

**DESCRIPTION OF A CHAIRMAN'S MARK OF THE
"RAILROAD RETIREMENT AND SURVIVORS'
IMPROVEMENT ACT OF 2000"
(H.R. 4844)**

Scheduled for Markup

by the

SENATE COMMITTEE ON FINANCE

on September 27, 2000

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION



September 25, 2000
JCX-101-00

CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
II. EXPLANATION OF THE BILL	2
A. Amendments to the Railroad Retirement Act of 1974	2
1. Structure and administration of railroad employee benefit system	2
2. Increased railroad retirement benefits	3
B. Amendments to the Internal Revenue Code of 1986	6

I. INTRODUCTION

This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of a Chairman's Mark of the "Railroad Retirement and Survivors' Improvement Act of 2000" (H.R. 4844)². The Senate Finance Committee has scheduled a markup of the proposal on September 27, 2000.

¹ This document may be cited as follows: Joint Committee on Taxation, *Description of a Chairman's Mark of the "Railroad Retirement and Survivors' Improvement Act of 2000"* (H.R. 4844) (JCX-101-00), September 25, 2000.

² H.R. 4844 was passed by the House on September 7, 2000. For legislative history, see H.R. Rept. No. 106-777. Parts I and II.

II. EXPLANATION OF THE BILL

A. Amendments to the Railroad Retirement Act of 1974

1. Structure and administration of railroad employee benefit system

Present Law

The Railroad Retirement Board is the Federal agency responsible for the administration of the Federal employment benefits system earned through railroad industry employment. It is headed by a three-member governing board that oversees its operations. The railroad retirement system provides retirement, disability and survivor benefits to qualifying individuals.³ Generally, a qualifying individual is any eligible individual with at least ten years of railroad service and the individual's spouse and dependents. The system, funded primarily by payroll taxes on covered employers and employees, includes a benefit roughly equivalent to Social Security (the "tier 1" benefit), an additional benefit similar those allowed in some private defined benefit pension plans (the "tier 2" benefit), and certain other benefits. Amounts received into the railroad retirement system are held in Federal accounts (primarily in the railroad retirement account) within the Federal Treasury until needed to pay benefits. The money in these accounts is invested in special interest-bearing Treasury obligations.

Description of Proposal

Railroad Retirement Investment Trust

The proposal would create a new railroad retirement investment trust (the "Trust"). The proposal would provide that the Trust is a private entity and not a department, agency, or instrumentality of the Federal government. The Trust would be organized in the District of Columbia and would be governed by a seven-member board of trustees.⁴ The board would independently manage and invest the assets of the Trust. Five members of the board would comprise a quorum and, with the exception of the adoption of investment guidelines, which must be by a unanimous vote of the trustees, all decisions would be made by a majority vote. The board of trustees would: (1) retain independent advisers to assist it in the formulation and adoption of its investment guidelines; (2) retain independent investment managers to invest the assets in a manner

³ The railroad unemployment insurance system also provides uniform unemployment insurance to covered employees.

⁴ The board of trustees would be comprised of the following seven members: (1) three representing the interests of labor; (2) three members representing the interests of management; and (3) one member representing the interests of the general public. The three members of the Railroad Retirement Board would not be eligible to serve on the board of trustees. The term of each member of the board of trustees would be three years, but the initial members would have staggered terms.

consistent with board guidelines; (4) pay administrative expenses of the Trust from the money in the Trust; and (5) transfer money to the disbursing agent to pay benefits and administrative expenses related to those benefits. The board would be subject to fiduciary standards similar to those applicable to pension fund fiduciaries under the Employment Retirement Income Security Act of 1974, as amended. The Railroad Retirement Board would enforce these standards.

The Trust's financial statements would be audited by an independent qualified public accountant. The Trust would be required to provide an annual management report to Congress about the operations and financial condition of the Trust.

