No. 03-1304

In the Supreme Court of the United States

DORIS STIEGLITZ WARD, INDIVIDUALLY AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED, PETITIONERS

v.

STATE OF SOUTH CAROLINA

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF SOUTH CAROLINA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

In *Davis* v. *Michigan Department of the Treasury*, 489 U.S. 803 (1989), this Court held that exempting state, but not federal, retirement benefits from state income tax violates the intergovernmental tax immunity doctrine, codified at 4 U.S.C. 111, and instructed States with a discriminatory tax system to eliminate the tax benefits enjoyed by state retirees or extend the benefits to federal retirees as well. The question presented is whether South Carolina satisfied this Court's mandate in *Davis* by eliminating a discriminatory tax exemption and simultaneously increasing the retirement benefits of all state retirees by a fixed percentage.

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This brief is submitted in response to the Court's order inviting the Solicitor General to express the views of the United States. The United States submits that the petition for a writ of certiorari should be denied. The decision below is consistent with this Court's precedents, and there is no conflict among the state appellate courts that have addressed the question presented.

STATEMENT

1. In 1989, this Court held in *Davis* v. *Michigan Department of the Treasury*, 489 U.S. 803 (1989), that States cannot discriminate against the United States

and its retired employees by taxing federal retirement benefits while exempting the benefits of state retirees from state income tax. Such a discriminatory taxing scheme violates "principles of intergovernmental tax immunity by favoring retired state and local government employees over retired federal employees." *Id.* at 817. The Court declined, however, to require those States with discriminatory tax systems to abolish their exemptions for state retirees, observing that a violation of the intergovernmental tax immunity doctrine could be remedied either "by extending the tax exemption to retired federal employees * * * or by eliminating the exemption for retired state and local government employees." *Id.* at 818.

2. Prior to the decision in *Davis*, South Carolina exempted all state retirement benefits from the State's personal income tax, but exempted only the first $3000 of federal retirement income. Pet. App. 3a. In response to *Davis*, South Carolina passed Act 189, which repealed the exemption for state retirement benefits and required the taxation of both federal and state retirement income in excess of $3000. See Act 189, § 39, 1989 S.C. Acts 1436-1439. In part to compensate retired state employees for the resultant tax obligation, Act 189 also increased retirement benefits to all state employees by seven percent. *Id.* § 60, 1989 S.C. Acts 1484-1488; Pet. App. 3a. As a result, all state retirees, even those domiciled in other States who are unaffected by the change in South Carolina's tax law, receive additional benefits. *Ibid.*

Petitioners, retired federal employees, subsequently filed this action to challenge Act 189 as inconsistent with *Davis* and in violation of the intergovernmental tax immunity doctrine. Pet. App. 11a-12a. Petitioners alleged that, by simultaneously eliminating the state retirees' tax exemption and increasing their benefits by seven percent, the State had granted "an unlawful 'tax rebate' to state retirees." *Id.* at 11a.

3. The South Carolina Court of Common Pleas upheld the constitutionality of Act 189. Pet. App. 10a-25a. The court reasoned that the South Carolina legislature had chosen "to tax federal and state retirees alike," and "*Davis* did not place any limitations on how a state could tax all retirees, as long as they were taxed in the same manner." *Id.* at 14a-15a. The court rejected petitioners' argument that the State had in fact given its retirees a discriminatory "tax rebate" by increasing their retirement benefits. *Id.* at 15a. That argument "confused the concepts of *taxation* and *take-home income*." *Ibid.* "Contrary to [petitioners'] premise," the court held, "*Davis* was not concerned with discriminatory state action in relation to take-home income, but rather with taxation." *Ibid.*

4. In a unanimous opinion, the Supreme Court of South Carolina affirmed. Pet. App. 1a-8a. In its view, "the doctrine of intergovernmental tax immunity does not deprive a state of its sovereignty to establish the level of its employees' compensation as long as the State does not discriminate in taxation based on the source of the income." *Id.* at 3a. Moreover, "in enacting Act 189, the General Assembly specifically followed the dictate of *Davis* by eliminating the tax exemption for both state and federal employees." *Id.* at 4a.

