

# MICHIGAN SUPREME COURT



## Office of Public Information

contact: Marcia McBrien | (517) 373-0129

FOR IMMEDIATE RELEASE

### CHANGES TO PUBLIC PENSION TAX EXEMPTIONS AT ISSUE IN ADVISORY OPINION CASE MICHIGAN SUPREME COURT WILL HEAR SEPTEMBER 7

**At Governor's request, Supreme Court to mull constitutionality of bill that would create sliding scale for reducing, eliminating tax exemption for pensions of public sector retirees**

LANSING, MI, September 1, 2011 – A recently enacted bill that phases out the tax exemption for public employee pensions – and whether it violates the Michigan and U.S. Constitutions – is at issue in a case that the Michigan Supreme Court will hear on Wednesday, September 7.

The Court will hear *In Re Request for Advisory Opinion Regarding Constitutionality of 2011 PA 38* under a Michigan state constitutional provision that allows the Governor or Legislature to ask the Court for an advisory opinion “as to the constitutionality of legislation.” Governor Rick Snyder has asked the Court to rule before October 1, the earliest date that any of the act’s provisions will take effect.

Opponents of 2011 PA 38 argue in part that the bill violates the Michigan Constitution because it reduces the pension income that public sector retirees have already earned. The bill’s supporters contend that the state Constitution does not create a permanent public pension tax exemption and that the bill is consistent with the Legislature’s power to tax.

The Court will hear oral arguments in its courtroom on the sixth floor of the Michigan Hall of Justice, starting at **10 a.m.** The Court’s oral arguments are open to the public. The argument will also be broadcast live on Michigan Government Television ([mgvtv.org](http://mgvtv.org)). MGTV will replay the oral argument at noon.

*Please note: The summary that follows is a brief account of a complicated case and may not reflect the way that some or all of the Court’s seven justices view the case. The attorneys may also disagree about the facts, issues, procedural history, or significance of the case. Briefs are online at [http://www.courts.michigan.gov/supremecourt/Clerk/msc\\_orals.htm](http://www.courts.michigan.gov/supremecourt/Clerk/msc_orals.htm). For more details about this case, please contact the attorneys.*

### IN RE REQUEST FOR ADVISORY OPINION REGARDING CONSTITUTIONALITY OF 2011 PA 38 (case no. 143157)

**Attorney for Attorney General in support of the validity of 2011 PA 38:** John J. Bursch/(517) 373-3203

**Attorney for Attorney General in opposition of the validity of 2011 PA 38:** B. Eric Restuccia/(517) 373-1124

**Attorney for amicus curiae Michigan State Employee Retirees Association Coordinating Council, Michigan Federation of Chapters of National Active and Retired Federal Employees Association, and AARP:** D. Daniel McLellan/(517) 337-0906

**Attorney for amicus curiae Michigan Bankers Association, Michigan Chamber of Commerce, and Michigan Retailers Association:** Peter H. Ellsworth/(517) 371-1730

**Attorney for amicus curiae Business Leaders for Michigan and Small Business Association of Michigan:** John D. Pirich/(517) 377-0712

**Attorney for amicus curiae International Union, United Automobile, Aerospace, and Agricultural Implement Workers of America (UAW):** Michael F. Saggau/(313) 926-5216

**Attorney for amicus curiae Michigan State AFL-CIO and Service Employees International Union (SEIU), Local 517M:** Mary Ellen Gurewitz/(313) 965-3464

**Attorney for amicus curiae Michigan Education Association (MEA):** James J. Chiodini/(517) 349-7744

**At issue:** Governor Rick Snyder has asked the Supreme Court to render an advisory opinion as to whether certain provisions of 2011 PA 38 are constitutional. Under PA 38, the current exemption for public employee pensions would be limited to retirees born before 1946 or earlier; the bill phases out the public pension exemption for those born later so that all pensions, both public and private, would be taxable. The bill also imposes a sliding scale for pension and income exemptions based on age and household income. Opponents of the bill argue that these changes violate the United States and Michigan constitutions, while proponents contend that the bill's provisions are consistent with the legislature's power to tax.

**Background:** On May 25, 2011, Governor Rick Snyder signed into law Enrolled House Bill 4361, which became 2011 PA 38; October 1, 2011 is the earliest date when any of the act's provisions will go into effect. The act eliminates the Michigan Business Tax and replaces it with a flat corporate income tax. PA 38 also limits the prior exemption for public pension income, depending on which of three age groups taxpayers fall into:

- Taxpayers who will be at least 67 years old in 2012 will keep their current pension exemptions. Public pension distributions for people in this age group will remain completely tax-exempt. Private pension retirees will have capped pension exemptions of \$45,120 per single filer and \$90,240 for joint filers.
- Taxpayers who will be between 60 and 66 in 2012 will have their pension exemption – whether public or private – capped at \$20,000 per single filer and \$40,000 per joint filer. At age 67, the pension exemption becomes a general income exemption with the same caps. But taxpayers in this group receive no pension or income exemptions if their total household resources (all income received less any net business, rental, or royalty losses) exceed \$75,000 per single filer and \$150,000 per joint filers.
- Taxpayers who will be 59 or younger in 2012 will have their pensions taxed, whether public or private. In place of a pension exemption, PA 38 provides that all taxpayers in this group, once they turn 67, will receive an income exemption of \$20,000 per single filer and \$40,000 per joint filers. As with the second group, these taxpayers are not eligible for the income exemption if their total household resources exceed \$75,000 per single filer and \$150,000 for joint filers.

According to the Legislature's fiscal analysis of PA 38, these changes are projected to provide \$224.9 million in tax revenue for Fiscal Year 2011-2012 and \$343.4 million for FY 2012-2013.

On June 15, 2011, the Michigan Supreme Court granted the Governor's request for an advisory opinion regarding the constitutionality of these and related provisions. Article 3, § 8 of the Michigan Constitution provides that either the Governor or the Legislature may request the Supreme Court's opinion "on important questions of law ... as to the constitutionality of legislation after it has been enacted into law but before its effective date."

The Governor asked the Court to address the following questions:

1. Does reducing or eliminating the statutory tax exemption for public-pension incomes impair accrued financial benefits of a "pension plan [or] retirement system of the state [or] its political subdivisions" under article 9, § 24 of the Michigan Constitution?
2. Does reducing or eliminating the statutory tax exemption for pension incomes impair a contract obligation in violation of article 1, § 10 of the Michigan Constitution, or of article 1, § 10 of the United States Constitution?
3. Does determining eligibility for income-tax exemptions based on total household resources, or age and total household resources, create a graduated income tax in violation of article 9, § 7 of the Michigan Constitution?
4. Does determining eligibility for income-tax exemptions based on date of birth violate equal protection of the law under article 1, § 2 of the Michigan Constitution, or under the 14<sup>th</sup> Amendment to the United States Constitution?

Opponents of PA 38 argue that

- The bill violates Article 9, §24 of the state Constitution because it reduces the pension income that public sector employees have already earned. Under this constitutional provision, the bill's opponents contend, public employees can rely on a certain level of retirement income; by reducing this income, the Legislature diminishes or impairs "a contractual obligation" of the state and its political subdivisions.
- Similarly, the bill violates public employees' constitutional right against impairment of contract (Article 1, § 10 of the state Constitution and Article 1, §10(1) of the U.S. Constitution). In effect, the argument goes, the state has gone back on its agreement with public employees by reducing their income after they have performed the work.
- PA 38 also violates Article 9, § 7 of the Michigan Constitution because it effectively creates a graduated tax – and eliminates exemptions in some cases – based on income levels, opponents assert. They point out that there are no other tax exemptions or deductions in Michigan for which eligibility is based on income.
- The bill's opponents also argue that basing tax exemptions on age and marital status violates equal protection of the laws. (Marital status is a factor because a pensioner who is otherwise ineligible for a full exemption becomes eligible if his or her spouse is born before 1946.)

Supporters of PA 38 argue that

- Article 9, §24 of the state Constitution does not create a permanent, irrevocable tax exemption for public pension distributions, or even imply that public pensioners should not pay taxes, the bill's supporters contend. When the ratifiers of Michigan's 1963 Constitution wanted to create a permanent tax exemption, they did so expressly – for example, for non-profit religious and educational organizations (Article 9, §4).
- Because there is no right to a permanent exemption for pension distributions, PA 38 does not violate public pensioners' right to contract. Even if public employees had a contract right to a tax exemption on public pension distributions, PA 38 does not alter the right to receive the pension or basic benefits, supporters maintain.
- PA 38 does not create a graduated income tax; income is either taxed at a flat rate of 4.35 percent, or is exempted from taxation. The use of exemptions does not convert a flat tax into a graduated income tax. "Total household resources" includes items that Michigan and the federal government ordinarily exclude from gross income, so PA 38's exemptions are not based on the taxpayer's income level, the bill's supporters argue.
- Because age is not a "suspect classification" for equal protection analysis, the "rational basis" test applies. Supporters argue that the lines drawn by the Legislature are rationally related to a legitimate governmental interest (protecting older retirees who are less able to adjust to tax changes that affect their income) and the bill is narrowly drafted to achieve that goal.

-- MSC --