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Pennsylvania Inheritance Tax
No. INH-04-008
Pension Benefit/Supplemental Pension Benefits

ISSUE 1

Whether a pension benefit held by the Taxpayer is subject to Pennsylvania Inheritance Tax where the Taxpayer died at age 59, his three children were designated as plan beneficiaries, and the Taxpayer had attained a sufficient amount of service to qualify for an unreduced retirement benefit during his lifetime?

CONCLUSION 1

The pension benefits are exempt from Pennsylvania inheritance tax as the Taxpayer's rights at death were limited to designating a beneficiary and receiving regular monthly payments under the plan. 61 Pa. Code § 93.131.

ISSUE 2

Whether a Supplemental Retirement Plan held by the Taxpayer is subject to Pennsylvania Inheritance Tax where the Taxpayer died at age 59, his three children were designated as plan beneficiaries, and the Taxpayer had attained a sufficient amount of service to qualify for an unreduced retirement benefit during his lifetime, including a right to borrow one-half of the plan proceeds prior to retirement?

CONCLUSION 2

The supplemental pension benefits are subject to Pennsylvania inheritance tax as Taxpayer had a right to withdraw the benefits of the plan at his death. 61 Pa. Code § 93.131.

FACTS

Taxpayer died at the age of 59, with twenty-seven years of service with his employer. Taxpayer remained actively employed by his employer up until his death. Taxpayer possessed two pension plan benefits: a traditional defined benefit pension plan as well as an elective defined contribution supplemental retirement plan. The defined benefit's Summary Plan Description provided that a plan participant is vested for the receipt of pension benefits upon earning five years of participation and achieving the age of 65. Under the Plan, a participant also became eligible for unreduced early retirement benefits at age 62, or if the sum of the participant's age plus credited service totaled 85 or more years. The Plan also provided that if a participant continued to work for the employer beyond the participant's normal retirement eligibility date, the participant was not eligible to receive pension benefits until the participant actually retired. Plan participants had no ability to pledge, anticipate or

assign pension plan proceeds, before or after retirement. At issue is whether the defined benefit pension Plan is subject to Pennsylvania inheritance tax.

Regarding the Supplemental Plan, participants became vested with two years of credited service and attainment of 65 years of age. A participant became eligible for an unreduced early retirement benefit if the participant retired at or after age 50 with at least two years of credited service. Additionally, a Supplemental Plan participant could withdraw from the Plan and receive fifty percent of all contributions made to the Plan in the form of a lump sum withdrawal, at any time during employment. At issue is whether the Supplemental Plan is subject to Pennsylvania inheritance tax.

DISCUSSION

Section 2111(r) of the Inheritance and Estate Tax Act of 1991 states in relevant part:

§ 9111. Transfers not subject to tax

(r) Payments under pension, stock bonus, profit-sharing, and other retirement plans, including, but not limited to, H.R. 10 plans, individual retirement accounts, individual retirement annuities, and individual retirement bonds to distributees designated by decedent or designated in accordance with the terms of the plan, are exempt from inheritance tax to the extent that decedent before his death did not otherwise have the right to possess (including proprietary rights at termination of employment), enjoy, assign or anticipate the payment made.

72 P.S. § 9111(r).

This provision has been supplemented by Department regulations promulgated in 1986:

§ 93.131. Payments from employment benefit plans and life insurance contracts.

(d) employment benefit plans.

(1) General Rule. Payments received from employment benefit plans will be exempt from the inheritance tax to the extent that one of the following exist:

(iii) The decedent during his lifetime did not have the right to possess, including proprietary rights at termination of employment, enjoys, assign or anticipate the payments made. A decedent will be considered as not having the right to possess, enjoy, assign or anticipate the employment benefit plan payments where the only rights under the plan are to designate a beneficiary or contingent beneficiaries, and to receive a regular monthly payment under the plan. The possession of either of these rights, alone or together, will not subject the plan to the inheritance tax, as long as no other rights exist.

(2) Exceptions.

- (i) To the extent that a decedent, before death, possessed rights in an employment benefit plan beyond those described in paragraph
- (ii) (1)(iii), payments received from the plan will be subject to tax unless exempted under paragraph 1(i) or (ii) or otherwise exempt by statute. Rights under a plan, which would subject the plan's payments to the tax, include, but are not limited to:
 - (A) Right to withdraw benefits, including right to withdraw only upon payment of a penalty or additional tax if the penalty or additional tax is smaller than 10% of the withdrawal.
 - (B) Right to borrow monies from the employment benefit plan.
 - (C) Right to assign the benefits of the employment benefit plan to another.
 - (D) Right to pledge the plan or its benefits.
 - (E) Right to anticipate the benefits of the employment benefit plan other than in regular monthly installments.
 - (F) Right by contract or otherwise, to materially alter the employment benefit plan.

61 Pa. Code § 93.131.

Consequently, payments from employee benefits plans are exempt from inheritance tax provided that the taxpayer, prior to his death, did not possess certain rights and powers over the plan benefit payments. 72 P.S. § 9111(r).

Here, Taxpayer while under the age of 59 ½ at death, had met sufficient credited service and age requirements to receive an unreduced retirement benefit from the defined benefit Plan, and as such, was free to begin receiving regular monthly distributions of his pension as a vested plan participant. However, as per the terms of the Plan, Taxpayer could not begin to receive these proceeds until he actually retired from service.

Further, any proceeds received by Taxpayer would not be subject to penalty or additional tax from the Internal Revenue Service, as Taxpayer could only receive the regular monthly distributions after he attained the age of 55 and had separated from service. See, generally, I.R.C. § 72(t). Additionally, Taxpayer had no right to borrow, pledge or assign Plan proceeds. Because Taxpayer did not possess any of the rights discussed above, the Plan proceeds are exempt from inheritance tax.

Regarding the Supplemental defined contribution plan, Taxpayer was fully vested at his death. However, unlike the defined benefit Plan, Taxpayer also had the ability to withdraw plan contributions at any time, and for any purpose. As such, the Supplemental Plan Proceeds become part of Taxpayer's gross estate for federal and state death/transfer tax purposes.

Therefore, the date of death balance as determined by the Plan Trustees is subject to Pennsylvania inheritance tax at the lineal rate of four and one-half percent. 72 P.S. § 9116(a)(1)(i).