The court disagreed with petitioners' argument that Act 189 was discriminatory because it was motivated, in part, by the state legislature's desire to compensate for the increased tax burden on state retirees. Pet. App. 4a. The court reasoned that *Davis* did not "hold[ ], or otherwise impl[y], that states may only raise retirement benefits for its state's retirees if the pension increase in no way serves to offset a prior tax exemption." *Ibid.* Rather, "*Davis* requires that the state *tax* federal and state retirees equally and does not concern itself with the manner in which a state chooses to *compensate* its retirees." *Id.* at 5a.

The court also rejected petitioners' argument that the additional benefits were effectively a "tax rebate." That argument was factually incorrect because there was "no direct correlation between state retirees' state tax obligations and the amount of increased retirement benefits." Pet. App. 6a. Act 189 did not establish a "dollar for dollar offset" of the additional tax burden and did not exempt the increased benefit from taxation. *Ibid.* It extended the benefit to all eligible retirees, including those domiciled outside of South Carolina who suffered no increased tax burden, and "actually increased the employment costs for South Carolina, while simultaneously bolstering the federal treasury." *Ibid.*

The South Carolina Supreme Court distinguished decisions of the Montana Supreme Court and Oregon Supreme Court invalidating state statutes that similarly repealed tax exemptions on state retirement benefits and increased the benefits received by state retirees. Pet. App. 6a-8a (citing *Sheehy* v. *Public Employees Ret. Div.*, 864 P.2d 762 (Mont. 1993); *Vogl* v. *Department of Revenue*, 960 P.2d 373 (Or. 1998)). In the court's view, those cases were factually distinguishable because they concerned meaningfully different tax schemes. Montana had not adopted a legitimate retirement benefit for all retirees but had instead provided additional benefits only for state retirees who were Montana residents. Act 189, by contrast, increased retirement benefits "to all state retirees" regardless of domicile. *Id.* at 7a. The invalidated Oregon statute was expressly intended to compensate state retirees for "damages" from the loss of their tax exemption and had "mathematically correlated" the benefit increases "to replace the lost state retirement income," while Act 189 "did not tie the pension benefit increase, dollar for dollar, to the lost tax exemption" and was not "designed to compensate state retirees for damages." *Id.* at 7a-8a.

DISCUSSION

The South Carolina Supreme Court's decision is consistent with this Court's precedents, and state appellate courts uniformly acknowledge that a State may increase compensation to retired state employees without running afoul of the intergovernmental tax immunity doctrine. Further review by this Court is therefore not warranted.

I. The Decision Below Is Consistent With This Court's Precedents

Review is unnecessary because the South Carolina Supreme Court's decision is correct and consistent with this Court's precedents.

1. Act 189 fully complies with the mandate of *Davis*. This Court held in *Davis* that a State's exemption of the retirement benefits of state employees, while the analogous benefits of retired federal employees were taxed, violated the intergovernmental tax immunity doctrine. The Court explained that a State could remedy this violation *either* "by extending [any] tax exemption to retired federal employees (or to all retired employees), *or* by eliminating the exemption for retired state and local government employees." *Davis*, 489 U.S. at 818. Act 189 fulfilled this mandate because it "repealed the tax exemption for state retirement benefits, thereby rendering all federal and state retirement benefits in excess of $3000 taxable." Pet. App. 3a.

