

Ohio Supreme Court Holds that SERP is Exempt from Cleveland Taxation

Overview

On September 26, 2017, the Ohio Supreme Court held in *MacDonald v. Cleveland Income Tax Board Of Review*¹ that amounts paid to a retired employee under a supplemental executive retirement plan ("SERP"), a nonqualified deferred compensation plan, were not subject to municipal income tax because such amounts qualified for the "pension" exemption under Cleveland Codified Ordinances § 191.0901(d).

This Tax Alert summarizes the factual background of the case, the Board of Tax Appeals' and the Ohio Supreme Court decisions, and provides taxpayer considerations.

Background

The taxpayer, a resident of Shaker Heights, near Cleveland, Ohio, retired on December 31, 2006 from National City Corporation ("Company") based in Cleveland, Ohio. At the time of the taxpayer's retirement, he qualified for benefits under the Company's supplemental executive retirement plan ("SERP").² The taxpayer's 2006 federal Form W-2 Box 5 included, among other amounts, approximately \$9.1 million which represented the present value of the SERP annuity benefit.³ No Cleveland municipal income tax was remitted on the \$9.1 million.⁴

The Company's SERP was created as a pension plan for certain highly compensated employees with the intention that it fall within the top hat exception to the Employee Retirement Income Security Act of 1974.⁵ This SERP was an unfunded, unsecured promise to pay the retirement benefit and was accounted for under GAAP as a pension.⁶ The SERP was further described by a Company executive as "a nonaccount balance plan, a nonelective, nonqualified defined benefit deferred compensation plan".⁷

Board of Tax Appeals' rulings

The city of Cleveland assessed the taxpayer on the \$9.1 million in SERP benefits.⁸ The taxpayer appealed the assessment to the municipal board of appeals ("MBOA") which denied taxpayer's appeal and upheld the assessment.⁹ The taxpayer then appealed to the Board of Tax Appeals ("BTA"). At issue in the BTA case was whether the benefits provided under the SERP were exempt as a "pension" under Cleveland Codified Ordinances § 191.0901(d) or taxable under Cleveland Codified Ordinances § 191.0101.¹⁰ The BTA reversed the decision of the MBOA and concluded that the SERP benefit was exempt as a pension.¹¹ The MBOA and Cleveland's tax administrator then appealed to the Ohio Supreme Court.¹²

¹ *MacDonald v. Cleveland Income Tax Bd. Of Rev.*, Slip Opinion No. 2017-Ohio-7798. A copy of the opinion is available [here](#).

² *MacDonald v. City of Cleveland Income Tax Bd. of Rev.*, Ohio Board of Tax Appeals, No. 2009-1130, April 20, 2016, p. 2.

³ *Id.*

⁴ *Id.*

⁵ *Id.* at p. 3.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.* at p. 2.

⁹ *Id.* at p. 1.

¹⁰ *Id.* at p. 2.

¹¹ *Id.* at p. 4.

¹² *MacDonald v. Cleveland Income Tax Bd. Of Rev.*, Slip Opinion No. 2017-Ohio-7798, ¶ 10.

Ohio Supreme Court decision

Before the Ohio Supreme Court, the City of Cleveland argued that the SERP benefit fell under the definition of taxable “qualifying wages” pursuant to Cleveland Codified Ordinances § 191.031501 which include “compensation attributable to a nonqualified deferred compensation plan,” and that no exemption is provided for nonqualified deferred compensation.¹³ The Ohio Supreme Court disagreed with the city’s arguments, holding that the SERP satisfied the pension exemption under Cleveland Codified Ordinances § 191.0901(d).¹⁴ The Court determined that the SERP was characterized as a pension by analyzing the plain meaning of the term “pension” by reference to Black’s Law Dictionary and Webster’s Third New International Dictionary as the term is not defined either in the Cleveland ordinances or in the Ohio Revised Code.¹⁵

Considerations

Income recognized pursuant to a nonqualified deferred compensation plan satisfying the definition of a SERP should be analyzed under the applicable municipality ordinances to determine whether the income is taxable or potentially satisfies an available pension exemption. Similarly, income from a SERP should also be evaluated under the applicable Ohio statutes for proper characterization for Ohio municipal personal income tax purposes.

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¹³ *Id.* at ¶ 14; Certain municipalities may not impose tax on income derived from nonqualified deferred compensation plans. See, e.g., Shaker Heights Codified Ordinances § 111.0301 (not including nonqualified deferred compensation in the definitions of items subject to tax under Shaker Heights Codified Ordinances § 111.0101). *MacDonald v. City of Shaker Heights*, Ohio Board of Tax Appeals, No. 2008-K-1883, December 28, 2012.

¹⁴ *MacDonald v. Cleveland Income Tax Bd. Of Rev.*, Slip Opinion No. 2017-Ohio-7798, ¶ 35.

¹⁵ *Id.* at ¶ 16.