

INTER-AMERICAN DEVELOPMENT BANK

COMPENSATION AND BENEFITS DIVISION

Dear Retiree:

Ref: **Retirement Tax Reimbursement Procedures**

This letter summarizes the conceptual approach that the Bank will follow and the procedures used to implement the tax reimbursement program.

Retirees Eligible for Tax Reimbursement Payments

All individuals who after 1980 received or will receive a pension (including commutation payments and early retirement and disability benefits) as a retiree or surviving spouse or a children's benefit under the Inter-American Development Bank Staff Retirement Plan which will be subject to tax, will be eligible to receive tax reimbursements.

Tax Reimbursement Procedures for Retirement Income

The approach used by the Bank in calculating tax reimbursements for retirement income is similar to that currently used for the reimbursement of U.S. Federal and State income taxes on Bank income. The calculation utilizes itemized deductions and personal exemptions reported by the retirees on their tax returns and such deductions and exemptions are allocated proportionally to all sources of income, including retiree outside income. Spouse income is taken into effect in the tax calculation (see Annex A for an example of the reimbursement calculation.)

The tax reimbursement procedure consists of a two-step process in which tax reimbursement payments are advanced to retirees based upon their estimates. **A settlement process is performed after tax returns have been filed.** Because the advances are made based upon estimates and because the retirees will establish their right to tax reimbursement only at settlement, tax payments are treated as advances and will not be reported as taxable income in the year of receipt. The amount of the settlement will be reported as taxable income in the year the settlement calculation is completed.

- (1) **Payment of Tax Advances** - In the initial year that a retiree becomes eligible for tax reimbursement on retirement income, a request may be made that the Bank make advance payments for anticipated taxes as a result of their retirement income. This request will be made by submitting to the Bank an IDB Tax Form 1R (a copy of which is enclosed) to estimate the necessary tax reimbursement or, in certain cases in which the special procedure discussed below is elected, to request that the Bank calculate such estimate. Upon review and approval by the Bank, quarterly tax advances will be made to the retiree to cover the anticipated tax liability.
- (2) **Settlement**
 - (a) **Regular Procedure** - Because payment of tax advances will be made based upon estimates and the final reimbursement calculation will take into account actual tax return information relative to spouse income, retirement income, outside income, itemized deductions and personal exemptions, retirees who receive tax advances

will be required to submit their tax returns to the Compensation and Benefits Division to perform the settlement calculation.

Retirees will provide directly to the Compensation and Benefits Division the appropriate information which will include a copy of the tax return(s) as filed together with a completed Settlement Request (IDB Tax Form 7R), a copy of which is enclosed. A sample settlement calculation to be performed by the Compensation and Benefits Division is included in Annex A (see Annex A, pages 3 and 4.)

Settlement Requests (IDB Tax Form 7R) must be submitted each year for which tax advance payments are made by the Bank. After tax returns for such years have been prepared, these requests must be submitted to the Compensation and Benefits Division by the first week in July. An explanation for any delay in meeting the deadline should be promptly sent to the Compensation and Benefits Division.

- (b) **Elective Special Procedure** - Under this procedure, which is available only for retirees who pay state taxes in Maryland, Virginia or the District of Columbia, the calculation of advances will be performed by the Bank based upon the following assumptions:
- (i) That the income of the retiree consists exclusively of retirement income received from the Bank Staff Retirement Fund, and
 - (ii) That itemized deductions (IRS Form 1040 schedule A) are equal to the Average Itemized Deduction (AID) amounts derived from the IRS tables, and, for federal purposes, the itemized deduction for state and local income taxes will be the state tax as computed by the Bank.

When this procedure is used, retirees are not required to submit their tax returns for review by the Compensation and Benefits Division, but they will be required to submit IDB Tax Form 7RS directly to the Compensation and Benefits Division. If the Elective Special Procedure is used, IDB Tax Form 7RS must be submitted to the Compensation and Benefits Division by the first week in July, following the year for which tax advances have been made or tax reimbursements are requested. Generally, it would **not** be advantageous for retirees to use this procedure if spouse income or outside income exists or if actual itemized deductions are less than the AID amount used to calculate the estimates. Copies of IDB Tax Form 7RS are available from the Bank upon request.

Procedures to Follow in the Initial Year of Eligibility for Reimbursements

Individuals who are eligible to receive reimbursements for taxes may request that advance payments be made by the Bank by completing the enclosed IDB Tax Form 1R in the initial year of eligibility. The form may be completed by estimating the tax liability on retirement income using the methodology in Annex A. Those retirees who elect the special procedure discussed above may request that the Bank calculate the advances.

Please note that any tax reimbursements advanced will not be reported as taxable income. Accordingly, in the initial year of eligibility, tax advances will not constitute taxable income.

Failure to submit IDB Tax Form 1R does not preclude a retiree from receiving a tax reimbursement. If IDB Tax Form 1R has not been submitted, the Bank will make no advance payments; however, reimbursements of taxes may be secured after tax returns have been filed by submitting copies of tax returns along with IDB Tax Form 7R to the Compensation and Benefits Division (or under the

Elective Special Procedures by submitting copies of IDB Tax Form 7RC to the Compensation and Benefits Division) for settlement by the first week in July. Reimbursement requests submitted after that time will not be accepted unless the due date for filing affected returns has been extended beyond that date.

Procedures to Follow in Future Years

Retirees who have filed an original IDB Tax Form 1R or have submitted a Settlement Request (IDB Tax Form 7R or 7RC) will not be required to file an IDB Tax Form 1R for future years. Rather, using the rate of tax reflected in the settlement process, the Bank will continue to make quarterly advance payments. This procedure is demonstrated in Annex A.

Unless the retiree submits a new IDB Tax Form 1R (which may be filed at any time prior to settlement), advance tax payments will be made by the Bank using the effective rate of tax as calculated in the prior year's settlement and taking into effect any changes in taxable retirement income for the year. For this reason, retirees may wish to submit a revised IDB Tax Form 1R if a material change in their tax situation is anticipated. When such revised form is submitted, it will be reviewed by the Bank and, if determined to be reasonable, quarterly tax advances will be based upon this estimate rather than the effective rates of tax in the prior year.

Any retiree, who has any questions or needs assistance in completing the enclosed IDB Tax Forms, should contact the Inter-American Development Bank, Compensation and Benefits Division, Stop E-0417, Washington, D.C. 20577 - telephone (202) 623-3267.

Enclosures: Annex A - "Illustrative Retiree Income Tax Reimbursement Calculation" (example using IDB Tax Form 6R).
Explanation IDB Tax Form 6R
IDB Tax Form 1R
IDB Tax Form 7R

**ILLUSTRATIVE RETIREE INCOME TAX REIMBURSEMENT
CALCULATION - FEDERAL INCOME TAXES**

The following information reflects when tax reimbursement on pension payments would be paid and how such payments would be calculated under the circumstances explained below. Although the Bank also reimburses for state and local taxes to which benefits payable under the Staff Retirement Plan are properly subjected, for purposes of simplicity the example reflects the reimbursement of federal taxes only.

Assumptions

- 1) A retiree with taxable benefits from the IDB staff retirement plan of \$60,000 in 2008 and \$62,000 in 2009.
- 2) That an IDB Tax Form 1R is submitted by the retiree in January, 2008 requesting \$6,000 in 2008 tax advances.
- 3) That the 2008 federal income tax return filed by the retiree reflects the following:

Taxable retirement income	60,000	
Spouse Income	30,000	
Outside Income	<u>10,000</u>	100,000
Deductions	10,000	
Personal Exemption.....	<u>6,400</u>	<u>(16,400)</u>
Taxable Income		<u><u>83,600</u></u>

ILLUSTRATIVE SCHEDULE OF RETIREMENT INCOME TAX REIMBURSEMENTS

March, 2008 - 1st Quarter.....	1,500 a/
May, 2008 - 2nd Quarter.....	1,500 a/
August, 2008 - 3rd Quarter	1,500 a/
December, 2008 - 4th Quarter.....	1,500 a/
March, 2009 - 1st Quarter.....	1,500 b/
May, 2009 - 2nd Quarter.....	1,500 b/
August, 2009	
(a) 2008 Settlement.....	2,093 c/
(b) 3rd Quarter 2009.....	3,224 d/
December, 2009 - 4th Quarter.....	3,225 d/

- a/ Quarterly payment of the amount requested by the retiree as a 2008 retirement tax advance.
- b/ Quarterly payment of the amount requested as an advance for the current year.
- c/ Payment of additional amount necessary to settle 2008 as calculated by the Compensation and Benefits Division on IDB Tax Form 6R, Part II, Section 5A (3). See page 4 of this annex.
- d/ Balance of required advance for 2009 divided equally between the 3rd and 4th quarter advance.

INTER-AMERICAN DEVELOPMENT BANK

2008 TAX SETTLEMENT STATEMENT AND SUMMARY OF TAX ADVANCE ACCOUNT
Part I

Name	Retiree No.
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TAX SETTLEMENT	1. NATIONAL \$	2. LOCAL \$
(a) IDB Taxable Retirement Income	60,000	
(b) Spouse Income	30,000	
(c) Subtotal (a + b).....	90,000	
(d) Outside Income of Retiree	10,000	
(e) Adjusted Gross Income (c + d).....	100,000	
(f) Income Ratio for Allocation of Deductions (c/e) ..	90.0%	
(g) Income Ratio for Settlement (a/c).....	66.7%	
(h) Deductions and	10,000	
Exemptions	6,400	
Total Deductions and Exemptions	16,400	
(i) Deductions and Exemptions for Reimburse- ment Calculation (f x h).....	14,760	
(j) Taxable Income (c - i)	75,240	
(k) Tax on the Amount on line j.....	12,140	
(l) Tax Settlement (k x g).....	8,093	
(m) Combined Tax Settlement.....	8,093	
(n) Combined Effective Tax Rate (m/1a).....	13.48%	

2008 TAX SETTLEMENT STATEMENT AND SUMMARY OF TAX ADVANCE ACCOUNT
Part II

Name	Retiree No.
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3.	TAX SETTLEMENT AMOUNT (Page 1, line m).....		8,093
4.	REQUIRED CURRENT YEAR ADVANCES.....		
	(a) IDB Taxable Retirement Income	62,000	
	(b) Tax Settlement (3)	8,093	
	(c) Gross Income attributable to retirement income ...	70,093	
	(d) Effective tax rate (Page 1, line N).....	13.48	
	(e) Advances to be paid		9,449
5.	SUMMARY OF AMOUNTS DUE RETIREE (IDB).....		
	A. Settlement of prior year		
	(1) Tax Settlement (3)	8,093	
	(2) Less Advances paid for prior year	6,000	
	(3) Adjustment due Retiree (IDB).....		2,093
	B. Current year advance activity.....		
	(1) Advances required for current year).....	9,449	
	(2) Current year advances paid to date	3,000	
	(3) Additional advances for current year		6,449
	C. COMBINED AMOUNT DUE RETIREE (IDB)...		8,542

SCHEDULED PAYMENTS FOR 2008/2009

	DUE RETIREE	DUE IDB	TOTAL
August 31, 2008 - Balance of Settlement	2,093		
Third Quarter Advance	3,224		
December 31, 2008.....	3,225		
Total	8,542		

SCHEDULED PAYMENTS FOR 2009

	DUE RETIREE
March 31, 2009	2,362
May 31, 2009	2,362

Inter-American Development Bank
EXPLANATION OF TAX SETTLEMENT STATEMENT AND
SUMMARY OF TAX ADVANCE ACCOUNT
(IDB TAX FORM 6R)

General

This explanation is provided to assist you in understanding the data contained in your Tax Settlement (IDB Tax Form 6R).

Calculations are based upon the data submitted by you to the Compensation and Benefits Division and the taxable pension amounts projected at the time the statement was prepared.

Detailed Explanation

- (1) National Tax Settlement
 - (a) **Gross Income Attributable to the Staff Retirement Plan** - This amount includes the portion of retirement benefits and Tax Settlements related thereto that were subject to a national tax.
 - (b) **Adjusted Gross Income** - This amount includes income from all sources that was subject to tax.
 - (c) **Deductions and Exemptions** - This amount is the total itemized or standard deduction and the total personal exemptions reflected on your return.
- (2) Local Tax Settlement - Same as National but number 2 on IDB Tax Form 6R.
- (3) Tax Settlement Amount - This is the tax reimbursement with respect to the prior year's Gross Income Attributable to the IDB Retirement Plan. The notification to the retiree constitutes the Bank's acceptance of the calculation and relieves the retiree of the obligation to repay the equivalent of such amounts advanced in the prior year. Accordingly, the Tax Settlement will be subject to tax in the current year. Such calculation, however, may be adjusted by the Bank in situations in which the calculation was based on erroneous or incomplete information.
- (4) Advance Account Activity
 - (a) **Settlement of Prior Year** - The related adjustment amount represents any differences between amounts advanced to the retiree for prior year's taxes and the tax reimbursement to which the retiree is entitled as computed in the settlement process.
 - (b) **Current Year's Advance Calculations** - The amount to be advanced for the current year is computed based upon the taxable portion of pension income received during the year plus the tax reimbursement for the prior year computed at settlement. The tax on this income is computed for purposes of advance payments using effective tax rates from the prior year's settlement calculation. If you anticipate that your personal tax situation in the current year will differ materially from last year, you may submit a new IDB Tax Form 1R requesting that tax advances be based upon your estimate rather than on tax rates in effect for the prior year.
- (5) Payments Due in Third and Fourth Quarter - The balance of the required advances to be paid are divided equally between the third and fourth quarter.