

Dawson v. Steager: Discrimination Against Federal Employees Under State Tax Regimes

By: Katie Arsenault

Earlier this year the United States Supreme Court considered whether a West Virginia state tax exemption violated a little known Federal law that permits states to tax the compensation of federal employees. In *Dawson v. Steager*, 139 S. Ct. 698 (2019) the Supreme Court unanimously held that a state tax exemption discriminated against federal employees in violation of 4 U.S.C. §11 (codifying the doctrine of intergovernmental tax immunity) because it treated retired state employees more favorably than similarly situated retired federal employees.

James Dawson (“Dawson”), a retired U.S. Marshal, discovered that his home state of West Virginia did not tax the pension benefits of retired state law enforcement employees, but did tax the pension benefits of similarly situated retired federal law enforcement employees such as himself. He brought suit against Dale W. Steager, the West Virginia State Tax Commissioner (“Commissioner”), in the Mercer County Circuit Court, alleging that W. Va. Code Ann. §11-21-12(c)(6) violated 4 U.S.C. §111 (hereinafter “Section 111”). Section 111 permits state taxation of federal employee compensation as long as the tax does not discriminate based on the source of the compensation. The trial court found that no “significant differences” existed between Dawson’s powers and duties as a U.S. Marshal, and those of the state law enforcement officers who benefitted from the West Virginia tax exemption. As a result, it held that the West Virginia tax law violated Section 111 by discriminating against federal employees based on the source of the compensation.

The Commissioner appealed to the West Virginia Supreme Court of Appeals. The state supreme court reversed the trial court, holding that the state statute did not violate Section 111 because it affected relatively few individuals and because the statute’s intent was to benefit state employees, not to harm federal employees. Dawson ultimately appealed this ruling to the United States Supreme Court.

The Commissioner initially argued that the West Virginia law did not violate Section 111 because the favored class was small and the statute treated most other state retirees no better than Dawson. It reasoned that law affected such a small number of people that it “couldn’t meaningfully interfere with the operations of the federal government.” The Supreme Court rejected this argument by emphasizing that Section 111 forbids any state tax that discriminates against federal officers or employees based on the source of compensation. It noted the scope of a law is not irrelevant because it determines the scope of federal employees that the statute must treat equally to avoid violating Section 111. The narrowness of the statute itself will never render it lawful if it discriminates against federal employees, no matter how small the number of individuals it affects.

The Commissioner next argued that the statute was lawful because it was not intended to harm federal retirees, only help state retirees. The Supreme Court rejected this argument as well reasoning that such discriminatory laws are almost always enacted to help state employees rather

than to discriminate against federal employees. A discriminatory law is unlawful under Section 111 no matter the intent for which the state enacted it.

The Commissioner alternatively argued that a U.S. Marshal is not “similarly situated” to local law enforcement officials even if they share similar job responsibilities. The Court reasoned that whether a federal employee is similarly situated with a state employee regarding a discriminatory state statute will depend on how the state has defined the favored class. The state statute awarded a tax exemption to retirement income for state police, firefighters and deputy sheriffs. The Supreme Court noted that the trial court focused on comparing the job responsibilities of the favored class to that of a U.S. Marshal and found no “significant differences” between them and the state supreme court did not disturb this factual finding. Ultimately the Supreme Court determined that the state’s chosen definition of its favored class confirmed that it discriminated against federal employees based on their source of income.

The Commissioner also argued that while the law treated Dawson differently than those retired state employees who enjoyed the tax exemption, his former job responsibilities were *also* similar to state employees who did not qualify for the tax benefits, and therefore the statute did not violate Section 111. The Supreme Court rejected this argument, holding that the proper question was not whether the federal employee is similarly situated to individuals who are not receiving the benefit, but whether he is similarly situated to individuals who are receiving the benefit. In its opinion, Dawson was similarly situated to individuals receiving the benefit, namely state police, firefighters and deputy sheriffs.

The Commissioner lastly argued that the West Virginia legislature did not intend to draw classifications based on former job duties, but instead based on the relative generosity of pension plans. In other words, the statute did not discriminate based on the source of compensation, but rather on the amount. The Supreme Court rejected this argument as well, noting that if the state had meant to draft a statute that drew the line between generous and not-as-generous pension plans it could have done so. The statute as written would not allow Dawson the tax-exempt benefit even if his pension plan was less generous than a state police officer’s pension. Ultimately the Supreme Court reversed the judgment of the West Virginia Supreme Court of Appeals and remanded the case for further proceedings regarding the determination of an appropriate remedy.