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OFFICIAL TRANSCRIPT  
PROCEEDINGS BEFORE  
THE SUPREME COURT  
OF THE  
UNITED STATES

**CAPTION:** PAUL S. DAVIS, Appellant V. MICHIGAN DEPARTMENT  
OF TREASURY

**CASE NO:** 87-1020

**PLACE:** WASHINGTON, D.C.

**DATE:** January 9, 1989

**PAGES:** 1 thru 42

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1 IN THE SUPREME COURT OF THE UNITED STATES

2 -----x  
3 PALL S. DAVIS, :

4 Appellant :

5 v. :

No. 87-1020

6 MICHIGAN DEPARTMENT OF TREASURY :  
7 -----x

8 Washington, D.C.

9 Monday, January 9, 1989

10 The above-entitled matter came on for oral  
11 argument before the Supreme Court of the United States  
12 at 1:51 o'clock p.m.

13 APPEARANCES:

14 PALL S. DAVIS, ESQ., East Lansing, Michigan; on behalf  
15 of the Appellant, appearing pro se.

16 MICHAEL K. KELLOGG, ESQ., Assistant to the Solicitor  
17 General, Department of Justice, Washington, D.C.; as  
18 Amicus Curiae supporting Appellant.

19 THOMAS L. CASEY, Assistant Solicitor General of Michigan,  
20 Lansing, Michigan; on behalf of the Appellee.

C O N T E N T S

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ORAL ARGUMENT OF

PAGE

PAUL S. DAVIS, ESQ.

On behalf of the Appellant

3

MICHAEL K. KELLOGG, ESQ.

As Amicus Curiae supporting Appellant

11

THOMAS L. CASEY, ESQ.

On behalf of the Appellee

22

REBUTTAL ARGUMENT OF

PAUL S. DAVIS, ESQ.

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P R O C E E D I N G S

(1:51 p.m.)

CHIEF JUSTICE REHNQUIST: We'll hear argument next in No. 87-1020, Paul Davis v. The Michigan Department of the Treasury.

Mr. Davis, you may proceed whenever you're ready.

ORAL ARGUMENT OF PAUL S. DAVIS

ON BEHALF OF THE APPELLANT

MR. DAVIS: Mr. Chief Justice, may it please the Court:

The State of Michigan in its income tax taxes federal retirement benefits, but exempts retirement benefits paid to retirees from the State of Michigan. Appellant submits that this different treatment constitutes an unlawful discrimination in violation of the federal statute 4 U.S.C. 111.

Appellant is a former federal employee and receives a retirement annuity under the Civil Service Retirement Act. For the year 1979 and succeeding years, Appellant, in compliance with the Michigan income tax law, paid Michigan income tax on his retirement benefits.

After the decision of this Court in Memphis Bank & Trust Company v. Garner, which was in 1983, Appellant filed amended returns for several years,

1 starting in the year -- tax year starting in 1979 and  
2 sought refunds of the income taxes which he had paid on  
3 his federal retirement benefits. The Michigan  
4 Commissioner of Revenue denied the requested refunds.

5 Appellant then filed a suit in the Michigan  
6 Court of Claims seeking a refund of those taxes. The  
7 court of claims ruled against Appellant, and Appellant  
8 then appealed to the Michigan Court of Appeals.

9 In the court of claims and the Michigan Court  
10 of Appeals, Appellant relied on the federal statute, 4  
11 U.S.C. 111, taking the position that the Michigan law  
12 discriminated against federal retirees, as compared with  
13 state retirees, in violation of the statute.

14 QUESTION: Mr. Davis, can I ask you a question  
15 about --

16 MR. DAVIS: Yes, sir.

17 QUESTION: -- the statute? The statute is one  
18 that gives the consent of the United States to certain  
19 taxation. Supposing the United States has not consented  
20 so the statute just simply doesn't apply, would there be  
21 any prohibition against this taxation?

22 MR. DAVIS: Yes, Your Honor. The  
23 constitutional principles would then apply.

24 QUESTION: You think --

25 MR. DAVIS: Of -- of course at the time the

1 statute was initiated, there was intergovernmental tax  
2 immunity --

3 QUESTION: Right.

4 MR. DAVIS: -- which would have exempted the  
5 retirement benefits.

6 QUESTION: And those cases have generally been  
7 repudiated pretty much by our later cases.

8 MR. DAVIS: Well, the Graves case, which I was  
9 going to mention, at the -- which was pending at the  
10 time the Public Salary Tax Act was being considered in  
11 1939, and, and the Graves case for the first time held  
12 that all state -- all federal salaries would be subject  
13 to taxation by the federal government, provided that the  
14 tax was nondiscriminatory.

15 QUESTION: But you think that even without the  
16 statute, you'd have a claim based directly on the  
17 Constitution?

18 MR. DAVIS: Yes, Your Honor.

19 QUESTION: Because the language of the statute  
20 really doesn't help you at all. It just -- just says  
21 the United States hasn't consented, if you're right on  
22 your reading of it. But -- but maybe what my -- what  
23 I'm suggesting is maybe the consent of the United States  
24 simply isn't necessary for this tax.

25 MR. DAVIS: Well, the consent of the United

1 States was conditioned upon the tax being  
2 nondiscriminatory and --

3 QUESTION: That's right, but I'm -- I'm saying  
4 -- say I agree with you that there's no consent of the  
5 United States, but then you still have to have the  
6 second question of whether the tax is nevertheless  
7 invalid because it violates the Constitution. And for  
8 that proposition, it seems to me you have to rely on  
9 some rather old cases.

10 MR. DAVIS: Well, Your Honor, in, in this case  
11 I've taken the position that since the statute applies,  
12 it's not necessary to consider the constitutional  
13 question, but the constitutional question is important.

14 QUESTION: But the -- but the statute doesn't  
15 contain any prohibition. There's nothing in the statute  
16 that prohibits anybody from taxing anything. It just  
17 says the United States consents to certain taxes.

18 MR. DAVIS: Well, it has -- it should be read  
19 I think in the -- in the light of the law at the time  
20 the statute was initiated, and at that time the federal  
21 salaries were exempt from state taxation and, and it was  
22 only as a result of this statute, together with the  
23 Graves case which, in effect, reached the same result,  
24 that the federal compensation was made taxable by the  
25 state. And the Graves case made clear that any such

1 taxation must be nondiscriminatory which, of course, was  
2 what the statute also said.

3 QUESTION: Mr. -- Mr. Davis, you don't think  
4 you can draw from the statute a kind of a negative  
5 implication that Congress does not consent or objects,  
6 if you will, to the taxation of things that don't fall  
7 within that definition?

8 MR. DAVIS: Well, yes, Your Honor. I think  
9 the statute by implication says that it consents to the  
10 taxation if the tax is nondiscriminatory, but does not  
11 consent if the tax is discriminatory.

12 QUESTION: Well, if one read the statute that  
13 way, it would put your case in a better light than just  
14 having to rely on the constitutional provisions,  
15 wouldn't it?

16 MR. DAVIS: Yes, sir. I think the two should  
17 be read together. In, in other words, the  
18 constitutional provision is important in defining what's  
19 meant by nondiscriminatory as in the light of  
20 intergovernmental tax relations between the federal and  
21 state governments.

22 The Memphis Bank & Trust case in -- involved a  
23 somewhat similar situation in the context of taxation on  
24 banks as distinguished from taxation on employees. And  
25 in that case, the State of Tennessee taxed bank earnings



1 under a formula where earnings from -- which in --  
2 included interest on federal securities but excluded  
3 interest on state securities. And this Court held that  
4 that was invalid. And we had the same situation in  
5 Michigan, and Michigan had to make refunds of  
6 substantial amounts to Michigan banks as a result of  
7 that decision.

8           The Public Salary Tax Act, as I say, was  
9 pending at the time the Graves case was decided. The  
10 State of Michigan takes the position that 4 U.S.C. 111  
11 applies by its terms only to present federal officers  
12 and employees, and the state asserts that Appellant is a  
13 retiree and not a federal employee, which of course is  
14 conceded. But the statute is not limited to  
15 compensation of present employees. It expressly covers  
16 pay or compensation for personal services as an officer  
17 or employee of the United States.

18           Appellant submits that his compensation is  
19 clearly part of his compensation as a federal employee  
20 and the cases which we've cited in our brief show that  
21 the courts consider retirement compensation as -- or  
22 retirement benefits as deferred compensation. And one  
23 of the cases refers to the federal retirement system as  
24 a deferred compensation plan.

25           The brief of the National Association of

1 Retired Federal Employees, filed as an amicus brief in  
2 this case, discusses the legislative history of the  
3 Retirement Act, and spells out various statements by the  
4 sponsors of that Act indicating that the retirement  
5 benefits are considered part of compensation and are  
6 matters of right and not matters of grace.

7           And the Treasury regulations which were  
8 enforced before 1933 also treated compensation --  
9 treated retirement benefits as compensation. They also  
10 exempted -- specifically exempted retirement benefits of  
11 state employees during that period, and that of course  
12 was in accordance with the intergovernmental tax  
13 immunities, which started with *McCulloch v. Maryland*.

14           The Michigan income tax clearly discriminates  
15 against federal retirees.

16           QUESTION: May I ask you a question about  
17 that, Mr. Davis?

18           MR. DAVIS: Yes, sir.

19           QUESTION: Supposing the Michigan system taxed  
20 the -- pensions of both federal employees and state  
21 employees, but granted an exemption to union workers in  
22 the automobile industry, something like that, just an  
23 entirely different exemption, would that discriminate  
24 against federal employees?

25           MR. DAVIS: No, sir. Well, it might

1 conceivably raise questions --

2 QUESTION: Well, you see, this suggestion I  
3 make is --

4 MR. DAVIS: -- (inaudible) laws, but not so  
5 far as this statute or intergovernmental tax immunities  
6 are concerned because they're not treating the state on  
7 the basis different from the federal government.

8 QUESTION: But does a statute which  
9 discriminates in favor of a small group of Michigan  
10 citizens discriminate against ex-federal employees?

11 MR. DAVIS: No, sir, not unless it gives a  
12 benefit to the state, as distinguished from the federal  
13 government.

14 QUESTION: I don't find that in the language  
15 of the statute either.

16 MR. DAVIS: Well, the statute of course --

17 QUESTION: It only refers to being  
18 discriminated against, and I'm not sure the federal  
19 employees have been discriminated against here. There's  
20 a discrimination in favor of one group of Michigan  
21 citizens. But you say if it was a different group of  
22 Michigan citizens, there would be no violation of the  
23 statute.

24 MR. DAVIS: Well, unless they bear some  
25 relationship to the state. In other words, this, this

1 is an attempt to favor the state as compared with the  
2 federal government, which is a violation of the statute  
3 and also the Constitution.

4 Appellant urges that this Court reverse the  
5 decision of the court of appeals and order that refunds  
6 be made of the taxes in question in this case.

