

STATE OF MICHIGAN
IN THE SUPREME COURT

IN RE REQUEST FOR ADVISORY OPINION
REGARDING CONSTITUTIONALITY OF
2011 PA 38

Docket No. 143157

AMICUS CURIAE BRIEF OF MICHIGAN STATE AFL-CIO
AND SERVICE EMPLOYEES INTERNATIONAL UNION, LOCAL 517M

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STATEMENT OF BASIS OF JURISDICTION

2011 PA 38 was signed by Governor Rick Snyder on May 25, 2011, and will be effective October 1, 2011. On May 31, 2011, Governor Snyder requested that this Court issue an advisory opinion as to the constitutionality of the law, and this Court granted the request, by order dated June 15, 2011.

STATEMENT OF QUESTIONS PRESENTED

The Court's Order of June 15, 2011 identified the following questions:

1. Does reducing or eliminating the statutory exemption for public-pension incomes as described in MCL 206.30, as amended, impair accrued financial benefits of a "pension plan [or] retirement system of the state [or] its political subdivisions" under Const 1963, art 9, § 24?

Amici curiae say that the answer is, "YES."

2. Does reducing or eliminating the statutory tax exemption for pension incomes, as described in MCL 206.30, as amended, impair a contract obligation in violation of Const 1963, art 1 § 10 or the US Const, art I, § 10(1)?

Amici curiae say that the answer is, "YES."

3. Does determining eligibility for income-tax exemptions on the basis of total household resources, or age and total household resources, as described in MCL 206.30(7) and (9), as amended, create a graduated income tax in violation of Const 1963, art 9, § 7?

Amici curiae do not address this question.

4. Does determining eligibility for income-tax exemptions on the basis of date of birth, as described in MCL 206.30(9), as amended, violate equal protection of the law under Const 1963, art 1, § 2 or the Fourteenth Amendment of the United States Constitution?

Amici curiae do not address this question.

INTEREST OF AMICI CURIAE

Proposed *amicus curiae* Service Employees International Union, Local 517M, is a labor organization which represents for purposes of collective bargaining more than 4,000 persons employed by the State of Michigan. It is committed to ensuring fair and reasonable wages, hours and working conditions for the employees it represents and seeks to insure as well that they enjoy the benefits of a secure retirement and that the promises made to them by the State of Michigan are respected and enforced.

Proposed *amicus curiae* Michigan AFL-CIO is a labor federation comprised of constituent labor organizations in Michigan. A primary objective of Michigan AFL-CIO is to improve the quality of life for working families in Michigan and it works in every forum to educate the public, and to advocate for working families in the legislative and judicial arenas.

STATEMENT OF FACTS

Amici curiae accept and adopt the statement of facts set forth as the statement of the case in the brief of the Attorney General arguing that 2011 PA 38 is unconstitutional.

ARGUMENT

INTRODUCTION

The State Employees' Retirement Act was passed in 1943. For the nearly seventy years since that time it has contained a vitally important promise to the state employees – that their pension benefits would be exempt from taxation.¹ There is an old adage, attributed to Jonathan Swift, that, "Promises and pie-crusts are made to be broken." But the citizens of Michigan, in adopting the Constitution of 1963, said that some promises must be kept, that the promises made by the state and local governments to their employees regarding their pension benefits are contractual commitments which cannot be impaired or diminished. The employees who have provided long and faithful service to the state and its citizens have quite reasonably and justifiably relied upon these promises in planning for their retirement based, at least in part, on the commitment made to them about what retirement income they should expect. The legislature in passing 2011 PA 38 has sought to remove the long standing tax exemption for the pensions of state and other public employees – and to do so not just prospectively but retroactively as to the accrued and vested pension benefits. By so doing it would impair and diminish the accrued pension benefits owed to the employees and would violate art 1, § 10 and art 9, § 24 of the Michigan Constitution and art I, § 10 of the United States Constitution.

¹ The same promise that pension benefits would be tax exempt is contained in other state pension plans and also in the income tax act.

I. 2011 PA 38'S REDUCTION OR ELIMINATION OF THE TAX EXEMPTION IN MCL 206.30 FOR PUBLIC PENSION INCOMES DIMINISHES AND IMPAIRS THE ACCRUED FINANCIAL BENEFITS OF PUBLIC EMPLOYEES IN VIOLATION OF CONST.1963, ART 9, § 24.

A. ART 9, § 24 REQUIRES THAT THE STATE AND ITS POLITICAL SUBDIVISIONS HONOR THEIR CONTRACTUAL PENSION OBLIGATIONS BY PROHIBITING THEM FROM IMPAIRING OR DIMINISHING ACCRUED FINANCIAL BENEFITS.

Const 1963, art 9, § 24 provides:

The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby.

Financial benefits arising on account of service rendered in each fiscal year shall be funded during that year and such funding shall not be used for financing underfunded accrued liabilities.

This article was added to the 1963 constitution to insure that the state and municipal governments keep the pension promises which they make to their employees. Other briefs have quoted the record of the Constitutional Convention in which Delegate Van Dusen explained that the purpose of the provision was to provide security to public employees, recognizing that pension benefits are "deferred compensation for work performed" and that "the public employee should have a contractual right to the benefits of the plan, which should not be diminished by the employing unit after the service has been performed."

B. THE TAX EXEMPTION IN MCL 206.30 WAS PART OF THE ACCRUED FINANCIAL BENEFIT.

The fundamental question in this case is whether the tax exemption, promised in the pension plans themselves and in the income tax act, is an accrued financial benefit. In *Studier v Michigan Public School Employees' Retirement Board*, 472 Mich 642 (2005), this court addressed the question of whether health insurance benefits were an accrued financial benefit which could not be impaired or diminished, concluding that they were not. In analyzing the question, the court examined the specific language of art 9, § 24, and concluded that the term "financial benefit" could include only the benefits that consist of monetary payments. There can be no question but that the tax exemption is a monetary payment and, thus, a financial benefit. It results in a larger monetary payment to the pension recipients than would be the case were it not to exist. For a state retiree receiving an annual pension of \$25,000 the removal of the tax exemption would take more than \$1,000 out of his pocket or bank account.

The brief of the Attorney General arguing that the statute is unconstitutional and the amicus brief of MSERA and the AARP exhaustively and persuasively explore this issue. We adopt their arguments rather than repeat them here.

II. THE TAX EXEMPTION WHICH WAS AN EXPLICIT PROVISION IN FIVE PUBLIC PENSION PLANS CREATED CONTRACT RIGHTS APART FROM THOSE PROTECTED BY ART 9, § 24.

As is noted in the statements of fact, five public pension systems have explicit promises that the pension benefits earned by the employees over the course of their work lives will be exempt from taxation. These are the State Employees' Retirement Act, MCL

38.40, the Public School Employees Retirement System Act, MCL 38.1346, et seq., the Michigan Legislative Retirement System Act, MCL 38.1057, et seq., the City Library Employees' Retirement System Act, MCL 38.1705, and the Judges Retirement Act of 1992, MCL 38.2670. We have argued that art 9, § 24 insures that these promises of tax exemption are contractual promises which cannot be impaired or diminished. However, contractual protection also arises by virtue of the common law. While the court held in *Brown v City of Highland Park*, 320 Mich 108 (1948), that the promise of a pension was not an enforceable contract, the law has changed dramatically and almost completely in the more than 60 years since that decision was rendered. Nearly every state now recognizes that a vested pension benefit is a contractual obligation which cannot be disregarded. The *amicus curiae* brief of the International Union, UAW presents a compelling argument that art 9, ¶ 24 is not the only source of contractual protection and that the specific provisions in the pension plans created vested accrued rights which must be respected. We adopt the UAW argument here.

III. 2011 PA 38'S REDUCTION OR ELIMINATION OF THE TAX EXEMPTION IN MCL 206.30 FOR PUBLIC PENSION INCOMES IMPAIRS THE CONTRACT OBLIGATIONS TO PUBLIC EMPLOYEES IN VIOLATION OF CONST 1963, ART 1, § 10 AND US CONST, ART 1, § 10(1).

Contractual protection of the accrued pension benefits of the employees, including the tax exemption, comes not just from art 9, § 24 and from the common law of contracts, but also from the contract clauses of the state and federal constitutions. US Const, art I, § 10 provides that "No State shall . . . pass any . . . Law impairing the Obligation of Contracts. . . ." Const 1963, art 1, § 10 similarly provides that "No . . . law impairing the obligation of contract shall be enacted."

It appears that the language in the Michigan Constitution of 1963, declaring in art 9, § 24 that pension obligations are contracts, and prohibiting their impairment, and in art 1, § 10 otherwise prohibiting the impairment of contracts, is derived from the United States Constitution. Each of these provisions recognizes the sanctity of contracts.

In analyzing a contract clause claim, the courts have held that it is necessary to determine whether there has been a “substantial impairment of a contractual relationship.” *General Motors Corp v Romein*, 503 US 181; 112 S Ct 1105; 117 L Ed 2d 328 (1992). It is beyond contest that the impairment here is substantial, in that it will reduce accrued pension benefits by more than four percent.

The amicus brief of MERSA and the AARP persuasively demonstrates that the contract clauses of the state and federal constitutions have been violated by this substantial impairment of the accrued pension benefits. We adopt that argument here.

IV. ARTICLE 9, § 2, THE CONSTITUTIONAL PROHIBITION AGAINST “SURRENDERING, SUSPENDING, OR CONTRACTING AWAY” THE STATES’ TAXATION AUTHORITY, HAS NO APPLICABILITY HERE.

The Attorney General’s brief in support of the Act argues that art 9, § 2 precludes the creation by art 9, § 24 of a “perpetual tax exemption.” This argument is nothing but a red herring. Art 9, § 24 does not create a tax exemption at all. It precludes the diminution or impairment of accrued financial benefits. Tax exemptions were specifically created in each of the five pension acts discussed, and in the Income Tax Act of 1967, as amended. Nor does art 9, § 24 require that the exemptions previously created by legislation be perpetual. No one is arguing here for perpetual tax exemptions. No one is contending that the legislature cannot terminate the tax exemptions for *future* pension benefits and impose

a tax on pension benefits which have not yet accrued. The brief of the Attorney General arguing against the constitutionality of the statute concedes that the legislature is free to amend the income tax act and the statutory pension plans so as to tax pension benefits which accrue after the effective date of PA 38. *Amici* MSERA and the AARP agree and so do we. The contention of *amici curiae*, however, is that the legislature cannot impose a tax on benefits which have *already accrued* and which accrued at a time when the tax exemptions were in effect.

To the extent that the Attorney General's brief in support of the act suggests that the creation of an exemption from tax is a surrender of the taxing power, and, thus, violative of art 9, § 2, it is completely wrong. The granting of exemptions from tax is not a surrender of the taxing power but rather an exercise of the power of taxation, as *amici* MSERA and AARP correctly argue at page 28 of their brief. *Lucking v People*, 320 Mich 495 (1948). *Rockwell Spring & Axel Co v Romulus Twp*, 365 Mich 632 (1962).

In *W.A. Foote Memorial Hospital v City of Jackson*, 390 Mich 193, 215 (1973), it was argued that art 9, § 2 was violated by an act which granted state and local tax exemptions to a legislatively authorized hospital authority. This court disposed of the argument in a paragraph, observing that,

Rather than abandoning its power of taxation, the Legislature has acted affirmatively and has exercised its power and discretion as explicitly authorized in art 9, § 3 by granting an exemption 'by law' in §§ 50, 51."

The question posed by the Court in its June 15 order is whether reducing or eliminating the exemption impairs *accrued financial benefits* in violation of Article 9, § 24. The far different question posed by the brief supporting the act was set forth at page 15 of the brief as follows: "whether article 9, § 24 creates a perpetual tax exemption for public

pension distributions. . . “ That is not the question which was asked because that is not the fact situation which underlies the legal issue here.

CONCLUSION AND RELIEF SOUGHT

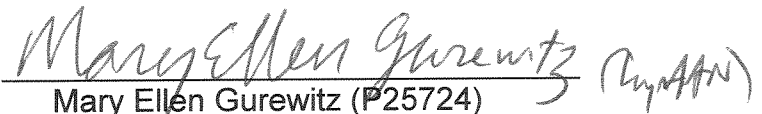
The legislature has been addressing the continuing budget deficit in a variety of ways, including this attempt to tax the pensions of state and other public employees. In 2010 PA 277, the legislature imposed a 3% deduction on the pay of state employees to be used to pay, in part, for the health care of retired state workers. In *AFSCME Council 25, et al v State Employees Retirement System, et al*, Docket No. 302959 (August 25, 2011), the Court of Appeals found this statute to be unconstitutional because it usurped the exclusive constitutional authority of the Michigan Civil Service Commission over state employee compensation. The court’s conclusion is equally applicable here:

The people can and should expect shared sacrifice; however, it cannot come at the expense of constitutional nullification, and the Legislature cannot expect to balance the budget on the backs of state workers. (Slip op at 16).

The tax imposed by 2011 PA 38 on the accrued pension benefits of state and other public employees violates art 9, § 24 and the contract clauses of the state and federal constitutions. We ask the court to so find.

Respectfully submitted,

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Dated: August 30, 2011