



FROM THE DESK OF

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Federal Income Tax and Railroad Retirement Benefits

The following questions and answers describe the tax statements issued by the Railroad Retirement Board (RRB) each January for Federal income tax purposes. Railroad retirement beneficiaries needing information about these statements, or about tax withholding from their benefits, should contact an office of the RRB. For further Federal income tax information, railroad retirement beneficiaries should contact the nearest office of the Internal Revenue Service (IRS).

1. How are the annuities paid under the Railroad Retirement Act treated under the Federal income tax laws?

A railroad retirement annuity is a single payment comprised of one or more of the following components, depending on the annuitant's age, the type of annuity being paid, and eligibility requirements: a Social Security Equivalent Benefit (SSEB) portion of tier I, a Non-Social Security Equivalent Benefit (NSSEB) portion of tier I, a tier II benefit, a vested dual benefit, and a supplemental annuity.

In most cases, part of a railroad retirement annuity is treated like a social security benefit for Federal income tax purposes, while other parts of the annuity are treated like private pensions for tax purposes. Consequently, most annuitants are sent two tax statements from the RRB each January, even though they receive only a single annuity payment each month.

2. Which railroad retirement benefits are treated as social security benefits for Federal income tax purposes?

The SSEB portion of tier I (the part of a railroad retirement annuity equivalent to a social security benefit based on comparable earnings) is treated for Federal income tax purposes the same way as a social security benefit. The amount of these benefits that may be subject to Federal income tax, if any, depends on the beneficiary's income. (To determine if any amount of a SSEB benefit is taxable, please refer to IRS publication 915, *Social Security and Equivalent Railroad Retirement Benefits*.) If part of a SSEB benefit is taxable, how much is taxable depends on the total amount of a beneficiary's benefits and other income. Usually, the higher that total amount, the greater the taxable part of a beneficiary's benefit.

Generally, up to 50 percent of a beneficiary's benefits will be taxable. However, up to 85 percent of his or her benefits can be taxable if either of the following situations applies.

- The total of one-half of a beneficiary's benefits and all his or her other income is more than \$34,000 (\$44,000 if a beneficiary is married filing jointly).

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- A beneficiary is married filing separately and lived with his or her spouse at any time during the year.

3. Which railroad retirement benefits are treated like private pensions for Federal income tax purposes?

The NSSEB portion of tier I, tier II benefits, vested dual benefits, and supplemental annuities are all treated like private pensions for Federal income tax purposes. In some cases, primarily those in which early retirement benefits are payable to retired employees and spouses between ages 60 and 62, some occupational disability benefits, and other categories of unique RRB entitlements, the entire annuity may be treated like a private pension. This is because social security benefits based on age and service are not payable before age 62, social security disability benefit entitlement requires total disability, and the Social Security Administration does not pay some categories of beneficiaries paid by the RRB.

4. What information is shown on the railroad retirement tax statements sent to annuitants in January?

One statement, Form RRB-1099 for U.S. citizens or residents (or Form RRB-1042S for nonresident aliens), shows the SSEB portion of tier I or special minimum guaranty payments made during the tax year, the amount of any such benefits that an annuitant may have repaid to the RRB during the tax year, and the net amount of these payments after subtracting the repaid amount. The amount of any offset for workers' compensation and the amount of Federal income tax withheld from these payments are also shown. Illustrations and explanations of items found on Form RRB-1099 and Form RRB-1042S can be found in IRS Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*.

The other statement, Form RRB-1099-R (for both U.S. citizens and nonresident aliens), shows the NSSEB portion of tier I, tier II, vested dual benefit, and supplemental annuity paid to the annuitant during the tax year, and may show an employee contribution amount. **The NSSEB portion of tier I along with tier II are considered contributory pension amounts and are shown as a single combined amount in the Contributory Amount Paid box (Item 4) on the statement.** The vested dual benefit and supplemental annuity are considered noncontributory pension amounts and are shown as separate items on the statement. The total gross paid amount shown on Form RRB-1099-R is the sum of the NSSEB portion of tier I, tier II, vested dual benefit and supplemental annuity payments. Also shown is the amount of Federal income tax withheld from these payments. The statement also shows the amount of any of these prior year benefits repaid by the annuitant to the RRB during the tax year. This amount is not subtracted from the gross amounts shown because its treatment depends on the years to which the repayment applies and its taxability in those years. To determine the year or years to which the repayment applies, annuitants should contact the RRB. Illustrations and explanations of items found on Form RRB-1099-R can be found in IRS Publication 575, *Pension and Annuity Income*.

If the annuitant is taxed as a nonresident alien of the United States, Form RRB-1042S and/or Form RRB-1099-R will show the rate of tax withholding (0 percent, 15 percent or 30 percent) and

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country of residence for income tax purposes. Nonresident aliens may receive more than one set of original tax statement Forms RRB-1042S and/or RRB-1099-R in a tax year if there was a change in the country of residence for income tax purposes, or a change in the rate of income tax applied to annuity payments. Nonresident aliens who resided in the United States for part of a tax year may receive a set of original U.S. citizen tax statement Forms RRB-1099 and/or RRB-1099-R and one or more sets of nonresident alien tax statement Forms RRB-1042S and/or RRB-1099-R.

The total Medicare premiums deducted from the railroad retirement annuity may also be shown on either Form RRB-1099 (Form RRB-1042S for nonresident aliens) or Form RRB-1099-R. Medicare premiums deducted from social security benefits paid by the RRB, paid by a third party, or paid through direct billing are not shown on RRB-issued tax statements.

Copy B and/or Copy 2 of Form RRB-1099-R must be submitted with the annuitant's tax return. Annuitants should retain copy C of all statements for their records, especially if they may be required to verify their income in connection with other Government programs.

5. What is the significance of the employee contribution amount?

For railroad retirement annuitants, the employee contribution amount is considered the amount of railroad retirement payroll taxes paid by the employee that exceeds the amount that would have been paid in social security taxes if the employee's railroad service had been covered under the Social Security Act. The employee contribution amount is referred to by the IRS as an employee's investment, or cost, in the contract. An employee contribution amount is **not** a payment or income received during the tax year. Only employee and survivor annuitants may have an employee contribution amount shown in Item 3 of their Form RRB-1099-R.

The contributory amount paid (NSSEB portion of tier I and/or tier II) is considered income and is reported to the IRS. The contributory amount paid is either fully taxable or partially taxable depending on whether the employee contribution amount has been used to compute a tax-free (nontaxable) portion of the contributory amount paid. If **no** employee contribution amount is shown on Form RRB-1099-R, then the contributory amount paid is fully taxable.

The use and recovery of the employee contribution amount is important for annuitants since it affects the amount of taxable income to be reported on income tax returns. There is a tax savings advantage in using (recovering) employee contributions since it may reduce the taxability of the contributory amount paid and in turn the amount of taxable income.

Annuitants should refer to IRS Publication 575, *Pension and Annuity Income*, and Publication 939, *General Rule for Pensions and Annuities*, for more information concerning the tax treatment of the contributory amount paid (see questions 6 and 7 below) and use of the employee contribution amount.

6. If an employee contribution amount is shown on my Form RRB-1099-R, may I use the entire amount?

The employee contribution amount shown is attributable to the railroad retirement account number. This means that the employee contribution amount must be shared by all eligible annuitants under that same railroad retirement account number.

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If an employee contribution amount is shown on your Form RRB-1099-R and your annuity beginning date is July 2, 1986, or later, you may be able to use some or all of the employee contribution amount shown to compute the nontaxable (tax-free) amount of your contributory amount paid. Therefore, your contributory amount paid and total gross paid shown on your Form RRB-1099-R may be partially taxable.

If an employee contribution amount is **not** shown on your Form RRB-1099-R, you **cannot** use or share the employee contribution amount. Therefore, your contributory amount paid and total gross paid shown on your Form RRB-1099-R are fully taxable.

When more than one annuitant is or was entitled to a contributory amount paid under the same railroad retirement account number, any eligible annuitants may **not** use the entire employee contribution amount shown on their Form RRB-1099-R for themselves. They must first determine the amount of the total employee contribution amount they are individually entitled to use. That means determining:

1. The portion of the total employee contribution amount still potentially available for use, and
2. The portion of that amount that must be shared by those eligible annuitants currently receiving contributory amounts paid.

For example, a survivor family group consists of a widow and two full-time students. All three annuitants are eligible to use a portion of the employee contribution amount shown on their Forms RRB-1099-R. They must determine the portion of the employee contribution amount they may each use. Question 7 below provides general information on how to calculate this amount. For more specific information, annuitants should refer to IRS Publication 575, *Pension and Annuity Income*, and Publication 939, *General Rule for Pensions and Annuities*.

Any change in the total number of eligible annuitants receiving contributory amounts paid will affect the nontaxable amounts of these annuitants. **This change is retroactive to the date on which the number of eligible annuitants changed.** Any of these changes could potentially affect the taxable amounts reported to the IRS on prior year income tax returns. Annuitants should determine if any change would require them to file original or amended U.S. Federal income tax returns for prior tax years. For more specific information, annuitants should refer to IRS Publication 575, *Pension and Annuity Income*, and Publication 939, *General Rule for Pensions and Annuities*.

7. How are contributory and noncontributory pension amounts taxed?

Amounts shown on Form RRB-1099-R are treated like private pensions and taxed either as contributory pension amounts or as noncontributory pension amounts. The NSSEB portion of tier I and tier II (shown as the contributory amount paid on the statement) are contributory pension amounts. Contributory pension amounts may be fully taxable or partially taxable depending on the presence and use (recovery) of the employee contribution amount. Vested dual benefits and supplemental annuities are considered noncontributory pension amounts. Noncontributory pension amounts are always fully taxable and do not involve the use of the employee contribution amount.

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For annuitants with annuity beginning dates **before July 2, 1986**, the contributory amount paid is fully taxable. These annuitants **cannot** use the employee contribution amount, even if the amount is shown on Form RRB-1099-R, to compute a nontaxable amount of their contributory amount paid because their employee contribution amount has been fully recovered. Since the contributory amount paid is fully taxable, the total gross pension paid in Item 7 of Form RRB-1099-R is fully taxable.

For annuitants with annuity beginning dates from **July 2, 1986, through December 31, 1986**, the contributory amount paid may be partially nontaxable for the life of the annuity. These annuitants may be able to use some or all of the employee contribution amount to compute a nontaxable contributory amount paid. Once that nontaxable amount is computed, it does not need to be recomputed and can be used for each tax year unless there is a change in the employee contribution amount, annuity beginning date, date of birth used to determine life expectancy, or the number of eligible annuitants receiving contributory amounts paid. Therefore, the contributory amount paid in Item 4 and the total gross pension paid in Item 7 of Form RRB-1099-R may be partially taxable.

For annuitants with annuity beginning dates effective **January 1, 1987, and later**, the contributory amount paid may be partially nontaxable for a specified period of time based on life expectancy as determined by IRS actuarial tables. These annuitants may use some or all of the employee contribution amount to compute the nontaxable amount of their contributory amount paid. Once that nontaxable amount is computed, it does not need to be recomputed and can be used for each tax year unless there is a change in the employee contribution amount, annuity beginning date, date of birth used to determine life expectancy, or the number of eligible annuitants receiving contributory amounts paid. Therefore, the contributory amount paid in Item 4 and the total gross pension paid in Item 7 of Form RRB-1099-R may be partially taxable. **However, once the specified life expectancy is met, the employee contribution amount is considered fully recovered, and the contributory amount paid and total gross pension paid are both fully taxable.**

The contributory amounts paid of disabled employee annuitants **under** minimum retirement age are fully taxable and these annuitants **cannot** use the employee contribution amount. Therefore, the contributory amount paid in Item 4 and the total gross pension paid in Item 7 of Form RRB-1099-R are fully taxable. (Minimum retirement age is generally the age at which individuals could retire based on age and service, which is age 60 with 30 or more years of railroad service or age 62 with less than 30 years of railroad service.) **However, once the disabled employee annuitant reaches minimum retirement age, the annuitant may use the employee contribution amount shown on Form RRB-1099-R to compute the nontaxable amount of his or her contributory amount paid.**

The RRB does not calculate the nontaxable amount of the contributory amount paid for annuitants. Annuitants should contact the IRS or their own tax preparer for assistance in calculating the nontaxable amount of their contributory amount paid. For more information on the tax treatment of the contributory amount paid, vested dual benefits, supplemental annuities, the employee contribution amount, and how to use the IRS actuarial tables, annuitants should refer to IRS Publication 939, *General Rule for Pensions and Annuities*, and IRS Publication 575, *Pension and Annuity Income*.

