

This chapter explains the computations involved in the taxation of railroad retirement annuities. The following computations are explained:

- taxable amount of the railroad retirement annuity,
- taxable amount of the supplemental annuity,
- the employee contribution amount,
- taxability under the Three-Year Rule,
- taxability under the General Rule/Simplified General Rule, and
- how payments and repayments affect the taxability of an annuity.

## **105 How a Railroad Retirement Annuity Is Taxed**

### **105.05**

Regular railroad retirement annuities consisting of tier 1, tier 2, and vested dual benefit components have been subject to United States Federal income tax since 1984. Supplemental annuities have been subject to Federal income tax since 1966. The residual lump sum (RLS) and lump sum death payment (LSDP) are not taxable.

The amount of tier 1 which would be payable if railroad employment had actually been covered under the Social Security Act, known as the social security equivalent benefit (SSEB), is treated as a social security benefit for Federal income tax purposes.

In addition, overall minimum (O/M) benefits are treated the same as social security benefits for Federal income tax purposes.

The portion of the tier 1 amount that exceeds social security equivalent benefits, known as the non-social security equivalent benefit (NSSEB), plus the tier 2 component are treated like contributory private and public service pensions for Federal income tax purposes. Either the Three-Year Rule or the General Rule is used to figure the taxability of these benefits. This is explained in section 115.

The vested dual benefit and supplemental annuity are treated like non-contributory private and public service pensions for Federal income tax purposes. The entire amount of the vested dual benefit and the entire amount of the supplemental annuity are included as taxable earnings.

## 110 How Tier 1 is Taxed

### 110.05

Certain parts of a railroad retirement annuity are taxed in the same manner as social security benefits - the entire tier 1 portion payable for December 1983 through November 1985; the social security equivalent benefit portion of tier 1 (SSEB) payable for December 1985 and later; and the overall minimum (O/M) payable for December 1983 and later.

#### **110.05.05 Tier 1/SSEB Portion of Tier 1**

The tier 1/SSEB portion of tier 1 of a railroad retirement annuity is equivalent to what the annuitant would have received if the employee's railroad service had been covered under the social security system rather than the railroad retirement system. Therefore, tier 1/SSEB payments are taxed like social security benefits.

Payments of tier 1 benefits due for the period December 1983 through November 1985 are taxable in the year in which paid, with an option available under certain conditions that these payments may be allocated by the annuitant to the year for which paid. SSEB payments due for the period December 1985 and later are taxable either in the year in which paid or in the year for which paid. Payments for months before December 1983 are not taxable, even if paid in 1984 or later.

#### **110.05.10 Overall Minimum (O/M)**

The overall minimum (O/M) guaranty is defined by the Internal Revenue Code Section 86(d) as being equivalent to what would be paid in social security benefits were the employee's railroad service covered under the social security system rather than the railroad retirement system. Therefore, payments made under the O/M for December 1983 and later, are taxed as social security benefits. Payments for months before December 1983 are not taxable, even if paid in 1984 or later.

### 110.10 Determining SSEB Amount

The SSEB provision of the "Consolidated Omnibus Budget Reconciliation Act of 1985" modified the tax law retroactive to January 1, 1986, as applied to some tier 1 benefits paid by the Railroad Retirement Board. The actual amount of the tier 1 benefit component has not changed; only the manner by which tier 1 is taxed has changed. For tax purposes, an SSEB amount will be computed for every annuitant whose tier 1 would not equal the benefit the annuitant would be entitled to receive if the Social Security Administration administered payment under its rules. The remainder of the tier 1 computed is the non-social security equivalent benefit (NSSEB) (see TOM 115.05).

### **110.10.05 SSEB Calculation Modular Program (SCAMP-ON-DEMAND)**

The SSEB/NSSEB amounts are calculated by the SSEB Calculation Modular Program (SCAMP). This program is used for all SSEB calculations, whether automated or manual input is required (SCAMP-ON-DEMAND). Therefore, if the input is the same (DOB, type of annuity, ABD) the SSEB calculation will be the same. There is no actual manual calculation available. The basis for the SSEB calculations in SCAMP is the Social Security Administration (SSA) on-line program, used to calculate SS benefit amounts with slight changes made for RR Act provisions, systems, and records limitations.

SCAMP can be called automatically by various TAX programs to calculate SSEB/NSSEB amounts. SCAMP can also be called manually through the input of data from Form G-816, WORKSHEET FOR SCAMP ON DEMAND. TAX examiners complete this form when the correct tier 1 SSEB/NSSEB split is unknown. Entries on the worksheet are keyed by the examiner onto the SCAMP-ON-DEMAND screens. Both the input and output information appears on the screen and may be printed.

The SSEB/NSSEB amounts are calculated and are accurate only if the SCAMP input data from the database or examiner entry is accurate. The data that is used for the SSEB split calculation includes the following fields, as applicable. For the calculation to be correct, the data in these fields must be accurate:

RR Claim Number	Payee Code
Prefix	Beneficiary Symbol
Beneficiary DOB	Beneficiary ABD
Employee DOB	Employee ABD
Annuity Formula	DF Onset Date
DF Termination Date	Employee Type of Annuity
Beneficiary Type of Annuity	Employee Type of Computation
Ben. Type of Computation	Net Tier 1
SSEB PIA	SSEB PIA Indicator
DRC Months	SS Reduction Amount
Workers' Comp. Red. Amount	O/M Rate

Public Dis. Ben. Red. Amount	RIB Limit/82 1/2% Amount
Own Emp. Ann. Red. Amount	Public Service Pension Amount
Stat. Share/Red. for Max. Amt	Sole Survivor Min. Guar. Amount

See Exhibit 1 for a display of Form G-816 and see Exhibit 2 for a display of the SCAMP-ON-DEMAND input/output screen.

### **110.10.10 SSEB By Definition/Categories of Cases**

In certain cases, the annuitant is receiving the same amount in tier 1 benefits as he would receive at SSA. These cases have no deeming provisions applied to the tier 1 calculation and, therefore, their entire tier 1 is considered an SSEB. SCAMP does not calculate SSEBs in these cases, but makes them all SSEB by definition. These categories are:

#### **EMPLOYEE**

- EE with full age 65 annuity.
- Reduced age EE paid under 1981 Amendments.
- 60/30 EE paid under 1983 Amendments who are over age 62 and have a full age reduction (eligible 1-1-86 or later).
- EE with a period of disability (other than Medicare-only).

#### **SPOUSE**

- Spouse of full age 65 or reduced age 62 EE unless spouse is receiving an annuity under the 1937 or 1974 Act.
- Spouse of 60/30 EE paid under the 1983 Amendments; EE and spouse are over age 62 and have a full age reduction (eligible 1-1-86 or later).
- Spouse with minor child under age 16, or disabled child in care if EE has a period of disability or is over 62.
- Divorced spouse annuitant (unless EE is 60/30 annuitant under 1974 Act).

#### **WIDOW(ER)**

- Widow(er) with an OBD before 2-68 who was over age 65 on his/her OBD.
- Widow(er) with an OBD of 2-68 or later and were over age 62 on his/her OBD.

- Disabled, divorced disabled, or remarried disabled widow(er) with a social security disability rating
- Remarried widow(er).
- Mothers and fathers (includes divorced and remarried).

### OTHER SURVIVORS

- Parents over 62
- Minor child under age 16, or disabled child or grandchild.
- Students.

### **110.10.15 When Tier 1 is an All Non-Social Security Equivalent Benefit (NSSEB) Amount**

#### **Tier 1 is All NSSEB By Definition**

Certain tier 1 amounts are not Social Security Equivalent Benefit (SSEB) payments because the Social Security Administration (SSA) would not pay them. The SSEB Calculation Modular Program (SCAMP) does not perform calculations for these tier 1 payments, but makes them SSEB = 0 by definition.

#### **Tier 1 is All NSSEB By Calculation**

Certain tier 1 amounts are not SSEB payments because the tier 1 amounts exceed what SSA would pay. This occurs when tier 1 offset amounts exceed what would be the SSEB portion of the tier 1 payment.

In these instances, any tier 1 payments are all NSSEB amounts. Below are lists of all NSSEB tier 1 amounts by annuitant type.

#### **Note:**

See TOM 110.10.15.05 for rules regarding:

- payment of tier 1 and overall minimum (OM) formula accruals due for payment periods **during which** nonpayment under Section 202(x)1 of the Social Security Act applies, and
- payment of tier 1 and OM formula accruals due for payment periods **prior to** periods during which nonpayment under Section 202(x)1 of the Social Security Act applies, but the individual is currently subject to those nonpayment provisions.

#### **A. EMPLOYEE**

1. A 60/30 age and service employee under age 62.
2. A disabled employee under age 62 with no period of disability (disability freeze).
3. An employee who does not have a SSA insured status, and, therefore, does not have a SSEB insured status.
4. An employee who is subject to nonpayment under Section 202(n) of the Social Security Act on his or her own wage record or as an auxiliary beneficiary on another individual's wage record. Section 202(n) covers both wage earners who have been removed (deported) from the United States and any auxiliary beneficiaries entitled on the wage record of a wage earner who has been removed (deported) from the United States. **If a wage earner is not payable under Section 202(n), auxiliary beneficiaries are also not payable.**

**Note 1:** Because auxiliary beneficiaries are not payable when the wage earner is not payable:

- Auxiliary beneficiaries' tier 1 amounts should be paid as NSSEB.
  - **The employee and any auxiliary beneficiaries entitled on the employee's wage record must be excluded from the overall minimum (OM) formula calculation.**
5. An employee who is subject to nonpayment under Section 202(x)(1) of the Social Security Act. Section 202(x)(1) covers four general categories of wage earners who are certain convicted prisoners, inmates of publically funded institutions, fugitives, probationers, and parolees. It does not cover auxiliary beneficiaries entitled on the wage records of these wage earners. **If a wage earner is not payable under Section 202(x)(1), auxiliary beneficiaries are payable without regard to the wage earner's nonpayment status.**

**Note 2:** Because auxiliary beneficiaries are payable without regard to the wage earner's nonpayment status:

- Auxiliary beneficiaries' tier 1 amounts should be paid as NSSEB, SSEB, or a SSEB/NSSEB split, whatever is appropriate.
- If the overall minimum (OM) formula applies with the employee excluded from the calculation, pay the OM as SSEB.

See FOM 1.150.5, Prisoner Conviction Cases - General, for definitions of what constitutes a criminal offense, a conviction, incarceration, and other issues related to this subject. Wage earners subject to nonpayment under

Section 202(x)(1) of the Social Security Act are listed in items a. through d. below.

- a. An employee who is incarcerated following conviction of a criminal offense.
- b. An employee who is confined by court order in an institution at public expense because he or she is:
  - 1) Found guilty of a criminal offense, but insane.
  - 2) Found not guilty of a criminal offense by reason of insanity.
  - 3) Incompetent to stand trial for a criminal offense.
  - 4) Suffers from a mental disease, defect, of incompetence that prevents him or her from standing trial for a criminal offense.
  - 5) A sexually dangerous person or predator who is not released from prison upon completion of his or her sentence for a criminal offense.
- c. An employee who is fleeing to avoid prosecution, or is fleeing to avoid confinement after prosecution for a criminal offense.
- d. An employee who is violating a condition of probation or parole imposed under Federal or State law.

