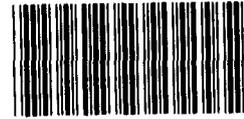


April 1990

TAX POLICY

Taxation of Pension Income for Retired New Jersey Police and Firefighters



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United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-237901

April 13, 1990

The Honorable Bill Bradley
United States Senate

The Honorable Frank R. Lautenberg
United States Senate

At your request, we evaluated the fairness of the actuarial tables used by the Internal Revenue Service (IRS) in computing taxable pension income and the feasibility of using actuarial tables that take into account occupation and other factors. We briefed your offices on these matters and, as agreed, this briefing report details the information presented.

BACKGROUND

Pension income is partially tax-free if employees contribute to their retirement plans. The tax-free portion is based on employee contributions and the life expectancy of the employee at retirement.

In calculating the taxable portion of pension income the Internal Revenue Code allows retirees to deduct their contributions from their retirement income, thereby reducing their taxable income. The deduction of contributions, however, is prorated over a number of years; the number is determined by the life expectancies of the retirees at retirement. Shorter life expectancies mean that more of the amount contributed is recovered in the early years of retirement and, therefore, taxable pension income is lower in those years. However, shorter life expectancies also mean that pension income becomes fully taxable sooner. The timing, but not the amount, of taxes paid on pension income depends on life expectancies.

The Treasury mandates the use of one table of life expectancies for retirees who made contributions before July 1986. For retirees who made contributions after June 1986, it mandates the use of an updated table of longer life expectancies. And, if retirees made contributions before and

after July 1986, they may use the shorter life expectancies for contributions made before July 1986, and the longer ones for contributions made after June 1986.

In addition to the rules mandated by Treasury, IRS allows retirees to use the simplified general rule. Under this rule, one life expectancy is applied to all contributions instead of applying the shorter and longer life expectancies to the contributions made before and after July 1986. Both sets of rules are described in the IRS Publication 575, Pension and Annuity Income. According to the New Jersey Policemen's Benevolent Association, police and firefighters have shorter life expectancies than the general population. The Association believes that if police and firefighters could use actuarial tables reflecting their shorter life expectancy, their taxable income and, therefore, their taxes in the early years of retirement would be less than under current law.

RESULTS IN BRIEF

Our analysis showed the following:

- The life expectancies we estimated for New Jersey police and firefighters are the same as those of the general population, but are shorter than the life expectancies in IRS' updated table. However, the effect of using the IRS updated table can be offset if the retirees use the table of shorter life expectancies for contributions made before July 1986.
- Using our estimates of New Jersey police and firefighters' life expectancies rather than the IRS updated table to prorate contributions made after June 1986 would result in a slight reduction in taxable pension income in the early years of retirement, followed by 1 or more years of increased taxable income. In our example of a 55 year-old male retiring on July 1, 1989, with 30 years of service, the present value of the savings would be \$108, which is less than 1 percent of the present value of the pension received over the recovery period.
- The total amount of taxes paid by retirees over the recovery period would be the same no matter what life expectancy table is used. Thus, if lower taxes are paid in the early years of retirement due to shorter life expectancies, more are paid later. Actual savings arise

from the time value of money. Using the same example of the 55 year-old retiree and the life expectancies for New Jersey police and firefighters rather than the IRS updated table to prorate contributions, would reduce taxes by \$17 per year for 22 years. However, in the twenty-third year, the retiree would have a tax increase of \$374. After that, the entire pension becomes taxable.

We do not believe that the relatively small tax savings warrants a separate table of life expectancies for police and firefighters. Not only are their life expectancies substantially the same as those of the general population, but developing separate tables would create a troublesome precedent since other occupational or demographic groups may request their own tables. This would complicate administration and create confusion for taxpayers who could fall into several of these different groups.

We found that IRS guidance in Publication 575 does not say when using the simplified general rule is to retirees' advantage. Retirees whose employers cannot determine contributions made before and after 1986 would be better off using the simplified general rule because they would pay fewer taxes in the early years of retirement. However, the publication directs these retirees to use the updated table of longer life expectancies for all contributions. Retirees, therefore, will pay more taxes in the early years of retirement.

