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August 20, 2013

Legend

Taxpayer =

State =

Statute =

Dear :

This is in reply to a letter dated March 28, 2013, requesting rulings on behalf of Taxpayer, concerning the federal income tax treatment under section 104(a)(1) of the Internal Revenue Code (Code) of certain disability retirement and death benefits provided to public employees and their survivors under the Statute.

Taxpayer is responsible for oversight and administration of 105 separate retirement plans for public employees - 2 state-wide retirement plans and 103 local retirement plans - established under and governed by the Statute and regulations. The retirement plans are qualified under section 401 of the Code. The Taxpayer is responsible for general oversight, administration, and day-to-day operation of the retirement plans that operate

under the same governing document, the Statute, and under regulations, promulgated by the Taxpayer.

Generally, all full-time employees working in the public sector of State who meet the applicable eligibility requirements are covered by and members of the retirement plans. Under the Statute, participation in the retirement plans is a condition of employment for eligible employees. In addition, the Statute requires eligible employees participating in the retirement plans that require employee contributions to make the required contributions as a condition of employment.

The retirement plans provide retirement, disability, and death benefits to eligible members and beneficiaries. These benefits are calculated based on the formula that applies to each retirement plan under the Statute and is generally based on the participant's job classification, compensation, years of creditable service, type of benefit, and form of payment.

Section 6 of the Statute provides that ordinary disability benefits are payable to members in service who become disabled outside the performance of their duties (i.e., non-duty related). Section 7 of the Statute provides that accidental disability benefits are payable to an eligible member in service who, before attaining the maximum age for the member's job classification, is unable to perform the essential duties of his job by reason of a personal injury sustained or a hazard undergone as a result of his duties (i.e., duty-related). Section 7 further limits accidental disability benefits to members whose disability: (1) is likely to be permanent; (2) is due to a personal injury sustained or a hazard undergone as a result of, and while in the performance of, his duties at some definite place and definite time; (3) incurred on or after the date the individual becomes a member of the relevant retirement plan (or, under certain circumstances, prior to such date); and (4) is without serious and willful misconduct on the member's part.

Sections 6 and 7 of the Statute require a member who makes an application for accidental disability benefits to undergo a medical examination by a medical panel and for the medical panel to submit its findings to the Taxpayer. The medical panel is charged with reviewing pertinent facts and written and oral evidence and making a determination of the member's disability. In the case of a member who has made application for accidental disability benefits, the medical panel must determine whether the disability was incurred in the line of duty and whether the disability might be the natural and proximate result of the accident or hazard undergone on account of the member's duties. The Taxpayer's regulations set forth the presumptions that apply with respect to specified injuries, illnesses, or causes of death that are determined to have been suffered in the line of duty. Sections 94, 94A and 94B of the Statute provide that these presumptions are rebuttable. Accordingly, pursuant to the rules, the Taxpayer is required to determine whether the presumptions apply, whether other factors might have contributed to the disability claimed by the member, and whether any event other than the accident or

hazard upon which the disability is claimed might have contributed to the disability claimed.

Sections 7 and 12(2) of the Statute provide that a member who the Taxpayer determines to be eligible for accidental disability retirement shall be entitled to an accidental disability retirement benefit equal to the sum of: (1) an annual annuity that is the actuarial equivalent of a lifetime annuity based on the member's accumulated regular contributions; (2) an annual pension equal to 72% of the member's regular annual compensation at the time the disability was sustained or the hazard was undergone; and (3) a fixed supplemental dependent allowance for certain surviving unmarried children of a member.

A member may elect to receive the aggregate accidental disability retirement benefit provided by Sections 7 and 12 (2) of the Statute under any of the three payment options - Option A, B, or C - available for normal retirement. Option C generally provides the member with a lifetime benefit based on the member's aggregate allowance, and survivor benefit equal to two-thirds of the yearly amount paid to the member during the member's lifetime payable to the member's surviving beneficiary.

The Statute provides certain specified death benefits (generally in lieu of the death benefit under the applicable payment option) to the beneficiary of a deceased member whose retirement is due to a disability retirement.

Section 9 of the Statute provides for an accidental death benefit which is payable in the event a member dies as a result of an injury incurred in the course of the performance of his duties or if a retiree dies as the natural or proximate result of the cause for which he retired (i.e., duty-related). The amount of the allowance under Section 9 consists of; (1) the amount of any accumulated total deductions credited to the member's account (return of accumulated deductions to beneficiary); and (2) an allowance to consist of a yearly amount of pension equal to 72% of the annual rate of compensation of such member on the date such injury was sustained or such hazard was undergone.

Section 100 of the Statute establishes a death benefit payable upon a police officer, firefighter, or correction officer, being killed in the line of duty. The surviving spouse of such police officer, firefighter, or correction officer is paid an annual amount of pension equal to the amount of salary which would have been paid to such member had he continued in service in the position held at the time of death. Upon the death of the spouse, eligible dependent children are entitled to 72% of the pension. Also, if there is any surviving child of such deceased member, the child shall receive an annual fixed amount. In addition, if the member was a member of a contributory retirement plan, the accumulated total deduction credited to his account shall be paid in one sum.

Section 101 of the Statute provides the surviving spouse of a deceased member who retired due to ordinary disability under Section 6 or accidental disability under Section 7 with an annual death benefit equal to a certain dollar amount depending on the retirement

plan that covered the deceased member at the time of death. The death benefit provided under Section 101 is in lieu of any other benefit to which the surviving spouse would be entitled under the Statute. Thus, a surviving spouse could not receive an Option C death benefit provided under Sections 7 and 12(2) in addition to the annual death benefit provided under Section 101.

Section 102 of the Statute provides that the State legislature, based on the report of the Taxpayer's actuary, shall make an annual determination of whether benefits paid will receive a cost-of-living adjustment (COLA) for the year. Section 103 of the Statute provides each local retirement board with the option of granting a cost-of-living adjustment under the retirement plan governed by that local board. Cost-of-living adjustments for the year apply with respect to all retirement benefits, pension, or annuities paid to a member, spouse or beneficiary under the applicable retirement plan.

Section 104(a)(1) of the Code 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 1.104-1(b) of the Income Tax Regulations provides that the exclusion from income of amounts described in 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. This exclusion, however, is not available and 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.

In Rev. Rul. 80-44, 1980-C.B. 34, a statute in the nature of a workmen's compensation act provided for an allowance of the greater of (A) 60 percent of the individual's average final compensation, or (B) the amount to which the individual would be entitled under the normal, years of service, retirement plan. The ruling concluded that the benefits under the statute were excludable under section 104(a)(1) of the Code to the extent that they did not exceed 60 percent of the final average compensation. Any excess over 60 percent of final average compensation was attributable to length of service, and therefore, not excludible from gross income. Rev. Rul. 80-44 also holds that benefits of the surviving spouse which are a continuation of the employee's benefits are excludible under section 104(a)(1) of the Code in the same percentage as the employee's benefits were excludible.

Rev. Rul. 80-84, 1980-1 C.B. 35, considered section 183 of a Los Angeles, California statute that provided benefits to survivors when "any member of the Fire or Police Department shall die ... after retirement, or while eligible for retirement from such department on account of years of service ...". The ruling concluded that benefits paid to employees' survivors may qualify as paid under a statute in the nature of a workmen's

compensation act where those benefits are a mere continuation of employees' section 104(a)(1) benefits.

In Rev. Rul. 85-104, 1985-2 C.B. 52, the Service considered a statute under which the participants who were disabled due to work-related injury or sickness, receive the greater of a fixed percentage of base salary or an amount computed on the basis of years of service. The Service concluded that an amount up to the percentage of base salary specified by the statute would be excludible from the participant's gross incomes under section 104(a)(1) of the Code but that any excess, computed on the basis of length of service, would not be excludible under section 104(a)(1).

Accordingly, based on the information submitted and representations made, and authorities cited above, we conclude as follows:

(1) Ordinary disability retirement benefits paid under Section 6 of the Statute to a member who suffers a disability outside the performance of duty will be considered taxable income to the member subject to basis recovery.

(2) Accidental disability retirement benefits paid under Section 7 of the Statute to a member who incurs a disability through the performance of duty shall not be considered gross income to the recipient under section 104(a)(1) of the Code but only to the extent the benefits paid do not exceed 72% of the member's regular annual compensation at the time of disability. In addition, any fixed supplemental dependent allowance will not be considered gross income under section 104(a)(1) of the Code.

(3) Survivor benefits that are paid under Section 101 of the Statute to survivors of a member who at the time of death was receiving an accidental disability retirement benefit under Section 7 of the Statute shall not be considered gross income to the recipient under section 104(a)(1) of the Code.

(4) Joint and survivor benefits under Option C of Sections 7 and 12(2) of the Statute paid to a survivor of an accidental disability retiree that does not exceed 72% of the member's regular annual compensation at the time of disability shall not be considered gross income under section 104(a)(1) of the Code. In addition, the fixed supplemental dependent allowance will not be considered gross income under Section 104(a)(1) of the Code.

(5) Accident disability retirement benefits paid under Section 7 of the Statute (or Option C) and survivor benefits paid under Section 9 of the Statute where the determination of the disability or death being duty-related was based upon the provisions of sections 94, 94A or 94B, shall not be considered gross income to the recipient under section 104(a)(1) of the Code but only to the extent the benefits paid do not exceed 72% of the member's regular annual compensation at the time of disability. In addition, the amount of any fixed

supplemental dependent allowance will not be considered gross income under Section 104(a)(1) of the Code.

(6) Survivor benefits paid under Section 9 of the Statute to the survivors of members or retirees who die as the natural and proximate result of a personal injury sustained or a hazard undergone while in the performance of duties shall not be considered gross income under section 104(a)(1) of the Code but only the extent the amount does not exceed 72% of the annual rate of compensation of such member.

(7) Survivor benefits paid under Section 100 to survivors of members who die as a result of the performance of duty will not be considered gross income to the recipient under section 104(a)(1) of the Code but only to the extent the benefit to the surviving spouse does not exceed the amount of the salary which would have been paid to the deceased member had he remained in service, or, upon the death of the spouse, the amount payable to eligible dependent children but only to the extent benefits paid do not exceed 72% of the member's pension, or the annual fixed amount to any eligible dependent child.

(8) Annual cost-of-living adjustments (COLAs) paid under Sections 102 and 103 of the Statute will not be considered gross income to the recipient to the same extent that the underlying duty-related disability retirement payments or survivor benefits are not considered gross income to the recipient under section 104(a)(1) of the Code.

No opinion is expressed or implied concerning the federal tax consequences under any other provision of the Code or regulations or Statute other than those specifically stated above.

These rulings are directed only to the Taxpayer who requested them. Section 6110(k)(3) of the Code provides that they may not be used or cited as precedent.

Sincerely

Harry Beker
Chief, Health and Welfare Branch
Office of Division Counsel/Associate
Chief Counsel (Tax Exempt &
Government Entities)