



ISSUE BRIEF

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Government Retirement Income and Taxation Detailed Chronology with Citations

Until the late 1980s, the pensions of Public Employee Retirement System (PERS) retirees were exempt from state income taxes. At that time, the state allowed partial exemptions from income taxation for federal retirement benefits and no special exemptions for private retirement benefits. However, a 1989 U.S. Supreme Court ruling affirmed that federal law required states to treat taxation of federal and state retirement benefits in the same manner, putting Oregon in violation of federal law. The Court did not rule on any aspect of taxation of private retirement benefits. This paper is a chronology of major events in regard to the state taxation of federal and state pension benefits.

1989 March 29. The U.S. Supreme Court rules that all federal, state, and local government retirement income must be taxed (or not taxed) in the same manner (*Davis v. Michigan*¹). The decision is based on federal law that required states not discriminate against federal employees based on the source of their compensation². The ruling puts nearly half of the states out of compliance with federal law, including Oregon.

Spring. The Oregon legislature passes HB 3508³, subjecting both federal and PERS pensions to state income taxes. The measure increases the benefits to PERS retirees to roughly offset the amount lost to taxation.

Fall. Oregon voters gather enough signatures to refer HB 3508 to the next general election ballot .

1990 November 6. The referred HB 3508 is rejected by voters in the general election

November 7. The Oregon Tax Court rules that the state is in violation of the *Davis* decision, and orders the state to provide refunds to retirees for state income taxes paid on federal retirement benefits (*Ragsdale v. Department of Revenue*⁴). The decision is appealed to the Oregon Supreme Court on the issue of the number of years for which a refund is required.

1991 Spring. The legislature passes HB 2352⁵. The measure directs state income taxes be imposed on both federal and PERS retirement benefits and allows retirees to file petition directly with Oregon Supreme Court to challenge constitutionality of taxing PERS benefits. The measure also provides a low-income tax credit for all pensions, public and private.

Spring. A benefit increase (one to four percent) is enacted through SB 656⁶. The increase acts to partially offset the impact of taxation on PERS retirees.

¹ 49 US 803 (1989).

² 4 USC 111

³ Chapter 906, Oregon Laws 1989.

⁴ 11 OTR 440 (1990).

⁵ Chapter 823, Oregon Laws 1991.

⁶ Chapter 796, Oregon Laws 1991.

1992 January 1. PERS starts withholding state income tax from retiree benefits.

January 3. The Oregon Supreme Court reviews the 1990 Oregon Tax Court ruling in *Ragsdale v. Department of Revenue*⁷ and holds that refunds of taxes are due for 1988 and 1989 but not for previous years. State and federal pensions are not taxed in 1990.

Spring. Oregon Department of Revenue issues refunds to federal retirees.

August 6. The Oregon Supreme Court rules that the state may tax PERS benefits (*Hughes v. State of Oregon*⁸). However, the court determined the imposition of income taxes was a breach of the workers' contractual rights, and that PERS retirees had to be compensated for taxes they paid on benefits that were attributable to service before the effective date of the Act (September 28, 1991). The court required a remedy for the PERS retirees but did not provide specifics in its ruling.

Summary of State Income Taxation of Retirement Benefits⁹

	Federal Government	PERS Government	Private
1987 and before	Taxed	Exempt	Taxed
1988	Refunded	Exempt	Taxed
1989	Refunded	Exempt	Taxed
1990	Exempt	Exempt	Taxed
1991 and after	Taxed *	Taxed *	Taxed*

* with tax credit allowed

1993 Spring. The legislature does not craft the *Hughes* remedy during the regular session but does authorize lawsuits seeking damages under the *Hughes* decision be appealed directly to the Oregon Supreme Court without review by the Court of Appeals (SB 307¹⁰).

1994 Winter/Spring. Several class action lawsuits are filed by state retirees seeking damages based on determination in the *Hughes* case that taxation of PERS benefits constituted breach of state's contract with retirees. Many of these cases are later consolidated into one primary case (*Stovall v. State of Oregon*¹¹).

July. The Oregon Tax Court rules in another suit that the benefit increase to PERS retirees provided by SB 656 (1991) does not violate the *Davis* decision (*Ragsdale v. Department of Revenue*¹²). The case is appealed to the Oregon Supreme Court.

1995 Spring. HB 3349¹³ is passed as a comprehensive solution to the taxation problem. The law provides a one-time retroactive payment to PERS retirees out of the PERS Fund as compensation for the taxation of PERS benefits since 1991 (plus interest). In addition, the law provides for increases in all future benefit payments adequate to compensate retirees to the extent required by the *Hughes* decision. An increase in state and local PERS employer contributions is to pay for the remedy.

⁷ 312 Or 529 (1992).

⁸ 314 Or 1 (1992).

⁹ Source: Legislative Revenue Office

¹⁰ Chapter 752, Oregon Laws 1993.

¹¹ 324 Or 92 (1996).

¹² 12 OTR 143 (1994), Tax Court #3535.

¹³ Chapter 569, Oregon Laws 1995.

