

U.S. Supreme Court rules West Virginia retiree tax exemption is discriminatory



David M. Kall | Thursday, February 21, 2019

On Wednesday, the U.S. Supreme Court ruled that a West Virginia income [tax scheme](#) favoring state law enforcement retirees over their federal counterparts is unconstitutionally discriminatory. In [Dawson v. Steager](#), the court agreed with retired U.S. Marshal James Dawson that West Virginia violated federal law codifying the intergovernmental tax immunity doctrine. The case now returns to state court to determine the appropriate remedy and how exactly the decision will affect West Virginia state income taxation of pension benefits.

Intergovernmental Tax Immunity

The intergovernmental tax immunity doctrine dates to the early days of the American republic. In the 1819 case [McCulloch v. Maryland](#), the U.S. Supreme Court invoked the Supremacy Clause of the U.S. Constitution to invalidate a Maryland tax on the Second Bank of the United States. Chief Justice John Marshall famously wrote that “the power to tax involves the power to destroy” and that states could defeat the federal policy behind the bank if allowed to tax it.

Over time the intergovernmental tax immunity doctrine evolved to allow state taxation of federal employees so long as they were levied in a non-discriminatory manner. That is, state taxes on federal employees may not treat their state employee counterparts more favorably. In 1939, Congress codified the doctrine as [4 U.S.C. § 111](#).

West Virginia Scheme Unconstitutional

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The high court ruled that West Virginia discriminates against Dawson because his federal pension is subject to state income taxation while retirement income for some state law enforcement officials is exempt. Key to the court's analysis was the West Virginia trial court's factual finding that there are not any "significant differences" between Dawson's former job responsibilities and those of the tax-exempt state law enforcement retirees. Given that Dawson and state law enforcement retirees were similarly situated, the court easily found the tax discriminatory.

The court then turned its attention a flurry of arguments that the state of West Virginia advanced. First, the court rejected the state's argument that the favored class is very small and therefore the discriminatory treatment could not meaningfully interfere with federal and state relations. The court found that *any* discriminatory tax that favors state over federal employees runs afoul of the federal law codifying the intergovernmental tax immunity doctrine.

Second, the court rejected the reasoning of the West Virginia Supreme Court that the state tax law scheme was not intended to harm federal retirees. According to the state of West Virginia, the state intended only to benefit the state retirees. The court ruled that the discriminatory treatment, not the intent behind the law, matters in this situation.

Third, the court did not accept the state's argument that Dawson was similarly situated to other state law enforcement retirees who do not receive the tax exemption benefit. To the court, the relevant inquiry was whether Dawson was similarly situated to state retirees who did receive the benefit. The court similarly rejected the state's efforts to challenge the nature of the favored class as depending on the size of the more generous federal pension benefit rather than the former job responsibilities of the retirees.

State Court to Decide Remedy

The case now returns to West Virginia state court to determine the appropriate remedy. The court's opinion provided some guidance on this front, as follows: "[I]f the State decides to exempt only a narrow subset of state retirees, the State can comply with § 111 by exempting only the comparable class of federal retirees." Still, it remains to be determined just how far reaching the "comparable class of federal retirees" goes relative to the exempt state law enforcement retirees. Though unlikely, the state court could take the approach to eliminate the discriminatory tax scheme by eliminating the exemption for state retirees and thus level the playing field.



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