

Internal Revenue Service

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Date:
June 11, 2012

Legend

Taxpayer =

State =

Statute =

Plan A =

Plan B =

Plan C =

Plan D =

Plan E =

Plan F =

Dear _____ :

This is in reply to your letter dated December 7, 2011 and subsequent correspondence concerning whether certain disability retirement payments made by System pursuant to Statute are excludable from the gross income of recipients under section 104(a)(1) of the Internal Revenue Code (the Code).

Taxpayer is a state-wide public employer retirement system (System). It provides death, disability and retirement benefits to public employees and their survivors through seven separate qualified retirement plans, six of which are the subject of this ruling. With few exceptions, all state employees must participate in one of the plans.

Section 29-109 of the Statute applies to Plans A, B, C, and D and provides for accidental disability retirement if a member is "totally and permanently incapacitated for duty as the natural and proximate result of an accident that occurred in the actual performance of duty at a definite time and place without negligence by the member" and if certain medical certification requirements are satisfied.

Sections 29- 109 (c)(1) and 29-111(b)(1) of the Statute apply to Plans E and F, and similarly provide for accidental disability retirement if "the member is totally and permanently incapacitated for duty arising out of or in the course of the actual performance of duty without willful negligence by the member.

Section 29-110 of the Statute applies to Plans A, B, C, D, and E, and provides for the calculation of the accidental disability retirement allowance as follows:

- (b) In general.- Except as provided in subsection (c) of this section, and accidental disability retirement allowance equals the lesser of:
 - (1) the members average final compensation; or
 - (2) the sum of:
 - (i) an annuity that is the actuarial equivalent of the member's accumulated contributions at retirement; and
 - (ii) a pension equal to two-thirds of the member's average final compensation.
- (c) Exception.-
 - (1) This subsection applies to a member of a State system other than [Plan E] who is at least normal retirement age.
 - (2) An accidental disability retirement allowance equals the greater of:
 - (i) a normal service retirement allowance; or
 - (ii) an accidental disability retirement allowance computed in accordance with subsection (b) of this section.

Section 29-111 (c) of the Statute applies to Plan F, and provides the same formula for calculation of the accidental disability retirement allowance as is provided for members under sections 29-110(b) and (c) above.

A member who is eligible to receive an accidental disability allowance paid under sections 29-110 and 29-111 of the Statute generally may elect to have a survivor allowance paid pursuant to a different payment option under sections 21-401 through 21-403. This survivor allowance is based upon an actuarial adjustment of the member's original accidental disability allowance. Members of Plans E and F who are married at the time of retirement may not elect a different payment option because these plans automatically provide a survivor allowance to the retiree's surviving spouse without any actuarial reduction in the member's original accidental disability allowance. Sections 24-403 and 26-402 of the Statute.

Both the accidental disability allowances under sections 29-110 and 29-111 of the Statute and any survivor allowances under sections 21-401 through 21-403 of the Statute are eligible for cost of living adjustments (COLA) as provided under sections 29-401 through 29-432 of the Statute.

Section 61(a)(1) provides that, except as otherwise provided, gross income includes all income from whatever source derived, including compensation for services.

Section 72(a) of the Code provides that, except as otherwise provided by law, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment or life insurance contract.

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. 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. Section 1.104-1(b) of the regulations also states that section 104(a)(1) applies to compensation which is paid under a workmen's compensation act to the survivor or survivors of a deceased employee.

In Revenue Ruling 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).

Benefits paid under the Statute for accidental disability allowances are paid only for work-related disabilities and those benefits are paid without regard to an employee's age or length of service, and are thus in the nature of a workmen's compensation act.

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

(1) Benefits paid under sections 29-110(b) and 29-111(c) of the Statute will not be gross income to the recipient to the extent that the benefits do not exceed 2/3rds of the employee's average final compensation. The portion of the benefit that exceeds that amount will be gross income to the recipient under section 72 of the Code.

(2) For a member who has reached normal retirement age and who receives the normal service allowance, the portion of the employee's benefit that equals 2/3rds of the employee's average final compensation will not be gross income to the recipient. The portion of the benefit that exceeds that amount will be gross income to the recipient under section 72 of the Code.

(3) Benefits paid under sections 21-401 through 21-403 and sections 24-403 and 26-402 to a survivor of an employee determined to have a job-related illness or injury will not be gross income to the recipient to the same extent the allowance was payable to the employee.

(4) COLA benefits paid under sections 29-401 through 29-432 of the Statute to (i) a member who is determined to have a job-related illness or disability, or (ii) a survivor of a member under subsection (i) receiving benefits under sections 21-401 through 21-403 will not be considered gross income to the recipient to the same extent as the accidental disability allowance or survivor benefit is not considered gross income to the recipient.

No opinion is expressed as to the federal tax consequences of the transaction under any other section of the Code or Statute other than those specifically stated above.

This ruling is directed only to the Taxpayer requesting 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)