THE STATE GIVETH AND THE STATE TAKETH: CONSTITUTIONAL PENSION PROTECTIONS AND THE RETROACTIVE REMOVAL OF PUBLIC PENSION TAX EXEMPTIONS

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INTRODUCTION

On May 12, 2011, the Michigan legislature narrowly passed Enrolled House Bill No. 4361,[1] which phased out and then eliminated its statutory tax exemption for public pension income.[2] Less than two weeks later, Governor Rick Snyder signed the bill into law.[3] With this action, Michigan became the first state that constitutionally protects its pension benefits as contractual obligations to eliminate a tax exemption on pension income.[4] Anticipating a constitutional challenge by pensioners, Governor Snyder requested that the Michigan Supreme Court issue an advisory opinion addressing whether the state could eliminate the tax exemption by statute, and the court agreed to do so.[5] On November 18, 2011, the court upheld the repeal as constitutional.[6]

Public pensions are one of the oldest rewards for public service.[7] First given to former military men in ancient Rome, pensions took root in the

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[1] Janet Novack, *Michigan Curbs Pension Tax Breaks for Retirees*, FORBES (May 13, 2011, 11:32 AM), http://www.forbes.com/sites/janetnovack/2011/05/13/michigan-curbs-pension-tax-breaks-for-retirees.

[2] H.R. 4361, 96th Leg., Reg. Sess. (Mich. 2011) (enacted).

[3] *Id.*

[4] *See* MICH. CONST. art. IX, § 24. New Mexico has a constitutional provision addressing pensions, but the New Mexico Supreme Court declined to read it as conferring contractual rights. *See* Pierce v. State, 910 P.2d 288, 301 (N.M. 1995). Instead, the court held that New Mexico's provision conferred vested rights. *Id.* at 302.

[5] *In re* Request for Advisory Op. Regarding Constitutionality of 2011 PA 38, 806 N.W.2d 683, 688 (Mich. 2011).

[6] *Id.*

[7] *See* ROBERT L. CLARK ET AL., A HISTORY OF PUBLIC SECTOR PENSIONS IN THE UNITED STATES 1-2 (2003).

United States before and during the American Revolution.[8] By the time of the Civil War, pensions were becoming a well-established practice in the United States—not only for military service, but for other forms of public service, including firefighting and teaching.[9] In 1879, the Supreme Court acknowledged that pensions were well embedded in the United States and refused to question the power of the national and state governments to grant pensions.[10] Today, every state offers some form of public pension.[11]

Initially, courts considered pensions gratuities.[12] In effect, "'[n]o pensioner ha[d] a vested legal right to his pension.'"[13] Governments had the unfettered discretion to grant, to modify, or to eliminate pensions at whim.[14] Faced with this reality, some states sought to protect public pensions with constitutional amendments.[15] Today, nine states have state constitutional provisions that aim to preserve public pensions.[16]

Many states also began to afford tax-favored treatment to their state public pension benefits, exempting them from state taxation. However, in 1989, the U.S. Supreme Court decided *Davis v. Michigan Department of Treasury*,[17] which held that if states chose to exempt state public pension benefits, they also had to exempt federal pension benefits.[18] Faced with that choice, states overwhelmingly chose to repeal their tax exemptions rather than to suffer the added loss of revenue.[19] That, in turn, spawned numerous lawsuits by state pensioners, who challenged the repeal as an interference with their vested rights to their pensions.[20] Relying heavily on a seminal

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8 *Id.*; *see also* United States v. Hall, 98 U.S. 343, 346 (1878) (noting that power to grant pensions was exercised by the states and by the Continental Congress during the Revolutionary War).

9 *See* CLARK ET AL., *supra* note 7, at 4.

10 *Hall*, 98 U.S. at 346 ("Power to grant pensions is not controverted, nor can it well be, as it was exercised by the States and by the Continental Congress during the war of the Revolution").

11 *See* PEW CENTER ON THE STATES, THE TRILLION DOLLAR GAP: UNDERFUNDED STATE RETIREMENT SYSTEMS AND THE ROADS TO REFORM 24 (2010), *available at* http://www.pewstates.org/uploadedFiles/PCS_Assets/2010/Trillion_Dollar_Gap_Underfunded_State_Retirement_Systems_and_the_Roads_to_Reform.pdf (noting that the report covered all 50 states).

12 *See, e.g.*, Frisbie v. United States, 157 U.S. 160, 166 (1895) (noting that there was no legal right to a pension).

13 *Id.* (quoting United States v. Teller, 107 U.S. 64, 68 (1883)).

14 *Id.* ("'Pensions are the bounties of the government, which Congress has the right to give, withhold, distribute, or recall, at its discretion.'" (quoting *Teller*, 107 U.S. at 68)).

15 *See, e.g.*, Studier v. Mich. Pub. Sch. Emps.' Ret. Bd., 698 N.W.2d 350, 359-60 (Mich. 2005) (recalling Delegate Richard Van Dusen's comments urging adoption of a constitutional provision that would protect public pensions on grounds that pensioners did not have security in their pensions).

16 Stephen C. Fehr, *States Test Whether Public Pension Benefits Given Can Be Taken Away*, STATELINE (Aug. 10, 2010), http://www.pewstates.org/projects/stateline/headlines/states-test-whether-public-pension-benefits-given-can-be-taken-away-85899374772.

17 489 U.S. 803 (1989).

18 *Id.* at 817-18.

19 *See infra* Part II.A-B.

20 *See, e.g.*, Spradling v. Colo. Dep't of Revenue, 870 P.2d 521 (Colo. App. 1993); Parrish v. Emps.' Ret. Sys., 398 S.E.2d 353 (Ga. 1990); Sheehy v. Pub. Emps. Ret. Div., 864 P.2d 762 (Mont.

decision by the Ohio Supreme Court, *Herrick v. Lindley*,[21] several state supreme courts upheld the tax-exemption repeals.[22] In *Herrick*, a case decided before *Davis*, the Ohio Supreme Court ruled the repeal of Ohio's tax exemption did not impair a contractual obligation, reasoning that while

> the net bankable retirement income might be the same whether the rate of a pension is reduced, or a tax is levied on such income[,] . . . [t]here is a definite legal distinction between reducing the rate of a pension and levying a tax upon the income received from that pension.[23]

To date, Michigan is the only state with a pension-protection provision to repeal its tax exemption. In upholding the constitutionality of Michigan's repeal, the Michigan Supreme Court looked to *Herrick* and its progeny for guidance.[24] While the existence of an express constitutional provision protecting state employees' rights to pension benefits could arguably render *Herrick* and its reasoning inapposite, Michigan's acceptance of *Herrick* may herald its adoption by other states with constitutional-pension provisions.

This Comment analyzes the constitutionality of repealing tax exemptions for public pensions in states where constitutional amendments treat pension benefits as contractual obligations. It proceeds in four parts. Part I briefly traces the historical and legal background concerning the protection of public pensions, including the history of public pensions and the rise of state constitutional amendments protecting them. Part II then describes the move by states to repeal tax exemptions immediately following the U.S. Supreme Court's 1989 decision in *Davis*. In so doing, it analyzes both *Herrick* and the cases that followed it. Part III discusses attempts by states with constitutional pension provisions to repeal tax exemptions after *Davis*, including Michigan's recent success. Part IV then critiques the reasoning of *Herrick* by arguing that there is no legal distinction between reducing the corpus of a pension payment and eliminating a tax exemption. This Comment concludes that states with constitutional amendments making pension benefits contractual obligations should not follow *Herrick* or the lead of Michigan.

1993); Pierce v. State, 910 P.2d 288 (N.M. 1995); Bailey v. State, 500 S.E.2d 54 (N.C. 1998); Hughes v. State, 838 P.2d 1018 (Or. 1992).

21 391 N.E.2d 729 (Ohio 1979).

22 *See infra* Part II.B.

23 *Herrick*, 391 N.E.2d at 733.

24 *In re* Request for Advisory Op. Regarding Constitutionality of 2011 PA 38, 806 N.W.2d 683, 697-98 & n.26 (Mich. 2011).

I. HISTORY OF PUBLIC PENSIONS AND THE RISE OF STATE CONSTITUTIONAL AMENDMENTS PROTECTING THEM

Public pensions date back to the Roman Empire, when the government awarded pensions for military service.[25] In America, public military pensions predated the Constitution, with the practice beginning before the Revolutionary War.[26] In the latter half of the nineteenth century, state and local governments began to provide civil servants with pensions. New York City created the first municipal retirement system in 1857, which provided a lump-sum payment to police officers injured in the line of duty.[27] New York City expanded its plan in 1878 to provide long-serving officers with benefits of one-half of their final salary upon retirement.[28] The practice then spread as other large municipalities began to create retirement systems, usually for firefighters, police officers, and teachers.[29]

In 1911, Massachusetts became the first state to create a general retirement system for its public employees.[30] By 1929, six states had general retirement systems in place.[31] The practice continued to spread, and today, all fifty states have public employee retirement systems.[32] Public pension plans now cover more than 19 million current and former state and local government employees.[33]

Initially, courts considered pensions mere gratuities, which the state legislature could take away at its whim.[34] The gratuity theory was premised on an understanding that pensions in those days did not arise from any

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25 CLARK ET AL., *supra* note 7, at 1.

26 *Id.* at 1-2; *see* United States v. Hall, 98 U.S. 343, 346 (1878).

27 Olivia S. Mitchell et al., *Developments in State and Local Pension Plans*, *in* PENSIONS IN THE PUBLIC SECTOR 11, 12 (Olivia S. Mitchell & Edwin C. Hustead eds., 2001).

