No. 09-981

IN THE

Supreme Court of the United States

JOHNSON CONTROLS, INC.; SECURITY GROUP, INC. AND SUBSIDIARIES, INCLUDING SARGENT & GREENLEAF, INC.; WILLIS NORTH AMERICA, INC. AND AFFILIATES; BUNZL USA, INC. AND SUBSIDIARIES INCLUDING MAK-PAK, INC.; TREDEGAR CORPORATION, INC. AND SUBSIDIARIES; RAYCOM TV BROADCASTING, INC., AS SUCCESSOR-IN-INTEREST OF COSMOS BROADCASTING CORPORATION AND AFFILIATES,

Petitioners,

v.

JOHNATHAN MILLER, SECRETARY OF THE FINANCE AND ADMINISTRATION CABINET OF THE COMMONWEALTH OF KENTUCKY; COMMONWEALTH OF KENTUCKY, DEPARTMENT OF REVENUE,

Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of Kentucky

BRIEF OF *AMICUS CURIAE* INSTITUTE FOR PROFESSIONALS IN TAXATION IN SUPPORT OF PETITIONERS

CASS D. VICKERS
State Tax Counsel
INSTITUTE FOR PROFESSIONALS IN TAXATION
1200 Abernathy Rd. NE
Bldg. 600, Suite L-2
Atlanta, GA 30328
(850) 907-0692

ROBERT S. GOLDMAN *
MARK E. HOLCOMB
DEBORAH A. LACOMBE
MADSEN GOLDMAN & HOLCOMB, LLP
1705 Metropolitan Blvd.
Suite 101
Tallahassee, FL 32308
(850) 523-0400
rgoldman@mgh-law.com

* Counsel of Record

Counsel for Amicus Curiae

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

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STATEMENT OF INTEREST OF AMICUS CURIAE

This brief *amicus curiae* in support of Petitioners, Johnson Controls, Inc., et al., is filed by the Institute for Professionals in Taxation ("IPT").[1] IPT is a non-profit educational organization formed in 1976 under the laws of the District of Columbia. Its offices are located in Atlanta, Georgia. IPT's organizational purposes include the promotion of uniform and equitable administration of income, ad valorem, and sales and use taxes. It has more than 4,400 members representing more than 1,400 businesses across the United States and in Canada. Represented within IPT's membership are numerous small businesses and most of the Fortune 500 companies. Member representation spans the industry spectrum, including aerospace, agriculture, manufacturing, wholesale and retail, communications, health care, financial, oil and gas, hospitality, transportation, and other sectors.

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[1] Pursuant to Supreme Court Rule 37, *amicus curiae* Institute for Professionals in Taxation states that no counsel for a party has written this brief in whole or in part and that no person or entity, other than *amicus curiae,* its members, or counsel, has made a monetary contribution to the preparation or submission of this brief. Counsel of record for all parties have received timely notice of the intent to file this brief, and all parties have consented to the submission of this brief in letters filed with the Clerk.

IPT members pay income taxes and other taxes and routinely file tax returns, amended returns, and refund claims in jurisdictions in which they operate. They are generally subject to taxing systems that, like Kentucky's, strongly encourage taxpayers to report and pay taxes in accordance with the positions of the revenue authorities. Accordingly, post-payment refund remedies are important to them. They are concerned at the prospect of a jurisprudence that permits such remedies to be extinguished, particularly on a selective basis as occurred in this case, through the expedient of refusing to pay refunds. If states that offer a refund remedy are free later to disavow it, this Court's due process precedents become meaningless, and corporate tax practices developed in reliance on those precedents have no value.

Unlike state tax issues arising under the Commerce Clause, the issues presented here cannot be resolved by Congress. The guidance of this Court is needed and IPT supports Petitioners in seeking it.

SUMMARY OF THE ARGUMENT

Kentucky has directly contravened this Court's precedents governing the deprivation of property interests without due process, including tax precedents such as *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco,* 496 U.S. 18 (1990), and *Reich v. Collins*, 513 U.S. 106 (1994), by amending its statutes to prohibit the payment of a select group of refunds. Extinguishing the right to a timely-sought, lawful refund is a confiscation of property. The year 2000 amendments to Kentucky Revised Statutes ("KRS") section 141.200 are not economic legislation, but are rather a repudiation of the Commonwealth's legal obligations. *United States v. Carlton*, 512 U.S. 26 (1994), has no bearing on Kentucky's attempt to destroy property rights created under Kentucky law. The legislation also re-classifies taxpayers and refund claims in several ways, with no rational basis, in violation of the Equal Protection Clause.

The Court should grant certiorari, not only to enforce its own precedents, but also to prevent states from refusing to honor valid taxpayer refund claims and disregarding *McKesson's* guarantees of meaningful backward-looking relief.

