

Date: January 8, 1997

VAOPGCPREC 1-97

From: General Counsel (022)

Subj: Countability of Distributions from Individual Retirement
Accounts as Income for Purposes of Pension and Parents'
Dependency and Indemnity Compensation
--XXXXXXXX, XXXXX X X XXX XXX

To: Acting Under Secretary for Benefits (20)

QUESTION PRESENTED:

Are distributions from an individual retirement account (IRA) countable as income for purposes of the improved pension program, the section 306 pension program, the old law pension program, and parents' dependency and indemnity compensation (DIC)?

COMMENTS:

1. This question arose in connection with a Board of Veterans' Appeals (Board) decision that IRA distributions should not be countable as income for improved-pension purposes until the claimant has recouped the amount of the claimant's contributions to the IRA. The Board based its decision on VAOPGCPREC 1-93 (O.G.C. Prec. 1-93), in which the General Counsel held that proceeds of a life insurance policy that is surrendered for cash should not be considered income for purposes of determining entitlement to improved pension under title 38, United States Code, to the extent that such proceeds consist of return of sums paid as part of the insurance premiums. The Board reasoned that IRA withdrawals are more analogous to proceeds of a life insurance policy that is surrendered for cash than to disbursements from a retirement fund held in trust for the benefit of a retiree.

2. Noting the conclusion of VAOPGCPREC 23-90 (O.G.C. Prec. 23-90) (formerly Op. G.C. 1-82) that withdrawal of retirement-fund contributions constitutes income for improved-pension purposes, the General Counsel, in VAOPGCPREC 1-93, drew a distinction between life insurance and retirement funds. Although the surrender of life insurance for cash

was recognized as somewhat analogous to withdrawal from a retirement fund, VAOPGCPREC 1-93 noted the clear congressional intent to include retirement-fund withdrawals as income for improved-pension purposes. Congress, on the other hand, did not address the surrender of life insurance in its various amendments of the pension laws. In the absence of clear direction from Congress, the General Counsel applied to the surrender of life insurance a liberal interpretation of the law, concluding that Congress' treatment of retirement funds should not be extended by analogy to other types of proceeds. See VAOPGCPREC 1-93.

3. We do not agree with the Board's view that an IRA is more analogous to a life insurance policy than to a retirement fund. An IRA is essentially a retirement plan that is not funded by employer contributions. See 60A Am. Jur. 2d *Pensions and Retirement Funds* §§ 42, 71 (1988).¹ Contrary to the Board's analysis, the terms "individual retirement account" and "retirement fund" both refer to sums that are held in trust for the eventual benefit of retirees. See 26 U.S.C. § 408(a); see also 33A Am. Jur. 2d *Federal Taxation* ¶ 8968 (1996); 60A Am. Jur. 2d *Pensions and Retirement Funds* § 42. Use of the term "retirement" reflects the retirement-planning objective in both cases. Although cash-surrender value is a consideration in the purchase of life insurance, the primary objective of life insurance is usually not retirement planning but financial security for beneficiaries in the event of the insured's death. The fact that an IRA may not be used to purchase life insurance contracts, see 26 U.S.C. § 408(a)(3); 33A Am. Jur. 2d *Federal Taxation* ¶ 8968; 60A Am. Jur. 2d *Pensions*

¹ When an employer contributes to an IRA in the name of an employee, the IRA is called a "simplified employee pension". See 33A Am. Jur. 2d *Federal Taxation* ¶ 9001 (1996); 60A Am. Jur. 2d *Pensions and Retirement Funds* § 34; see also 26 U.S.C. § 408(k). An IRA is not a pension plan if the employer makes no contributions but merely collects voluntary contributions through payroll deductions. 60A Am. Jur. 2d *Pensions and Retirement Funds* § 71.

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and Retirement Funds § 43, also suggests a distinction between the purposes of IRAs and life insurance.

