



City of Portland, Oregon



BUREAU OF FIRE AND POLICE DISABILITY AND RETIREMENT

1800 SW First Ave., Suite 450, Portland, OR 97201 · (503) 823-6823 · Fax: (503) 823-5166

Samuel Hutchison, Director

fpdr@portlandoregon.gov

Date: July 21, 2015

To: FPDR Board of Trustees

From: Nancy Hartline, FPDR Financial Manager

Re: Tax Reporting of FPDR Two Service-Connected Death before Retirement Benefit

As a result of discussions at recent Board meetings about the proper taxation of service-connected disability retirement benefits under the FPDR, FPDR staff and outside legal counsel, Lorne Dauenhauer, reviewed the tax reporting of other FPDR benefits. On the basis of that review, we determined that, although FPDR is correctly reporting the tax treatment of most benefits, FPDR Two pre-retirement service-connected or occupational death benefits were sometimes being reported incorrectly.

The FPDR Two pre-retirement service-connected or occupational death benefit (Charter Section 5-308) has two parts:

- Prior to the late member's earliest retirement date, the death benefit is 75% of the member's rate of Base Pay at death. This part of the benefit has always been correctly treated as a nontaxable benefit and paid through our disability payment process.
- However, commencing at what would have been the deceased member's earliest retirement date, the death benefit is 50% of the member's Final Pay, increased by any FPDR Two benefit adjustments since the member's death. This part of the death benefit has been reported as taxable, except in the case of members killed in the line of duty, and paid through our pension payment process.

Internal Revenue Code (IRC) § 104(a)(1) excludes from gross income amounts received by members under workers' compensation acts, since those amounts are compensation for personal injuries or sickness. Treasury Regulation § 1.104-1(b) extends that statutory exclusion to payments to a deceased member's survivors where the payments are a continuation of benefits otherwise excludable under IRC § 104(a)(1). Accordingly, FPDR Two pre-retirement service-connected or occupational disability benefits and death benefits are excluded from gross income as these benefits are considered "in the nature of a workers' compensation act." However, IRC § 104(a)(1) does not apply to the death benefit if it is determined based on the deceased member's age, length of service or prior contributions. Since FPDR Two pre-retirement service-connected or occupational death benefits are at all times based solely on members' pay (i.e., either 75% x Base Pay rate at death or 50% x Final Pay), then these benefits should be reported as non-taxable. The additional tax offset benefit authorized by state statute and paid on these death benefits is not based on a member's rate of pay and therefore is taxable.

Another IRC section, IRC § 101(h), excludes from taxable income survivor annuities paid to the spouse/child of a public safety officer killed in the line of duty. Unlike IRC § 104(a)(1), the IRC § 101(h) exclusion extends to the additional tax offset benefit since tax treatment under IRC § 101(h) does not depend on *how* the death benefit is calculated.

Since 2011, ten FPDR Two survivors received pre-retirement service-connected death benefits whose benefits were incorrectly reported as taxable income to them. To correct this error, FPDR staff has issued corrected 1099-Rs to these individuals and to IRS going back to 2011; we also have communicated with these individuals regarding the appropriate tax treatment of these benefit payments. Prospectively, FPDR will ensure appropriate tax reporting for pre-retirement service-connected survivors' benefits consistent with IRC §§ 101(h) and 104(a).

FPDR staff would like to thank member Del Stevens, whose comments on a nontaxable service-connected disability retirement benefit prompted this review.

Oregon Oregon Public Employees Retirement System

Rule 459-030-0025

Standards for Review of Police Officers and Firefighters Retirement Plans

- (1) For purposes of this rule:
 - (a) "Assumed rate" has the same meaning as provided in OAR 459-007-0001 (Definitions).
 - (b) "Valuation date" means the date set by the Board as of which the retirement benefits under the public employer's retirement plan and the retirement benefits under the PERS Plan shall be compared.
- (2) A determination whether a public employer provides retirement benefits to its police officers and firefighters that are equal to or better than the benefits that would be provided to them by PERS will be made as of the valuation date.
- (3) The Board will consider the aggregate total actuarial present value, as of the valuation date, of all retirement benefits accrued up to the valuation date and projected to be accrued thereafter to the date of projected retirement by the group of police officers and firefighters employed on the valuation date by the public employer. The Board will compare the retirement benefits provided under the public employer's retirement plan for each of the following classes of employees to the retirement benefits provided to the equivalent class of employees participating in the PERS Plan:
 - (a) Police officers or firefighters who would have established membership in the system before January 1, 1996, as described in ORS 238.430 (Limitation on benefits payable to persons establishing membership on or after January 1, 1996)(2), and would have been entitled to receive benefits under the PERS Plan;
 - (b) Police officers or firefighters who would have established membership in the system on or after January 1, 1996, as described in ORS 238.430 (Limitation on benefits payable to persons establishing membership on or after January 1, 1996), and before August 29, 2003, as described in 238A.025 (Oregon Public Service Retirement Plan established), and would have been entitled to receive benefits under the PERS Plan; and
 - (c) Police officers or firefighters who would have established membership in the system on or after August 29, 2003, and would have been entitled to benefits under the PERS Plan.
- (4) For each class of employees described in section (3) of this rule:

