U.S. Railroad Retirement Board
844 North Rush Street
Chicago Illinois, 60611-2092

Phone: (312) 751-7139
TTY: (312) 751-4701
Web: http://www.rrb.gov

# Legal Opinion L-2006-05
# February 10, 2006

TO : Ronald Russo
Director of Policy and Systems
Office of Programs

FROM : Steven A. Bartholow
General Counsel

SUBJECT : Limited Liability Company Member - Investor
Disability Work Deductions

This is to advise you, in response to a request referred to my Office by a member of your staff, of my opinion as to whether any or all of the income received by the subject annuitant as a member of a Limited Liability Company (LLC) constitutes earnings for purposes of the $400 per month earnings limitation imposed on disability annuities under the Railroad Retirement Act. As discussed below, in my opinion, to the extent evidence establishes that the income is solely a return on his investment, paid without performing services, the disability annuitant may continue to receive an annuity without incurring the deduction. A copy of this memorandum has also been sent directly to the inquirer.

The inquiry concerns an individual who receives a disability annuity under section 2(a)(1)(iv) of the Railroad Retirement Act (45 U.S.C. § 231a(a)(1)(iv)). The annuitant's wife runs a business in partnership with another individual. The disability annuitant wishes to buy out the unrelated partner's share in the business, which will then form as a LLC, electing taxation as a partnership under the regulations of the Internal Revenue Service (IRS). It is intended that the wife will continue to run the business. The disability annuitant, while remaining a member of the company under relevant State limited liability company law, will participate as a financial "partner" only, and will not perform any services to the business.

A disability annuitant is subject to an earnings limitation imposed by section 2(e)(4) of the Railroad Retirement Act (45 U.S.C. § 231a(e)(4)). That section requires that no annuity be paid for any month in which a disability annuitant earns over $400, if the annuitant earns over $4,800 in that calendar year. The limitation applies to both wages earned as an employee in non-railroad employment, and to earnings from self-employment.

I have previously advised that income to a member of a LLC will conform to the election by the LLC to be accorded tax treatment as a partnership or as a corporation. See Legal Opinions L-2000-8 (income from LLC for purposes of work deductions assessed by section 2(f)(1) against retirement and survivor annuities) and L-2002-10 (income from LLC for purposes of determining last non-railroad employer and to determine continuation of a "current connection" with railroad employment). Consequently, if any payment to the disability annuitant would be considered earnings paid to a "partner", then that payment would also be earnings for purposes of the $400 monthly earnings limitation imposed by RRA section 2(e)(4).

For purposes of the $400 limitation, the Board considers income to be earned in employment if it constitutes "wages" as defined by section 209 of the Social Security Act (SS Act) (42 U.S.C. § 409). Income will be considered earned from self employment if it meets the definition of earnings from self-employment of section 211 of the Social Security Act (42 U.S.C. § 411). Regulations of the Internal Revenue Service, issued for purposes of assessing the tax on self-employment under the parallel provision of the Internal Revenue Code (26 U.S.C. § 1401),

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generally define earnings from self-employment to include an individual's "distributive share (whether or not distributed) * * * from any trade or business carried on by any partnership of which he is a member." 26 CFR 1.1402(a)-1(a). That regulation further specifically provides that income from a trade or business:

> * * * includes payments received by him from a partnership of which he is a member for services rendered to the partnership or for the use of capital by the partnership, to the extent the payments are determined without regard to the income of the partnership. * * *

Income from the LLC to the disability annuitant may be reportable as self-employment income under section 211 of the SS Act, even if "for use of capital". However, the purpose of SS Act section 211 and section 1401 of the Internal Revenue Code, differ from the purpose of RRA section 2(e)(4).

The SS Act and IRC sections define which earnings will establish credit toward benefits, while section 2(e)(4) limits the amount of benefits to annuitants capable of working. Prior opinions of the General Counsel have therefore recognized that income reported as earnings, but not received for services performed in a trade or business, will not constitute earnings when applying the earnings restriction provisions of the RRA. See Legal Opinion L-2000-35 (holding income from sale of inventory at close of business to be sale of assets rather than earnings).

The Social Security Administration applies a similar rule when determining whether a beneficiary under the Social Security Act is subject to the earnings restriction imposed by section 203 of that Act (42 U.S.C. 403). Regulations issued under the SS Act allow a beneficiary to exclude from gross earnings, for purposes of section 203 only, any self-employment income that is not attributable to any significant work activity performed in the operation or management of a trade, profession, or business which can be related to the income received. See: 20 CFR 404.429(b)(2)(ii), as amended, 70 Fed. Reg. 28809, 28812 (May 19, 2005). Income is presumed to be earnings for limitation purposes until the beneficiary shows the contrary based on satisfactory evidence. Id. Satisfactory evidence that services are not significant would be evidence that services are taken to protect an investment in an operating business and are too irregular, occasional or minor to have a bearing on the income which the beneficiary receives from the business. See 20 CFR 404.429(b)(3)(ii), 70 Fed. Reg. 28812.

The criteria specified by the Social Security Administration for use under section 203 of the SS Act illustrate a useful framework to determine whether income constitutes earnings under RRA section 2(e)(4) as well. Accordingly, if the disability annuitant in this case receives income as a member of the Limited Liability Company formed with his wife, he may continue to receive his disability annuity without deductions imposed by section 2(e)(4) of the Railroad Retirement Act if he establishes by satisfactory evidence that he performs no significant services to the business.