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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-144324-05

Date:
December 14, 2005

Legend:

Employer =

Dear :

This responds to your letter of July 25, 2005 and subsequent correspondence, requesting rulings on behalf of Employer concerning the Federal income tax treatment of long-term disability benefits under sections 104 and 105 of the Internal Revenue Code (the Code).

You represent that Employer intends to provide long-term disability coverage to its eligible employees. Disability benefits will be provided through a group insurance policy with a third-party insurance carrier. Employer will pay for the cost of long-term disability coverage that provides benefits for up to two years after an employee becomes disabled. Employer-provided coverage will be paid on a pre-tax basis and Employer will not include the cost of the coverage in the gross income of its employees.

Employer will also give employees the opportunity to elect supplemental long-term disability coverage that provides benefits solely for the period commencing after the two-year period during which benefits are provided through the employer-provided coverage and continuing until the employee's attainment of age 65. Employees who elect supplemental disability coverage are required to purchase the coverage on an after-tax basis through after-tax payroll deductions. Eligible employees are not required to elect supplement coverage. However, if an employee does not elect supplemental coverage, benefits will be provided only for a period of up to two years after the employee becomes disabled. At no time will an employee receive benefits pursuant to both employer-provided and supplemental coverage. Contributions by Employer for the long-term disability coverage and contributions by employees for the supplemental long-

term disability coverage will be clearly demarcated as to the amounts that are earmarked to pay for the employer-provided coverage and the amounts that are earmarked to pay for the supplemental coverage.

Section 104(a)(3) 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. Section 1.104-1(d) refers to section 1.105-1 of the regulations for rules relating to the determination of the amount attributable to employer contributions.

Section 1.105-1(b) of the regulations provides that all amounts received by employees through an accident or health plan which is financed solely by their employer are subject to the provisions of section 105(a).

Under section 105(a), amounts received by an employee through accident or health insurance for personal injuries or sickness must 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 1.105-1(c)(1) of the regulations provides that in the case of amounts received by an employee through an accident or health plan which is financed partially by his employer and partially by contributions of the employee, section 105(a) applies to the extent that such payments are attributable to contributions of the employer that were not includible in the employee's gross income. The portion of the amounts which is attributable to the contributions of the employer shall be determined in accordance with section 1.105-1(d) of the regulations in the case of insured plans.

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 ruling concludes that the plan is not a contributory plan under

section 1.105-1(c)(1) of the regulations. The ruling holds that 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).

In your case, at no time do employees receive benefits pursuant to both the pre-tax employer-provided disability coverage and the employee-provided after-tax supplemental disability coverage. Supplemental disability benefits are paid only when an employee elects supplemental coverage and only after the employee is no longer entitled to receive employer-provided disability benefits. At no time are benefits attributable to the pre-tax employer-provided coverage and the after-tax employee supplemental coverage financed by both Employer and employee contributions. Therefore, the 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 the representations made, we conclude as follows:

(1) Long-term disability benefits paid to an employee pursuant to employer-provided coverage (i.e., benefits paid during the first two years of the employee's disability) are attributable solely to pre-tax employer contributions and are includible in the employee's gross income under section 105(a).

(2) Long-term disability benefits paid to an employee pursuant to the supplemental coverage (i.e., benefits paid after the first two years of the employee's disability) are attributable solely to after-tax employee contributions and are excludable from the employee's gross income under section 104(a)(3).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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 representatives.

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