



Legal Opinion L-2001-05
March 1, 2001

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TO : Nancy Z. Marks
Chief of Calculation Analysis and Systems
Through: Ronald Russo
Director of Policy and Systems

FROM : Steven A. Bartholow
General Counsel

SUBJECT : Employee Work Deductions- Prizes, Awards, and Gratuities

This is in response to your memorandum dated December 26, 2000, wherein you asked two questions about the treatment of wages received in the form of a prize, award or a gratuity. In the case at issue an employee annuitant received a trip to Germany from his non-railroad employer. He received a Form 1099-Misc from his employer for the value of this trip. The employee reported the value of the trip as self-employment income on his tax return. The Social Security Administration reported this amount as self-employment income.

Your first question is how this self-employment income should be treated for purposes of work deductions under section 2(f)(1) of the Railroad Retirement Act (45 U.S.C. § 231a(f)(1)). That section provides that a portion of the railroad retirement annuity 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. According to a memorandum of the Reconsideration Specialist dated December 4, 2000, the Social Security procedure (RS 02505.240, number 56) provides that prizes, awards, and gratuities are not earnings for work deduction purposes when the prize is not part of the wage structure of the employee. In this case, the evidence is quite clear that the prize was not part of the wage structure of the annuitant.

Since work deductions under the Railroad Retirement Act are to be made in the same manner as they are made under the Social Security Act, I agree with your conclusion that the value of the prize should not be included in the earnings of the annuitant for work deduction purposes.

Your second question concerns the treatment of the value of the prize for recomputation of the Tier 1 annuity component. The Tier 1 annuity component is computed under section 3(a)(1) of the Railroad Retirement Act (45 U.S.C. § 231b(a)(1)). That section provides that the Tier 1 annuity component is equal to the amount that would be payable under the Social Security Act if all of the employee's earnings under the Railroad Retirement Act had been creditable under the Social Security Act.

Therefore, if the Social Security Administration would use the value of the prize to compute or recompute a social security benefit, then the value of the prize should be used to compute or recompute a Tier 1 annuity component. According to the evidence currently in file, the value of the prize was reported as self-employment income by the annuitant on his income tax return. The annuitant also states that he paid all relevant taxes on the value of the prize. Therefore, it appears that he paid the relevant FICA tax on the value of the prize. The value of the prize would then be used to compute or recompute a social security benefit, and the value of the prize should also be used to compute or recompute the amount of the Tier 1 annuity component.