will also be allowed, as well as a special election period for newly eligible employees. If no election is made, all contributions will be directed to the "Premium Account." All elections are made before the amounts are earned.

Amounts directed through the election to the “Wage Replacement Account” can only be used to provide a participant with wage replacement, supplemental unemployment, supplemental disability, and dislocation benefits. These amounts cannot be converted to cash at the election of a participant and will be paid only for one of the foregoing purposes. Amounts remaining in a participant’s “Wage Replacement Account” upon the participant’s death are forfeited. Any forfeited amounts are used first to pay administrative expenses and then reallocated on a prorata basis to the accounts of other participants.

Amounts directed to the “Premium Account” (and amounts that go to this account if there is no election) may be used to pay premiums for health plan coverage for a participant or his or her qualifying dependents or group-term life insurance coverage for the participant. Key employees and any individual who is simultaneously covered by another employer’s group-term life program will not be permitted to elect group-term life insurance coverage. Amounts remaining in a participant’s “Premium Account” upon the participant’s death may only be used for health plan premium continuation or redirected to the healthcare reimbursement account by the participant’s surviving spouse or qualifying dependents. In the event there is no surviving spouse or qualifying dependents, any remaining amounts in the “Premium Account” are forfeited. Any forfeited amounts are used first to pay administrative expenses and then reallocated on a prorata basis to the accounts of other participants.

During each semiannual election period, each participant with a “Premium Account” balance will be eligible to transfer all or a portion of the “Premium Account” balance to two reimbursement accounts: a “Healthcare Reimbursement Account” and a “Dependent Care Reimbursement Account.” Once amounts are allocated to these two accounts, such amounts may be used solely for reimbursement of the appropriate expenses. If such amounts are not used, they will be forfeited.

The “Healthcare Reimbursement Account” may be used only by a participant for reimbursement of expenses incurred by the participant, spouse, or other qualifying dependents for medical care as defined in section 213(d) of the Code. Amounts in this account may only be used to reimburse eligible expenses incurred after the date of the semiannual election. To the extent necessary to satisfy any nondiscrimination rules, a participant’s benefits may be denied or limited.

The “Dependent Care Reimbursement Account” may only be used by employees. Sole proprietors, partners, and two-percent or greater shareholders in a Subchapter S corporation are excluded from participation in this benefit. Additionally, a participant who is a non-bargaining-unit employee of an employer that maintains a separate dependent care program under section 129 of the Code will not be able to participate in the “Dependent Care Reimbursement Account.” This account may only be used to reimburse expenses incurred during a period in which the participant was covered by the account. To facilitate the preparation of annual Form W-2 reporting,

reimbursements for a prior calendar year must be requested by January 15th of the following year.

Section 105(a) of the Code provides that, in general, amounts received by an employee through employer-provided accident or health insurance for personal injuries or sickness shall be included in gross income.

Section 105(e) of the Code provides that, for purposes of section 105, amounts received under an accident or health plan for employees shall be treated as amounts received through accident or health insurance.

Section 1.105-5(a) of the Income Tax Regulations provides that, in general, an accident or health plan is an arrangement for the payment of amounts to employees in the event of personal injuries or sickness.

Accordingly, because the "Healthcare Reimbursement Account" is an arrangement for the payment of amounts to participants in the event of person injuries or sickness, the account constitutes accident and health insurance for purposes of sections 105(a) and (b) of the Code, pursuant to section 105(e) of the Code.

Section 105(b) of the Code provides an exception to the general rule of inclusion under section 105(a). Section 105(b) provides that, except in the case of amounts attributable to deductions allowed under section 213 for any prior taxable year, gross income does not include amounts received by an employee for personal injuries or sickness if such amounts are paid directly or indirectly to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care of the taxpayer, his spouse, or dependents. Section 1.105-2 of the regulations elaborates on section 105(b) of the Code by indicating that only amounts that are paid specifically to reimburse the taxpayer for expenses incurred by him for the prescribed medical care are excludible from gross income. Thus, section 105(b) does not apply to amounts that the taxpayer would be entitled to receive irrespective of whether or not he incurs expenses for medical care. In addition section 105(h)(1) of the Code provides that unless the plan satisfies the nondiscrimination requirements of section 105(h)(2), amounts paid under a self-insured medical expense reimbursement plan to a highly compensated individual will not be excludible from that individual's gross income under section 105(b) of the Code to the extent the amounts constitute excess reimbursements.