Transfers to the Trust

Upon the creation of the Trust, the Railroad Retirement Board shall direct the Secretary of the Treasury to transfer to the Trust (1) the portion of the railroad retirement account which is not needed to pay current administrative expenses; and (2) the portion of the Social Security equivalent benefit account⁵ which is not needed to pay current benefits. The Board of Trustees for the Trust would consult with the Secretary of the Treasury to develop an appropriate method of transferring or converting existing obligations held by the accounts.

Effective Date

The provisions generally would be effective on the date of enactment.

2. Increased railroad retirement benefits

Present Law

Annuity benefits for widows and widowers

The railroad retirement system, funded primarily by payroll taxes on covered employers and employees, provides a benefit roughly equivalent to Social Security (the "tier 1" benefit), an additional benefit similar to those allowed in some private defined benefit pension plans (the "tier 2" benefit) and certain other benefits. The spouse of a deceased railroad employee may be eligible for any of these benefits.⁶ A widow's or widower's tier 1 benefit generally equals the

⁵ The Social Security equivalent benefit account annually receives amounts from or pays amounts to the Social Security trust funds based upon a hypothetical calculation which assumes railroad employment had been directly covered by Social Security.

⁶ Generally, the benefits for the surviving spouse are calculated with reference to the railroad retirement benefit for the deceased employee at the date of death before any benefit reductions required under the Railroad Retirement Act, the Social Security Act, and any public service pension.

amount of the deceased employee's tier 1 benefits on the date of death.⁷ Tier 2 benefits for the widow or widower, however, are limited to one-half of the deceased employee's tier 2 benefits on the date of death.⁸

Retirement age

Generally, an employee aged 60 with 30 years of service may retire and collect full tier 2 benefits. However, tier 1 benefits for an employee with 30 years of service are actuarially reduced for retirement before age 62. This actuarial reduction did not apply prior to 1984.

Vesting requirements

Under present law (both tier 1 and tier 2), an employee must have 10 years of covered service to be vested in the railroad retirement system.

Railroad retirement maximum benefit

Present law limits the total amount of monthly railroad retirement benefits (tier 1 and tier 2) payable to an employee and an employee's spouse at the time the employee's annuity payout begins. The maximum benefit is based on the highest two years of creditable railroad retirement or social security covered earnings in the 10-year period ending with the year the employee's annuity payout begins.

Description of Proposal

Annuity benefits for widows and widowers

Generally, the proposal would increase tier 2 benefits for widows and widowers to 100 percent of the deceased employee's benefits on the date of death. When coupled with the present law tier 1 benefit for widows and widowers, the proposal would provide widows and widowers essentially the same benefit as that payable to the railroad employee prior to death.

Retirement age

The proposal would reduce the age at which full tier 1 retirement benefits are payable to an individual with 30 years service to 60.

⁷ These amounts are indexed for inflation annually.

⁸ These amounts are indexed for inflation annually.

Vesting requirements

The proposal would reduce the years of covered service to be vested in the railroad retirement system from the present 10 years to 5 years. For this purpose, employees with less than 10 years of railroad employment before 1996 would have to meet either the 10-year vesting requirement or have 5 years of post-1995 railroad service to be vested.

Railroad retirement maximum benefit

The proposal would repeal the present-law maximum limit on monthly railroad retirement benefits.

Effective Date

The provision related to the expansion of tier 2 benefits to widows and widowers generally would be effective on January 1, 2001, and would apply to annuity amounts accruing after December 31, 2000. The provision related to the elimination of the actuarial reduction in tier 1 benefits generally would be effective for annuities that begin to accrue on or after January 1, 2001. The provision relating to the faster vesting requirement would be effective on January 1, 2001. The provision relating to the repeal of the railroad retirement maximum benefit would be effective on January 1, 2001, and would apply to annuity amounts accruing for months after December 31, 2000.

B. Amendments to the Internal Revenue Code of 1986

Present Law

Under present law, tier 2 railroad retirement benefits are funded primarily through a tier 2 payroll tax. Present law also imposes a supplemental annuity tax, which is used to finance supplemental annuity benefits, as well as some tier 2 benefits.

