JURISDICTION: **OKLAHOMA TAX COMMISSION - DECISION**
CITE: **2002-10-01-033 / PRECEDENTIAL**
ID: **P0000039**
DATE: **10-01-02**
DISPOSITION: **SUSTAINED**
TAX TYPE: **INCOME**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. PROTESTANT was born August 2, 1945, and began working for the United States Postal Services at 31 years of age.

2. PROTESTANT retired due to disability from the United States Postal Service and receives civil service disability retirement annuity payments.

3. Protestants filed joint Oklahoma individual income tax returns for 1996, 1997 and 1998, claiming a $5,500.00 exclusion each year for retirement benefits. Protestants took the exclusion based on PROTESTANT's federal civil service disability benefits received for tax years 1996, 1997 and 1998.

4. For each year, the Division disallowed the claimed retirement exclusion and by letter dated January 3, 2000, caused to be issued against Protestants a proposed assessment of additional tax and interest in the following amounts:

	1996	1997	1998
Tax Due	$ 337.00	$ 336.00	$ 340.00
Interest through 1/3/2000	137.52	86.72	36.75
Total	$ 474.52	$ 422.72	$ 376.75
Total Tax and Interest Due		$1,273.99	

5. By letter dated January 15, 2000, and stamped received on January 25, 2000, Protestants filed a timely protest to the proposed assessments.

6. For the tax years at issue, PROTESTANT had not yet attained the minimum retirement age.

7. The instructions accompanying the 1993 and 1994 Oklahoma individual income tax returns provide, at paragraph 3, that retirement benefits, not to exceed $5,500.00, which are received by an individual from certain expressed retirement systems, including the civil service of the United States, are exempt from taxable income.[1]

[1] Disability retirement benefits are not addressed in paragraph 3 or elsewhere in the 1993 and 1994 instructions.

8. THE auditor, Amended Section of the Audit Division, testified that she examined Protestants' 1996, 1997 and 1998 Oklahoma individual income tax returns. THE AUDITOR stated that she reviewed PROTESTANT's 1099(R)s, searched the records and determined that PROTESTANT was too young to take the exclusion and disallowed the $5,500.00 retirement benefits exclusion for the tax years at issue. Further, the auditor stated that because there was confusion both internally and externally about what qualified as retirement benefits, a clarification was added to the instructions which accompany the Oklahoma income tax returns, beginning with the 1995 tax year.

9. An additional provision was added to the paragraph regarding the $5,500.00 retirement benefits exclusion on the 1996, 1997 and 1998 instructions as follows:

> If you retired on disability and the payments you receive are taxed as ordinary income (not retirement benefits) until you reach minimum retirement age, the income taxed as ordinary income does not qualify for this exclusion. . . .

ISSUE

Whether the federal disability retirement annuity payments received by Protestant qualify for Oklahoma's retirement benefits exclusion.

CONTENTIONS

Protestants contend that PROTESTANT is a retired federal employee drawing federal civil service retirement benefits, and also state that the funds in question are an annuity payment from a pension plan. As such, therefore, they are not a continuation of wages but a retirement benefit. Likewise, Protestants contend, at age 60 the benefit will continue as a disability retirement benefit and not change to regular retirement. PROTESTANT states, ". . . it makes no difference whether it is called ordinary income or retirement benefits I still am a retired federal employee under federal laws and I think I should be able to claim this deduction . . . ." Additionally, Protestants contend that based upon *Paul S. Davis v. Michigan Department of Treasury*, the benefits, whether called ordinary income or not, are still a source of income, which cannot be discriminated against, according to the Supreme Court ruling.

The Division contends that because the term "retirement benefits" is not specifically defined by the Oklahoma Statutes, it is necessary to turn to the Internal Revenue Code for proper interpretation of the term. Division further argues that the IRS does not allow disability retirees to exclude any portion of their benefits from taxable income until after the taxpayer has reached minimum retirement age. Division concludes that Oklahoma's treatment of disability retirement benefits must follow the IRS treatment and that because PROTESTANT has not yet reached retirement age, he is not able to claim the exemption created by Section 2358 of Title 68. Division also contends that the *Davis v. Michigan* case does not control in this instance because Oklahoma treats federal civil service disability retirement benefits the same as Oklahoma state civil service disability retirement benefits.

CONCLUSIONS OF LAW

1. The Tax Commission has jurisdiction over this protest pursuant to Section 207 of the Oklahoma Tax Procedure Code. 68 O.S. 1991, ∋ 207.

2. Section 2358(D)(9) of the Oklahoma Income Tax Act exempts up to $5,500.00 of retirement benefits received by an individual from certain enumerated sources of retirement, including the civil service of the United States.

3. The Income Tax Division published its policy regarding disability retirement benefits pursuant to the provisions added to the Instructions accompanying the 1996, 1997 and 1998 Oklahoma income tax returns.

4. A rule for the purposes of the Administrative Procedures Act[2] means "any agency statement or group of related statements of general applicability and future effect that implements, interprets or prescribes law or policy, or describes the procedure or practice requirements of the agency." 75 O.S. 1991, ∋ 250.3(2).

5. An agency rule which has not been promulgated as required by the Administrative Procedures Act is not valid or effective against any person or party and may not be invoked by the agency for any purpose. 75 O.S. 1991, ∋ 308.2(A).

6. In fact, Section 302(C) of Title 75 specifically prohibits an agency from taking the following action:

> C. An agency shall not by internal policy, memorandum, or other form of action not otherwise authorized by the Administrative Procedures Act:
>
> 1. amend, interpret, implement, or repeal a statute or a rule;
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> 2. expand upon or limit a statute or a rule; and
>
> 3. except as authorized by the Constitution of the United States, the Oklahoma Constitution or a statute, expand or limit a right guaranteed by the Constitution of the United States, the Oklahoma Constitution, a statute, or a rule.
>
> 75 O.S. 1991, ∋ 302(C).

7. Additionally, any agency memorandum, internal policy, or other form of action violative of Section 302 is null, void and unenforceable. 75 O.S. 1991, ∋ 302(D).

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[2] 75 O.S. 1991, ∋ 250 *et seq.*, ∋ 301 *et seq.*

8. The statement of policy regarding the $5,500.00 income tax exemption and disability retirement benefits expressed in the Instructions for years 1996, 1997 and 1998 met the definition of a rule in Section 250.3(2) but was not promulgated as required by the Administrative Procedures Act and is therefore unenforceable.

9. Protestants' protest should be sustained.

DISPOSITION

It is the DETERMINATION of the undersigned OKLAHOMA TAX COMMISSION, based upon the specific facts and circumstances of this case, that the protest to the proposed assessment for income tax be sustained.

OKLAHOMA TAX COMMISSION