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INDIVIDUAL INCOME TAX – RAILROAD EMPLOYEE BENEFITS

(Replaces Revenue Administrative Bulletin 1991-13 for Tax Years Starting January 2012)

RAB 2016-13. This Revenue Administrative Bulletin (RAB) describes the Michigan income tax treatment of railroad employee benefits received by a resident taxpayer and addresses the relationship between railroad retirement benefits and non-railroad retirement benefits.[1] It updates RAB 1991-13 to reflect changes to the Income Tax Act (ITA) made by 2011 PA 38. For tax years prior to 2012, refer to RAB 1991-13.

RAILROAD RETIREMENT BENEFITS

The Railroad Retirement Act of 1974[2] (RRA) provides retirement, disability, spousal, and survivor benefits to railroad retirees. The RRA provides two types of benefits known as Tier I and Tier II.

Tier I Benefits. A retiree's Tier I pension benefits, commonly referred to as social security equivalent benefits because they approximate Social Security benefits, are based on railroad credits which are adjusted for any Social Security credits an employee has accrued from non-railroad employment. To the extent that a taxpayer includes Tier I railroad retirement benefits in his or her federal AGI, he or she may deduct the same amount in determining Michigan taxable income under MCL 206.30(1)(e)(ii).[3] Michigan's taxable income is federal AGI with certain section 30 adjustments.[4]

Tier II Benefits. Tier II railroad retirement benefits received by railroad retirees are in addition to the Tier I benefits. The Tier II benefit is comparable to a private pension benefit. Tier II

[1] This RAB does not address treatment of retirement benefits such as those from the U.S. armed forces or the Michigan National Guard.
[2] 45 USC 231, *et seq.*
[3] Taxpayers whose gross income exceeds a federal limit must include a portion of their Tier I railroad retirement benefits in their federal gross income. IRC 86.
[4] MCL 206.30.

benefits are financed through a payroll tax, the majority of which is paid by the employer. Tier II benefit amounts are based solely on a worker's earnings while working for a railroad.

In 1984, benefits provided under the RRA, other than Tier I railroad retirement benefits, became subject to federal income taxation under IRC 72(r). However, Congress left in place the exemption from state taxation. Under 45 USC 231m, "no annuity or supplemental annuity shall be … subject to any tax" by any state. Therefore, Michigan may not tax retirement benefits received by a railroad retiree which qualify as an annuity.

Michigan Statute. Before 2012, the Michigan Income Tax Act did not expressly address railroad retirement benefits. The benefits were exempt from state taxation by operation of federal law.[5] Beginning in 2012, the Income Tax Act was amended to specifically exclude railroad retirement benefits from tax under section 30(1)(e)(ii)[6] if such benefits were included in adjusted gross income. Furthermore, Tier I and Tier II railroad benefits are not defined as "retirement or pension benefits" for purposes of the pension subtraction under section 30(1)(f). Therefore, Tier I and Tier II benefits are not subject to the 2012 tax law changes that limited the pension subtraction based on the date of birth under section 30(9). However, if a railroad retiree also has non-railroad retirement benefits, the subtraction allowed for those non-railroad retirement benefits may, in some instances, be reduced by the amount of the Tier I and Tier II benefits.

NON-RAILROAD RETIREMENT BENEFITS

The 2012 changes to pensions and retirement benefits [7] created three groups of taxpayers based upon year of birth.[8]

1. <u>*Taxpayers born before 1946*</u>. Generally, taxpayers who were born before 1946 are able to continue to subtract both railroad and *non-railroad* retirement benefits to the extent included in the federal adjusted gross income in the same manner as before. For tax year 2015, subtractions for private pensions are limited to $49,811 for a single filer and $99,623 for joint return filers. [9] While the subtraction for public pensions is unlimited, the permitted private pension subtraction is reduced dollar-for-dollar by any non-railroad public retirement benefits.

2. <u>*Taxpayers born during 1946-1952*</u>. For taxpayers born during 1946 through 1952, *non-railroad* pension and retirement benefits included in the federal adjusted gross income are subject to a limited deduction for retirement and pension benefits of $20,000 for single filers or $40,000 for joint return filers. Railroad retirement benefits remain fully deductible.

However, for taxpayers born during 1946-1952, *non-railroad* pension and retirement benefits are not deductible under the Michigan ITA beginning the year the taxpayer turns age 67. For these taxpayers, the *non-railroad* pension and retirement benefits deduction are replaced with a unrestricted "standard deduction" against all income of $20,000 for single filers or $40,000 for joint return filers. The standard deduction in section 30(9) replaces the pension subtraction. For

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[5] "[N]o annuity or supplemental annuity shall … be subject to any tax …" 23 USC 231m(a).
[6] MCL 206.30(1)(e)(ii) provides a deduction from AGI for retirement or pension benefits under RRA, 45 USC 231v.
[7] MCL 206.30(9).
[8] On a joint return, the pension and retirement deduction is based on the oldest spouse's date of birth.
[9] The private pension limits for taxpayer born before 1946 are indexed to inflation. MCL 206.30(f)(*iv*).

these taxpayers, the standard deduction is reduced by the amount of railroad retirement benefits that were deducted on the Michigan return.

Example 1. For tax year 2014, a single taxpayer born in 1948 who is age 66 reports the following:

Federal		
Gross income:		
Non-railroad pension	$21,000	
Railroad pension	25,000	
Other income	5,000	
Adjusted Gross Income		$51,000
Michigan		
Subtractions from AGI:		
Non-railroad pension	($20,000)	
Railroad pension	(25,000)	
2014 Personal exemption	(4,000)	
Total subtractions		(49,000)
Michigan Taxable Income		$ 2,000

In 2015, the same taxpayer born in 1948 who is now age 67 has the same income, however, the taxpayer's Michigan subtractions have changed.

Federal		
Gross income:		
Non-railroad pension	$21,000	
Railroad pension	25,000	
Other income	5,000	
Adjusted Gross Income		$51,000
Michigan		
Subtractions from AGI:		
Railroad pension	($25,000)	
Age 67 Standard deduction*	0	
2015 Personal exemption	(4,000)	
Total subtractions		(29,000)
Michigan Taxable Income		$22,000

* A person who takes the railroad pension deduction and any Social Security claimed in AGI is not eligible for the unrestricted deduction of $20,000.00 for a single return or $40,000.00 for a joint return under this subdivision. Michigan tax forms are designed to ensure that the most advantageous election is made.

3. *Taxpayers born in 1953 or later.* For taxpayers born during 1953 or later, *non-railroad* pension and retirement benefits are not deductible under the Michigan Income Tax Act; only the railroad retirement benefits are deductible. However, beginning the year the taxpayer turns 67, the taxpayer may claim a standard deduction against all income of $20,000 for single filers or

$40,000 for joint return filers. The standard deduction is reduced by the amount of railroad retirement benefits included in federal adjusted gross income by the taxpayer. Taxpayers may not deduct Social Security benefits or claim personal exemptions if they claim the standard deduction on their Michigan returns. Although there is a statutory election, the Department's forms will maximize the taxpayer's deduction. Taxpayers in this group will turn 67 in 2020 or later.

Example 2. For tax year 2015, a single taxpayer born in 1953 who is age 62 reports the following:

Federal		
Gross income:		
Non-railroad pension	$21,000	
Railroad pension	25,000	
Other income	5,000	
Adjusted Gross Income		$51,000
Michigan		
Subtractions from AGI:		
Non-railroad pension	0	
Railroad pension	(25,000)	
2015 Personal exemption	(4,000)	
Total subtractions		(29,000)
Michigan Taxable Income		$22,000

In 2020, the taxpayer born in 1953 will be 67. If the taxpayer has the same federal adjusted gross income as he had in 2015, the taxpayer may subtract the railroad pension of $25,000 and the personal exemption in lieu of taking the $20,000 standard deduction.

UNEMPLOYMENT, SICK, AND TERMINATION ALLOWANCE BENEFITS

Railroad unemployment benefits are not subject to Michigan income tax under the federal Railroad Unemployment Insurance Act, 45 USC 352(e). The taxpayer may deduct the amount of the railroad unemployment benefits and sick pay from Michigan taxable income to the extent it was included in federal adjusted gross income.

Benefits provided under Title VII of the Railroad Reorganization Act,[10] such as termination allowance or settlement of claims arising from collective bargaining agreements, are included in federal adjusted gross income and are not unemployment, sick pay or retirement benefits. Such benefits are taxable under the Michigan Income Tax Act.

[10] 45 USC 797, *et seq.*