

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

October 17, 2001

State =

Plan =

Statute A =

Statute B =

Statute C =

Statute D =

Dear :

This responds to your request of February 26, 2001, on behalf of the Plan and the State, concerning whether "in-service" disability benefits paid to disabled members of the Plan and to deceased members' beneficiaries are excludable from the gross income of the recipients under section 104(a)(1) of the Internal Revenue Code (the "Code").

The Plan was created by the State Legislature in 1953 to provide retirement and disability benefits to most public employees of the State and local governments who are not covered by another public retirement system. Benefits are also payable to qualified survivors of deceased Plan members. The Plan was updated in 2000 when the State Legislature passed a statute establishing a new class of disability benefits for Special Service members.

Subsection b of Statute A provides that,

...a member who has become totally and permanently incapacitated for duty in the member's special service occupation as the natural and proximate result of an injury, disease, or exposure occurring or aggravated while in the actual

performance of duty at some definite place and time shall be eligible to retire under this subsection,

Subsection c of Statute A states,

Disease under this subsection shall mean heart disease or any disease of the lungs or respiratory tract and shall be presumed to have been contracted while on active duty as a result of strain, exposure, or the inhalation of noxious fumes, poison, or gases. ...

Subsection d of Statute A provides that,

Upon retirement for an in-service disability as provided by this subsection, a member shall receive the greater of a monthly in-service disability retirement allowance calculated under this subsection or a monthly retirement allowance as provided in ...[regular length of service retirement]. The monthly in-service disability allowance calculated under this subsection shall consist of an allowance equal to one-twelfth of sixty percent of the member's three-year average covered wage or its actuarial equivalent as provided under ... [Statute B].

Statute B provides that upon retirement, a member may elect to receive: (1) an actuarially reduced benefit and a designated lump-sum death benefit to a named beneficiary; (2) his or her retirement allowance and death benefits as provided in Statute C; (3) an actuarially determined increased retirement allowance and no death benefits under Statute C; (4) an actuarially reduced benefit and a lifetime annuity to a contingent annuitant at death; (5) a guaranteed payment for one hundred and twenty months to the member or, in the event of death, his or her named beneficiary or beneficiaries; or (6) with respect to retirement on or after July 1, 2001, an actuarially reduced benefit and a lifetime annuity to a contingent annuitant at death but if the contingent annuitant dies prior to the member, the member reverts to the benefit provided in (2) above.

Statute C states,

If a member dies on or after the first day of the member's first month of entitlement, the excess, if any, of the accumulated contributions by the member as of said date over the total gross monthly retirement allowances received by the member under the retirement system will be paid to the member's beneficiary ...

Statute D states,

Except as otherwise provided in this section, a vested member who is at least fifty-five years of age, upon retirement prior to the normal retirement date for that member, is entitled to receive a monthly retirement allowance determined in the same manner as provided for normal retirement in section ... reduced as follows

Benefits under Statute A are reduced by the amount of any disability benefits received from the Social Security Administration, whereas benefits under Statute D are not. Subsection 4 of Statute A provides that upon commencing to receive disability benefits from the Social Security Administration or the Railroad Retirement Board, a member receiving benefits under Statute A may elect to “waive” his benefits under Statute A and receive the benefits payable under subsection 2 of Statute D.

Section 104(a)(1) of the Code states that, “Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc. expenses) for any prior taxable year, gross income does not include—(1) Amounts received under workmen's compensation acts as compensation for personal injuries or sickness... .”

Section 1.104-1(b) of the Income Tax Regulations states that section 104(a)(1) excludes from gross income amounts that are received by an employee under a workmen's compensation act or under a statute in the nature of a workmen's compensation act that provides compensation to employees for personal injuries or sickness incurred in the course of employment. Section 104(a)(1) also applies to compensation which is paid under a workmen's compensation act to the survivor or survivors of a deceased employee. However, section 104(a)(1) does not apply to a retirement pension or annuity to the extent that it is determined by reference to the employee's age or length of service, or the employee's prior contributions, even though the employee's retirement is occasioned by an occupational injury or sickness.

Accordingly, whether benefit payments are excludable by the recipient under section 104(a)(1) of the Code depends upon the nature of the statute under which they are paid, not the particular circumstances of the recipient, and benefits will not be excludable where the statute allows for disability payments for any reason other than on-the-job injuries. See, Haar v. Commissioner, 78 T.C. 864, (1982), aff'd. 709 F.2d 1206 (8th Cir. 1983).

“In-Service” Disability Benefits –
Subsections b and c of Statute A

In Take v. Commissioner, 82 T.C. 630 at 635-637 (1984) aff'd 804 F2d 553 (9th Cir.

