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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

FEB 09 2007

T:EP:RA:4K

Re: Ruling Requests

Taxpayer =

Plan =

Pooled Retiree Health Account =

Separate 401(h) Accounts =

Year 1 =

Year 2 =

Date 1 =

Dear

This letter is in response to your request of January 27, 2006, as modified by letters of May 22, 2006, and November 13, 2006, for rulings concerning the funding of retiree medical accounts as described in section 401(h)(6) of the Code.

The Plan is a defined benefit plan, intended to be qualified under section 401(a) of the Code. The date of the last determination letter received by the Plan is Date 1. The Plan has a calendar plan year.

The Plan provides for an account under section 401(h) of the Code to provide health benefits after retirement for participants, spouses, and their dependents (the "401(h) Account). The 401(h) Account was established in Year 1. Effective in Year 2 (which is six years after Year 1), the Plan was amended to provide for the determination of attributed retiree medical balances ("Attributed Balances") within the 401(h) Account for all participants.

Attributed Balances for participants who are key employees are held in such employees' Separate 401(h) Accounts. Attributed Balances for participants who are not key employees ("non-key employees") are maintained, on a notional basis, within the Pooled 401(h) Account. If a participant who is not a key employee becomes a key employee, an amount equal to the Attributed Balance of the participant is moved from the Pooled Retired Health Account to a Separate 401(h) Account for the participant.

Retiree medical benefits for any participant who is a key employee are charged against the assets of the employee's Separate 401(h) Account. If the assets of a key employee's Separate 401(h) Account are exhausted, no further retiree medical benefits are paid to the employee. All amounts within the 401(h) Account not held within Separate 401(h) Accounts of key employees are available to pay retiree medical benefits to all participants who are not key employees.

Attributed Balances are determined as follows:

The Attributed Balance of each participant was initially set at zero.

Commencing in Year 2, the Attributed Balance of each participant is credited each year with an amount equal to the lesser of:

(1) the maximum annual addition with respect to the participant under section 415(c) of the Code, and

(2) an amount determined by dividing the actuarial present value of the future expected retiree medical benefits payable to the participant reduced by the existing Attributed Balance of the participant, by the participant's expected future service years.

The source of the funds used to credit the lesser of (1) and (2) above may be either external contributions from the Taxpayer or prior Taxpayer contributions to the 401(h) Account that have not been either allocated to the Separate Account of any key employee or notionally allocated to the account of any non-key employee within the Pooled Retiree Health Account.

The Attributed Balance of each participant is further credited each year with interest at a rate equal to the average rate of return earned on the trust fund for the Plan.

The Attributed Balance of each participant is reduced each year by benefits or expenses chargeable to such Attributed Balance.

Presently, no amounts (other than interest) are credited to the Separate 401(h) Accounts of key employees subsequent to their retirements. Subject to the receipt of a favorable ruling from the Service on this ruling request, the Taxpayer proposes to amend the Plan to permit the crediting of the Attributed Balance of each retired key employee with an amount equal to the lesser of:

(1) the maximum annual addition with respect to the participant under section 415(c) of the Code, and

(2) the actuarial present value of the future expected retiree medical benefits payable to the participant reduced by the existing Attributed Balance of the participant.

In accordance with the foregoing you have requested a ruling that:

> The mere allocation of funds to the Separate 401(h) Accounts of key employees subsequent to the retirements of such key employees will not cause the Plan to fail to satisfy the requirements of section 415(c) of the Code.

Law

Section 401(h) of the Code 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 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 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 providing of such benefits,

(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, and

(6) in the case of an employee who is a key employee, a separate account is established and maintained for such benefits payable to such employee (and his spouse and dependents) and such benefits (to the extent attributable to plan years beginning after March 31, 1984, for which the employee is a key employee) are only payable to such employee (and his spouse and dependents) from such separate account.

For purposes of paragraph (6), the term "key employee" means any employee, who at any time during the plan year or any preceding plan year during which contributions were made on behalf of such employee, is or was a key employee as defined in as defined in section 416(i). In no event shall the requirements of paragraph (1) be treated as met if the aggregate actual contributions for medical benefits, when added to actual contributions for life insurance under the plan, exceed 25 percent of the total actual contributions to the plan (other than contributions to fund past service credits) after the date on which the account was established.

Section 414(i) of the Code provides that the term "defined contribution plan" means a plan which provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income expenses, gains, and losses, and any forfeitures of accounts of other participants, which may be allocated to such participant's account.

Section 415(c)(1) of the Code provides that contributions and other additions with respect to a participant in a defined contribution plan exceed the limitation of that subsection if, when expressed as an annual addition (within the meaning of paragraph (2)) to the participant's account, such annual addition is greater than the lesser of

(A) $

(B) percent of the participant's compensation.

Section 415(c)(2) of the Code provides that for purposes of paragraph (1), the term "annual addition" means the sum for any year of ----

(A) employer contributions,

(B) the employee contributions, and

(C) forfeitures

Section 415(l)(1) of the Code provides that for purposes of that section, contributions to any individual medical account which is part of a pension or annuity plan shall be treated as an annual addition to a defined contribution plan for purposes of subsection (c). Section 415(l)(1) further provides that section (c)(1)(B) shall not apply to any amount treated as an annual addition under the preceding sentence.

