

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:TE/GE:EB:HW PLR-106840-01

Date:

June 19, 2001

City =

Plan =

Dear

This responds to your request of January 31, 2001, 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 full-time employees of the City's Police Department and their beneficiaries.

Section 5.4 of the Plan sets forth the disability benefits under the Plan and provides as follows:

(a) Ordinary disability.

If a Participant is credited with at least five Years of Eligibility Service and reaches a Termination Date by reason of total and permanent disability, as defined in this Section 5.4, the Participant shall be entitled to receive a monthly disability benefit equal to 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 an actuarial reduction for payment prior to Normal Retirement Date, 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) 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:
- (A) the benefit determined pursuant to (a) above; or
 - (B) if the line of duty disability is a catastrophic disability, as defined 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 below, the greater of: (i) a monthly benefit equal to the greater of 33 $\frac{1}{3}$ % of the Participant's Compensation, or (ii) the Participant's Employee Contributions Benefit.

Section 5.4 (b)(2)(A) 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 for the City as a Covered Individual and which has been ruled compensable under the workers' compensation law of [State]."

Section 5.4(b)(2)(B) of the Plan defines "catastrophic disability" as "a line of duty disability (i) by reason of which the participant will be permanently prevented from engaging in any substantial gainful employment; or (ii) which severely limits one or more major life activities... ."

Section 5.4(b)(2)(C) of the Plan defines "non-catastrophic disability" as a line of duty disability which is not a catastrophic disability.

Section 5.8(b) of the Plan provides for a line of duty death benefit 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) or (2) as applicable.

- (1) General benefit. The Beneficiary shall be entitled to receive:
- (A) 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

- (B) 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.

- (A) 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 ...
- (B) 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 in an amount equal to 66 $\frac{2}{3}$ % of the Participant's Compensation determined as of the day before the Participant's death.

Section 5.8(c) of the Plan defines line of duty death for purposes of Section 5.8 as death from accident or injury "sustained as a result of service for the City as a Covered Individual and which has been ruled compensable under the Workers' Compensation Law of [State]."

You request a ruling that sections 5.4(b) and 5.8(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 5.4(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 5.4(b)(1) 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 the amount provided under sections 5.4(b)(1)(A) or (B). A Participant who terminates employment by reason of a non-catastrophic disability is entitled to receive a monthly benefit equal to the greater of the amount provided under sections 5.4(b)(1)(A) or (C).

The monthly benefits payable under sections 5.4(b)(1)(B)(ii) and (C)(ii) of the Plan (the Participant's Employee Contributions Benefit) are determined by reference to the Participant's prior contributions. Accordingly, monthly benefits payable under sections 5.4(b)(1)(A), (B)(ii) and (C)(ii) are not excludable from gross income because they are based on age, length of service, or prior contributions..

However, the monthly benefits payable under sections 5.4(b)(1)(B)(i) and 5.4(b)(1)(C)(i) 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.

Section 5.8(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 5.8(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 sections 5.8(b)(1) or 5.8(b)(2), as applicable.

Sections 5.8(b)(1) provides that the beneficiary shall receive "The Participant's Employee Contributions Benefit" (5.8(b)(1)(A)) plus a lump sum equal to the participant's annualized compensation (5.8(b)(1)(B)).

Benefits payable under section 5.8(b)(1)(A) are determined by reference to the Participant's prior contributions. Accordingly, amounts payable under section 5.8(b)(1)(A) are not excludable from the recipient's gross income. However, the benefits payable under section 5.8(b)(1)(B) are not determined by reference to the Participant's age, length of service or prior contributions.

Section 5.8(b)(2) provides that a surviving spouse 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.

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) Sections 5.4(b)(1) and 5.8(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 received under section 5.4(b)(1)(B) 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 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 5.4(b)(1)(C) 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 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.
- (4) An "Employee Contributions Benefit" received under section 5.8(b)(1)(A) 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.
- (5) A lump sum payment of a "Participants Annualized Compensation" received under section 5.8(b)(1) (B) of the Plan is excludable from a survivor's gross income under section 104(a)(1) of the Code.
- (6) Amounts received by a surviving spouse under section 5.8(b)(2) of the Plan are excludable from the surviving spouse'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,
Felix Zech
Assistant Chief, Health & Welfare Branch
Office of Division Counsel /
Associate Chief Counsel
(Tax Exempt & Government Entities)

Enclosures

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