4. It is apparent from the above discussion that IRAs² may be considered private retirement, annuity, and endowment plans, as referenced in the legislative history of the improved pension program. H.R. Rep. No. 1225, 95th Cong., 2d Sess. 38 (1978), reprinted in 1978 U.S.C.C.A.N. 5583, 5619. As we noted in VAOPGCPREC 1-93, that history makes clear that Congress intended that payments from such plans be counted as income for improved-pension purposes under Pub. L. No. 95-588, 92 Stat. 2497 (1978). In commenting on the legislation eliminating in its entirety the exclusion of certain retirement-fund distributions from pension income determinations, the House Committee report criticized recouplement of retirement-fund contributions under prior law as creating a period of "false entitlement" for persons with little or no real need. H.R. Rep. No. 1225, 95 Cong., 2d Sess. 7, reprinted in 1978 U.S.C.C.A.N. at 5588. In view of the foregoing, we conclude that the holding in VAOPGCPREC 23-90 that retirement-fund withdrawals constitute income for improved-pension purposes, regardless of whether interest is included in the payment, is equally applicable to IRAs.

5. Under the major revision of the pension laws in 1959, which created what is now known as "section 306" pension,

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² The term "IRA" is sometimes also used to refer to a retirement-savings arrangement known as an "individual retirement annuity". See 33A Am. Jur. 2d *Federal Taxation* ¶ 8968. An individual retirement annuity is an annuity or endowment contract issued by an insurance company, where: (1) the contract is nontransferable; (2) the owner's interest in it is nonforfeitable; and (3) certain limitations on contributions and distributions exist. *Id.*; 60A Am. Jur. 2d *Pensions and Retirement Funds* § 43; see 26 U.S.C. § 408(b). Such retirement arrangements are analogous to individual retirement accounts for purposes of VA income determinations.

payments from a public or private retirement, annuity, or endowment plan were not considered countable income for pension purposes until the pensioner had recouped his or her own contributions to the plan. See Pub. L. No. 86-211, § 2(a), 73 Stat. 432 (1959); see also former 38 C.F.R. §§ 3.251(d)(4) and 3.252(c)(4) (Supp. 1963) (providing by regulation a similar recoupment rule applicable to parents' DIC and old law pension). In 1964, Congress amended the statutes governing what is now known as section 306 pension to provide for the exclusion of ten percent of "the amount of payments to an individual under public or private retirement, annuity, endowment, or similar plans or programs." See Pub. L. No. 88-664, § 1(a), 78 Stat. 1094 (1964). Similar exclusions applicable to old law pension and parents' DIC were enacted in Pub. L. No. 88-664, § 10, 78 Stat. at 1096, and Pub. L. No. 89-730, § 2, 80 Stat. 1157, 1158 (1966), respectively.

6. Although Congress eliminated the ten-percent exclusion when it established the improved pension program in 1978, the exclusion still applies to old law and section 306 pension and parents' DIC. Under section 306(a)(2) of Pub. L. No. 95-588, 92 Stat. at 2508, any person entitled to receive pension as of December 31, 1978, (the day prior to the day on which the improved pension program took effect) under laws then in effect, could continue to receive pension at the rate being paid as of that date, subject to the laws applicable as of that date. A similar provision applicable to old law pension was included in section 306(b)(3) of Pub. L. No. 95-588. The ten-percent exclusion applicable to parents' DIC was not affected by Pub. L. No. 95-588 and is currently codified at 38 U.S.C. § 1315(f)(1)(G).
Regula-
tions governing implementation of the ten-percent exclusion are currently codified at 38 C.F.R. § 3.262(e)(1), (2), (4).

7. By replacing the statutory and regulatory provisions permitting recoupment of a retiree's contributions to a retirement fund with provisions permitting the exclusion of ten percent of payments under a retirement plan, Congress made clear that all retirement distributions not excluded by the ten-percent exclusion are to be considered income for purposes of old law and section 306 pension and parents'

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DIC. Since, as discussed above, an IRA is in the nature of a retirement plan, an individual receiving old law or section 306 pension or parents' DIC may exclude from income only ten percent of any distributions from an IRA. IRA distributions not so excluded must be considered income, regardless of whether the payment derives from the retiree's contributions or from interest.

HELD:

Distributions from an individual retirement account are fully countable as income for purposes of the improved pension program. Ten percent of such distributions may be excluded from income for purposes of benefits under the section 306 pension program, benefits under the old law pension program, and parents' dependency and indemnity compensation payable under 38 U.S.C. § 1315.

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