For retirees who do know their contributions made before July 1986, Publication 575 does not indicate that, in some cases, using the simplified general rule may also be to their advantage. Our analysis showed that whether the rule does work to the advantage of retirees depends on (1) the proportion of total contributions made after July 1986, (2) gender, and (3) age at retirement. In order to determine if using the simplified general rule is to a particular retiree's advantage, retirees must compute their taxable pension income using both actuarial tables and compare that income to the taxable income using the simplified general rule.

RECOMMENDATION

The Commissioner, Internal Revenue Service, should revise IRS Publication 575 to clarify when retirees can use the simplified general rule to their advantage. If retirees do

know their contributions made before and after July 1986, they should be instructed that the use of the simplified general rule may or may not be to their advantage. The publication should also instruct retirees, whose employers cannot separate the contributions they made, to use the simplified general rule because it is always to their advantage to do so.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to review the fairness of the current actuarial tables used by IRS and to evaluate an alternative approach advocated by the New Jersey Policemen's Benevolent Association that takes into account occupational and other variables.

To accomplish the first objective, we compared the actuarial tables used by IRS with actuarial tables for the general U.S. population. To accomplish the second objective, we estimated life expectancies for retired New Jersey police and firefighters, using standard actuarial procedures from data provided by The Prudential Insurance Company of America. Limitations to the use of the data are discussed in appendix I.

We then calculated the potential tax savings available to the police and firefighters if they calculated their taxable income on the basis of our estimates of their life expectancies instead of life expectancies used in IRS' tables.

We interviewed IRS and Treasury Department officials to obtain information on the actuarial tables used by the IRS and to determine their views on the issues raised in this report.

We did our work between February and November 1989 and in accordance with generally accepted government auditing standards.

AGENCY COMMENTS

We obtained informal comments from IRS officials. They agreed with our conclusions and recommendation.

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As arranged with your offices, we are sending copies of this briefing report to the Joint Committee on Taxation and to other interested parties. If you have questions about this report, please call me at 272-7904. The major contributors to this report are listed in appendix II.



Paul L. Posner
Associate Director, Tax Policy
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ABBREVIATIONS

IRS Internal Revenue Service
OPM Office of Personnel Management

TAXATION OF RETIRED NEW JERSEY POLICE
AND FIREFIGHTERS' PENSION INCOME

GAO Background

**Recovery of contributions
to pensions and annuities**

BACKGROUND

Pension and annuity income may be fully taxable or only partially taxable. They are fully taxable if, during their employment, individuals make no contributions to their retirement plans. If contributions are made with income that has been taxed, then retirement income is only partially taxable. The contributions are not taxed when recovered after retirement.

For all retirees with a pension starting date after July 1, 1986, recovery of contributions is spread over the life expectancy of the retiree. The division between taxable and nontaxable income is based on an employee's contributions to the pension and the expected return from it.

The expected return is the total income a retiree can expect to receive from the pension. It is determined by multiplying the annual pension income by the retiree's life expectancy as of the annuity starting date. The life expectancy is taken from actuarial tables prescribed by the IRS.

In general, shorter life expectancies mean that taxpayers will pay less tax in the initial years of retirement because a greater share of their contributions would be deducted from total taxable pension income in those years. However, use of the life expectancies in the IRS actuarial tables affects only the timing, not the total amount, of taxable income recognized by retirees. Therefore, assuming the same tax rate, the total taxes paid over the years would remain the same. This is so even if retirees die before they recover all their contributions. In these cases, a deduction for the unrecovered contributions may be taken on the retiree's final income tax return.

GAO What We Did

- **Reviewed actuarial tables**
 - **Compared IRS tables with other tables**
 - **Evaluated alternative approach**
 - **Estimated life expectancies of NJ police and firefighters**
 - **Estimated tax savings for NJ police and firefighters**
-

WHAT WE DID

Our objectives were to review the fairness of the actuarial tables currently used by the IRS and to evaluate the desirability of an alternative approach advocated by the New Jersey Policemen's Benevolent Association that takes into account occupational and other variables.