- (a) The aggregate total actuarial present value as of the valuation date of the projected full-career retirement benefits provided by the public employer must be equal to or better than those provided by PERS to the equivalent class of employees.
 - (b) The actuarial present value of projected retirement benefits for each individual employee need not be equal to or better than the present value that employee would have received as a member of that employee's equivalent class in PERS.
 - (c) The public employer's retirement plan or plans must provide at least eighty percent (80%) of the actuarial present value of projected retirement benefits in each of the major categories of retirement benefits available under PERS, namely: a service retirement benefit, including post retirement health care and a disability retirement benefit, also including post retirement health care.
- (5) In adopting the following methods and assumptions, to be used in conducting an actuarial review of a public employer's retirement plan, preference has been given to the simplest, least expensive methodology consistent with ORS 237.610 (Definitions for ORS 237.610 and 237.620) to 237.620 (Membership of police officers and firefighters in Public Employees Retirement System) and applicable actuarial standards:
- (a) Only employer funded benefits shall be used as the basis for the test comparison. Any contribution deemed as an employee contribution will be treated as an employee contribution for testing purposes, even if paid for by the employer unless the employer's plan specifies that the employer is responsible to make the contribution on the employee's behalf and that responsibility is nonelective.
 - (b) The Full Formula, Money Match, Formula Plus Annuity, and OPSRP Pension benefit formulas shall be used as the basis for valuing PERS benefits.
 - (c) Prior service benefits that depend on earnings shall be valued using the assumed rate, taking into consideration guaranteed plan returns.
 - (d) Future service benefits that depend on earnings shall be valued using the assumed rate, taking into consideration guaranteed plan returns.
 - (e) Benefits will be assumed to be paid in the typical and customary distribution form given the structure of the underlying plan. For example, PERS benefits will be paid using the most recent distribution assumption as of the valuation date, and benefits from a defined contribution program will be assumed to be paid as a lump sum at the date of projected retirement.
 - (f) Lump sum/annuity conversions, if needed, shall be calculated using the assumed rate.
 - (g) The assumed rate will be used to discount projected future benefits back to the valuation date.
 - (h) Benefit comparisons shall use a hypothetical PERS member data standard for each demographic group.
- (6) In conducting an actuarial review of the public employer's retirement plan, the actuary retained by the Board will use its current actuarial assumptions for police officers and firefighters of public employers participating in PERS for those employees, subject to any

exceptions noted above.

- (7) The Board will consider the estimated cost of the benefits to be provided, the estimated value of projected benefits to the employee, and the proportion of the cost being paid by the public employer and the participating police officers and firefighters. Whether the benefits are provided by contract, trust, insurance, or a combination thereof shall have no effect on the Board's determination.
- (8) In considering a public employer's retirement plan provisions, the Board may not value portability of pension credits, tax advantages, Social Security benefits or participation, any worker's compensation component of a public employer's retirement plan as determined by the employer or any portion of a benefit funded by the member.
- (9) The Board may not consider benefits provided by the PERS Plan under ORS 238.362 (Increased benefits payable in compensation for certain damages attributable to taxation of benefits)—238.368 (Retirement allowance increases for members who retired before January 1, 1991) or benefits provided by the employer's retirement plan under ORS 237.635 (Mandated increase in benefits payable under systems other than Public Employees Retirement System)—237.637 (Additional mandated increase in benefits payable under systems other than Public Employees Retirement System). The employer must identify benefits paid to comply with ORS 237.635 (Mandated increase in benefits payable under systems other than Public Employees Retirement System)—237.637 (Additional mandated increase in benefits payable under systems other than Public Employees Retirement System).
- (10) Additional actuarial assumptions needed to evaluate the public employer's retirement plan may be considered by the Board's actuary to be consistent with assumptions specified in these rules. Any disputes as to the appropriateness of additional actuarial assumptions may be resolved by the Board in its sole discretion.

Location: https://oregon.public.law/rules/oar_459-030-0025

Original Source: Rule 459-030-0025 — Standards for Review of Police Officers and Firefighters Retirement Plans, <https://secure.sos.state.or.us/oard/view.action?ruleNumber=459-030-0025> (last accessed Jun. 8, 2021).



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Oregon Public Employees Retirement System

Chapter 459

Division 30

LOCAL PUBLIC EMPLOYER RETIREMENT PLANS FOR POLICE OFFICERS AND FIRE FIGHTERS

459-030-0025

Standards for Review of Police Officers and Firefighters Retirement Plans

(1) For purposes of this rule:

(a) "Assumed rate" has the same meaning as provided in OAR 459-007-0001.

(b) "Valuation date" means the date set by the Board as of which the retirement benefits under the public employer's retirement plan and the retirement benefits under the PERS Plan shall be compared.

(2) A determination whether a public employer provides retirement benefits to its police officers and firefighters that are equal to or better than the benefits that would be provided to them by PERS will be made as of the valuation date.