Under the Supplemental Plan, a specific amount is allocated to the "Healthcare Reimbursement Account" to be used exclusively to reimburse otherwise unreimbursed expenses incurred for medical care as defined under section 213(d) of the Code. Accordingly, amounts paid from the "Healthcare Reimbursement Account" to reimburse expenses incurred for the medical care (as defined in section 213(d)) of the participant, his spouse, and his dependents (as defined in section 152) and not deducted under section 213 for any prior taxable year will be excludible from the participant's gross

income under section 105(b) of the Code provided that they do not constitute discriminatory excess reimbursements under section 105(h) of the Code.

Section 106(a) of the Code provides that, in general, gross income of an employee does not include employer-provided coverage under an accident or health plan. Section 1.106-1 of the regulations provides that the employer may contribute to an accident or health plan by paying the premium (or a portion of the premium) on a policy of accident or health insurance covering one or more of his employees. Accordingly, direction by participants of the payment or partial self-payment for health insurance coverage provided by Trust (whether active, COBRA, or Medicare) is excludible from the gross income of participants under section 106 of the Code.

Section 129 of the Code provides an exclusion from gross income of the employee for amounts paid or incurred by the employer for dependent care assistance provided to the employee if the assistance is furnished pursuant to a dependent care assistance program described in section 129. Section 129(e)(1) defines "dependent care assistance" as the payment of, or provision of, those services which if paid for by the employee would be considered employment-related expenses under section 21(b)(2) relating to the dependent care credit.

Section 129(a)(2) limits the amount that may be excluded with respect to dependent care assistance services provided during the taxable year. Generally, the exclusion cannot exceed $5,000, or $2,500 in the case of a separate return by a married individual. The exclusion may be further reduced because of the earned income limitation in section 129(b). Section 129(c) prohibits certain payments to related individuals.

Section 129(d)(1) requires the dependent care assistance program to be a separate written plan of the employer for the exclusive benefit of the employees. The program must meet the requirements of section 129(d)(2) through (8). If a program qualifies as a dependent care assistance program but fails to meet these requirements in operation then the program shall be treated as a dependent care assistance program in the case of employees who are not highly compensated employees.

Section 129(d)(2) provides that contributions or benefits provided under the plan shall not discriminate in favor of highly-compensated employees (within the meaning of section 414(q)) or their dependents.

The eligibility test of section 129(d)(3) requires that the program benefit employees who qualify under a classification set up by the employer and found by the Secretary not to be discriminatory in favor of highly-compensated employees or their dependents.

Section 129(d)(4) provides that not more than 25% of the amounts paid or incurred by the employer for dependent care assistance during the year may be provided for the

class of individuals who are shareholders or owners (or their spouses or dependents).

Section 129(d)(5) provides that a program is not required to be funded.

Section 129(d)(6) requires that reasonable notification of the availability and terms of the program must be provided to eligible employees.

Section 129(d)(7) requires that the employee be given a written statement on or before January 31, showing the amounts paid or expenses incurred by the employer in providing dependent care assistance to the employee during the previous calendar year. Section 6051(a)(9) requires that this statement be included on the employee's Form W-2.

Section 129(d)(8)(A) requires that the average benefits provided for dependent care assistance to all non-highly-compensated employees be at least 55% of the average benefits provided to all highly-compensated employees.

If a plan provides for the exclusion of certain employees subject to rules similar to the rules of section 410(b)(4), then section 129(d)(9)(A) provides that employees who have not attained age 21 and completed 1 year of service may be excluded from the tests in section 129(d)(3) and (8). Section 129(d)(9)(B) also excludes employees covered by certain collective bargaining agreements.

