

INTERNAL REVENUE SERVICE

Index Number: 104.02-00

Number: **199935028**

Release Date: 9/3/1999

CC:EBEO:6 PLR-100461-99

June 2, 1999

State =

City =

Plan =

Dear

This responds to your request of December 31, 1998, on behalf of City, concerning whether line of duty disability benefits paid to disabled participants in the Plan (or to the survivor or survivors of deceased participants) are excludable from the gross income of the recipients under section 104(a)(1) of the Internal Revenue Code (the "Code").

The Plan was established by City ordinance to provide retirement benefits, disability benefits and survivor's benefits to certain designated full-time employees of the City Police Department and Fire Department and their beneficiaries.

Section 31 of the Plan sets forth the disability benefits under the Plan and provides as follows:

(a) Ordinary disability. If a Participant reaches a Termination Date by reason of total and permanent disability, the Participant shall be entitled to receive a monthly disability benefit equal to the greater of the amounts determined in accordance with paragraph (1) or paragraph (2), as follows:

- (1) If the Participant is credited with at least five Years of Credited Service, the monthly benefit payable pursuant to this paragraph (1) shall be 20% of the Participant's Average Compensation.
- (2) If the Participant is credited with at least five Years of Credited Service, the monthly benefit payable pursuant to this paragraph (2)

shall be the Participant's Accrued Benefit (based upon the Participant's actual Years of Credited Service and Average Compensation at his or her Termination Date), without Actuarial Reduction and, notwithstanding the provisions of (c) below hereof, without reduction for any benefits payable under the Workers' Compensation Law of [State].

(b) Line of duty disability.

- (1) Except as provided in paragraph (2) of this subsection, a Participant (regardless of his length of service) who terminates employment by reason of total and permanent disability, which, as determined in accordance with rules established by the 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 the greater of:
  - (i) The benefit determined pursuant to (a) above; or
  - (ii) If the line of duty disability is a catastrophic disability, as defined in subparagraph (2)(ii) below, the greater of: (A) a monthly benefit equal to the greater 66  $\frac{2}{3}$ % of the Participant's Compensation; or (B) the Participant's Employee Contributions Benefit; or,
  - (iii) If the line of duty disability is a non-catastrophic disability, as defined in subparagraph (2)(iii) below, the greater of: (A) a monthly benefit equal to 33  $\frac{1}{3}$ % of the Participant's Compensation, or (B) the Participant's Employee Contributions Benefit.

Section 31(b)(2)(i) of the Plan defines "line of duty disability" as a total and permanent disability which is 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.

Section 31(b)(2)(ii) of the Plan defines "catastrophic disability" as 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... .

Section 31(b)(2)(iii) of the Plan defines "non-catastrophic disability" as a line of duty disability which is not a catastrophic disability.

Section 39(b) of the Plan provides - Line of duty death benefit. 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:
  - (i) The Participant's Employee Contributions Benefit, payable in one or more installments over a period which meets the requirements of Section 40 and which is designated by the Participant or, if the Participant has made no designation, by his or her Beneficiary; plus
  - (ii) An amount, payable as a single lump sum, 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 benefit.
  - (i) If all of the following conditions are met, then the surviving spouse of a deceased Participant shall be entitled to receive a survivor benefit, in lieu of any other Plan benefit ...
  - (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 life or earlier remarriage in an amount equal to 66 $\frac{2}{3}$ % 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 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 ...
- (3) Surviving children's benefit
  - (i) If all of the following conditions are met, then the surviving children of a deceased Participant shall receive a survivor benefit, in lieu of any other plan benefit ...

- (ii) A. For purposes of this subsection, the line of duty survivors 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 ...

Section 39(b)(4) of the Plan defines, for purposes of this section, the term "line of duty" as death from an injury or illness which has been sustained as an active covered employee and which has been ruled compensable under the workers compensation law of State.

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 line of duty disability benefits paid pursuant to sections 31(b) and 39(b) of the Plan are, therefore, 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.