(3) The Board will consider the aggregate total actuarial present value, as of the valuation date, of all retirement benefits accrued up to the valuation date and projected to be accrued thereafter to the date of projected retirement by the group of police officers and firefighters employed on the valuation date by the public employer. The Board will compare the retirement benefits provided under the public employer's retirement plan for each of the following classes of employees to the retirement benefits provided to the equivalent class of employees participating in the PERS Plan:

(a) Police officers or firefighters who would have established membership in the system before January 1, 1996, as described in ORS 238.430(2), and would have been entitled to receive benefits under the PERS Plan;

(b) Police officers or firefighters who would have established membership in the system on or after January 1, 1996, as described in ORS 238.430, and before August 29, 2003, as described in 238A.025, and would have been entitled to receive benefits under the PERS Plan; and

(c) Police officers or firefighters who would have established membership in the system on or after August 29, 2003, and would have been entitled to benefits under the PERS Plan.

(4) For each class of employees described in section (3) of this rule:

(a) The aggregate total actuarial present value as of the valuation date of the projected full-career retirement benefits provided by the public employer must be equal to or better than those provided by PERS to the equivalent class of employees.

(b) The actuarial present value of projected retirement benefits for each individual employee need not be equal to or better than the present value that employee would have received as a member of that employee's equivalent class in PERS.

(c) The public employer's retirement plan or plans must provide at least eighty percent (80%) of the actuarial present value of projected retirement benefits in each of the major categories of retirement benefits available under PERS, namely: a service retirement benefit, including post retirement health care and a disability retirement benefit, also including post retirement health care.

(5) In adopting the following methods and assumptions, to be used in conducting an actuarial review of a public employer's retirement plan, preference has been given to the simplest, least expensive methodology consistent with ORS 237.610 to 237.620 and applicable actuarial standards:

(a) Only employer funded benefits shall be used as the basis for the test comparison. Any contribution deemed as an employee contribution will be treated as an employee contribution for testing purposes, even if paid for by the employer unless the employer's plan specifies that the employer is responsible to make the contribution on the employee's behalf and that responsibility is nonelective.

(b) The Full Formula, Money Match, Formula Plus Annuity, and OPSRP Pension benefit formulas shall be used as the basis for valuing PERS benefits.

(c) Prior service benefits that depend on earnings shall be valued using the assumed rate, taking into consideration guaranteed plan returns.

(d) Future service benefits that depend on earnings shall be valued using the assumed rate, taking into consideration guaranteed plan returns.

(e) Benefits will be assumed to be paid in the typical and customary distribution form given the structure of the underlying plan. For example, PERS benefits will be paid using the most recent distribution assumption as of the valuation date, and benefits from a defined contribution program will be assumed to be paid as a lump sum at the date of projected retirement.

(f) Lump sum/annuity conversions, if needed, shall be calculated using the assumed rate.

(g) The assumed rate will be used to discount projected future benefits back to the valuation date.

(h) Benefit comparisons shall use a hypothetical PERS member data standard for each demographic group.

(6) In conducting an actuarial review of the public employer's retirement plan, the actuary retained by the Board will use its current actuarial assumptions for police officers and firefighters of public employers participating in PERS for those employees, subject to any exceptions noted above.

(7) The Board will consider the estimated cost of the benefits to be provided, the estimated value of projected benefits to the employee, and the proportion of the cost being paid by the public employer and the participating police officers and firefighters. Whether the benefits are provided by contract, trust, insurance, or a combination thereof shall have no effect on the Board's determination.

(8) In considering a public employer's retirement plan provisions, the Board may not value portability of pension credits, tax advantages, Social Security benefits or participation, any worker's compensation component of a public employer's retirement plan as determined by the employer or any portion of a benefit funded by the member.

(9) The Board may not consider benefits provided by the PERS Plan under ORS 238.362-238.368 or benefits provided by the employer's retirement plan under ORS 237.635-237.637. The employer must identify benefits paid to comply with ORS 237.635-237.637.

(10) Additional actuarial assumptions needed to evaluate the public employer's retirement plan may be considered by the Board's actuary to be consistent with assumptions specified in these rules. Any disputes as to the appropriateness of additional actuarial assumptions may be resolved by the Board in its sole discretion.

Statutory/Other Authority: ORS 238.650

Statutes/Other Implemented: ORS 237.620

History:

PERS 11-2020, minor correction filed 06/24/2020, effective 06/24/2020

PERS 8-2010, f. & cert. ef. 8-2-10

PERS 2-2009, f. & cert. ef. 2-12-09

PERS 9-2005, f. & cert. ef. 2-22-05

PERS 1-1989, f. & cert. ef. 12-4-89

PER 15-1981, f. & ef. 11-23-81

PER 4-1978, f. & ef. 11-2-78

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Of Attorneys for Plaintiffs.

STATE OF OREGON
Marion County Circuit Courts
MAY 04 2009
ENTERED

FILED
MAY 04 2009
Marion County Circuit Court

6
7 CIRCUIT COURT FOR THE STATE OF OREGON
8 COUNTY OF MARION

9 BRADFORD D. HOWSER and BRYON)
BEAULIEU,)

Case No.: 05C17254

10 Plaintiffs,)

STIPULATED ORDER REGARDING
RESOLUTION OF CLAIMS

11 On behalf of themselves and all others)
12 similarly situated,)

13 v.)