1986) the court stated,

...The ordinance under which payments were received purports to compensate employees for occupational disabilities. However paragraph 2 creates an irrebuttable presumption that certain enumerated disabilities are occupationally related. Paragraph 2 does not sufficiently limit the criteria for compensability to meet the requirement that the statute allow disability payments solely for service-related personal injury or sickness. ...[Thus] paragraph 2 is not a statute in the nature of a workmen's compensation act.

In the instant case, subsection c of Statute A fails to sufficiently limit benefits to line of duty injury or sickness because it creates a presumption of work relatedness. Accordingly, subsection c of Statute A is not a statute in the nature of a workmen's compensation act, and benefits received under subsection c of Statute A (i.e. benefits awarded to members on the basis of the presumption created in subsection c of Statute A) are not excludable from the gross income of the recipients under section 104(a)(1) of the Code. Subsection b of Statute A, however, limits benefits to members who suffer personal injury or sickness incurred in the performance of duty and is therefore a statute in the nature of a workmen's compensation act. Moreover, subsection b of Statute A does not exclude an illness listed in subsection c. Therefore, monthly benefits received by employees under subsection b (including benefits received by employees who have heart, lung or respiratory disease but have established work-relatedness without reliance on the presumption in subsection c) are received under a statute in the nature of a workmen's compensation act and are excludable from the recipients' gross incomes under section 104(a)(1) of the Code to the extent of one-twelfth of sixty percent of the members three year average covered wage. Amounts in excess of one-twelfth of sixty percent of the members three year average covered wage are not excludable under section 104(a)(1) of the Code because they are based on age, length of service or prior contributions.

Survivor Benefits Statute B and Statute C

In Rev. Rul. 80-44, 1980-1 C.B. 34, the Service concluded that if an employee elected to reduce the employee's lifetime allowance in order to increase the survivor's benefit,

The resulting increases in survivor's benefits is directly attributable to a reduction in the employee's lifetime benefits. The percentage of the increase equal to the percentage of lifetime benefits excludable under section 104(a)(1) of the Code is thus a continuation of lifetime section 104(a)(1) benefits. This percentage of the increase thus qualifies as

payments under a workmen's compensation act to survivors of a deceased employee, and under section 1.104-1(b) of the regulations it is excludable from gross income under section 104(a)(1).

In the instant case, an employee may reduce his benefits to provide survivor benefits. The survivor benefits provided under Statute B are attributable to a reduction in the employee's lifetime benefits. Accordingly, we conclude that, except for benefits computed under Statute C, the percentage of the benefits received under Statute B equal to the percentage of employee's lifetime section 104(a)(1) benefits qualifies as payment under a workmen's compensation act to survivor or survivors of a deceased employee and is excludable from gross income. However, because survivor benefits computed under Statute C are expressly determined by reference to the employee's prior contributions, they are not excludable under section 104(a)(1).

Waiver of "In-Service" Disability Benefits – Statute D

In Carlton v. United States, 86 USTC ¶9164, aff'd F.2d 173 (Fed. Cir. 1986), the city's pension plan provided that police and fire department members who were eligible for both a service pension and a service-connected disability pension could apply to be retired under either provision. If a police or fire department member incurred any work-related illness or impairment resulting in a loss of earning power, he could apply for workers' compensation. However, any payments received as a workers' compensation award would reduce the amount of disability payments by the amount of the award. The service pension, by contrast, was not affected by worker's compensation. The taxpayers in Carlton were receiving service pensions in amounts based on the number of years they served with the police department. Although shortly after their retirements they received workers' compensation awards for service-connected disabilities, their approved retirement applications opted for the years of service pensions. Therefore, notwithstanding a finding that they were disabled at the time of their retirement, the Court held that no part of the taxpayers' benefits were excludable under section 104(a)(1) of the Code.

Under subsection 4 of Statute A, employees may choose to receive benefits under Subsection b of Statute A, a statute in the nature of a workmen's compensation act, or to receive benefits based on age and length of service under Statute D. Employees who choose to receive benefits under Statute D have elected to receive their benefits under a statute that is not in the nature of a workmen's compensation act because the benefits are based on age, length of service or prior contributions. Accordingly, as in Carlton, no part of the benefits received under Statute D may be excludable from the employee's gross income under section 104(a)(1).

Except as specifically ruled upon above, no opinion is expressed or implied with respect

to the application of any other provisions of the Code or the regulations to the benefits described.

This ruling is directed only to the Taxpayers who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,
Felix Zech
Assistant Chief, Health & Welfare Branch
Office of Division Counsel /
Associate Chief Counsel
(Tax Exempt & Government Entities)

Enclosures

Copy of this letter

Copy for section 6110 purposes

cc: