

Internal Revenue Service

Department of the Treasury

Number: **200236014**
Release Date: 9/6/2002
Index Number: 104.02-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:TE/GE:EB:HW PLR-105700-02

Date:

05/30/2002

City =

Plan =

Dear :

This responds to a ruling request dated December 21, 2001, submitted on behalf of the City by its authorized representative, concerning whether line of duty disability benefits paid to disabled participants in the Plan are excludable from the gross income of the recipients under section 104(a)(1) of the Internal Revenue Code (the "Code").

The Plan was adopted by City ordinance to provide retirement benefits, disability benefits and survivor's benefits to certain employees of the City and their beneficiaries.

Section 31(a) of the Plan provides for ordinary disability benefits to Participants who reach a Termination Date by reason of total and permanent disability.

Section 31(b) the Plan sets forth the line of duty disability benefits under the Plan and provides as follows:

- (1) Except as provided in paragraph (2) of this subsection, a Participant (regardless of his or her length of service) who terminates employment by reason of total and permanent disability, which, as determined in accordance with rules established by the Plan Administrator, is incurred as a result of an accident or injury which has been sustained as an active Covered Employee and which has been ruled compensable under the Workers' Compensation Law of [State], shall be entitled to receive a monthly benefit equal to:
 - (i) For Employees who are Covered Employees as of June 30, 2001, the greater of:
 - A. The benefit determined pursuant to [an ordinary disability];
 - or

- B. The greater of: (I) a monthly benefit equal to the greater 66 $\frac{2}{3}$ % of the Participant's Compensation; or (II) the Participant's Employee Contributions Benefit.
- (ii) Employees who become Covered Employees on or after July 1, 2001, the greater of:
 - A. The benefits determined pursuant to [an ordinary disability]; or
 - B. If the line of duty disability is a catastrophic disability, as defined in subparagraph (2)(ii) below, the greater of: (I) a monthly benefit equal to the greater 66 $\frac{2}{3}$ % of the Participant's Compensation, or (II) the Participant's Employee Contributions Benefit; or
 - C. If the line of duty disability is a non-catastrophic disability, as defined in subparagraph (2)(iii) below, the greater of: (I) a monthly benefit equal to the greater 50% of the Participant's Compensation, or (II) the Participant's Employee Contributions Benefit.
- (2) In paragraph (1) of this subsection the following terms have the meanings indicated.
 - (i) "Line of duty disability" means a total and permanent disability incurred as a result of an accident or injury which has been sustained as a result of service as an active Covered Employee and which has been ruled compensable under the Workers' Compensation Law of [State].
 - (ii) "Catastrophic disability" means a line of duty disability:
 - a. By reason of which the Participant will be permanently prevented from engaging in any substantial gainful employment, or
 - b. Which severely limits one or more major life activities.
 - c. For purposes of this Section (iii), "substantial gainful employment" means the ability to perform a moderate amount of work with reasonable regularity, without reference to the type of work performed by the Participant before his or her Termination Date. "Major life activities" include caring

for one's self, walking, seeing, hearing, speaking, breathing or learning.

- (iii) "Non-catastrophic disability" means a line of duty disability which is not a catastrophic disability.

Section 39(b) of the Plan provides for line of duty death benefits under the Plan as follows:

In the event of the death of a Participant, prior to the Participant's Benefit Commencement Date, while in the line of duty (as defined below), the Participant's Beneficiary shall be entitled to receive the benefits described in subparagraphs (1), (2) or (3), as applicable.

(1) General Benefit

The Beneficiary shall be entitled to receive as a single lump sum the benefit described in paragraph (i), plus that described in paragraph (ii), where:

- (i) is an amount equal to the Participant's Employee Contributions Benefit; and
- (ii) is an amount equal to the Participant's annualized Compensation determined as of the date of death; provided, however, that the benefit provided by this subparagraph (ii) shall be payable only if the Participant has died while a Covered Employee.

(2) Surviving spouse / Domestic Partner benefit

- (i) If all the following conditions are met, then the surviving spouse or Domestic Partner of a deceased Participant shall be entitled to receive a survivor benefit, in lieu of any other Plan benefit:
 - A. The Participant is married on the date of death, or the Participant and his or her partner are validly listed as Domestic Partners on the City's Domestic Partnership Registry on the date of death and have been so listed for one year prior to the date of death;
 - B. The Participant's death occurs before the Benefit Commencement Date;
 - C. The Participant has designated the Participant's surviving spouse or Domestic Partner as his or her Beneficiary;

- D. The Participant has died in the line of duty as described in this Section 39(b)(4); and
 - E. Upon death of the Participant, the spouse or partner does not elect to receive the benefits provided in Section 39(b)(1).
- (ii)
- A. For purposes of this subsection, the line of duty survivor benefit is a monthly income commencing in the month next following the Participant's death and continuing for the remainder of the spouse's or partner's life or earlier remarriage of the spouse, or marriage, remarriage or re-registry of the Domestic Partner, in an amount equal to 66 and 2/3% of the Participant's Compensation determined as of the day before the Participant's death.
 - B. In the event of the death or remarriage of the spouse, or marriage, remarriage or re-registry of the Domestic Partner, following the death of the Participant, a monthly benefit equal to 50% of such Compensation shall be paid, in the aggregate, to the Participant's surviving children who are named as contingent beneficiaries.

Section 39(b)(3) of the Plan provides for surviving children's benefit. Section 39(b)(3)(ii) states that for purposes of this subsection, the line of duty survivor children's benefit is a monthly income commencing in the month next following the Participant's death in an amount equal to 50% of the participant's Compensation determined as of the day before the Participant's death and paid, in the aggregate, to the Participant's surviving children who are named as primary beneficiaries.

You request a ruling that sections 31(b) and 39(b) of the Plan are statutes in the nature of workmen's compensation acts and benefits paid thereunder are excludable from the gross income of the recipients under section 104(a)(1) of the Code.

Section 61(a) of the Code provides that, except as otherwise provided by law, gross income means all income from whatever source derived, including compensation for services.

Section 104(a)(1) of the Code provides that gross income does not include 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) of the Code excludes from gross income amounts 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 the employee for personal injury 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. Section 104(a)(1) does not apply to a retirement pension or annuity to the extent 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. Section 104(a)(1) also does not apply to amounts which are received as compensation for a non-occupational injury or sickness nor to amounts received as compensation for an occupational injury or sickness to the extent that they are in excess of the amount provided in the applicable workmen's compensation act or acts.

Benefits payable under section 31(b)(1) of the Plan are limited to total and permanent disabilities that have been ruled compensable under the Workers' Compensation Law of the State. Accordingly, section 31(b)(1) constitutes a statute in the nature of a workmen's compensation act.

The benefits payable under section 31(b)(1)(i)(A) and section 31(b)(1)(ii)(A) of the Plan are determined pursuant to the ordinary disability provision of section 31(a). The benefits payable under section 31(a) are determined by reference to the Participant's length of service or prior contributions (i.e. Accrued Benefit).

Employees covered as of June 30, 2001, who terminate employment by reason of total and permanent disability are entitled to receive monthly benefits equal to the greater of the amount provided under sections 31(b)(1)(i)(A) or 31(b)(1)(i)(B).

Employees who become Covered Employees on or after July 1, 2001, who terminate employment by reason of total and permanent disability are entitled to receive monthly benefits equal to the greater of the amount provided under sections 31(b)(1)(ii)(A) or if the line of duty line of disability is a catastrophic disability, the amount provided under 31(b)(1)(ii)(B) or if the line of duty disability is a non-catastrophic disability, the amount provided under section 31(b)(1)(ii)(C).

The monthly benefits payable under sections 31(b)(1)(i)(B)(II) and 31(b)(1)(ii)(B)(II) and (C)(II) of the Plan (the Participant's Employee Contributions Benefit) are determined by reference to the Participant's prior contributions. However, the monthly benefits payable under sections 31(b)(1)(i)(B)(I) and 31(b)(1)(ii)(B)(I) and (C)(I) of the Plan (66 $\frac{2}{3}$ %, 66 $\frac{2}{3}$ % and 50% of compensation, respectively) are not determined by reference to the Participant's age, length of service or prior contributions.

Section 39(b) of the Plan provides benefits which are limited to survivors of employees who die as a result of accident or injury sustained in the line of duty. Accordingly, section 39(b) of the Plan is a statute in the nature of a workmen's compensation act. A Participant's beneficiary is entitled to receive the benefits described in section 39(b)(1), section 39(b)(2) or section 39(b)(3).

Section 39(b)(i) provides that the beneficiary shall receive "The Participant's Employee Contributions Benefit" (section 39(b)(1)(i)) plus a lump sum equal to the Participant's

annualized compensation (section 39(b)(1)(ii)). Benefits payable under section 39(b)(1)(i) are determined by reference to the Participant's prior contributions. However, the benefits payable under section 39(b)(1)(ii) are not determined by reference to the Participant's age, length of service or prior contributions.

Section 39(b)(2)(ii)(A) provides that a surviving spouse or domestic partner shall be entitled to receive monthly benefit of 66 $\frac{2}{3}$ % of the Participant's Compensation which is not determined by reference to the Participant's age, length of service, or prior contributions.

Monthly benefits under section 39(b)(2)(ii)(B) equal 50% of the Participant's Compensation to surviving children who are named as contingent beneficiaries, upon the death or remarriage of the spouse, or marriage, remarriage or re-registration of the Domestic Partner. Section 39(b)(3) of the Plan provides benefits to deceased Participant's surviving children.

Based on the authorities cited above and on the representations made, we conclude as follows:

- (1) Sections 31(b) and 39(b) of the Plan constitute statutes in the nature of workmen's compensation acts under section 1.104-1(b) of the regulations.
- (2) Monthly benefits provided under section 31(b)(1)(i)(A) and section 31(b)(1)(ii)(A) of the Plan are determined pursuant to the ordinary disability provisions of section 31(a). Because the monthly benefits payable under section 31(a) are determined by reference to the Participant's length of service or prior contributions, they are not excludable under section 104(a)(1) of the Code.
- (3) Monthly benefits received under sections 31(b)(1)(i)(B)(I) and 31(b)(1)(ii)(B)(I) are excludable under section 104(a)(1) of the Code to the extent they do not exceed 66 $\frac{2}{3}$ % of the Participant's Compensation. Amounts in excess of 66 $\frac{2}{3}$ % of the Participant's Compensation under section 31(b)(1)(i)(B)(II) and section 31(b)(1)(ii)(B)(II) are not excludable from gross income because they are determined by reference to age, length of service or prior contributions.
- (4) Amounts received under section 31(b)(1)(ii)(C)(I) the Plan for non-catastrophic disability are excludable under section 104(a)(1) of the Code to the extent they do not exceed 50% of the Participant's Compensation. Amounts in excess of 50% of the Participant's Compensation under section 31(b)(1)(ii)(C)(II) are not excludable from gross income because they are determined by reference to age, length of service or prior contributions.
- (5) An "Employee Contributions Benefit" received under section 39(b)(1)(i) of the Plan is not excludable from a survivor's gross income under section 104(a)(1) of the Code because it is determined by reference to the employees prior contributions.

(6) A lump sum payment of a "Participants Annualized Compensation" received under section 39(b)(1) (ii) of the Plan is excludable from a survivor's gross income under section 104(a)(1) of the Code.

(7) Amounts received by a surviving spouse or domestic partner or children under sections 39(b)(2)(ii) and 39(b)(3) of the Plan are excludable from gross income under section 104(a)(1) of the Code.

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

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

Enclosures

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