Executive Summary:

Social Security & Railroad Deduction

(Income Tax)

July, 2014

Joint Subcommittee to Evaluate Tax Preferences

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| * Preference:   § 58.1-322 (C)(4) |
| * Summary:   In calculating Virginia adjusted gross income, a taxpayer is allowed a subtraction for Social Security benefits and certain federal railroad retirement benefits, to the extent such income was included in the taxpayer's federal adjusted gross income. |
| * Revenue Impact:   The subtraction accounts for approximately $304.0 million in reduced state tax revenues (Tax Year 2011). |
| * Joint Subcommittee Recommendation:   (to be completed after joint subcommittee meeting) |

Preference Report:

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Preference Description

Subdivison C 4 of § 58.1-322 of the Code of Virginia allows a taxpayer to subtract, to the extent included in his federal adjusted gross income, "[b]enefits received under Title II of the Social Security Act and other benefits subject to federal income taxation solely pursuant to § 86 of the Internal Revenue Code" for purposes of determining his Virginia taxable income.

The benefits referred to in § 86 of the Internal Revenue Code are Tier I Railroad Retirement benefits, a program established in the 1930's to provide federal retirement for railroad workers. These benefits were designed to be equivalent to the annuity offered by Social Security, and are reduced by any Social Security payments that a beneficiary might receive. Thus, the benefits are treated the same for federal tax purposes.

A portion of Social security and Tier I railroad retirement benefits are taxable under federal law, based upon income. For a single taxpayer, if one-half of his benefits plus all other income, including tax-exempt interest, exceeds a base amount of $25,000, a portion of benefits will be taxable. For married couples filing jointly, the base amount is $32,000. Depending on income, up to 85 percent of the benefits may be taxable. The subtraction found at subdivision C 4 of § 58.1-322 allows this taxable amount of income included in the taxpayer's federal adjusted gross income -- not the entirety of the taxpayer's benefit -- to be subtracted in determining his Virginia taxable income.

Preference Purpose

Prior to changes in federal law in 1984, Social Security and Tier I railroad retirement benefits were not considered taxable income. The state subtraction was enacted when a portion of such benefits became a part of federal adjusted gross income for tax purposes. Ostensibly, this change was implemented to maintain the historical status quo in Virginia that these retirement benefits were not subject to state taxation.

Legislative History & Background

1983: The Virginia General Assembly enacted a subtraction, to the extent included in federal adjusted gross income, for "[b]enefits received under Title II of the Social Security Act."[[1]](#footnote-1)

1984: The subtraction was amended in 1984 to also include Tier I railroad retirement benefits.

The subtraction has not been further amended since 1984.

Revenue Impact

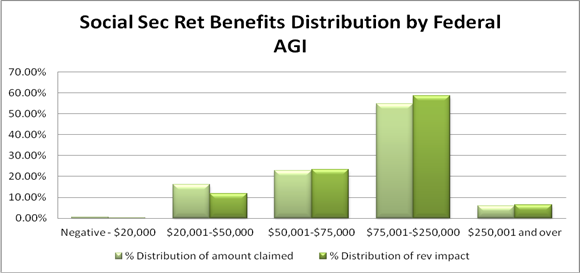
Tax year 2011 individual income tax returns show that 434,290 taxpayers claimed on average $12,863 in social security and tier 1 railroad retirements benefits for a total of $5.6 billion. Based on TAX individual model which calculates the income tax liability for each return, the revenue impact of the tax preference was estimated at $304 million for an average amount of $700 per return. The tax preference encompasses social security and tier 1 railroad retirement benefits. Tier 1 railroad retirement benefits revenue impact was estimated at $3.2 million based on monthly data reported by the Railroad Retirement Board and the Social Security administration. Tier 1 railroad retirement benefits subtraction could not be repealed.



**Distribution of Social Security and Tier 1 Railroad Retirements Benefits by Federal AGI (FAGI)**

The Department of Taxation analyzed the distribution of the benefits based on Federal Adjusted Gross Income (FAGI) reported by taxpayers on the Virginia individual income tax return.[[2]](#footnote-2) The table and the chart below show that taxpayers with FAGI between $75,001 and $250,000 have the largest share of the tax preference claimed (54.69%) and the estimated revenue impact (58.53%). Their income tax liability is reduced by an estimated average amount of $1,084. On the other hand, taxpayers with FAGI less or equal to $20,000 have the smallest share of the tax preference and the lowest average estimated revenue impact of $14.





**Distribution of Social Security and Tier 1 Railroad Retirements Benefits by filing status**

Taxpayers who file a joint return claimed the majority of the income tax preference. Their income tax liability is reduced by an average estimated amount of $801.



\*For nonresidents, the amount claimed has been adjusted to reflect VA portion of the tax preference.

Other States

Of the 41 states that have an income tax, 28 states (including Virginia) and the District of Columbia, provide for the full subtraction of Social Security and Tier I railroad retirement benefits.[[3]](#footnote-3) The remaining 13 states take a variety of approaches to taxing the benefit income:

* Connecticut, Kansas, and Missouri have established income-based exemptions, whereby the entire amount of the benefit may be subtracted if federal adjusted gross income is below a certain threshold. For example, Kansas allows a full exemption if the taxpayer's federal adjusted gross income is $75,000 or less, regardless of filing status.
* Colorado, Utah, and West Virginia provide an exemption or credit for retirement income that can be used to avoid paying taxes on Social Security income. For example, Colorado taxpayers age 65 and older may exclude up to $24,000 of retirement earnings from state taxes. Utah allows retired taxpayers age 65 or older to claim a nonrefundable tax credit of up to $450 ($900 for married couples) to offset taxes on Social Security benefits.
* Minnesota, Montana, Nebraska, New Mexico, North Dakota, Rhode Island, and Vermont tax all of the benefits included in federal adjusted gross income.

Other Information

Social Security benefits and Tier I railroad benefits also interact with another Virginia-based income deduction. Pursuant to subdivision D 5 b of § 58.1-322, taxpayers born on or between January 2, 1939 and January 1, 1948 may be eligible to claim an income-based age deduction of up to $12,000. The amount of the deduction is based on a sliding income scale. For purposes of determining the amount of the deduction, a taxpayer's income is based on his federal adjusted gross income minus any Social Security benefits or Tier I railroad retirement benefits.

In addition to the Tier I railroad benefits discussed herein, some taxpayers are eligible for additional railroad retirement benefits referred to as "Tier II railroad retirement benefits." These Tier II benefits were created enacted by the United States Congress in the Railroad Retirement Act of 1974, and are comparable to private pension plans. The federal Act prohibits state taxation of Tier II benefits. As a result, there is nothing in the Code of Virginia that specifically references the taxation (or exclusion from taxation) of these benefits. However, the Virginia Administrative Code does indicate that these benefits shall be subtracted from federal adjusted gross income in computing Virginia taxable income.[[4]](#footnote-4) Data from Tax Year 2011 indicates that a subtraction for Tier II benefits was claimed on 6,534 returns, with an estimated revenue impact of $2.89 million dollars.



\*For nonresidents, the amount claimed has been adjusted to reflect VA portion of the tax preference.

Joint Subcommittee Recommendation

(to be completed after Joint Subcommittee meeting)

Preference Report Compiled by Staff from the Virginia Division of Legislative Services and the Virginia Department of Taxation

1. Chapter 472 of the Acts of Assembly of 1983. [↑](#footnote-ref-1)
2. The income groups used in this analysis are not equivalent to the income groups used in the federal Consumer Expenditure Survey. [↑](#footnote-ref-2)
3. Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming do not have an individual income tax. Tennessee and New Hampshire do not tax income or Social Security, but do tax interest and dividends. [↑](#footnote-ref-3)
4. 23 VAC 10-110-142(5). [↑](#footnote-ref-4)