**Note 3:** See TOM 110.10.15.05 for rules regarding the tax accounting of tier 1 and overall minimum (OM) formula **accrual payments** when nonpayment under section 202(x)(1) of the Social Security Act applies to the wage earner.

6. An employee whose tier 1 calculates to all NSSEB because of tier 1 offset amounts.

## **B. SPOUSE**

1. A spouse of an age and service 60/30 employee under age 62.
2. A spouse of a disabled employee under age 62 with no period of disability (disability freeze).
3. A spouse under age 62 who does not have a minor child under age 16, or disabled child in his or her care, regardless of the employee's age.

4. A spouse with a minor child under age 18 in his or her care. The child must be at least age 16, but less than age 18, and not disabled. This is often referred to as a Nancy Johnson spouse.
5. A spouse of an employee who does not have a SSA insured status, and, therefore, does not have a SSEB insured status.
6. A spouse who is subject to nonpayment under Section 202(n) of the Social Security Act on his or her own wage record or as an auxiliary beneficiary on another individual's wage record. Section 202(n) covers both wage earners who have been removed (deported) from the United States and any auxiliary beneficiaries entitled on the wage record of a wage earner who has been removed (deported) from the United States. **If a wage earner is not payable under Section 202(n), auxiliary beneficiaries are also not payable.**

**Note 1:** If the overall minimum (OM) formula applies with the spouse excluded from the calculation, pay the OM as SSEB.

7. A spouse who is subject to nonpayment under Section 202(x)(1) of the Social Security Act. Section 202(x)(1) covers the general categories of wage earners who are certain convicted prisoners, inmates of publically funded institutions, fugitives, probationers, and parolees. See the eight specific categories of wage earners shown below. It does not cover auxiliary beneficiaries entitled on the wage records of these wage earners. **If a wage earner is not payable under Section 202(x)(1), auxiliary beneficiaries are payable without regard to the wage earner's nonpayment status.**

**Note 2:** If the overall minimum (OM) formula applies with the spouse excluded from the calculation, pay the OM as SSEB.

See FOM 1.150.5, Prisoner Conviction Cases – General, for definitions of what constitutes a criminal offense, a conviction, incarceration, and other issues related to this subject. Wage earners subject to nonpayment under Section 202(x)(1) of the Social Security Act are listed in items a. through d. below.

- a. A spouse who is incarcerated following conviction of a criminal offense.
- b. A spouse who is confined by court order in an institution at public expense because he or she is:
  - 1) Found guilty of a criminal offense, but insane.
  - 2) Found not guilty of a criminal offense by reason of insanity.
  - 3) Incompetent to stand trial for a criminal offense.



- 4) Suffers from a mental disease, defect, of incompetence that prevents him or her from standing trial for a criminal offense.
  - 5) A sexually dangerous person or predator who is not released from prison upon completion of his or her sentence for a criminal offense.
- c. A spouse who is fleeing to avoid prosecution, or is fleeing to avoid confinement after prosecution for a criminal offense.
  - d. A spouse who is violating a condition of probation or parole imposed under Federal or State law.

See TOM 110.10.15.05 for rules regarding the tax accounting of tier 1 and overall minimum (OM) formula **accrual payments** when nonpayment under section 202(x)(1) of the Social Security Act applies to the wage earner.

8. A spouse whose tier 1 calculates to all NSSEB because of tier 1 offset amounts.

### C. **WIDOW(ER)**

1. A disabled widow(er) under age 60 with no social security disability rating.
2. A widow(er) with a minor child under age 18 in his or her care. The child must be at least age 16, but less than age 18, and not disabled. This is often referred to as a Nancy Johnson widow(er).
3. A widow(er) of an employee who does not have a SSA insured status, and, therefore, does not have a SSEB insured status.
4. A widow(er) who is subject to nonpayment under Section 202(n) of the Social Security Act on his or her own wage record or as an auxiliary beneficiary on another individual's wage record. Section 202(n) covers both wage earners who have been removed (deported) from the United States and any auxiliary beneficiaries entitled on the wage record of a wage earner who has been removed (deported) from the United States. **If a wage earner is not payable under Section 202(n), auxiliary beneficiaries are also not payable.**
5. A widow(er) who is subject to nonpayment under Section 202(x)(1) of the Social Security Act. Section 202(x)(1) covers four general categories of wage earners who are certain convicted prisoners, inmates of publically funded institutions, fugitives, probationers, and parolees. It does not cover auxiliary beneficiaries entitled on the wage records of these wage earners. **If a wage earner is not payable under Section 202(x)(1), auxiliary**

**beneficiaries are payable without regard to the wage earner's nonpayment status.**

See FOM 1.150.5, Prisoner Conviction Cases – General, for definitions of what constitutes a criminal offense, a conviction, incarceration, and other issues related to this subject. Wage earners subject to nonpayment under Section 202(x)(1) of the Social Security Act are listed in items a. through d. below.

- a. A widow(er) who is incarcerated following conviction of a criminal offense.
- b. A widow(er) who is confined by court order in an institution at public expense because he or she is:
  - 1) Found guilty of a criminal offense, but insane.
  - 2) Found not guilty of a criminal offense by reason of insanity.
  - 3) Incompetent to stand trial for a criminal offense.
  - 4) Suffers from a mental disease, defect, of incompetence that prevents him or her from standing trial for a criminal offense.
  - 5) A sexually dangerous person or predator who is not released from prison upon completion of his or her sentence for a criminal offense.
- c. A widow(er) who is fleeing to avoid prosecution, or is fleeing to avoid confinement after prosecution for a criminal offense.
- d. A widow(er) who is violating a condition of probation or parole imposed under Federal or State law.

**Note:** See TOM 110.10.15.05 for rules regarding the tax accounting of tier 1 accrual payments when nonpayment under section 202(x)(1) of the Social Security Act applies to the wage earner.

6. A widow(er) whose tier 1 calculates to all NSSEB because of tier 1 offset amounts.

**D. OTHER SURVIVORS**

1. Parents under age 62.
2. A survivor of an employee who does not have a SSA insured status, and, therefore, does not have a SSEB insured status.

3. A survivor who is subject to nonpayment under Section 202(n) of the Social Security Act on his or her own wage record or as an auxiliary beneficiary on another individual's wage record. Section 202(n) covers both wage earners who have been removed (deported) from the United States and any auxiliary beneficiaries entitled on the wage record of a wage earner who has been removed (deported) from the United States. **If a wage earner is not payable under Section 202(n), auxiliary beneficiaries are also not payable.**
  
4. A survivor who is subject to nonpayment under Section 202(x)(1) of the Social Security Act. Section 202(x)(1) covers four general categories of wage earners who are certain convicted prisoners, inmates of publically funded institutions, fugitives, probationers, and parolees. It does not cover auxiliary beneficiaries entitled on the wage records of these wage earners. **If a wage earner is not payable under Section 202(x)(1), auxiliary beneficiaries are payable without regard to the wage earner's nonpayment status.**

See FOM 1.150.5, Prisoner Conviction Cases - General, for definitions of what constitutes a criminal offense, a conviction, incarceration, and other issues related to this subject. Wage earners subject to nonpayment under Section 202(x)(1) of the Social Security Act are listed in items a. through d. below.

- a. A survivor who is incarcerated following conviction of a criminal offense.
  
- b. A survivor who is confined by court order in an institution at public expense because he or she is:
  - 1) Found guilty of a criminal offense, but insane.
  - 2) Found not guilty of a criminal offense by reason of insanity.
  - 3) Incompetent to stand trial for a criminal offense.
  - 4) Suffers from a mental disease, defect, of incompetence that prevents him or her from standing trial for a criminal offense.
  - 5) A sexually dangerous person or predator who is not released from prison upon completion of his or her sentence for a criminal offense.
  
- c. A survivor who is fleeing to avoid prosecution, or is fleeing to avoid confinement after prosecution for a criminal offense.
  
- d. A survivor who is violating a condition of probation or parole imposed under Federal or State law.

**Note:** See TOM 110.10.15.05 for rules regarding the tax accounting of tier 1 **accrual payments** when nonpayment under section 202(x)(1) of the Social Security Act applies to the wage earner.

5. A survivor whose tier 1 calculates to all NSSEB because of tier 1 offset amounts.

### **110.10.15.05 Special Tax Accounting Rules For Tier 1 and Overall Minimum Formula Accrual Payments Due Individuals Subject to Nonpayment Under Section 202(x)(1) of the Social Security Act**

#### **1. Tier 1 Accrual Due For a Payment Period Within the Nonpayment Period**

Any tier 1 accrual due for a period **within** the nonpayment period is payable as **NSSEB**.

#### **2. Overall Minimum Formula Accrual Due For a Payment Period Within the Nonpayment Period**

Any overall minimum (OM) formula accrual due for a payment period **within** the nonpayment period may be payable if the OM still applies with the individual subject to nonpayment **excluded from the OM calculation**. If the OM still applies, the OM accrual is payable as **SSEB**.

#### **3. Tier 1 Accrual Due For a Payment Period Prior to the Nonpayment Period**

Any tier 1 accrual due for a period **prior to** the nonpayment period **should be paid without regard to the individual's nonpayment status**. That means the tier 1 accrual is payable as **NSSEB, SSEB, or a SSEB/NSSEB split, whichever is applicable**.

#### **4. Overall Minimum Formula Accrual Due For a Payment Period Prior to the Nonpayment Period**

Any overall minimum (OM) formula accrual due for a period prior to the nonpayment period **should be paid without regard to the individual's nonpayment status**. That means the individual subject to nonpayment should be **included in the OM calculation**. The OM accrual is payable as **SSEB**.

### **110.10.20 SSEB/NSSEB Split/Categories of Cases**

An SSEB is calculated for those annuitants whose tier 1 is not defined to be equal to the SSEB because the railroad retirement annuity has certain deeming provisions (deemed period of disability, deemed age 65) applied to the calculation of the tier 1 benefit. Types of cases with a calculated SSEB are:

EMPLOYEE

- Reduced age EE paid under the 1937 or 1974 Act.
- 60/30 EE over age 62 paid under the 1974 Act or 1983 Amendments without a full age reduction (eligible before 1-1-86).
- Disabled EE over age 62 with no period of disability.

SPOUSE

- Spouse of reduced age EE paid under the 1937 or 1974 Act.
- Spouse of 60/30 EE over age 62 paid under the 1974 Act or 1983 Amendments without a full age reduction (eligible before 1-1-86).
- Spouse of disabled EE over age 62 with no period of disability.
- Divorced spouse of 60/30 EE who retired under the 1974 Act.
- Reduced age spouse paid under the 1937 or 1974 Act and EE disabled with a period of disability.
- Spouse of full age EE.

WIDOW(ER)

- Disabled widow(er) paid under the 1937 Act.
- Widow(er) with OBD before 2-68 who was under age 65 on OBD.

**110.10.25 Default to All SSEB or All NSSEB**

When SCAMP must compute an SSEB because the annuitant falls into one of the categories under 110.10.20, but all the information it needs to compute the SSEB is not available, the SCAMP computation defaults to SSEB = Net Tier 1, or all SSEB. If the unavailable information is not a missing or invalid date of birth, and the date of birth indicates the annuitant is under age 62, the SCAMP computation defaults to all NSSEB.

