87-SBE-076

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

| | | |
|---|---|---|
| In the Matter of the Appeal of | ) | |
| | ) | No. 87R-0153-VN |
| FRANK A. AIELLO | ) | |
| | ) | |

| | |
|---|---|
| For Appellant: | Frank A. Aiello<br>in pro. per. |
| For Respondent: | David Lew<br>Counsel |

## O P I N I O N

This appeal is made pursuant to section 19057, subdivision (a),[1] of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim, of Frank A. Aiello for refund of personal income tax in the amount of $1,149 for the year 1985.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

Appeal of Frank A. Aiello

The issue presented for our decision is whether a cash payment given by a former employer in lieu of continued participation in a group health insurance plan was includable in appellant's gross income.

Appellant is a retired employee of the Kaiser Steel company (Kaiser). In 1984, Kaiser was attempting to sell its steel plant in Fontana in the County of San Bernardino. An apparent condition of the sales agreement required that Kaiser eliminate or reduce the cost associated with the group health insurance plan that it was obligated to provide to its retired employees. Consequently, Kaiser decided to offer its retirees the option of either continuing to receive health insurance coverage under a new plan with reduced benefits or taking a lump-sum cash payment in lieu of their continued participation in any Kaiser group plan. If they chose the latter so-called buy-out option, retirees were free to use the cash payment to purchase their own health insurance but were not legally or contractually bound to do so.

Appellant was among those retired Kaiser employees who elected to receive the cash payment rather than the reduced health benefits. On his return for 1985, he reported the payment as part of his gross income for the taxable year. Subsequently, however, appellant filed an amended return, claiming a refund of the amount of tax corresponding to the cash payment. The Franchise Tax Board denied the refund claim and appellant filed this appeal.

In these proceedings, appellant contends that the cash payment should be excluded from gross income under section 106 of the Internal Revenue Code as an employer contribution to an employee's health plan. As authority for his position, appellant has cited Revenue Ruling 62-199, 1962-2 C.B. 38. Appellant asserts that, for those retired Kaiser employees who chose to continue their participation in a Kaiser group health plan, the Franchise Tax Board has not included in their gross income the value of the insurance premiums paid on their behalf by Kaiser. It is appellant's position that the cash payment should likewise not be includable in his gross income since the money was provided to enable him to obtain his own health insurance.

Revenue and Taxation Code section 17071 states that gross income shall be defined by section 61 of the Internal Revenue Code which provides as follows:

> (a) Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
>
> (1) Compensation for services, including fees, commissions, fringe benefits, and similar items;. ..

Revenue and Taxation Code section 17131 further provides that items that are specifically excluded from gross income shall be determined in accordance with-applicable sections of the Internal Revenue Code.

Section 106 of the Internal Revenue Code states that gross income does not include contributions by the employer to accident or health plans for compensation (through insurance or otherwise) to the employee for personal injuries or sickness. Treasury Regulation section 1.106-1 provides, in part, that the employer may contribute to anaccident or health plan either by paying the premium on a policy of accident or health insurance covering its employees or by contributing to a separate trust or fund that provides accident or health benefits directly or through insurance to the employees.

In general, section 106 of the Internal Revenue Code deals only with the treatment of contributions by an employer to an accident or health plan for the benefit of its employees, and has no application to payments made by the employer directly to the employee. (Laverty v. Commissioner, 61 T.C. 160, 165 (1973), affd., 523 F.2d 479 (9th Cir. 1975).) Thus, premium costs paid by a company under an accident and health plan as its share of the cost of providing medical insurance coverage for its retired employees are excludable from the gross income of a retired employee under section 106. (Rev. Rul. 62-199, supra.) On the other hand, payments by employers made directly to employees for the express purpose of facilitating their purchase of health insurance have been held to be outside the statutory exclusion of section 106 and thus includable in the employee's gross income. (See Rev. Rul. 57-33, 1957-1 C.B. 303; Rev. Rul. 75-241, 1975-1 C.B. 316; Rev. Rul. 85-44, 1985-1 C.B. 22.) Revenue Ruling 75-241, supra, for example, involves a government contractor who was required by federal law to pay health and welfare benefits to his employees on a parity with benefits prevailing in the locality. The contractor could also discharge this obligation by paying cash directly to his employees *in* lieu of the health and welfare bcne'fits. Since the contractor was not required by law or contract

to verify that the payments were used by his employees to purchase health and welfare benefits and, in fact, did not obtain such verification, the Internal Revenue Service determined that the employees had complete control of the disposition of the funds.2/ The payments were therefore held to be wages attributable to services performed by the employees and includable in their gross income.

In recognition of Congressional intent to tax all gains except those specifically exempted, the United States Supreme court has broadly defined gross income as the "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." (Commissioner v. Glenshaw Glass Company, 348 U.S. 426, 431 [99 L.Ed. 483, 4901 (1955).) Here, while the cash payment may have been provided in lieu of continued health insurance coverage, appellant was not under any obligation to purchase health insurance with the proceeds. Appellant thus had complete control or dominion over the disposition of the payment. Moreover, inasmuch as appellant received the cash payment directly from Kaiser, the proceeds were not excludable from gross income under section 106 of the Internal Revenue Code as an employer contribution to an employee's accident or health plan.3/ Appellant's reliance on Revenue Ruling 62-199, supra, is misplaced, for that ruling involved the payment by a company of the premiums for a health insurance plan for its retirees. That revenue ruling did not involve, as here, the payment of monies directly to a retired employee.

Based on the foregoing, respondent's action in this matter must be sustained.

2/ In Revenue Ruling 61-146, 1961-2 C.B. 25, the Internal Revenue Service held, in part, that amounts paid directly to employees for the purpose of reimbursing them for their payment of premiums for health insurance, but only after verification that the premiums had actually been paid by the employees, were excludable from the gross income of the employees under section 106.

3/ Pursuant to Revenue and Taxation code section 17210, appellant may be entitled to a medical expense deduction as allowed under Internal Revenue code section 213 for amounts paid for the cost of medical care insurance.

Appeal of Frank A. Aiello

## O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Frank A. Aiello for refund of personal income tax in the amount of $1,149 for the year 1985, be and the same is hereby sustained.

Done at Sacramento, California, this 3t.h day of December 1987, by the State Board of Equalization, with Board Members Mr. Collis, Mr. D'ronenburg, Mr. Carpenter, and Ms. Baker present.

Conway H. Collis, chairman

Ernest J. Dronenburg, Jr., Member

Paul Carpenter, Member

Anne Baker*, Member

_____, Member

*For Gray Davis, per Government Code section 7.9