



Memorandum 27 /2005

Commonwealth of Massachusetts | Public Employee Retirement Administration Commission
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MEMORANDUM

TO: All Retirement Boards

FROM: Joseph E. Connarton, Executive Director

RE: Recent Federal Case Regarding Status of Disability Retirement Allowances For Federal Income Tax Purposes

DATE: September 8, 2005

A U.S. District Court has ruled in Wheeler v. United States, U.S. District Court, District of Massachusetts, Civ. No. 03-40128-FDS that when a member retired for superannuation and is later granted an accidental disability retirement, the superannuation retirement allowance is taxable when received and a later retroactive receipt of an accidental disability retirement allowance does not act to “reclassify” the payments for federal income tax treatment. The underlying principle is that income is taxed on an annual basis, its status determined when it is received by the tax payer.

A member of a Retirement System was diagnosed as having prostate cancer in December 1994 and had surgery in January 1995. He retired in May 1996 for superannuation. He apparently didn't know that he was eligible for accidental disability until October 1999. He applied for and received accidental disability retirement in May 2000, retroactive to the day he retired for superannuation. His allowance was increased and he received a retroactive payment for the difference between the superannuation and the accidental disability retirement. The member and his wife took the position that the superannuation retirement allowance that he had received had been reclassified as an accidental disability allowance and that as the result they were entitled to a refund of the taxes they had paid on the superannuation retirement allowance. The IRS denied their claim.

The Court, upholding the IRS, has ruled that at the time that the superannuation retirement allowance was received it was taxable under the federal income tax laws. The court recognized that the lump sum retroactive payment and the accidental disability retirement allowance that he received after May 2000 is not taxable because the payment is in the nature of a payment for workers' compensation and not calculated by reference to the member's age, length of service or contributions to the Retirement System.

If you would like to receive a copy of the case, please contact Susan Childs, (617) 666-4446 Ext 907.