When the missing information is available on the tax accounting system (TAS), SCAMP will pick up the information and recalculate the SSEB. This recalculation can occur on a mass adjustment, daily award activity, or on the monthly TAS recertification run.

When SCAMP processing produces a default to SSEB or a default to NSSEB, it also produces default codes each with a referral message. Up to five codes can be displayed on the SCAMP-ON-DEMAND output screen as DEFAULT REF-

MSG 1, DEFAULT REF-MSG 2, DEFAULT REF-MSG 3, DEFAULT REF-MSG 4, and DEFAULT REF-MSG 5. See Exhibit 3 for a list of the default codes and their messages.

### **110.15 SSEB Attainments**

Annuitants who originally do not have an SSEB because they would not be entitled to an SS benefit if the employee's railroad service were covered under the social security system can subsequently become entitled to an SSEB when they attain their SSEB date of entitlement. The SSEB date of entitlement can be based on their attaining the age for SS benefit eligibility or being granted a disability rating under SS Act rules (period of disability in employee cases).

SSEB attainment processing is handled by the Tax Withholding Recertification Program (TAS RECERT), which is run once a month. This processing recomputes the annuitant's SSEB amount using SCAMP, recalculates tax withholding, and generates an RL-120 tax notice. SSEB attainment processing is restricted to records never handled by SCAMP, period of disability records, and annuitants who will attain their SSEB date of entitlement in the current processing month.

Explanations of the SSEB attainment categories follow.

#### **110.15.05 Age**

An annuitant attains his(her) SSEB date of entitlement the month (s)he would be eligible for an SS benefit for the whole month were the employee's railroad service covered under the social security system. This would be the month in which the annuitant attains the applicable age for his/her annuity as explained in sections 110.10.10 - 110.10.20.

TAS contains the annuitant's SSEB date of entitlement based on the type of annuity and automatically computes the SSEB at that time. A TL-123 or TL-124 notice will be sent to the annuitants 2-3 months in advance to advise them of the upcoming change in their taxable amount. See Exhibit 4 for a display of the TL-123 notice. See Exhibit 5 for a display of the TL-124 notice.

#### **110.15.10 Period of Disability Granted**

An employee or widow(er) annuitant can also attain an SSEB date of entitlement after five full months of being disabled under Social Security Act rules (a period of disability for employee annuitants or a disability rating for widow(er)s). This attainment of a period of disability can occur prior to the SSEB age attainment or after the SSEB age attainment. In cases where the period of disability is effective after age 62, the SSEB date of entitlement in TAS is still based on their ages, but their date of attainment of a period of disability is five full months after

the waiting period begins. At that time, the tier 1 amount becomes all SSEB by definition.

For employee annuitants, there are three types of period of disability, but only two of them are considered a period of disability for SSEB taxation purposes: a regular period of disability and an unilateral period of disability (where a joint period of disability is required but SSA has either not rated the employee yet or has rated the employee not disabled). A Medicare only period of disability is not considered a period of disability for SSEB purposes because the employee is not insured for an SS benefit and, therefore, wouldn't be eligible for a benefit under the social security system.

Form Letter RL-210, the AB-32 appeals backed paper for period of disability denials, and the period of disability denial code paragraphs explain the effect that a period of disability has on how railroad retirement benefits are taxed.

### **110.15.15 Development of Period of Disability After Age 65**

Because the granting of a period of disability changes the taxability of tier 1, a period of disability that would decrease the employee's tax liability for tax years 1986 and later may be to the employee's tax advantage, even if the employee is over age 65 when the period of disability is granted. However, since there are other categories of cases where the tier 1 is all SSEB, it is not necessary to develop for a period of disability for tax purposes in all situations. The types of cases where it may be to the employee's tax advantage to have a period of disability effective date prior to age 65 are those cases listed under section 110.10.15 (all NSSEB), and section 110.10.20 (SSEB/NSSEB split). The types of cases where it would have no effect on the employee's tax liability to develop for a period of disability when the employee is age 65 or older, are listed under section 110.10.10 (all SSEB).

## **115 Taxed Like a Contributory Private and Public Service Pension**

### **115.05 Taxed Like a Contributory Private and Public Service Pension**

Contributory private and public service pensions are taxed differently from social security benefits. Contributory pensions are only taxed on the part of the pension that exceeds the amount of contributions made by the wage earner. Whether the entire pension is excluded from taxation until the contributions are recovered or only a part of the pension is excluded from taxation until contributions are recovered depends on which recovery tax rule applies, Three-Year Rule or General Rule. The non-social security equivalent benefit (NSSEB) and the tier 2 of a railroad retirement annuity are considered contributory private or public service pensions for tax purposes.

The employee contribution amount is explained under section 115.10; the Three-Year Rule is explained under section 115.20; and the General Rule is explained under section 115.25.

<b>Non-SSEB Portion of Tier 1</b>	The non-social security equivalent benefit (NSSEB) portion of tier 1 of a railroad retirement annuity is the amount of tier 1 that exceeds the SSEB portion of tier 1. The NSSEB can equal the tier 1 amount, be less than the tier 1 amount, or be equal to zero. NSSEB payments for December 1985, and later, made in January 1, 1986, or later, are taxable as explained above.
<b>Calculation</b>	The NSSEB is calculated by subtracting the SSEB portion of tier 1 as calculated by SCAMP from the net tier 1 amount. The result is the NSSEB portion of tier 1. An NSSEB is calculated for those annuitants as explained under section 110.10.20.
<b>Defined Categories (all NSSEB)</b>	In certain cases, the annuitant is receiving a tier 1 amount but would not be eligible for SS benefits because (s)he does not meet the requirements for an age or disability benefit under the social security system. NSSEB, in these cases, is defined to be the entire tier 1. These categories are listed under section 110.10.15.
<b>Attainments (period of disability terminations)</b>	It is possible for annuitants to not have an NSSEB (everything is SSEB) and then to become entitled to an NSSEB (either part NSSEB or all NSSEB). This can happen if a period of disability terminates and the employee is either; 1) under age 62 (it becomes all NSSEB); or 2) the employee is age 62-64 (it becomes part NSSEB). Although this is not a true attainment, it is shown here for informational purposes.
<b>Tier 2</b>	The entire tier 2 of a railroad retirement annuity is considered a contributory private or public service pension for tax purposes. Tier 2 payments for December 1983 and later, paid January 1, 1984 or later, are taxable as explained above. Payments for months before December 1983 are not taxable, even if paid in 1984 or later.



## 115.10 How Employee Contribution Amount Is Computed

The amount of the employee contributions is the amount the employee paid in Railroad Retirement Act (RRA) taxes exceeding the amount that would have been paid in FICA taxes under SSA. The employee contribution (EEC) amount is computed from the day the employee started working in the railroad industry.

The EEC formula is provided for information only. Examiners should secure the EEC as explained in RCM Chapter 7.4, Appendix A, or access the Contribution and Recovered Data (CONTRI/RECV) screen of the general TAX screens. Refer to TOM 3105.25.

### **Standard Formula**

The EEC is computed by applying the annual RR tax rate and the annual SS tax rate to each year's compensation, up to the respective maximums. The difference between these two figures is the EEC for the year. The total EEC amount is determined by totaling the EEC for all years.

The standard formula cannot be used for the following periods:

- 1937 – 1950
- 1959
- 1965
- 10/73 - 9/81
- 10/81 – Present

The EEC in these periods is explained below:

### **Earnings in 1937 - 1950 period**

The total maximum creditable earnings in this period are identified. The total earnings in the period 1937-1950 are broken down using the yearly maximum of \$3,600.00 as follows:

Step	Action
1	The total earnings are divided by \$3,600.00 to determine the number of years (up to 14) to which earnings should be attributed.

2	The earnings for that number of years are attributed at \$3,600.00 per year beginning with 1950 and going backwards.
3	The last year will be a partial earnings amount less than \$3,600.00.

As long as \$3,600.00 is attributed to a year in this period, the additional RRA taxes paid for that year based on earnings of \$3,600.00 will be considered the employee contribution for that year. In 1950, this is \$171.00; in 1949, \$186.00, etc. As the earnings in this period are broken down, earnings in the final year counted are less than \$3,600.00. Whatever amount is left is attributed to that year. The additional RRA tax for that year is based on the actual earnings attributed, rather than \$3,600.00.

### **1959 period**

In 1959, the earnings base and RR tax rate changed. There is no access to a monthly breakdown, so if the employee did not work all 12 months, we don't know in which months the \$1,750.00 earnings base and 6.25% tax rate applies, and in which months the \$2,880.00 earnings base and 2.75% tax rate applies. An average tax rate is used to determine the EEC. The 1959 tier compensation is multiplied by the factor .040578 to determine the EEC for 1959. The 1959 gross amount is not used and the RR maximum creditable compensation of \$4,550.00 cannot be exceeded. The factor (.040578) is determined as follows:

Step	Action		
1	TOTAL RR TAX BASED ON MAX IN 1959 / TOTAL RR MAX EARNINGS IN 1959		
	$\$298.38 / \$4,550.00 = .065578$		
2	TOTAL SS TAX BASED ON MAX IN 1959 / TOTAL SS MAX EARNINGS IN 1959		
	$\$113.75 / \$4,550.00 = .025$		
3	Step 1	-	Step 2
	065578	-	.025000

### **1965 period**

The RR tax rate changed in October 1965, from 8.125% to 7.125%. The months of service are identified in the record for 1965. If the employee has less than 12

months of service in 1965, the compensation per month is averaged by dividing the compensation by the months of service. Which months the employee worked are determined, and the appropriate tax rate is applied to the average earnings for those months. The SS maximum is not exceeded when determining the SS tax amount.

**EXAMPLE:** The employee had 10 months in 1965 and earned \$3,588.79; he worked March through December. The average monthly earnings are \$358.88.

For the period 3/65 - 9/65:

COMP	RR TAX RATE	RR TAX	SS TAX RATE	SS TAX	EEC
2,512.16	8.125%	204.11	3.625%	91.07	113.04

For the period 10/65 - 12/65:

COMP	RR TAX RATE	RR TAX	SS TAX RATE	SS TAX	EEC
1,076.65	7.125%	76.71	3.625%	39.03	37.68
1965 EEC = 150.72					

### **10/73 - 9/81 period**

The RR and SS tax rates and creditable compensation maximums are the same for this period. Therefore, the employee contribution amount, for each year in this period, is zero.

### **10/81 - current period**

The tier 1 tax rate and creditable compensation maximum are equivalent to the SS tax rate and compensation maximum for this period, as during the period 10/73 through 9/81. However the employee contribution amount for each year in this period equals a 2% tax on the tier 2 compensation. The tier 1 calculation is eliminated.

To determine the compensation for the periods 1/73 - 9/73 and 10/81 - 12/81, when an employee has less than 12 months in either of these years, the earnings per month are averaged and allocated to the actual months worked, as described in the section for 1965.

The employee contribution amount was incorrectly computed for 1988 based on an incorrect tier 2 tax rate of 4.25% that was used in the computation. The

correct tier 2 tax rate for 1988 is 4.9%. All tax records in which the employee contribution amount included 1988 compensation were corrected in 1990.

### **SUMMARY**

The following table summarizes the EEC calculation. The compensation amounts shown are the maximum amounts. All the dollar amounts entered are for demonstration purposes only. The percentages will be used for every employee.

YEAR	RR TAX			SS TAX			EMPLOYEE
	COMP	X RATE	= RR TAX	COMP	X RATE	= SS TAX	CONTRIBUTION
1937	3600	2.75	99.00	3000	1.0%	30.00	69.00
1938	3600	2.75	99.00	3000	1.0%	30.00	69.00
1939	3600	2.75	99.00	3000	1.0%	30.00	69.00
1940	3600	3.00	108.00	3000	1.0%	30.00	78.00
1941	3600	3.00	108.00	3000	1.0%	0.00	78.00
1942	3600	3.00	108.00	3000	1.0%	30.00	78.00
1943	3600	3.25	117.00	3000	1.0%	30.00	87.00
1944	3600	3.25	117.00	3000	1.0%	30.00	87.00
1945	3600	3.25	117.00	3000	1.0%	30.00	87.00
1946	3600	3.50	126.00	3000	1.0%	30.00	96.00
1947	3600	5.75	207.00	3000	1.0%	30.00	177.00
1948	3600	5.75	207.00	3000	1.0%	30.00	177.00
1949	3600	6.00	216.00	3000	1.0%	30.00	186.00
1950	3600	6.00	216.00	3000	1.5%	45.00	171.00
1951	3600	6.00	216.00	3600	1.5%	54.00	162.00
1952	3600	6.25	225.00	3600	1.5%	54.00	171.00
1953	3600	6.25	225.00	3600	1.5%	54.00	171.00
1954	3900	6.25	243.75	3600	2.0%	72.00	171.75

1955	4200	6.25	262.50	4200	2.0%	84.00	178.50
1956	4200	6.25	262.50	4200	2.0%	84.00	178.50
1957	4200	6.25	262.50	4200	2.25%	94.50	168.00
1958	4200	6.25	262.50	4200	2.25%	94.50	168.00
1959	Multiply comp. (up to 4550) by .040578 to get 1959 EEC						184.63
1960	4800	6.75	324.00	4800	3.0%	144.00	180.00
1961	4800	6.75	324.00	4800	3.0%	144.00	180.00
1962	4800	7.25	348.00	4800	3.125%	150.00	198.00
1963	4900	7.25	355.25	4800	3.625%	174.00	181.25
1964	5400	7.25	391.50	4800	3.625%	174.00	217.50
1/65-9/65	4050	8.125	329.06	3600	3.625%	130.50	198.56
10/65-12/65	1350	7.125	96.19	1200	3.625%	43.50	52.69
1966	6600	7.95	524.70	6600	4.2%	277.20	247.50
1967	6600	8.65	570.90	6600	4.4%	290.40	280.50
1968	7800	8.90	694.20	7800	4.4%	343.20	351.00
1969	7800	9.55	744.90	7800	4.8%	374.40	370.50
1970	7800	9.55	744.90	7800	4.8%	374.40	370.50
1971	7800	9.95	776.10	7800	5.2%	405.60	370.50
1972	9000	9.95	895.50	9000	5.2%	468.00	427.50
1/73 - 9/73	8100	7.125	577.12	8100	3.625%	293.63	283.49
10/73-12/73	2700	5.85	157.95	2700	5.85%	157.95	0
1974	13200	5.85	772.20	13200	5.85%	772.20	0
1975	14100	5.85	824.85	14100	5.85%	824.85	0
1976	15300	5.85	895.05	15300	5.85%	895.05	0

1977	16500	5.85	965.25	16500	5.85%	965.25	0
1978	17700	6.05	1070.85	17700	6.05%	1070.85	0
1979	22900	6.13	1403.77	22900	6.13%	1403.77	0
1980	25900	6.13	1587.67	25900	6.13%	1587.67	0
1/81- 9/81	22275	7.125	1587.09	22275	3.625%	807.47	779.62
10/81 - 12/81	T1 7425	6.65	493.76	7425	6.65%	493.76	0
	T2 5550	2.00	111.00	-	-	-	111.00
1982	T1 32400	6.70	2170.80	32400	6.7%	2170.80	0
	T2 24300	2.00	486.00	-	-	-	486.00
1983	T1 35700	6.70	2391.90	35700	6.7%	2391.90	0
	T2 26700	2.00	534.00	-	-	-	534.00
1984	T1 37800	*7.00	2646.00	37800	7.0%	2646.00	0
	T2 28200	2.75	775.50	-	-	-	775.50
1985	T1 39600	7.05	2791.80	39600	7.05%	2791.80	0
	T2 29700	3.50	1039.50	-	-	-	1039.50
1986	T1 42000	7.15	3003.00	42000	7.15%	3003.00	0
	T2 31500	4.25	1338.75	-	-	-	1338.75
1987	T1 43800	7.15	3131.70	43800	7.15%	3131.70	0
	T2 32700	4.25	1389.75	-	-	-	1389.75

1988	T1 45000	7.51	3379.50	45000	7.51%	3379.50	0
	T2 33600	4.90	1646.40	-	-	-	1646.40
1989	T1 48000	7.51	3604.80	48000	7.51%	3604.80	0
	T2 35700	4.90	1749.30	-	-	-	1749.30
1990	T1 51300	7.65	3924.45	51300	7.65%	3924.45	0
	T2 38100	4.90	1866.90	-	-	-	1866.90
1991	T1 53400	7.65	4085.10	53400	7.65%	4085.10	0
	T2 39600	4.90	1940.40	-	-	-	1940.40
Total Through 1991:							20628.99

\*Employees received a credit of 0.3% in 1984.

### 115.15 How Employee Contributions Are Recovered

As explained in section 115.05, contributory pensions are only taxed on the part of the pension remaining after the contributions have been recovered. The method used to determine how contributions are recovered depends upon which recovery rule applies, Three-Year Rule or General Rule.

Under the Three-Year Rule, any NSSEB/tier 2 benefits paid under a railroad account number to the employee, spouse, and/or survivor(s) from their annuity beginning date are applied towards recovery of the employee contributions. No part of the NSSEB/tier 2 benefit is taxable until the total of all NSSEB/tier 2 benefits paid under the employee's account equals or exceeds the amount of the employee's contributions. These contributions should be recovered within a 36-month period.

Under the General Rule, part of the NSSEB/tier 2 benefit is nontaxable and the remainder is taxable immediately from the annuity beginning date. Only the nontaxable amount paid to employees and survivors goes toward recovery of the employee contributions. Spouses do not have a nontaxable amount and do not recover employee contributions.

[Effective for tax year 1992, contribution recovery processing, as well as General Rule computations, will be eliminated. Tax statements released in January 1993 for the 1992 tax year will not contain contribution recovery data.]

### **115.20 Three-Year Rule**

The Three-Year Rule provision of the Internal Revenue Code applies for annuities beginning before July 2, 1986. By definition the Three-Year Rule is applied if the employee contributions can be recovered from NSSEB/tier 2 benefits paid under the employee's claim number within a 36-month period, or three years.

On September 6, 1992 and October 30, 1992, all cases that were unrecovered under the Three-Year Rule (002), or whose tax rule code was undetermined (000) were converted to a tax rule code of General Rule, Unrecovered - Temporary Determination (015).

#### **115.20.05 How Annuitants Were Affected**

Generally, annuities with beginning dates prior to July 2, 1986, are covered under the Three-Year Rule and those with beginning dates after July 1, 1986, are covered under the General Rule. Based on an administrative decision, however, the Tax Accounting System (TAS) did not process cases under the General Rule until the Three-Year Rule was eliminated effective July 2, 1986. Since TAS was not able to implement the General Rule provision timely, the Three-Year Rule computations were applied to all annuitants on the rolls until that time, unless an inquiry was made regarding General Rule taxes for 1986. In such case, a manual corrected statement was issued for 1986 reporting tax information under the General Rule.

#### **115.20.10 NSSEB/Tier 2 All Nontaxable Until Contributions Recovered**

Under the Three-Year Rule, an annuitant can receive NSSEB/tier 2 benefits tax-free until the employee's contributions have been recovered. Until the contributions are recovered, no part of the NSSEB/tier 2 benefit payable to any family member is taxable.

#### **115.20.15 NSSEB/Tier 2 Taxable When Contributions Recovered**

Under the Three-Year Rule, NSSEB/tier 2 benefits become fully taxable only after the NSSEB/tier 2 benefits paid under the employee's claim number exceed the amount of the employee contribution.

NOTE: The Internal Revenue Service (IRS) states in Publication 575 that 1989 was the last year amounts could be excluded on tax returns under the Three-Year Rule. IRS also advised that these excluded amounts should be removed



from tax statements. Therefore, effective in 1992, TAS converted all remaining unrecovered Three-Year Rule cases to General Rule.

### **115.25 General Rule**

The General Rule provision of the Internal Revenue Code repealed the Three-Year Rule for annuities beginning after July 1, 1986. The General Rule applies to these annuities and allows for the taxation of part of the NSSEB/tier 2 benefit from the annuity beginning date. The remainder is tax free from the annuity beginning date.

Beginning with tax year 1992, the Railroad Retirement Board no longer tracks or reports taxable and nontaxable amounts under the General Rule. Tax statements released in January of 1993 for the 1992 tax year will not contain taxable amounts.

#### **115.25.05 Annuitants Affected**

Generally, annuities with beginning dates after July 1, 1986, are covered under the General Rule. However, for multiple annuitants paid on the same employee record, the annuity beginning date for the first retirement and survivor annuitant paid determines the applicable tax rule for each retirement or survivor annuitant. See section 115.25.20 .

Annuitants with an ABD/OBD of July 2, 1986, and later, who have NSSEB/tier 2 benefits are affected by the General Rule. The only exceptions to this are explained in section 115.25.20. To correctly apply the General Rule to annuitants paid in 1986 and 1987, a General Rule mass adjustment was run after the December 1987 cost-of-living operation to determine the nontaxable NSSEB/tier 2 amounts and to correct the taxable NSSEB/tier 2 amounts for these annuitants under General Rule computations for 1987. See TOM 400 for a description of the General Rule mass adjustment.

General Rule computations for new annuitants coming on the rolls after the December 1987 mass adjustment were implemented in 1988.

There are two categories of annuitants covered under the General Rule. The first category includes those with ABD/OBDs of July 2, 1986, through December 31, 1986. These are generally referred to as 1986 General Rule cases. These annuitants are entitled to a permanent nontaxable NSSEB/tier 2 amount, which remains static for the life of the annuitant. The second category includes those annuitants with ABD/OBDs after December 31, 1986. These are generally referred to as 1987 General Rule cases. These individuals are entitled to a "temporary" nontaxable NSSEB/tier 2 amount until the employee contributions have been fully recovered.

### **115.25.10 A Portion of NSSEB/Tier 2 Nontaxable From ABD**

Under the General Rule, part of the tier 2/NSSEB is nontaxable and the remainder is taxable immediately from the annuity beginning date. The nontaxable portion represents a prorated return of the employee's investment (the employee contributions). The nontaxable amount is computed based on the amount of the employee contributions and the expected return, which is the total amount of annuities expected to be received by the annuitant based on life expectancy factors at the annuity beginning date.

As explained in section 115.25.05, the nontaxable amount is permanent and remains static for the life of the annuitant for 1986 General Rule cases. This means that recovery of the employee contributions is immaterial. The nontaxable amount continues even if the contributions have been recovered.

However, for 1987 General Rule cases, although the computation of the nontaxable amount is static, the total nontaxable amount received is limited to the amount of the employee's unrecovered contributions. Once the total of all nontaxable NSSEB/tier 2 payments made to the employee and/or survivors exceed the amount of the employee contributions, the NSSEB/tier 2 components become fully taxable. In some cases, the contributions may be recovered before the annuitant dies, because he or she has outlived his or her life expectancy.

See section 115.25.25 for an explanation of how the nontaxable amount is calculated.

### **115.25.15 Spouse Annuity is All Taxable From the ABD**

The NSSEB/tier 2 components of a spouse annuity are considered fully taxable from the annuity beginning date under the General Rule. Therefore, no part of the spouse's NSSEB/tier 2 (or divorced spouse's NSSEB) can be used toward recovery of the employee contributions.

### **115.25.20 Determining Applicable Tax Rule**

The initial determining factor used in assessing which tax rule to apply - General Rule or Three-Year Rule - is the ABD/OBD. As long as the ABD/OBD is before July 2, 1986, the Three-Year Rule will apply. [The exceptions are the old Three-Year Rule unrecovered cases that converted to General Rule in 1992.]

However, there are certain situations where the ABD/OBD is not the determining factor in applying the appropriate tax rule:

- **Retirement cases** - If an employee is a Three-Year Rule case and the spouse comes on the rolls with an ABD of August 1, 1986, the Three Year Rule will also be applied to the spouse even though her ABD is after July 1, 1986. The NSSEB/tier 2 payments made to both the employee and the spouse will be

applied toward recovery of the contributions and will not become taxable until the contributions are recovered.

- Survivor cases - If the employee was under the Three-Year Rule, the survivor can be under the General rule if the OBD is July 2, 1986, or later. Likewise, if the employee was a 1986 ABD General Rule case, the survivor can be a 1987 ABD General Rule case. For survivors, the tax rule determination and General Rule calculation are re-done based on the survivor's OBD, his or her age at the OBD, and the amount of any unrecovered contributions.

For example, in the case of a spouse to widow conversion, a new tax rule determination is made for the widow based on her new OBD. If she had previously been a spouse under the Three-Year Rule, she can now be under the General Rule if her OBD is July 2, 1986, or later. If the employee had been a 1986 ABD General Rule case and the widow had been a General Rule spouse with a fully taxable NSSEB/tier 2, she can now be a 1987 OBD General Rule case, providing her OBD is January 1, 1987, or later. In such cases, if the employee's contributions have not yet been recovered, the widow will be entitled to a nontaxable amount of her NSSEB/tier 2 payments until the contributions have been fully recovered. Thereafter, her NSSEB/tier 2 will become fully taxable

However, in the case of a survivor family group or split-family group, if the first annuitant paid is a widow covered under the Three-Year Rule, and a child becomes entitled later with an OBD in 1987, the child will also be considered a Three-Year Rule case as long as the widow is still in current payment status or in suspense. (Annuitants in suspense are still considered on the rolls and, therefore, still entitled.) The entire NSSEB/tier 2 payments received by both the widow and the child will be applied toward recovery of the contributions and will not become taxable until the contributions are recovered.

Likewise, in a survivor family group or split-family group, if the first annuitant on the rolls is covered under the General Rule with an OBD of August 1, 1986, and is still entitled when a subsequent annuitant comes on the rolls later, the new annuitant will also be covered under the General Rule as an individual with an OBD in 1986, even though the subsequent survivor's actual OBD may be January 1, 1987 or later. The computation of the permanent nontaxable NSSEB/tier 2 would not change, and recovery of the employee contributions does not have to be considered for all survivors on the rolls.

- Existence of Continuous Entitlement - A distinction should be made here between a situation where there is continuous entitlement and one in which there is no continuous entitlement. Applying the appropriate tax rule when there is new entitlement and there are multiple annuitants involved, depends on whether or not the annuitant(s) from the previous entitlement is/are still in current pay status, or in suspense, at the OBD of the newly entitled annuitant. (Annuitants in suspense are still considered on the rolls and, therefore, still

entitled.) This new annuitant could either be entitled for the first time or could now be entitled again after having been previously terminated. As long as there is one annuitant still currently entitled at the OBD of the new entitlement, the tax rule for the new annuitant will be the same as the annuitants who are still currently entitled. If all annuitants from a previous entitlement have terminated, and a new annuitant comes on the rolls subsequently, a new tax rule determination will be made.

The same is true in a retirement case, where an employee's disability annuity terminates because he has recovered and he later becomes entitled to a new annuity based on age and service. If his disability annuity was considered under the Three-Year Rule and his age and service annuity begins after July 1, 1986, the tax rule can be recalculated now to be under the General Rule.

In summary, whichever tax rule is applied to the first retirement or survivor annuitant on the rolls, the same tax rule is applied to any subsequent annuitants in the same family or split-family group later coming on the rolls, as long as there is continuous entitlement of one or more annuitants. If there is no continuous entitlement, a new tax rule determination will be made.

- Change in ABD/OBD - There are also situations where an annuitant can change from a Three-Year Rule case to a General Rule case or vice versa. This can happen if there is a change in ABD/OBD. This involves a new entitlement or change in entitlement; therefore, a recalculation of the tax rule is allowed. Any benefits not due from the "erroneous" entitlement must be repaid and any contributions recovered will be added back into the contribution amount to be recovered. In retirement cases, the change in tax rule will be effective for both the employee and spouse. In survivor cases, all annuitants paid under the claim number are affected. A change in tax rule for survivors can only happen if the first annuitant's OBD changes.

In the situation where an annuitant's tax rule changed during the tax year, two annual statements will be released, one showing Three-Year Rule information and the other General Rule information. The most common situations are spouse to widow conversion cases, where the widow(er) could have been a spouse under the Three-Year Rule and then converts to a widow(er) under the General Rule. This could also apply to employees who were under the Three-Year Rule for part of the year and become General Rule upon a new entitlement for the rest of the year.

For those annuitants still in partial payment status at the end of the year, their annuity statements will reflect the tax rule determined based on the partial ABD. If the partial ABD determined the tax rule to be the General Rule, but once they are paid final in the next tax year the final ABD is determined to be prior to July 2, 1986, the tax rule must be changed to Three-Year Rule and a corrected statement for the previous tax year should be released.

### **115.25.25 Calculating the General Rule Exclusion Amount**

The following describes how the General Rule exclusion amount, or nontaxable amount, is calculated:

- How the Family Nontaxable Amount is Determined - The nontaxable amount is based on several factors:

First Monthly Rate - This is the NSSEB/tier 2 after deductions for actuarial adjustment, waiver, or work deductions paid on the first final recurring rate to the employee or all first paid survivors.

Expected Return - This is the total NSSEB/tier 2 (based on the first final monthly rate) expected to be paid to the employee or all first paid survivors over the life of the annuity.

Exclusion Factor - This is the result of dividing the amount of the unrecovered contributions as of the ABD/OBD by the expected return.

Family Monthly Nontaxable Amount - This is the first monthly rate multiplied by the exclusion factor. This is also called the tax-free amount or the exclusion amount.

- How Each Annuitant's Monthly Nontaxable Amount is Determined --

Retirement - The family monthly nontaxable amount applies only to the employee NSSEB/tier 2.

Survivor - The family monthly nontaxable amount is distributed among all survivor annuitants by proration; it is redistributed if a new survivor annuitant comes on the rolls or a survivor is terminated.

- How to Compute the Nontaxable Amount in an Accrual - The computation of the nontaxable portion of an accrual will depend on what type of payment resulted in the accrual:

Recertifications - If the payment is a regular recertification increasing rates previously paid (the award covers a period in which the annuitant already received paid amounts), the entire accrual is considered taxable. This is because the monthly nontaxable amount originally computed must remain static, whether the annuity rate subsequently goes up or down. Therefore, the amount the accrual represents is the taxable portion of the annuity, which can change with any annuity adjustment. Accruals from recertifications where a portion of the accrual was used to recover an overpayment are treated in the same manner. The entire NSSEB/tier 2 accrual is taxable.

For partial to final awards, the monthly nontaxable amount is first recalculated based on final rate information and then multiplied by the number of months covered in the accrual going back to the ABD. All the nontaxable amounts considered while in partial payment status are subtracted from this nontaxable amount computed. The result is the nontaxable portion of the accrual.

In zero accrual recertification situations, where the accrual was withheld to offset an overpayment, the withheld accrual, which normally would have been paid out, is considered entirely taxable. If no accrual would be paid because the recertified rates are lower than the previously paid rates, no nontaxable/taxable amounts are computed.

Initial Awards/Reinstatements - To determine the nontaxable portion of an accrual resulting from an initial award or a reinstatement award, the number of months covered in the accrual period is first determined. That number is multiplied by the monthly nontaxable amount originally computed. The result is the nontaxable portion of the accrual.

Reinstatement/Recertifications - To determine the nontaxable portion of an accrual resulting from a reinstatement/recertification award, the net paid amount of the accrual is first determined. The exclusion percentage is then applied to that amount. The exclusion percentage was originally computed when the annuitant was paid final. The net paid amount of the accrual is determined by taking the sum of the accrual NSSEB/tier 2 paid amounts (after 1983) minus any actuarial adjustments and annuity waiver. The resulting nontaxable amount cannot exceed the amount of the accrual.

Spouse to Widow Conversions - The accrual from a spouse to widow conversion is not treated like an initial award accrual but is similar. To determine the nontaxable portion of the accrual from a spouse to widow award, the number of months since the widow(er)'s OBD is computed. That amount is multiplied by the new recurring NSSEB/tier 2 nontaxable amount computed for the widow(er). (This nontaxable amount is based on the amount of unrecovered contributions as of the spouse to widow award.) The result is the nontaxable portion of the accrual. This handling applies to General Rule widow(er)s who were previously General Rule spouses.

The spouse to widow accrual for General Rule widow(er)s who were previously Three-Year Rule spouses with unrecovered employee contributions are handled differently. This accrual is considered fully taxable. No nontaxable amounts are computed (these widow(er)s would be receiving a larger nontaxable amount than to which they are entitled). Their NSSEB/tier 2 was nontaxable during the interim widow period when a portion of it should have been taxable as a General Rule widow(er). If nontaxable NSSEB/ tier 2 amounts were computed on the spouse to widow accrual equal to the number of months in the accrual times the widow(er)'s monthly

nontaxable NSSEB/tier 2 amount, the widow(er) would be receiving too much in nontaxable amounts and too little in net taxable amounts. Therefore, the entire accrual is considered taxable. Although the taxable accrual may be overstated, the widow(er)'s first regular monthly payment and later payments will be correctly split between a taxable and nontaxable portion.

A General Rule widow(er) who was previously a Three-Year Rule spouse with the employee contribution fully recovered has a fully taxable spouse to widow accrual since the NSSEB/tier 2 was fully taxable while a spouse and is

NOTE: For those General Rule widow(er)s who were previously General Rule spouses, it may be possible for a negative net taxable NSSEB/tier 2 amount to be computed if the nontaxable NSSEB/tier 2 amount is accrual. If so, the negative amount may or may not balance out by subsequent net taxable amounts during the rest of the tax year, depending on whether or not entitlement continues. If entitlement ceases while the negative net taxable amount exists, there is nothing taxable for the year.