14 PUBLIC EMPLOYEES RETIREMENT)
SYSTEM, PUBLIC EMPLOYEES)
15 RETIREMENT BOARD, STATE OF)
OREGON and OREGON DEPARTMENT)
16 OF REVENUE,)

17 Defendants.)

18
19 WHEREAS, pursuant to the Settlement Agreement approved by the court on
20 December 11, 2006 and the Claims Resolution Process Order approved by the Court on
21 March 26, 2008, the parties have determined the members of the class and administered class
22 claims as pursuant to the Settlement Agreement and the Claims Resolution Process Order as
23 set forth below.

24 ///

25 ///

26 ///

Page 1- STIPULATED ORDER REGARDING RESOLUTION OF CLAIMS

Law Office of Paul R.J. Connolly
2731 12th Street SE | PO Box 3095
Salem, OR 97302
Ph: 503.585.2054 | Fax: 503.584.7037

1 1. The following ninety-one (91) class members' claims have been paid in full:

- 2 1. Adair, Pamela
- 3 2. Adamson-Woods, October
- 4 3. Anderson, Paul
- 5 4. Arwood, Sunny
- 6 5. Barnum, David
- 7 6. Beaulieu, Bryon
- 8 7. Blehm, Everett
- 9 8. Bourcier, Leeann
- 10 9. Britton, Mark
- 11 10. Buckmaster, Douglas
- 12 11. Carter, Robert
- 13 12. Champion, Richard
- 14 13. Chuey, Robert
- 15 14. Corbin, Terry
- 16 15. Crymes, David
- 17 16. Cummings, William
- 18 17. Cupp, Gary
- 19 18. Cyr, Mary Ann
- 20 19. Denney, Dennis
- 21 20. Dufur, Candace
- 22 21. Ell, Kim
- 23 22. Follingstad, Sheila
- 24 23. Fox, Stephen
- 25 24. Fredricks, Lance
- 26 25. Harris, Jerry W
- 27 26. Harvey, Nancy
- 28 27. Hill, Karen
- 29 28. Hosek, Ronald
- 30 29. Houlihan, Michael
- 31 30. Howser, Bradford
- 32 31. Hughes, Dianna
- 33 32. Huisman, James
- 34 33. Humphrey, James
- 35 34. Jackson, Wenona R
- 36 35. Jensen, Harvey
- 37 36. Johnson, Roger O
- 38 37. Jordan, Michael
- 39 38. Kea, Wayne
- 40 39. Kirkpatrick, John
- 41 40. Knutsen, Douglas
- 42 41. Koberstein, William B
- 43 42. Lambert, Kathleen S
- 44 43. Laudahal-Gratteri, Candace
- 45 44. Lecoe-Graham, Kelli J
- 46 45. Lemay, Patrick E
- 47 46. Linerud, Myron A
- 48 47. Longley, Darlene
- 49 48. Lovejoy, Ronald
- 50 49. Macartney, Stephen
- 51 50. Marshall, Landy

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- 1 51. Mckirgan, Thomas
- 2 52. Mellor, Linda Mae
- 3 53. Mohler, Betty
- 4 54. Moore, Wayne
- 5 55. Mudge, Gary
- 6 56. Myers, Don
- 7 57. Nebeker, John
- 8 58. Nichols, Nancy E
- 9 59. O'Connor, Patrick
- 10 60. Otto-Spears, Candace L
- 11 61. Palaroan, Ted T
- 12 62. Pegg, Judith
- 13 63. Perkins, Donald
- 14 64. Phelps, Kim
- 15 65. Plumb, Carol A
- 16 66. Pool, Sandra J
- 17 67. Popiel, Richard
- 18 68. Robinson, William
- 19 69. Rudiger, Barbara
- 20 70. Sabatini, Janice M
- 21 71. Saylor, David
- 22 72. Schjoll, Richard
- 23 73. Sprague, Jimmie
- 24 74. Taylor, Lorelei G
- 25 75. Terry, Jack
- 26 76. Thalman, David
77. Thomasson, Mitzi G
78. Thompson, Donald
79. Thompson, Lena
80. Thompson, Lillian D
81. Todd, Aaron D
82. Turney, Lisa A
83. Warren, Kirk L
84. Wilkins, Curtis
85. Williams, Dwight
86. Winstead, Gene
87. Wojcik, George
88. Wroot, Scott
89. Young, David E
90. Young, Jerry
91. Zbinden, Michael

2. On April 3, 2009 Class Counsel filed Motion by Class Counsel for Order Declaring Abandoned the Claims of Class Members Paul Bieker, Stephen Hunter, Earl Myers, John Newcomer and Veronica Taylor. On April 13, 2009, the court signed the Order, as a result the claims of Paul Bieker, Stephen Hunter, Earl Myers, John Newcomer and Veronica Taylor have been declared abandoned.