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8. Does Form RRB-1099-R show the taxable amount of any contributory railroad retirement benefits or just the total amount of such benefits paid during the tax year?

Form RRB-1099-R shows the **total** amount of any contributory railroad retirement benefits (NSSEB and tier II) paid during the tax year. The RRB does **not** calculate the taxable amounts. It is up to the annuitant to determine the taxable and nontaxable (tax-free) amounts of the contributory amount paid using the employee contribution amount.

9. Can an employee contribution amount change?

Yes. The employee contribution amount shown on Form RRB-1099-R is based on the latest railroad service and earnings information available on the RRB's records. Railroad service and earnings information (and the corresponding employee contribution amount) often changes in the first year after an employee retires from railroad service. That is when the employee's final railroad service and earnings information is furnished to the RRB by his or her employer. As a result, the employee contribution amount shown on the most recent Form RRB-1099-R may have increased or decreased from a previously-issued Form RRB-1099-R.

Any change in an employee contribution amount is fully retroactive to the railroad retirement annuity beginning date. Therefore, the nontaxable amount of the contributory amount paid should be recomputed. This could affect the taxable amounts reported to the IRS on prior income tax returns. Generally, an increase in the employee contribution amount is advantageous, as it will yield a larger tax-free amount. However, a decrease in the employee contribution amount may be disadvantageous since it may result in an increased tax liability. In any case, annuitants should determine if any change in their employee contribution amount would require them to file original or amended Federal income tax returns for prior tax years.

10. What if a person receives social security as well as railroad retirement benefits?

Railroad retirement annuitants who also received social security benefits during the tax year receive a Form SSA-1099 (or Form SSA-1042S if they are nonresident aliens) from the Social Security Administration. They should add the net social security equivalent or special guaranty amount shown on Form RRB-1099 (or Form RRB-1042S) to the net social security income amount shown on Form SSA-1099 (or Form SSA-1042S) to get the correct total amount of these benefits. They should then enter this total on the Social Security Benefits Worksheet in the instructions for Form 1040 or 1040A to determine if part of their social security and railroad retirement social security equivalent benefits is taxable income.

Additional information on the taxability of these benefits can be found in IRS Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*.

11. Are the residual lump sums, lump-sum death payments or separation allowance lump-sum amounts paid by the RRB subject to Federal income tax?

No. These amounts are nontaxable and are not subject to Federal income tax. The RRB does not report these amounts on statements.

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12. If an annuity was due but unpaid at the time of an annuitant's death, it may be payable to another person. Would that person be subject to Federal income tax on this annuity?

Yes, if the deceased annuitant would have had to pay Federal income tax on the benefit. The taxable amount of the annuity is reported to the IRS and on Form RRB-1099 (or Form RRB-1042S) or Form RRB-1099-R, as appropriate, which is sent to the person who received the annuity.

13. Are Federal income taxes withheld from railroad retirement annuities?

Yes, and the amounts withheld are shown on the statements issued by the RRB each year. However, an annuitant may request that Federal income taxes not be withheld, unless the annuitant is a nonresident alien or a U.S. citizen living outside the 50 States or Washington, D.C.

Annuitants can voluntarily choose to have Federal income tax withheld from their SSEB payments. To do so, they must complete IRS Form W-4V, *Voluntary Withholding Request*, and send it to the RRB.

Annuitants who are taxed as U.S. citizens and who do not live outside the 50 States or Washington, D.C., and wish to have Federal income taxes withheld from their NSSEB and tier II (contributory amount paid), vested dual benefit, and supplemental annuity payments must complete a tax withholding election on Form RRB W-4P, *Withholding Certificate For Railroad Retirement Payments*, and send it to the RRB. An annuitant is **not** required to file Form RRB W-4P. If that form is not filed, the RRB will withhold taxes only if the combined portions of the NSSEB and tier II (contributory amount paid), vested dual benefit and supplemental annuity payments are equal to or exceed an annual threshold amount. In that case, the RRB withholds taxes as if the annuitant were married and claiming three allowances.