The State's simultaneous decision to increase retirement benefits generally to all state retirees is not inconsistent with *Davis*. Indeed, this Court suggested in *Davis* that increasing state retiree compensation would not violate the intergovernmental tax immunity doctrine. The Court was unmoved by the dissent's suggestion in *Davis* that a State could simply increase benefits to state retirees in order to replace the invalidated tax exemption. The Court implicitly endorsed such an approach as non-discriminatory and consistent with the purpose of the intergovernmental tax immunity doctrine, reasoning that "[i]n order to provide the same after-tax benefits to all retired state employees by means of increased salaries or benefit payments instead of a tax exemption, the State would have to increase its outlays by more than the cost of the current tax exemption, since the increased payments to retirees would result in higher federal income tax payments in some circumstances." *Davis*, 489 U.S. at 815 n.4. In contrast, "[t]axes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar." *Ibid.*

Consistent with this analysis, Act 189 has no impermissibly discriminatory effect: "The General Assembly's increase in retirement actually increased the employment costs for South Carolina, while simultaneously bolstering the federal treasury." Pet. App. 6a. Act 189 ensures that the State is not artificially reducing "the state's employment cost at the expense of the federal treasury" and accordingly remedies the unconstitutionally discriminatory tax.[1]

Petitioners suggest (Pet. 19) that a State's freedom to increase retirement benefits to its retirees is somehow diminished if the State has previously violated the doctrine of intergovernmental tax immunity by discriminating against federal retirees, but they offer no support for that proposition. *Davis* forbids only discriminatory *taxation*; it does not purport to preclude States from benefitting their retirees in other ways.

2. Contrary to petitioners' suggestion, the decision below does not conflict in any way with *West Lynn Creamery, Inc.* v. *Healy*, 512 U.S. 186 (1994), which held that a State could not charge both in-state and out-of-state milk producers a premium and then distribute the proceeds solely to in-state producers. *Id.* at 190-191. The Court reasoned that such a system violated the Commerce Clause because its "avowed purpose and its undisputed effect are to enable higher cost Massachusetts dairy farmers to compete with lower cost dairy farmers in other States." *Id.* at 194.

West Lynn does not assist petitioners. Although this Court's dormant Commerce Clause jurisprudence bears some "conceptual similarity," *West Lynn*, 512 U.S. at 200 n.17, to the field of intergovernmental taxation, there is a fundamental difference between the

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[1] The fact that Act 189 fails to provide a prospective benefit to the plaintiffs in no way reduces the extent to which it remedies the discriminatory and artificial subsidy problems identified in *Davis*. It has long been established that States can remedy unconstitutionally discriminatory taxes either by reducing the plaintiff's tax burden or by increasing the taxes of others similarly situated, *Davis*, 489 U.S. at 817-818; *Iowa-Des Moines Nat'l Bank* v. *Bennett*, 284 U.S. 239, 247 (1931), even though only the former directly benefits the plaintiff.

protections afforded by the Commerce Clause and those provided by the doctrine of intergovernmental tax immunity that renders *West Lynn* inapposite. The Commerce Clause generally prohibits discriminatory treatment of interstate commerce, regardless of the form that discrimination takes. *West Lynn Creamery*, 512 U.S. at 192; *Baldwin* v. *G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935). The doctrine of intergovernmental tax immunity, by contrast, prohibits only discriminatory *taxation*; it does not limit a State's ability to employ its spending power to set benefits for state retirees at whatever level the State may choose. The difference is significant because a discriminatory subsidy, at least when funded by a related facially non-discriminatory tax, poses the same danger of protectionism that the Commerce Clause addresses. An increase in the federally-taxable benefits of state workers, by contrast, eliminates the danger that the intergovernmental tax immunity doctrine addresses by redressing any artificial reduction of state costs at the expense of the federal treasury. See *Davis*, 489 U.S. at 815 n.4.

In any event, the limitations of the dormant Commerce Clause apply only when a State acts "in its distinctive governmental capacity," not when it acts "in the more general capacity of a market participant" or proprietor. *New Energy Co.* v. *Limbach*, 486 U.S. 269, 277 (1988); see *Reeves, Inc.* v. *Stake*, 447 U.S. 429, 438 & n.10, 446 (1980) (holding that the state-operator of a cement plant may favor in-state buyers over out-of-state buyers and explaining that the market-participant exception to the dormant Commerce Clause is supported by "[c]onsideration of [state] sovereignty"). Where, as here, a State provides employment benefits to its retired employees, it is indisputably acting in its proprietary capacity. Cf. *Clark* v. *United States*, 691

F.2d 837, 841-842 (7th Cir. 1982) (rejecting equal protection challenge to law mandating cost-of-living adjustments for federal but not state pensioners because the "United States, acting in its *proprietary* rather than its *governmental* capacity, has special responsibilities and obligations to its employees that it does not have to non-federal employees") (emphasis added).

II. There Is No Conflict Over The Question Presented

1. Contrary to petitioners' claim that "the courts are in conflict about whether increases in state employees' compensation * * * are unconstitutional" (Pet. 10), every state appellate court that has considered the issue has concluded, like the court below, that "[a] state is entitled to raise the level of taxable compensation of its employees if it so chooses." Pet. App. 5a. The decisions of the Montana and Oregon Supreme Courts—*Sheehy* v. *Public Employees Ret. Div.*, 864 P.2d 762 (Mont. 1993), and *Vogl* v. *Department of Revenue*, 960 P.2d 373 (Or. 1998)—that petitioners claim "directly conflict[]" (Pet. 14) with the court's decision below and with a second decision by the Oregon Supreme Court, see *Ragsdale* v. *Department of Revenue*, 895 P.2d 1348, 1354 (en banc), cert. denied, 516 U.S. 1011 (1995), do not announce any contrary rule of law or apply any meaningfully different legal test. The differing outcomes in those cases are attributable to the peculiar characteristics of the various state laws reviewed and not to any actual conflict among the decisions.

a. In *Ragsdale*, 895 P.2d at 1354, the Oregon Supreme Court recognized that "not only is there nothing express in *Davis* or in 4 U.S.C. Section 111 that would regulate the level of compensation of state employees, it would be illogical to suggest that there is anything in the underlying principle of intergovernmental tax immunity that would invalidate a state compensation plan in aspects unrelated to the level of taxation." But, the court continued, "[a] tax rebate or tax benefit program only for state employees clearly would be impermissible." *Id.* at 1356. Applying these principles to the 1991 Oregon statute before it, the court concluded that the law was permissible "compensation of [the State's] employees," because "there [was] no mathematical correlation between taxes and the benefits created," and "every state retiree who qualifie[d] for [the] benefits (based on years of service) * * * receive[d] the benefits, regardless of the state retiree's residency." *Id.* at 1350-1351, 1356.

The Oregon Supreme Court applied the same standard a few years later in *Vogl* v. *Department of Revenue*, 960 P.2d 373 (1998), to determine whether a 1995 increase in retirement benefits to state employees was permissible. The court again observed that the State could legitimately provide retirees "a general increase in compensation to 'make up' for lost net income," *id.* at 380, but could not institute "a tax *rebate* that discriminates against federal retirees." *Id.* at 379. Unlike the 1991 statute at issue in *Ragsdale*, the 1995 statute contained the hallmarks of a tax rebate: the retirement benefits were calculated "using a formula that [wa]s more closely and obviously tied to the Oregon personal income tax rate"; it allowed a benefit only as to the portion of the retiree's income attributable to service rendered before "the effective date of the exemption repeal"; it provided that no retiree would "acquire a right, contractual or otherwise, to the increased benefits"; and it expressly provided that the increased benefits were "full and final payment of damages for any claim arising out of the repeal of the previously existing exemption." *Id.* at 376-377. On these facts, the court concluded that the increased benefit was an impermissible "*rebate*." *Id.* at 380.

In *Sheehy*, 864 P.2d at 768, the Montana Supreme Court similarly did not dispute that a State may compensate retirees through "an actual and legitimate pension or retirement benefit," but held that Montana could not grant state retirees a discriminatory "partial tax rebate denominated otherwise in an attempt to evade the requirements of federal law." The statute at issue in that case repealed a tax exemption on state retirement benefits while simultaneously increasing benefits to the subset of retirees living in Montana that were newly subject to the tax; these additional benefits, moreover, were paid directly out of the State's general revenues, not the retirement fund from which retirement benefits were traditionally paid. *Ibid.* In light of these peculiar characteristics, the court reasoned that the additional payment "is not an actual and legitimate pension or retirement benefit" but a "tax rebate denominated otherwise." *Ibid.*[2]

[2] Petitioners also cite *Almeter* v. *Virginia Dep't of Taxation*, No. LL-821-4, 2000 WL 1687589, at *2 (Va. Cir. Ct. Nov. 6, 2000), as contributing to a division among the lower courts. Pet. 15-16. That decision was issued by a state trial court, however, and thus cannot contribute to a conflict among "state court[s] of last resort" within the meaning of this Court's Rule 10. In any event, the *Almeter* court's reasoning is consistent with the decision below and the analysis in *Sheehy*, *Ragsdale*, and *Vogl*. As in those cases, the *Almeter* court held that a State can validly "pay extra money to state retirees" and concluded that a one-time lump-sum payment to all state retirees and an across-the-board increase in benefits to all state retirees constituted compensation, not a tax rebate. See 2000 WL 1687589, at *1-*2.

b. Although petitioners are correct that the "outcomes" in these cases differ (Pet. 10), these differences are attributable to factual dissimilarities among the statutes under review, not, as petitioners claim, to "deep[ ] confus[ion]" over the "showing that is required to demonstrate that increased compensation is in fact an unconstitutional tax rebate." *Ibid.* The courts themselves ascribe the varying outcomes to fundamental differences among the retirement benefits under review. See *Ragsdale*, 895 P.2d at 1355-1356 (distinguishing *Sheehy* on the ground that the Montana statute provided that "only retirees who are Montana *residents* will receive the benefit" and that "the retirement benefits at issue are funded solely by the Montana *general fund*," which was not true of the 1991 Oregon law); *Vogl*, 960 P.2d at 379-380 (distinguishing *Ragsdale* on the ground that the 1995 statute before the court in *Vogl* "differs from its predecessor in several significant ways").

The South Carolina Supreme Court correctly pointed out that Act 189 lacks characteristics that other courts have found to establish that other state statutes were effectively tax rebates. Accordingly, the South Carolina Supreme Court rejected petitioners' argument that Act 189 would be unconstitutional under *Sheehy* and *Vogl*. The court explained that "the Montana Supreme Court [in *Sheehy*] relied heavily on the fact the adjustment was provided only to state retirees who are Montana residents," but "Act 189 provides the increase to all state retirees, regardless of their domicile." Pet. App. 7a. Moreover, the statute under review in *Vogl* "explicitly stated that its purpose was to compensate for damages" and "the benefit increases under [it] were mathematically correlated to replace the lost state retirement income," neither of which was true of Act 189.

Ibid. Petitioners may disagree with the weight the South Carolina Supreme Court assigned to those distinctions, but that disagreement reflects nothing more than a fact-bound dispute that does not implicate a broad conflict over a question of law.

2. Petitioners also err in contending (Pet. 14-15) that the court below departed from the analytical path followed by other state courts by holding that compensation can "*never* be characterized as an unconstitutional tax rebate." The court did not adopt such a sweeping rule. It held only that the particular increase before it was "not, in effect, a 'tax rebate.'" Pet. App. 3a. Nor did the court hold, as petitioners claim (Pet. 3; Reply Br. 1, 9), that the State has an "unfettered," "absolute" Tenth Amendment right to determine state employee compensation. It held instead that the State was free "to establish the level of its employees' compensation *as long as the State does not discriminate in taxation based on the source of the income*." Pet. App. 3a (emphasis added). Thus, like the Montana and Oregon courts, the court below recognized that a State may not perpetuate a discriminatory tax scheme merely by disguising a tax rebate as compensation. *Ibid.*

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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