INTERNAL REVENUE SERVICE

Number: **200046012**
Release Date: 11/17/2000
Index Nos: 083.13-00 402.00-00
451.14-00 105.00-00 106.00-00

CC:TEGE:EB:EC - PLR-106780-00

August 8, 2000

Plan =

X =

This is in response to your request for a ruling on behalf of X concerning the federal income tax consequences of an amendment to Plan on which X previously received a private letter ruling (PLR 9314005). That ruling concluded that benefits payable under the terms of the Plan and a grantor trust, commonly referred to as a "Rabbi Trust," were includible when paid or made available, that the creation and operation of the trust did not result in income to participants or beneficiaries under the doctrines of constructive receipt and economic benefit or under § 83 of the Internal Revenue Code. The ruling also concluded that the trust would be classified as a trust within the meaning of § 301.7701-4(a) of the Procedure and Administration Regulations and that X should be treated as the owner of the entire trust under § 677 of the Code.

X now proposes to amend the Plan to provide for a new class of plan participant. Under the terms of the amendment an employee must (1) have retired, (2) have completed at least 15 years of active participation in a group health insurance plan or health maintenance organization maintained by X, (3) have been enrolled in such plan or organization on the day before retirement and (4) receive an immediate annuity from X's qualified pension plan, in order to be included in the new class. The amendment provides that this new class of plan participant, their spouses, dependents and survivors ("Participants") are entitled to receive health care benefits under the Plan in accordance with the terms of the health care plan or organization in which they participate. The benefits may be paid either in the form of reimbursements to a Participant for covered expenses paid or incurred, to the service provider that renders the health care, or to a Voluntary Employee Beneficiary Association that has paid or is expected to pay the costs of the covered health care. Participants are not entitled to

any payment that results in a double benefit under the Plan or any other plan maintained by X.

X has represented that the amendment will not change the level of benefits payable to Participants under the Plan and it will have no effect on eligibility or the amount of health care benefits to which a Participant may be entitled. Finally, X has represented that none of X's plans is subject to Title I of The Employee Income Security Act of 1974 ("ERISA").

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

Section 83(a) of the Internal Revenue Code provides that the excess (if any) of the fair market value of property transferred in connection with the performance of services over the amount paid (if any) for the property is includible in the gross income of the person who performed the services for the first taxable year in which the property becomes transferable or is not subject to a substantial risk of forfeiture.

Section 1.83-3(e) of the Income Tax Regulations provides that for purposes of § 83 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. Property also includes a beneficial interest in assets (including money) transferred or set aside from claims of the transferor's creditors, for example, in a trust or escrow account.

Section 105(a) of the Code provides that, generally, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

Section 105(b) of the Code provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by the taxpayer for the medical care (as defined in § 213(d)) of the taxpayer, the taxpayer's spouse, and dependents (as defined in §152). However, pursuant to §105(h)(1) of the Code, the exclusion provided in §105(b) does not apply to excess reimbursements paid to highly compensated individuals under a discriminatory self-insured medical expense reimbursement plan.

Section 105(e) of the Code states that 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 generally, an accident or health plan is an arrangement for the payment of amounts to employees in the event

of personal injuries or sickness. An accident or health plan may be either insured or noninsured.

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 states that the gross income of an employee does not include contributions which his 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 §152 of the Code. The employer may contribute to an accident or health plan either by paying the premium on a policy of accident or health insurance covering one or more of the employees, or by contributing to a separate trust or fund which provides accident or health benefits directly or through insurance to one or more of the employees. However, if the insurance policy, trust, or fund provides other benefits in addition to accident or health §106 applies only to the portion of the contributions allocable to the accident or health benefits.

In Rev. Rul. 62-199, 1962-2 CB 38, the Service concluded that §106 applies to retired employees as well as active employees.

Section 402(b) of the Code provides that contributions made by an employer to an employees' trust that is not exempt from tax under § 501(a) are included in the employee's gross income in accordance with § 83, except that the value of the employee's interest in the trust will be substituted for the fair market value of the property in applying § 83. Under § 1.402(b)-1(a)(l) of the regulations, employer contributions to a nonexempt employee's trust are included as compensation in the employee's gross income for the taxable year in which the contribution is made, but only to the extent that the employee's interest in such contribution is substantially vested, as defined in the regulations under § 83.

Section 451(a) of the Code and § 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 § 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.

Various revenue rulings have considered the tax consequences of nonqualified deferred compensation arrangements. Rev. Rul. 60-31, Situations 1-3, 1960-1 C.B. 174, holds that a mere promise to pay, not represented by notes or secured in any way, does not constitute receipt of income within the meaning of the cash receipts and disbursements method of accounting. See also Rev. Rul. 69-650, 1969-2 C.B. 106, and Rev. Rul. 69-649, 1969-2 C.B. 106.

Under the economic benefit doctrine, an employee has currently includible income from an economic or financial benefit received as compensation, though not in cash form. Economic benefit applies when assets are unconditionally and irrevocably paid into a fund or trust to be used for the employee's sole benefit. Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd per curiam, 194 F. 2d 541 (6th Cir. 1952), Rev. Rul. 60-31, Situation 4. In Rev. Rul. 72-25, 1972-1 C.B. 127, and Rev. Rul. 68-99, 1968-1 C.B. 193, an employee does not receive income as a result of the employer's purchase of an insurance contract to provide a source of funds for deferred compensation because the insurance contract is the employer's asset, subject to claims of the employer's creditors.

Under the terms of the trust, amounts have been placed in trust to provide benefits to Participants in accordance with the terms of the Plan. However, the trustee has the obligation to hold the trust assets and income for the benefit of X's general creditors in the event of X's insolvency. The trust agreement further provides that a Participant receives no beneficial ownership in or preferred claim on trust assets. Therefore, although amounts are held in trust, in the event of X's insolvency, they are fully within reach of X's general creditors, as are any other assets of X.

Section 301.7701-4(a) of the Procedure and Administration Regulations provides that, generally, an arrangement will be treated as a trust if it can be shown that the purpose of the arrangement is to vest in trustees the responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Section 671 of the Code provides that where a grantor shall be treated as the owner of any portion of a trust under subpart E, part I, subchapter J, chapter 1 of the Code, there shall then be included in computing the taxable income and credits of the grantor those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against tax of an individual.

Section 677(a)(2) of the Code provides that the grantor shall be treated as the owner of any portion of a trust whose income without the approval of or consent of any adverse party, is, or, in the discretion of the grantor or a nonadverse party, or both, may be held or accumulated for the future distribution to the grantor.

Section 1.677(a)-1(d) of the regulations provides that under § 677 of the Code, a grantor is, in general, treated as the owner of a portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor.

Based on the information submitted and representations made and provided the provisions of the Plan and Trust requiring use of Plan and trust assets to satisfy claims of X's general creditors in the event of X's insolvency, is enforceable by such creditors under the federal and state law, we conclude that:

1. The trust will be classified as a trust within the meaning of § 301.7701-4(a) of the regulations and because trust assets may be used to discharge X's obligations to Participants, X shall be treated as the owner the trust under § 677 of the Code. Accordingly, under § 671, there shall be included in computing the taxable income and credits of X all items of income, deductions, and credits against tax of the trust.

2. The adoption of the amendment to the Plan and the use of trust assets to provide health care benefits to Participants under X's health care benefits plans, will not constitute a transfer of property within the meaning of § 83 and § 1.83-3(e) of the regulations, and will not result in current realization of income by Participants under § 402(b).

3. The adoption of the amendment to the Plan will not cause Participants who are on the cash receipts and disbursements method of accounting to recognize income prior to the amounts being paid or made available whichever is earlier, under either the doctrine of constructive receipt, within the meaning of § 451 of the Code, nor under the economic benefit doctrine.

4. Except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 for any prior taxable year, amounts paid from the trust directly or indirectly to a Participant to reimburse the Participant under the X's health care plan for expenses incurred for the medical care (as defined in § 213(d)) of the retired employee, his or her spouse and dependents (as defined in section 152) are excludable from gross income under §105(b) of the Code, (provided there are no excess reimbursements of highly compensated individuals under §105(h) of the Code).

5. Premiums paid from the trust for accident or health insurance under the X's health care plan which compensates a Participant for personal injuries or sickness incurred by the retired employee, his or her spouse and dependents (as defined in §152) are excludable from gross income under§ 106 of the Code.

Except as specifically ruled on above, no opinion is expressed as to the federal tax consequences of the above transaction under any other provision of the Code. Specifically, no opinion is expressed or implied concerning whether the employer's retiree health care plan is a discriminatory self-insured accident and health plan within the meaning of §105(h) of the Code.

This ruling is directed only to the taxpayer who requested it and applies only to the Plan and trust submitted as of the date of this ruling. If the Plan or the trust are amended, this ruling may not necessarily remain in effect. Section 6110(j)(3) of the Code provides that this ruling may not be used or cited as precedent.

Sincerely yours,

CHARLES T. DELIEE
Chief, Executive Compensation Branch
Office of Division Counsel/ Associate
Chief Counsel
(Tax Exempt and Government Entities)

Enclosure:
Copy for § 6110 purposes