

# MACRS

## CHAPTER 32 AND FEDERAL TAXATION ISSUES



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## WHAT WE WILL COVER TODAY

- Private Letter Ruling 2013
- What's not in the Private Letter Ruling
- Rollovers - What's new
- Determination Letter - Cycle C
- Limitations on buybacks - inactive members

## PRIVATE LETTER RULING

- “A private letter ruling, or PLR, is a written statement issued to a taxpayer that interprets and applies tax laws to the taxpayer’s represented set of facts. A PLR is issued in response to a written request submitted by a taxpayer. A PLR may not be relied on as precedent by other taxpayers or by IRS personnel.”

## PRIVATE LETTER RULING 2013

- PERAC's request: March 28, 2013
- Posing 8 questions
- IRS' response: August 20, 2013

## PLR QUESTION 1

- Ordinary disability retirement
- Taxable income

“...[B]enefits paid under Section 6 of the statute to a member who suffers a disability outside of the performance of duty will be considered taxable income to the member subject to basis recovery.”

## PLR QUESTION 2

- Accidental disability retirement (pension portion)
- Income not taxable

“...[B]enefits paid under Section 7 of the statute to a member who incurs a disability through the performance of duty shall not be considered gross income to the recipient under section 104(a)(1) of the Code...”

## PLR QUESTION 2 (Cont'd.)

- ADR benefits not gross income “but only to the extent the benefits paid do not exceed 72% percent of the member’s regular annual compensation at the time of disability.”
- Remember: The IRS is referring to the pension portion only. The annuity part is subject to federal taxation.

## PLR QUESTION 2 (Cont'd.)

- ADR Dependent allowances
  - “In addition, any fixed supplemental dependent allowance will not be considered gross income under section 104(a)(1) of the Code.”

## PLR QUESTION 3

- Section 101 and ADR survivors:
  - “Survivor benefits that are paid under Section 101 of the Statute to survivors of a member who at the time of death was receiving an accidental disability retirement benefit under Section 7 of the Statute shall not be considered gross income to the recipient under section 104(a)(1) of the Code.”

## PLR QUESTION 3 (Cont'd.)

### Meet Jack Sprat.

- Quabbin police officer.
- Retires in 1994 under the Heart Law.
- Picks Option B.
- Dies in 2013 after being hit by a bus.
- Annuity account depleted.
- Widow only eligible for Section 101.

### Meet John Smith.

- Quabbin police officer.
- Retires in 1994 under the Heart Law.
- Picks Option B.
- Dies in 2013 of a massive heart attack.
- Annuity account depleted.
- Widow eligible for Section 9.

## PLR QUESTION 3 SILENCE

- Section 101 and ordinary disability retirement survivors
- Nothing in the PLR addresses this.
- But as the successor in interest to a Section 6 benefit, the Section 101 benefit to an ordinary disability retirement survivor will be taxable.

## PLR QUESTION 4

- “Joint and survivor benefits under Option C of Sections 7 and 12(2) of the Statute paid to a survivor of an accidental disability retiree that does not exceed 72% of the member’s regular annual compensation at the time of disability shall not be considered gross income under section 104(a)(1) of the Code...”

## PLR QUESTION 5

- “Accidental disability retirement benefits paid under Section 7 of the Statute (or Option C) and survivor benefits paid under Section 9 of the Statute where the determination of the disability or death being duty- related was based upon the provisions of sections 94, 94A or 94B, shall not be considered gross income to the recipient under section 104(a)(1) of the Code...”

## PLR QUESTION 5 (Cont'd.)

- “In addition, the amount of any fixed supplemental dependent allowance will not be considered gross income under Section 104(a)(1).”

## PLR QUESTION 6

- “Survivor benefits paid under Section 9 of the Statute to the survivors of members or retirees who die as the natural and proximate result of a personal injury sustained or a hazard undergone while in the performance of duties shall not be considered gross income under section 104(a)(1) of the Code but only to the extent the amount does not exceed 72% of the annual rate of compensation of such member.”

## PLR QUESTION 7

- “Survivor benefits paid under Section 100 to survivors of members who die as a result of the performance of duty will not be considered gross income to the recipient under section 104(a)(1) of the Code...”

## PLR QUESTION 7 (Cont'd.)

- "...but only to the extent the benefit to the surviving spouse does not exceed the amount of the salary which would have been paid to the decease [sic] member had he remained in service..."

## PLR QUESTION 7 (Cont'd.)

- "....or, upon the death of the spouse, the amount payable to eligible dependent children but only to the extent benefits paid do not exceed 72% of the member's pension, or the annual fixed amount to any eligible dependent child."