Sections 3121(a)(18), 3306(b)(13), and 3401(a)(18) provide that payments made or benefits furnished under a section 129 dependent care assistance program are not subject to withholding for employment or income taxes.

The taxpayer's program provides for the payment of dependent care expenses. The program year is the calendar year. The dependent care account may only be used to reimburse expenses incurred during a period in which the employee was covered by the program. No reimbursement of retroactively elected amounts may be made. Only the employer makes contributions to the program. Employee contributions are not permitted. Employees may not elect to receive cash or other current compensation in lieu of the employer contributions to the program. Employees make annual elections indicating the amount of dependent care expenses they expect to incur and be reimbursed. Employees are permitted to make semiannual adjustments to these elections.

The program documents limit eligibility to participate in the dependent care program to employees. Sole proprietors, partners, and two-percent shareholders are not eligible to participate. Non-bargaining-unit employees of an employer that maintains a separate dependent care program under section 129 are also not eligible to participate. An employee is not eligible to participate for any program year in which he or she is a highly compensated employee as defined in section 414(q).

The program documents provide that only dependent care expenses within the meaning of section 21(b)(2), relating to expenses for household and dependent care services necessary for gainful employment, may be reimbursed. The program documents limit the amount that may be reimbursed to the lesser of the participant's account balance designated for dependent care expenses or the limits set forth in section 129(a)(2). The program documents provide specific rules describing adequate substantiation for purposes of receiving reimbursement under the program including identifying information required with respect to the service provider as set forth in section 129(e)(9). Amounts to be excluded under section 129 are reported on the employee's Form W-2 as required by section 6051(a)(9). In order to facilitate this reporting requirement, the program requires that participants request reimbursements for the calendar year by January 15th of the following year.

The taxpayer's program provides for the payment of dependent care expenses as described in section 129 of the Code. Therefore, to the extent the dependent care benefits under the program meet the requirements under section 129(d) of the Code, the dependent care benefits will be excludible from an employee's income under section 129(a).

Section 1.501(c)(9)-6 of the regulations provides that benefits realized by a person on account of the activities of an organization described in section 501(c)(9) of the Internal Revenue Code shall be included in gross income to the extent provided in the Code.

Section 79 of the Code provides, in general, that the cost of group-term life insurance provided under a policy (or policies) carried directly or indirectly by an employer (or employers) is included in the gross income of the employee, but only to the extent that the cost exceeds the sum of (1) the cost of $50,000 of such insurance, and (2) the amount (if any) paid by the employee toward the purchase of such insurance. A policy of life insurance is "carried directly or indirectly" by an employer if the employer pays any cost of the life insurance directly or through another person. See section 1.79-0 of the regulations.

The employers of participants make contributions to the Trust that are used to pay the cost of the group-term life insurance coverage. Thus, the life insurance coverage is "carried directly or indirectly" by the participants' employers for purposes of section 79 of the Code and is subject to the rules of section 79.

Assuming a Participant electing group-term life insurance coverage under the program is not also receiving group-term coverage simultaneously from another employer, the group-term coverage provided under the program will be excludible under section 79 of the Code.

Section 61(a) of the Code provides that, unless otherwise excepted, gross income includes all compensation received for services performed, including fringe benefits.

However, section 83 of the Code governs transfers of property in connection with the performance of services.

Under section 83(a) of the Code, if, in connection with the performance of services, property is transferred to any person other than the service recipient, the excess of the fair market value of the property, on the first day that the rights to the property are either transferable or not subject to a substantial risk of forfeiture, over the amount paid for the property, is included in the service provider's gross income for the first taxable year in which the rights to the property are either transferable or not subject to a substantial risk of forfeiture.

The term "property" includes real and personal property, other than money or an unfunded and unsecured promise to pay money or property in the future. Thus, a promise to pay money or property in the future is "property" if it is either funded or secured. The term "property" also includes a beneficial interest in assets (including money) that are transferred or set aside from the claims of creditors of the transferor, such as in a trust or escrow account. See section 1.83-3(e) of the regulations.

