Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:HW PLR-164963-02
Date:
04/01/2003

Taxpayer:

Plan:

Dear :

This responds to your letter of November 19, 2002 and supplemental submission of February 14, 2003, requesting rulings on behalf of Taxpayer concerning the proper Federal tax treatment of a medical reimbursement plan and a qualified parking payment plan. This ruling responds only to your ruling requests concerning the medical reimbursement plan as amended by your submission of February 14, 2003. Your ruling request concerning parking will be addressed under separate cover by Employment Tax Branch 2 of the Tax Exempt & Government Entities Division.

You represent that Taxpayer has established the Plan, which is an employer-provided reimbursement plan for employees' qualified expenses other than health insurance (there is also a separate health insurance program for employees). You represent that all benefits under the Plan are nontaxable benefits to the employees. All eligible employees can participate in the Plan, although participation is restricted for those employees who do not select health insurance coverage. The Plan reimburses participating employees for medical expenses, as defined in § 213(d) of the Internal Revenue Code (the Code)(except for health insurance premiums and long-term care expenses and insurance), of the employee and the employee's spouse and dependents as defined in §152 to the extent that the employee or the employee's spouse or dependants have not been reimbursed for the expense, or are not entitled to reimbursement from any other plan. You represent that the Plan satisfies the nondiscrimination rules of §105 (h) the Code.

The medical reimbursement plan is available only to those employees who have elected, through salary reduction, to purchase employer-sponsored health insurance. Under the Plan, Taxpayer pays for the medical reimbursement plan and employees do not make any salary reduction elections to pay for the medical reimbursement plan. At the beginning of the plan year, Taxpayer designates a specified annual aggregate amount of reimbursements or payments based on each employee's wages and personal exemptions reported on Form W-4. Thus, employees with a higher

withholding rate have a lower aggregate amount; those with a lower withholding rate have a higher aggregate amount. The annual aggregate amount of the medical expense reimbursements with respect to a particular employee is not related to the employee's salary reduction to purchase health insurance under Taxpayer's health insurance program, and the salary reduction never exceeds the actual cost of employer-sponsored health insurance.

Under the Plan, only those medical expenses that an employee incurs while a participant in the Plan will be reimbursed. Any qualified medical expenses in excess of the available reimbursement amount can be carried over for reimbursement in the next plan year. The amount designated by Taxpayer for medical expense reimbursements that an employee does not use during the plan year is carried over to the next plan year, provided that the employee continues to participate in the Plan. Thus, the employee will have the carryover balance available, as well as additional amounts, for medical expenses in the next plan year. An employee cannot receive cash or any other benefit in lieu of medical expense reimbursements or payments. In addition, Taxpayer requires employees to substantiate medical expenses before reimbursements or payments are made. Although an annual aggregate amount is designated at the beginning of the plan year for each employee, only a pro-rata portion of that amount is available for reimbursement of substantiated medical expenses on each payday.

Section 61(a)(1) of the Code and §1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in Subtitle A, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 106 provides that 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) to the employee for personal injuries or sickness incurred by the employee or the employee's spouse or dependents (as defined in §152).

Section 105(a) provides that, except as otherwise provided in § 105, 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) states that except in the case of amounts attributable to (and not in excess of) deductions allowed under §213 (relating to medical 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 or the taxpayer's spouse or dependents (as defined in § 152).

Section 1.105-2 of the regulations provides that only amounts that are paid specifically to reimburse the taxpayer for expenses incurred by the taxpayer for the prescribed medical care are excludable from gross income. Thus, § 105(b) does not apply to amounts that the taxpayer would be entitled to receive irrespective of whether or not the

taxpayer incurs expenses for medical care.

In Rev. Rul. 2002-41, 2002-28 I.R.B. 75, an employer sponsors a major medical plan that provides coverage under a policy of accident and health insurance and is paid for in part pursuant to salary reduction elections under the employer's cafeteria plan. The employer also sponsors a health reimbursement arrangement (HRA) that is paid for solely by the employer and not through salary reduction contributions. Coverage under the HRA is available only to those employees who participate in the major medical plan. No portion of the salary reduction for the major medical plan is attributable to the HRA. The HRA reimburses substantiated medical care expenses (as defined in § 213(d)) of participating employees and their spouses and dependants (as defined in §152) up to a maximum annual reimbursement amount. Unused amounts from one coverage period are carried forward to subsequent coverage periods. Participating employees have no right to receive cash or any other benefit in lieu of medical expense reimbursements. The ruling concludes that coverage and reimbursements made under the HRA are excludable from the gross income of participating employees under §§ 106 and 105.

Notice 2002-45, 2002-28 I.R.B. 93, provides that an HRA is an arrangement that: (1) is paid for solely by the employer and not pursuant to salary reduction; (2) reimburses the employee for medical care expenses as defined in § 213(d); and (3) provides that any unused portion of the maximum dollar amount available during the coverage period is carried forward to subsequent periods. Notice 2002-45 also provides that, with the exception of amounts carried forward from previous coverage periods, the maximum reimbursement amount under an HRA for a coverage period need not be available to the employee-participant at all times during the coverage period. In addition, an HRA may reimburse claims incurred during one coverage period in a later coverage period, provided that the individual was covered under the HRA when the claim was incurred. Notice 2002-45 further provides that benefits under an HRA must be limited to reimbursements of § 213(d) expenses and that such expense reimbursements must be substantiated to be excludable under § 105.

The Plan is an employer-provided accident and health plan that is paid for solely by the Taxpayer and amounts are used exclusively to reimburse employees for expenses incurred for medical care as defined in § 213(d). No benefits other than reimbursements for medical care expenses are available at any time to participants either in the form of cash or other nontaxable or taxable benefits. Accordingly, the Plan meets the requirements as set forth in Rev. Rul. 2002-41 and Notice 2002-45.

Based on the information submitted and the representations made, we conclude that coverage of medical reimbursements under the Plan is excludable from a participating employee's gross income under § 106 of the Code and that reimbursements of medical care expenses under the Plan are excludable from a participating employee's gross income under § 105(b) of the Code.

No opinion is expressed concerning whether the medical reimbursement plan discriminates within the meaning of section 105(h) of the Code. Moreover, no opinion is expressed concerning the Federal tax consequences of the Plan under any provision of the Code other than those specifically stated herein.

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)

Enclosures:
Copy of Letter
Copy for Section 6110 purposes