



MEMORANDUM

TO: All Pension Clients

FROM: Klausner, Kaufman, Jensen & Levinson

Re: Tax treatment of duty-related disability pensions for first responders

Date: March 12, 2019

It has come to our attention that some disability retirees across the state have expressed confusion as to the tax treatment of their duty-related disability/service-connected disability pension.

The tax treatment of a duty-related disability pension is fact specific and depends on the express provisions of a particular plan. As a general rule, duty-related disability pension benefits are ordinarily treated as exempt from federal income tax if the benefit is not determined by reference to an employee's age or length of service.

Section 104(a)(1) of the Internal Revenue Code and the corresponding Treasury regulations provide that in the case of a benefit which is "in the nature of worker's compensation" resulting from an accident or illness incurred in the line of duty, such income will be exempt from taxation. *See* §1.104-1(b) of the Treasury Regulations.

When a duty-related disability pension is granted, the Board necessarily makes a finding that the injury or illness occurred in the line of duty. A number of states have presumptive disease statutes for certain employee groups (primarily first responders) which eliminate the necessity of proof of duty related causation. In Florida, for example, disabilities for first responders resulting from heart disease, hypertension, tuberculosis, hepatitis and other diseases are presumed to have occurred in the line of duty if, at the time of hire, the employee passed a physical examination which did not reveal the existence of the condition. Each state with a similar statute may have different conditions attached to the availability of this presumption, so law governing any particular plan should be consulted.

There are specific rules which determine whether a presumed cause will permit tax exempt status. In order for tax exempt status to apply to a disability based on a presumed cause, the case law requires that the presumption must be “rebuttable.” This means evidence of a non-duty related cause can be presented which would disallow the presumption. So, if the existence of a presumption can be overcome by rebuttable evidence, but there is a finding by the Board that the presumption applies to a particular disability then a tax exemption would apply. In some plans, however, regardless of any contrary evidence as to causation, the presumption always applies. This is an “irreputable presumption.” In those cases, the benefit will not be treated as tax exempt.

In any duty related disability, the primary basis to receive tax exempt status is whether the benefit is calculated based on accrued years of service or whether, like workers’ compensation, it is a fixed percentage of pay. In some plans, the disability benefit will be the greater of a fixed percentage of pay or the accrued benefit. In that case, the amount of the benefit in excess of the fixed sum will be taxable. The following examples illustrate this point:

- 1) The **full** amount of the duty-related disability pension is exempt from taxation, as long as the entire benefit is calculated based a **fixed** percentage of pay.
- 2) Where a member’s accrued benefit based on years of service exceeds a fixed percentage of pay, a portion of the benefit will be taxable.

Set forth below are two examples:

Specified duty-related disability benefit:
50% of pensionable earnings
Member’s accrued benefit based on years of service at time of disability:
3% of pensionable earnings x 25 years of service (75% accrued benefit)
In this example, the portion of the duty-related disability benefit in excess of 50% of pensionable wages would be taxable. The fixed portion would be tax exempt.

Specified duty-related disability benefit:
66 2/3% of pensionable earnings
Member’s accrued benefit based on years of service at time of disability:
3% of pensionable earnings x 20 years of service (60% accrued benefit)
In this example, all of the duty-related disability benefit would be tax exempt.

In some plans, the entirety of the disability benefit is based on years of service. In that case, none of the benefit would be tax exempt.

It is not the duty of plans to give individual tax advice and this memo is not intended to provide individualized tax advice to any members. Rather, it is hoped that this memo can serve as general background when members meet with their personal tax professionals. Any individual determination would require a review of the member’s particular situation and the specific plan provisions.

If any Plan believes a formal legal opinion, individualized for the particular plan, would be beneficial, one can be provided upon request.