Opinion No. 90-03

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OPINION OF: HAL STRATTON, Attorney General

BY: Andrea R. Buzzard, Assistant Attorney General

TO: Honorable Billy J. McKibben, State Senator, 617 W. Ave A, Lovington, New Mexico 88260. Honorable Ben Lujan, State Representative, Rt. 1, Box 102, Santa Fe, New Mexico 87501. Mr. Carlos A. Gallegos, Executive Secretary, Public Employees Retirement Association, P. O. Box 2123, Santa Fe, New Mexico 87504-2123

QUESTIONS

Would repeal of the state income tax exemptions for teacher pensions and public employee pensions remedy constitutional defects of the proposed retiree health care act, under the theory that such exemptions would be "traded" for retiree health care?

CONCLUSIONS

No, because those tax exemptions are not property rights, irrepealable contractual entitlements, or pension benefits.

ANALYSIS

The proposed retire health care act would provide health care benefits to current retirees of the public employees retirement association and to current retirees of the educational retirement system. The Wyatt Company conducted a study entitled "Analysis of Retiree Health Care Benefits" dated December 1989, in which it observes that HB 504's benefits are "very rich compared to many plans." Id. at 8. In that study, Wyatt Company projects the Accumulated Post Retirement Benefit Obligation ("APBO") for a retiree health care program, based on HB 504, to be:

Year	Accumulated Post Retirement Benefit Obligation
1990	$ 702,342,404
1995	$ 935,268,177
2000	$1,065,835,265
2005	$1,156,124,990

Id. at 6.[1] Whether the legislature later could discontinue the plan, should it now decide to assume that liability without sufficient funding,[2] is an issue that might well be litigated if the legislature later repeals or substantially modifies the plan.

The Attorney General advised previously that the proposed retiree health care act conflicted with the anti-donation clause and the extra-compensation prohibition of the New Mexico Constitution, article IX, § 27.[3] Succinctly stated, the legislature constitutionally may not give money, in the form of additional benefits, to people who no longer work for the government. This proposal is an unconstitutional attempt to provide those persons with extra compensation after they have rendered services to the government.

The question we are now asked to address is whether repeal of the state income tax exemptions for pension benefits of those current retirees would overcome the constitutional infirmities of the proposed retiree health care program. The suggested theory is that current retirees would "trade" the existing state income tax exemptions contained in NMSA 1978, § 10-11-135 (Cum. Supp. 1989) and NMSA 1978, § 22-11-42(A) (Repl. Pamp. 1989) for the benefit of retiree health care.

The proposal is not truly a "trade." According to a "Bill Analysis and Fiscal Impact Report, Income Taxes-Discussion Draft," at 5, elimination of those state income tax exemptions would generate annually approximately $2,500,000 additional revenue to the general fund. Thus, the new tax revenue clearly does not meet revenue requirements of retiree health care for current retirees. Moreover, whether retirees are "fungible," such that a retiree who is not affected by the income tax repeal due to other exemptions could be viewed, nevertheless, as "trading" something, is debatable. Fundamentally, however, the theory is flawed because it depends upon a false premise, namely, that the tax exemption for pension benefits is a vested property right or irrepealable contractual entitlement. Court decisions do not support the premise. Therefore, we advise that the proposed trade-off will not cure the constitutional infirmities of the proposed retiree health care program.

Courts do not regard an income tax exemption as "salary," as a vested right, or as a permanent contractual entitlement. In **O'Malley v. Woodrough,** 307 U.S. 277(1939), the United States Supreme Court concluded that income taxation of a federal judge's salary did not unconstitutionally "diminish" his salary. The plaintiff judge contended that taxing his salary as federal judge contravened Article III, § 1 of the federal constitution, providing that the compensation of judges "shall not be diminished during their continuance in office." The Supreme Court believed that the judge's argument "trivalized" the importance of the protection afforded by the constitutional provision, stating:

To subject [judges] to a general tax is merely to recognize that judges are also citizens, and that their particular function in government does not generate an immunity from sharing with their fellow citizens the material burden of the government whose Constitution and laws they are charged with administering.