Section 415(l)(2) of the Code provides that for purposes of paragraph (1), the term "individual medical account" means any separate account -----

(A) which is established for a participant under a pension or annuity plan, and

(B) from which benefits described in section 401(h) are payable solely to such participant, his spouse, or his dependents.

Section 1.401-14(b)(2) of the regulations provides that a plan which provides medical benefits described in section 401(h) must not discriminate in favor of officers, shareholders, supervisor employees, or highly compensated employees with respect to contributions or benefits under the plan. The determination of whether such a plan so discriminates is made with reference to the retirement portion of the plan as well as the portion providing the medical benefits described in section 401(h). Thus, for example, a plan will not be qualified under section 401 if it discriminates in favor of employees who are officers or shareholders with respect to either portion of the plan.

Section 1.415-6(b)(7)(i) of the regulations provides that an annual addition is credited to the account of a participant for a particular limitation year if it is allocated to the participant's account under the terms of the plan as of any date within the limitation year. However, an amount is not allocated as of any date within a limitation year if such allocation is dependent upon participation in the plan as of any date subsequent to such date.

Analysis

Section 415(l)(1) of the Code provides that amounts contributed to any individual medical account which is part of a pension plan are treated as an annual additions for purposes of section 415(c). Section 1.415-6(b)(7)(i) of the regulations provides that annual additions are credited to the account of a participant when the addition is allocated to the account of the participant under the terms of the plan.

In the instant case, although Attributed Balances within the Pooled Retiree Health Account are determined for non-key employees, such Attributed Balances are not accounts within the meaning of section 415(c)(1) of the Code. This is so because the benefits of non-key employees are not based solely on the amounts credited to their individual Attributed Balances. Furthermore, the amounts credited to the Attributed Balance of any particular non-key employee are available to pay the benefits of any other non-key employee.

In contrast, the benefits of key employees are based solely on the amounts credited to their individual Attributed Balances. In addition, the amounts credited to the Attributed Balance of any particular key employee are not available to pay the benefits of any non-key employee or any other key employee. Accordingly, the Attributed Balances of key employees are accounts within the meaning of section 415(c)(1) of the Code.

Thus, in the case of a non-key employee who subsequently becomes a key employee, any amounts transferred from the Pooled Retiree Health Account to the Separate 401(h) Account of the employee are treated as transfers into an account with a beginning account balance of zero. Accordingly, all amounts transferred to the separate account of the employee are subject to the limitations of section 415(c) of the Code. Thus, because transfers from the Pooled Health Account to Separate 401(h) Accounts of key employees do constitute annual additions, it may take more than one year to transfer the entire Attributed Balance of a non-key employee who subsequently becomes a key employee to the Separate 401(h) Account of the employee.

Section 415(c)(2) of the Code provides an annual addition limit equal to the lesser of subparagraphs (A) and (B) thereof. Subparagraph (A) provides an annual addition limit equal to $40,000. Section 415(c)(2)(B) provides an annual addition limit equal to 100% of a participant's compensation. However, section 415(l)(1) provides that section 415(c)(2)(B) does not apply in the case of contributions allocated to individual medical accounts. Accordingly, employers are not precluded from allocating contributions to the individual medical accounts of retired key employees with no compensation who would otherwise be subject to an annual addition limit of $0 (because 100% of $0, the compensation of the retired participant, is $0)[1].

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[1] see Tax Reform Act of 1986 Explanation of Technical Corrections Provisions. Prepared by the Staff of the Joint Committee on Taxation and released on May 15, 1987, page 124 , which states that " The effect of this rule also is to permit the funding of post-retirement medical benefits on behalf of a key employee during periods when the employee has no compensation from the employer (e.g., after retirement).

In the instant case, the Taxpayer proposes to fund the post-retirement medical benefits of retired key employees directly through external contributions and indirectly through transfers of unallocated funds (i.e. funds that have not been notionally allocated to non-key employees) from the Pooled Health Account. Either source of funding is acceptable provided that, at all times, the contributions or benefits provided under the Plan do not discriminate in favor of highly compensated employees. See section 401(a)(4) of the Code and section 1.401-14 of the regulations. Furthermore, any external contributions by the Taxpayer to the Separate 401(h) Account of retired key employees are subject to the subordination limits of section 401(h) of the Code.

Conclusion

The mere allocation of funds to the Separate 401(h) Accounts of key employees subsequent to the retirements of such key employees, as limited by the Plan, will not cause the Plan to fail to satisfy the requirements of section 415(c) of the Code.

Allocation of funds to the Separate Accounts of key employees must not, however, discriminate in favor of highly compensated employees. In addition, if the sources of the funds for such allocations are external contributions from the Taxpayer, such contributions are subject to the subordination limits of section 401(h). Furthermore, in the case of any non-key employee who subsequently becomes a key employee, the total(s) of any amounts transferred from the Pooled Retiree Health Account to the separate account of the employee, plus any other allocations (e.g. forfeitures or external contributions), may not exceed the limits provided under section 415(c)(1) in the year(s) of such transfer(s).

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited by others as precedent.