

Final Order Denying Refund: 01-20190156R
Indiana Individual Income Tax
For the Year 2017

NOTICE: IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Final Order Denying Refund.

HOLDING

In preparing her 2017 Indiana income tax return, Individual Retiree was required to reduce her Civil Service Annuity Deduction by the total amount of Railroad Retirement Benefits she received; the Department's IT-40 Instruction Booklet was incorrect in explaining to what extent she was required to calculate that reduction.

ISSUE

I. Individual Income Tax - Civil Service Annuity Deduction.

Authority: IC § 6-3-2-3.7; IC § 6-3-2-3.7(a)(2); *F.A. Wilhelm Const. Co., Inc. v. Ind. Dep't of State Revenue*, 586 N.E.2d 953 (Ind. Tax Ct. 1992); *C & C Oil v. Ind. Dep't of State Revenue*, 570 N.E.2d 1376 (Ind. Tax Ct. 1991); Income Tax Information Bulletin 6 (July 2015); IT-40 Booklet 2017; Social Security Office of Retirement and Disability Policy, An Overview of the Railroad Retirement Program.

Taxpayer argues that the Department erred in reducing her Civil Service Annuity Deduction, that the Department should restore the original deduction, and as a result is entitled to an additional refund of Indiana income tax.

STATEMENT OF FACTS

Taxpayer is an Indiana resident who filed a 2017 Indiana individual income tax return. On that return, Taxpayer reported receiving Civil Service Annuity ("CSA") proceeds. In calculating her 2017 income tax, Taxpayer reduced the amount of taxable income by the amount of CSA income. In doing so, Taxpayer originally claimed a refund of approximately \$500.

The Indiana Department of Revenue ("Department") disagreed with Taxpayer's calculation. The Department determined that Taxpayer was not entitled to reduce her taxable income by the \$16,000 CSA amount originally reported. The Department reduced the CSA deduction to approximately \$12,000. In a letter dated June 2018, the Department explained:

After reviewing the correspondence received and account, the department decreased the Civil Service Annuity Deduction from \$16,000 to [approximately \$12,000]. While the maximum credit allowance is \$16,000, it was reduced because you claimed the deduction for Taxable Railroad Benefits in the amount of [\$4,000].

In making the adjustment, the Department reduced the \$500 refund originally claimed to approximately \$300.

Taxpayer disagreed with the adjustment, the partial refund denial, and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer explained the basis for the protest. This Final Order Denying Refund results.

I. Individual Income Tax - Civil Service Annuity Deduction.

DISCUSSION

The issue is whether the Department erred when it reduced the amount of Taxpayer's CSA deduction from \$16,000 to approximately \$12,000 by subtracting from the CSA deduction Railroad Retirement Benefits. Taxpayer maintains that she is entitled to the entire \$16,000 deduction while the Department maintains that she is entitled to a lesser deduction.

Indiana's statutory authority for allowing the \$16,000 deduction is found at IC § 6-3-2-3.7, which provides as

follows:

(a) Each taxable year, an individual or the individual's surviving spouse is entitled to an adjusted gross income tax deduction equal to the remainder of:

(1) the:

(A) first eight thousand dollars (\$8,000) for taxable years beginning after December 31, 2014, and before January 1, 2016; and

(B) **first sixteen thousand dollars (\$16,000)**, for taxable years beginning after December 31, 2015; which is received by the individual or the individual's surviving spouse during the taxable year from a federal civil service annuity, and which is included in adjusted gross income under Section 62 of the Internal Revenue Code; **minus**

(2) the total amount of **social security benefits and railroad retirement benefits** received by the individual or the individual's surviving spouse during the taxable year.

(b) The individual is only entitled to the deduction provided by this section if the individual is at least sixty-two (62) years of age before the end of the taxable year. This subsection does not apply to the individual's surviving spouse. (**Emphasis added**).

The Department issued Income Tax Information Bulletin 6 (July 2015), 20150826 Ind. Reg. 045150277NRA, which explains as follows:

IC [§] 6-3-2-3.7 allows a deduction for a portion of a federal civil service annuity. To qualify for the civil service annuity adjustment, the taxpayer must be at least 62 years old at the close of the tax year and have received a civil service annuity included in the taxpayer's adjusted gross income while a resident of Indiana. The individual's surviving spouse also qualifies for the deduction but does not have to be age 62 or older to qualify.

The allowable adjustment is equal to the federal civil service annuity received up to a maximum of \$8,000 for 2015 and \$16,000 for 2016 and thereafter, minus the total amount of Social Security and **tier 1 and tier 2** railroad retirement benefits received while a resident of Indiana. See *also* Income Tax Information Bulletin 6 (December 2017), 20180131 Ind. Reg. 045180048NRA.

(Emphasis added).

Taxpayer disagrees with the Department's interpretation explaining that she was not required to deduct the two reported amounts of railroad retirement benefits received during 2017. Taxpayer explains that the two tiers of benefit amounts are "substantially different" and that "the two types of railroad payments should be treated entirely different."

According to Taxpayer, the "Tier 1" railroad benefits are "the equivalent of Social Security for railroad employees" while "Tier 2" benefits are "essentially a pension not unlike any corporate pension." Under Taxpayer's interpretation, Tier 1 benefits are subtracted from the exempt CSA amount while Tier 2 benefits are not subtracted from the exempt CSA. Taxpayer concludes that because she did not receive any Tier 1 benefits, she is entitled to the original \$16,000 CSA deduction because none of her railroad benefits should have been subtracted from the \$16,000 amount.

According to the Social Security Bulletin, Vo. 68, No. 2, 2008, "Tier 1 benefits that [Railroad Retirement Benefit] provides for its beneficiaries are designed to take the place of Social Security" while Tier 2 benefits are an additional "benefit available to railroad workers . . . designed to resemble a comparable private defined benefit pension." Social Security Office of Retirement and Disability Policy, An Overview of the Railroad Retirement Program, <https://www.ssa.gov/policy/docs/ssb/v68n2/v68n2p41.html> (last visited March 6, 2019).

Taxpayer's interpretation flies in the face of the plain language of the statute which requires that the CSA be reduced by:

[T]he total amount of **social security benefits and railroad retirement benefits** received by the individual or the individual's surviving spouse during the taxable year. IC § 6-3-2-3.7(a)(2).

The statute makes no distinction between Tier 1 benefits and Tier 2 benefits and both category of benefits must be subtracted from the \$16,000 CSA deduction.

Taxpayer's interpretation is also at odds with the Department's clear instruction on this matter.

The allowable adjustment is equal to the federal civil service annuity received up to a maximum . . . \$16,000 for 2016 and thereafter, minus the total amount of Social Security and tier 1 and tier 2 railroad retirement benefits received while a resident of Indiana. Income Tax Information Bulletin 6.

Nonetheless, Taxpayer points to the Department's own 2017 instructions for completing the IT-40. The instructions for calculating the Civil Service Deduction provide:

To figure the [CSA] deduction, begin with the taxable amount of civil service annuity income or \$16,000, whichever is less. Subtract from that amount any Social Security income and *tier 1 Railroad Retirement income* (issued by the Railroad Retirement Board) the surviving spouse received. Indiana Department of Revenue, IT-40 Full-Year Resident Individual Income Tax Booklet (2017) ("IT-40 Booklet 2017"), <https://www.in.gov/dor/5695.html> (last visited March 6, 2019).

(Emphasis added).

The Department's instruction booklet on this matter is misleading. As noted above, both the statute and the Department's own specific instructions on the issue require that both Tier 1 and Tier 2 benefits be subtracted from the standard \$16,000 CSA deduction. The statute could not be clearer on the matter; a taxpayer must subtract from the CSA "the *total* amount of Social Security and tier 1 and tier 2 railroad retirement benefits." IC § 6-3-2-3.7(a)(2).

To the extent that the Department's IT-40 booklet instructions are at odds with the plain language of the statute, the instructions are incorrect and invalid.

Of course the Department regrets the reliance Taxpayer justifiably placed in the Department's instructions on this matter. However, the Department is bound to comply with the "plain and unambiguous" language of the statute and may not "limit[] or extend[] its operation." *F.A. Wilhelm Const. Co., Inc. v. Ind. Dep't of State Revenue*, 586 N.E.2d 953, 955 (Ind. Tax Ct. 1992) (citing *C & C Oil v. Ind. Dep't of State Revenue*, 570 N.E.2d 1376, 1380 (Ind. Tax Ct. 1991)).

FINDING

Taxpayer's protest is respectfully denied.

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