

Internal Revenue Service

Number: **200527012**
Release Date: 7/8/2005
Index Number: 104.01-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No.

Telephone Number: _____

Refer Reply To:
CC:TEGE:EB:HW
PLR-160587-04

Date:
April 01, 2005

LEGEND

Taxpayer =

Dear _____:

This is in reply to your letter dated September 8, 2004, in which you requested rulings on behalf of Taxpayer concerning the Federal income tax treatment of long-term disability benefits paid through a long-term disability insurance program (the Plan).

The Taxpayer currently provides long-term disability coverage to its eligible employees by purchasing a group policy from a third party carrier. The Taxpayer pays the entire premium for the coverage on behalf of the employees, and does not include the cost of the coverage in the employee's gross income.

The Taxpayer intends to amend the Plan to provide that each employee must decide for each plan year whether to have the Taxpayer continue to pay the long-term disability insurance premiums charged by the third-party carrier, or to pay the insurance premium with after-tax dollars. Each employee will make the election in writing prior to the beginning of each plan year to either have the Taxpayer continue to pay for the long-term disability coverage or to have the premium included in his or her gross income. You represent that the amount included in the employee's gross income will be the premium that the insurance carrier bills for that employee's coverage in that plan year. You further represent that the plan year will begin on the anniversary date of the insurance policy purchased under the Plan and end on the day before the following anniversary date of the insurance policy. The election will be irrevocable for the plan year once the plan year begins. Employees will be able to make a new premium payment election for the following plan year prior to the beginning of the next plan year. If no election is made by a particular employee, the Taxpayer will pay the premiums for such employee, and such premiums will not be included in the employee's gross income.

Section 104(a)(3) of the Internal Revenue Code (the Code) states 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 (on either a group or individual basis), the exclusion provided under section 104(a)(3) does not apply to any amounts received by his employees through such fund or insurance.

In Rev. Rul. 2004-55, 2004-2 I.R.B. 1, an employer provides long-term disability benefits through a group insurance policy with a third party insurance carrier. The employer pays the entire premium for the coverage and does not include the cost of the coverage in the employee's gross income. The employer amends the plan to provide that each employee may either continue to have the premiums paid by the employer on a pre-tax basis, or irrevocably elect to have the employer pay for the long-term disability coverage on an after-tax basis. The employee's election must apply to the entire cost of the coverage, and the employer must include the appropriate proportion of the group premium in the employee's income for that year. The ruling concludes that the long-term disability benefits received by an employee who elects to have the employer pay for coverage on an after-tax basis are excludable under section 104(a)(3), and the benefits received by an employee whose coverage is paid on a pre-tax basis are includible in gross income under section 105(a).

With respect to each employee, the amended Plan is financed either solely by the Taxpayer or solely by the employee. At no time is the coverage under the amended plan financed by both Taxpayer 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 that the long-term disability benefits paid to an employee who has elected to have the premiums included in gross income for the plan year are excludable from the employee's gross income under section 104(a)(3) of the Internal Revenue 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.

Sincerely,

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