ARGUMENT

Introduction

When the dust settled after a lengthy period of confusion and conflict within the organs of Kentucky government,[2] the result was that for years prior to

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[2] Viewing the pronouncements of the executive, legislative, and judicial branches collectively, corporate taxpayers were told first that combined returns for unitary groups were permitted; then that such returns were not permitted; then that such returns were either required or permitted (it is not clear which); then that such returns would not be permitted for future years; then that some returns that had previously been

December 31, 1995, any unitary group of corporations could report and pay Kentucky corporate income taxes on a combined basis *except* for a few disfavored companies whose timely amended returns, some of which had been pending for several years, were legislatively extinguished.

As explained in the Petition and the opinion below, the controversy was spawned by the Kentucky Revenue Cabinet's 1988 reversal of a longstanding interpretation of Kentucky law. *See Miller v. Johnson Controls, Inc.*, 296 S.W.3d 392, 393-394 (Ky. 2009). Specifically, Revenue Policy 41P225 (November 27, 1988) declared that unitary groups could no longer file combined income tax returns. In a decision dated December 22, 1994, the Kentucky Supreme Court rejected the Cabinet's position, *GTE v. Revenue Cabinet*, 889 S.W.2d 788 (Ky. 1994).

Before and after the *GTE* decision, corporations that initially filed separately amended their prior income tax returns to report on a combined basis, and sought refunds. *See Johnson Controls*, 296 S.W.3d at 394. In the year 2000, the Kentucky General Assembly amended KRS 141.200 to extinguish the refund claims filed after the date of *GTE*. 2000 Ky. Acts ch. 543.

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filed for prior years were not permitted, while others filed for the same years were permitted.

Corporations that filed returns on a combined basis prior to December 22, 1994, acted in direct contravention of the position of the Kentucky Revenue Cabinet announced in Revenue Policy 41P225. However, these corporations were allowed to retain any benefit of combined filing. Further, some of the companies that had originally filed separate returns in compliance with the Cabinet's directives, and filed combined amended returns seeking refunds after December 22, 1994, received refunds. Others, including Petitioners, were denied refunds. The benefits of combined filing were bestowed and withheld arbitrarily, with no principle distinguishing the favored and disadvantaged classes. The Supreme Court of Kentucky upheld these results. *Johnson Controls,* 296 S.W.3d at 403.

This case does not involve any assertion of a general constitutional right, independent of state law, to file combined state income tax returns. The issue here is the evisceration of a due process remedy available under state law and required by this Court's precedents, and the selective punitive treatment of some unitary groups that filed combined returns in accordance with state law.

These circumstances present issues of due process and equal protection. IPT offers the following relevant matter that has not been brought to the attention of the Court.[3]

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[3] The Kentucky courts apparently never determined whether Petitioners' groups were unitary. Presumably because the 2000

I.
Procedural Due Process

A. Protection is not limited to federal constitutional violations.

When a state seeks to deny continued enjoyment of a recognized property interest, it must provide an opportunity to contest the grounds of the denial. *See e.g., Fuentes v. Shevin*, 407 U.S. 67, 80-81 (1972) (prejudgment writ of replevin); *Perry v. Sindermann*, 408 U.S. 593, 603 (1972) (termination of employment despite *de facto* tenure program); *Goss v. Lopez*, 419 U.S. 565, 572 (1975) (suspension from public school system); *Memphis Light, Gas & Water Div. v. Craft*, 436 U.S. 1, 11 (1978) (discontinuation of municipal utility service); *Barry v. Barchi*, 443 U.S. 55, 64-66 (1979) (suspension of horse trainer's license); *Bell v. Burson*, 402 U.S. 535, 539 (1971) (suspension of driver's license); *Goldberg v. Kelly*, 397 U.S. 254, 261-263 (1970) (termination of public assistance benefits). As this Court has explained: "For when a person has an opportunity to speak up in his own defense, and when the State must listen to what he has to say, substantively

amendments to KRS 141.200, if constitutional, would be dispositive and render unnecessary any inquiry into the existence of unitary relationships, the parties and the courts focused on the validity of the legislation. IPT will do so as well, effectively assuming that Petitioners were unitary groups.

unfair and simply mistaken deprivations of property interests can be prevented." *Fuentes,* 407 U.S. at 81.

Property interests have their sources outside the Constitution. "[T]hey are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law-rules or understandings that secure certain benefits and that support claims of entitlement to those benefits." *Board of Regents v. Roth,* 408 U.S. 564, 577 (1972) (noting also, at page 571, that the wooden distinction between "rights" and "privileges" concerning the applicability of procedural due process protections has been rejected). The Court has recognized that claims are protected property interests. *See Mullane v. Central Hanover Bank & Trust Co.,* 339 U.S. 306, 313 (1950) (claim against trustee); *Richards v. Jefferson County, Ala.*, 517 U.S. 793, 804 (1996) ("chose in action").