Tier 2 payroll taxes⁹

Present law imposes a tier 2 payroll tax on railroad employers, employees, and employee representatives. The tax on employers is equal to 16.1 percent of covered compensation. The employee-level tax is equal to 4.9 percent of covered compensation.¹⁰ The tier 2 tax on railroad employee representatives is equal to 14.75 percent of covered compensation.

The maximum amount of compensation taken into account for tier 2 payroll tax purposes is \$56,700 (for 2000).

Supplemental annuity tax

A cents-per-hour tax is imposed on railroad employers and employee representatives to fund supplemental annuity benefits. The rate of tax is determined quarterly by the Railroad Retirement Board based on the level necessary to fund current benefits, plus administrative costs. The current rate of tax is 26.5 cents per hour. Special rules apply in the case of an employer with respect to employees covered by a supplemental pension plan established pursuant to collective bargaining.

Description of Proposal

In general

The proposal would: (1) lower the tier 2 payroll tax rates for employers and employee representatives in 2001 and 2002 and provide a modified method of calculating the rate of all tier 2 taxes after 2002; (2) repeal the supplemental annuity tax; and (3) provide tax-exempt status for the Trust created by the proposal described in A.1., above.

⁹ Present law also imposes a tier 1 tax on railroad employers, employees, and employee representatives. This tax is essentially equivalent to Social Security taxes, and is used primarily to fund tier 1 benefits, which are essentially equivalent to Social Security benefits.

¹⁰ Like tier 1 and Social Security taxes, the employee-level tier 2 tax is deducted from the employee's compensation and remitted by the employer.

Payroll taxes

The proposal would lower the tier 2 tax rate on employers to 15.60 percent of covered compensation in 2001 and 14.20 percent in calendar year 2002. The proposal would lower the tier 2 tax rate for employee representatives to 14.75 percent of covered compensation in 2001 and 14.20 percent in calendar year 2002. The proposal would not change the tier 2 tax on employees for 2001 and 2002.

Beginning in calendar year 2003, the proposal would provide for automatic modifications in the tier 2 tax rates for employers, employee representatives, and employees based on the ratio of certain asset balances to the sum of benefits and administrative expenses (the “average account benefits ratio”). The average account benefits ratio would be the sum of the account benefits ratio for the previous 10 fiscal years divided by 10. The account benefits ratio would be determined by dividing the sum of the fair market value of the assets in the railroad retirement account and the Trust at the close of the fiscal year by the sum of total benefit payments and administrative expenses of the Trust for such fiscal year. Because the average account benefits ratio is expected to be between 4.0 and 6.1 in 2003, the table would be designed to produce a 13.10 tax rate for employers and employee representatives and a 4.90 tax rate for employees in calendar year 2003. The Secretary of the Treasury would use the following table to make adjustments to the tier 2 tax rates.

Average account benefits ratio		Applicable percentage for employer and employee representative tier 2 taxes (percent)	Applicable percentage for employee tier 2 taxes (percent)
At least	But less than		
	2.5	22.1	4.9
2.5	3.0	18.1	4.9
3.0	3.5	15.1	4.9
3.5	4.0	14.1	4.9
4.0	6.1	13.1	4.9
6.1	6.5	12.6	4.4
6.5	7.0	12.1	3.9
7.0	7.5	11.6	3.4
7.5	8.0	11.1	2.9
8.0	8.5	10.1	1.9
8.5	9.0	9.1	0.9
9.0		8.2	0

Supplemental annuity tax

The proposal would repeal the supplemental annuity tax.¹¹ Supplemental annuity benefits would not be affected by the elimination of the supplemental annuity tax.

Tax exemption for the Trust

The proposal would provide tax-exempt status for the newly created Trust under Code section 501(c).

Effective Date

The provisions generally would be effective for calendar years beginning after December 31, 2000. The provision relating to the tax-exempt status of the Trust would be effective on the date of enactment.

¹¹ The funds in the supplemental annuity account would be transferred to the Trust and the account would be eliminated by the board of the Trust as soon as possible after December 31, 2000.