

**MEMO# 12532**

August 24, 2000

# **IRS RELEASES PRIVATE LETTER RULING ON THE USE OF 401(K) CONTRIBUTIONS TO FUND LONG-TERM DISABILITY INSURANCE**

[12532] August 24, 2000 TO: PENSION COMMITTEE No. 62-00 RE: IRS RELEASES PRIVATE LETTER RULING ON THE USE OF 401(K) CONTRIBUTIONS TO FUND LONG-TERM DISABILITY INSURANCE The Internal Revenue Service has recently released a private letter ruling regarding the use of 401(k) contributions to purchase long-term disability insurance. In PLR 200031060, the Service ruled that a 401(k)'s purchase of long-term disability insurance out of designated employee elective deferrals will not violate the contingent benefit prohibition of section 401(k)(4)(A). In addition, the Service stated that the tax liability will be deferred until the long-term disability benefits are paid from the plan. The facts of the PLR are as follows. An employer sponsors a qualified profit-sharing plan that includes a 401(k) feature. The plan wishes to allow participants to direct the plan trustee to allocate part of their salary deferral contributions to purchase commercial group long-term disability insurance ("LTDI") through the plan. The purpose of this benefit is to allow continuation of benefit accumulations that otherwise would not result if a plan participant was unable to work due to a disability. The premium would be deducted from the participant's plan account on a monthly basis. Under the policy, one year after a covered plan participant becomes disabled, the policy would begin to pay the plan's trust monthly amounts equal to 1/12 of the elective deferrals, employer matching contributions and qualified non-electing contributions made to the plan on behalf of the participant for the plan year before the disability began. These monthly payments would be paid until the employee's disability ends, the employee dies, the plan terminates, the participant withdraws any of his account attributable to the policy proceeds or until maximum payments have been made based on the participant's age at disability onset. The plan proposes that the disability benefits paid to the plan and credited to participants' accounts would be treated the same as any other accumulations under the plan. Participants in the plan would be permitted to direct the investment of such amounts as they would had they been able to continue to make salary deferrals to the plan. The Service ruled as follows: • Plan participants who elect long-term disability coverage will not be taxed on the cost of coverage currently; • Benefits paid to the plan are not annual additions subject to the limits of section 415(c); 2• LTDI benefits are not taxable to participants when paid to the plan; • Plan distributions to participants of amounts received from a LTDI policy and any earnings thereon will be fully taxed to participants under section 402(a); and • Purchase of LTDI coverage will not violate the "contingent benefit" prohibition under section 401(k)(4)(A). A copy of PLR 200031060 is attached. Kathryn A. Ricard Associate Counsel Attachment Attachment (in .pdf format)

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