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Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

August 30, 2001

County =

Plan =

Dear

This responds to a ruling request dated April 24, 2001, submitted on behalf of the County 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 established by County ordinance to provide retirement benefits, disability benefits and survivor's benefits to certain employees of the County and their beneficiaries.

Section 4.04 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 a Participant has completed at least five Years of Eligibility Service, the annual benefit payable pursuant to this paragraph (1) shall be equal to 1.6%, multiplied by the Participant's Average Compensation, multiplied by the Participant's Years of Credited Service, to a maximum of 35 years. If the Participant is under age 62 or has earned less than 25 Years of Credited Service as of the Termination Date, the Participant's Years of Credited Service are projected so that they include both the actual Years of Credited Services, plus any Credited Service which would otherwise have been earned as the earlier of: (A) the Participant's 62nd birthday or

(B) the date the Participant would have earned 25 Years of Credited Service.

- (2) if the Participant has completed at least five Years of Eligibility Service, the annual 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 Section 4.04(d) below, 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, a monthly benefit equal to 66 $\frac{2}{3}$ % of the Participant's Compensation; plus 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, a monthly benefit equal to 33 $\frac{1}{3}$ % of the Participant's Compensation, plus the Participant's Employee Contributions Benefit.

Section 4.04(b)(2)(i) of the Plan defines "line of duty disability" as "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]."

Section 4.04(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 4.04(b)(2)(iii) of the Plan defines “non-catastrophic disability” as a line of duty disability which is not a catastrophic disability.

Under section 1.05(p) of the Plan, the “Employee Contributions Benefit” consists of contributions to the Plan and earnings thereon.

You request a ruling that section 4.04(b) of the Plan is a statute in the nature of a workmen’s compensation act 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 4.04(b) 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 4.04(b) constitutes a statute in the nature of a workmen's compensation act. A Participant who terminates employment by reason of a catastrophic disability is entitled to receive a monthly benefit equal to the greater of 66 $\frac{2}{3}$ % of the participant's compensation, plus the participant's Employee Contribution benefit or the participant's ordinary disability benefit. A Participant who terminates employment by reason of a non-catastrophic disability is entitled to receive a monthly

benefit equal to the greater of 33 $\frac{1}{3}$ % of the participant's compensation plus the participant's Employee Contributions Benefit or the Participant's Ordinary Disability benefit.

In Rev. Rul. 68-10, 1968-1 C.B. 50, the Service concluded that payments based on a percentage of an employee's compensation (100% in that case) were excludable under section 104(a)(1).

The monthly benefits payable under sections 4.04(b)(1)(ii) and 4.04(b)(1)(iii) of the Plan (66 $\frac{2}{3}$ % and 33 $\frac{1}{3}$ % of compensation, respectively) are not determined by reference to the Participant's age, length of service or prior contributions. However, the Participant's Ordinary disability benefit and Employee's Contribution Benefit are not excludable from gross income under section 104(a)(1) of the Code because they are based on age, length of service, or prior contributions..

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

- (1) Section 4.04(b) of the Plan constitutes a statute in the nature of a workmen's compensation act under section 1.104-1(b) of the regulations.
- (2) Monthly benefits received under section 4.04(b)(1)(ii) of the Plan for catastrophic disability 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 received under section 4.04(b)(1)(ii) of the Plan in excess of 66 $\frac{2}{3}$ % of the Participant's Compensation are not excludable from gross income because they are determined by reference to age, length of service or prior contributions.
- (3) Amounts received under section 4.04(b)(1)(iii) of the Plan for non-catastrophic disability 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. Amounts received under section 4.04(b)(1)(iii) of the Plan in excess of 33 $\frac{1}{3}$ % of the Participant's Compensation are not excludable from gross income because they are determined by reference to age, length of service or prior contributions.

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,

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

Enclosures

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