Spring. The Governor vetoes a measure (SB 562) that would have exempted all retirement benefits – including all government pensions and up to \$50,000 of private pensions – from state income taxation.

June 2. Oregon Supreme Court affirms the 1994 Oregon Tax Court decision on *Ragsdale v. Department of Revenue*¹⁴ and holds that the SB 656 (1991) benefit increase to PERS retirees does not violate the *Davis* decision.

November 15. In light of HB 3349, a Marion County Circuit Court rules in one of the class action suits, *Stovall v. State of Oregon*¹⁵, that the PERS Fund could not be used for a state General Fund obligation. The court also rules that local governments cannot be required to pay for the remedy, effectively stopping the implementation of HB 3349. The ruling is immediately appealed to the Oregon Supreme Court.

1996 August 29. The Oregon Supreme Court overturns the lower court decision in *Stovall*¹⁶, re-instating the remedy to PERS retirees set forth in HB 3349. Several other minor issues are remanded to the lower court for resolution.

1997 February 1. PERS retiree benefits are increased for eligible retirees by up to 9.89% to compensate for state income taxation (as required by HB 3349).

Spring. HB 2034¹⁷ is enacted to clarify administrative issues in providing the retroactive payment. The law resolves the remaining issues in the state pensioner class action lawsuits (*Stovall*).

October 8. The settlement for the *Stovall* case is made in Marion County Circuit Court.

Fall. Retroactive benefit payments required by HB 3349 are mailed to current state retirees.

1998 June 18. Oregon Supreme Court rules that the remedy provided to PERS retirees in 1995 amounted to a “tax rebate,” effectively violating the *Davis* decision, and declares that similar compensation is owed to federal retirees (*Vogl v. State of Oregon*¹⁸). The court specifically says it does not overrule the 1995 *Ragsdale* decision, which upheld the SB 656 benefit increases from 1991. The case is remanded to the Oregon Tax Court to determine the remedy for the plaintiff.

1999 January 7. The Oregon Tax Court approves the agreement between the state and the *Vogl* plaintiffs. The agreement specifies refunds are owed to all federal retirees who paid Oregon income taxes on federal pension benefits related to services performed before October 1, 1991, for the years 1991 to present¹⁹. The agreement also requires the Department of Revenue to seek enactment of legislation to address four main points²⁰: 1) authorization to make refunds to federal retirees that did not file protective claims for 1991-1998; 2) authorization to make refunds to decedents’ estates or heirs without reopening the estate; 3) express legislative approval of a modification to taxable income that would exclude federal retirement benefits for service rendered before October 1, 1991, and for tax

¹⁴ 321 Or 216 (1995).

¹⁵ Marion County Circuit Court -- CC 94C10334.

¹⁶ 324 Or 92 (1996).

¹⁷ Chapter 175, Oregon Laws 1997.

¹⁸ 326 Or _____ (1998).

¹⁹ Stipulated Order Providing Vogl/Dixon Relief, Oregon Tax Court, November 17, 1998.

²⁰ *Ibid*

years 1998 and beyond; and 4) denial of retirement income credit for nontaxable federal pension income.

January 11. Legislation is introduced to implement the Oregon Tax Court agreement. In its final form, SB 259 would allow refunds of state income taxes to be paid after June 30, 1999, to federal retirees that did not file protective claims for 1991-1994. Refunds would also be allowed for all federal retirees for 1995-1997 tax years without filing protective claims and a credit for estimated tax payments for 1998. SB 259 also would establish procedures for refunds to beneficiaries of deceased federal retirees. SB 260 would prospectively allow a subtraction of federal retirement income from state taxable income and deny any retirement income credit for nontaxable federal pension income. In addition, refunds are allowed for taxes paid on qualified federal retirement income for "open" tax years (i.e., post-1994 tax years, and 1991-1994 years secured by protective claims).

February 10. The Department of Revenue begins mailing refund checks to federal retirees for open tax years.

June 28. The Governor vetoes SB 259 ²¹.

June 29. The Governor signs SB 260 ²².

June 30. Provisions of SB 259 are placed in SB 1136. However, in the new legislation refunds for federal retirees that did not file protective claims for 1991-1994 are allowed only after July 1, 2001.

August 20. The Governor signs SB 1136 ²³.

October 23. Payments to beneficiaries authorized by SB 1136 are allowed. SB 260 takes effect and a subtraction for federal pension income is allowed beginning with the 1998 tax year.

Future Action

Federal retirees have until April 16, 2001 to file claims for tax years 1991-1995. Payments will be made after July 1, 2001, per SB 1136 requirements. All payments must be made by June 30, 2003.

²¹ Excerpt from Governor's Veto Message, June 28, 1999: "There are not sufficient resources to adequately fund local schools without unacceptable cuts in other important state services...In the interest of funding schools at an acceptable level without damaging other programs critical to the health and safety of all Oregonians, we are now forced to wait to pay this debt (to federal retirees and their beneficiaries)."

²² Chapter 403 Oregon Laws 1999

²³ Chapter 996, Oregon Laws 1999