

Taxpayer is a subsidiary of Parent. Taxpayer has a fiscal calendar year accounting period and files its tax returns under the accrual method.

Taxpayer maintains Pension Plan, a defined benefit pension plan. Pension Plan was established on Date 1. Pension Plan received its most recent IRS determination letter on Date 2. Pension Plan was designed in accordance with the applicable tax-qualification requirements of the Code.

Under the current Pension Plan provisions, participants are generally eligible to receive retirement benefits on or after their normal or early retirement age, provided the participants have terminated. Pension Plan's participants are therefore generally ineligible to receive benefit payments prior to their separation from employment.

Pension Plan includes an overfunded section 401(h) account ("Pension Plan's 401(h) Account"), which is used to fund medical benefits for certain participants under Retiree Medical Plan. Pension Plan provides that an "eligible retiree" for whom medical benefits may be funded by Pension Plan's 401(h) Account is a participant other than a key employee (as defined by Pension Plan) who has satisfied the eligibility requirements of and elected to receive benefits under Retiree Medical Plan and includes the lawful spouse of the participant (if the spouse is entitled to receive benefits under Retiree Medical Plan). The medical benefits that may be funded by Pension Plan's 401(h) Account are any expenses for medical care for which eligible retirees are entitled to reimbursement under the terms of Retiree Medical Plan and any medical expense reimbursement plan which is a part thereof. Eligibility under Retiree Medical Plan is generally limited to a closed group of former employees who commenced employment at a participating company before certain dates and who satisfy the other eligibility requirements of Retiree Medical Plan.

Taxpayer represents that no contributions have been made to Pension Plan's 401(h) Account since Year A. Pension Plan's 401(h) Account became overfunded primarily due to positive investment performance and a decline in the number of eligible retirees. Taxpayer anticipates that the funding surplus will continue to grow as the number of eligible retirees continues to decline. Pension Plan's 401(h) Account therefore has significantly more assets than needed to satisfy the liabilities for medical benefits under Retiree Medical Plan.

Taxpayer desires to use some of the surplus funds in Pension Plan's 401(h) Account to fund medical benefits for participants who currently participate in Pension Plan and Active Medical Plan and who are not permitted, under the current terms of Pension Plan, to receive retirement benefits while they remain employed but who would otherwise be legally permitted to receive retirement benefits under section 401(a)(36). Taxpayer wishes to use part of the surplus in Pension Plan's 401(h) Account to fund benefits under Active Medical Plan for these participants and their eligible spouses and dependents.

Taxpayer proposes to amend Pension Plan to allow participants (“401(a)(36)-Eligible Participants”) to elect to receive retirement benefits under Pension Plan upon attainment of age 59½ but prior to their separation from employment, pursuant to section 401(a)(36) (“Proposed 401(a)(36) Amendment”). Taxpayer anticipates that all forms of benefit payment, including a lump-sum option, would be available to 401(a)(36)-Eligible Participants.

In connection with this amendment, Taxpayer proposes to further amend Pension Plan to allow Pension Plan’s 401(h) Account to fund medical benefits for the 401(a)(36)-Eligible Participants, and their eligible spouses and dependents, under Active Medical Plan (“Proposed 401(h) Amendment,” and together with Proposed 401(a)(36) Amendment, “Proposed Amendments”). Taxpayer intends to implement Proposed Amendments as soon as practical upon receiving an affirmative ruling from the Internal Revenue Service.

Taxpayer represents that no section 420 transfers were made to Pension Plan’s 401(h) Account nor any predecessor’s 401(h) account since Date 3, and that, to the best of Taxpayer’s knowledge, no section 420 transfers were made prior to Date 3.

Taxpayer represents that Taxpayer does not have a contractual obligation to fund medical benefits for any of the employees who would be impacted by Proposed Amendments.

Ruling Requested

Taxpayer requests a ruling that the payment of medical benefits from Pension Plan’s 401(h) Account to fund medical benefits provided under Active Medical Plan for 401(a)(36)-Eligible Participants, as provided for in Proposed Amendments, does not violate section 401(h) or § 1.401-14 or otherwise jeopardize Pension Plan’s tax-qualified status under section 401(a).

Law

Section 401(a) describes the requirements for a qualified 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 the employer’s employees or their beneficiaries.

Section 501(a) provides that an organization described in section 401(a) is generally exempt from federal income tax.

Section 401(a)(36) provides that a trust forming part of a pension plan shall not be treated as failing to constitute a qualified trust under section 401 solely because the plan provides that a distribution may be made from the trust to an employee who has attained age 59½ and who is not separated from employment at the time of the distribution.

