



UNITED STATES OF AMERICA
RAILROAD RETIREMENT BOARD
844 NORTH RUSH STREET
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GENERAL COUNSEL

**March 7, 2013
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Mr. Andy Dillion, State Treasurer
Michigan Department of Treasury
Richard H. Austin Building
430 West Allegan Street
Lansing, MI, 48922

C. 1631-13

Dear Mr. Dillon:

This letter is to bring to your attention a conflict between the Michigan Income Tax Code and the Railroad Retirement Act (RRA) (45 U.S.C. § 231 et. seq.), which results in the invalidity of the Michigan Code provision under the supremacy clause of the United States Constitution.

The Railroad Retirement Board (RRB), an independent agency in the executive branch of the United States Government, is charged with administering the RRA. As you may know, the RRA replaces the Social Security Act for railroad workers. Section 14 of the RRA (45 U.S.C. § 231m) expressly prohibits the taxation of benefits paid under the federal statute:

14(a) Except as provided in subsection (b) of this section and the Internal Revenue Code of 1986 [26 U.S.C.A. § 1 et seq.], notwithstanding any other law of the United States, or of any State, * * * no annuity or supplemental annuity shall be assignable or subject to any tax * * *.

(b)(1) This section shall not operate to exclude the amount of any supplemental annuity * * * from income taxable pursuant to the Federal income tax provisions * * *.

The Internal Revenue Code requires that the portion of a railroad retirement annuity which is equivalent to a social security benefit is subject to taxation on the same basis as a social security benefit. See Section 86(d)(1) of the Code (26 U.S.C. § 86(d)(1)). The Code further provides that the remaining portion of a railroad retirement annuity and any supplemental annuity shall be taxable as income to the same extent as a private pension under an employer plan. See section 72(r) of the Code (26 U.S.C. § 72(r)). These Internal Revenue Code provisions implement the exceptions to the prohibition against taxation contained in section 14 of the RRA, but only for purposes of Federal income taxes. Section 14 of the Act clearly continues to exempt railroad retirement annuities, including supplemental annuities, from income taxation by States.

Recent changes to the Michigan Code, specifically MCL § 206.30, regarding the taxation of retirement and pension benefits for individuals born after 1945 appear to bypass Congress' mandated exemption from State income tax. As I understand the relevant provisions of the Michigan Code, individuals born after 1945 are able to deduct their railroad retirement benefits paid under the RRA from their income subject to Michigan State income taxation without limitation only until they attain age 67. Once they attain age 67, if these annuitants continue to deduct their railroad retirement benefits paid under the RRA from their taxable income for Michigan State income tax purposes, they are barred from claiming a \$20,000 deduction for a single return and a \$40,000 deduction for a joint return available to other taxpayers of similar age. By denying the \$20,000/\$40,000 deduction to individuals who are paid an annuity under the RRA, the State of Michigan in effect assesses a State tax on annuities payable under the RRA.

It should be noted that in Hisquierdo v. Hisquierdo, 439 U.S. 572, 584 (1979), the United States Supreme Court addressed the validity of the anti-tax provision found in section 14 of the RRA:

Like anti-attachment provisions generally (citations omitted), it ensures that the benefits actually reach the beneficiary. It pre-empts all state law that stands in its way. It protects the benefits from legal process "notwithstanding any other law ... of any State." Even state tax-collection laws must bow to its command, for Congress added that phrase in an amendment designed in part to ensure that neither federal nor state tax collectors would encroach on the distribution of benefits.

Subsequent to Hisquierdo, Congress amended the RRA to allow for the taxation of benefits payable under the RRA for Federal income taxation purposes. However, no such amendment was made for State income tax purposes.

Courts of other states have recognized that section 14 of the RRA prohibits taxation of annuities under the RRA. See, e.g., Jaeb v. Commissioner of Revenue, 1989 Minn. Tax LEXIS 60 (Minn. Tax Court, May 2, 1989); Becraft v. Dept. of Revenue, 2005 Ore. Tax LEXIS 254 (Ore. Tax Court, December 7, 2005). Moreover, I note that while the Supreme Court of Michigan has issued an advisory opinion which concluded that the MCL 206.30 did not violate the impairment of contract prohibition of Article I, Section 10(1) of the U.S. Constitution, or violate equal protection under the law under the 14th Amendment to the U.S. Constitution, the Michigan Supreme Court did not consider invalidity as a result of a conflict with Federal law pursuant to the supremacy clause of Article VI of the U.S. Constitution. In re Request for Advisory Opinion Regarding Constitutionality of 2011 PA 38, 806 N.W. 2d 683 (Mich., 2011).

Accordingly, pursuant to section 14 of the RRA, railroad retirement annuities remain exempt from Michigan income taxation.

Sincerely,



Karl T. Blank
General Counsel