28 *Id.*

29 *See* CLARK ET AL., *supra* note 7, at 4 (explaining that several large cities started offering their employees pensions after 1850).

30 *Id.*

31 *Id.* at 5. As public pensions began to spread amongst the states, the federal government also formalized its own comprehensive pension plan for civil workers with the passage of the Federal Employees Retirement Act in 1920. *Id.*

32 *See* PEW CENTER ON THE STATES, *supra* note 11, at 24.

33 *See* ERIKA BECKER-MEDINA, U.S. CENSUS BUREAU, PUBLIC-EMPLOYEE RETIREMENT SYSTEMS STATE- AND LOCALLY-ADMINISTERED PENSIONS SUMMARY REPORT: 2010, at 5 (2012), *available at* http://www.census.gov/prod/2012pubs/g10-aret-sl.pdf.

34 Note, *Public Employee Pensions in Times of Fiscal Distress*, 90 HARV. L. REV. 992, 993 (1977). The U.S. Supreme Court and various lower courts explicitly held that since pensions were gratuities, workers had no legal rights to them. *See, e.g.*, Lynch v. United States, 292 U.S. 571, 577 (1934); Frisbie v. United States, 157 U.S. 160, 166 (1895); United States v. Teller, 107 U.S. 64, 68 (1883); Pecoy v. City of Chicago, 106 N.E. 435, 436 (Ill. 1914), *superseded by constitution adopted in 1970*, ILL. CONST. art. XIII, § 5, *as recognized in* Buddell v. Bd. of Trs., 514 N.E.2d 184, 186 (Ill. 1987).

agreement between the state and the employee.[35] Rather, legislatures simply granted pensions at will, and therefore, in the eyes of the courts, pensions were little more than gifts.[36] Thus, a state was "free to confer, modify, or deny pensions as it please[d], with the minimal protection that the action not be arbitrary or capricious."[37]

The Illinois Supreme Court's 1914 decision in *Pecoy v. City of Chicago*[38] illustrates this line of cases. In *Pecoy*, a police officer sued to receive his pension.[39] At the time of his appointment, a statute provided that anyone who served ten years would receive a pension.[40] He served ten years before being wrongfully terminated.[41] He argued that the statute, as it existed at the time of his appointment, became part of his employment contract.[42] Therefore, he contended, the benefits that accrued under the statute had vested as property rights.[43] The court flatly rejected this argument, citing the string of U.S. Supreme Court decisions that classified pensions as gratuities.[44] Moreover, the court ruled that the petitioner's contributions to the pension plan did not change the gratuitous nature of his pension.[45] It reasoned that the contributions were not a payment by him into his own pension, but rather a condition of his employment.[46] That is, he knew at the beginning of his employment that 1 percent of his salary would never be paid to him, but instead would simply shift from one department fund (the salary fund) to another (the pension fund).[47]

Although this reasoning may seem arcane, it survives to this day, as the federal courts continue to consider pensions to be gratuities.[48] But in the years since, many state courts moved away from the gratuity model and began considering public retirement systems as creating enforceable legal

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35 *Lynch*, 292 U.S. at 577.

36 United States v. Cook, 257 U.S. 523, 527 (1922).

37 Note, *supra* note 34, at 993.

38 106 N.E. 435 (Ill. 1914), *superseded by constitution adopted in 1970*, ILL. CONST. art. XIII, § 5, *as recognized in* Buddell v. Bd. of Trs., 514 N.E.2d 184, 186 (Ill. 1987).

39 *Id.* at 436.

40 *Id.*

41 *Id.*

42 *Id.*

43 *Id.*

44 *Pecoy*, 106 N.E. at 436.

45 *Id.*

46 *Id.*

47 *Id.*

48 Deborah Kemp, *Public Pension Plans: The Need for Federal Regulation*, 10 HAMLINE L. REV. 27, 32 (1987). An 1889 Supreme Court decision, which continues to be good law, established public pensions as gratuities. Pennie v. Reis, 132 U.S. 464, 471 (1889). Several courts have interpreted state law as following this reasoning. *See, e.g.*, Kunin v. Feofanov, 69 F.3d 59, 63 (5th Cir. 1995) (per curiam) (treating Texas statewide pensions as gratuities); Haverstock v. State Pub. Emps. Ret. Fund, 490 N.E.2d 357, 360-61 (Ind. Ct. App. 1986) ("Pensions are mere gratuities springing from the appreciation and graciousness of the state.").

rights.[49] A large number of courts, including the supreme courts of North Dakota, South Carolina, South Dakota, and Washington, have held that public employees have a contractual right to their pension benefits.[50] These courts essentially accepted the reasoning of the petitioner in *Pecoy*, holding that a provision granting a pension at the time of employment becomes part of a worker's employment contract.[51] Some courts distinguished the historical military pensions from those of civil servants on the grounds that civil servants, unlike members of the military in bygone eras, actually contributed to pension funds, thus departing from the *Pecoy* court's position that such contributions did not make pensions less gratuitous.[52] For example, in a case involving Georgia's attempt to reduce retired firemen's pensions, the Georgia Supreme Court noted that regardless of whatever other claims there might be, a fireman's contributions to the pension fund invested the fireman with "substantial rights" that could not be taken away without due process of the law.[53] In holding that firemen had legal rights to their pensions, the court noted that the pensions had served as inducements to individuals to become firemen.[54]

Although later courts would rely on similar arguments, they also looked to the intent of the legislatures that passed pension statutes in order to determine whether to characterize pensions as vested rights or as gratuities.[55] Thus, even though courts do not generally construe statutes as creating contractual rights, courts will recognize a contract where the legislature has clearly expressed an intent to bind itself.[56]

Courts deciding whether a pension statute creates enforceable rights consider whether the text of the statute contains language that evinces a purposeful creation of contractual rights.[57] The South Carolina Supreme

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49 *See infra* notes 50-84 and accompanying text.

50 Payne v. Bd. of Trs. of the Teachers' Ins. & Ret. Fund, 35 N.W.2d 553, 556 (N.D. 1948) ("The relation thus established is in the nature of a contract, the terms of which are contained in the law so accepted by the teacher."); Layman v. State, 630 S.E.2d 265, 269 (S.C. 2006) ("We find it telling that the legislature used terms that are indicative of a contract"); Tait v. Freeman, 57 N.W.2d 520, 522 (S.D. 1953) ("Cases involving the question of whether there is a vested right to receive a pension are legion. We believe the better reasoned cases hold the relationship between the member of [sic] retirement system and the system is contractual." (citations omitted)); Bakenhus v. City of Seattle, 296 P.2d 536, 538 (Wash. 1956) ("'But, where . . . services are rendered under such a pension statute, the pension provisions become a part of the contemplated compensation for those services, and so in a sense a part of the contract of employment itself.'" (quoting O'Dea v. Cook, 169 P. 366, 367 (Cal. 1917))).

51 *Pecoy*, 106 N.E. at 436.

52 *E.g.*, Trotzier v. McElroy, 186 S.E. 817, 819-20 (Ga. 1936).

53 *Id.* at 819.

54 *Id.*

55 *See, e.g.*, *Layman*, 630 S.E.2d at 268 ("[I]f the statute indicates that the legislature intended to bind itself contractually, a contract may be found to exist.").

56 *Id.*

57 *Id.*

Court found such language in *Layman v. State*.[58] There, the court found that South Carolina's Teacher and Employee Retention Incentive program statutory scheme created contractual pension rights.[59] In particular, the court focused on statutory terms that showed an intent to create entitlements, terms such as "eligible," "complies," "requirements," and "shall agree."[60]

Maine and New Jersey declined to go as far as extending enforceable contractual rights, but the supreme courts of both states have suggested that pension benefits are more than mere gratuities.[61] Minnesota has protected its pension benefits through promissory estoppel,[62] finding that its public pension could not be viewed through "strict conventional contract principles."[63] Such principles, the court wrote, would not allow the flexibility required for pension plans.[64] However, the court reasoned that Minnesota had induced potential employees with promises of pensions, and employees had relied on those promises.[65] Thus, the court held that the state was estopped from modifying or eliminating its pension plan.[66]

In the same vein, Connecticut, New Mexico, and Wyoming courts have ruled that their respective retirement systems created property interests in pension benefits.[67] Connecticut's Supreme Court ruled that employees have some legal right to their pensions.[68] Nonetheless, like the Minnesota court, it rejected the contract approach as not giving enough flexibility.[69] However, unlike the Minnesota court, which used promissory estoppel to give flexibility, the Connecticut Supreme Court turned to property rights.[70]

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58 630 S.E.2d 265 (S.C. 2006).

59 *Id.* at 268.

60 *Id.* at 269 ("'A . . . member who is *eligible* [to retire under [the Teacher and Employee Retention Incentive program]] . . . and *complies* with the *requirements* of this article . . . . *shall agree*'" (second alteration in original) (quoting S.C. CODE ANN. § 9-1-2210(A) (2004))).

61 Spiller v. State, 627 A.2d 513, 519 (Me. 1993) (Wathen, J., dissenting) (recognizing that state employees have "legitimate retirement expectations" in receiving their pension benefits even though these interests do not confer contractual rights to the employees); Spina v. Consol. Police & Firemen's Pension Fund Comm'n, 197 A.2d 169, 173, 175 (N.J. 1964) (holding that pension benefits were not a gratuity but declining to define them as contractual rights).

62 Christensen v. Minneapolis Mun. Emps. Ret. Bd., 331 N.W.2d 740, 748 (Minn. 1983).

63 *Id.*

64 *Id.* at 747.

65 *Id.* at 749.

66 *Id.*

67 Pineman v. Oechslin, 488 A.2d 803, 810 (Conn. 1985) (concluding that while the state retirement system did not grant contractual rights, it did create property interests); Pierce v. State, 910 P.2d 288, 301 (N.M. 1995) (holding that the state's pension statutory language created vested rights which were substantially property rights); Peterson v. Sweetwater Cnty. Sch. Dist. No. One, 929 P.2d 525, 530 (Wyo. 1996) (stating that "legitimate retirement expectations may constitute property rights that may not be deprived without due process of law").

68 *Pineman*, 488 A.2d at 810.

69 *Id.*

70 *Id.*

The Connecticut Supreme Court ruled that the State could not modify or eliminate its pension—thereby depriving employees of their property—without due process of the law.[71]

Despite courts protecting pensioners through case law, some states sought to protect pensioners' benefits through constitutional amendments. Nine states have constitutional amendments specifically addressing pension benefits.[72] The language of these provisions varies from state to state. For example, the Alaska Constitution provides that "[m]embership in employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of these systems shall not be diminished or impaired."[73] The New York Constitution states that "membership in any pension or retirement system of the state or of a civil division thereof shall be a contractual relationship, the benefits of which shall not be diminished or impaired."[74] The Michigan Constitution provides that "[t]he 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."[75] These provisions convey the state legislatures' undeniably clear intent to embrace the contractual-relationship view.

New Mexico's provision is subtly different; it states that, "[u]pon meeting the minimum service requirements of an applicable retirement plan created by law for employees of the state . . . , a member of a plan shall acquire a vested property right with due process protections under the applicable provisions of the New Mexico and United States constitutions."[76] While New Mexico is not the only state to confer property rights to pensions, it is the only state to do so via a constitutional provision rather than case law.[77]

All the other states with constitutional provisions protecting public pension benefits explicitly make the pension benefits contractual obliga-

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[71] *Id.* Since the employees did not raise any due process arguments, the court ruled in favor of the state. *See id.*

[72] Alaska, Arizona, Hawaii, Illinois, Louisiana, Michigan, New Mexico, New York, and Texas have constitutional amendments specifically addressing pensions. Whitney Cloud, Comment, *State Pension Deficits, the Recession, and a Modern View of the Contracts Clause*, 120 YALE L.J. 2199, 2203 n.20 (2011); Fehr, *supra* note 16

[73] ALASKA CONST. art. XII, § 7.

[74] N.Y. CONST. art. V, § 7.

[75] MICH. CONST. art. IX, § 24.

[76] N.M. CONST. art. XX, § 22. New Mexico solidified its property-rights approach after its supreme court decided *Pierce v. State*, 910 P.2d 288 (N.M. 1995). *See infra* notes 175-182 and accompanying text.

[77] Wyoming and Connecticut confer property rights to pensions via case law. *See, e.g.*, Pineman v. Oechslin, 488 A.2d 803, 810 (Conn. 1985); Peterson v. Sweetwater Cnty. Sch. Dist. No. One, 929 P.2d 525, 531 (Wyo. 1996).

tions.[78] Exactly what these provisions protect as a contractual right, however, varies widely from state to state. For instance, Texas's provision "applies only to a public retirement system that is not a statewide system" and allows local governments to exempt their retirement systems through voter referendum.[79] This provision means that Texas effectively still treats statewide pension plans as gratuities.[80] In contrast, the other seven states with constitutional provisions confer contractual rights on all public pension plans, both local and statewide.[81] Alaska, Arizona, Illinois, and New York protect past and future benefit accruals.[82] However, Hawaii, Louisiana, and Michigan only protect past benefit accruals.[83] Thus, notwithstanding that Texas's provision provides for a number of carve-outs, Michigan's provision is generally considered one of the narrowest of the constitutional provisions, while New York's is among the broadest.[84]

States that made pensions contractual obligations via constitutional amendment placed pension benefits under the protection of the federal Contract Clause and, in many cases, their state contract clauses.[85] The U.S. Constitution provides that "[n]o State shall . . . pass any . . . Law impairing

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78 *See* Amy B. Monahan, *Public Pension Plan Reform: The Legal Framework*, 5 EDUC. FIN. & POL'Y 617, 622-24 (2010) (discussing Alaska, Arizona, Illinois, and New York, which "provide through specific constitutional protections that state retirement plans cannot be amended in any way that results in a participant receiving a lower retirement benefit than that which would be payable under the plan terms in effect as of the date the employee first became eligible to participate in the plan.").

79 TEX. CONST. art. XVI, § 66.

80 *See* Kunin v. Feofanov, 69 F.3d 59, 63 (5th Cir. 1995) (per curiam) (explaining that the state may change the conditions of pension benefits, modify amounts paid, or abolish pension benefits altogether); *see also* Anna K. Selby, Comment, *Pensions in a Pinch: Why Texas Should Reconsider Its Policies on Public Retirement Benefit Protection*, 43 TEX. TECH L. REV. 1211, 1218-31, 1238-44 (2011) (offering an in-depth review of Texas's provision).

81 Monahan, *supra* note 78, at 622-24.

82 ALASKA CONST. art. XII, § 7; ARIZ. CONST. art. XXIX, § 1; ILL. CONST. art. XIII, § 5; N.Y. CONST. art. V, § 7; *see also* Monahan, *supra* note 78, at 622-24. The Alaska Constitution refers to "accrued benefits," but its courts have interpreted this provision as protecting future accruals. *See, e.g.*, Hammond v. Hoffbeck, 627 P.2d 1052, 1057 (Alaska 1981) (finding that the right to future benefits under Alaska's pension plan vests immediately).

83 HAW. CONST. art. XVI, § 2; LA. CONST. art. X, § 29; MICH. CONST. art. IX, § 24; *Selby*, *supra* note 80, at 1233-34.

84 Michigan's provision protects against diminishment of "accrued financial benefits." MICH. CONST. art. IX, § 24. New York's provision protects against diminishment of "benefits." N.Y. CONST. art. V, § 7. *See Selby*, *supra* note 80, at 1233 (noting that New York benefits are some of the broadest, while Michigan's protections are narrower, restricting guarantees to "accrued benefits").

85 Many state constitutions have their own contract clause provision and the language generally tracks that of the U.S. Constitution. Brian A. Schar, Note, *Contract Clause Law Under State Constitutions: A Model for Heightened Scrutiny*, 1 TEX. REV. L. & POL. 123, 129 (1997). As such, state courts draw from U.S. Supreme Court decisions discussing the federal Contract Clause when interpreting their own clauses. *See id.* at 130-33 (observing that many states follow the federal framework in applying their own contract clause provisions but interpret these precedents differently).

the Obligation of Contracts."[86] Nearly all state constitutions contain similar language.[87] The protection of the Contract Clause is not absolute.[88] The U.S. Supreme Court has recognized that some accommodation must be made to ensure that states can protect significant public interests.[89] In *United States Trust Co. v. New Jersey*,[90] the Court created a three-part test to determine whether a state violates the Constitution when it seeks to modify its own contractual obligations.[91] First, the Court identifies whether a valid contractual obligation is present.[92] Second, it determines whether the state's action in question impairs that contract.[93] Third, the Court looks to whether the impairment is reasonable and necessary to serve a legitimate and important public purpose.[94] State courts have adopted the Supreme Court's test when dealing with state constitutional contract challenges to pension modifications.[95] Thus, once a state places pensions under the Contract Clause, pensions become more difficult to unilaterally modify or eliminate.[96] Unlike those that view pensions as gratuities, a state that binds itself in contract to its employees cannot arbitrarily alter pension benefits. Rather, a state's power to change pension benefits is limited to what is "reasonable and necessary."[97]

Thus, where a court finds a tax exemption to be a contractual obligation, its repeal must be reasonable and necessary.[98] However, the issue of "reasonable and necessary" was rarely litigated before the 1990s because, although many states offered tax exemptions, few ever tried to repeal

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86 U.S. CONST. art. I, § 10.

87 *See* Schar, *supra* note 85, at 129-33 (discussing the many states with state constitutional contract provisions and how their courts interpret the level of protection granted by their constitutions in comparison to the U.S. Constitution).

88 Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 428-29 (1934) (dismissing a rigid application of the federal Contract Clause as impractical and inconsistent with previous judicial decisions).

89 *Id.* at 434-35.

90 431 U.S. 1 (1977).

91 *Id.* at 22-29; *see also* Cloud, *supra* note 72, at 2203-04 (discussing the three-part test from *U.S. Trust*).

92 *U.S. Trust*, 431 U.S. at 22-23.

93 *See id.* at 27-28.

94 *See id.* at 22-23.

95 Cloud, *supra* note 72, at 2204 (observing that states adopted *U.S. Trust's* three-part test, but applied it inconsistently).

96 Generally, courts have found that contractual rights can be altered so long as equal or greater benefits are substituted for those benefits that are diminished or removed. *See, e.g.*, Newcomb v. Ogden City Pub. Sch. Teachers' Ret. Comm'n, 243 P.2d 941, 948 (Utah 1952) ("[T]he Legislature may not provide for the termination of a retirement system unless a substantial substitute is provided for"); Op. Att'y Gen. of Mich. No. 6697, 1991 Mich. AG LEXIS 39, at *15 (Dec. 18, 1991) (suggesting Michigan could reduce its pension benefits if it substituted benefits of equal or greater value).

97 Bailey v. State, 500 S.E.2d 54, 60 (N.C. 1998).

98 *See id.*

them.[99] That changed with the Supreme Court's decision in *Davis v. Michigan Department of Treasury*.

II. *DAVIS*, ITS AFTERMATH, AND THE ROLE OF *HERRICK* IN COURTS' REASONING

While many states provided tax exemptions for income from local and state pensions, these states rarely exempted federal pensions from taxation. The U.S. Supreme Court invalidated this inconsistent tax treatment in *Davis*.[100] In the wake of *Davis*, many states attempted to repeal their tax exemptions, and those efforts led to lawsuits by pensioners arguing that they had legal entitlements to the tax exemptions.[101] Many of the state courts addressing those challenges rejected them, relying in large part on *Herrick v. Lindley*, a pre-*Davis* case in which the Ohio Supreme Court upheld the repeal of that state's tax exemption.

In this Part, Section A discusses the Supreme Court's mandate in *Davis* that states treat state and federal pensions equally for tax purposes. Section B explores the litigation that followed states' attempts to come into line with *Davis* by repealing their tax exemptions. Particular attention is given to *Herrick*, on which many courts have relied in upholding their states' post-*Davis* repeals.

A. *The* Davis *Decision Requires Equal Tax Treatment of State and Federal Pensions*

In 1989, the Supreme Court decided *Davis* and fundamentally changed the landscape for tax-exempt public pensions. In *Davis*, a Michigan resident and former federal employee sued the State of Michigan after being denied a refund of tax he had paid on his federal pension benefits.[102] The Michigan resident argued that the state's practice of exempting state pensions from income taxes but not federal pensions violated 4 U.S.C. § 111, which preserves federal employees' immunity from discriminatory state taxation.[103]

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[99] Only Maine, Ohio, and Rhode Island considered repeals prior to the *Davis* decision. *See* Blair v. State Tax Assessor, 485 A.2d 957, 958-59 (Me. 1984); Herrick v. Lindley, 391 N.E.2d 729, 731 (Ohio 1979); Linnane v. Clark, 557 A.2d 477, 479 (R.I. 1989).

[100] Davis v. Mich. Dep't of Treasury, 489 U.S. 803, 817 (1989).

[101] *See, e.g.*, Spradling v. Colo. Dep't of Revenue, 870 P.2d 521, 522 (Colo. App. 1993); Parrish v. Emps.' Ret. Sys., 398 S.E.2d 353, 353-54 (Ga. 1990); Sheehy v. Pub. Emps. Ret. Div., 864 P.2d 762, 764-65 (Mont. 1993); *Bailey*, 500 S.E.2d at 59; Pierce v. State, 910 P.2d 288, 292 (N.M. 1995); Hughes v. State, 838 P.2d 1018, 1023 (Or. 1992).

[102] *Davis*, 489 U.S. at 805-06.

[103] *Id.* at 808.

The Michigan courts uniformly rejected his claim.[104] However, the U.S. Supreme Court agreed with the retired federal employee, holding that tax exemptions for state retirees that did not apply to federal retirees violated what the Court referred to as the "principles of intergovernmental tax immunity."[105]

Yet, while the Court found that the resident was entitled to a refund of past paid taxes, the Court declined to grant prospective relief.[106] In so doing, the Court declined to invalidate the provision in its entirety, and instead simply mandated equal treatment.[107] The Court left Michigan and other states free to determine how to achieve equality. As the Court noted, states could "either . . . extend[] the tax exemption to retired federal employees [or] . . . eliminat[e] the exemption for retired state and local government employees."[108] Although Michigan declined to repeal the exemption and instead extended it to federal employees, many other states, faced with the prospect of large revenue losses, immediately chose to repeal their tax exemptions.[109]

Not surprisingly, these repeals spawned lawsuits by aggrieved public pensioners.[110] However, none of the lawsuits sparked by post-*Davis* repeals involved states that had expressly protected public pension benefits with constitutional amendments. New Mexico considered the issue in 1995[111]—three years before it ratified its constitutional provision in 1998.[112] Thus, at the time of New Mexico's challenge, the New Mexico Supreme Court had no basis to address whether a constitutional provision prevented the repeal of its tax exemption.

While none of the states with provisions that protect pension benefits were involved in the post-*Davis* litigation, several state courts in non-provision states still found that their states' pensioners had statutorily created contractual rights to their tax exemptions.[113] The Oregon case *Hughes v. State*[114] and the later North Carolina case *Bailey v. State*[115] typify these court decisions.

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104 *Id.* at 807.

105 *Id.* at 817.

106 *Id.*

107 *Id.* at 817-18.

108 *Davis*, 489 U.S. at 818.

109 *See, e.g.*, Spradling v. Colo. Dep't of Revenue, 870 P.2d 521, 522 (Colo. App. 1993); Sheehy v. Pub. Emps. Ret. Div., 864 P.2d 762, 764 (Mont. 1993).

110 *See, e.g.*, Parrish v. Emps.' Ret. Sys., 398 S.E.2d 353, 353-54 (Ga. 1990); Hughes v. State, 838 P.2d 1018, 1020 (Or. 1992).

111 Pierce v. State, 910 P.2d 288, 301 (N.M. 1995).

112 N.M. CONST. art. XX, § 22 (West, Westlaw through May 2012) (indicating that the amendment was ratified in 1998).

113 *See, e.g.*, Bailey v. State, 500 S.E.2d 54, 60 (N.C. 1998); *Hughes*, 838 P.2d at 1033.

114 838 P.2d 1018 (Or. 1992).

115 500 S.E.2d 54 (N.C. 1998).

Following *Davis*, the Oregon legislature decided to modify the statutory language of its Public Employees Retirement System ("PERS").[116] Under the revised language, pension benefits would not be subject to any state, county, or municipal taxes *except* personal income tax.[117] The language repealed Oregon's tax exemption, which had been in place since the state enacted the Public Employees' Retirement Act in 1945.[118] Pensioners sued the state, arguing that the tax exemption was a term of the state's offer of employment.[119] Their acceptance of that offer created a binding contract that required that their pension benefits be provided pursuant to the terms of the offer.[120] Oregon argued that while PERS did create a contract, the tax exemption was not a term of that contract, and even if it were, the repeal was a breach of contract, not an impairment of contract.[121]

The Oregon Supreme Court rejected the state's arguments.[122] In its decision, the court likened the tax exemption to the "'valuable [tax] privileges'"[123] at stake in *Piqua Branch of State Bank v. Knoop*.[124] In *Knoop*, Ohio granted a bank charter, which provided that banks incorporated under the charter would be subject to a 6-percent tax in lieu of all other taxes.[125] Ohio subsequently tried to tax the banks at a higher rate.[126] In finding that the increased tax was a contractual impairment, the U.S. Supreme Court noted that the special tax rate was a "valuable privilege" and that should such a privilege induce a bank to accept the charter, the privilege would become part of a contract between Ohio and the bank.[127] The Oregon court, drawing upon *Knoop*, found that the tax exemption, which induced pensioners to accept the state's offer of employment, was part of the PERS contract between the state and the pensioners.[128] The court also recognized that the tax exemption had benefitted Oregon by allowing it to acquire workers for less upfront pay in exchange for tax-exempt pension payments later on.[129] In the court's words, the "[g]overnment propose[d] to keep the benefit of lower cost, but to take away the promise that its employees accepted in order to

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116 *Hughes*, 838 P.2d at 1023.
117 *Id.*
118 *Id.* at 1021.
119 *Id.* at 1023.
120 *Id.*
121 *Id.* at 1024.
122 *Hughes*, 838 P.2d at 1028-34.
123 *Id.* at 1031 (quoting *Piqua Branch of State Bank v. Knoop*, 57 U.S. (16 How.) 369, 379-80 (1853)).
124 57 U.S. (16 How.) 369 (1853).
125 *Id.* at 377.
126 *Id.* at 378.
127 *Id.* at 379-80.
128 *Hughes*, 838 P.2d at 1032.
129 *Id.* at 1042 n.7.

lower that cost, thereby keeping the benefit of its bargain but depriving the employees of the benefit of theirs."[130]

Similar to Oregon, the North Carolina General Assembly attempted two modifications of its tax exemption after *Davis*.[131] North Carolina would first have extended its tax exemption to all governmental employees, local, state, and federal.[132] Second, it would have capped the amount of annual benefits that would be exempt at $4,000.[133] A number of local and state pensioners sued, arguing that they had a contractual right to the tax exemption and that the new law capping the exempt amount at $4,000 violated that right.[134] Thus, they contended that "the State's removal of the exemption beyond the amount of $4,000 operated unconstitutionally to deprive them of benefits to which they had a vested right."[135]

The North Carolina Supreme Court agreed with the pensioners and struck down the cap.[136] In reaching its decision, the court first ruled that the statutory retirement scheme had created a contract between the pensioners and the state.[137] The court based its decision on "the premise that retirement benefits are presently earned but deferred compensation to which employees have a vested contractual right."[138] It then concluded that the tax exemption was a term of that contract.[139] The court emphasized the "expectational interests" of employees, which it found to underlie the U.S. Constitution's Contract Clause.[140] In that respect, the court observed that the Contract Clause is designed to "safeguard" expectational interests.[141]

In striking down the cap on the tax exemption, the *Bailey* court stressed that the tax exemption had served as an inducement to government workers to work for the government.[142] Thus, the court found that North Carolina was prohibited from limiting the exemption after the fact.[143] On that point, the *Bailey* court quoted at length from Oregon's *Hughes*, noting that the government was trying to keep the benefit of its bargain while

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130 *Id.*
131 Bailey v. State, 500 S.E.2d 54, 59 (N.C. 1998).
132 *Id.*
133 *Id.*
134 *Id.*
135 *Id.*
136 *Id.* at 76.
137 *Bailey*, 500 S.E.2d at 63.
138 *Id.* at 60 (citing *Simpson v. N.C. Local Gov't Emps.' Ret. Sys.*, 363 S.E.2d 90, 93-94 (N.C. Ct. App. 1987), *aff'd*, 372 S.E.2d 559 (N.C. 1988) (per curiam)).
139 *Id.* at 63.
140 *Id.* at 62-63.
141 *Id.* at 62.
142 *Id.* at 59.
143 *Bailey*, 500 S.E.2d at 60.

shirking its obligations.[144] The court appealed to fundamental fairness, which barred North Carolina from taking such action.[145]

However, not all courts have followed Oregon and North Carolina. While other courts have found that pensioners had a contractual right to their tax exemptions, they still upheld repeals of those exemptions.[146] For example, the Georgia Supreme Court found that Georgia's retirement scheme did create a contractual entitlement, but the court nonetheless affirmed the repeal of the state's tax exemption.[147] Addressing the issue of contractual rights, the court reasoned, "[s]ince each retiree contributed to the retirement system and performed services while the law exempting retirement benefits from state income taxation was in effect, that law became part of the contract of employment of the retiree."[148] Nonetheless, the court found that the statute creating a contractual right to pensions granted an irrevocable tax in violation of the Georgia Constitution.[149] Having thus dispatched with the contractual right to a tax exemption, the court had little trouble concluding that the exemption could be repealed.[150]

Yet other courts addressing these post-*Davis* challenges completely broke with *Bailey* and *Hughes*, each finding that its state's tax exemption was simply not part of a contract between the state and its pensioners.[151] For instance, in *Sheehy v. Public Employees Retirement Division*,[152] the Montana Supreme Court ruled that employees had no contractual right to the state's tax exemption, resting its decision in part on the tax exemption's location within the statutory scheme—away from other benefits of its retirement scheme.[153] Given that location, the court concluded that the statute did not "make or imply any promises regarding ongoing or future tax treatment of state retirement benefits."[154] Colorado and New Mexico also upheld repeals of their tax exemptions; however, unlike Montana, Colorado and New Mexico relied on the 1979 Ohio case *Herrick*, accepting its formalistic

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144 *Id.* at 65-66.

145 *Id.* at 65. The court's reliance on a conception of fundamental fairness is not without its critics, who argue, amongst other things, that it severely limits the protection against a state contracting away its power of taxation. *See* Dana Edward Simpson, Note, *Choosing Fairness over Fundamentals: How* Bailey v. North Carolina *Undermines the Constitutional Prohibition Against the State Contracting away Its Power of Taxation*, 77 N.C. L. REV. 2217, 2242 (1999).

146 *See, e.g.*, Parrish v. Emps.' Ret. Sys., 398 S.E.2d 353, 354 (Ga. 1990) (finding that an amendment to the state constitution prohibited such "irrevocable" tax exemptions).

147 *Id.*

148 *Id.*

149 *Id.* at 355.

150 *Id.*

151 Spradling v. Colo. Dep't of Revenue, 870 P.2d 521, 523-24 (Colo. App. 1993); Pierce v. State, 910 P.2d 288, 304-05 (N.M. 1995).

152 864 P.2d 762 (Mont. 1993).

153 *Id.* at 765-66.

154 *Id.*

distinction between reducing the corpus of a pension payment and taxing a pension payment.[155]

B. *The* Herrick *Court's Reasoning and Its Use by Other States' Courts*

Prior to *Davis*, Maine, Ohio, and Rhode Island had already considered the repeal of tax exemptions for public pensions.[156] While one state court's decision is not binding precedent in another state, it can have persuasive value.[157] As such, courts considering similar repeals after *Davis* could and did look to decisions from those states. Maine and Rhode Island upheld their repeals, but they did so based on peculiar reasons, given that their exemptions had each been adopted as part of extensive revisions to their respective tax codes.[158] Thus, Ohio's *Herrick* decision would prove to be a much more instructive case.[159]

In *Herrick*, pensioners sued after the state subjected their previously tax-exempt retirement benefits to income taxation.[160] The pensioners contended that the tax exemption "conferred a valuable benefit in the form of an absolute exemption from state taxation, and that they had acquired a vested right in this exemption to be received upon retirement."[161] The Ohio Supreme Court disagreed, holding that the pensioners did not have a vested right in a continuing tax exemption.[162] Rather, the court held pensioners had a vested right in receiving pension payments only at a certain level.[163] Although subjecting the benefits to taxation might lead to the same outcome as reducing the benefits, the court ruled that there was a clear legal distinction

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155 *See Spradling*, 870 P.2d at 524; *Pierce*, 910 P.2d at 295-96.

156 *See* Blair v. State Tax Assessor, 485 A.2d 957, 959 (Me. 1984); Herrick v. Lindley, 391 N.E.2d 729, 731 (Ohio 1979); Linnane v. Clark, 557 A.2d 477, 477 (R.I. 1989).

157 *See Spradling*, 870 P.2d at 524; Gavin Reinke, Comment, *When a Promise Isn't a Promise: Public Employers' Ability to Alter Pension Plans of Retired Employees*, 64 VAND. L. REV. 1673, 1698 (2011).

158 *See Blair*, 485 A.2d at 960; *Linnane*, 557 A.2d at 478-79. While many states have contemplated repealing their tax exemptions, Maine actually considered instituting a new tax exemption for private and public pensions. Stephen C. Fehr, *As Michigan Passes Pension Tax, Maine Considers Repealing One*, STATELINE (Sept. 19, 2011), http://www.pewstates.org/projects/stateline/headlines/as-michigan-passes-pension-tax-maine-considers-repealing-one-85899375121. That measure did not pass the state legislature. Susan M. Cover, *Budget Compromise Heads to Legislature*, THE MORNING SENTINEL (Apr. 11, 2012), http://www.onlinesentinel.com/news/budget-compromise-heads-to-legislature_2012-04-10.html.

159 *See* Hughes v. State, 838 P.2d 1018, 1058 (Or. 1992) (Peterson, J., dissenting) (calling *Herrick* "apposite" to Oregon's repeal of its tax exemption).

160 *Herrick*, 391 N.E.2d at 731.

161 *Id.*

162 *Id.* at 733.

163 *Id.* Although *Herrick* does not specifically state it, Ohio courts treat rights vested under a statute as a contractual right. *See, e.g.*, Horvath v. State Teachers Ret. Bd., 697 N.E.2d 644, 654 (Ohio 1998).

between reducing a pension payment and imposing a new tax on a pension payment.[164] In an often-cited passage, the court wrote:

> By the clear language of these sections [concerning Ohio's public employee retirement system], . . . retirees have a vested right to receive a retirement allowance or similar benefit at the rate fixed by law when such benefit was conferred. However, [no part of the statutory scheme] grants a vested right to a continuing tax exemption.
>
> Admittedly the net bankable retirement income might be the same whether the rate of a pension is reduced, or a tax is levied on such income. However, there is a definite legal distinction between reducing the rate of a pension and levying a tax upon the income received from that pension. The vesting statutes prohibit only a reduction in the rate of payment. They do not prohibit the imposition of a tax.[165]

In short, the *Herrick* court took a very permissive view of the state's ability to impose new taxes on vested pension benefits, so long as the amount of the pretax disbursement was not affected.[166]

The court then concluded that in enacting the tax exemption to begin with, "it was not the intent of the General Assembly to grant appellees a vested right to receive their pensions exempt from tax taxation," and therefore, the tax exemption did not create any contractual rights protected by the U.S. Constitution's Contract Clause or a similar provision in the Ohio Constitution.[167] First, the court reasoned that if Ohio had wanted to give away its power of taxation, it would have done so unambiguously.[168] The court noted that when a state gives up its ability to tax, it limits its ability to deal with changing economic realities.[169] Second, the court concluded that it should construe any ambiguity so as to find no relinquishment of the state's ability to tax.[170] While Ohio clearly and unambiguously gave rights to pension payments, the court held that there was no clear indication that it intended to give a right to a tax exemption.[171] Thus, the court found that eliminating a tax exemption did not run afoul of either the federal Contract Clause[172] or the Ohio Constitution's similar provision.[173]

In post-*Davis* cases, the courts of New Mexico and Colorado, as well as the dissent in Oregon's *Hughes* decision, found *Herrick*'s "legal distinc-

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164 *Herrick*, 391 N.E.2d at 733.

165 *Id.* at 732-33.

166 *See id.*

167 *Id.* at 733.

168 *Id.*

169 *Id.*

170 *Herrick*, 391 N.E.2d at 733.

171 *Id.* at 732-33.

172 U.S. CONST. art. I, § 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts").

173 OHIO CONST. art. II, § 28 ("The general assembly shall have no power to pass . . . laws impairing the obligation of contracts").

tion" to be persuasive.[174] In *Pierce v. State*, the New Mexico Supreme Court upheld the repeal of its tax exemption.[175] In response to *Davis*, New Mexico, like other states, repealed several longstanding tax exemptions for its public pensions.[176] In upholding those repeals, the New Mexico Supreme Court first distinguished a vested right from a contractual right.[177] A vested right, the court ruled, can be created by the common law, a statute, or a contract, whereas only a contract can form a contractual right.[178] After approvingly discussing *Herrick* at length, the court ruled that pensioners had a vested right to their payments, but not to an ongoing tax exemption.[179] The court then examined the text of its four retirement plans in detail to see if any of the language granted a contractual right to the tax exemption.[180] It concluded that the statutory schemes were expressly written to limit the conferral of contractual rights to the benefits themselves and did not extend any contractual rights to the tax exemption.[181] Thus, the court rejected the plaintiffs' contention that they had a contractual right to the tax exemption.[182]

In *Spradling v. Colorado Department of Revenue*,[183] the Colorado Court of Appeals likewise upheld the Colorado General Assembly's modification of the state's tax exemption on public pensions. In 1989, the General Assembly limited the tax exemption for disability benefits to beneficiaries over the age of fifty-five.[184] The court rejected the plaintiffs' argument that they had "a contractual right [to the tax exemption that was] indistinguishable from the right to the benefits themselves."[185] While "recogniz[ing] that other jurisdictions ha[d] reached the opposite conclusion under similar circumstances," the *Spradling* court was "persuaded that the better-reasoned view [was] that espoused by the Ohio Supreme Court in *Harrick*

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174 *See* Spradling v. Colo. Dep't of Revenue, 870 P.2d 521, 524 (Colo. App. 1993); Pierce v. State, 910 P.2d 288, 295 (N.M. 1995); Hughes v. State, 838 P.2d 1018, 1058 (Or. 1992) (Peterson, J., dissenting).