To accomplish the first objective, we compared the actuarial tables used by IRS with tables for the general U.S. population as published by the National Center for Health Statistics, Department of Health and Human Services. The center's statistics--the most current data available on life expectancies of the U.S. population--are from the U.S. Decennial Life Tables for 1979-81. To accomplish the second objective, we obtained exposure¹ and death data on retired New Jersey police and firefighters for the period July 1, 1987, to July 1, 1988, from The Prudential Insurance Company of America. Prudential carries the group life insurance coverage for New Jersey's Police and Firemen's Retirement System.

Using the data, we were able to estimate life expectancies for the retired police and firefighters using standard actuarial techniques. We compared their life expectancies with life expectancies of the general U.S. population and those used by the IRS.

We then estimated the potential tax savings that would be available to the police and firefighters if they calculated their taxable income according to life expectancies we estimated instead of those prescribed by the IRS for prorating contributions made after July 1986.

We interviewed IRS and Treasury Department officials to obtain information on the actuarial tables used by the IRS and their views on the issues raised in the report.

An important limitation to our report is that the amount of data on retired New Jersey police and firefighters is small. The data provided by Prudential included 9,399 lives exposed and 139 deaths. Thus, current and future life expectancies of retired New Jersey police and firefighters could be higher or lower than our estimates.

¹"Exposure" is the number of persons subject to death in a given period of time.

GAO Taxable Pension Income Using The General Rule

- Taxpayers may use the life expectancies in the 1954 IRS table, the 1986 IRS table, or both to calculate taxable income depending on when they made contributions.

TAXABLE PENSION INCOME USING THE GENERAL RULE

Taxable pension income may be calculated according to the general rule or the simplified general rule. Both rules are discussed in IRS Publication 575, Pension and Annuity Income.

Under the general rule, retirees must elect to use the life expectancies in IRS table I, IRS table V, or both in figuring the taxable part of pension income. IRS first adopted table I in 1954 and table V in 1986. The 1954 table has shorter life expectancies than the 1986 table.² By choosing the 1954 table instead of the 1986 table, retirees recover their contributions over a shorter time period. For example, a male retiree, age 60 at retirement, could recover his contributions in 18 years (using the 1954 table) instead of 24 years (using the 1986 table). This would lower the retiree's taxable income and, thus, the retiree's taxes for the first 18 years, but increase them for the next 6 years. The total taxes paid would remain the same over the 24-year period, but the timing of the tax payments would change.

Retirees who made all their contributions to their pensions before July 1986 may use either actuarial table.

Retirees who made contributions to a pension before and after July 1, 1986, may choose to use both tables. To calculate their taxable pension income these retirees may use the 1954 table for contributions made before July 1986, but must use the 1986 table for contributions made after June 1986. If retirees do not know how much they contributed before July 1986, they must use either the 1986 table for all contributions or the simplified general rule. (This rule is explained on page 24.)

In general, the greater the proportion of contributions made after June 1986, the greater the length of time needed to recover contributions. To continue the example used above, if one-half the contributions were made before July 1986, retirees would recover their contributions in 20.6 years instead of 18 years by using the 1954 table or 24 years by using the 1986 table. Again, total taxes paid would remain the same over the recovery period; only the timing of the payments would change.

²Both tables consist of life expectancies for a single life. There are other tables for joint and survivor pensions, temporary pensions, and the present value of any guaranteed refund feature.

GAO NJ Policemen's Ass'n Position
On Taxing Pension Income

- Shorter life expectancy of police and firefighters
 - Taxable portion of pension income is too high
 - Separate actuarial tables for police and firefighters needed
-

NEW JERSEY POLICEMEN'S BENEVOLENT ASSOCIATION'S
POSITION ON TAXING PENSION INCOME

The New Jersey Policemen's Benevolent Association believes that the life expectancy of police and firefighters is shorter than that of the general population because of the stress of their occupation. As a result, they question the fairness of the IRS' actuarial tables used to calculate the taxable portion of pension income. The IRS tables are used by everyone regardless of what their actual life expectancy may be.