7 I'd like to reserve the remainder of my time  
8 for rebuttal.

9 QUESTION: Thank you, Mr. Davis.

10 Mr. Kellogg, we'll hear now from you.

11 ORAL ARGUMENT OF MICHAEL K. KELLOGG

12 AS AMICUS CURIAE SUPPORTING APPELLANT

13 MR. KELLOGG: Thank you, Chief Justice, and  
14 may it please the Court:

15 The statute at issue here, 4 U.S.C. 111,  
16 precludes states from levying discriminatory taxes upon  
17 the compensation of federal employees. In response to  
18 Justice Stevens' question, I believe that the last  
19 clause of Section 111 has to be read as an affirmative  
20 prohibition upon discriminatory --

21 QUESTION: Why does an exception from a broad  
22 consent have to be read as an affirmative prohibition?

23 MR. KELLOGG: Well, for -- one reason is the  
24 historical context in which the statute was passed. At  
25 that time, the Court, the year before, had abrogated the

1 doctrine of intergovernmental immunity insofar as it  
2 applied to federal taxation of state employees. This  
3 tax act was designed to subject the income of state  
4 employees to federal taxation. At the same time the  
5 Court felt --

6 QUESTION: It was designed to increase the  
7 power of the state to tax federal employees. That was  
8 the purpose of the statute.

9 MR. KELLOGG: That's correct. Some sort of  
10 reciprocity.

11 QUESTION: So that if you had no statute here,  
12 what would be the objection to this, this tax?

13 MR. KELLOGG: Well, the constitutional  
14 doctrine of intergovernmental immunity precludes the  
15 states from opposing any sort of discriminatory tax on --

16 QUESTION: But would this be a discriminatory  
17 tax in my other hypothetical if they exempted automobile  
18 workers' pensions?

19 MR. KELLOGG: I think it would be for some of  
20 the reasons you stated in your dissent in the County of  
21 Fresno case. I would note that the Court in that --

22 QUESTION: That's quite different. That --  
23 right there you are worried about the electoral body  
24 there that would discriminate against the federal  
25 employees.

1 MR. KELLOGG: Well, that's certainly the  
2 motivating force behind the doctrine. The federal  
3 government has no representation in the individual  
4 states and, therefore, there's not the usual sort of  
5 political restraint upon the taxing power of the  
6 states. By forcing the state to treat those who deal  
7 with itself the same as those who deal with the federal  
8 governments, the state is precluded from pursuing its  
9 own parochial interests at the expense of the federal  
10 government.

11 QUESTION: But your view -- just to be sure  
12 I'm clear on it, your view is this would be an  
13 unconstitutional tax even if you didn't have this  
14 statute.

15 MR. KELLOGG: Yes, it would be an  
16 unconstitutional tax. The Court has never wavered. The  
17 doctrine of intergovernmental --

18 QUESTION: So, my -- my, my own view is that  
19 the government's position would be much weaker here if  
20 it has to depend on just the Constitution if it can't  
21 get any affirmative mileage out of the statute.

22 MR. KELLOGG: Well, we certainly believe we  
23 get affirmative mileage out of the statute, but the  
24 constitutional doctrine, although it has wavered  
25 considerably in, in the scope of the doctrine given it

1 to it by the Court, the Court has never wavered in the  
2 basic principle that the states are precluded from  
3 imposing a discriminatory tax upon those who deal with  
4 the federal government.

5 For example, in the Memphis Bank case  
6 mentioned by Appellant, the state in that case taxed  
7 federal obligations while exempting from taxations  
8 federal obligations.

9 QUESTION: Oh, yes, but this case would be  
10 entirely different if the only people whose pensions  
11 were being taxed were federal -- ex-federal employees.  
12 But that's not this case. Federal employees are in the  
13 same class as all Michigan citizens except Michigan  
14 employees.

15 MR. KELLOGG: And that was exactly the case in  
16 the Memphis Bank case and in the Phillips Chemical case,  
17 as well as in the City of Manassas case, which the Court  
18 summarily affirmed last term.

19 In the Memphis Bank case, the Court  
20 specifically noted that the obligations of private  
21 entities were taxed to the same extent as the  
22 obligations of federal entities. Only the obligations  
23 of state entities were exempted from the taxation.

24 Similarly, in the Phillips Chemical case,  
25 lessees of private property --

1 QUESTION: But again, was that not a statute  
2 that contained a prohibition?

3 MR. KELLOGG: It was a statutory prohibition  
4 on discrimination, but the Court specifically noted that  
5 it interpreted the statute to the same extent as the  
6 constitutional doctrine. So, the Court relied on  
7 constitutional cases in construing the scope of the  
8 nondiscrimination principle in this statute.

9 We think that the Court should do essentially  
10 the same thing here. There's no reason why the  
11 nondiscrimination principle in Section 111 should have  
12 any different scope than the Court has given to  
13 nondiscrimination --

14 QUESTION: Why -- why should Congress enact a  
15 statute like this if all it meant to do was to proclaim  
16 the Constitution?

17 MR. KELLOGG: Well, because at the time the  
18 statute was originally proposed, the states were  
19 precluded, under the case of Collector v. Day and  
20 Dobbins case, from taxing those who dealt with the  
21 federal government at all. The doctrine of  
22 intergovernmental immunity, as originally interpreted,  
23 was a very broad one which precluded states from  
24 imposing any tax on the income of those who dealt with  
25 the federal government.



1 QUESTION: When was this statute enacted?

2 MR. KELLOGG: The statute was enacted in 1939.

3 The statute was enacted exactly three weeks after this  
4 Court decided in the Graves case that, in fact, federal  
5 taxes -- federal incomes were subject to state taxation.  
6 So, in effect, a statute which had been proposed to open  
7 up the federal government to this sort of taxation,  
8 ended up being merely a codification of the Court's  
9 decision three weeks earlier.

10 But it was originally proposed in order to  
11 have some sort of parity because the Court had decided  
12 in 1938 in Helvering v. Gerhardt that state incomes were  
13 subject to federal taxation. And Congress merely felt  
14 that there should be some sort of parity in the two  
15 sorts of taxations. That's why the -- that's why the  
16 statute was proposed.

17 As it ended up being enacted, it merely  
18 codifies the constitutional principle of  
19 nondiscrimination, which this Court stated last term, is  
20 at the heart of modern intergovernmental tax immunity.

21 So, we would state --

22 QUESTION: Let me -- let me take you one step  
23 further. In -- instead of all Michigan employees,  
24 supposing it just exempted Michigan police officers, but  
25 doesn't exempt FBI agents who live in the -- in the

1 state, would it still be unconstitutional?

2 MR. KELLOGG: It, it would still be  
3 unconstitutional.

4 QUESTION: Supposing it just investigated --  
5 it exempted Michigan legislators, but didn't invest --  
6 exempt Michigan congressmen, do you think that would  
7 still make it unconstitutional?

8 MR. KELLOGG: Well, the -- the inquiry would  
9 be whether there are significant differences between the  
10 two classes so that they're not similarly situated.

11 QUESTION: Well, I'm assuming no, assuming  
12 that they'd perform exactly the same jobs. But if you  
13 just exempt one Michigan employee who has a counterpart  
14 in the federal system, the, the tax is unconstitutional?

15 MR. KELLOGG: I would say that that would have  
16 to be. The, the --

17 QUESTION: It has to be?

18 MR. KELLOGG: There has to be a break--

19 QUESTION: Do you think that's what Congress  
20 intended here?

21 MR. KELLOGG: Now, Michigan argues, of course,  
22 that retirees are not covered under Section 111, that it  
23 only applies to compensation of current employees. We  
24 would say that that's both wrong and irrelevant. It's  
25 wrong because a pension is deferred compensation for

1 services as a federal employee within the meaning of the  
2 statute.

3 It's also irrelevant for the reasons explained  
4 that the statute merely codifies the constitutional  
5 principle which would apply to the pensions of federal  
6 employees whether or not they fell within the meaning of  
7 the statute.

8 QUESTION: Well, that -- that's not logical.  
9 It doesn't codify it if it's different from it. Your  
10 first argument -- it doesn't codify it if it's different  
11 from it. If he's right that -- that it only covers  
12 current employees, it does not codify the constitutional  
13 principle.

14 MR. KELLOGG: Not completely. I mean, it's  
15 not an exhaustive codification.

16 QUESTION: You can't have it both ways.

17 MR. KELLOGG: Just as applied to this specific  
18 group of employees in the same way that the statute in  
19 Memphis Bank codified the constitutional principle as  
20 applied to federal obligations.

21 Now, Michigan, while acknowledging that its  
22 statute treats state employees more favorably for tax  
23 purposes than federal employees --

24 QUESTION: (Inaudible) ex-employees.

25 MR. KELLOGG: Ex-employees.

1           Argues that the tax is nonetheless -- that  
2 this sort of discrimination is nonetheless  
3 constitutionally permissible for several reasons.

4           The first is the point Justice Stevens was  
5 inquiring about that the federal retirees are not  
6 singled out for a tax imposed upon them alone. As I  
7 noted, the Court has already unanimously rejected that  
8 argument in both the Memphis Bank case and in the  
9 Phillips Chemical case in which private parties dealing  
10 with the federal government, as well as federal  
11 employees, were taxed in a similar way whereas the state  
12 got a special tax exemption. In both cases, the Court  
13 stressed that however it treats private entities, the  
14 state cannot impose a heavier tax burden on those who  
15 deal with the federal government than on those with whom  
16 it deals itself.

17           The second argument that Michigan puts forward  
18 is that the discrimination is justified --

19           QUESTION: Mr. Kellogg, supposing in this case  
20 the State of Michigan had said we're going to tax  
21 Michigan employees and federal employees on their  
22 retirement benefits, but we're not going to, to tax  
23 private employees.

24           MR. KELLOGG: It's not clear from the Court's  
25 precedents whether that would be permitted or not. We

1 would argue that it would constitute discrimination.

2           QUESTION: But that's not Phillips and it's  
3 not Memphis, is it?

4           MR. KELLOGG: But it's not Memphis. In the  
5 County of Fresno case, in Justice Stevens in his dissent  
6 made an argument as to why such a tax would be  
7 constitutionally suspect. The majority did not have to  
8 deal with that question in that case, however, because  
9 the Court specifically found that private parties, state  
10 employees and federal employees were all treated in a  
11 similar way, that there was no discrimination.

12           I would note that there is one case in 1962 in  
13 which the Court summarily affirmed a district court  
14 decision upholding a tax exemption given to charitable  
15 organizations that did not apply to either the states or  
16 the federal government. And the reasoning of the  
17 district court in that case was that the charitable  
18 organizations, because they have no power to tax and are  
19 dependent upon voluntary contributions, are not  
20 similarly situated with the state and federal  
21 governments. Now, because that was a summary  
22 affirmance, it's not clear to what extent the  
23 precedential value of that would -- would exist now.

24           A final argument that the State of Michigan  
25 makes is that the economic burden on the United States

1 is simply not sufficient -- significant enough to  
2 interfere with essential government functions. But it's  
3 precisely that sort of amorphous inquiry into the degree  
4 of interference with governmental functions that has  
5 been long since abandoned by this Court and has been  
6 replaced by the principle of nondiscrimination, which  
7 makes such an inquiry unnecessary. Once it is shown  
8 that the state's system of taxation viewed as a whole  
9 treats those who deal with the states more favorably, no  
10 further inquiry is necessary into the economic effects  
11 of the tax.

12           Simply put, the State of Michigan must make a  
13 choice. They can tax both federal and state pensions,  
14 or they can make both federal and state pensions  
15 nontaxable. But they cannot impose a tax on federal  
16 pensions that does not imply to state pensions, a tax  
17 that increases the costs and decreases the revenues of  
18 the federal government while simultaneously decreasing  
19 the costs and increasing the revenues of the federal --  
20 of the state government. It's precisely that sort of  
21 disparity in treatment that the doctrine of  
22 intergovernmental immunity was designed to prevent.