Page 3– STIPULATED ORDER REGARDING RESOLUTION OF CLAIMS

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1 3. The parties have reviewed and analyzed all other claims in good faith and using their
2 best efforts. As a result, the parties hereby stipulate and agree that the following twenty (20)
3 putative claimants, each of whom submitted a Notice of Intent to File a Claim, did not in fact
4 have a viable claim because of one or another of the following reasons:

5 (1) Claimant did not receive PERS benefits during the years for which
6 compensation was to be paid under the Settlement Agreement, or

7 (2) The HB 3349 distribution offset the amount of their claim entirely, or

8 (3) Analysis of their tax liability revealed that they did not overpay their taxes.

9 Therefore, none of these putative claimants are entitled to compensation under the terms of
10 the Settlement Agreement:

- 11 1. Richard Allen
- 12 2. Jody Bartow
- 13 3. Richard Doyle
- 14 4. Elvera Foster
- 15 5. Georgann Gulley
- 16 6. Ronald Harrison
- 17 7. Paul Johnson
- 18 8. Robert Long
- 19 9. Barbara Madsen
- 20 10. Sherry Mckinney
- 21 11. Brian Murphy
- 22 12. Patrick Pritt
- 23 13. Terry Starnes
- 24 14. William Schneider
- 25 15. Theresa Terry
- 26 16. Mary Townsend
17. Charles Turney
18. Dawn Urban
19. Brian Vanosdol
20. Bradley Wanamaker

21 ///

22 ///

23 ///

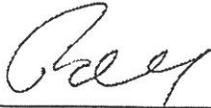
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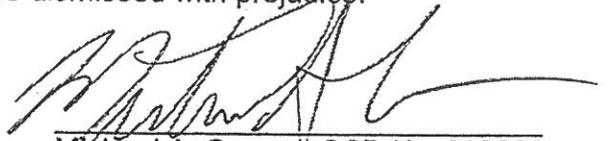
26 ///

Page 4- STIPULATED ORDER REGARDING RESOLUTION OF CLAIMS

1 Therefore, the parties stipulate that all terms of the court approved Settlement
2 Agreement have been fulfilled and the case may be dismissed with prejudice.

3 

4 Paul R.J. Connolly, OSB No. 844090
5 Of Attorneys for Plaintiffs
6 Date: April 30, 2009



Michael A. Casper, OSB No. 062000
Of Attorneys for Defendants.
Date: April 29, 2009

7 IT IS SO ORDERED this 4th day of May 2009



Hon. Don A. Dickey
Circuit Court Judge

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JAY AND FRANCES SEWARDS,
Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL
REVENUE,
Respondent-Appellee.

No. 12-72985

T.C. No.
24080-08

OPINION

Appeal from the United States Tax Court
Maurice B. Foley, Tax Court Judge, Presiding

Argued and Submitted
April 10, 2015—Pasadena, California

Filed May 12, 2015

Before: Barry G. Silverman and Carlos T. Bea, Circuit
Judges, and Gordon J. Quist, Senior District Judge.*

Opinion by Judge Quist

* The Honorable Gordon J. Quist, Senior District Judge for the U.S. District Court for the Western District of Michigan, sitting by designation.

SUMMARY**

Tax

The panel affirmed the Tax Court's denial of a petition for redetermination of a 2006 federal income tax deficiency based on the failure to report disability retirement payments.

Income is excluded from taxation under 26 U.S.C. § 104(a)(1) if it is received under workmen's compensation acts as compensation for personal injuries or sickness. Taxpayer retired due to a service-connected disability and received a disability pension equal to one-half his previous salary. Based on his years of service, he received an additional amount to bring his pension up to what he would have received as a service pension. The panel held that this additional amount was taxable because it was paid not based on taxpayer's injuries, but based on his years of service.

COUNSEL

Marshall W. Taylor (argued), Taylor, Simonson & Winter, LLP, Claremont, California, for Petitioner-Appellant.

Kathryn Keneally, Assistant Attorney General, Robert Metzler (argued), and Melissa Briggs, Tax Division, Department of Justice, Washington, D.C., for Respondent-Appellee.

** This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

OPINION

QUIST, Senior District Judge:

This case involves the taxation of retirement payments made to Jay Sowards, a former employee of the Los Angeles County Sheriff's Department. Like all County employees who retire with a service-connected disability, Sowards was entitled to receive a disability pension equal to one-half his previous salary. Because Sowards had completed 34 years of service, however, he received an additional amount to bring his pension up to what he would have received as a service pension. The question presented in this case is whether that additional amount is taxable under the Internal Revenue Code. Sowards argues that the entire amount of the retirement allowance may be excluded from taxation because it is a worker's compensation pension.¹ The Tax Court rejected Sowards's argument, concluding that the portion of Sowards's retirement allowance exceeding what he would have received solely based on disability is subject to taxation. Sowards now appeals that ruling. We have jurisdiction under 26 U.S.C. § 7482(a)(1), and we affirm the judgment of the Tax Court.

I.

