

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

05/15/2002

Legend

Statute =

Taxpayer =

Dear :

This letter responds to a letter from your authorized representative dated December 21, 2001, requesting a ruling on the proper federal income tax treatment of certain disability payments made by Taxpayer to members and survivors under the Statute.

Section 31720 of the Statute provides that:

Any member permanently incapacitated for the performance of duty shall be retired for disability regardless of age if, and only if:

- (a) The member's incapacity is a result of injury or disease arising out of and in the course of the member's employment, and such employment contributes substantially to such incapacity, or
- (b) The member has completed five years of service, and
- (c) The member has not waived retirement in respect to the particular incapacity or aggravation thereof as provided by Section 21009....

Section 31720.5 of the Statute provides:

If a safety member, a fireman member, or a member in active law enforcement who has completed five years or more of service under a pension system established pursuant to Chapter 4 (commencing with Section 31900) or under a pension system established pursuant to Chapter 5 (commencing with Section 32200) or both or under this retirement system or under the State Employees' Retirement System or

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under a retirement system established under this chapter in another county, and develops heart trouble, such heart trouble so developing or manifesting itself in such cases shall be presumed to arise out of and in the course of employment. Such heart trouble so developing or manifesting itself in such cases shall in no case be attributed to any disease existing prior to such development or manifestation.

Section 31727.4 of the Statute provides:

Upon retirement of any member for service-connected disability, he shall receive an annual allowance payable in monthly installments, equal to one-half of his final compensation. Notwithstanding any other provision of this chapter, any member upon retirement for service-connected disability shall receive a current service pension or a current service pension combined with a prior service pension purchased by the contributions of the county or district sufficient which when added to the service retirement annuity will equal one-half of his final compensation or, if qualified for a service retirement, he shall receive his service retirement allowance if such allowance is greater but in no event shall it exceed the limitation as set forth in section 31676.1 as it now reads or may hereafter be amended to read. The provisions of this section shall also apply to any employee who becomes disabled for service connected causes prior to the first day of the calendar month when he would normally become a member.

Section 31786 of the Statute provides that when a retired member dies, the allowance received because of service-connected disability shall be paid, for life to specified survivors.

Sections 31762, 31763 and 31764 of the Statute provide for a member to elect to reduce his or her retirement allowance during his or her lifetime in order to increase their survivor's benefits.

Sections 31787, 31787.5 and 31787.6 of the Statute provide benefits to survivors of members who die as the result of accident, injury, or disease incurred in the course of or performance of duty. Section 31787 provides that if an employee dies as a result of injury or disease arising out of and in the course of employment, the employee's survivor may elect to receive an annual allowance equal to one-half of the employee's final compensation instead of the death benefit provided for nonservice-connected death under section 31780.

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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 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.

In Take v. Commissioner, 82 T.C. 630 at 635-637 (1984) aff'd 804 F2d 553 (9th Cir. 1986) the court stated,

...The ordinance under which payments were received purports to compensate employees for occupational disabilities. However paragraph 2 creates an irrebuttable presumption that certain enumerated disabilities are occupationally related. Paragraph 2 does not sufficiently limit the criteria for compensability to meet the requirement that the statute allow disability payments solely for service-related personal injury or sickness.

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...[Thus] paragraph 2 is not a statute in the nature of a workmen's compensation act.

In Rev. Rul. 80-44, 1980-1 C.B. 34, the taxpayer was receiving disability payments. A portion of each payment was excludable under section 104(a)(1) and a portion was not excludable under section 104(a)(1) because it was attributable to length of service. Under the plan, the employee could reduce his disability payment allowance in order to increase the survivor's benefit. The ruling holds that if an employee elects to reduce the employee's lifetime allowance in order to increase the survivor's benefit, the reduction is attributable pro rata among the components of the lifetime allowance. Thus, the increase in the survivor's benefits is partially attributable to a reduction of the employee's excludable section 104(a)(1) benefit which is excludable by the survivor from gross income and a reduction of the employee's nonexcludable benefit which is includable by the survivor in gross income.

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

Benefits received under section 31720(a) of the Statute (except for those members who are retired on the basis of the irrebuttable presumption provided in section 31720.5) as a result of injury or disease arising out of and in the course of employment are received under a statute in the nature of a workmen's compensation act and are excludable under section 104(a)(1) of the Code.

With respect to those members who are retired under section 31720(a) pursuant to the irrebuttable presumption provided in section 31720.5, the Statute is not a statute in the nature of a workmen's compensation act and benefits received by such members pursuant to section 31720.5 are not excludable from gross income under section 104(a)(1) of the Code. Like the statute in Take v. Commissioner, section 31720.5 provides for benefits to a certain class of employees based on a presumption that the disability is employment related. Under section 31720.5, the payment of benefits are for disabilities that are not work-related and are not restricted to a class of employees who can retire only if their incapacity is the result of injury or disease arising out of and in the course of employment.

With respect to those members retiring under section 31720(b) of the Statute who have completed five years of service, the Statute is not a statute in the nature of a workmen's compensation act because they can retire regardless of the cause of their incapacity. Thus, the benefits are not restricted to a class of employees who incur an occupational injury, sickness or death. Accordingly, benefits received under section 31720(b) of the Statute are not excludable from gross income under section 104(a)(1) of the Code.

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Under section 31727.4 of the Statute, if an employee receiving an allowance because of a service-connected disability, is also qualified for a service retirement, the employee may receive the service retirement allowance if such allowance is greater. The amount equal to the member's service-connected disability allowance (one-half of the member's final compensation) is excludable under section 104(a)(1) of the Code. Benefits received by such members pursuant to section 31727.4 of the Statute in excess of 50 percent of the member's final compensation are not excludable under section 104(a)(1) because they are based upon age and years of service.

Section 31786 of the Statute provides benefits which are limited to the survivors of employees who die as result of service-connected disability. Section 31786 of the Statute is a statute in the nature of a workmen's compensation act and the benefits received under section 31786 are excludable from gross income under section 104(a)(1) of the Code.

The survivor benefits provided under sections 31762, 31763 and 31764 of the Statute are attributable to a reduction in the employee's lifetime benefits. Accordingly, we conclude that a percentage of the survivor benefits received under sections 31762, 31763 and 31764 equal to the percentage of an employee's lifetime benefit excludable under section 104(a)(1) qualifies as payment under a workmen's compensation act to the survivor or survivors of a deceased employee and is excludable from gross income.

Sections 31787, 31787.5 and 31787.6 of the Statute provide benefits which are limited to survivors of employees who die as a result of accident, injury or disease sustained in the course or performance of duty. Sections 31787, 31787.5 and 31787.6 are statutes in the nature of a workmen's compensation act and benefits received under these sections of the Statute are excludable from gross income under section 104(a)(1) of the Code. Because the survivor can elect to receive the benefits provided under these sections or the benefits provided in the case of nonservice-connected death under section 31780, only that amount which is payable as a result of death due to service-connected injury or disease under the applicable part of section 31787 is excludable from gross income under section 104(a)(1). The excess is includable in the recipient's gross income because it is received under the nonservice-connected provisions of section 31780.

Payments received under any provision of the Statute on account of nonservice-connected disability are not received under a statute in the nature of a workmen's compensation act and are therefore not excludable from gross income under section 104(a)(1) of the Code.

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Except as specifically ruled upon above, no opinion is expressed or implied with respect to the application of any other provision of the Code or the regulations to the benefits described.

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