U.S. Railroad Retirement Board
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Legal Opinion L-2005-18
July 15, 2005

TO : Marie Leeson
Chief of Calculation Analysis and Systems
Through: Ronald Russo
Director of Policy and Systems

FROM : Steven A. Bartholow
General Counsel

SUBJECT : Treatment of Royalties for Work Deduction Purposes

This is in reply to your inquiry regarding the treatment of royalties in work deduction cases. You noted that current agency procedure in the Retirement Claims Manual (RCM) provides that "royalties, to the extent that they flow from property created by the person's own efforts, are not counted as earnings." You asked whether this procedure should be modified to be consistent with Social Security regulations and procedure governing the treatment of royalties in work deduction cases.

You advised that section 404.429(b)(2)(i) of the social security regulations (20 CFR 404.429(b)(2)(i)) indicated that royalties should be excluded for excess earnings purposes if the beneficiary has attained age 65.[1] In addition, you pointed out that section RS 02505.060 of the Social Security Administration's Program Operations Manual also provides that royalties attributable to a copyright or patent obtained by the beneficiary before attainment of age 65 are excluded from gross earnings if the individual concerned has attained age 65.

For the reasons explained below, it is my opinion that the agency's procedure should be modified to specify that for an annuitant who has attained retirement age, royalties, to the extent that they flow from property created by the annuitant prior to the taxable year in which he or she attained retirement age, are not counted as earnings.

Section 2(f)(1) of the Railroad Retirement Act (45 U.S.C. § 231a(f)(1)) provides that the tier I portion of an employee's railroad retirement annuity and a vested dual benefit shall be subject to work deductions under section 203 of the Social Security Act (42 U.S.C. § 403) in the same manner as benefits under that Act are subject to work deductions. The Railroad Retirement Act thus directs that we look to the Social Security Act in the assessment of work deductions.

The section of the Social Security Administration's regulations cited in your inquiry, section 404.429(b)(2)(i), was originally published as a final rule on October 20, 1982 (47 F.R. 46690). Background information published with the final rule stated that the final regulations were being issued to implement three sections of Public Law (P.L.) 96-473. P.L. 96-473 had been enacted on October 19, 1980 for the purpose of eliminating some unintended and harsh effects of the limitations on the use of the

[1] Section 404.429(b)(2)(i), 20 CFR 404.429(b)(2)(i) (2004), provided that:

"An individual who has attained age 65 on or before the last day of his or her taxable year shall have excluded from his or her gross earnings from self-employment, royalties attributable to a copyright or patent obtained before the taxable year in which he or she attained age 65 if the copyright or patent is on property created by his or her own personal efforts * * *."

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monthly earnings test imposed by the Social Security Amendments of 1977. Prior to 1977, two tests were used to determine the amount of benefits payable for each year, an annual earnings test and a monthly earnings test. Use of the monthly earnings test sometimes resulted in beneficiaries who earned the same amount of income in a given year receiving different total annual benefits because of differences in their work patterns. In order to correct this inequity, the Social Security Amendments of 1977 eliminated the monthly earnings test except for the first taxable year in which a beneficiary has a non-service month in or after the month of entitlement to Social Security benefits. The monthly earnings test in effect before 1978 allowed a self-employed beneficiary to receive a benefit for any month in which he or she did not render substantial services in self-employment and did not earn over the applicable monthly limit in wages, regardless of total yearly earnings. A threshold of 45 hours of work per month was the primary test used to determine whether an individual had engaged in substantial services. The 1977 elimination of the monthly earnings test affected, among certain other groups, persons who received income from their businesses after their initial month of entitlement but performed little or no work, such as retired partners who received a distributive share of the partnership income after retirement. Under the monthly earnings test before 1978, retired partners receiving such payments could receive Social Security benefits for any month in which they did not perform substantial services. With the elimination of the substantial services test under the 1977 provisions, the payments to such retired partners resulted, in many cases, in partial or complete loss of benefits.

Section 3 of Public Law 96-473 relieved problems caused by the 1977 amendments by providing that, for purposes of the earnings test, income received in a year after the initial year of entitlement to social security benefits (other than disability or childhood disability benefits) that is not attributable to service performed after the month in which the beneficiary initially became entitled to social security benefits shall be excluded from gross income. Section 3(a) of P.L. 96-473 dealt specifically with royalties, amending section 203(f)(5)(D) of the Social Security Act to read as follows:

> (D) In the case of –
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> (i) an individual who has attained the age of 65 on or before the last day of the taxable year, and who shows to the satisfaction of the Secretary that he or she is receiving royalties attributable to a copyright or patent obtained before the taxable year in which he or she attained such age and that the property to which the copyright or patent relates was created by his or her own personal efforts, or
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> (ii) an individual who has become entitled to insurance benefits under this title, other than benefits under section 223 or benefits payable under section 202(d) by reason of being under a disability, and who shows to the satisfaction of the Secretary that he or she is receiving, in a year after his or her initial year of entitlement to such benefits, any other income not attributable to services performed after the month in which he or she initially became entitled to such benefits, there shall be excluded from gross income any such royalties or other income.

In 1983, the phrase “retirement age (as defined in section 216(l))” was substituted for the phrase “the age of 65”. **See** Public Law 98-21, section 201(c)(1)(B), 97 Stat. 109, as amended by Public Law 98-369, section 2662(c)(1), 98 Stat. 1159. Section 404.429(b)(2)(i) of the Social Security regulations, which referred to “the age of 65”, has just been amended, effective June 20, 2005, to reflect the statutory amendment. **See** 70 Fed. Register, No. 96, pp. 28809 – 28815, May 19, 2005. That regulation now provides that:

> (2) For the sole purpose of the earnings test under this subpart –

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(i) If you reach full retirement age, as defined in Sec. 404.409(a), on or before the last day of your taxable year, you will have excluded from your gross earnings from self-employment, your royalties attributable to a copyright or patent obtained before the taxable year in which you reach full retirement age.

As noted earlier in this discussion, section 2(f)(1) of the Railroad Retirement Act expressly provides that work deductions for a railroad retirement annuitant shall be assessed under section 203 of the Social Security Act. It is therefore my opinion that the RCM should be amended to conform to the provisions of section 203 (f)(5)(D) of the Social Security Act.