175 *Pierce*, 910 P.2d at 307.

176 *Id.* at 292; *see also* Bailey v. State, 500 S.E.2d 54, 59 (N.C. 1998) (discussing the repeal of tax exemptions for public pensions in North Carolina); *Hughes*, 838 P.2d at 1023 (addressing the repeal of tax exemptions for public pensions in Oregon).

177 *Pierce*, 910 P.2d at 296.

178 *Id.*

179 *See id.* at 294-96, 302.

180 *See id.* at 296-301.

181 *Id.* at 301-02.

182 *Id.* New Mexico has a constitutional provision protecting public pension rights; however, it does not confer contractual rights. Instead, it makes pension benefits property rights protected by due process of the law. N.M. CONST. art. XX, § 22.

183 870 P.2d 521 (Colo. App. 1993).

184 *Id.* at 522.

185 *Id.*

[sic]."[186] Thus, like the New Mexico court, the Colorado court also accepted *Herrick*'s legal distinction.

As this Section has demonstrated, different state courts have taken different approaches post-*Davis* in evaluating their legislatures' attempts to repeal tax exemptions on pension income. Many of these analyses relied on the *Herrick* court's distinction between taxing the corpus of a pension and merely reducing the amount paid to pensioners. However, none of the courts discussed in this Section were faced with a constitutional amendment that specifically set forth pensions as contractual obligations.

III. ATTEMPTS TO REPEAL TAX EXEMPTIONS IN STATES WITH CONSTITUTIONAL PROVISIONS

Although several states repealed their tax exemptions following *Davis*, no state with a constitutional amendment protecting pension benefits as contractual rights attempted to do so. However, the legislature in at least one such state, Michigan, considered a proposal to repeal its tax exemption for public benefits.[187] In December 1991, upon the request of several state representatives, then Attorney General Frank Kelley issued an advisory opinion on the question, "Do the statutory exemptions of state and local public pension benefits from state income tax constitute accrued financial benefits which are protected by Const. 1963, art 9, § 24, from legislative limitation or repeal?"[188]

Article 9, § 24, of the Michigan Constitution states that:

> 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.[189]

The Attorney General concluded that this provision allowed Michigan to constitutionally repeal the tax exemption *prospectively* for new hires or for benefits not yet accrued, given the fact that the provision only conferred contractual rights on accrued benefits.[190] In addition, the Attorney General opined that the legislature could retroactively repeal the tax exemption so long as any repeal provided alternative benefits that were equal to or greater than the benefits that were limited or repealed, thus resulting in "no consti-

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186 *Id.* at 524.

187 *See* Op. Att'y Gen. of Mich. No. 6697, *supra* note 96, at *2 (requesting the Attorney General's opinion on the constitutionality of changes to the tax exemption; State Senators John J.H. Schwarz and William Faust, along with Representative Frank M. Fitzgerald posed the question).

188 *Id.*

189 MICH. CONST. art. IX, § 24.

190 Op. Att'y Gen. of Mich. No. 6697, *supra* note 96, at *9-10.

tutionally cognizable impairment of the pension benefit."[191] The Attorney General then stated that the only remaining question was whether the tax exemption could be repealed retroactively on accrued benefits without providing alternative benefits.[192] The Attorney General declined to address that question, however, stating that the issue was still being researched, and that "[w]hen the research is completed, [the Attorney General's] response [would] be forthcoming."[193] But that response never came, and the proposal ultimately withered.

Nearly two decades later, the financial downturn of 2008 provided a new impetus for Michigan to reconsider repealing its tax exemption—to capture additional revenue. This led to Michigan becoming the first state with a constitutional provision protecting pension benefits to repeal its tax exemption.[194] In signing the legislation into law, the Michigan governor indicated that repealing the tax exemption was part of a larger plan to help combat Michigan's budget deficit.[195] Seeking to head off inevitable litigation, the governor asked the Michigan Supreme Court to issue an advisory opinion addressing the repeal's constitutionality, and the court agreed to do so.[196]

The court issued its ruling in November 2011,[197] advising that the tax repeal was constitutional.[198] Taking a textualist position, the court found that public employees did not have a contractual right to the tax exemption because the tax exemption did not "accrue[]" as required by the plain language of Michigan's provision; the court concluded that the tax exemption did not "grow over time."[199] The court then approvingly cited *Herrick*'s legal distinction between diminishing the corpus and increasing taxes, stating that the tax exemption was "simply a postdistribution effect of the accrued financial benefits that have otherwise been paid in full."[200]

Although Michigan is the only constitutional-provision state to have repealed its tax exemption, it is not the only such state to have contemplated the possibility. Given the strain the Great Recession has placed on state budgets, other states with constitutional provisions have also considered

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191 *Id.* at *15.

192 *Id.* at *15-16.

193 *Id.* at *16.

194 Novack, *supra* note 1.

195 Press Release, Office of the Governor of Mich., Governor Snyder Unveils Recommended Budget to Provide Foundation for Michigan's Reinvention (Feb. 17, 2011), *available at* http://www.michigan.gov/snyder/0,1607,7-277--251733--,00.html.

196 *In re* Request for Advisory Op. Regarding Constitutionality of 2011 PA 38, 806 N.W.2d 683, 688 (Mich. 2011).

197 *Id.* at 683.

198 *Id.* at 688-89.

199 *Id.* at 695-97 (quoting Studier v. Mich. Pub. Sch. Emps.' Ret. Bd., 698 N.W.2d 350, 358 (Mich. 2005) (internal quotation marks omitted)).

200 *Id.* at 697-98.

repeals of their tax exemptions.[201] In April 2011, the Hawaii legislature considered and rejected a bill that would have repealed its tax exemption after its attorney general issued an advisory opinion concluding such a move could be unconstitutional.[202] In that advisory opinion, Hawaii's attorney general cautioned that because the repeal would be subject to "constitutional legal attack," it might be litigated for years to come.[203] It bears note that Hawaii's constitutional protection is substantially broader than Michigan's because it is not limited to financial benefits as Michigan's is.[204] Rather, Hawaii's provision provides that "[m]embership in any employees' retirement system of the State or any political subdivision thereof shall be a contractual relationship, the accrued benefits of which shall not be diminished or impaired."[205] This may prove to be an important distinction if the Hawaii Supreme Court follows a textualist view as Michigan's Supreme Court has done, wherein the court allowed health benefits to be diminished because they were not *financial* benefits.[206]

Arizona, which similarly provides constitutional protection to public pension benefits, has not moved to repeal its tax exemption, though its legislature has at least broached the subject.[207] When the prospect was recently raised, however, members of the Arizona legislature indicated that doing so would require modification of the state constitution.[208] It therefore appears that at least part of Arizona's legislature reads the constitutional provision as encompassing the state's tax exemption. Thus, for the time being, it seems that Arizona will not pursue a repeal.

IV. *HERRICK*'S REASONING SHOULD NOT BE RELIED UPON BY STATES WITH CONSTITUTIONAL PENSION PROTECTIONS

As other states with constitutional provisions that protect public pension benefits ponder repealing their tax exemptions, they may be tempted to follow Michigan's lead and rely upon *Herrick*'s distinction between reduc-

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201 *See* Reinke, *supra* note 157, at 1679-83 (discussing how states are seeking to modify their pension plans in light of the financial downturn).

202 *See* Mark Niesse, *Pension Tax Proposal on Life Support in Hawaii*, BENEFITSPRO (Apr. 13, 2011), http://www.benefitspro.com/2011/04/13/pension-tax-proposal-on-life-support-in-hawaii.

203 Letter from Hugh R. Jones, Supervising Deputy Att'y Gen. of Haw., Tax Div., to Clayton Hee, Chairperson, Haw. Senate Comm. on Judiciary & Labor (Mar. 18, 2011), *available at* http://blogs.starbulletin.com/inpolitics/wp-content/uploads/2011/04/AG-David-Louie-HB1092-1.pdf.

204 *See* MICH. CONST. art. IX, § 24.

205 HAW. CONST. art. XVI, § 2.

206 *See* Studier v. Mich. Pub. Sch. Emps.' Ret. Bd., 698 N.W.2d 350, 356 (Mich. 2005).

207 *See* Rich Danker, *Arizona's Pension Change Shows That No Union Is Untouchable*, FORBES (Apr. 21, 2011, 1:42 PM), http://blogs.forbes.com/richdanker/2011/04/21/arizonas-pension-change-shows-that-no-union-is-untouchable.

208 *See id.*

ing the amount of pretax disbursements and imposing new taxes on the disbursements. But they would be unwise to do so. In this Part, Section A demonstrates that *Herrick*'s wooden reasoning allows states to tax away pension benefits and thus, do indirectly what they are not able to accomplish directly. Section B then argues that using that rote formalism to permit the legislatures in those states to raid public pensions under the guise of taxation would be inconsistent with the manifest intent behind the provisions protecting public pensions.

A. Herrick*'s Legal Distinction Would Allow a State to Do Indirectly What It Is Unable to Do Directly*

Herrick's reasoning is unsound, most notably because it would allow states to circumvent their contractual obligations. Without question, a statute that simply diminished the amount of pension distributions would be inconsistent with state law (whether by way of judicial decision or by constitutional provision) protecting public pension benefits as contractual rights. Indeed, the *Herrick* court acknowledged this expressly.[209] It makes little sense to deny a state legislature the right to diminish pension benefits for fear of allowing it to interfere with vested contractual rights, but then to permit the legislature to accomplish the exact same outcome through the tax code—especially because in either case, the money is taken away from pensioners and placed in the general treasury.

Nevertheless, *Herrick*'s narrow focus on the formal distinction between taxing benefits and reducing them allows legislatures to accomplish exactly that sleight of hand. Notably, states can and do enter into binding contracts—enforceable under the Contract Clause—not to exercise their taxing authority. As early as the 1812 decision of *New Jersey v. Wilson*,[210] the Supreme Court held that states have the power to contract for permanent tax exemptions.[211] And the Supreme Court has reiterated this position through the years—expressly distinguishing the taxing power (which a state can contract away) from the police power (which a state cannot contract away).[212] Indeed, the Court has even used the Contract Clause to invalidate a state's attempt to remove a tax exemption on municipal bonds.[213]

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209 Herrick v. Lindley, 391 N.E.2d 729, 733 (Ohio 1979).

210 11 U.S. (7 Cranch) 164 (1812).

211 *Id.* at 166-67. At issue in *Wilson* was an act that granted a permanent tax exemption on lands given to the Delaware Indian Tribe. *Id.* at 165. The tribe sold the lands, and the legislature attempted to repeal the exemption and tax the property. *Id.* at 166. The new owners successfully sued, with the U.S. Supreme Court holding that the tax exemption was contracted for and that a repeal of the exemption would violate the Contract Clause of the U.S. Constitution. *Id.* at 166-67.

212 *E.g.*, U.S. Trust Co. v. New Jersey, 431 U.S. 1, 23-24 (1977).

213 Murray v. Charleston, 96 U.S. 432, 443-46 (1878).

When states used tax-exempt public pensions to entice potential employees to public service, they did exactly that. Pensions are now recognized as deferred compensation for work already performed.[214] As deferred compensation, they are part of the overall compensation a public employee accepts.[215] Public employees often work for lower wages than their private-sector counterparts.[216] Governments are rarely able to pay their employees salaries that would be competitive with the private sector, so they equalize the disparity by offering attractive and liberal retirement plans, including tax exemptions on pension benefits.[217] Public employees are willing to work for lower current wages in part because of the additional compensation they receive upon retirement.[218] Without the reward of more compensation later on, many public employees would likely find their salaries to be unacceptably low.[219]

A tax-exempt pension is, without question, more valuable than a non-exempt pension.[220] If public employees are willing to accept lower wages because of the prospect of receiving greater deferred compensation, public employees would be willing to accept even lower wages if the later compensation were of higher value.[221] Tax exemptions create just such an increase, thus functioning as part of the consideration a public employee accepts in forming an employment contract with the state.[222]

When states repeal their tax exemptions, they modify their employees' employment contracts—often years after employees rendered their service.[223] In doing so, they retroactively change the structure of the bargain that they struck with their employees.[224] As the Oregon Supreme Court not-

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214 Davis v. Mich. Dep't of the Treasury, 489 U.S. 803, 808 (1989); *see* Darryl B. Simko, *Of Public Pensions, State Constitutional Contract Protection, and Fiscal Constraint*, 69 TEMP. L. REV. 1059, 1062 (1996).

215 Birnbaum v. N.Y. State Teachers Ret. Sys., 152 N.E.2d 241, 245 (N.Y. 1958).

216 *See id.*; Simko, *supra* note 214, at 1062.

217 Christensen v. Minneapolis Mun. Emps. Ret. Bd., 331 N.W.2d 740, 747 (Minn. 1983).

218 *See Birnbaum*, 152 N.E.2d at 245; *see also* Simko, *supra* note 214, at 1062.

219 *See* Simko, *supra* note 214, at 1062.

220 *Cf.* Katie Babe, Comment, *Property Tax Relief for the Elderly: A Survey of the Nation*, 6 MARQ. ELDER'S ADVISOR 325, 325-26 (2005) (explaining how homestead exemptions benefit the elderly by reducing their tax liability).

221 After *Davis*, several states passed legislation that increased benefits for retirees in order to offset the loss of the tax exemption. *See* Melanie Clark, *Recent Developments in Utah Law—The Utah Legislature May Increase State Retirement Benefit to Offset Tax Burden*, 2005 UTAH L. REV. 1361, 1361-65. States seemed to recognize the bargained-for nature of the tax exemption. Indeed, in one case challenging Utah's benefit increase, the State argued that elimination of the tax exemption would result in a "substantial, de facto cut in state employees' pay." Thompson v. Utah State Tax Comm'n, 112 P.3d 1205, 1206 (Utah 2004).

222 *See* Hughes v. State, 838 P.2d 1018, 1042 (Or. 1992).

223 *See id.* (discussing how the terms of a state employee's employment contract are set at the time of acceptance).

224 *Id.* at 1043.

ed in *Hughes*, this unfairly allows the state to retain the benefit of the original bargain (receiving the employee's services at a lower wage than would otherwise have been paid), while depriving the employee of her half of the bargain (more pay later).[225]

Noting this unfairness, the North Carolina Supreme Court in *Bailey* analogized a state's taxing of previously exempt public pensions to a state issuing tax-exempt bonds and then subsequently taxing them.[226] The analogy is apt. When a purchaser of a tax-exempt municipal bond accepts a lower interest rate than is available on commercial bonds, he does so because the state's promise not to tax the bond's interest adds value to the investment; without this assurance, no rational investor would accept the lower municipal interest rate.[227] Removing the tax exemption when the investor attempts to redeem the bond would fundamentally rework the original bargain and violate the terms of the original purchase contract. Removing a tax exemption from vested pension rights—years after the employee has performed the work—is no different.[228] In both cases, the state has used a tax exemption to induce individuals to accept worse terms than are available elsewhere, and it is fundamentally inequitable for the state to later remove the future benefit it promised up front.

In order to prevent these attempts to rework employment contracts years after the fact, some states have passed constitutional provisions that protect public pension benefits.[229] Yet repealing a previous tax exemption rewrites employment contracts. Thus, when the Michigan Supreme Court adopted the bald formalism of *Herrick*, it overlooked the obvious point of the state's constitutional provision. Whatever can be said of that reasoning, it plainly does not further the intent of the drafters, who saw fit to afford public pension benefits constitutional protection.

Indeed, this naked formalism runs afoul of the established constitutional rule that "what [a state] cannot do directly, they will not be permitted to accomplish by indirect means."[230] If a state has deemed pension benefits to be contractual entitlements (either by judicial decision or by constitutional amendment), then the Contract Clause clearly prevents it from diminish-

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[225] *See id.* at 1042 n.7.

[226] Bailey v. State, 500 S.E.2d 54, 65 (N.C. 1998).

[227] *See* Jason M. Hall, Comment, *Financing Religious Educational Institutions with Tax-Exempt Public Bond Proceeds*, 83 B.U. L. REV. 685, 700 (2003).

[228] *Bailey*, 500 S.E.2d at 65.

[229] *See* Hammond v. Hoffbeck, 627 P.2d 1052, 1056 (Alaska 1981) ("Under the rule mandated by Alaska's Constitution . . . these benefits are regarded as an element of the bargained-for consideration given in exchange for an employee's assumption and performance of the duties of his employment.").

[230] Watson v. Mercer, 33 U.S. (8 Pet.) 88, 92 (1834). At least one state supreme court has similarly recognized that "[i]t is a very clear proposition, that what cannot lawfully be done directly, cannot be done indirectly—no device, though it be so cunningly contrived as to make wrong appear to be right, can justify it." Sanders v. Cabaniss, 43 Ala. 173, 188 (1869).

ing pension benefits directly.[231] As such, states that have recognized pension benefits as contractual entitlements are barred from simply lowering the amount paid out to retirees.[232] Yet, the formal distinction drawn by the Ohio and Michigan Supreme Courts allows those states to overcome their constitutionally specified contractual obligations to pay the full pension benefits by simply subjecting the benefits to a tax, thus shirking their constitutional obligations and inequitably diminishing pension benefits.

B. *Adopting* Herrick*'s Reasoning Would Cause States' Pension Provisions to Be Read Contrary to Their Ratifiers' Intent*

Herrick's formal reasoning is particularly ill suited for states with constitutional provisions protecting pension benefits because it undermines the purpose of having the amendments. The manifest purpose of a constitutional provision protecting public pensions is to place public pension benefits beyond the reach of state politics (and thus entice workers to accept public employment).[233] For example, New York's highest court described at length the people's intent in ratifying its provision in *Birnbaum v. New York State Teachers Retirement System*.[234] There, the court observed that the legislature specifically intended the constitutional provision protecting New York's public pension benefits to overcome a previous dictum that pensions were gratuities subject to the legislature's will.[235] The people ratified the state's provision in order to prevent the legislature from diminishing pensions.[236] The court noted that prior to New York's amendment, an employee's rights only became established at retirement.[237] After the amendment, however, an employee's rights are conferred the moment he begins working, thereby allowing the employee to "look forward" to his pension.[238] The ratifiers intended to give employees security in their pensions.[239] That goal is undermined by allowing previously tax-exempt pensions to be taxed.

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231 *See* U.S. CONST. art I, § 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts").

232 *See* Herrick v. Lindley, 391 N.E.2d 729, 733 (Ohio 1979) ("The vesting statutes prohibit . . . a reduction in the rate of payment."); Hughes v. State, 838 P.2d 1018, 1042 (Or. 1992) (observing that the terms of state employees' contracts are set forth in state law).

233 *See, e.g.*, Ass'n of Prof'l & Technical Emps. v. City of Detroit, 398 N.W.2d 436, 438-39 (Mich. Ct. App. 1986) (discussing how the constitutional provision is meant to protect against the impairment of pension benefits for work already performed).

234 152 N.E.2d 241 (N.Y. 1958).

235 *Id.* at 245.

236 *Id.* at 244.

237 *Id.* at 245.

238 *Id.*

239 *Id.* While there are other tools for interpreting constitutions, this Comment focuses on the ratifiers' original intent because the courts in states with constitutional pension provisions tend to inter-

The Michigan Supreme Court often relies on constitutional debates to discern the ratifiers' intent,[240] and Michigan's constitutional debates reflect the people's intent, as in New York, to protect pensions from "the will of the Legislature."[241] Speaking at Michigan's constitutional convention, Delegate Richard Van Dusen stated that Michigan's provision was designed, in part, to give employees security that they did not enjoy under a gratuity approach.[242] He also noted that the gratuity approach was inadequate because pensions are earned compensation that is merely deferred.[243] As such, Van Dusen argued that employees should have a "contractual right to the benefits of the pension *plan*," which would prevent those benefits from being diminished.[244]

The commentary that accompanied the enactment of Alaska's constitutional provision echoes similar sentiments.[245] It states that Alaska's provision was meant to "assure state and municipal employees who are now tied into various retirement plans that their benefits under these plans will not be diminished or impaired when the Territory becomes a state."[246] As in Michigan and New York, the ratifiers in Alaska intended to secure public employees' pension benefits.[247]

The recurrent theme confirms that amendments aimed at protecting public pension benefits were intended to secure pension benefits for public employees by placing them beyond the whim of the shifting temporal majorities reflected in the legislature, thus avoiding "potential for abuse" during times of fiscal distress.[248] The legislature could increase or decrease taxes at will, and pensioners would have little security in what their pension

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pret their constitutions that way. *See, e.g.*, Hammond v. Hoffbeck, 627 P.2d 1052, 1056 n.7 (Alaska 1981); Musselman v. Governor, 533 N.W.2d 237, 246 (Mich. 1995).

240 The Michigan Supreme Court often interprets the Michigan Constitution in light of the ratifiers' intent, which it discerns from the records of constitutional debates. *See, e.g.*, Studier v. Mich. Pub. Sch. Emps.' Ret. Bd., 698 N.W.2d 350, 359 (Mich. 2005) ("[T]he proper objective in consulting constitutional convention debates is not to discern the intent of the framers in proposing or supporting a specific provision, but to determine the intent of the ratifiers in adopting the provision.").

241 *Birnbaum*, 152 N.E.2d at 245.

242 1 STATE OF MICHIGAN CONSTITUTIONAL CONVENTION 1961 OFFICIAL RECORD 770-71 (Austin C. Knapp ed., 1962) (statement of Del. Van Dusen).

243 *Id.*

244 *Id.* at 771 (emphasis added).

245 6 Proceedings of the Alaska Constitutional Convention 140 (Dec. 16, 1955). The Alaska Supreme Court relies upon the official commentary on the provisions in order to discern the ratifiers' intent when interpreting its state's constitution. Hammond v. Hoffbeck, 627 P.2d 1052, 1056 n.7 (Alaska 1981).

246 6 Proceedings of the Alaska Constitutional Convention 140 (Dec. 16, 1955).

247 *See* id.

248 Note, *supra* note 34, at 993 ("[F]inancially troubled governments have [looked to altering retirement schemes] as a source of fiscal relief. . . . Whatever their form, such efforts clearly call into question the protection to be afforded to the public employee in his pension.").

benefits would effectively be, not just prior to retirement but even during retirement.[249]

To be sure, one could argue that the provisions do provide some level of protection to pension benefits. As the court in *Herrick* suggested, the provisions would at least prevent the corpus of the payment from being reduced.[250] Such a reading does not return pensions to gratuities, rendering the provisions mere surplusage in contravention of accepted constitutional interpretation.[251] This interpretation, however, still runs directly counter to the obvious purpose of the provisions—to protect public pension benefits and to provide public employees with security. While states may argue that they are only bringing public pension tax treatment in line with the tax treatment of other forms of income, the fact remains that the ratifiers singled out public pensions for special treatment. There can be no misunderstanding that by the plain language of the provisions, the ratifiers understood the provisions as providing protections to public pensions that may not be provided to other income. Indeed, at the time many of these provisions were passed, public pensions had already been tax-exempted for years, and public pensions' tax-exempt nature would have been engrained as a benefit of public service.[252]

Nonetheless, *Herrick*'s reasoning lets states undeniably diminish pension benefits by taxing the benefit once the state has paid it out. While the *Herrick* court saw a legal distinction between reducing the corpus and im-

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249 Michigan sought to soften the effect of its repeal by incrementally phasing out its tax exemption depending on the age of the retiree. *In re* Request for Advisory Op. Regarding Constitutionality of 2011 PA 38, 806 N.W.2d 683, 688 (Mich. 2011). The Michigan Supreme Court held that this did not violate the Equal Protection Clause of the Fourteenth Amendment to the U.S. Constitution given that the state had a rational basis for believing that older individuals would be less able to handle the financial loss of the tax exemption. *Id.* at 705.

250 *See* Herrick v. Lindley, 391 N.E.2d 729, 732-33 (Ohio 1979) ("The vesting statutes prohibit . . . a reduction in the rate of payment.").

251 The U.S. Supreme Court has long disfavored reading the Constitution to make language surplusage. *See* Marbury v. Madison, 5 U.S. (1 Cranch) 137, 174 (1803) ("It cannot be presumed that any clause in the [C]onstitution is intended to be without effect; and therefore such a construction is inadmissible"). State courts have followed the Supreme Court's lead. *See, e.g.*, Idaho Press Club, Inc. v. State Legislature, 132 P.3d 397, 400 (Idaho 2006) ("We should avoid an interpretation which would render terms of a constitution surplusage."); Pig Pro Nonstock Coop. v. Moore, 568 N.W.2d 217, 224 (Neb. 1997) ("[A constitutional provision] 'must be construed as a whole, and no part will be rejected as meaningless or surplusage, if it can be avoided.'" (quoting State *ex rel.* Spire v. Beermann, 455 N.W.2d 749, 752 (Neb. 1990))); *In re* Plurality Elections, 8 A. 881, 883 (R.I. 1887) ("It seems to us that the more natural and reasonable way of construing section 10 is to construe it as relating to these elections; since, if we construe it so, the words 'under this constitution' have an effect, whereas if we construe it as extending to all state and town elections whatever by the people, the words are mere surplusage."); Spradlin v. Jim Walter Homes, Inc., 34 S.W.3d 578, 579 (Tex. 2000) ("We avoid constructions that would render any constitutional provision meaningless or nugatory.").

252 For example, Michigan ratified its provision in 1963 but had tax exemptions in place as early as 1927. *See* Op. Att'y Gen. of Mich. No. 6697, *supra* note 96, at *3 n.2.

posing new taxes on pension distributions, even it acknowledged that the net outcome would be the same.[253] The net outcome is pensioners having less income on which to live and less clarity as to just how much that diminished amount will be. Such uncertainty cannot be read in harmony with the manifest intent of those who ratified a constitutional provision that protects public pension benefits: to provide pensioners with security.

CONCLUSION

As the economic downturn drags on, states faced with budgetary constraints may follow Michigan and try to repeal their own tax exemptions for public pensions. While those states that constitutionally protect their public pension benefits might reflexively look to Michigan, and in turn to *Herrick*, in seeking to justify a drive to repeal such a tax exemption, they would be mistaken to do so. The naked formalism of *Herrick* and the Michigan Supreme Court's advisory opinion fails to account adequately for the obvious intent behind a constitutional provision that protects public pension benefits. From the standpoint of those provisions and the vested contractual expectations of public employees they are designed to protect, there is simply no real distinction between diminishing the corpus of a pension payment and taxing it away. Moreover, allowing states to revoke tax exemptions in public pensions years after the benefits have vested contravenes the very point of constitutional provisions that cordon off public pensions from a legislature's temporal desire to find revenue. In essence, it allows states to circumvent the protections of their constitutions.

Moreover, the Ohio Supreme Court in *Herrick* was not faced with a constitutional provision that protects pensions. And while the Michigan Supreme Court did consider one, the Michigan Constitution provides the narrowest protection of public pensions of any state with a similar provision—protecting only accrued financial benefits. In holding that Michigan could repeal its tax exemption, the Michigan Supreme Court relied in large part on the specific language of its limited-scope constitutional provision. However, since the constitutional provisions protecting pension benefits in other states are materially broader than Michigan's, the Michigan Supreme Court's reasoning cannot be simply exported to those jurisdictions. Rather, should courts in those jurisdictions face similar repeal statutes, they should consider the issue afresh and give proper credence to the expressed intent of their respective constitutional provisions: protecting as inviolate vested pension rights.

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253 *Herrick*, 391 N.E.2d at 733.