



Member repayments

Tax Letter No. 9 (Rev. 01/12)

When you make repayments to IMRF

This letter explains how a repayment you make to IMRF may be used when filing your taxes. This letter only covers payments where there was an unintentional prepayment of your monthly pension or disability benefit. This letter does **not** cover payments to purchase or reinstate service credit. For a more detailed explanation, we are including an excerpt from IRS Publication 525, "Taxable and Nontaxable Income," attached with this page. Because this topic is complicated, you may also wish to discuss this with your tax advisor.

Why did IMRF pay me too much in benefits?

Occasionally, IMRF pays a benefit which is larger than the amount you are immediately entitled to. This is called a "benefit prepayment," and it can occur if you sign an agreement asking IMRF to pay you a higher disability benefit until you receive a Social Security or workers' compensation award.

What do I have to do then?

When IMRF makes a benefit prepayment (pays you a larger amount in benefits than you are immediately entitled to), you are asked to pay the money back (make a repayment) to IMRF. If you received the benefit prepayment in a **previous** year and you included the payment from IMRF as income for federal income tax, the question becomes:

How much of the repayment can I use on my taxes?

Where possible, IMRF will reduce the reportable income for the amount of any repayment. This reduction will automatically correct your tax reporting and you have no additional steps for tax reporting. However, for:

- amounts deducted from a refund of your IMRF contributions, we cannot reduce the reportable income since the payments are taxed differently
- amounts repaid that are greater than the current year's payments, we cannot reduce the current tax statement for the full amount of the repayment.

In these two instances, IMRF will issue a letter in January following the tax year that shows what parts of your repayment may be used as an adjustment on your tax return.

How do you report the tax adjustment from the letter?

The details of how you report the repayment is shown on the enclosed excerpt from IRS Publication 525. The instructions indicate that if you make a repayment to IMRF of less than \$3,000, you would report the amount you paid as a miscellaneous deduction on Line 23 of 1040 Schedule A. If you make a repayment to IMRF of more than \$3,000, the amount you paid may be taken either as a deduction on Line 28 of 1040 Schedule A, or you can use it as a tax credit by recalculating your previous year's federal income tax return.

More questions?

For additional information, you may wish to discuss this with your tax advisor or call the IRS (please see your telephone book for a local number).

Illinois Municipal Retirement Fund

Member Services Representatives 1-800-ASK-IMRF (1-800-275-4673)

Taxable and Nontaxable Income

For use in preparing
2011 Returns



The following text is excerpted from IRS Publication 525. It is the section that discusses “Repayments,” for use in preparing 2011 returns, pages 36-37.

Repayments

If you had to repay an amount that you included in your income in an earlier year, you may be able to deduct the amount repaid from your income for the year in which you repaid it. Or, if the amount you repaid is more than \$3,000, you may be able to take a credit against your tax for the year in which you repaid it. In most cases, you can claim a deduction or credit only if the repayment qualifies as an expense or loss incurred in your trade or business or in a for-profit transaction.

Type of deduction. The type of deduction you are allowed in the year of repayment depends on the type of income you included in the earlier year. In most cases, you deduct the repayment on the same form or schedule on which you previously reported it as income. For example, if you reported it as self-employment income, deduct it as a business expense on Schedule C or Schedule C-EZ (Form 1040) or Schedule F (Form 1040). If you reported it as a capital gain, deduct it as a capital loss as explained in the Instructions for Schedule D (Form 1040). If you reported it as wages, unemployment compensation, or other nonbusiness income, deduct it as a miscellaneous itemized deduction on Schedule A (Form 1040).

If you repaid social security or equivalent railroad retirement benefits, see Publication 915.

Repayment of \$3,000 or less. If the amount you repaid was \$3,000 or less, deduct it from your income in the year you repaid it. If you must deduct it as a miscellaneous itemized deduction, enter it on Schedule A (Form 1040), line 23.

Repayment over \$3,000. If the amount you repaid was more than \$3,000, you can deduct the repayment (as explained earlier under *Type of deduction*). However, you can choose instead to take a tax credit for the year of repayment if you included the income under a claim of right. This means that at the time you included the income, it appeared that you had an unrestricted right to it. If you qualify for this choice, figure your tax under both methods and compare the

results. Use the method (deduction or credit) that results in less tax.

CAUTION:
When determining whether the amount you repaid was less than \$3,000, consider the total amount being repaid on the return. Each instance of repayment is not considered separately.

Method 1. Figure your tax for 2011 claiming a deduction for the repaid amount. If you must deduct it as a miscellaneous itemized deduction, enter it on Schedule A (Form 1040), line 28.

Method 2. Figure your tax for 2011 claiming a credit for the repaid amount. Follow these steps.

1. Figure your tax for 2011 without deducting the repaid amount.
2. Refigure your tax from the earlier year without including in income the amount you repaid in 2011.
3. Subtract the tax in (2) from the tax shown on your return for the earlier year. This is the credit.
4. Subtract the answer in (3) from the tax for 2011 figured without the deduction (step 1).

If method 1 results in less tax, deduct the amount repaid. If method 2 results in less tax, claim the credit figured in (3) above on Form 1040, line 71, by adding the amount of the credit to other credits claimed on this line, and entering “I.R.C. 1341” in the column to the right of line 71.

Example. For 2010 you filed a return and reported your income on the cash method. In 2011 you repaid \$5,000 included in your 2010 income under a claim of right. Your filing status in 2011 and 2010 is single. Your income and tax for both years are as follows:

	2010	
	With Income	Without Income
Taxable Income	\$15,000	\$10,000
Tax	\$1,835	\$1,085

	2011	
	Without Deduction	With Deduction
Taxable Income	\$49,950	\$44,950
Tax	\$8,675	\$7,425

Your tax under method 1 is \$7,425. Your tax under method 2 is \$7,925, figured as follows:

Tax previously determined for 2010	\$1,835
Less: Tax as refigured	- 1,085
Decrease in 2010 tax	<u>\$ 750</u>

Regular tax liability for 2011	\$8,675
Less: Decrease in 2010 tax	- 750
Refigured tax for 2011	<u>\$7,925</u>

You pay less tax using method 1, so you should take a deduction for the repayment in 2011.

Repayment rules do not apply. This discussion does not apply to:

- Deductions for bad debts;
- Deductions for theft losses due to criminal fraud or embezzlement in a transaction entered into for profit;
- Deductions from sales to customers, such as returns and allowances, and similar items; or
- Deductions for legal and other expenses of contesting the repayment.

Year of deduction (or credit). If you use the cash method, you can take the deduction (or credit, if applicable) for the tax year in which you actually make the repayment. If you use any other accounting method, you can deduct the repayment or claim a credit for it only for the tax year in which it is a proper deduction under your accounting method. For example, if you use an accrual method, you are entitled to the deduction or credit in the tax year in which the obligation for the repayment accrues.