A "transfer" of property occurs when a person acquires a beneficial interest in the property, disregarding any lapse restriction as defined in section 1.83-3(i) of the regulations. See section 1.83-3(a)(1) of the regulations.

According to section 83(c)(1) of the Code, a substantial risk of forfeiture exists when the rights of a person in property are subject to a substantial risk of forfeiture if the person's rights to full enjoyment of the property are conditioned on the future performance of services by any individual. Section 1.83-3(c)(1) of the regulations further states that whether a risk of forfeiture is substantial or not depends on the facts and circumstances. A substantial risk of forfeiture exists where rights in property that are transferred are conditioned, directly or indirectly, on the future performance (or refraining from performance) of substantial services by any person, or the occurrence of a condition related to the purpose of the transfer, and the possibility of forfeiture is substantial if the condition is not satisfied.

Section 451(a) of the Code and section 1.451-1(a) of the regulations provide that an item of gross income is includible in gross income for the taxable year in which actually or constructively received by a taxpayer using the cash receipts and disbursements method of accounting. Under section 1.451-2(a) of the regulations, income is constructively received in the taxable year during which it is credited to a taxpayer's account or set apart or otherwise made available so that the taxpayer may draw on it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Although there is property and a transfer of property when amounts are contributed to Trust on behalf of participants in Supplemental Plan, there is a substantial risk of

forfeiture when those amounts are contributed to Trust. Specifically, a participant cannot use the amounts in Trust until a condition related to the purpose of the transfer occurs. Thus, when amounts are contributed to Trust on behalf of a participant the participant is not subject to immediate taxation under section 83 of the Code.

Regarding the "Wage Replacement Account," when a participant meets the criteria to receive benefits from the "Wage Replacement Account" (regardless of whether or not the participant actually submits a form to Trust applying for these benefits), there is no longer a substantial risk of forfeiture with respect to amounts in the "Wage Replacement Account" to which the participant could have received had the participant submitted a claim for those benefits. Thus, when a participant meets the criteria to receive benefits from the "Wage Replacement Account," the participant must include in gross income as compensation under section 83 of the Code the amount of benefits to which the participant is entitled regardless of whether or not the participant actually received those benefits. Additionally, Trust must meet the income tax withholding and employment tax requirements with respect to the amounts that a participant must include in gross income under section 83.

Section 501(c)(9) of the Code describes a voluntary employees beneficiary association (VEBA) providing for the payment of life, sick, accident, or other benefits to its members or their dependents or designated beneficiaries, and in which no part of the net earnings inures (other than through such payments) to the benefit of any private shareholder or individual.

Section 1.501(c)(9)-3(a) of the regulations provides that the life, sick, accident, or other benefits provided by a VEBA must be payable to its members or their dependents or designated beneficiaries. Further, a VEBA is not operated for the purpose of providing life, sick, accident, or other benefits unless substantially all of its operations are in furtherance of the provision of such benefits. In addition, an organization is not described in this section if it systematically and knowingly provides benefits (of more than a de minimis amount) that are not permitted by paragraph (b), (c), (d), or (e) of this section.

Section 1.501(c)(9)-3(b) of the regulations provides that the term "life benefits" means a benefit (including a burial benefit or a wreath) payable by reason of the death of a member or dependent. A "life benefit" may be provided directly or through insurance. It generally must consist of current protection, but also may include a right to convert to individual coverage on the termination of eligibility for coverage through the association, or a permanent benefit as defined in, and subject to the conditions in, the regulations under section 79.

Section 1.501(c)(9)-3(c) of the regulations provides that the term "sick and accident benefits" means amounts furnished to or on behalf of a member or a member's dependents in the event of illness or personal injury to a member or dependent. Such

benefits may be provided through reimbursement to a member or a member's dependents for amount expended because of illness or personal injury, or through the payment of premiums to a medical benefit or health insurance program.