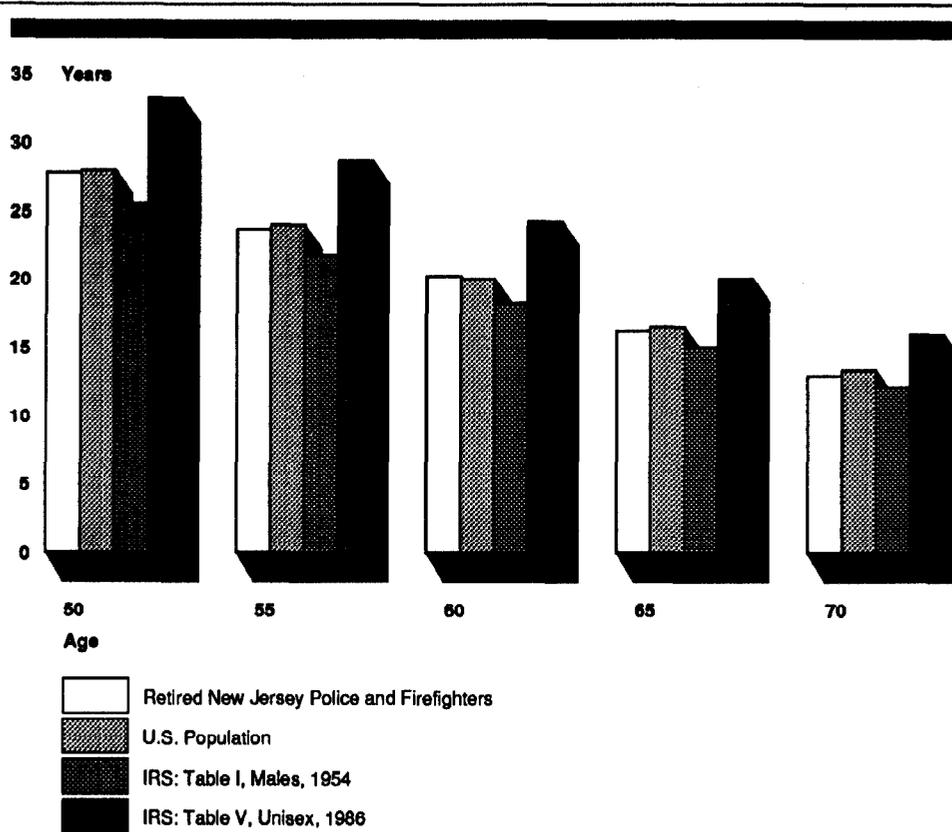
The Association believes that because of their lower life expectancy, they will not get back all of their contributions to their pensions. The Association believes the taxable portion of their pensions will thus be too high as will the taxes paid on the pensions.

The solution, according to the Association, is to have the IRS prescribe a separate set of actuarial tables for use by police and firefighters so that they may recoup their contributions over what they consider a shorter and more realistic period of time.

GAO Comparison of Life Expectancies

Figure I.1:

Average Life Expectancy at Ages 50-70



Life expectancies of retired New Jersey police and firefighters were computed by GAO from data supplied by The Prudential Insurance Company of America.

Life expectancies of U.S. population are from U.S. Decennial Life Tables for 1979-81, National Center for Health Statistics, U.S. Department of Health and Human Services.

Life expectancies used by IRS are from IRS Publication 575 (Rev. Nov. 88), Pension and Annuity Income.

COMPARISON OF LIFE EXPECTANCIES

Our estimations of the life expectancies of the New Jersey police and firefighters are virtually the same as those for the total U.S. population. This means that police officers and firefighters, once they retire, have a life expectancy generally no different than that of the general population. The life expectancies for males in the IRS 1954 table, however, are about 2 years shorter than those of the U.S. population, while the life expectancies in the IRS 1986 table are about 4 years longer.

The IRS 1954 table is based on the 1937 Standard Annuity Table; the IRS 1986 table is based on the 1983 annuity table. The 1986 table is an updated actuarial table that reflects the increased projected longevity of the population. The IRS also made it a unisex table because of Supreme Court rulings on discrimination, according to an IRS official. The general effect of the new table is to stretch out the time needed to recover pension contributions, particularly for male retirees.