The Los Angeles County Employees Retirement Association (LACERA) manages retirement assets and payments for retired Los Angeles County employees. Los Angeles County employees who sustain service-connected

¹ Although the payments at issue were made to Jay Sowards, his wife is also a party to the case because they are joint taxpayers. For purposes of clarity, however, this Opinion will refer only to Mr. Sowards.

injuries may retire on account of a service-connected disability. Cal. Gov't Code § 31720. The California statute that governs payments for employees who retire with a service-connected disability provides:

[The employee] shall receive an annual retirement allowance payable in monthly installments, equal to one-half of his final compensation. Notwithstanding any other provisions 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

Cal. Gov't Code § 31727.4. An individual's service retirement allowance is calculated using a statutory formula based on the individual's final salary, years of service, and age at retirement. Cal. Gov't Code § 31664.

Sewards worked for the Los Angeles County Sheriff's Department until November 29, 2000, when he was placed on involuntary medical disability leave due to service-connected injuries. While on disability leave, Sewards received his \$14,093 per month salary. After exhausting his disability leave, Sewards applied for and received a service retirement allowance based on his 34 years of service. After it became

clear that his injuries were permanent, however, Swards applied for and received a service-connected disability retirement allowance. Swards received the amount of his service retirement allowance because it was greater than one-half his final salary.

In each year from 2001 through 2005, LACERA sent Swards a Form 1099-R indicating that the taxable amount of his retirement allowance was not determined; as a result, Swards paid no tax on the pension. In 2006, LACERA sent Swards a 1099-R indicating that a portion of his retirement allowance was taxable. Swards did not, however, report as taxable any of the income from his retirement allowance on his 2006 tax return. The IRS subsequently issued a notice of deficiency, and Swards filed a petition with the Tax Court. The Tax Court, considering the petition on the basis of stipulated facts, held that the portion of Swards's pension that exceeded one-half his final salary was taxable.

II.

We review the Tax Court's interpretation of the Internal Revenue Code and its legal conclusions de novo. *Teruya Bros., Ltd. v. Comm'r*, 580 F.3d 1038, 1043 (9th Cir. 2009). The application of law to a stipulated factual record is also reviewed de novo. *Samueli v. Comm'r*, 661 F.3d 399, 407 (9th Cir. 2011).

III.

A.

Gross income includes "all income from whatever source derived." 26 U.S.C. § 61(a). "An accession to wealth . . . is

presumed to be taxable income, unless the taxpayer can demonstrate that it fits into one of the Tax Code's specific exemptions." *Hawkins v. United States*, 30 F.3d 1077, 1079 (9th Cir. 1994). Section 104(a)(1) of the Internal Revenue Code specifically excludes from taxation "amounts received under workmen's compensation acts as compensation for personal injuries or sickness." 26 U.S.C. § 104(a)(1). Treasury Regulation §1.104-1(b) provides:

Section 104(a)(1) excludes from gross income amounts which are received by an employee under a workmen's compensation act . . . or under a statute in the nature of a workmen's compensation act which provides compensation to employees for personal injuries or sickness incurred in the course of employment. . . . However, section 104(a)(1) does not apply to a retirement pension or annuity to the extent that 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.

Treas. Reg. § 1.104-1(b).

The Commissioner agrees that the California statute authorizing Swards's retirement allowance is in the nature of a workmen's compensation act. The Commissioner further agrees that the portion of Swards's retirement allowance that represents one-half of Swards's final salary is excludable from taxation as a service-connected disability payment. The Commissioner argues, however, that the amount that

represents the difference between one-half of Swards's final salary and his service retirement allowance is subject to taxation pursuant to Treasury Regulation § 1.104-1(b). Swards responds that the regulation does not apply to the payments at issue, and that if it does, the regulation exceeds the scope of the statute and is invalid.

B.

There is no dispute that Swards's retirement allowance is calculated with reference to his years of service. Swards argues, however, that this fact does not bring the payments within the limitation in Treasury Regulation §1.104-1(b) because Swards was eligible for retirement, and received any pension at all, solely because of his service-connected disability. The limitation in the regulation, he argues, applies only where an individual *qualified* for a retirement allowance based on years of service, rather than because of a service-connected disability. Under Swards's reading of the regulation, a retiree may exclude the entire allowance pursuant to § 104(a) so long as he retired because of a service-connected disability, even if his retirement payments are calculated based on his age or years of service. On the other hand, the Commissioner argues that the limitation applies when an individual who retires with a service-connected disability receives an allowance amount that is at least in part based on his years of service.

Treasury Regulation §1.104-1(b) "limits the scope of § 104(a)(1)" by specifying that the workmen's compensation exclusion "does not apply to a retirement pension to the extent that it is determined by reference to the employee's age and length of service." *Picard v. Comm'r*, 165 F.3d 744, 745 (9th Cir. 1999) (internal quotation marks omitted). Thus,

whether retirement benefits “are excludable from gross income depends on whether the [the relevant statute] determines [the taxpayer’s] benefits by reference to his length of service.” *Id.*

As noted, Sowards argues that an individual’s benefit is determined by age or length of service only when such factors are used to decide whether the individual qualifies for retirement, but not when such factors are used to calculate the amount of the benefit. In our judgment, however, Sowards’s interpretation is not supported by the text of the regulation. Rather, the interpretation advocated by the Commissioner aligns with the most natural reading of the regulation.

