

EXECUTIVE SUMMARY:
SOCIAL SECURITY & RAILROAD RETIREMENT
BENEFITS DEDUCTION

(INCOME TAX)

JULY, 2014

JOINT SUBCOMMITTEE TO EVALUATE TAX PREFERENCES

- 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:

The Joint Subcommittee recommended that the preference be continued.

PREFERENCE REPORT: SOCIAL SECURITY & RAILROAD RETIREMENT BENEFITS DEDUCTION

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Preference Description

Subdivision 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 include 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

1984: The subtraction was amended in 1984 to also include Tier I railroad retirement benefits (and other benefits subject to federal taxation pursuant to § 86 of the Internal Revenue Code).²

The subtraction has not been further amended since 1984.

It is also relevant to note that federal law prohibits state taxation of all Railroad Retirement benefits.³ The state subtraction found at subdivision C 4 of § 58.1-322 specifically reflects this prohibition in subtracting out any Tier I Railroad Retirement benefits included in federal adjusted gross income in determining Virginia taxable income. However, the Virginia Code does not specifically mention Tier II Railroad Retirement benefits, another class of federal benefits not taxable at the state level. These are also subtracted from federal adjusted gross income for Virginia tax purposes, as set forth in the Virginia Administrative Code. A more detailed discussion of Tier II Railroad Retirement benefits can be found below in the section entitled "Other Information."

Revenue Impact

In Taxable Year 2011, 434,290 individual income tax returns claimed an average subtraction of \$12,863 in Social Security and Tier 1 Railroad Retirements benefits for a total subtraction amount of approximately \$5.6 billion. The revenue impact of the subtraction for Taxable Year 2011 was estimated at \$304 million for an average amount of \$700 per return.

Social Security and Tier 1 Railroad Benefits Subtraction Claimed for Taxable Year 2011

Taxable Year	Number of returns	Amount Claimed ⁴ (in millions)	Average Subtraction Per Return	Estimated Revenue Impact (in millions)	Average Reduced Tax Liability Per Return
2011	434,290	\$5,586.3	\$12,863	\$304.0	\$700

¹ Chapter 472 of the Acts of Assembly of 1983.

² Chapter 162 of the Acts of Assembly of 1984.

³ 45 U.S.C. §231m.

⁴ For nonresidents, the amount claimed has been adjusted to reflect the Virginia portion of the subtraction.

Based on data from the Railroad Retirement Board and the Social Security Administration, the Department estimates that \$3.2 million of the total \$304 million impact in Taxable Year 2011 was due to Tier 1 Railroad Retirement benefits, and the remaining \$300.8 million was due to Social Security benefits.

Distribution of the Social Security and Tier 1 Railroad Retirements Benefits Subtraction 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.⁵ The table and the chart below show that taxpayers with FAGI between \$75,001 and \$250,000 claimed the largest share of the tax preference (54.69%) and the estimated revenue impact (58.53%) in Taxable Year 2011. Their income tax liability was reduced by an estimated average amount of \$1,084 during Taxable Year 2011. On the other hand, taxpayers with FAGI less than or equal to \$20,000 claimed the smallest share of the tax preference and only reduced their tax liability by an estimated \$14 per taxpayer.

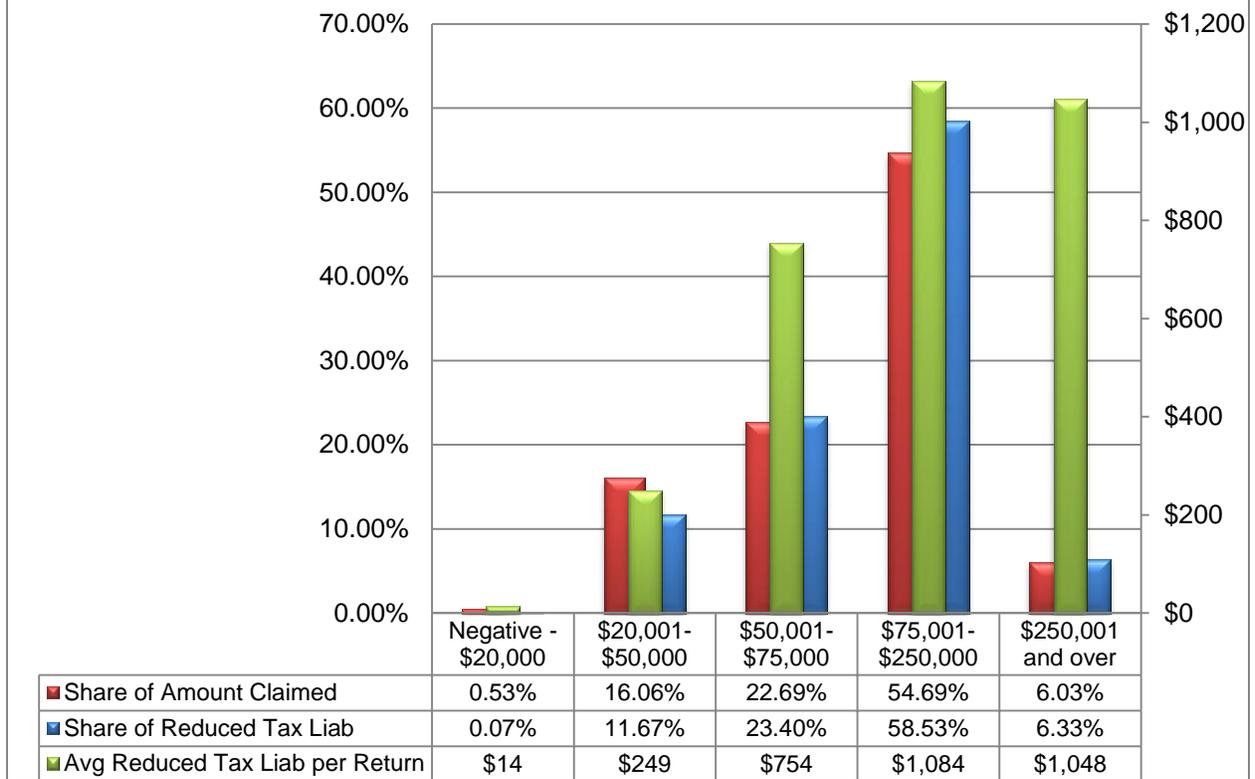
Subtraction Claimed By Federal AGI (Taxable Year 2011)

FAGI	Number of Returns	Amount Claimed ⁶ (in millions)	Share of Amount Claimed	Average Subtraction Per Return	Estimated Revenue Impact (in millions)	Share of Reduced Tax Liability	Average Reduced Tax Liability Per Return
Negative - \$20,000	15,162	\$29.8	0.53%	\$1,964	\$0.2	0.07%	\$14
\$20,001-\$50,000	142,324	\$897.2	16.06%	\$6,304	\$35.5	11.67%	\$249
\$50,001-\$75,000	94,302	\$1,267.6	22.69%	\$13,442	\$71.1	23.40%	\$754
\$75,001-\$250,000	164,123	\$3,054.9	54.69%	\$18,614	\$177.9	58.53%	\$1,084
\$250,001 and over	18,379	\$336.8	6.03%	\$18,323	\$19.3	6.33%	\$1,048

⁵ The income groups used in this analysis are not equivalent to the income groups used in the federal Consumer Expenditure Survey.

⁶ For nonresidents, the amount claimed has been adjusted to reflect the Virginia portion of the subtraction.

Social Security Benefits Distribution and Average Reduced Tax Liability per Return by Income Level



Distribution of the Social Security and Tier 1 Railroad Retirements Benefits Subtraction by Filing Status

Taxpayers who filed a joint return claimed the majority of the income tax preference. Their income tax liability was reduced by an average estimated amount of \$801 during Taxable Year 2011.

Subtraction Claimed By Filing Status (Taxable Year 2011)

Filing Status	Number of Returns	Amount Claimed ⁷ (in millions)	Share of Amount Claimed	Average Subtraction Per Return	Estimated Revenue Impact (in millions)	Share of Reduced Tax Liability	Average Reduced Tax Liability Per Return
Single	146,579	\$1,448.5	25.93%	\$9,882	\$77.0	25.33%	\$525
Joint	277,818	\$4,039.0	72.30%	\$14,538	\$222.5	73.18%	\$801
Separate	9,893	\$98.8	1.77%	\$9,992	\$4.5	1.49%	\$457

⁷ For nonresidents, the amount claimed has been adjusted to reflect the Virginia portion of the subtraction.

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.⁸ The remaining 13 states take a variety of approaches to taxing the Social Security income. As mentioned above, no state is permitted to tax the Railroad Retirement benefits:

- 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 Social Security benefits included in federal adjusted gross income.

Other Information

Social Security benefits and Tier I Railroad Retirement 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 Retirement 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. Although there is nothing in the Code of Virginia that specifically references the taxation (or exclusion from taxation) of these benefits, the federal Act prohibits state taxation of these benefits. Accordingly, the Virginia Administrative Code indicates that these benefits shall be subtracted from federal adjusted gross income in computing Virginia taxable

⁸ 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.

income.⁹ Data from Taxable 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.

Tier 2 Railroad Benefits Subtraction Claimed for Taxable Year 2011

Taxable Year	Number of Returns	Amount Claimed ¹⁰ (in millions)	Average Subtraction per Return	Estimated Revenue Impact (in millions)	Average Reduced Tax Liability Per Return
2011	6,534	\$87.50	\$13,391	\$2.89	\$442

By Federal AGI

FAGI	Number of Returns	Amount Claimed ¹¹ (in millions)	Share of Amount Claimed	Average Subtraction per Return	Estimated Revenue Impact (in millions)	Share of Reduced Tax Liability	Average Reduced Tax Liability per Return
Negative - \$20,000	1,577	\$10.72	12.25%	\$6,795	\$0.03	1.19%	\$22
\$20,001-\$50,000	2,156	\$28.65	32.74%	\$13,287	\$0.54	18.77%	\$252
\$50,001-\$75,000	1,191	\$19.01	21.72%	\$15,958	\$0.76	26.11%	\$634
\$75,001-\$250,000	1,510	\$27.45	31.37%	\$18,178	\$1.46	50.59%	\$969
\$250,001 and over	100	\$1.68	1.92%	\$16,788	\$0.10	3.33%	\$964

By Filing Status

Filing Status	Number of returns	Amount Claimed ¹² (in millions)	Share of Amount Claimed	Average Subtraction per Return	Estimated Revenue Impact (in millions)	Share of Reduced Tax Liability	Average Reduced Tax Liability per Return
Single	2,545	\$20.07	22.93%	\$7,885	\$0.56	19.33%	\$220
Joint	3,894	\$66.33	75.81%	\$17,034	\$2.29	79.18%	\$588
Separate	95	\$1.10	1.26%	\$11,572	\$0.04	1.49%	\$454

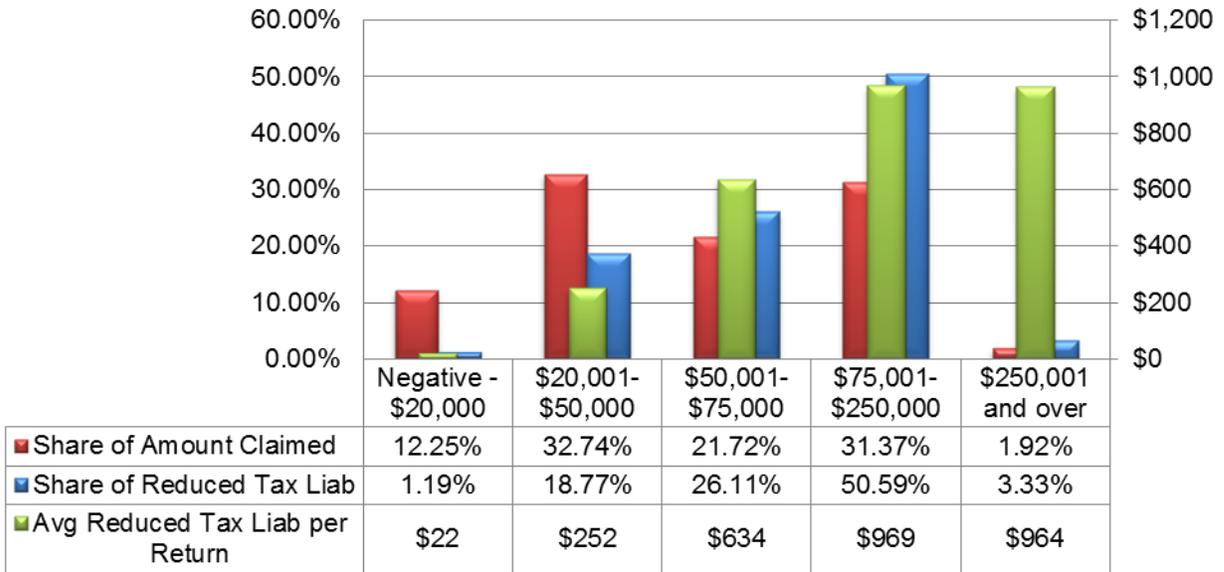
⁹ 23 VAC 10-110-142(5).

¹⁰ For nonresidents, the amount claimed has been adjusted to reflect VA portion of the tax preference.

¹¹ For nonresidents, the amount claimed has been adjusted to reflect VA portion of the tax preference.

¹² For nonresidents, the amount claimed has been adjusted to reflect VA portion of the tax preference.

Tier 2 Railroad benefits distribution and Average Reduced Tax Liability per Return by Income Level



Joint Subcommittee Recommendation

At its July 24, 2014 meeting, the Joint Subcommittee recommended that the income tax subtraction found at Subdivision C 4 of § 58.1-322 of the Code of Virginia for income related to Social Security and Railroad Retirement benefits be continued.