

L-99-10
September 17, 1999

TO : Peter A. Larson
Director of Fiscal Operations

FROM : Steven A. Bartholow
General Counsel

SUBJECT : Request for Legal Opinion - Productivity Fund Buyout
Payments Involving Partial RRTA Refund

This is in response to your memorandum dated July 19, 1999, requesting legal advice on a variety of issues related to productivity fund buyout payments by a class I railroad.

The background provided indicates that in 1991, the employer and union reached an agreement to buy out employees' rights and eliminate future payments to a productivity fund for a payment of \$60,000 to employees who elected to participate. Front-end payments of \$20,000 were paid to employees upon election of the buyout, with back-end payments of \$40,000 payable at the time the employee resigned, retired or died. In 1994 the employer filed a Claim for Refund with the Internal Revenue Service (IRS) for calendar years 1991, 1992, and 1993, arguing that productivity fund buyout payments were made in exchange for the relinquishment of contract rights and were not compensation for services under the Railroad Retirement Tax Act (RRTA). The IRS initially denied the claim for refund, but eventually settled with the employer based on hazards of litigation and refunded 33 1/3% of the RRTA taxes paid by both the employer and employees based upon a formula which took into consideration both the front-end and back-end payments. The settlement provided that no additional RRTA taxes would be withheld with respect to the \$40,000 back-end payments made after September 1998. The back-end payments will be treated as nonqualified deferred compensation earned at the time the employee made his or her election to participate in the buy-out. Presumably, at this point, the employee had no substantial risk of forfeiture of the back-end payment. See

26 U.S.C. 3231(e)(8).

You inquire whether the productivity fund buyout payments are creditable Tier I and Tier II compensation under the Railroad Retirement/Railroad Unemployment Insurance Acts (RRA/RUIA). Section 1(h) of the RRA (45 U.S.C. 231(h)) generally defines compensation as any form of money remuneration paid to an employee for services rendered. Section 1(i)(1) of the RUIA (45 U.S.C. 351(i)(1)) contains a substantially identical definition as does section 3231(e) of the RRTA (26 U.S.C. 3231(e)). In L-82-176 we noted that the definitions of compensation under the RRA, RUIA and the RRTA are substantially similar and should be read in tandem. It is my opinion that the statutory definitions of compensation referenced above are broad enough to include the productivity buyout payments at issue.

You next question whether the employer is required to file adjustment reports, Form BA-4, due to the refund of RRTA taxes. Adjustment reports are not necessary for the front-end payments. Although the employer was provided a partial refund of RRTA taxes, the refund was made pursuant to a settlement with the IRS based on *hazards of litigation*. The IRS never conceded that the productivity buyout payments did not constitute compensation under the RRTA. Consequently, adjustment reports are not needed. However, it would appear that adjustments reports might be necessary for some back-end payments which the employer reported as compensation when paid. As we understand the agreement between the employer and IRS, the back-end payments were considered compensation only at the time of no substantial risk of forfeiture, which is at the time the front-end payments were elected, not at the time the back-end payments were actually made. Whether back-end payments should be removed from compensation should be determined by reference to section 211.16 of the Board's regulations which generally limits corrections to records of compensation to within 4 years after they were required to be reported.

Question three requests guidance as to the effect of the settlement between the employer and the IRS on the financial interchange system between the Railroad Retirement Board and the Social Security Administration (SSA). To answer this question we must postulate how SSA would treat the same set of facts with respect to an employer covered under the Social Security Act. It is my opinion that there would be no effect on the interchange. As noted previously, the IRS did not concede that the productivity buyout payments are not compensatory. It is my opinion that the productivity fund payments would be treated as wages by SSA in the same manner as we have suggested they be treated under the RRA.

Finally, you inquire as to whether the settlement has any effect on the payment of annuities to participating employees who have subsequently retired. Receipt of the back-end payments would have no effect on annuities because, as noted earlier, they are not compensation when paid. Likewise, there are no adjustments to be made with respect to the front-end payments. However, some adjustments may be required with respect to the back-end payments reported as compensation at time of payment. Such an adjustment could affect the computation of an employee's annuity.

cc: Chief Financial Officer
Chief Actuary