

**ADDRESS OF**

**GERALD L. BALILES  
GOVERNOR**

**Before the  
Special Session II of the  
Virginia General Assembly  
Monday, April 24, 1989**



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**The Remarks of**

**THE HONORABLE GERALD L. BALILES  
GOVERNOR OF THE COMMONWEALTH OF VIRGINIA**

**before the**

**Special Session of the Virginia General Assembly**

**State Capitol**

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**Mr. Speaker, Mr. President, members of the Virginia General Assembly, distinguished guests, ladies and gentlemen.**

**It is an unprecedented circumstance that has obliged me to call you back into special session.**

**Whether one views the present situation with apprehension, speculation or optimism, allow me to make two observations.**

**The first is directed at how we came to be in this room in April.**

**It seems obvious that whatever early warning systems this state employed -- or, for that matter, the other 22 states similarly affected -- they were insufficiently sensitive to predict the potential effects of Davis v. Michigan Department of the Treasury. We can debate whether that should be cause to do things differently in the future.**

**I will note, however, that we would likely find it most difficult to fashion a logical, reasoned budget process capable of taking into account every potential court-ruling, adverse or otherwise. Virginia's inclination, in the past, has been to rest our budgetary decisions upon facts, rather than speculation.**

In this present instance, however, as in all others, the buck stops on the third floor of this building -- and I accept that.

Now, my second observation.

The Supreme Court has ruled. The question before us now is what are we to do about it?

I say, we must remedy the situation equitably.

In forming my proposal, I have been guided by one overriding principle: Fairness.

And, by that I mean fairness to retirees -- all retirees-- and fairness to the interests of the Commonwealth as a whole.

Further, I have deliberately adhered to an underlying principle of the income tax. It is meant to be progressive, whereby citizens pay according to their ability to pay.

I recognize that there are those who support -- for philosophical, theoretical or other reasons -- income tax measures which are more regressive in their application, meaning that the stock clerk earning \$14,000 pays proportionately more than the stock broker who earns \$140,000.

But, as I say, when it is possible, I prefer a more progressive approach -- a fair approach -- and I emphasize this because I think it is important for you to understand my own assumptions as we prepared this proposal.

Now, let me review the facts of the litigation and their effect on Virginia.

On March 28th the United States Supreme Court rendered decision in the case of Davis v. Michigan Department of the Treasury, essentially ruling that Michigan's income tax law, which taxed different classes of public retirees in different ways, was unconstitutional.

Of course, for more than 47 years Virginia has been doing the same thing.

In the early 1940s, this legislature, in an effort to help retired state and local employees, granted them a full exemption on their retirement benefits from the state income tax.

Apparently, the General Assembly -- and many other state legislatures -- felt that this was one way to equalize the benefits between state and local retirees and the relatively higher-paid federal retirees.

The Supreme Court now says that is unconstitutional.

So, we meet in special session today to comply with the requirements of the Supreme Court decision.

Let me emphasize, in addition to what the Court ruled, there are three critical points it did not address.

First, the Davis case did not address the question of whether Michigan or any state in a similar situation was required to refund taxes retroactively -- or, putting it another way, to return funds collected from federal retirees prior to the Court's decision.

For reasons I will shortly spell out, it is Virginia's legal position that the Commonwealth is not liable for such retroactive refunds.

Second -- and, let me add that a lot of people have missed this point -- the Supreme Court did not tell Michigan that equal treatment of public employee pension benefits obliges that state, or any other state, to exempt federal retirees from taxation.

The Supreme Court simply said treat everyone the same. Saying either tax or don't tax, the Court ruled that states must apply the law evenly to all public retirees.

Aside from that, the Court said the choice is up to us on how to proceed.

The third point: The Court in no way addressed the question of the taxation of private retirement benefits.

While this omission was understandable given the legal issues involved in the Davis case, upon reflection it is an omission I believe Virginia cannot ignore.

We certainly cannot overlook private retirees if we intend to resolve the broader issue of taxing retirement income equitably.

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So, to restate our situation: We must examine the question of taxing retirement income as it applies both to the past and to the future.

With respect to the question of retroactive refunds, we will defend the proposition that Virginia taxpayers should not be penalized for relying upon the constitutionality of a state income tax structure that has been in place and unchallenged for nearly half a century.

This is not merely a legal or academic issue.

If, for example, the courts hold in the future that refunds are required within the limits of a state's statute of limitations, Virginia's obligations for the period 1985-1988 alone could exceed one-half billion dollars.

I recognize, of course, that this legal position is strongly opposed by some federal retirees. They have a right to make known their opinion.

Further, they should have the opportunity to file individual refund claims if they choose to do so.

Consequently, I recommend that you enact at this session legislation extending our statute of limitations. Specifically, the legislation will permit federal retirees to file refund claims for a 12 month period following a final ruling by the courts on the question of the retroactive effects of the Davis case.

Passage of this legislation will preserve the right of federal retirees for refunds if the courts rule in their favor. If our position is upheld, such claims, of course, become moot.

Now, from the issue of the past -- or retroactivity -- I turn to the future.

Simply put, we must decide how best to change Virginia's current structure of taxing retirement benefits to both conform to the Supreme Court's ruling, and to treat all Virginia retirees equitably.

Again, this choice, in my judgment, should be guided by the principle of fairness.

And, that entails considering both the effect on individual retirees and on the cost to all taxpayers.

Recognize this one fact: Whatever tax relief we give to one group of taxpayers -- in this case retirees -- will be at the expense of other Virginia citizens. That is unavoidable.

Obviously, in considering the cost to the state as a whole, we sifted through and considered any number of approaches.

For instance, we could exempt all retirees from the state income tax. That would cost, in this budget year alone, almost \$200 million.

Or, we could simply provide a set amount for exemption from the state income tax -- say, \$10,000 -- for all retirees. That would cost about twice the amount of the proposal I am about to set out.

But, both of these approaches -- which would obviously necessitate cutting the budget or raising taxes -- were of concern for more than just their cost. They were also not recommended because of the fundamental equities involved.

For example, a \$10,000 exemption on all retirement income means that a retired top corporate executive, or a four-star general, gets the same tax relief as a retired shipyard worker with a much smaller pension.

In my view, such an arrangement would fly in the face of our traditional approach to income taxation and would be strikingly inconsistent with the framework of low and moderate income tax relief already provided by this General Assembly for working Virginians.

So, if the principles of fairness, fiscal responsibility, and consistency are sound, they quickly lead us to an approach which focuses no longer on the source of a retiree's retirement income, but on the amount of that income.

Right now, all federal retirees and all private retirees pay state income tax because of the source of their retirement income.

All state and local retirees, for the same reason, do not.

My proposal says, instead, that when it comes to retirement income, it is not the source that counts, but the amount.

Also, keep in mind, as I describe my proposal, that I intend to keep social security benefits free from taxation. These benefits, annually averaging around \$6,000, are enjoyed by the vast majority of retired Virginians.

Now to the principal features of my proposal -- and why.

I propose that we establish a state retirement income threshold --a dividing line -- below which no person's retirement income will be subject to state taxation.



I recommend that for all Virginians over the age of 55 receiving retirement income, that threshold should be \$16,000.

Some have suggested that tax relief for retirees should begin at age 60, or 62, or 65. These options are unquestionably less costly. However, it is clear that 55 conforms to the age at which full retirement benefits may begin for state and local employees.

Let me also be very clear on this: The proposed \$16,000 income dividing line is not an exemption; it is a threshold.

That means that if a retiree's benefits, less social security, exceed the \$16,000 retirement income threshold, then all of that person's retirement income will be subject to the state income tax.

This is, of course, precisely the same income tax threshold approach we now apply to low-income working Virginians.

In other words, if a retiree has total retirement income of less than \$16,000 -- not counting social security -- that person will pay no state income tax.

If, on the other hand, a Virginia citizen's retirement income exceeds the \$16,000 threshold, that person will pay the state income tax, according to the existing brackets, on the full amount of that retirement income.

There are four reasons why I recommend this \$16,000 retirement income threshold amount for your consideration.

First, a \$16,000 retirement income tax threshold for retirees will benefit for the first time about 300,000 of the federal retirees and private retirees who filed a tax return in Virginia last year.

Also, this threshold continues to exclude all but the highest paid of Virginia's state and local retirees.

In fact, had the \$16,000 threshold been in effect in 1987, four out of every five of all retirees who filed a return would not have paid any state income tax that year.

Second, a \$16,000 threshold for retirees is twice what we provided to working couples under the Virginia Tax Reform Act of 1987.

Third, the cost of this tax relief package, while substantial, can be handled without cutting existing state programs.

Fourth, my proposal will permit Virginians with retirement income of less than \$16,000 to work at another job and pay state income tax only on their earned income.

These four reasons convinced me that the \$16,000 retirement income tax threshold is the most responsive, yet responsible, option available.

Now, before I address the cost of my proposal, let me discuss the effect that it will specifically have on state and local retirees, federal retirees, and private retirees.

Presently, about 55,600 state and local retirees receive benefits under the Virginia Supplemental Retirement System. The average VSRS benefit this year for each retiree was about \$6,250 -- which, as I said, is typically supplemented after age 62 by about \$6,000 in social security benefits.

If my proposal had been in effect last year, virtually 90 percent -- 9 out of 10 -- of Virginia's state and local retirees would have had their retirement benefits free from taxation.

In other words, only those earning the highest benefits would not have had their retirement income free from taxation.

While I frankly would have preferred to have found an equitable retirement income threshold that eliminated all VSRS retirees from liability, excluding all but the very highest paid VSRS members is an important advantage of this approach.

As for federal retirees, let me be up front about this proposal. Most will like it; some -- meaning those with higher retirement incomes -- will not.

Because of the relatively higher retirement benefits of federal workers, the proposed tax threshold will provide tax relief for the majority of federal retirees, but not for all.

Take, for example, military retirees: Under this proposal, all ranks will continue to enjoy tax-free social security benefits.

And, the vast majority of retired enlisted men and women, who, in fact, have retirement income of less than \$16,000 per year, will for the first time face no Virginia income tax liability.

However, many officers and senior non-commissioned officers have annual retirement benefits exceeding -- sometimes, far exceeding -- \$16,000. Therefore, they will continue to pay the state income tax.

Now to the issue of private retirees.

For the first time, private retirees will be treated equally with public retirees.

More important, the vast majority of private retirees have total retirement incomes of less than \$16,000. They will -- for the first time -- not have to pay state income taxes at all.

The occupations of the private retirees who will fall under the \$16,000 retirement income threshold will run the gamut: From the retired mine worker in Grundy, to the retired salesman in Petersburg; from the retired shipyard worker in Newport News, to the retired small-business owner in Prince William County.

On balance, then, I believe the proposed \$16,000 retirement income tax threshold will provide to retirees more equitable tax relief in the future than has been provided in the past.

Now let me turn to the cost of this proposal.

If we leave the law unchanged -- meaning our current income tax structure -- the total additional cost of providing the \$16,000 retirement income threshold for all retirees would be \$79.3 million for the remainder of this biennium.

However, by repealing our existing and much less comprehensive income tax age credits and subtractions, and by now including the highest income state and local retirees, the net cost of this plan will amount to \$45.7 million.

I propose that this \$45.7 million amount be taken from the \$70.7 million Revenue Reserve Fund appropriated in the 1988-90 Budget.

Secretary Connock will provide to each member of the Assembly detailed information on the derivation of these costs.

He and his staff will also be available to answer any specific questions you may have.

But, let me sum up this proposal:

With this approach, for the first time four of five Virginians receiving retirement income will not pay state income tax on that income.

For the first time, all retirees -- state, local, federal and private -- will be treated alike under the state tax laws.

For the first time, the vast majority of private retirees will be free from state income taxes.

And, for the first time a majority of federal retirees will be free from state income taxes.

The Supreme Court said treat all public retirees the same.

I believe this plan does that and, at the same time, reaches out to grant private retirees identical tax relief.

Ladies and gentlemen, in conclusion I want to thank each member of the Senate and House Finance Committees for the many hours already invested toward finding an equitable response to the Supreme Court's ruling.

The issue before us is indeed complex. I expect that alternatives to my proposal will be submitted.

But, fairness, in my view, should be the chief characteristic of whatever remedy we reach.

I believe that the proposal I am submitting is a balanced, fiscally-responsible plan. It deals with retirement benefits equitably and progressively. It is a fair approach.

I look forward to working with you during the remainder of this special session so we may turn a difficult challenge into an opportunity -- and an opportunity into just and equitable tax relief for all retired Virginians.

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