

Part III - Administrative, Procedural, and Miscellaneous

Tier 2 Tax Rates for 2004

Notice 2003-78

This notice publishes the tier 2 Railroad Retirement Tax Act (RRTA) tax rates for 2004 under §§ 3201(b), 3221(b), and 3211(b) of the Internal Revenue Code for railroad employees, employers, and employee representatives, respectively. For 2004, the tier 2 tax rate on employees is 4.9 percent of compensation and the tier 2 tax rate on employers and employee representatives is 13.1 percent of compensation.

BACKGROUND

Under RRTA, railroad employment is subject to a separate and distinct system of taxes from the taxes imposed under the Federal Insurance Contributions Act (Old-Age, Survivors, and Disability Insurance (social security) and Hospital Insurance (Medicare) taxes), which covers most other employees. Parts of the RRTA system are the responsibility of Internal Revenue Service and parts of the system are the responsibility of the U. S. Railroad Retirement Board (RRB), an independent agency of the Federal Government. The role of the RRB is to administer the benefits under the railroad retirement system.

The taxes under the RRTA on compensation paid to railroad employees and employee representatives (a group unique to the railroad industry) are the primary source of funding for the railroad retirement system. There are two levels of taxes or "tiers." Tier 1 provides equivalent social security and Medicare benefits, and tier 2 provides a private pension benefit.

Tier 1 benefits are financed by tier 1 taxes imposed under §§ 3201(a), 3211(a), and 3221(a). The same tax rates apply to employees and employers. The tier 1 tax rate is 7.65 percent (6.2 percent for railroad retirement and 1.45 percent for Medicare). Tier 1 uses the same annual contribution and benefit base as the social security wage base for earnings subject to the 6.2 percent rate. The contribution and benefit base is \$87,900 for compensation paid in 2004. See 68 Fed. Reg. 60,437 (Oct. 22, 2003). There is no maximum on earnings subject to tier 1 tax at the 1.45 percent rate for Medicare. The tier 1 tax rates for employee representatives are 12.4 percent for railroad retirement and 2.9 percent for Medicare.

Tier 2 benefits are financed by tier 2 taxes imposed under §§ 3201(b), 3211(b), and 3221(b). A separate annual base applies to the tier 2 tax. The contribution and benefit base is \$65,100 for compensation paid in 2004. See 68 Fed. Reg. 60,437 (Oct. 22, 2003). The tax rates for tier 2 differ from those applicable for tier 1 and tier 2 tax is not assessed equally on the employer and employee (the employer pays a significantly greater share of this tax).

The Railroad Retirement and Survivors' Improvement Act of 2001 (Act), Pub. L. 107-90, 115 Stat. 878, set the tier 2 tax rates for 2002 and 2003. Under the Act, the tier 2 tax rates for employers were 15.6 percent for 2002 and 14.2 percent for 2003. The tier 2 tax rates for employee representatives were 14.75 percent for 2002 and 14.2 percent for 2003. The tier 2 tax rate for employees was 4.9 percent for 2002 and 2003. The Act also provided a means of determining future adjustments in the tier 2 tax rates, depending on railroad retirement fund levels. This change allows tier 2 tax rates to "be raised or lowered automatically, without further action by Congress, depending on the level of funds available to pay benefits." H.R. Rep. No. 82, 107th Cong., 1st Sess., 13 (2001).

Beginning with 2004, tier 2 tax rates will be based on an average account benefits ratio. Section 3241(c)(1) provides that the term "average account benefits ratio" means, with respect to any calendar year, the average determined by the Secretary of the Treasury of the account benefits ratios for the 10 most recent fiscal years ending before such calendar year. The account benefits ratios, used to determine the average account benefits ratio, are computed by the RRB. Pursuant to 45 U.S.C. § 231v, each year the RRB must compute the account benefits ratio for the fiscal year ending in such year and certify the account benefits ratio for such fiscal year to the Secretary of the Treasury. See 20 C.F.R. §§ 206.1 and 206.2 (2003) for information on how the account benefits ratios are computed.

Section 3241(b) provides the schedule for the tier 2 tax rates based on the average account benefits ratio. Depending on the average account benefits ratio, the tier 2 tax rate for employers and employee representatives will range between 8.2 percent and 22.1 percent, while the tier 2 tax rate for employees will be between 0 percent and 4.9 percent.

The average of the account benefits ratios certified by RRB for the 10 most recent fiscal years ending before 2004, increased to the next highest multiple of 0.1, is 5.9. Section 3241(b) provides that, if the average account benefits ratio is at least 4.0, but less than 6.1, the applicable percentage for employers and employee representatives under §§ 3221(b) and 3211(b), respectively, is 13.1 percent and the applicable percentage for employees under § 3201(b) is 4.9 percent.

TIER 2 TAX RATES

The tier 2 tax rate on employees will remain at 4.9 percent in 2004, but the tier 2 tax rates on employers and employee representatives will decrease to 13.1 percent in 2004. These rates were published in the Federal Register on November 25, 2003, as required by § 3241(d).

DRAFTING INFORMATION

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