Id. at 282.[4] Similarly, in **Black v. Graves,** 12 N.Y.S.2d 785 (App. Div.), aff'd, 281 N.Y. 792, 24 N.E.2d 478 (1939), the court held that subjecting a judge's salary to state income taxation by statute enacted after he assumed office did not diminish his salary

contrary to New York's constitution stating: "An income tax is an excise for the privileges and immunities which the state provides and its residents enjoy." Id. at 786.

In the context of statutes repealing an exemption from state income tax for public pension benefits, courts have upheld those repeals. In **Blair v. State Tax Assessor,** 485 A.2d 957 (Me. 1984), Maine public retirees brought a class action suit contesting the constitutionality of a 1969 revision of the state income tax code that impliedly repealed the pension exemption from state income tax contained in a 1942 state retirement act. The retirees alleged that the repeal of that pension exemption was a breach of contract, because the tax-exempt status of retirement benefits was "an essential term of their "contractual' retirement plan arrangement with the state." The court held that the retirees had no contractual entitlement to a permanent tax exemption stating:

Even if we were to find the exemption to be a contractual right of state employment, the legislative grant of such right would violate the Maine Constitution, which states: "The legislature shall never, in any manner, suspend or surrender the power of taxation." Me. Const. art. IX, § 9. We cannot presume the legislature would intentionally enact a statute that would contract away the power to tax on a permanent basis.

Id. at 960.[5]

In **Herrick v. Lindley,** 59 Ohio St.2d 22, 391 N.E.2d 729 (1979), the court held that Ohio's retired public employees and teachers did not have a vested right to exemption of their pensions from state income tax. A law enacted in 1972 repealed the tax exemption for public pensions. Notwithstanding that statutes of both state retirement plans characterized retirement benefits as "vested rights," the court concluded that the legislature did not intend to grant a vested right to the tax exemption stating:

[R]etirees have a vested right to receive a retirement allowance or similar benefit at the rate fixed by law when such benefit was conferred. However, neither R. C. 145.561 nor 3307.71 grant a vested right to continuing tax exemption.

The power to tax being a fundamental governmental power its impairment shall not be based upon a debatable construction of statutory language. [E]very reasonable doubt should be resolved against such an impairment.

[I]t was not the intent of the General Assembly to grant [retirees] a vested right to receive their pensions exempt from state income taxation.

[T]here is a distinction between the right to receive retirement benefits unfettered by subsequent reductions in the rate of those benefits and the right to a permanent tax exemption.

Id. at 27-28, 391 N.E.2d at 732-33. See also **Fulton Bag & Cotton Mills v. Williams,** 212 Ga. 783, 785-86, 95 S.E.2d 848, 851 (1956) (upholding repeal of a tax exemption stating: "A person has no vested right in statutory privileges or exemptions").

Courts do not liken pension tax exemptions to pension benefits. In **Streight v. Ragland,** 280 Ark. 206, 655 S.W.2d 459 (1983), the court upheld, against an equal protection challenge, state income tax exemptions for pensions of government employees. State pensions were exempt in full and federal pensions were partially exempted. But the court declined to adopt, as a rational basis for the exemption, the traditional theory that supports the validity of state pension plans, namely, the "inducement to enter government employment" rationale.[6] That theory seemingly could not apply, because the state could have no interest in encouraging entry into federal civil service. Id. at 214, 655 S.W.2d at 464. Instead, the court hypothesized a "lure" theory to support its decision: The tax exemption encourages public pensioners from out of state to relocate in Arkansas and encourages Arkansas public pensioners to remain.[7] Cf. **Chronis v. State ex rel. Rodriguez,** 100 N.M. 342, 670 P.2d 953 (1983) (holding that a tax credit for liquor dealers was an unconstitutional subsidy).

In **Court v. Commonwealth,** 207 Va. 556, 151 S.E.2d 384 (1966), the court construed a state statute that excluded from gross income armed service pensions. The taxpayers urged the court to adopt a liberal interpretation of the tax exemption statute, comparing the statute to pension acts. The court refused: "In the first place we are not concerned here with a pension statute which might be entitled to a liberal construction. We are dealing with a statute exempting a certain class of income from taxation ---- a statute which requires a strict construction." Id. at 560, 151 S.E.2d at 387.

New Mexico's public pension benefits are deferred compensation, and a public employee who retires obviously has met "vesting" requirements of the retirement system.[8] Those benefits, therefore, may well be protected against a subsequent reduction in the rate of those benefits.

But there is a definite legal distinction between reducing the rate of pension benefits and levying a tax upon the income received from those pension benefits. Levying a tax does not "diminish" current salary or compensation. By extension, such tax would not diminish compensation that is deferred. Pension tax exemptions are not pension benefits. Repeal of an exemption statute is not akin to reducing pension benefits. An income tax is measured by the property of the taxpayer. Retirees, depending on their circumstances, may or may not be affected by any such repeal and, if affected, would be affected in varying degrees.

Taxation is a legislative function without any limitation except such as is imposed by constitutional provisions,[9] and exemptions from taxation are strictly matters of legislative grace.[10] Courts do not presume an intention on the part of the legislature to surrender its taxing power in the absence of a clear showing to the contrary. **Burns v. State, Bureau of Revenue, Income Tax Div.,** 79 N.M. 53, 55, 439 P.2d 702, 704, cert. denied, 393 U.S. 841 (1968) (silence in the act ceding jurisdiction over federal land is not a clear

indication of intent to surrender the power to tax); **New Mexico v. United States Trust Co.,** 174 U.S. 545, 547 (1899) (construing a statute exempting a railroad company from taxation with respect to right-of-way land and re-affirming the "rule of construction which has been announced many times and in many ways, that the taxing power of the State is never presumed to be relinquished unless the intention be expressed in terms too clear to be mistaken"). Sections 10-11-135 and 22-11-42(A) and their predecessor statutes do not express a legislative intent to surrender the state's taxing power or to contract it away.

The only reason current retirees advance a "property right" argument with respect to the tax exemptions arises from the statutory placement of those exemptions in the retirement plan acts. In **Covington v. Kentucky,** 173 U.S. 231, 239 (1899), the United States Supreme Court stated:

Before a statute -- particularly one relating to taxation -- should be held to be irrepealable, or not subject to amendment, an intent not to repeal or amend must be so directly and unmistakably expressed as to leave no room for doubt; otherwise, the intent is not plainly expressed. It is not so expressed when the intent arises only from inference or conjecture.

The legislature, when it granted the pension exemptions in 1947 and 1957,[11] did not express any intent that those exemptions were irrepealable or not subject to amendment. We may not infer such an intent simply from the placement of those exemptions in the state's retirement acts.[12] In **Hackman v. Director of Revenue,** 771 S.W.2d 77 (Mo.), petition for cert. filed, 1989 WL 113830 (1989), the court considered it insignificant that the pension tax exemptions were found in the pension plan acts, holding, contrary to a dissenting opinion, that **Davis v. Michigan Dept. of Treasury,** 109 S. Ct. 1500 (1989) required state tax refunds to eligible federal pensioners.

Based on the authority cited, we conclude that repeal of the state income tax exemptions for teacher pensions and public employee pensions does not remedy constitutional defects of the proposed retiree health care act under a theory that those exemptions would be "traded" for retiree health care. Those exemptions are not property rights, irrepealable contractual entitlements, or pension benefits. Hence, elimination of the favorable tax treatment for current retirees is not consideration for a multi-million dollar health care plan that the state proposes to provide them.

ATTORNEY GENERAL

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GENERAL FOOTNOTES

n1 The liabilities shown above apply to the current active and retired population. Id. at 6. The report does not expressly state the liability attributable solely to current public retirees. Segal and Company's April, 1989 actuarial report about the retiree health care

bill states that the accrued actuarial liability for current retirees' medical benefits ranges from approximately $222,000,000 to approximately $312,000,000. Those figures represent the actuarial present value of medical benefits expected to be paid to all current retirees over their projected remaining lifetimes, both Association retirees and those retired under the educational retirement system.

n2 The current "tax trade" proposal of the Public School Insurance Authority would fund benefits under the retiree health care act for seven to eight years. See "New Mexico Public School Insurance Authority Policy Statement, Retiree Health Care Act," dated November 15, 1989, at 7.

n3 See February 17, 1989 and February 27, 1989 letters to Honorable Billy J. McKibben. See also Att'y Gen. Op. 88-66 (1988) (cost of living adjustment to pensions enacted after retirees retired may not be applied constitutionally to increase those retirees' pensions).

n4 See also **Welch v. Finney,** 305 U.S. 134, 146 (1938) ("Taxation is neither a penalty imposed on a taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens").

n5 The court in Blair held that the legislature's adoption in 1969 of a comprehensive system of state income taxation pre-empted the entire area of taxation and, therefore, impliedly repealed the earlier enacted state income tax exemption for state pension benefits. See also **Linnane v. Clark,** 557 A.2d 477 (R.I. 1989) (earlier enacted municipal and state public pension tax exemptions were impliedly repealed by 1971 state income tax act, distinguishing **Police and Firefighters Retirement Association v. Norberg,** 476 A.2d 1034 (R.J. 1984)).

n6 See **State ex rel. Sena v. Trujillo,** 46 N.M. 361, 368, 129 P.2d 329, 333 (1942).

n7 Concurring Justice Van Ausdall wrote:

That the present scheme of things with exemption heaped upon exemption, distinctions overdrawn, and fanciful reasons grasped out of the air to justify a special interest, is sorry, seems to only state the obvious.

Probably no useful purpose is served by observing that these exemptions point out the inordinate, and unhealthy, influence that the beneficiaries of these enactments have in the legislative halls. But in the interest of conscience, this observation must be made.

n8 See **Copeland v. Copeland,** 91 N.M. 409, 411-12, 575 P.2d 99, 101-102 (1978); **State ex rel. Sena v. Trujillo,** 46 N.M. 361, 367, 129 P.2d 329, 332 (1942).

n9 See **First State Bank of Mountainair v. State Tax Commission,** 40 N.M. 319, 323, 59 P.2d 667, 669 (1936); **Flynn, Welch & Yates v. State Tax Commission,** 38 N.M.

131, 136, 28 P.2d 889, 891 (1934); **Asplund v. Alarid,** 29 N.M. 129, 137, 219 P. 786, 789 (1923).

n10 See **Murphy v. Taxation and Revenue Department,** 94 N.M. 90, 93, 607 P.2d 628, 631 (App.), aff'd 94 N.M. 54, 607 P.2d 592 (1980); **New Mexico Elec. Serv. Co. v. Jones,** 80 N.M. 791, 794, 461 P.2d 924, 927 (Ct. App. 1969) (tax exemptions are strictly construed against the exemption; intent to create an exemption cannot be raised by implication).

n11 Section 10-11-135's tax exemption was originally enacted by 1947 N.M. Laws, ch. 167, § 19. Section 22-11-42(A) was originally enacted by 1957 N.M. Laws, ch 197, § 56.

n12 Furthermore, we doubt seriously that any state legislature could make any act irrepealable and thereby permanently bind future legislatures to a particular statutory scheme. See **State Office Bldg. Comm'n v. Trujillo,** 46 N.M. 29, 52, 120 P.2d 434, 448 (1941) (legislature cannot tie the hands of another legislature). Such a doctrine would be wholly inconsistent with a representative form of government.