If benefits are computed by a formula that does not refer to the employee's age, length of service, or prior contributions and are provided to a class that is restricted to employees with service-incurred injuries, sickness or death, then the benefits are payments for the injuries, sickness or death, and the statute under which the benefits are paid qualifies as a statute in the nature of a workmen's compensation act. See, Rev. Rul. 80-84, 1980-1 C.B. 35; Rev. Rul. 83-77, 1083-1 C.B. 37 and Rev. Rul. 72-291, 1972-1 C.B. 36. Whether a payment is in the nature of workmen's compensation depends upon whether it is made because of injury sustained in the line of duty, not upon the amount paid. The fact that the amount received is based on a percentage of the employee's salary on the date of the disability does not disqualify the payment from qualifying as one in the nature of workmen's compensation. See, Rev. Rul. 68-10, 1968-1 C.B. 50.

In Rev. Rul. 80-44, 1980-1 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 excludable from gross income.

Based on the Statute, regulations and rulings cited above and on the representations made, we rule as follows:

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. A Participant who terminates employment by reason of total or permanent disability is entitled to receive a monthly benefit equal to the greater of sections 31(b)(1)(i) or 31(b)(1)(ii) or 31(b)(1)(iii).

The benefits payable under section 31(b)(1)(i) of the Plan are determined pursuant to the ordinary disability provisions of section 31(a). The monthly benefits payable under section 31(a)(1) are not determined by reference to the Participant's age, length of service or prior contributions and equal 20% of the Participant's Average Compensation. The monthly benefits payable under section 31(a)(2) are determined by reference to the Participant's length of service or prior contributions (i.e. Accrued Benefit). Accordingly, monthly benefits payable under section 31(b)(1)(i) are excludable under section 104(a)(1) of the Code to the extent they do not exceed 20% of the Participant's Average Compensation. Any amounts in excess of 20% of Average Compensation are not excludable from gross income.

The monthly benefits payable under sections 31(b)(1)(ii) of the Plan are not determined by reference to the Participant's age, length of service or prior contributions and equal 66 2/3% of the Participant's Compensation. The monthly benefits payable under

sections 31(b)(1)(ii) of the Plan equal the Participant's Employee Contributions Benefit. Accordingly, monthly benefits payable under section 31(b)(1)(ii) 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. Any amounts in excess of 66 $\frac{2}{3}$ % of Average Compensation are not excludable from gross income.

The monthly benefits payable under sections 31(b)(1)(iii) of the Plan are not determined by reference to the Participant's age, length of service or prior contributions and equal 33 $\frac{1}{3}$ % of the Participant's Compensation. The monthly benefits payable under sections 31(b)(1)(iii) of the Plan equal the Participant's Employee Contributions Benefit. Accordingly, monthly benefits payable under section 31(b)(1)(iii) are excludable under section 104(a)(1) of the Code to the extent they do not exceed 33 $\frac{1}{3}$ % of the Participant's Compensation. Any amounts in excess of 33 $\frac{1}{3}$ % of Average Compensation are not excludable from gross income.

Section 39(b) of the Plan provides for line of duty death benefits to Participants' beneficiaries. A Participant's beneficiary is entitled to receive the benefits described in sections 39(b)(1) or 39(b)(2) or 39(b)(3), as applicable.

Benefits payable under section 39(b)(1)(i) are determined by reference to the Participant's age, length of service or prior contributions. (Employee Contributions Benefit). The benefit payable under section 39(b)(1)(ii) (a single lump sum equal to the Participant's annualized Compensation) is not determined by reference to the Participant's age, length of service or prior contributions. Accordingly, amounts payable under section 39(b)(1)(i) are not excludable from the recipient's gross income. The amount payable under section 39(b)(1)(ii) is excludable from the recipient's gross income under section 104(a)(1) of the Code.

Monthly benefits under section 39(b)(2) equal either 66 $\frac{2}{3}$ % of the Participant's Compensation or 50% of the Participant's Compensation. In either case, the amounts are not determined by reference to the Participant's age, length of service, or prior contributions and are thus excludable from the recipient's gross income under section 104(a)(1) of the Code.

Monthly benefits under section 39(b)(3) equal 50% of the Participant's Compensation. This amount is not determined by reference to the Participant's age, length of service or prior contributions and is thus excludable from the recipient's 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, Branch 6  
Office of the Associate Chief Counsel  
(Employee Benefits and  
Exempt Organizations)

Enclosures

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