Oregon

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PERS Policy Paper – Tax Remedy Payments

Background

Until the late 1980s, PERS benefit payments were exempt from state income taxes, while federal retirement benefits were partially exempt. A 1989 federal Supreme Court ruling directed that states must tax federal and state retirement benefits in the same manner. In 1991, the Oregon legislature passed a law to subject PERS benefits to state income tax. Imposing that tax on PERS benefits was challenged to the Oregon Supreme Court, which held that the legislature's imposition violated the benefit contract for PERS members.

Senate Bill 656 (1991) and House Bill 3349 (1995) were passed to establish "tax remedy" payments to mitigate the effect of subjecting PERS benefits to state income tax. SB 656 was found by the Oregon Supreme Court to be an inadequate remedy, and HB 3349 was enacted as a settlement of the litigation. As a result, eligible members receive the higher of the two tax remedy payments. The tax remedy formula under SB 656 is based on the member's total service time. Under HB 3349, the tax remedy is based on the amount of the member's service time before the tax was imposed.

Eligibility for Tax Remedy Payments

Tier Two and OPSRP members are NOT eligible for tax remedy payments. Tier One members who established membership before July 14, 1995, and have either service time before October 1, 1991, or at least 10 years of creditable service, are eligible. Legislation approved in 2011 (House Bill 2456) eliminated the tax remedy payment for members retiring on or after January 1, 2012, who do not pay Oregon income taxes because they are not residents of Oregon.

Recent Legislation

In 2013, Senate Bill 822 eliminated tax remedy payments for all out-of-state benefit recipients, regardless of when the member retired. This expansion was challenged and the Oregon Supreme Court, in its 2015 *Moro* decision, upheld the Legislature's elimination of the tax remedy for those who do not pay Oregon state income tax on their PERS benefits because they do not reside in Oregon. This expansion reduced employer costs by $55 million in the 2015-17 biennium because system liability was reduced by over $400 million, based on the December 31, 2013 system valuation.

Elimination or Restoration of Tax Remedy Payments

ORS 238.372-384 establishes two ways for PERS to determine a benefit recipient's residency: 1) receive information from the Oregon Department of Revenue (DOR) to determine whether the recipient filed an Oregon income tax return as a resident in the previous calendar year; or 2) receive a certification from the recipient that, under penalty of perjury, their benefit is subject to Oregon income taxes as an Oregon resident. This determination is limited to these two methods because other indications of residency (address on file, driver's license, or voter registration) do not always correlate to whether the recipient actually pays income taxes as an Oregon resident.

In mid-October each year, PERS works with the DOR to determine whether a benefit recipient from the prior calendar year did file an Oregon income tax return as a resident. If PERS cannot determine that the recipient did so, PERS then sends a letter to the recipient asking them to certify residency status, either by returning a form to PERS or going online to certify residency.

If the recipient does not certify before the end of that calendar year, the statute directs PERS to stop paying the tax remedy benefit for that next calendar year. A second letter is sent to those recipients who have not certified, explaining that the tax remedy payment will be removed for the next calendar year. If the recipient certifies at a later time that their benefit is subject to Oregon income tax as a resident, the tax remedy payment is restored for the next calendar year.

Tax Remedy Payment Data

Year Processed (following CY payment affected)	2013	2014	2015	2016	2017
# of Payment Recipients Submitted to DOR	112,707	109,374	116,469	118,202	118,334
# DOR Reported as Tax Filing Residents in Prior Year	92,810	93,964	96,061	97,979	97,996
# DOR Reported as NOT Filing Taxes	19,897	15,410	20,408	20,222	20,338
# Accounts Tax Remedy Turned OFF for Next Year	17,208	1,362	2,518	1,597	1,883
Amount Turned OFF Each Month	$2,280,670	$170,015	$240,121	$189,983	$209,145

Policy Considerations

1. Administrative Challenges. PERS' determination that the recipient is not eligible for the tax remedy payment, because the recipient did not file an Oregon resident return with the DOR nor separately certify their status, can be challenged through the administrative review process. The following table shows the number of administrative appeals and contested case hearings that have resulted from this process over the last five years:

Year Processed (following calendar year payment affected)	2013	2014	2015	2016	2017
# of Tax Remedy Administrative Appeals Filed	841	76	119	114	69
# of Contested Case Hearings From Those Appeals	22	9	17	10	10
# of Tax Remedy Appeals Not Filed Timely	44	13	12	12	16

After 2013, the first year of the program, the number of challenges dropped significantly to less than 1% of the tax remedy benefit tested each year. Anecdotal complaints about the process are not a significant share of those who are reviewed each year. The once-a-year reporting and payment cycle was established to make this process administratively feasible and would always be expected to catch people both coming in and leaving Oregon over the course of time.

2. Cost Savings. Eliminating the tax remedy payment for those who do not pay Oregon income taxes saved PERS employers millions of dollars in this biennium, and those savings will persist so long as those benefits are not restored, either by relaxing controls or requiring restoration to those recipients who do not timely re-certify when prompted.

3. Judicial Review. Importantly, the Oregon Supreme Court has already reviewed the statute and found it to be a constitutional reduction in benefits, which resulted in the savings to employer costs. Modifications to the tax remedy eligibility review process not only could impact system-wide savings but also open the reduction to another round of judicial review.

Policy Recommendation

The significant employer cost savings from eliminating tax remedy payments for those recipients who do not pay Oregon income taxes because they do not reside in Oregon should remain in place. PERS will continue to seek to improve its communication and processes to ensure recipients who need to certify their eligibility understand the importance of doing so, and have simple and efficient ways to do so. Those few members who have failed to file their tax returns or process their certifications timely do not indicate that wholesale changes to the current system are warranted at this time.

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