14. How is tax withholding applied to the railroad retirement benefits of nonresident aliens?

A nonresident alien is a person who is neither a citizen nor a resident of the United States. Under the Internal Revenue Code, nonresident aliens are subject to a 30-percent tax on income from sources within the United States not connected to a U.S. trade or business. The 30-percent rate applies to all annuity payments exceeding social security equivalent payments and to 85 percent of the annuity portion treated as a social security benefit. The Internal Revenue Code also requires the RRB to withhold the tax. The tax can be at a rate lower than 30 percent or can be eliminated entirely if a tax treaty between the United States and the country of residence provides such an exemption, and the nonresident alien completes and sends Form RRB-1001, *Nonresident Questionnaire*, to the RRB. Form RRB-1001 secures citizenship, residency and tax treaty claim information for nonresident beneficiaries (nonresident aliens or U.S. citizens residing outside the United States).

Form RRB-1001 is sent by the RRB to nonresident aliens every three years to renew the claim for a tax treaty exemption. **Failure by a nonresident alien to complete Form RRB-1001 will cause loss of the exemption until the exemption is renewed.** Such renewals have no retroactivity. Also, a nonresident alien must include his or her United States taxpayer identifying number on Form RRB-1001. Otherwise, any tax treaty exemption claimed on the form is not valid. The majority of nonresident aliens receiving annuities from the RRB are citizens of Canada, which has a tax treaty with the United States.

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If a Canadian citizen claims an exemption under the tax treaty, no tax is withheld from the SSEB portion of tier I and a tax withholding rate of 15 percent is applied to the benefit portions treated like pension payments.

Additional information concerning the taxation of nonresident aliens can be found in IRS Publication 519, *U.S. Tax Guide for Aliens*.

15. Are unemployment benefits paid under the Railroad Unemployment Insurance Act subject to Federal income tax?

All unemployment benefit payments are subject to Federal income tax. Each January, the RRB sends Form 1099-G to individuals, showing the total amount of railroad unemployment benefits paid during the previous year.

16. Are sickness benefits paid by the RRB subject to Federal income tax?

Sickness benefits paid by the RRB, except for sickness benefits paid for on-the-job injuries, are subject to Federal income tax under the same limitations and conditions that apply to the taxation of sick pay received by workers in other industries. Each January, the RRB sends Form W-2 to affected beneficiaries. This form shows the amount of sickness benefits that each beneficiary should include in his or her taxable income.

17. Does the RRB withhold Federal income tax from unemployment and sickness benefits?

The RRB withholds Federal income tax from unemployment and sickness benefits only if requested to do so by the beneficiary. A beneficiary can request withholding of 10 percent of his or her unemployment benefits by filing IRS Form W-4V, *Voluntary Withholding Request*, with the RRB. A beneficiary can request withholding from sickness benefits by filing IRS Form W-4S, *Request for Federal Income Tax Withholding from Sick Pay*.

18. Are railroad retirement and railroad unemployment and sickness benefits paid by the RRB subject to State income taxes?

The Railroad Retirement and Railroad Unemployment Insurance Acts specifically exempt these benefits from State income taxes.

19. Can a railroad employee claim a tax credit on his or her Federal income tax return if the employer withheld excess railroad retirement taxes during the year?

If any one railroad employer withheld more than the annual maximum amount, the employee must ask that employer to refund the excess. It cannot be claimed on the employee's return.

20. Can a railroad employee working two jobs during the year get a tax credit if excess retirement payroll taxes were withheld by the employers?

Railroad employees who also worked for a nonrailroad social security covered employer in the same year may, under certain circumstances, receive a tax credit equivalent to any excess social security taxes withheld.

Employees who worked for two or more railroads during the year, or who had tier I taxes withheld from their RRB sickness benefits in addition to their railroad earnings, may be eligible for a tax credit of any excess tier I or tier II railroad retirement taxes withheld. The amount of tier I taxes withheld

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from sickness benefits paid by the RRB is shown on Form W-2 issued to affected beneficiaries. Employees who had tier I taxes withheld from their supplemental sickness benefits (benefits paid under an RRB-approved nongovernmental sickness insurance plan, such as a supplemental sickness benefit plan established by a railroad) may also be eligible for a tax credit of any excess tier I tax.

Such tax credits may be claimed on an employee's Federal income tax return.

Employees who worked for two or more railroads, received sickness benefits, or had both railroad retirement and social security taxes withheld from their earnings should see IRS Publication 505, *Tax Withholding and Estimated Tax*, for information on how to figure any excess railroad retirement or social security tax withheld.

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