Section 1.501(c)(9)-3(d) of the regulations provides that the term "other benefits" includes only benefits that are similar to life, sick, or accident benefits. A benefit is similar to a life, sick, or accident benefit if it is intended to safeguard or improve the health of a member or a member's dependents, or it protects against a contingency that interrupts or impairs a member's earning power.

Under section 1.501(c)(9)-3(e) of the regulations "other benefits" include vacation benefits, the provision of childcare facilities, income maintenance payments in the event of economic dislocation, temporary living expense loans and grants at times of disaster, supplemental unemployment compensation benefits (as defined in section 501(c)(17) of the Code), and educational or training benefits or courses.

Rev. Rul. 66-212, 1966-2 C.B. 230, considered whether an organization previously recognized as tax exempt under section 501(c)(9) of the Code jeopardized its exemption by reimbursing its members for premiums paid under the Medicare program. The ruling held that the reimbursement program did not jeopardize the organization's tax-exempt status because it was, in effect, providing additional benefits of the type contemplated by section 501(c)(9) of the Code.

The wage replacement benefit include a disability benefit, a supplemental unemployment benefit, and a dislocation benefit. The disability benefit is permissible under section 1.501(c)(9)-3(c) of the regulations. The supplemental unemployment benefit is permissible under section 1.510(c)(9)-3(e) of the regulations. The dislocation benefit is a permissible "other benefit" under section 1.501(c)(9)-3(e) of the regulations, which includes income maintenance payments in the event of economic dislocation. The health benefits and group-term life insurance benefits under Supplemental Plan are clearly permissible benefits under section 501(c)(9) of the Code. The dependent care reimbursement benefits are "other benefits" within the meaning of section 1.501(c)(9)-3(e) of the regulations. Thus, none of the additional benefits jeopardizes the tax-exempt status of Trust.

Based on the information submitted and representations made, we rule as follows:

1. Employer contributions and coverage under Supplemental Plan will not subject participants to immediate taxation for the contributions or benefits under Supplemental Plan. However, when the applicable eligibility criteria for any wage replacement benefit are met, a participant is immediately taxable under section 83 on any wage replacement benefits to which the participant is entitled to under Supplemental Plan even if the participant does not actually receive those benefits, and Trust must fulfill any income

tax withholding and employment tax obligations with respect to those amounts.

2. The utilization of the following benefits is excludible from gross income by virtue of the following applicable sections of the Code:

A. To the extent the "Healthcare Reimbursement Account" under the Supplemental Plan meets the requirements of section 105(h), healthcare reimbursement benefits received under the Supplemental Plan will be excludible from a participant's gross income under section 105(b).

B. To the extent the dependent care reimbursement benefits under Supplemental Plan meet the requirements of section 129(d) of the Code, dependent care reimbursement benefits will be excludible from a participant's gross income under section 129(a).

C. Assuming a participant electing group-term life insurance coverage under the Supplemental Plan is not also receiving group-term life coverage simultaneously from another employer, group-term life coverage under Supplemental Plan will be excludible under section 79 of the Code.

D. The direction by participants of the payment or partial self-payment for health insurance coverage provided by Trust (whether active, COBRA, or Medicare) is excludible from gross income of participants under section 106 of the Code.

3. The Supplemental Plan (and its schedule of benefits) does not jeopardize the tax-exempt status of Trust under section 501(c)(9) of the Code.

You also requested a ruling that Supplemental Plan is not a cafeteria plan under section 125 of the Code. Section 8.07 of Rev. Proc. 99-4, 1999-1 I.R.B. 115, provides that the Service does not issue letter rulings or determination letters on whether a plan satisfies the requirements of section 125. Accordingly, we cannot rule on this issue.

No opinion is expressed or implied concerning the tax consequences of this arrangement under any provision of the Code or regulations other than those specifically stated above. Specifically, no opinion is expressed or implied concerning whether the "Healthcare Reimbursement Account" constitute discriminatory self-insured medical expense reimbursement plans within the meaning of section 105(h) 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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

MARK SCHWIMMER
Chief, Branch 4
Office of the Associate Chief Counsel
(Employee Benefits and Exempt Organizations)

Enclosure: For 6110 purposes