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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
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Telephone Number:

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Date:
September 30, 2015

Taxpayer =
HRA Plan =
401(k) Plan =

Dear :

This letter is in response to your ruling request dated March 15, 2013, as supplemented by correspondence dated November 25, 2013, May 28, 2015 and September 2, 2015 for a private letter ruling concerning the HRA Plan and the 401(k) Plan.

The following facts and representations have been submitted under penalties of perjury in support of your request:

Pursuant to a collective bargaining agreement, Taxpayer proposes to amend two plans. The first is a medical expense reimbursement plan for retirees, known as the HRA Plan, funded through a trust ("Trust") that the Taxpayer represents is a VEBA as described in section 501(c)(9) of the Internal Revenue Code (the "Code"). Each participant has a retiree HRA that is funded by mandatory contributions from each employee's salary. Each retiree HRA is only usable by the employee on or after his or her retirement to provide reimbursement of qualified medical expenses under section 213(d).

The second plan is a defined contribution retirement plan called the 401(k) Plan. The 401(k) plan is a collectively-bargained plan, intended to be a tax qualified defined contribution plan.

Pursuant to the collective bargaining agreement, each employee accrues a certain amount of paid time off each year. The total amount of paid time off allowed to an employee for any year is determined pursuant to a formula, and such total amount includes a certain number of days of paid vacation for each "Vacation Year." A Vacation Year runs from May 1 of each year through April 30 of the following year. Under the collective bargaining agreement, any unused vacation time at the end of a Vacation Year may not be carried over; any unused vacation time up to 21 days is forfeited, and the excess of any unused vacation time over 21 days is paid out as regular wages. For purposes of this ruling, the term "annual Unused Vacation" refers only to the unused vacation up to 21 days that may not be carried over and is not paid out as regular wages.

Pursuant to a collective bargaining agreement, Taxpayer is proposing to amend the HRA Plan and 401(k) Plan to allow each employee covered under such collective bargaining agreement to make an annual irrevocable election before the start of the calendar year in which the leave is earned (that is, before the start of the calendar year in which the Vacation Year begins), to have the dollar equivalent (determined under a formula set forth in the collective bargaining agreement) of the annual Unused Vacation up to 21 days contributed by Taxpayer into the 401(k) Plan, the employee's retiree HRA, or a combination of both. An employee may not make this election with respect to any unused vacation in excess of 21 days. Such amounts are paid to the employee as regular wages.

In the event that any amount attributable to any employee's annual Unused Vacation cannot be contributed to the 401(k) Plan due to the annual limitations under sections 401(a)(17) and 415(c), the Taxpayer will contribute the dollar equivalent of the excess amount to the employee's retiree HRA at the same time that the Taxpayer would have made such contribution to the 401(k) Plan. In the event that an employee fails to make an employee election by the end of the calendar year preceding the Vacation Year, the dollar equivalent of the entirety of such annual Unused Vacation will be contributed as an employer contribution to the 401(k) Plan, and any excess amounts above the annual limitations will be contributed to the retiree HRA.

Based on the above facts and representations, you request the following rulings:

(1) The proposed amendment to the 401(k) Plan will not cause the plan to offer an additional cash or deferred arrangement pursuant to section 401(k), such that the Taxpayer's contributions of accrued vacation amounts are considered employee pre-tax contributions subject to the annual limitation under section 402(g); and

(2) The proposed amendment to the Trust and payments made from the Trust to the HRA Plan that are used to reimburse qualified medical expenses (as defined in section 213(d)) of retired employees, their spouses, and their dependents are excludable from the gross income of retired employees, their spouses and dependents under sections 105(b) and 106.

With respect to the first ruling request, section 401(a) provides that a trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of its employees or their beneficiaries constitutes a qualified trust under that section if a series of conditions are met.

Section 401(a)(4) provides as one of those conditions that the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees (within the meaning of section 414(q)). A plan maintained pursuant to a collective bargaining agreement is deemed to satisfy the nondiscrimination requirements.

Section 401(a)(17) provides that a trust will not constitute a qualified trust unless, under the plan of which the trust is a part, each employee is subject to the annual section 401(a)(17) compensation limit.

Section 401(k)(2)(A) provides, in pertinent part, that a qualified cash or deferred arrangement is any arrangement which is part of a profit sharing plan or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan, which meets the requirements of section 401(a), and under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash.

Section 402(g)(1) provides, in part, that the elective deferrals of any individual for any taxable year shall be included in such individual's gross income to the extent the amount of such deferrals for the taxable year exceeds the applicable dollar amount.

Section 402(g)(3)(A) provides that the term "elective deferrals" includes, in part, with respect to any taxable year, any employer contribution under a qualified cash or deferred arrangement (as defined in section 401(k)) to the extent not includible under section 402(e)(3)).

Section 415(a)(1)(B) provides that a trust which is part of a pension, profit-sharing, or stock bonus plan shall not constitute a qualified trust under section 401(a) if, in the case of a defined contribution plan, contributions and other additions under the plan with respect to any participant for any taxable year exceed the limitation of section 415(c).

Section 415(c)(1) provides that contributions and other additions with respect to a participant exceed the limitation of section 415(c) if, when expressed as an annual

addition to the participant's account, the annual addition is greater than the lesser of the applicable annual dollar limitation or 100 percent of the participant's compensation.

Section 1.401(k)-1(a)(3)(i) of the Income Tax Regulations (the "Regulations") provides that a cash or deferred election is any election by an employee to have the employer either: (A) provide an amount to the employee in the form of cash or some other taxable benefit that is not currently available, or (B) contribute an amount to a trust, or provide an accrual or other benefit, under a plan deferring the receipt of compensation.

Section 1.401(k)-6 defines non-elective contributions as employer contributions (other than matching contributions) with respect to which the employee may not elect to have the contributions paid to the employee in cash or other benefits instead of being contributed to the plan.

Section 1.401(k)-6 defines elective contributions as contributions made pursuant to a cash or deferred election under a cash or deferred arrangement.

Section 1.415(c)-1(b)(1)(i) generally defines the term "annual addition" as the sum, credited to a participant's account for any limitation year, of (A) employer contributions, (B) employee contributions, and (C) forfeitures.

Revenue Ruling 2009-31, 2009-39 I.R.B. 395, provides that annual employer non-elective contributions of the dollar equivalent of unused paid time off to a qualified profit-sharing plan that vary for each employee will not cause the plan to fail to meet the qualification requirements of section 401(a), provided that the contributions satisfy the applicable requirements of sections 401(a)(4) and 415(c) and, where applicable, other requirements of the Code.

Under the 401(k) Plan, amounts attributable to unused accrued vacation contributions up to a stated limit may only be distributed, and therefore made available to employees, in the future. While employees are permitted to make an annual irrevocable election as to which plan the contributions are to be made to, they are not permitted to elect to have the contributions paid in cash or other taxable benefit. Accordingly, the proposed amendment to the 401(k) Plan will not cause the plan to offer an additional cash or deferred arrangement pursuant to section 401(k), such that the Taxpayer's contributions of annual Unused Vacation are considered employee pre-tax contributions subject to the annual limitation under section 402(g).

With respect to the second ruling request, section 61(a)(1) and §1.61-21(a)(3) 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 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 section 152). 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, section 106 applies only to the portion of the contributions allocable to accident or health benefits.

Section 105(b) states that except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts attributable to employer-provided coverage (1) 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 section 213(d)) of the taxpayer or the taxpayer's spouse or dependents (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B)) and any child (as defined in section 152(f)(1)) who has not attained age 27 as of the end of the taxable year. Section 1.105-2 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, section 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, 2002-2 C.B. 75, an employer sponsors a health reimbursement arrangement (HRA) that is paid for solely by the employer and not through salary reduction contributions. The HRA reimburses substantiated medical care expenses (as defined in section 213(d)) of participating employees and their spouses and dependents (as defined in section 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. In Situation 2 of Rev. Rul. 2002-41, the maximum reimbursement amount under the HRA that is not applied to reimburse medical care expenses before an employee retires or otherwise terminates employment continues to be available after retirement or termination for any medical care expense under section 213(d) incurred by the former employee or the former employee's spouse and dependents. The ruling concludes that coverage and reimbursements made under the HRA are excludable from the gross income of participating employees under sections 106 and 105.

Notice 2002-45, 2002-2 C.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 section 213(d)) incurred by the employee and the employee's spouse and dependents (as defined in section 152); 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 benefits under an HRA must be limited to reimbursements of section 213(d) expenses and that all such expense reimbursements must be substantiated to be excludable under section 105. Notice 2002-45 further provides that medical care expense reimbursements under an HRA are excludable under section 105(b) if the reimbursements are provided to the following individuals: current and former employees (including retired employees), their spouses and dependents (as defined in section 152 as modified by the last sentence of section 152(b)), and the spouses and dependents of deceased employees.

Under the collectively bargained HRA Plan, if the employee timely elects to have annual Unused Vacation contributed to his or her retiree HRA, such amounts are paid solely by Taxpayer and not pursuant to salary reduction elections or otherwise. The amounts will be used to provide benefits that reimburse eligible post-retirement medical expenses and will not be used to provide for the payment of death benefits, bonuses, or separation pay nor may amounts be used to provide other taxable or nontaxable benefits. Thus, the collectively bargained HRA Plan meets the requirements of Rev. Rul. 2002-41 and Notice 2002-45 and the amounts are excludable from the gross income of retired employees, their spouses and dependents under sections 105(b) and 106.

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 based upon the assumption that the 401(k) Plan satisfies the qualification requirements set forth in section 401(a).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party.

While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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,

Ingrid Grinde
Senior Tax Law Specialist
Qualified Plans Branch 3
Tax Exempt & Government Entities

cc: