

General Information Letter: Federal law prohibits state taxation of sickness benefits paid under the Railroad Retirement and Unemployment Insurance Act, so any amount of these benefits included in adjusted gross income of a taxpayer may be subtracted in computing base income.

September 13, 2012

Dear:

This is in response to your letter email dated April 10, 2012 in which you state the following:

After reviewing the tax code we feel Illinois is not subtracting Railroad Retirement Sickness Benefits correctly and would like some guidance from the state as to whether or not they agree with our research.

Sickness benefits paid under the Railroad Retirement and Unemployment Insurance Acts are not taxable by states. See attached 45 USC §352(e), 45 USC §231m, and Railroad Retirement Board Publication 1202, Pg 4, No. 18 (Feb 2010).

IL 1040 provides for a subtraction to income for railroad retirement plans and railroad retirement benefits. IL Schedule M provides for a subtraction for Railroad unemployment income at line 35 and states to attach form 1099G. It further states to not include retirement or third party sick pay on line 35. See attached IL 1040 Instructions, IL Sch M Instructions.

Sickness benefits paid by the U.S. Railroad Retirement Board under the Railroad Unemployment Insurance Act are “third-party sick pay” because it comes from the Railroad Retirement Board and not directly from the taxpayer’s employer, the railroad company. If a taxpayer receives only sickness benefits (and not unemployment benefits) from the Railroad Retirement Board, he will receive only a W-2 showing the amount of sickness benefits. The taxpayer will not receive a 1099G unless he also receives unemployment benefits in addition to sickness benefits. See attached RRB Form UB-9 Publication pg 14. The sickness benefits are not taxable by states, but are included in federal income and therefore must be subtracted from state income.

Therefore, where does an IL taxpayer who receives sickness benefits from the Railroad Retirement Board subtract the nontaxable sickness benefits from his Illinois return? Is it done on IL 1040 Line 5 or IL Sch M?

For a state example, see the attached for how North Carolina handles the railroad sickness benefit pay. Included are the NC D-400 and Instructions showing that sickness benefits are subtracted on line 44 which would be equivalent to subtracting on line 5 of the IL 1040 (as railroad retirement benefits). See attached NC D-400 Instructions Line 44 page 13 and IL 1040 Line 5 instructions. For ease of reading the attachments, relevant portions have been highlighted and some non-relevant document pages have been removed.

According to the Department of Revenue (“Department”) regulations, the Department may issue only two types of letter rulings: Private Letter Rulings (“PLR”) and General Information Letters (“GIL”). The regulations explaining these two types of rulings issued by the Department can be found in 2

Ill.Admin.Code §1200, or on the website <http://www.tax.illinois.gov/LegalInformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

An individual's base income for Illinois income tax liability is the taxpayer's federal adjusted gross income as modified by certain addition and subtraction modifications set forth in Section 203 of the Illinois Income Tax Act ("IITA;" 35 ILCS 5/101 et seq.). One such modification allowed as a reduction to base income in arriving at net income is any amount included in federal adjusted gross income which is exempt from State tax by federal law. The statutory language can be found in IITA Section 203(a)(2)(N):

(N) An amount equal to all amounts included in such total which are exempt from taxation by this State either by reason of its statutes or Constitution or by reason of the Constitution, treaties or statutes of the United States; provided that, in the case of any statute of this State that exempts income derived from bonds or other obligations from the tax imposed under this Act, the amount exempted shall be the interest net of bond premium amortization;

As you point out in your letter, sickness benefits paid under the federal Railroad Unemployment Insurance Act, 45 U.S.C. Section 352(e), are not taxable by states:

352. Benefits

...
(e) Assignment, taxation, garnishment, attachment, etc., of benefits Notwithstanding any other law of the United States, or of any State, Territory or the District of Columbia, no benefits shall be assignable or be subject to any tax or to garnishment, attachment, or other legal process under any circumstances whatsoever, nor shall the payment thereof be anticipated.

The Department regulations, specifically 86 Ill.Admin.Code 100.2470(c), provides a list that is intended to be exhaustive of exempt income along with the specific statutes to which each exempt income item relates. The Railroad Unemployment Insurance Act is included in paragraph 18 of Section 2470(c). Your client may therefore subtract the nontaxable sickness benefits from his Illinois return on IL-1040 Line 5.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Heidi Scott
Associate Counsel -- Income Tax