### **115.25.30 Explanation of Form G-310**

General Rule calculations are automatically performed by certain TAX programs. The General Rule exclusion amount, or monthly nontaxable amount, can also be computed manually on Form G-310, WORKSHEET TO ESTIMATE GENERAL RULE NONTAXABLE AMOUNT. A more detailed explanation of the use of Form G-310 is in TOM 3200.

Form G-310 is used by TAX examiners when preparing manual original or corrected tax statements. Common situations when Form G-310 is used are in partial to final awards, spouse to widow conversions, and survivor family group situations, where payees drop in and out, causing redistribution of the monthly nontaxable amount.

### **115.25.35 When to Recompute the Exclusion Amount**

Under the General Rule, there are only a few situations when the nontaxable amount should be recomputed:

Partial to final cases - When an annuity is recertified from partial to final payment status, the nontaxable portion of the NSSEB/tier 2 is recomputed based on the final monthly NSSEB/tier 2 component(s).

If the annuity is still in partial payment status at the end of the year and has been determined to be covered under the General Rule, the annuitant's annual statement will reflect taxable amounts based on the partial ABD and partial rate information.

Initial final awards - Once the tax rule determination has been made and the General Rule calculations of the nontaxable amount have been made, there is no need for any recomputation of the nontaxable amount unless the ABD/OBD changes.

Return to Railroad Service - No Recomputation - If a General Rule employee returns to railroad service, there is no new tax rule determination or recalculation of nontaxable amounts when he becomes re-entitled. Since the employee is only in suspense while he returns to railroad service, he does not get a new ABD when he ceases work. Therefore, the nontaxable amount calculated originally at his ABD remains the same after he becomes re-entitled to a railroad annuity. However, any additional contributions the employee accumulated during his return to railroad service are added to any unrecovered contributions, the total of which must be recovered before the NSSEB/tier 2 become fully taxable (in cases where the ABD is January 1, 1987, or later).

Annuity Rate Adjustments - No Recomputation - If the NSSEB/tier 2 increases due to cost-of-living or other annuity adjustments, or if it decreases due to SSA entitlement, age 62 attainment, period of disability attainment, vested dual benefit attainment, or date of birth change, etc., the nontaxable portion of the NSSEB/tier 2 is not recomputed.

Change in Survivor Family Group Composition - In the case of a survivor family group or split-family group, where annuitants drop in and out, the family's total monthly nontaxable amount computed at the initial entitlement never gets recalculated upon a new entitlement as long as one or more annuitants are still in current pay status at that time. A family's total monthly nontaxable amount gets prorated among all the beneficiaries in current pay status by a ratio of:

$$\frac{\text{annuitant's monthly NSSEB/tier 2}}{\text{family's total monthly NSSEB/tier 2}}$$

Therefore, if one drops out or a new annuitant comes on the rolls, the family's total monthly nontaxable amount simply gets re-prorated according to the ratio based on the new NSSEB/tier 2 rates (if recomputed) among the annuitants.

If a new annuitant comes on the rolls and there are no others in current pay status under the same claim number, a new tax rule determination is made and a new nontaxable amount (based on the amount of unrecovered contributions) is recomputed.



## **115.30 Simplified General Rule**

In 1988, IRS introduced a new method of computing taxable/nontaxable amounts for General Rule cases, called the Simplified General Rule.

The Simplified General Rule does not change any of the taxation concepts that apply under the General Rule. The same concepts also apply under the Simplified General Rule. However, the difference between the two rules is that the computations of the taxable/nontaxable amounts under the Simplified General Rule are much less complex than those under the regular General Rule.

### **115.30.05 When the Simplified General Rule May Be Applied**

General Rule annuitants (ABD is after July 1, 1986) may choose to use the more simple method of computing their taxable/nontaxable NSSEB/tier 2 amounts by applying the Simplified General Rule only if they are employee or survivor beneficiaries entitled for life and under age 75 as of the annuity beginning date. Young widow(ers), minor children, and students who have fixed periods of entitlement cannot use the Simplified General Rule.

If chosen as the method of computation, the Simplified General Rule may be applied effective with tax year 1988. Taxpayers may also change from the General Rule to the Simplified General Rule (or the other way around) for prior years by filing amended returns for all their tax years beginning with the year in which the first annuity payment was received. Generally, the change may be retroactive to 3 prior years. If a change is made, the same method must be used for all tax years unless the taxpayer chooses the Simplified General Rule for 1988 and later years but not for 1986 or 1987. In such case, if the annuity beginning date is after July 1, 1986, and before January 1, 1988, the taxpayer can start to use the Simplified General Rule in 1988 without amending the 1986 or 1987 returns. The taxpayer has the option to amend both the 1986 and 1987 returns to apply the Simplified General Rule if he chooses to apply it to 1988. However, he cannot amend 1987 without also amending 1986 (providing the first annuity was received in 1986).

### **115.30.10 How to Calculate the Taxable/Nontaxable Amount**

IRS has devised a worksheet for General Rule taxpayers to use in computing their taxable/nontaxable pension or annuity amounts under the Simplified General Rule. This WORKSHEET FOR SIMPLIFIED GENERAL RULE appears in IRS Publication 575, Pension and Annuity Income (Including Simplified General Rule). Railroad retirement annuitants may use the worksheet to compute their taxable/ nontaxable NSSEB/tier 2 amounts. Items 4, 14, and 15 on Form RRB-1099-R (W-2P) provide the annuitant with the information he or she needs to complete the worksheet. (However, effective with tax statements for the 1992 tax year, these items will no longer be provided on the statement, except for the contributory amount paid item. The statements will no longer report taxable

contributory amounts. Annuitants must begin calculating the taxable and tax-free portion of their NSSEB-tier 2 payments under either the General Rule or the Simplified General Rule, whichever method they prefer.)

TAS was not changed to compute the General Rule under the simplified method since the Simplified General Rule calculation is an option for the taxpayer. Any inquiries received on Simplified General Rule computations should be referred to the IRS.

### **115.35 When Employee Contributions Are Recovered**

Contribution recovered amounts and contribution recovery dates are automatically computed by various TAX programs. Contribution recovery can also be computed manually by TAX examiners on Form G-1009, WORKSHEET TO DETERMINE THE EMPLOYEE CONTRIBUTION RECOVERED AMOUNT.

[Effective for tax year 1992, contribution recovery processing, as well as General Rule computations, will be eliminated. Tax statements computed for the 1992 tax year and on, will not include contribution recovery data.]

#### **115.35.05 Explanation of Form G-1009**

Form G-1009, WORKSHEET TO DETERMINE THE EMPLOYEE CONTRIBUTION RECOVERED AMOUNT is used by TAX examiners when preparing manual tax statements and when correcting the claim tax record of the taxation database, where contribution recovery data reside.

In Three-Year Rule cases, Form G-1009 is used when the employee contributions cannot be deemed to be recovered. That is, if the annuitant came on the rolls after December 1983, a determination must be made whether the employee contributions have been recovered. The actual amount of all NSSEB/tier 2 benefits paid under the employee's claim number must be added up and compared to the employee contribution amount.

In General Rule cases, only the nontaxable portions of the NSSEB/ tier 2 paid to employees and survivors should be included in these computations. The difference between the contribution amount and the total of contributions recovered to date is then divided by the total NSSEB/tier 2 amount payable (or paid) to all family members. The result is the number of months it would take before contributions are recovered and the NSSEB/tier 2 become fully taxable (in Three-Year cases and 1987 General Rule cases). The contribution recovery date is determined based on the computed number of months from the ABD/OBD.

### **115.35.10 TAX Daily Database Update**

The TAX daily database update programs perform contribution recovery processing. When daily activity (awards, suspensions, terminations, etc.) is updated to the taxation database by the daily database update program (DELTA), contribution recovery data is calculated and updated in the claim tax record of the database. DELTA will also calculate recovered amounts and contribution recovery dates for Three-Year Rule cases based on the activity being updated and from the last date contribution recovery data was updated. GRACE is the program that performs contribution recovery processing for General Rule cases. Net taxable and nontaxable NSSEB/tier 2 amounts are also calculated and posted in the recurring and nonrecurring rate records created from the activities being updated. If recovery occurs, the update programs will adjust and update tax rule codes as well as net taxable/nontaxable amounts. See TOM 600 for more detailed explanations of the TAX daily database update programs.

### **115.35.15 TAX Monthly Database Update**

Once a month, certain TAX programs request employee contribution amount data from the bureau of research and employment accounts for cases where the contribution amount is missing and updates this data to the taxation database. As part of the update process, contribution recovery is performed. Recovered amounts and recovery dates are calculated and posted to the claim tax record with net taxable and nontaxable NSSEB/tier 2 amounts derived and posted on a new recurring rate record opened.

The monthly TAS recertification (TAS Recert) run also can affect contribution recovery processing, but only as it goes through the daily check writing job stream and through DELTA/GRACE for update to the taxation database. See

TOM 600 for a description of the monthly database update program and TAS RECERT.

### **115.35.20 TAX Year-End Update**

In addition to the monthly request, there is a "year-end" request for employee contribution amount data from the bureau of research and employment accounts. This is not actually performed at year end, but it is usually performed once a year around August or September after the Railroad Retirement Board receives lag data from the railroads. Contribution recovery calculations and updates are performed in a manner similar to the monthly update.

The year-end statement operation also performs contribution recovery calculations, although it will not update them to the TAX database. The year-end calculations are performed because the total contribution recovered amount (through the current tax year), in addition to the employee contribution amount,

are reported on the annual tax statement to the annuitant. Therefore, the calculation is done for statement purposes only and only if contribution recovered amounts have not already been updated through the end of the tax year. If recovery occurs within the tax year, it will be reflected on the statement.

### **115.35.25 TAX Mass Adjustment Update**

TAX has a number of mass adjustment update programs that will call contribution recovery processing. The mass adjustment programs update the following to the taxation database: Cost-of-Living, RAIL, AERO, vested dual benefit cutback and restore, and SUP ANN cutback and restore adjustments. Contribution recovered amounts and contribution recovery dates are calculated and updated to the claim tax record. New recurring and/or nonrecurring rate records are created with net taxable and nontaxable NSSEB/tier 2 amounts posted accordingly. If recovery occurs, tax rule codes will also be adjusted and updated.

### **115.35.30 TAX Manual/On-Line Correction Programs**

The G-1102 manual correction system for nonrecurring rate record corrections also calls contribution recovery processing under both the Three-Year Rule and General Rule. In addition to posting a new nonrecurring rate record based on data manually input by TAX examiners, the claim tax record may also be adjusted for contribution recovery. If recovery occurs, a new recurring rate record may also be opened, reflecting a new tax rule code, and new net taxable and nontaxable NSSEB/tier 2 amounts. The new tax rule codes will also be reflected in the claim tax record and annuitant tax record.