Moreover, the interpretation advocated by the Commissioner in this case is consistent with the interpretation adopted by the IRS in Revenue Rulings issued over the last 40 years. In Revenue Ruling 72-44, the IRS examined a Louisiana statute that provided disability payments for firefighters injured in the line of duty. Rev. Rul. 72-44, 1972-1 C.B. 32. Like the California statute at issue in this case, the Louisiana statute provided for a firefighter to receive a disability pension equal to the greater of one-half his salary or the amount of his service pension. *Id.* The IRS concluded that an individual’s payments were excludable from taxation only to the extent that they did not exceed one-half of the individual’s salary. *Id.* The IRS examined a similar statute in Revenue Ruling 80-44 and reached the same conclusion. Rev. Rul. 80-44, 1980-1 C.B. 34.

The IRS’s consistent interpretation of Treasury Regulation §1.104-1(b) through Revenue Rulings is entitled to deference. As the Supreme Court has explained:

[Revenue] Rulings simply reflect the agency's longstanding interpretation of its own regulations. Because that interpretation is reasonable, it attracts substantial judicial deference. . . . Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law.

United States v. Cleveland Indians Baseball Co., 532 U.S. 200, 220 (2001) (internal citations and quotation marks omitted). The IRS's long-standing interpretation of Treasury Regulation §1.104-1(b) through Revenue Rulings is reasonable, and thus entitled to substantial deference.

Finally, the Tax Court cases that Sowards cites fail to demonstrate that the IRS's consistent interpretation of Treasury Regulation §1.104-1(b) is at odds with its text. Unlike the retirement payments at issue in this case, the payments in those cases were calculated without reference to the retirees' years of service. *Byrne v. Comm'r*, 84 T.C.M. 704 (2002) (concluding that disability payments calculated without reference to years of service were not taxable); *Givens v. Comm'r*, 90 T.C. 1145 (1988) (concluding that payments for on-the-job injuries labeled as "sick pay" qualified for exclusion). Thus, the decisions in those cases provide little insight into the issue presented here.

The text of Treasury Regulation §1.104-1(b) and the consistent interpretation of that text by the IRS demonstrate that it applies to retirement payments that are calculated with reference to an employee's age or length of service.

Accordingly, Swards's argument that the payments at issue fall outside the limitation in that regulation fails.

C.

Swards argues that, if Treasury Regulation §1.104-1(b) is interpreted to apply to payments that are calculated with reference to an employee's age or length of service, it is invalid, because that reading is inconsistent with § 104(a)(1) and beyond the scope of the agency's rulemaking authority.

The Treasury Department has authority to issue "all needful rules and regulations for the enforcement of [the Internal Revenue Code.]" 26 U.S.C. § 7805(a). To determine whether a Treasury regulation is valid, courts apply the two-step analysis announced in *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842–43 (1984). *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 52 (2011). First, the court must determine "whether Congress has 'directly addressed the precise question at issue.'" *Id.* (quoting *Chevron*, 467 U.S. at 842). If Congress has not done so, the court must determine whether the rule is "a 'reasonable interpretation' of the enacted text." *Id.* at 58 (quoting *Chevron*, 467 U.S. at 844). An express congressional grant of authority to issue rules and regulations, like that found in 26 U.S.C. § 7805(a), is "a very good indicator of delegation meriting *Chevron* treatment." *Id.* at 57 (quoting *United States v. Mead Corp.*, 533 U.S. 218, 229 (2001)).

Section 104(a)(1) provides that workmen's compensation payments for injury or sickness are excludable, but leaves open the question of how to determine whether a payment is made for injury or sickness, as opposed to some other reason.

Thus, Congress has not directly addressed the precise question at issue—namely, the tax treatment of payments that, while triggered by work-related injury or sickness, are calculated based on years of service. Accordingly, the first step of the *Chevron* analysis is satisfied.²

Treasury Regulation § 1.104-1(b) is a reasonable interpretation of § 104(a)(1). As the Sixth Circuit explained: “Section 104(a)(1) is designed to exclude disability payments, not pension payments, from income. Treas. Reg. § 1.104(b) [the prior version of Treasury Regulation § 1.104-1(b)] simply identifies what is a pension payment and distinguishes it from a disability payment.” *Wiedmaier v. Comm’r*, 774 F.2d 109, 111 (6th Cir. 1985). The regulation does not, as Sowards argues, create a subclass of disability pension recipients. Rather, the regulation simply clarifies when a payment is made for personal injuries or sickness, and when

² Our court’s decision in *Take v. Comm’r*, 804 F.2d 553 (9th Cir. 1986) (Kennedy, J.), does not bar us from concluding that the statute is ambiguous as to the tax treatment of those payments which, though under a workmen’s compensation statute, are not calculated by reference to the extent of the worker’s disability. In *Take*, we held that the disability pension statute of Anchorage, Alaska, which established an irrebuttable presumption that “heart, lung, and respiratory system illnesses” suffered by firefighters would be presumed to be occupational disabilities, was not a workmen’s compensation act. *Id.* at 555. We explained that “[s]tatutes that do not restrict the payment of benefits to cases of work-related injury or sickness are not considered to be ‘workmen’s compensation acts’ under section 104.” *Id.* at 557 (emphasis added). Thus, *Take* holds that for a statute to count as a workmen’s compensation act, every worker paid pursuant to that statute must have suffered a disability. *Take* does not hold, however, that every dollar paid to those workers must have been paid on account of that disability. Sowards’s argument to the contrary is incorrect.

it is made for some other reason, such as years of service. Accordingly, the regulation is consistent with the statute.