The rule requiring an opportunity to be heard also applies in the context of taxation. "Because exaction of a tax constitutes a deprivation of property, the State must provide procedural safeguards against unlawful exactions in order to satisfy the commands of the Due Process Clause." *McKesson,* 496 U.S. at 36. In other words, there must be a procedural mechanism for the taxpayer to contest the tax. As this Court observed in *Richards*: "Whether acting through its judiciary or through its legislature, a State may not deprive a person of all existing remedies for the enforcement of a right, which the State has no power to destroy, unless there is, or was, afforded to him some real opportunity to protect it." *Richards,* 517 U.S. at 804 (quoting *Brinkerhoff-Faris Trust & Savings Co. v. Hill,* 281 U.S. 673, 681-82 (1930)).[4]

To maintain, as have the Commonwealth and its high court, that the due process right to contest taxation exists only when the disputed taxes violate another federal constitutional limitation, is to disregard not only the language of *McKesson* but also the large body of jurisprudence relating to deprivation of property interests. The Due Process Clause guarantees procedural rights regardless of whether the objection to termination of employment, to revocation of a license, or to exaction of a tax, is based on federal constitutional grounds or upon other grounds. *See McKesson,* 496 U.S. at 39 (holding the state must provide a clear and certain remedy for "any erroneous or unlawful tax collection"). Although a denial of due process is *unconstitutional, it can arise out of state action that* violates no other constitutional guarantee. "Any significant taking of property by the State is within the purview of the Due Process Clause." *Fuentes,* 407 U.S. at 86.

[4] There could be a variety of reasons for objecting to a tax, including a claim that the law does not impose the tax asserted; that the taxpayer did not engage in the activity taxed; that an exemption is available; that the tax was previously paid; or that the tax was incorrectly computed.

The Kentucky Supreme Court's incorrect interpretation of due process law generally, and of *McKesson* in particular, would inevitably mean that the Due Process Clause of the Fourteenth Amendment provides no protection against erroneous or unlawful state taxes absent another federal constitutional violation. But the Amendment by its terms operates against the states, and protects against deprivations of property without due process, entirely on its own. It does not merely admonish the states against violating other provisions of the Constitution.

Under Kentucky's view of due process, a state could constitutionally provide no remedy at all for taxes collected in violation its law. A state taxing authority's assertion that a tax is due would be conclusive. Similarly, a tax based on a statute that violates a state constitution would be immune from federal due process scrutiny. In the entire realm of human and commercial activity, deprivations through taxation would alone be subject to this special exception from the requirements of due process. And a state remedy statute implementing it would be an impractical oddity, containing provisions limiting its availability to taxpayers that object to a tax on federal constitutional grounds.

The majority opinion below devotes no attention to these remarkable and unworkable consequences of its constitutional theory. Also missing is any response to the dissent of Justice Abramson, which examines the precedents cited in *McKesson* and concludes that "a tax exacted in violation of state law, no less than one in violation of federal law, raises the exact same due process concerns and requires the same meaningful procedural safeguards." *Johnson Controls,* 296 S.W.3d at 414 (Abramson, J., dissenting).

The Kentucky court's interpretation of *McKesson* is central to its holding that the 2000 amendments to KRS 141.200 are constitutional. After noting that *GTE* did not involve a federal constitutional challenge,[5] the Kentucky Supreme Court in the opinion below opined that this leads to the application of the deferential standard for economic legislation, as explicated in *Carlton*: "Since constitutionality was not involved, the analysis then goes from deprivation of property without due process of law to the well-established analysis of when and how the government may enact economic legislation, specifically revenue-controlling legislation, under the *Carlton* line of cases." *Johnson Controls*, 296 S.W.3d at 402. Conversely, if the lower court's narrow view of *McKesson* is incorrect, that decision is dispositive, the 2000 amendments to KRS 141.200 are unconstitutional, and there is no need to resort to an analysis under *Carlton.*

[5] Notably, the court pointed to the basis for the claim in *GTE* rather than the present case, which raises, in addition to a due process objection, a federal equal protection claim.

The holding by a state's highest court that the Due Process Clause only protects against violations of other federal constitutional provisions is of substantial concern to IPT. This Court should grant certiorari and put that contention to rest.

