State Taxes

High Court to Decide If Federal Retirees Get State Tax Break

The U.S. Supreme Court will hear a challenge by a retired U.S. marshal to a West Virginia tax provision that allows more favorable tax treatment of state and local law enforcement retiree benefits.

Maybe it was the McCulloch v. Maryland citation in the U.S. government’s brief.

The U.S. government began its argument for the high court to take the case—and overturn a West Virginia Supreme Court decision allowing the inconsistent tax treatment—by citing the 1819 U.S. Supreme Court decision in McCulloch, which established the intergovernmental tax immunity doctrine.

The U.S. government isn’t a party to the case but filed an argument in support of retired U.S. Marshal James Dawson, urging the court to hear his appeal. “It’s predictable that the court took the case, because the U.S. Solicitor General said to,” Eric Hageman, an associate at McDermott, Will & Emery in Washington, told Bloomberg Tax June 25. Hageman noted that the court rejected the issue three times during the 1990s.

“The biggest hurdle was the court deciding it was worth their time,” Steve Johnson, a tax law professor at Florida State University College of Law, told Bloomberg Tax after the high court granted review June 25. Now that the Supreme Court has concluded that it should hear the case, “the only real drama is whether the court will stick with Davis,” he said.

Choice of Tests Johnson was referring to Davis v. Michigan Dep’t of the Treasury, in which the Supreme Court said in 1989 that a court must consider whether there are any significant differences between federal and state employees. The West Virginia high court applied a “totality of the circumstances” test to justify the different tax treatments.

“ ‘Totality of the circumstances’ is mushy and highly manipulable,” Johnson said—the court could stick with Davis, go with the totality of the circumstances, or come up with a third reason. “It doesn’t make sense to go for a third reason,” he said.

Both Johnson and Hageman referenced the desire of states to find new sources of revenue. Hageman said the court is showing more interest in state and local taxes.

Hageman said businesses need to pay attention to what is going on in state legislatures and “make sure they have a seat at the table, and the legislatures aren’t running afoul of the U.S. Constitution as they come up with unusual ways to tax businesses.”

Whatever the court decides, the impact will likely be limited to the state-federal immunity doctrine—which means one government can’t tax the other directly, Johnson said. “Dawson could potentially touch on the doctrine in ways we can’t anticipate now, but I don’t see any vast impact beyond this context.”


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