In short, the question of how to differentiate between payments made to a employee as compensation for a workplace injury from those made for some other purpose is not answered by § 104(a)(1). Because the Treasury Department's rule is a reasonable interpretation of that statute, it is within the scope of the agency's delegated authority.

IV.

“[T]he fundamental question in determining whether benefits are excludable under § 104(a) is upon what basis were the retirement payments in question paid?” *Picard*, 165 F.3d at 746 (internal quotation marks omitted). Like any other County employee who retired with a service-connected disability, Sowards was entitled to receive one-half his final salary based on his injuries. That amount was excludable. Because Sowards had completed 34 years of service, however, he received additional amounts so that, in accordance with the state statute, his service-connected disability pension was the same as what he would have received as a service pension. Those additional amounts were paid not based on his injuries, but based on his years of service, and thus were not excludable.

For the foregoing reasons, the Tax Court's decision is **AFFIRMED**.

Portland FPDR Funding Policy

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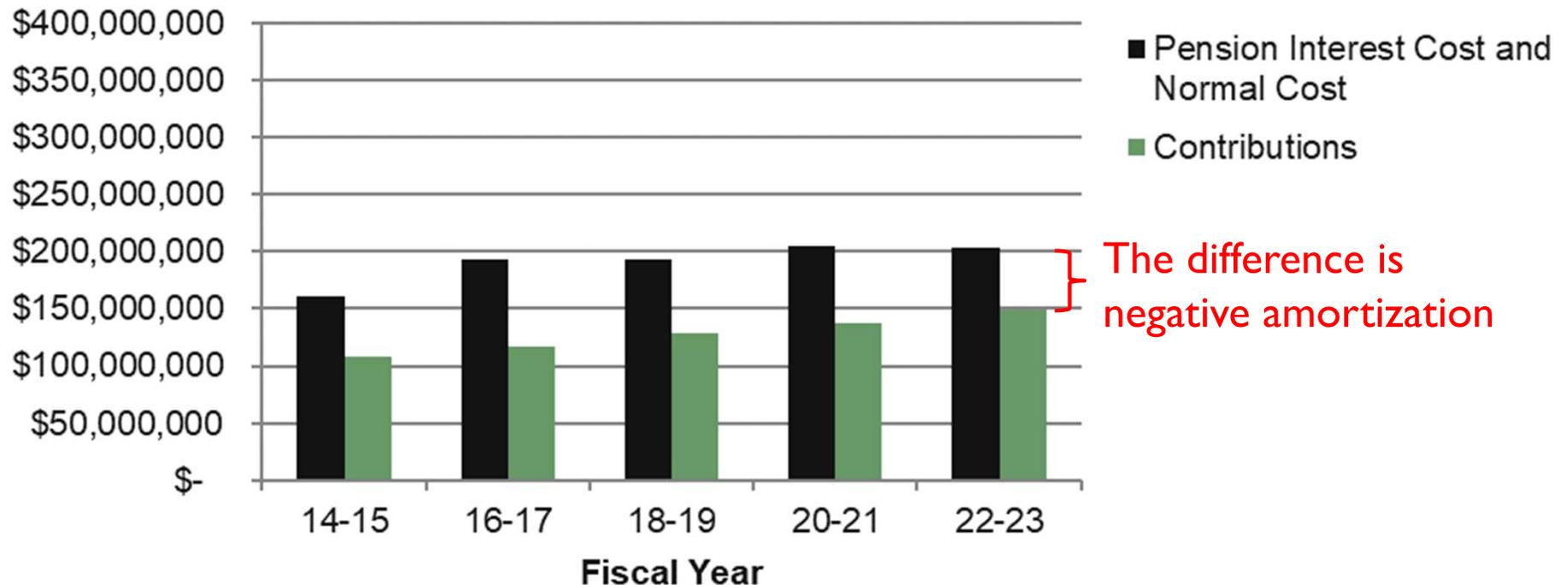
Credit Ratings Agency: Red Flag

- ▶ The City has had a credit rating of Aaa since 1976
- ▶ Credit ratings agency Moody's placed the City of Portland on Rating Under Review for Downgrade on November 3.
- ▶ FPDR is a central focus of Moody's review.

Actuarial Basis vs. Cash Basis

- ▶ **Negative amortization:** When contributions are insufficient to cover Interest Cost and Normal Cost

FPDR One and Two



FPDR One and Two Comparison

