August 18, 1997
L-97-30

**TO** **:** Peter A. Larson
Chief Financial Officer

**FROM** **:** Catherine C. Cook
General Counsel

**SUBJECT** **:** Back Pay Reporting of Class Action Settlement Miscellaneous Compensation

This is in reply to your memorandum of July 28, 1997, regarding the reporting of back pay as miscellaneous compensation.

You advise that in June 1993, the Illinois Central Railroad ("IC")settled a class action law suit filed on the basis that the IC had wrongfully rejected a class of minorities for employment. Part of the settlement proceeds were denominated as "back pay." The IC withheld railroad retirement taxes from that amount and reported one month of creditable service and compensation. None of the class members ever had an employment relationship with the IC.

The IC now believes that the payment of taxes on this amount and the reporting of service and compensation were in error. It has filed a report to eliminate the month of service and compensation reported for each individual, and has requested a refund of the taxes paid from the Internal Revenue Service.

In view of the absence of an employment relation, the crediting of the service month and tier II compensation is clearly in error. In regard to the reporting of the payment as tier I compensation, section 211.11 of the Board's regulations provides that:

> Any payment made to an employee by an employer which is excluded from compensation under the Railroad Retirement Act, but which is subject to taxes under the Railroad Retirement Tax Act, shall be considered compensation for purposes of this part but only for the limited purpose of computing the portion of the annuity computed under section 3(a), 4(a), or 4(f) of the Railroad Retirement Act (commonly called the tier I component).

The RRB will not make an independent ruling on the taxability of payments, since that issue is within the jurisdiction of the Internal Revenue Service. If taxes under the Railroad Retirement Tax Act have been paid based on the payments in question, then those payments qualify as payments which have been subject to taxes under the Railroad Retirement Tax Act as stated in the regulation.

The wording of section 211.11, which specifies a payment made to an employee by an employer, would seem to require an employer-employee relationship. However, the statutory provision on which the regulation is based (section 410(a) of the Railroad Retirement Solvency Act, Pub. L. 98-76, which added subsection (h)(8) to section 1 of the Railroad Retirement Act), was analyzed in Legal Opinion L-88-108 as follows.

> * * * With its enactment the definition of compensation under the RRA has taken on a much broader meaning. A payment which was excluded from compensation by virtue of other provisions in the RRA or which did not meet the definition of compensation under the agency's traditional interpretation of section 1(h) now must be considered compensation for tier I purposes if RRTA taxes have been paid with respect to that payment.

Since tier I taxes have been paid in regard to the payments in question, it follows that they should be credited as miscellaneous compensation. This result seems to me reasonable in view of the alternative, which is that the taxes would have been paid under the Railroad Retirement Tax Act but no credit granted under either the Railroad Retirement Act or the Social Security Act. If the Internal Revenue Service should refund the taxes paid attributable to these payments, then those payments would not be creditable as miscellaneous compensation.