The 1937 and 1983 annuity tables were developed by the Society of Actuaries. These tables reflect the lower mortality experience of annuitants rather than the higher mortality experience of the total population, as in the U.S. life table. Annuitants live longer, on the average, than the general population because they tend to be in higher socioeconomic positions. Also, it would not pay for a person in poor health, for example, or in some other high-risk category, to purchase a life annuity.³

IRS officials told us that the annuity tables were used to develop the life expectancies because they were the best tables available for this purpose. They said they were the best because they include only the experience of pensioners and annuitants. The U.S. life tables include the mortality experience of the entire population, not just pensioners and annuitants.

³By purchasing a life annuity a person receives periodic payments, usually monthly or annually, for as long as he or she lives.

GAO Tax Savings Using NJ P&F Life Expectancies

Table I.1:

Tax Savings Using New Jersey Police and Firefighters' Life Expectancies

	<u>Example 1</u>	<u>Example 2</u>	<u>Example 3</u>
Age at retirement	55	60	55
Years of service	30	35	30
Retirement date	7/1/89	7/1/94	7/1/96
Annual retirement income	\$19,950	\$26,200	\$28,050
Annual tax-free portion splitting contributions under the general rule	\$1,695	\$2,699	\$2,216
Annual tax-free portion using N.J. police and firefighters' experience	\$1,755	\$2,908	\$2,440
Additional annual tax-free income using N.J. experience	\$60	\$209	\$224
Annual tax savings (assuming 28-percent marginal tax rate)	\$17	\$59	\$63
Years of lower taxes	22	19	23
Years of higher taxes	1	2	3
Present value of tax savings over the recovery period assuming an 8-percent interest rate	\$108	\$330	\$433
Present value of pension income over recovery period	\$206,903	\$262,440	\$303,220

TAX SAVINGS USING NEW JERSEY POLICE
AND FIREFIGHTERS' LIFE EXPECTANCIES

Our three examples show that the annual tax savings are small for male police and firefighters, using our estimate of their life expectancies rather than the IRS tables. There are two reasons for this. First, New Jersey police and firefighters may use the IRS 1954 table for contributions made before July 1986. Second, the use of the tables affects only the timing of taxes paid, not the total amount paid.

While our estimated life expectancies of New Jersey police and firefighters are lower than the life expectancies prescribed in IRS' 1986 table, they are higher than those prescribed in IRS' 1954 table. Because of this, the police and firefighters would be able to save taxes in the early years of their pensions by applying their own life expectancies to contributions made after June 1986. For those police and firefighters retiring now or in the near future, the proportion of contributions made after June 1986, to those made before July 1986, will be small. In the examples, their contributions are recovered 1 to 3 years sooner. The small reduction in recovery period leads to a small savings in taxes each year.

For those police and firefighters retiring in the middle 1990s, the use of their own estimated life expectancies instead of the IRS 1986 table would produce greater tax savings in the early years of retirement. However, as examples 2 and 3 show, annual tax savings would still be relatively small, \$59 and \$63.

Even for police and firefighters who make all their contributions after 1986 and retire with 30 years service in 2016, for example, the annual tax savings in the early years of retirement would still be small. We estimate that the annual tax savings would be about \$300.

The use of the tables affects only the timing of taxes paid, not the total amount paid, even if a retiree dies before recovering all contributions. By recovering contributions sooner, and therefore paying fewer taxes in the early years, a taxpayer's pension becomes fully taxable sooner. For the later years, accordingly, the taxpayer will pay higher taxes than he or she would have if the contributions had not been recovered sooner. The amount of extra taxes paid in the later years will just equal the taxes saved in the early years. In the examples, this results in a small present value associated with the payment of taxes later rather than sooner. For example 3, the tax savings is less than 1 percent of the present value of the pension received over the recovery period.

GAO Treasury's Position on Taxing Pension Income

- Prescribing multiple actuarial tables unworkable
 - Use of tables affects only timing of income recognition
 - Single set of tables balances considerations of fairness and simplicity
-

TREASURY'S POSITION ON TAXING PENSION
INCOME OF POLICE AND FIREFIGHTERS

The Department of the Treasury stated in a letter to Senator Bradley, dated March 11, 1988, that if the IRS were required to prescribe a separate set of actuarial tables for police and firefighters, it would have no basis for failing to prescribe numerous sets of tables for other groups on the basis of occupation or other characteristics, such as gender, race, or health.

Treasury said developing multiple tables would be costly and their use could produce disputes. Would retirees then be allowed to choose the most favorable table for themselves on the basis of just one of their characteristics? To elaborate on Treasury's position, would a retiree who is a white female but in poor health be able to use a table of life expectancies on the basis of all persons who are in poor health, or only females in poor health, or only white females in poor health, or only females, or only white females? Or a person could switch from a low-risk to a high-risk job before retirement. Which tables would he or she be able to use? The Treasury believes that prescribing multiple tables would be unworkable.

Treasury also pointed out that the use of actuarial tables neither increases nor decreases the total amount of taxable income recognized by retirees. The use of actuarial tables affects only the timing of income recognition. Treasury pointed out that if a retiree dies before recovering the full amount of his or her contributions, a deduction for the unrecovered amount may be taken on his or her final income tax return. If, however, the retiree lives longer than the actuarial tables project, his or her entire pension becomes taxable after the contributions have been fully recovered.

The total amount of taxes paid by the retiree would not increase or decrease either; only the timing of payment would be affected. If less tax is paid in the early years of retirement due to shorter life expectancy, more will be paid in the later years. Treasury, however, pointed out that the timing of income recognition and payment of taxes is important to both the taxpayer and the government because of time-value-of-money considerations.

In summary, the Treasury believes that the use of a single set of actuarial tables properly balances the competing considerations of fairness and simplicity in determining the proper timing of income recognition. We agree.

GAO Taxable Pension Income Using The Simplified General Rule

Table I.2:

Percentage of Total Contributions Made
After July 1986 Needed to Use Simplified
General Rule to One's Advantage

<u>Age at Retirement</u>	<u>Percentage</u>	<u>Age at Retirement</u>	<u>Percentage</u>
55	54.7	66	0.0
56	12.7	67	10.4
57	26.0	68	27.3
58	39.2	69	44.2
59	52.3	70	59.8
60	64.5	71	0.0
61	50.2	72	0.0
62	62.3	73	0.0
63	76.0	74	0.0
64	88.0	75	17.2
65	100.0		

Note: Contributions made by males after June 30, 1986, for a pension based on a single life, must equal or exceed the above percentages in order to use the simplified general rule advantageously instead of splitting contributions under the general rule.

TAXABLE PENSION INCOME USING THE SIMPLIFIED GENERAL RULE

To make the calculation of taxable pension income simpler, the IRS developed the simplified general rule, which many retirees can use.¹ Under this rule, retirees divide their total contributions by a number of months established by the IRS to determine the amount of their monthly pension income that is tax-free. For example, the life expectancy given by IRS for retirees age 55 or under is 300 months or 25 years. Retirees do not have to allocate their contributions before and after July 1986.

Life expectancies under the simplified general rule are generally somewhere between the two life expectancies in the 1954 and 1986 tables, but vary considerably depending on the age at retirement.

We developed a formula for determining when to use the simplified general rule in order to lower taxable pension income. We found that it is always advantageous to use the simplified general rule instead of the 1986 table, if retirees do not know how much of their contributions were made before and after July 1986. This would be the case, for example, if a retiree's employer does not or cannot allocate contributions between the two periods. However, it is not always advantageous to use the simplified general rule if employers do allocate retirees' contributions. Whether or not it is advantageous depends on gender and age at retirement. It is advantageous if the contributions made after June 1986, are equal to or greater than a certain percentage of total contributions. Table I.2 shows the percentages for male retirees ages 55 to 75.

For example, to use the simplified general rule to their advantage, males who retired at age 55 with a pension based on a single life would have to have made 54.7 percent or more of their contributions after June 1986. For age 65, the most common retirement age, it is never advantageous to use the simplified general rule. However, if he waits 1 year to retire at age 66, it is always advantageous to use it.

For females with a pension based on a single life, it is always advantageous to use the simplified general rule except for those retiring between 63 and 65. At age 63, a female would need 22 percent or more of her contributions made after June 1986 to use the rule advantageously. At age 64 it would be 60 percent; at age 65 it would never be advantageous.

¹Conditions for using the simplified general rule are in IRS Publication 575, Pension and Annuity Income.

GAO Retirees May Have Problems
Understanding IRS Guidance

- When retirees can separate their contributions
- When retirees cannot separate their contributions

RETIREEES MAY HAVE PROBLEMS UNDERSTANDING IRS GUIDANCE

IRS Publication 575 explains how to report pension income on federal tax returns and requires retirees to choose one of several methods for calculating taxable pension income. It contains 38 pages of instructions, examples, worksheets, and forms, and 66 pages of actuarial tables. While retirees are told it is to their advantage to separate contributions made before and after July 1986 to have a lower taxable pension income, retirees are not given instructions on when they would lower taxable pension income by using the simplified general rule. To determine which rule to use, retirees need to know the amount of contributions made after July 1, 1986.

When retirees do know the amount of their contributions made after July 1986, the publication does not inform them that it may or may not be to their advantage to use the simplified general rule. Our analysis showed that whether it is depends on (1) the proportion of total contributions made after July 1, 1986, (2) gender, and (3) age at retirement. In order to determine if using the simplified general rule is to their advantage, retirees must compute their taxable pension income using the IRS' 1986 table and compare that to the taxable income using the simplified general rule.

However, many organizations do not provide their employees with total contributions made after July 1, 1986, according to IRS and Treasury officials. For example, the Office of Personnel Management (OPM) does not provide such information to federal employees because the information is not automated. An OPM official said that federal employees may request annual data on salary and contributions from their personnel files and calculate contributions made before July 1986.

When retirees do not know the amount of their contributions made before July 1986, the publication directs them to use the 1986 table for all contributions even though using the simplified general rule would result in a lower taxable pension income over the recovery period.

GAO Conclusions

- Separate life expectancy tables are not warranted
 - In practice the IRS tables are adequate
 - IRS guidance is not clear on when retirees can use the simplified general rule to lower their taxable pension income
-

CONCLUSIONS

Separate Life Expectancy Tables Are Not Warranted

In Treasury's opinion, the small present value of savings due to differences in the timing of tax payments and difficulties of developing and administering specialized tables do not warrant IRS prescribing different life expectancies for police and firefighters.

We agree. Our position is based on the low tax savings that would be available to police and firefighters if they used the life expectancies we estimated for New Jersey police and firefighters to calculate the tax-free portion of their pensions, rather than the updated IRS tables.

As Treasury said, and we agree, this would also create a precedent for others to demand special tables. Treasury said there would be substantial administrative costs and difficulties in developing numerous sets of actuarial tables for the many groups that would claim different life expectancies.

In Practice The IRS Tables Are Adequate

While the updated life expectancies prescribed by the IRS were not developed from the mortality experience of all retirees, and may therefore be too high for some, their use is offset if retirees use the shorter life expectancies for contributions made before July 1986.

Choosing The Most Advantageous Method For Calculating Taxable Pension Income Is Not Clear

IRS guidance in Publication 575 on computing the tax on pension income involves several alternative methods for calculating the tax. We believe many people would have difficulty choosing the most advantageous method. For instance, it is not clear when retirees would find it advantageous to use the simplified general rule rather than the general rule.

If retirees can separate their contributions made before and after July 1986, use of the simplified general rule may or may not be to their advantage. If retirees cannot separate the contributions they made, they are not instructed to use the simplified general rule, which would always be to their advantage.

GAO Recommendation

The Commissioner of the Internal Revenue Service should revise Publication 575 to clarify when retirees should use the simplified general rule in order to reduce taxable pension income.

RECOMMENDATION

The Commissioner of the Internal Revenue Service should revise publication 575 to clarify when retirees can use the simplified general rule to their advantage. If retirees know the amount of their contributions made before and after July 1986, they should be instructed that the use of the simplified general rule may or may not be to their advantage. In order to determine if using the simplified general rule is to their advantage, retirees must compute their taxable pension income using the IRS' 1986 table and compare that to the taxable income using the simplified general rule. The publication should also instruct retirees, whose employers do not separate the contributions they made, to use the simplified general rule because it is always to their advantage to do so.

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