

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

January 9, 2001

Legend

Statute =

Plan =

Dear

This letter responds to a letter from your authorized representative dated August 25, 2000, requesting a ruling on the proper federal income tax treatment of certain disability retirement benefits paid to members of the Plan under the Statute.

The term "duty disability" is defined in Section 54-2-11 of the Statute.

If a member shall become totally incapacitated for duty by reason of injury, illness or disease resulting from performance of duty and if the Board of Trustees shall find such injury, illness or disease to have resulted from the performance of duty, on written application to the Board of Trustees by or on behalf of such member or by the head of his or her department such member shall be retired, notwithstanding that during such period of notification the member may have separated from service, provided that the medical director, after examination of such member, shall certify to the Board of Trustees his or her total incapacity. If said member was separated from service after filing of the written application, and had attained twenty-five (25) years or more of service prior to the date of separation, the Board of Trustees shall retire said member, under this section and under Sections 54-2-12 and 54-2-13 of this Code.

Sections 54-2-12(a)(1) and 54-2-13(a)(1) of the Statute provides:

Each such member shall receive a disability pension of fifty percent (50%), or such other higher percentage that is in effect and applies to such member [the percentage payable upon age and years of service retirement at the earlier of age 60 or 25 years of service], of the member's

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average final compensation at the time of disability retirement. On the date that a member who retired under Section 54-2-11 of this Code would have accrued twenty-five (25) years of creditable service had the member continued in active service, or on the date that the member reaches age sixty (60), whichever comes first, the member shall be eligible for optional benefits as provided in [City Charter], as amended.

Sections 54-2-12(a)(2) and 54-2-13(a)(2) of the Statute provides:

In addition to the disability pension provided for in Section [54-2-12(a)(1) or 13(a)(1)] of this Code, any member who receives a disability pension pursuant to Section[s] [54-2-12(a)(1) or 13(a)(1)] of this Code and has not accrued a total of twenty-five (25) years of creditable service, as of the date of the member's disability retirement shall receive a supplemental disability payment in the amount of sixteen and two-thirds percent (16 $\frac{2}{3}$ %) of the member's average final compensation at the time of disability retirement. This supplemental payment shall terminate upon the expiration of the period when a member who retired under Section 54-2-11 of this Code and who receives benefits under Section[s] [54-2-12(a)(1) or 13(a)(1)] of this Code would have accrued twenty-five (25) years of creditable service had the member continued in active service, or on the date that the member reaches age sixty (60), whichever comes first.

Section 61(a) of the Internal Revenue 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

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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 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, 1983-1 C.B. 37; Rev. Rul. 80-44, 1980-1 C.B. 34. 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.

However, where, under an employer's retirement rules, an employee's disability retirement pension is converted when he reaches a certain age to a regular service retirement pension, the section 104(a)(1) exclusion ceases to apply at the time of the conversion. See, Rev. Rul. 80-14, 1980-1 C.B. 33.

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

Sections 54-2-11, 12 and 13 of the Statute restrict benefits to a class of employees with service-incurred injuries or diseases resulting in disabilities and constitute statutes in the nature of workmen's compensation acts. Sections 54-2-12 and 13 provide for payment of a percentage of the injured employee's final compensation at the time of the occurrence of the disability based upon the retirement benefit payable upon the earlier of age 60 or 25 years of service, plus an additional 16 $\frac{2}{3}$ % payable until the earlier of age 60 or when the employee would have had 25 years of service without regard to the employee's actual age, length of service or prior contributions.

Thus, disability benefits paid under Sections 54-2-11, 12 and 13 of the Statute to a disabled member prior to the time of conversion from duty disability retirement to regular service retirement (the earlier of when the member would have accrued twenty-five (25) years of creditable service had the member continued in active service or on the date that the member reaches age sixty) 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.

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

Enclosure:

Copy for section 6100 purposes

cc: