

by the end of the school term and permanently electing early retirement for the school years ending in Year A or Year B only.

Eligible employees opting for early retirement were required to make an irrevocable election between options (1) or (2) at the time they notified Taxpayer of their early retirement. Retiree health benefits are provided to those electing them until the employee becomes eligible for Medicare, thereby providing a benefit lasting between one and ten years, depending on the age of the eligible employee.

Retirees who participate in Plan will be able to use their benefits only to pay for health care insurance premiums. However, the annual benefit of \$c does not fully cover annual costs for health care insurance premiums and the retiree is required to pay the difference.

Section 61(a)(1) provides that, except as otherwise provided in Subtitle A, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items. Section 1.61-21(a)(3) and (4) of the Income Tax Regulations state that a fringe benefit provided in connection with the performance of services shall be considered to have been provided as compensation to the person performing such services.

Section 106 of the Code provides that the 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 gross income of an employee does not include contributions which the employee's employer makes to an accident or health plan for compensation (through insurance or otherwise) for personal injuries or sickness to the employee or the employee's spouse or dependents.

Rev. Rul. 75-539, 1975-2 C.B. 45, describes two labor contracts. Contract A provides that upon retirement, an employee will receive a portion of accumulated unused sick leave credits as a cash payment or, at the election of the employee, the payment may be applied to continue the employee's participation in the employer's health plan. Contract B provides that the value of a portion of the accumulated unused sick leave credits will be used to pay for continued participation in the employer's health plan.

Rev. Rul. 75-539 holds that, under Contract A, the value of unused accumulated sick leave credits used to continue health coverage is constructively received by the retired employee under section 451 of the Code, and therefore is includible in the retired employee's gross income. Under Contract A, the amount of the premium payments is considered an employee contribution out of salary and not a contribution by the employer under section 106 of the Code. However, under Contract B, the value of unused accumulated sick leave credits, which may not be received in cash, is not constructively received by the retired employee, but is a contribution by the employer to

the employer's health plan that is excludable from the retired employee's gross income under section 106 of the Code.

Rev. Rul 2005-24 describes a health reimbursement arrangement. Situation 1 of the ruling states that when an employee retires, the employer automatically and on a mandatory basis (as determined under the Plan) contributes an amount to the reimbursement plan equal to the value of all or a portion of the retired employee's accumulated unused vacation and sick leave. Relying on Rev. Rul. 75-539, the ruling concludes that the reimbursement plan described in Situation 1 meets the requirements for tax-favored treatment.

Based on the representations made and authorities cited above, we conclude that the entire amount received by employees who elected option (2) is includible in the employees' gross income under section 61 of the Code. Those employees who elected option (1) must include in gross income under section 61 of the Code the amount they could have received had they elected option (2). For income tax purposes, employees who elected option (1) must be treated as if they had elected option (2).

No opinion is expressed as to the federal tax consequences of the transaction under any other section of the Code or statute other than those specifically stated above.

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,

Harry Beker, Branch Chief
Health and Welfare Branch
Office of Associate Chief Counsel/Division
Counsel
(Tax Exempt & Government Entities)