The claim tax record on-line correction system, TAXCOR, calls contribution recovery processing only under the Three-Year Rule. Contribution recovery processing can be triggered by examiner on-line corrections/entries to the claim tax record. Recovered amounts, recovery dates, tax rules, and net taxable/nontaxable NSSEB/tier 2 amounts may be adjusted and updated in the claim tax record, annuitant tax record, recurring rate record, or nonrecurring rate record. If recovery under the Three-Year Rule occurs, all database records and fields will be adjusted and updated.

## **120 Taxed Like A Non-Contrib Private & Public Service Pension**

### **120.05 Taxed Like A Non-Contributory Private And Public Service Pension**

Non-contributory private and public service pensions are taxed differently than social security benefits and contributory private pensions. Since non-contributory private and public service pensions are not based on contributions by the wage earner, there are no contributions to recover before the non-contributory private and public service pension is taxable. Therefore, these types of pensions are taxable from the beginning date. The vested dual benefit and supplemental

annuity components of a railroad retirement annuity are taxable as non-contributory private or public service pensions.

#### **120.05.05 Vested Dual Benefit**

The entire vested dual benefit (VDB) component of a railroad retirement annuity due for the period December 1983 and later is taxable as a non-contributory private or public service pension amount from the annuitant's VDB date of entitlement. The VDB is taxable in the year in which paid.

#### **120.05.10 Supplemental Annuity**

The entire supplemental annuity (SUP ANN) of a railroad retirement annuity due for the period November 1966 and later is taxable as a [non-contributory] private or public service pension amount from the annuitant's SUP ANN date of entitlement. The SUP ANN is taxable in the year in which paid.

### **125 Residual Lump Sum and Lump Death Payment**

#### **125.05 Residual Lump Sum (RLS) Not Taxable**

The residual lump sum (RLS) guarantees the railroad employee and his survivors to receive as much in regular retirement and survivor benefits as the employee paid in railroad retirement taxes for the years 1937 through 1974. The RLS can be payable if no one is entitled to a monthly benefit in the month the employee died. If there is future entitlement, those rights may be waived. The RLS can be paid to a beneficiary designated by the employee. If there is no one designated by the employee, the RLS can also be paid to children, or to the deceased employee's estate.

For Federal income tax purposes, the RLS cannot be taxable until the employee contributions have been recovered. However, since the RLS represents a refund of the railroad retirement taxes withheld from the employee's pay prior to 1975 less any benefits (NSSEB, tier 2) already paid on the employee's account, it should never be taxable because it represents a return on the employee's contributions. Therefore, the RLS is a nontaxable payment.

#### **125.10 Lump Sum Death Payment (LSDP) Not Taxable**

The lump sum death payment (LSDP) is payable only if no one is entitled to a monthly benefit in the month the employee dies. The LSDP cannot be designated. It is payable to a widow(er) or payer of burial expenses. It can also be assigned to a funeral home by the person who assumes responsibility for paying the burial expenses.

For Federal income tax purposes, the LSDP is a nontaxable payment.

## 130 How States Tax Railroad Annuities

Section 14 of the Railroad Retirement Act (45 U.S.C. §231m) provides that no annuity or supplemental annuity shall be subject to any tax under any state law.

## 135 Crediting Payments and Repayments

### 135.05

Paid and repaid amounts made in the specific tax year are accumulated and reported on the annual tax statements.

### 135.10 Paid Amounts (PAIDS)

The following sections discuss how paid amounts are credited for each component of a railroad retirement annuity.

#### 135.10.05 SSEB/OM Pairs

SSEB/OM paid amounts consist of any SSEB/OM amounts paid or accreted to the annuitant's tax liability in the period of January 1984 or later. (Although SSEB was not effective until January 1986 the entire tier 1 payment from January 1984 through December 1985 are treated like SSEB for tax purposes.) SSEB payments are also accounted for by the taxable year for which they are paid. The annuitant can choose to apply the payments for prior taxable years to the year they were actually paid or to the years for which they were paid. (It may be more advantageous to apply the payment to the year for which the accrual was due if the annuitant's income was lower for that year.) Any payments for the period prior to January 1984 are not taxable. SSEB/OM paid amounts are before:

- Legal process (garnishment or assignment) offset;
- Workers' Compensation offset;
- Full or partial withholding;
- Accrual recovery for any RR/SUP ANN/SS/RUIA overpayment;
- SMI premium deduction;
- Tax withholding.

#### But after:

- Actuarial adjustment;
- Waiver;

- Work deductions.

### **135.10.10 NSSEB/Tier 2 Pairs**

NSSEB and tier 2 paid amounts consist of any NSSEB tier 2 amounts paid or accreted to the annuitant's tax liability in the specific tax year, regardless of what tax year the payment was for. NSSEB/tier 2 paid amounts are before:

- Legal process (garnishment or assignment) offset;
- Full or partial withholding;
- Accrual recovery for any RR/SUP ANN/SS/RUIA overpayment;
- SMI premium deduction;
- Tax withholding.

#### **But after:**

- Actuarial adjustment;
- Waiver;
- Work deductions;
- Workers' Compensation offset to the NSSEB only.

### **135.10.15 Vested Dual Benefit Pairs**

Vested dual benefit (VDB) paid amounts consist of any VDB amounts paid or accreted to the annuitant's tax liability in the specific tax year, regardless of what tax year the payment was for. VDB paid amounts are before:

- Legal process (garnishment or assignment) offset;
- Full or partial withholding;
- Accrual recovery for any RR/SUP ANN/SS/RUIA overpayment;
- SMI premium deduction;
- Tax withholding.

#### **But after:**

- Actuarial adjustment;

- Waiver;
- Work deductions;
- Cutback.

VDB Cutback - As stated above, the amount of VDB after cutback is taxable. Therefore, during the period in which the VDB was cut back, the amount that was actually paid the annuitant was considered taxable, not the amount that was cut back

VDB Restoration - When the VDB cutback amount is restored to the annuitant, the cutback amount will be taxable in the year it is paid, not in the year it was due.

### **135.10.20 Supplemental Annuity Paid**

Supplemental annuity (SUP ANN) paid amounts consist of any SUP ANN amounts paid or accreted to the annuitant's tax liability in the specific tax year, regardless of what tax year the payment was paid for. SUP ANN paid amounts are before:

- Accrual recovery for any RR/SUP ANN/RUIA overpayments;
- Tax withholding.

But after:

- Waiver;
- Cutback.

SUP ANN Cutback - As stated above, the amount of SUP ANN after cutback is taxable. Therefore, during the period in which the SUP ANN was cut back, the amount that was actually paid the annuitant was considered taxable, not the amount that was cut back.

SUP ANN Restoration - When the SUP ANN cutback amount is restored to the annuitant, the cutback amount will be taxable in the year it is paid, not in the year it was due.

### **135.15 Repaid Amounts (REPAIDS)**

The following sections discuss how repaid amounts are credited for each component of a railroad retirement annuity.



### **135.15.05 SSEB/OM Repaid**

SSEB/OM repaid amounts consist of any SSEB/OM amounts repaid, returned, or recovered for payments issued prior to death. This includes payments issued in a period or for a period prior to December 1983. SSEB/OM repaid amounts are attributable to the year in which received. Internal Revenue Code allows nontaxable SSEB/OM repaid amounts to be offset against taxable SSEB/OM paid amounts. Therefore, a net SSEB/OM amount can be a negative amount. This negative amount can be used to offset a positive amount on any other Form RRB-1099 or SSA-1099 the annuitant may receive. Generally, a repayment is prorated into the taxable tier components unless the overpayment was for a specific component (e.g., entitlement to an SS benefit caused an SSEB overpayment).

### **135.15.10 NSSEB/Tier 2 Repaid Under the Three-Year Rule**

- Three-Year Rule recovered - NSSEB/tier 2 repaid amounts consist of any NSSEB/tier 2 amounts repaid, returned, or recovered for the period December 1983 or later and issued for a period after the employee contributions are recovered and issued prior to death. NSSEB/tier 2 repayments are creditable for tax purposes only if the original payment was reported as taxable when paid.

Only repayments that are attributable to a specific tax year can be credited to that tax year (the year in which the overpayment was incurred or in which a returned payment was issued). Repayments made in any tax year may reduce that tax year's tax liability only to the extent that the current year's payments were "overpaid." Unlike SSEB, the net taxable amount for any year cannot be less than zero, regardless of the amount of repayment. The annuitant may need to amend a prior year income tax return to take into account a "credit" for a repayment attributable to an overpayment in a prior tax year. If the total NSSEB/tier 2 repayment in that year exceeds \$3,000, a "claim of right" may be exercised by the taxpayer (see IRS Publication 575 for details).

For the annuitant to determine what credit to take for the repaid amount, he should contact the Railroad Retirement Board to find out what years were involved in the overpayment.

Returned payments that were issued in the same tax year in which they were returned are not considered repaid, but are subtracted from the paid for that tax year.

- Three-Year Rule not recovered - NSSEB/tier 2 repaid amounts cannot be credited if the employee contributions have not been recovered. Any NSSEB/tier 2 payments made before employee contributions are recovered

are considered nontaxable. Therefore, if nontaxable amounts are repaid, returned, or recovered, no repaid credit is given for tax purposes.

### **135.15.15 NSSEB/Tier 2 Repaid Under the General Rule**

Under the General Rule, NSSEB/tier 2 repaid amounts are broken down between taxable and nontaxable repaid amounts. Under the Three-Year Rule, the entire NSSEB/tier 2 repaid amount attributed to a period for December 1983 or later, issued for a period after contributions are recovered, and issued prior to death, is considered a taxable repaid amount and, therefore, creditable for tax purposes. The only nontaxable repaid amounts under the Three-Year Rule are attributed to pre-1984 periods.

TAS determines taxable/nontaxable NSSEB/tier 2 repaid amounts under the General Rule as follows:

- Returned checks - When a payment issued for a period prior to death is returned, repaid amounts are broken down by tiers according to the payment structure in force at the time the payment went out. If the NSSEB/tier 2 of the original payment is broken down between net taxable and nontaxable paid amounts, the NSSEB/tier 2 repaid amounts for the returned check are broken down in the same net taxable and nontaxable repaid amounts.
- Full withholding - When payments are in suspense to recover an overpayment by full withholding, TAS posts corresponding paid and repaid amounts for every month the annuity is in suspense. If the NSSEB/tier 2 paid amount is broken down between net taxable and nontaxable amounts, the NSSEB/tier 2 repaid amount is also broken down between the same net taxable and nontaxable amounts.
- Partial withholding - When partial withholding is in force to recover an overpayment, if the tiers to which the overpayment is attributed are not available through manual award form entry, TAS prorates the repaid amount to the current tier rates in effect. If the NSSEB/tier 2 paid amount is broken down between net taxable and nontaxable amounts, then the NSSEB/tier 2 repaid amount is also broken down between the same net taxable and nontaxable amounts.
- Recovery from accrual - For overpayment recoveries from accruals, the net taxable and nontaxable repaid amounts are determined in the same manner as overpayment recoveries through partial withholding. That is, the total NSSEB/tier 2 repaid amount will be prorated between net taxable and nontaxable NSSEB/tier 2 based on the current recurring NSSEB/tier 2 rate.
- Cash refund - Currently, cash refunds are entered into TAS through the manual correction system by TAX examiners. By accessing payment information through the TAX screens, the amount of the cash refund may be

matched up with a posted payment. In that case, the cash refund is posted as a repaid amount based on the tier structure of that payment. If the payment was broken down between net taxable and nontaxable NSSEB/tier 2 paid amounts, then the NSSEB/tier 2 repaid amounts are also broken down between the same net taxable and nontaxable amounts.