Section 401(h) provides that, under regulations prescribed by the Secretary, and subject to the provisions of section 420, a pension or annuity plan may provide for the payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees, their spouses, and their dependents, but only if—

- (1) such benefits are subordinate to the retirement benefits provided by the plan;
- (2) a separate account is established and maintained for such benefits;
- (3) the employer's contributions to such separate account are reasonable and ascertainable;
- (4) it is impossible, at any time prior to the satisfaction of all liabilities under the plan to provide such benefits, for any part of the corpus or income of such separate account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits;
- (5) notwithstanding the provisions of section 401(a)(2), upon the satisfaction of all liabilities under the plan to provide such benefits, any amount remaining in such separate account must, under the terms of the plan, be returned to the employer; and
- (6) in the case of an employee who is a key employee, a separate account is established and maintained for such benefits payable to such employee (and his spouse and dependents) and such benefits (to the extent attributable to plan years beginning after March 31, 1984, for which the employee is a key employee) are only payable to such employee (and his spouse and dependents) from such separate account.

Section 1.401-14(a) provides that, under section 401(h), a qualified pension or annuity plan may make provision for the payment of sickness, accident, hospitalization, and medical expenses for retired employees, their spouses, and their dependents. The term "medical benefits described in section 401(h)" is used in § 1.401-14 to describe such payments.

Section 1.401-14(b)(1) provides that, under section 401(h), a qualified pension or annuity plan may provide for the payment of medical benefits described in section 401(h) only for retired employees, their spouses, or their dependents. To be "retired" for purposes of eligibility to receive medical benefits described in section 401(h), an employee must be eligible to receive retirement benefits provided under the pension plan, or else be retired by an employer providing such medical benefits by reason of permanent disability. For purposes of the preceding sentence, an employee is not considered to be eligible to receive retirement benefits provided under the plan if he is

still employed by the employer and a separation from employment is a condition to receiving the retirement benefits.

Section 1.401-14(c) sets forth requirements which must be met for a qualified pension or annuity plan to provide medical benefits described in section 401(h):

- (1) The plan must specify the medical benefits described in section 401(h) which will be available and must contain provisions for determining the amount which will be paid. Such benefits, when added to any life insurance protection provided for under the plan, must be subordinate to the retirement benefits provided by such plan.
- (2) A separate account must be maintained with respect to contributions to fund medical benefits described in section 401(h).
- (3) Amounts contributed to fund medical benefits, as described in section 401(h), must be reasonable and ascertainable.
- (4) It must be impossible, at any time prior to the satisfaction of all liabilities under the plan to provide for the payment of medical benefits described in section 401(h), for any part of the corpus or income of the medical benefits account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits.
- (5) The plan must provide that any amounts which are contributed to fund medical benefits described in section 401(h) and which remain in the medical benefits account upon the satisfaction of all liabilities arising out of the operation of the medical benefits portion of the plan are to be returned to the employer.

Analysis

The second sentence of § 1.401-14(b)(1) provides that an employee is eligible to receive medical benefits from a 401(h) account as a “retired employee” if the employee is eligible to receive retirement benefits under the associated pension plan. Taxpayer’s Proposed 401(a)(36) Amendment would allow 401(a)(36)-Eligible Participants to receive retirement benefits under the terms of Pension Plan. Upon passage of Taxpayer’s Proposed 401(a)(36) Amendment, 401(a)(36)-Eligible Participants would therefore satisfy the definition of a “retired employee” as described in the second sentence of § 1.401-14(b)(1).

The third sentence of § 1.401-14(b)(1) provides that an employee is not considered to be eligible to receive retirement benefits under the plan if he is still employed by the employer and a separation from employment is a condition to receiving the retirement benefits. Because Taxpayer’s Proposed 401(a)(36) Amendment would allow 401(a)(36)-Eligible Participants to receive retirement benefits under the terms of

Pension Plan prior to their separation from employment, separation from employment would not be a condition to 401(a)(36)-Eligible Participants receiving retirement benefits under Pension Plan. Accordingly, 401(a)(36)-Eligible Participants would not be excluded from being considered eligible to receive retirement benefits under the third sentence of § 1.401-14(b)(1).

Ruling

We conclude that adoption of Taxpayer's Proposed Amendments, allowing the use of payments from Pension Plan's 401(h) Account to fund medical benefits for participants who are eligible to take pension distributions in accordance with section 401(a)(36), would not violate section 401(h) or § 1.401-14 or otherwise cause Pension Plan to lose its tax-qualified status under section 401(a).

The ruling contained in this letter is based upon information and representations submitted by Taxpayer and accompanied by penalty of perjury statements executed by an appropriate party, as specified in Rev. Proc. 2024-1, 2024-1 I.R.B. 1, sections 7.01(16)(b) and 8.05(4). This office has not verified any of the material submitted in support of the request for rulings. This material is subject to verification upon examination. The Associate Office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts, the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based, or—in the case of a transaction involving a continuing action or series of actions—the controlling facts change during the course of the transaction. See Rev. Proc. 2024-1, section 11.05.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter ruling. Specifically, no opinion is provided on any income tax consequences to Taxpayer as a result of the use of Pension Plan's 401(h) Account to provide health benefits to the employees who have not separated from employment. In addition, no opinion is expressed as to whether the Pension Plan satisfies any requirements of section 401(a) not expressly discussed.

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.

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,

Jeremy D. Lamb
Senior Counsel
Qualified Plans Branch 2
Office of Associate Chief Counsel
(Employee Benefits, Exempt Organizations, and
Employment Taxes)

cc: