No. 16-688

IN THE
Supreme Court of the United States

SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP.,
Petitioner,
v.
MICHIGAN DEPARTMENT OF TREASURY,
Respondent.

On Petition for a Writ of Certiorari to the Michigan Court of Appeals

BRIEF OF TAX FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF *AMICUS CURIAE*[1]

The Tax Foundation submits this brief as *amicus curiae* in support of Petitioner in the above-captioned matter.

[1] Pursuant to Supreme Court Rule 37.6, counsel for *Amicus* represents that it authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *Amicus* or its counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Pursuant to Rule 37.2(a), counsel for *Amicus* represents that all parties were provided notice of *Amicus's* intention to file this brief at least 10 days before its due date. Letters from the parties consenting to the filing of the brief have been obtained and filed with the Clerk of the Court.

The Tax Foundation is a non-partisan, non-profit research organization founded in 1937 to educate taxpayers on tax policy. Based in Washington, D.C., we seek to make information about government finance more accessible to the general public. Our analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability. The Tax Foundation's Center for Legal Reform furthers these goals by educating the legal community about economics and principled tax policy.

This Court's decision will provide guidance on the nature of retroactive tax legislation and to what extent such legislation is constitutional. Retroactive state tax laws play a vital role in defining the scope of state tax authority. Because *Amicus* has testified and written extensively on the issues involved in this case, because this Court's decision may be looked to as authority by the many state courts considering this issue, and because any decision will significantly impact taxpayers and state tax administration, *Amicus* has an institutional interest in this Court's ruling.

SUMMARY OF ARGUMENT

While the Due Process Clause of the Fourteenth Amendment provides protection from legislative overreach in the realm of retroactive state tax laws, the extent of this protection is unclear. Despite this Court's decision in *Carlton*, lower courts and State courts are divided in their evaluation of the constitutionality of retroactive tax laws. Many courts are upholding state laws with increasingly long periods of retroactivity, stretching the bounds of "legitimate purpose" and a "modest" period of retroactivity to the point where states can essentially do whatever they please, unsettling expectations and saddling taxpayers with years of unanticipated tax obligations.

Without a clear standard, this problem will only continue to proliferate. This case represents a clear opportunity for this Court to intervene and provide guidance on the Due Process limits of retroactive tax legislation.

ARGUMENT

I. THIS COURT'S GUIDANCE IS NEEDED TO ADDRESS THE TREND OF RETROACTIVE STATE TAX LAWS THAT NEITHER COMPORT WITH THE DUE PROCESS CLAUSE NOR THIS COURT'S DECISIONS.

This Court's decision in *Carlton* holds that "a tax statute's retroactive application must be supported by a legitimate legislative purpose furthered by rational means" in order to meet the requirements of Due Process. *United States v. Carlton*, 512 U.S. 26, 26 (1994). In *Carlton*, tax legislation was retroactively applied to correct a clear drafting error which created a loophole that would have caused significant and unexpected revenue loss. The mistake was noticed soon after the original statute was enacted and Congress moved to enact a curative retroactive amendment. The time period of retroactivity was a fourteen months. In its analysis, the Court in *Carlton* upheld the statute because (1) Congress' purpose in enacting the amendment was neither illegitimate nor arbitrary and (2) Congress acted promptly and established only a modest period of retroactivity. *Id.* at 32–33. These factors form a two-prong test to determine if a retroactive tax statute is constitutional under the Due Process Clause.

A. States Interpret *Carlton's* "Legitimate Purpose" Exception to Encompass Everything.

In *Carlton*, Justices Scalia and O'Connor worried that states might assert that any and all retroactive legislation is legitimate and of a curative nature. Justice Scalia in his concurrence in *Carlton* warned against using "post-legislation legislative history" to show that a measure is curative "despite the uncontested plain meaning of the statute." *Id.* at 39 (Scalia, J., concurring in the judgment). Justice O'Connor too expressed concern about curative measures, arguing that any new laws in an area where laws already exist "can be said to serve the legislative purpose of fixing a perceived problem." *Id.* at 36 (O'Connor, J., concurring in the judgment). These worries have proven true.

First, *Carlton* provides that retroactive legislation cannot be enacted for an "illegitimate" or "arbitrary" legislative purpose. In *Carlton*, the Court determined that the purpose for retroactively enacting the amendment was legitimate because it was "curative": Congress sought to correct a mistake that would have led to extreme and unanticipated revenue loss. In its reasoning, the Court in *Carlton* gave weight to the fact that a significant, unanticipated revenue loss was imminent and that it was obvious the drafters of the original statute did not intend to create a loophole.

Unfortunately, many courts interpret this to mean that any retroactive law that prevents revenue loss or raises funds automatically constitutes a legitimate legislative purpose. In such states, the bar is set very low when it comes to justifying retroactive tax statutes. For example, Washington courts have held valid a statute preventing unanticipated revenue loss with an eight-year retroactive period, but has also held valid a statute with a four-year retroactivity period where revenue loss was expected. *See In re Estate of Hambleton*, 335 P.3d 398 (Wash. 2014), *cert. denied*, 136 S. Ct. 318 (2015); *Dot Foods, Inc. v. Dep't of Revenue*, 372 P.3d 747 (Wash. 2016). Iowa courts have determined that protection of the public fisc alone is a legitimate legislative purpose. *See Zaber v. City of Dubuque*, 789 N.W.2d 634, 645 (Iowa 2010). The Ninth Circuit has held "preventing a loss of government revenue is a legitimate legislative purpose." *Mont. Rail Link, Inc. v. United States*, 76 F.3d 991, 994 (9th Cir. 1996). New York courts have upheld raising funds as a legitimate purpose so long as the revenue loss was unexpected. *See James Square Assoc., LP v. Mullen*, 993 N.E.2d 374, 383 (N.Y. 2013).

Second, state courts have expanded the definition of "curative" to encompass any change that brings the law into line with what is conjectured to be the purpose and intent contemplated by the drafters of the original statute. Taxpayers who have won judgments have seen their victories undone by "curative" retroactive tax laws enacted and then upheld by courts. *See, e.g.*, *Caprio v. N.Y. State Dep't of Taxation & Fin.*, 37 N.E.3d 707, *reargument denied*, 38 N.E.3d 817 (N.Y. 2015); *Miller v. Johnson Controls, Inc.*, 296 S.W.3d 392 (Ky. 2009); *Allegis Realty Investors v. Novak*, 860 N.E.2d 255 (Ill. 2006); *Ainley Kennels & Fabrication, Inc. v. City of Dubuque*, No. 15-1213, 2016 WL 5480688 (Iowa Ct. App. Sept. 28, 2016); *Jefferson Cnty. Comm'n v. Edwards*, 49 So. 3d 685 (Ala. 2010); *In re Estate of Hambleton*, 335 P.3d 398 (Wash. 2014), *cert. denied*, 136 S. Ct. 318 (2015); *Dot Foods, Inc. v. Dep't of Revenue*, 372 P.3d 747 (Wash.

2016), *as amended on denial of reconsideration* (Apr. 28, 2016); *U.S. Bancorp v. Dep't of Revenue*, 103 P.3d 85 (Or. 2004); *Gen. Motors Corp. v. Dep't. of Treasury*, 803 N.W.2d 698 (Mich. Ct. App. 2010); *Gillette Commercial Operations N. Am. & Subsidiaries v. Dep't of Treasury*, 878 N.W.2d 891 (Mich. Ct. App. 2015), *appeal denied*, 880 N.W.2d 230 (Mich. 2016). Only one state has struck down retroactive legislation: California. *See City of Modesto v. Nat'l Med, Inc.*, 27 Cal. Rptr. 3d 215, 222 (Cal. Ct. App. 2005).

Retroactive tax legislation to reverse an unfavorable court ruling is arbitrary and disrupts the separation of powers. The legislature should not be able to arbitrarily undermine the authority of the judiciary. If expected revenue loss alone is a legitimate purpose, anytime a court decides in favor of a taxpayer the legislature can essentially overturn the decision through legislation. States should not get a free pass to change settled outcomes retroactively decades later just because they left something ambiguous, unaddressed, or deliberately open to multiple interpretations or agency regulation.

In this case, unlike the drafting error in *Carlton*, Michigan deliberately adopted a Compact that restricted their power to adopt non-conforming tax apportionment formula rules. The provisions were plainly in the Compact were a major reason businesses supported its adoption, with Michigan trading away potentially higher tax revenues in order to gain the benefits of Michigan adhering to a more uniform multistate corporate tax system. Decades later, when a court ruling resulted in Michigan concluding the revenue losses exceeded the uniformity gains, they withdrew but did so retroactively. Despite no evidence that Michigan policymakers who adopted the Compact were unaware of the revenue impacts, the statute was upheld as curative to prevent unanticipated revenue loss.

The lack of clear rules on the constitutional limits of retroactive tax laws has led to courts pushing the boundaries of Due Process further and further. This case presents an opportunity for this Court to provide guidance as to whether preventing revenue loss or raising funds alone makes a retroactive statute legitimate, or if something more is required. This case also presents an opportunity for this Court to address whether "curative" retroactive changes encompass provisions deliberately adopted but left ambiguous, or provisions (or court interpretations of those provisions) later legislators decide they now do not like.

B. Lower Courts Are Divided On How Many Years of Retroactivity is Permissible Under the Due Process Clause.

Carlton calls for a "modest" period of retroactivity, 512 U.S. at 27, and this Court has yet to uphold a retroactive tax statute that reaches back more than one or two years. *See Nichols v. Coolidge*, 274 U.S. 531, 543 (1927) (holding that a twelve-year retroactive period violated Due Process). In her concurrence in *Carlton*, Justice O'Connor stated that any longer time period would raise grave constitutional questions. *See Carlton*, 512 U.S. at 38 (O'Connor, J., concurring).

Despite this, there are a variety of different ideas among states as to what constitutes a "modest" time period. Some states have limited the scope of tax retroactivity. In South Carolina, a two to three-year retroactivity period is "simply excessive." *Rivers v. State*, 490 S.E.2d 261, 265 (S.C. 1997). New York generally only upholds statutes with a one-year period of retroactivity. *Mullen*, 993 N.E.2d at 382–83. Iowa has adopted a two-year bright line rule only for non-curative measures. *See Ainley Kennels & Fabrication, Inc. v. City of Dubuque*, No. 15-1213, 2016 WL 5480688, at *6 (Iowa Ct. App. Sept. 28, 2016).

Other state courts have upheld longer periods of retroactivity, some stretching a decade. Kentucky applies a very broad "facts and circumstances" test and has upheld retroactive periods of over ten years. *See Miller v. Johnson Controls, Inc.*, 296 S.W.3d 392, 392 (Ky. 2009). Washington permitted retroactive periods of eight years. *See In re Estate of Hambleton*, 335 P.3d at 411. In one Washington case, the court upheld a statute that reached back twenty-seven years, although the statute of limitations limited the period of retroactivity to four years. *See Dot Foods, Inc.*, 372 P.3d at 751. Circuit courts have also weighed in on the issue. The Ninth Circuit has upheld retroactive periods of up to six years. *See Mont. Rail Link, Inc.*, 76 F.3d at 993.

Some states have experienced changes in their rules limiting retroactivity. In California, courts had generally only allowed a one-year period of retroactivity. *See Nat'l Med, Inc.*, 27 Cal. Rptr. 3d at 222. However, some California courts now use a "facts and circumstances" test and retroactivity periods of up to four years have been upheld. *See River Garden Ret. Home v. Franchise Tax Bd.*, 113 Cal. Rptr. 3d 62, 80 (Cal. Ct. App. 2010).

Furthermore, what constitutes a modest time period for curative measures differs greatly compared to non-curative measures. Arizona permits any period of retroactivity as generally comporting with Due Process so long as the statute is curative. *See Enter. Leasing Co. of Phx. v. Ariz. Dep't of Revenue*, 211 P.3d 1, 4 (Ariz. Ct. App. 2008). New York generally only permits a retroactivity period of one year for non-curative measures. *See Mullen*, 993 N.E.2d at 382–83. On the other hand, New York has upheld curative measures with much longer periods of retroactivity. *See Caprio*, 37 N.E.3d at 716–17.

In the case at bar, the Michigan Court of Appeals upheld a period of retroactivity of six-and-a-half years. The Michigan Court of Appeals did not try to ascertain what time period would violate Due Process. By choosing to leave that question open, the Michigan Court of Appeals encourages the Michigan legislature to pass measures with increasingly long periods of retroactivity.

States are split, with some adhering to the temporal standard suggested in *Carlton* while others uphold longer and longer periods of retroactivity by pointing to similar time periods previously upheld. Such an expansion is dangerous, depriving taxpayers of reliance on the laws as they exist now, not as they may be changed to have retroactively meant at some point in the future. *Cf. Carlton*, at 512 U.S. at 40 (Scalia, J., concurring in the judgment) ("[I]n the case of a tax-incentive provision, as opposed to a tax on a continuous activity (like the earning of income), the critical event is the taxpayer's reliance on the incentive, and the key timing issue is whether the change occurs after the reliance; that it occurs immediately after rather than long after renders it no less harsh.")

Guidance is needed on the permissible temporal limits on tax retroactivity. This case also presents a vehicle for this Court to clarify whether the curative or non-curative nature of a retroactive tax measure affects the temporal limits permitted under the Due Process Clause.

CONCLUSION

For the foregoing reasons, *Amicus* respectfully requests that this Court grant the petition for certiorari.

Respectfully submitted,

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