- If the amount of the cash refund cannot be matched with a payment through accessing the TAX screens, the examiners request the folders for the overpayment information so that the correct posting of net taxable and nontaxable repaid amounts can be performed.

### **135.15.20 NSSEB/Tier 2 Repaid Under 1986 General Rule**

NSSEB/tier 2 repaid amounts consist of the taxable NSSEB/tier 2 amounts repaid, returned, or recovered for annuitants covered under the General Rule. The payments must also have been issued prior to death. For tax purposes, credit for repayment is not given for the nontaxable portion of the payment.

Since a portion of NSSEB/tier 2 payments is taxable right away from the ABD/OBD with a permanent nontaxable portion for 1986 General Rule annuitants, and contribution recovery is not a factor in determining taxable/nontaxable payments, any NSSEB/tier 2 payment repaid, returned, or recovered is credited, generally, in the amount that it was taxable.

Only repayments that are attributable to a specific tax year can be credited to that tax year (the year in which the overpayment was incurred or in which a returned payment was issued). Repayments made in any tax year may reduce that tax year's tax liability only to the extent that the current year's payments were "overpaid." Unlike SSEB, the net taxable amount for any year cannot be less than zero, regardless of the amount of repayment. The annuitant may need to amend a prior year income tax return to take into account a "credit" for a repayment attributable to an overpayment in a prior tax year. If the total NSSEB/tier 2 repayment in that year exceeds \$3,000, a "claim of right" may be exercised by the taxpayer (see IRS Publication 575 for details).

For the annuitant to determine what credit to take for the repaid amount, he should contact the Railroad Retirement Board to find out what years were involved in the overpayment.

Returned payments that were issued in the same tax year in which they were returned are not considered repaid, but are subtracted from the paid for that tax year.

### **135.15.25 NSSEB/Tier 2 Repaid Under 1987 General Rule**

- 1987 General Rule recovered - NSSEB/tier 2 repaid amounts consist of the taxable NSSEB/tier 2 amounts repaid, returned, or recovered for annuitants

covered under the General Rule. The payments must also have been issued prior to death. For tax purposes, credit for repayment is not given for the nontaxable portion of the payment.

Since the entire NSSEB/tier 2 becomes taxable after the employee contributions have been recovered for 1987 General Rule annuitants, any NSSEB/tier 2 repayment attributed to a period after contributions have been recovered is fully creditable. No split between taxable and nontaxable repaid needs to be computed.

- 1987 General Rule not recovered - NSSEB/tier 2 repaid amounts consist of the taxable NSSEB/tier 2 amounts repaid, returned, or recovered for annuitants covered under the General Rule. The payments must also have been issued prior to death. For tax purposes, credit for repayment is not given for the nontaxable portion of the payment.

Since a portion of NSSEB/tier 2 payments is taxable right away from the ABD/OBD, any NSSEB/tier 2 payment repaid, returned, or recovered is credited, generally, in the amount that it was taxable, if contributions have not been recovered.

All other discussion regarding the treatment of NSSEB/tier 2 repaid amounts are the same as explained under section 135.15.10.

### **135.15.30 Vested Dual Benefit Repaid**

December 1983 or later and issued prior to death. Repayment of a VDB payment is creditable for tax purposes if the original payment was reported as taxable when paid.

Repayments made in any tax year may reduce that tax year's tax liability only to the extent that the current year's payments were "overpaid." Unlike SSEB, the net taxable amount for any year cannot be less than zero, regardless of the amount of repayment. The annuitant may need to amend a prior income tax return to take into account a "credit" for a repayment attributable to an overpayment in a prior tax year.

For the annuitant to determine what credit to take for the repaid amount, he should contact the Railroad Retirement Board to find out what years were involved in the overpayment.

Returned payments that were issued in the same tax year in which they were returned will not be considered repaid, but will be subtracted from the paid for that tax year.

### **135.15.35 Supplemental Annuity Repaid**

Supplemental annuity (SUP ANN) repaid amounts consist of SUP ANN amounts repaid, returned, or recovered for the period November 1966 and later and issued prior to death. Since supplemental annuities have been taxable since inception, all supplemental annuity repayments are creditable for tax purposes.

SUP ANN repayments are treated in the same way for tax purposes as VDB repayments explained in section 135.15.30.

### **135.20 Negative Paid Amounts**

Return or recovery of taxable and certain nontaxable payments to or by the RRB usually requires credit of either a repaid amount or a negative paid amount to the annuitant's record for tax accounting purposes. Repaid amounts are discussed under section 135.15. Negative paid amounts are discussed below.

#### **135.20.05 SSEB/OM Negative Paid**

An SSEB/OM negative paid amount is posted to TAS for return or recovery of any SSEB/OM payment issued for the period December 1983 or later and issued after death. Any negative paid amount is always posted to the account of the deceased, even if a cross-beneficiary recovery was involved. Any negative paid assessment is limited to benefits that were taxable when paid.

#### **135.20.10 NSSEB/Tier 2 Negative Paid**

An NSSEB/tier 2 negative paid amount is posted to TAS for:

- Return or recovery of any NSSEB/tier 2 payment issued for the period December 1983 or later and issued after death;
- Return or recovery of any NSSEB/tier 2 payment issued prior to death if employee contributions have not been recovered for Three-Year Rule cases, and including payments issued in a period or for a period prior to December 1983; and
- Return or recovery of any NSSEB/tier 2 payment issued after death, split between net taxable and nontaxable amounts for General Rule cases, either in accordance with the original payment's split or the current payment's split.

Any negative paid amount caused by issue after death is always posted to the account of the deceased, even if a cross-beneficiary recovery was involved. The negative paid amount for payments issued prior to death is always posted to the annuitant's account from whom recovery was affected.

**135.20.15 Vested Dual Benefit Negative Pairs**

A vested dual benefit (VDB) negative paid amount is posted to TAS for return or recovery of any VDB payment issued for the period December 1983 or later and issued after death. Any negative paid amount is always posted to the account of the deceased, even if a cross-beneficiary recovery was involved. Any negative paid assessment is limited to benefits that were reported taxable when paid.

**135.20.20 Supplemental Annuity Negative Pairs**

A supplemental annuity (SUP ANN) negative paid amount is posted to TAS for return or recovery of any SUP ANN payment issued after death. This includes payments issued from November 1966 and on, since the supplemental annuity has always been taxable. Any negative paid amount is always credited to the account of the deceased, even if a cross-beneficiary recovery was involved. Any negative paid assessment is limited to benefits that were reported taxable when paid.

**SCAMP On Demand Default Referral Messages**

<b>MESSAGE NUMBER</b>	
0100	ANNUITANT'S DATE OF BIRTH NOT VALID FOR SSEB SCAMP PROCESSING.
0101	ANNUITY/ORIGINAL BEGINNING DATE NOT VALID FOR SSEB SCAMP PROCESSING.
0102	ANNUITANT'S TYPE OF ANNUITY CODE NOT VALID FOR SSEB SCAMP PROCESSING.
0103	BENEFICIARY SYMBOL NOT VALID FOR SSEB SCAMP PROCESSING.
0104	DISABILITY FREEZE/ONSET DATE NOT VALID FOR SSEB SCAMP PROCESSING.
0105	TIER 1 BEGINNING DATE NOT VALID FOR SSEB SCAMP PROCESSING.
0106	EMPLOYEE'S DATE OF BIRTH NOT VALID FOR SSEB SCAMP PROCESSING.

0107	RATE EFFECTIVE DATE NOT VALID FOR SSEB SCAMP PROCESSING.
0108	ACCOUNTING/VOUCHER DATE NOT VALID FOR SSEB SCAMP PROCESSING.
0109	TYPE OF COMPUTATION CODE NOT VALID FOR SSEB SCAMP PROCESSING.
0110	ANNUITY FORMULA CODE NOT VALID FOR SSEB SCAMP PROCESSING.
0111	INSURED STATUS CODE NOT VALID FOR SSEB SCAMP PROCESSING.
0112	EMPLOYEE'S TYPE OF ANNUITY NOT VALID FOR SSEB SCAMP PROCESSING.
0113	EMPLOYEE'S TYPE OF COMPUTATION NOT VALID FOR SSEB SCAMP PROCESSING.
0114	NET TIER 1 OR OM RATE NOT VALID FOR SSEB SCAMP PROCESSING.
0115	SSEB PIA NOT VALID FOR SSEB SCAMP PROCESSING.
0116	SOCIAL SECURITY BENEFIT AMOUNT NOT VALID FOR SSEB SCAMP PROCESSING.
0117	WORKER'S COMPENSATION REDUCTION AMOUNT NOT VALID FOR SSEB SCAMP PROCESSING.
0118	PUBLIC DISABILITY BENEFIT REDUCTION AMOUNT NOT VALID FOR SSEB SCAMP PROCESSING.
0119	DELAYED RETIREMENT CREDIT MONTHS NOT VALID FOR SSEB SCAMP PROCESSING.
0120	PUBLIC SERVICE PENSION AMOUNT NOT VALID FOR SSEB SCAMP PROCESSING.
0121	ANNUITANT'S OWN EMPLOYEE ANNUITY REDUCTION AMOUNT NOT VALID FOR SSEB SCAMP PROCESSING.
0122	STATUTORY SHARE/REDUCTION MAXIMUM RATE NOT VALID FOR SSEB SCAMP PROCESSING.

0123	SOLE SURVIVOR MINIMUM GUARANTY AMOUNT NOT VALID FOR SSEB SCAMP PROCESSING.
0124	RIB LIMIT/82 1/2% AMOUNT NOT VALID FOR SSEB SCAMP PROCESSING.
0125	DISABILITY FREEZE TERMINATION DATE NOT VALID FOR SSEB SCAMP PROCESSING.
0126	RETIREMENT/SURVIVOR INDICATOR NOT VALID FOR SSEB SCAMP PROCESSING.
0127	PIA INDICATOR INVALID FOR SSEB SCAMP PROCESSING.
0128	OM FORMULA BEING PAID; EE LESS THAN 62, NO DF, DATA NOT CONSISTENT FOR SCAMP PROCESSING.
0129	ATTAINMENT CASE BYPASSED (USED BY MECHANICAL SYSTEM ONLY - NOT USED BY SCAMP-ON-DEMAND).
0130	EE/SP INDICATOR INVALID FOR RETIREMENT PROCESSING.

I-100	TAX COMPUTATIONS	I-100
EXHIBIT 6	G-310	EXHIBIT 6
I-100	TAX COMPUTATIONS	I-100
EXHIBIT 6	G-310	EXHIBIT 6
I-100	TAX COMPUTATIONS	I-100
EXHIBIT 7	RL-515	EXHIBIT 7
I-100	TAX COMPUTATIONS	I-100
EXHIBIT 8	G-1009	EXHIBIT 8

### SUMMARY

The following table summarizes the EEC calculation. The compensation amounts shown are the maximum amounts. All the dollar amounts entered are for demonstration purposes only. The percentages will be used for every employee.