## PLR QUESTION 8

- “Annual cost-of-living adjustments (COLAs) of the Statute will not be considered gross income to the recipient to the same extent that the underlying duty-related disability retirement payments or survivor benefits are not considered gross income to the recipient under section 104(a)(1) of the Code.”

## NOT IN THE PLR

- Chapter 41, Section 111F benefits
- Scenarios involving the return of a member's annuity account

## NOT IN THE PLR (Cont'd.)

- Always a taxable event:
  - A member requests the return of his accumulated deductions and receives it.
  - A member dies in service, and there is no 12(2)(d) to be paid, but there is a return of his accumulated deductions to his named beneficiary.
  - A member dies in service and his spouse gets a Section 9. The accumulated total deductions are paid to the beneficiary designated on the return of deductions form.
  - A police officer is shot and killed, his spouse gets the Section 100. His remaining accumulated deductions are paid to the beneficiary listed on the form.
  - A retired member who selected option b dies. His remaining accumulated deductions are paid to the beneficiary listed on the form.

## ROLLOVERS - WHAT'S NEW

- Defense of Marriage Act, partial repeal
- 401(k)s

## U.S. v. WINDSOR | 133 S.Ct. 2675 (2013)

- Decided June 26, 2013
- Thea Spyer and Edith Windsor married in Ontario, Canada in 2007, after living as a couple from 1963 on.
- The marriage was recognized as valid by the State of NY.
- Thea died in 2009, leaving a sizeable estate to her wife.

## U.S. v. WINDSOR | 133 S.Ct. 2675 (2013)

- Estate tax was enormous, and IRS said Edith could not avail herself of the spousal exemption because of Section 3 of the Defense of Marriage Act (“DOMA”).
- Section 3 defines “spouse” for federal law purposes as a married person of the opposite sex.
- Edith paid the estate tax (\$363k) but sued for a refund.

## U.S. v. WINDSOR | 133 S.Ct. 2675 (2013)

- Standing and jurisdictional issues were involved but are not relevant to our discussion today.
- Supreme Court holding: Section 3 of DOMA is unconstitutional.
- Rationale: Section 3 denies due process and equal protection under the 5<sup>th</sup> Amendment to a class of people, namely, same sex couples whose marriages are recognized by the state.

## IRS REVENUE RULING 2013-17

- In the wake of Windsor, the IRS will recognize marriages entered into between persons of the same sex for federal tax purposes.
- This is true even if the couple resides in a state which does not recognize same sex marriage, as long as they were married in a state which does.
- This does not extend to domestic partnerships, civil unions or similar arrangements.

## WHAT DOES THIS MEAN TO US?

- After Windsor for states recognizing same sex marriage, and after Revenue Ruling 2013-17 for states that do not, a spouse in a validly entered into same sex marriage must be treated as a spouse instead of a non-spouse for pension rollover purposes.

## ROLLOVERS FROM 401(k)

- May public pension plans in Massachusetts accept rollovers from 401(k)s?
- Yes. Among others, an eligible plan is described as “a qualified plan under Code Sections 401(a) or 403(a).”
- Basically, a “401(k)” is really a “401(a)”. It is a type of 401(a) plan specifically designed to comply with the rule contained in section 401(k).

## THE NEW CYCLE C

- The then 106 systems in Massachusetts asked for and received favorable determination letters in the first Cycle C, which was from February 1, 2008 to January 31, 2009.
- 103 of the systems worked in conjunction with PERAC in obtaining the ruling.
- State, Teachers and Boston had to file separately for determination letters.

## THE NEW CYCLE C (Cont'd.)

- These determination letters expire and need to be applied for anew every few years.
- Although we have until the end of “Cycle E” to apply for new determination letters, PERAC and its tax counsel believe it would be prudent to file in “Cycle C” which ends on January 31, 2014.
- See PERAC Memo # 23/2013.

## TAX LIMITATIONS ON INACTIVE MEMBER PURCHASES OF SERVICE

- The question of whether an inactive member may purchase service has been a challenging one, but is allowable where the statute specifically permits it.
- Inactive members are no longer limited in their buyback to \$40,000 or what they make in a year.

## TAX LIMITATIONS ON INACTIVE MEMBER PURCHASES OF SERVICE (Cont'd.)

- The Pension Protection Act amended the wording of section 415(n) of the Code to read “participant” instead of “employee”.
- The change allows inactive members to make purchases not subject to the \$40,000 or amount earned in a year limitations.
- The service purchases in question, however, must still be permissible under our plan.