23           QUESTION: It seems sort of silly, though,  
24 doesn't it? I mean, so they will tax them both and just  
25 increase the pensions for the state workers. You get

1 exactly the same result as, as you would get by not  
2 taxing the state workers I suppose.

3 MR. KELLOGG: No, it wouldn't be the same  
4 result.

5 QUESTION: Why not?

6 MR. KELLOGG: Because state pensions are  
7 subject to federal tax. If the state increased its own  
8 pensions in order to reflect the fact that they are now  
9 taxed, they would be subject to a higher federal tax  
10 burden. So, they would have to increase them --

11 QUESTION: Increase them a little bit more.

12 MR. KELLOGG: -- by more, which means in  
13 effect that what the state is doing is getting the  
14 federal government to subsidize its pensions through its  
15 discriminatory taxation.

16 QUESTION: And that's a no-no.

17 MR. KELLOGG: Yes.

18 Unless the Court has any further questions,  
19 nothing further.

20 QUESTION: Thank you, Mr. Kellogg.

21 Mr. Casey, we'll hear now from you.

22 ORAL ARGUMENT OF THOMAS L. CASEY

23 ON BEHALF OF THE APPELLEE

24 MR. CASEY: Mr. Chief Justice, and may it  
25 please the Court:

1 Michigan courts held that Mr. Davis is not an  
2 employee within the meaning of the -- Section 111. We  
3 believe that judgment is correct and should be affirmed.

4 Alternatively, we believe that even if he is  
5 covered by this statute, the Michigan classification  
6 system is permissible, because if you look at the  
7 legislative history of that statute, it is clear that  
8 the only type of discrimination which is prohibited is  
9 discrimination which is aimed at or which threatens the  
10 efficient operation of the federal government itself,  
11 not the individual employee.

12 Finally, we submit that if the constitutional  
13 doctrine of intergovernmental tax immunity applies, the  
14 Michigan classification is still permissible because  
15 that doctrine also, when properly interpreted according  
16 to its constitutional foundations, only prohibits  
17 discrimination which substantially interferes with the  
18 federal government's activities. They are directed at  
19 the sovereigns not at the individuals.

20 The Michigan courts decided this case on a  
21 preliminary statutory interpretation question: is Mr.  
22 Davis, a retiree, an employee within the meaning of  
23 Section 111? They found that he was not. We believe  
24 that decision is absolutely correct. It is consistent  
25 with the definition of employee and annuitant in the



1 civil service statutes. It's consistent with the  
2 definitions in the Internal Revenue Code. It's  
3 consistent with definitions in the Michigan Income Tax  
4 Act and the Michigan Administrative Code. For those  
5 reasons, the judgment should be affirmed.

6           If, however, the Court finds that Mr. Davis is  
7 deemed to be an employee and may assert the protections  
8 of this statute, we must look further into the  
9 background of the statute. Unlike Mr. Davis and the  
10 federal government, we submit that this statute is more  
11 than merely a codification of the constitutional  
12 principle. We believe when you look at the, the  
13 congressional history and the context of the times and  
14 the evolution of the doctrine, it's clear that the  
15 statute does two things, both of which are designed to  
16 narrow the preexisting constitutional doctrine as it  
17 existed before Graves.

18           The first thing the statute does is it  
19 contains a broad waiver of immunity for employees, and  
20 the other thing that the statute does, it contains a  
21 narrow exception to that immunity for taxation which  
22 discriminates against employees because of the source of  
23 the compensation. As we'll show, the legislative  
24 history indicates that that portion of the statute was  
25 intended to preserve the immunity of the United States.

1 It was not intended to preserve any immunity of the  
2 individual employee.

3 QUESTION: Well, how, how, how do you show  
4 that from the legislative history?

5 MR. CASEY: The only real legislative history  
6 dealing with this aspect are the reports of the Senate  
7 and House committees, which we have cited and quoted  
8 from in our brief. The text of the bills was debated on  
9 the House and Senate floors, but there -- there was no  
10 debate that I've been able to locate dealing with this  
11 discrimination question.

12 Those reports from the House and Senate  
13 committees clearly indicate -- we've quoted them on --  
14 in our brief on page 34 and 35. There's an extensive  
15 quotation. It's from the Senate report pages 11 and 12,  
16 and the first sentence there reads: "The consent is not  
17 intended to operate, nor could it operate, as a consent  
18 to any taxation to which as individuals these officers  
19 and employees are entitled to object." And it goes on  
20 to indicate that an individual employee may assert  
21 whatever individual constitutional rights he or she may  
22 have.

23 If Mr. Davis feels this classification in the  
24 Michigan tax system violates his own equal protection  
25 rights, he may assert that as an individual. We submit

1 that it does not violate those rights since there is  
2 substantial rational basis for the statute.

3 The last line of that quotation indicates the  
4 true extent of the -- the narrowness of the exception to  
5 the broad waiver of immunity. Quoting from the Senate  
6 and House reports, "To protect the Federal Government  
7 against the unlikely possibility of State and local  
8 taxation of compensation of Federal officers and  
9 employees which is aimed at, or threatens the efficient  
10 operation of, the Federal Government, the consent is  
11 expressly confined to taxation which does not  
12 discriminate against such officers or employees because  
13 of the source of their compensation."

14 It's clear that that narrow exception to the  
15 broad waiver of immunity was designed to protect the  
16 federal government against taxation by the states which  
17 is aimed at or threatens the efficient operation of the  
18 federal government.

19 QUESTION: So, you suggest from that bit of  
20 legislative history that no individual has a right, when  
21 he is taxed in violation of the provision, only perhaps  
22 the United States could sue?

23 MR. CASEY: Mr. Davis can make the allegation,  
24 but in order to substantiate coverage under this  
25 statute, it has to be alleged and proven that the

1 discrimination against him has this kind of substantial  
2 interference with federal activities. The statute has  
3 to be found to be aimed at or threaten the efficient  
4 operation of the federal government itself.

5 QUESTION: Well, there's nothing in the  
6 statute at all that suggests that. That would be purely  
7 imported from this sentence in the legislative history,  
8 wouldn't it?

9 MR. CASEY: That's correct. The, the statute  
10 itself by its terms does not define the word  
11 "discriminate."

12 QUESTION: Well, in fact, the statute refers  
13 to discrimination against the officer or employee of the  
14 United States, indicating a concern with the individual.

15 MR. CASEY: If it could be shown, for example,  
16 in this case if the taxation effort against Mr. Davis  
17 was so severe that the federal government was its -- the  
18 operations of the federal government were threatened,  
19 that would be sufficient under the statute.

20 QUESTION: Yes, but under that view, they --  
21 you're saying it would -- it would be permissible for  
22 them, unless you can make that kind of a showing, to  
23 give an exemption to every Michigan citizen except  
24 federal employees?

25 MR. CASEY: In those circumstances, it would

1 seem that that statute would be clearly aimed at the  
2 federal government.

3 QUESTION: Without -- but you wouldn't have to  
4 prove anything beyond the fact that it discriminated  
5 against federal employees, would you?

6 MR. CASEY: There would have to be some  
7 showing of the effect of the statute on the federal  
8 government.

9 QUESTION: Why? I don't understand that  
10 because in, in its terms it would discriminate against  
11 federal employees. I thought your argument was that  
12 this doesn't discriminate against federal employees; it  
13 discriminates in favor of a small group of Michigan  
14 citizens, which is a quite different argument.

15 MR. CASEY: What -- we view the Michigan  
16 system as a classification which confers a benefit on  
17 retired state employees. The rest of the world, many  
18 millions of Michigan taxpayers, are all treated the  
19 same, including the, the few thousand retired federal  
20 employees.

21 QUESTION: But that's a very different  
22 argument for saying -- from saying that Mr. Davis has to  
23 prove that the -- the operations of the federal  
24 government are going to grind to a halt if they don't  
25 get this exemption.

1 MR. CASEY: Well, the first part of the  
2 statute is a broad exception -- or, excuse me -- a broad  
3 waiver of immunity. At the time the statute was  
4 proposed, the states could not tax the Income of federal  
5 employees. This came up while the Graves case was still  
6 pending. The Congress was aware that there was a shift  
7 evolving in the interpretation of the constitutional  
8 doctrine, but as this legislation was proposed, states  
9 could not tax federal employees. The first sentence --

10 QUESTION: Why, why should we look at the time  
11 when it was proposed? It seems to me we look at the  
12 time it was adopted. At the time Congress adopted it,  
13 there was already -- it was already clear that -- that  
14 the states could tax the federal --

15 MR. CASEY: Graves said that the states can  
16 tax federal employees.

17 QUESTION: And Graves came out three weeks  
18 before the statute was passed, isn't that right?

19 MR. CASEY: That's correct. So, we say -- we  
20 submit that the statute is narrower than the  
21 constitutional doctrine.

22 The only -- the statute prohibits  
23 discrimination which is aimed at or which threatens the  
24 efficient operation of the federal government. That is  
25 the only type of discrimination which the statute

1 exempts from taxation. The, the statute consents to  
2 taxation of federal employees, but to protect the  
3 federal government, there is this exception for  
4 discriminatory taxes which are aimed at or threaten the  
5 efficient operation of the federal government.

6 QUESTION: Well, it seems to me if all 50  
7 states could engage in selective taxation of this type,  
8 that there certainly is a threat to the federal  
9 government interest.

10 MR. CASEY: If all 50 states did engage in  
11 this and there was sufficient financial consequences to  
12 the federal government, then yes, there would be a  
13 violation of the statute.

14 QUESTION: Well, I think --

15 MR. CASEY: In this case there was no --

16 QUESTION: I think it's the mere threat of  
17 that under your interpretation.

18 MR. CASEY: Well, we submit there has to be  
19 more than just a mere threat. The Graves case and --  
20 and others indicate there -- the harm to the federal  
21 government cannot be mere speculation. There has to be  
22 some kind of showing of, of harm. That -- Graves was an  
23 economic burcen case and not a discrimination case, but  
24 we're arguing, in essence, that the discrimination  
25 aspect should be interpreted substantially the same as

1 the economic burden aspect.

2 In the Phillips case, for example, upon which  
3 Mr. Davis relies very heavily, the Court specifically  
4 said in -- in at least two points in the opinion that  
5 where taxation of the private use of the government's  
6 property is concerned, the government's interest must be  
7 weighed in the balance. That's all we're asking the  
8 Court to do in interpreting this statute or the  
9 constitutional doctrine: weigh the government's  
10 interests in the balance. If the government's  
11 interests, as a government, as a sovereign entity, are  
12 not harmed by the Michigan statute, there is no  
13 violation of the federal statute --

14 QUESTION: But the Phillips -- Phillips was a  
15 county school tax in Texas on one leasehold interest of  
16 the government. Certainly if you had taken that by  
17 itself, you would have said the federal government isn't  
18 going to stand and fall on whether that -- It must be  
19 the idea if the practice became widespread or the  
20 potential threat, as Justice O'Connor says, not just  
21 that one particular bit of taxation is going to stop the  
22 federal government in its tracks.

23 MR. CASEY: The -- In, in Phillips this Court  
24 made a specific finding that the discrimination did  
25 affect not only the private lessee, but also the federal



1 government. The, the key word in our interpretation  
2 here is there has to be discrimination against the  
3 private entity and the federal government not just --

4 QUESTION: You, you say in Phillips that the  
5 discrimination was against the government itself as, as  
6 an owner, whereas here it's just against a government  
7 employee?

8 MR. CASEY: Yes. There is no allegation and  
9 no showing on the facts of this case that the federal  
10 government suffers any adverse consequences at all from  
11 the Michigan classification. Had the federal government  
12 come in or had Mr. Davis alleged and shown some negative  
13 impact on the federal government, we would have a  
14 different case.

15 What, what we're asking the Court to do is  
16 interpret this federal statute and the constitutional  
17 doctrine in such a way as to say that discrimination is  
18 prohibited -- discrimination against an employee is  
19 prohibited only if it has this kind of substantial  
20 adverse effect on the government, not just on the  
21 individual.

22 They argue for a broad interpretation of the  
23 constitutional doctrine. They say that the  
24 discrimination is prohibited if it affects the federal  
25 government or anyone with whom the federal government

1 deals. Clearly that is too broad, we suggest.

2 QUESTION: Well, but the statute certainly  
3 says that.

4 MR. CASEY: I, I don't, don't believe the  
5 statute does say that.

6 QUESTION: You don't think it does?

7 MR. CASEY: We view the statute as doing two  
8 things, as I said. Number one, it is -- It is a very  
9 broad consent to taxation. It's a broad waiver of the  
10 constitutional immunity from taxation that individuals  
11 had at that time. Secondly, it is a -- there's a narrow  
12 exception to that waiver in the last sentence that we've  
13 quoted from the Senate report. And the only basis for  
14 that exception is to protect the federal government as  
15 an entity.

16 Now, this dovetails very neatly with the  
17 economic burden cases involving the constitutional  
18 doctrine where the Court has pointed out that the -- the  
19 whole basis for the doctrine is to protect the integrity  
20 of two sovereign governments. It's not designed to  
21 protect in -- individual employees from having to pay a  
22 higher burden of tax. It's not designed now under the  
23 modern doctrine to protect the federal government from  
24 having to ultimately pay the entire economic burden.

25 All, all we're saying is that when you're

1 looking at an alleged violation of either the statute or  
2 the constitutional doctrine, the focus has to be on the  
3 impact on the sovereign entity of the federal  
4 government. We believe that's consistent with the  
5 congressional history of the statute and with the  
6 constitutional principles underlying the doctrine of  
7 intergovernmental tax immunity.

8           The United States in its amicus brief has  
9 argued that there might be some economic burden to it.  
10 We submit that that is pure speculation. As I  
11 understand their argument, they're saying if Michigan  
12 taxed its state retirees, then if the Michigan  
13 legislature raised the state pensions, then some of that  
14 extra pension money would go to the federal government  
15 in the form of federal income taxes. We submit there's  
16 no guarantee that that would happen at all. That is  
17 pure speculation. And Graves, as we've quoted  
18 extensively in our brief, indicates that you cannot  
19 speculate as to the negative impact on the government.

20           QUESTION: What, what is the rate of the tax  
21 that we're talking about?

22           MR. CASEY: Michigan income tax is 4.6 percent.

23           QUESTION: So, in other words, if they gave a  
24 4.6 percent increase or I guess the after-tax equivalent  
25 of 4.6 percent, then that would equalize it. Yes.

1 MR. CASEY: Well, it's kind of ironic here.  
2 If Michigan did, as the government hypothesizes -- tax  
3 its state employees and then raises the pension, Mr.  
4 Davis, the plaintiff in this case, would not get any  
5 benefits. A hundred and thirty thousand or so state  
6 retirees --

7 QUESTION: Well, he might be entitled to a  
8 refund for the period that the discrimination occurred.

9 MR. CASEY: Perhaps, but -- yes. But there  
10 are some --

11 QUESTION: Which is probably what he's much  
12 more interested in than the future.

13 MR. CASEY: True, but -- now, we don't have  
14 much of a factual record in this case, but my  
15 understanding is that there are about 24,000 retired  
16 federal employees in the State of Michigan. I assume  
17 they're interested in it, too.

18 But if Michigan chose to tax its state  
19 employees -- state retirees, then those 130,000 people  
20 would suffer. The federal retirees would not gain  
21 anything, and the only entity that would benefit would  
22 be the United States government. We submit that that's  
23 not the appropriate way to look at it. The appropriate  
24 way to look at it is does the federal government suffer  
25 now, not will they get a benefit in the future if the

1 situation changes.

2 QUESTION: Do you have an idea of how many  
3 taxpayers there are in Michigan?

4 MR. CASEY: There are approximately four and a  
5 half million individual taxpayers in Michigan.

6 QUESTION: And they're all treated the same as  
7 the federal employees.

8 MR. CASEY: Except for the 130,000 state  
9 retirees who benefit from this.

10 QUESTION: Michigan's income tax isn't  
11 graduated then. It's just a flat 4 --

12 MR. CASEY: Flat 4.6. There's a Michigan  
13 constitutional prohibition against a graduated income  
14 tax.

15 One other element that the United States has  
16 raised, it says that it is unprotected from taxation  
17 efforts by Michigan. We submit that that is simply not  
18 the case. In *Washington v. United States*, this Court's  
19 opinion said that a political check is provided when a  
20 state tax falls on a significant group of state citizens  
21 who can be counted upon to use their votes to keep the  
22 state from raising the tax excessively and thus placing  
23 an unfair burden on the federal government.

24 In -- in this case, we have four million, 300  
25 and some thousand Michigan taxpayers who are in exactly

1 the same situation as the 24,000 federal retirees. That  
2 we submit is a significant group of state citizens whose  
3 votes will protect the federal retirees.

4 we have argued to some extent in our brief a  
5 -- we -- we've made an argument about the appropriate  
6 remedy. Should we lose all our substantive arguments, we  
7 admit that Mr. Davis should get his tax refund with  
8 interest, but the question arises what about these other  
9 24,000 people.

10 I've discussed that extensively in our brief,  
11 and if the Court has no questions about it, I don't  
12 propose to argue it in detail here except to say that we  
13 suggest that the proper remedy would be to remand the  
14 case to the state to let the state courts or the state  
15 legislature make the first determination about whether  
16 the exemption should be extended or withdrawn.

17 QUESTION: My, my only question about that  
18 question is why that question is here. Is -- is it  
19 here? This is not a class action, is it?

20 MR. CASEY: It's not a class action, but --

21 QUESTION: So, why do we have to answer that  
22 at all?

23 MR. CASEY: -- If, if this Court issues an  
24 opinion stating that the current Michigan classification  
25 is unconstitutional or in violation of the statute,

1 there are these 24,000 taxpayers out there.

2 QUESTION: Well, that's -- there are other  
3 days in the future too.

4 MR. CASEY: Well, that -- that's --

5 QUESTION: But that's not -- It's not here, is  
6 it? Is that question here?

7 MR. CASEY: It is not specifically raised, no.  
8 We put it in more or less as a preventative measure to  
9 indicate that if the choice is between extending the  
10 exemption to the federal retirees or withdrawing it from  
11 the state retirees, we would prefer extending it to the  
12 state retirees.

13 If I may briefly conclude, we suggest that Mr.  
14 Davis and the United States in this case are asking the  
15 Court for a per se rule that he as an individual retired  
16 federal employee is entitled to every tax benefit that  
17 Michigan law gives retired state employees, regardless  
18 of whether the federal government as a sovereign entity  
19 suffers any adverse effects from the state tax statutes.

20 We urge this Court to reject such a per se  
21 rule and instead interpret the federal statute and the  
22 constitutional doctrine according to their fundamental  
23 underlying premise, which is protecting the functions of  
24 government as entities from the taxing power of other  
25 government -- governments.

1           The, the purpose of the constitutional  
2 doctrine and the purpose of the statute is not to  
3 protect individual employees as individuals. Mr. Davis  
4 has his own individual equal protection remedy he may  
5 assert. The purpose of the statute and the Constitution  
6 is to protect governments as sovereigns from each  
7 other.

8           We submit that on the facts of this case,  
9 there has been no allegation and no showing that the  
10 Michigan classification system has that kind of effect  
11 on the federal government and, therefore, the judgment  
12 of the State of Michigan Court of Appeals should be  
13 affirmed.

14           If there are no questions --

15           QUESTION: Thank you, Mr. Casey.

16           Mr. Davis, you have four minutes remaining.

17           REBUTTAL ARGUMENT OF PAUL S. DAVIS

18           MR. DAVIS: If the Court please, the argument  
19 with respect to the scope of the statute -- the, the  
20 state takes the position that present employees are not  
21 covered. But the present retirees who are no longer  
22 present employees are not covered. But the statute does  
23 not limit the scope to present employees because it says  
24 -- refers to compensation for personal services as an  
25 officer or employee. And as I mentioned earlier, this



1 is deferred compensation. So, it's our position that  
2 this is clearly within the scope of the statute.

3 Now, with respect to the adverse effect on the  
4 United States government, both in the Phillips case and  
5 in the Memphis Bank case, the objections were made, in  
6 one case by the landowner or lessee, in the other case  
7 by the bank, not by the government itself. And those --  
8 those cases demonstrate that once discrimination is  
9 shown, that is the end of the inquiry. It's not  
10 necessary to show a specific damage or economic effects  
11 to the government itself. And that's the reason for the  
12 -- in effect, a blanket ban on discrimination against  
13 the federal government.

14 QUESTION: Of course, in the Phillips case,  
15 Mr. Davis, it was the government -- the United States  
16 was the owner of the underlying leasehold. So, I  
17 suppose you can say it suffered damage by demonstration  
18 as soon as the tax was imposed. Here you're a degree or  
19 two removed from that, the tax being on -- on your  
20 income and not on the government.

21 MR. DAVIS: Well, it's a difference of degree,  
22 but still the -- the impact was on somebody dealing with  
23 the United States, just as retirees are people who are  
24 former employees of the government who deal with the  
25 government. So, it's -- the same principle should be

1 applicable.

2 Now, a question was raised about this overall  
3 impact. Now, there are several other states. In  
4 Appellant's brief mention was made of the -- I, I guess  
5 it may have been the jurisdictional statement. Mention  
6 was made of the fact that the State of Virginia and the  
7 State of Georgia have similar statutes. And the brief  
8 of the National Association which intervened, which has  
9 appeared as an amicus, also mentions the States of  
10 Arizona, New York and Arkansas as being states which  
11 have similar statutes. So, it may have a broad effect  
12 in that way. I don't think that's particularly  
13 relevant, but since the Court asked about it, I thought  
14 it might be mentioned.

15 With, with respect to the remedy, as has been  
16 pointed out, Appellant takes the position he's entitled  
17 to a refund of the taxes which he has paid. And for the  
18 future, it is up to the state to decide whether it  
19 should extend the exemption to -- given by the state to  
20 its retirees to all federal retirees, or whether the  
21 state should tax both its own and federal retirees which  
22 is done by some other states.

23 If the Court has no further questions, I -- I  
24 have nothing further.

25 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Davis.

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The case is submitted.

(Whereupon, at 2:39 o'clock p.m., the case in the above-entitled matter was submitted.)

CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represents an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of The United States in the Matter of:

NO. 87-1020 - PAUL S. DAVIS, Appellant V. MICHIGAN DEPARTMENT OF TREASURY

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and that these attached pages constitutes the original transcript of the proceedings for the records of the court.

BY alan friedman  
(REPORTER)

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