B. Parameters of the due process right

The nature of the remedy that due process requires varies with the circumstances. *Mathews v. Eldridge*, 424 U.S. 319, 332-334 (1976). In some cases the remedy must be available prior to the deprivation; in other cases a post-deprivation remedy is sufficient. *Id.* Again, the same is true in the context of taxation. This Court has not required states to provide a pre-deprivation remedy for contesting state taxes in all cases. A post-deprivation remedy may suffice. As observed in *McKesson*:

> Allowing taxpayers to litigate their tax liabilities prior to payment might threaten a government's financial security, both by creating unpredictable interim revenue shortfalls against which the State cannot easily prepare, and by making the ultimate collection of validly imposed taxes more difficult. To protect government's exceedingly strong interest in financial stability in this context, we have long held that a State may employ various financial sanctions and summary remedies, such as distress sales, in order to encourage taxpayers to make timely

> payments prior to resolution of any dispute over the validity of the tax assessment.

McKesson, 496 U.S. at 37 (footnote omitted).

Although the Due Process Clause permits a state to offer only a post-deprivation remedy for unlawful taxes, such a remedy must be meaningful:

> If a State places a taxpayer under duress promptly to pay a tax when due and relegates him to a postpayment refund action in which he can challenge the tax's legality, the Due Process Clause of the Fourteenth Amendment obligates the State to provide meaningful backward-looking relief to rectify any unconstitutional deprivation.

McKesson, 496 U.S. at 31 (footnotes omitted). In cases like *McKesson*, where the illegality of the tax stems from discrimination against interstate commerce, a refund is not the only constitutionally acceptable way to correct the discriminatory treatment. However, the remedy must be *meaningful*. "In the end, the State's postdeprivation procedure would provide petitioner with all of the process it is due: an opportunity to contest the validity of the tax and a 'clear and certain remedy' designed to render the opportunity meaningful by preventing any permanent unlawful deprivation of property." *Id.* at 40.

In some cases both pre-deprivation and post-deprivation remedies are available, and states have argued, after a taxpayer has chosen the post-deprivation remedy, that the tax should have been contested prior to payment. This Court has rejected such contentions. "[A] State may not 'bait and switch' by 'hold[ing] out what plainly appears to be a 'clear and certain' postdeprivation remedy and then declare, only after the disputed taxes have been paid, that no such remedy exists.'" *Newsweek, Inc. v. Florida Dep't. of Revenue*, 522 U.S. 442, 444 (1998) (quoting *Reich*, 513 U.S. at 108, 111) (second alteration in original). Although a state may require taxpayers to litigate first and pay later, it cannot apply such a requirement to a taxpayer who "reasonably relied on the apparent availability of a post-payment refund when paying the tax." *Newsweek*, 513 U.S. at 445. In this regard, it does not matter when or how the taxpayer became aware that the taxes in question were not due, provided he seeks a refund within the limitations period prescribed for refunds. *See Reich*, 513 U.S. at 113.

The following principles emerge from this Court's precedents:

- A state must provide taxpayers with a meaningful remedy for contesting a tax;

- If a state places a taxpayer under duress to pay a tax before contesting it, there must be a post-payment remedy that provides meaningful backward-looking relief; and

- Regardless of the adequacy of a state's pre-deprivation remedies, if it holds out a post-payment refund remedy, it cannot, after the taxes have been paid, deny the availability of that remedy.

Kentucky strongly encourages taxpayers to pay the tax and seek relief by way of refund claim later. *See Revenue Cabinet v. Gossum*, 887 S.W.2d 329, 332 (Ky. 1994) ("Kentucky's system is structured so that a taxpayer is coerced into paying the tax in advance to avoid financial sanctions."). Kentucky not only held out a refund remedy for Petitioners to invoke, but it provided strong incentives for them to use that remedy rather than adopt a more advantageous filing position which would have enabled them to withhold the taxes they now seek to recover. A state cannot on the one hand virtually compel taxpayers to rely on the post-deprivation remedy of a refund claim, and then withdraw that remedy after it has been properly invoked.

A failure to appreciate this is one of the flaws in the Kentucky Supreme Court's reliance on *United States v. Carlton*. Quoting the *Carlton* passage that "tax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code," *Carlton*, 512 U.S. at 33, the court below found no due process violation in this case. *Carlton* is entirely inapplicable to this case, as discussed below. It is sufficient to point out here that the availability of Kentucky's post-deprivation remedy is a matter of constitutional imperative under *McKesson* and *Reich.* To say, as does the majority below, that due process is satisfied because the amendments to KRS 141.200 "took away the *dispute,*" *Johnson Controls,* 296 S.W.3d at 403, does not resolve the constitutional problem. The Commonwealth's mechanics and semantics notwithstanding, Kentucky denied Petitioners the meaningful backward-looking relief *McKesson* requires.

The Court should grant certiorari and make clear that this is not permissible.

C. <u>The due process violation in this case is egregious.</u>

The published position of the Kentucky Revenue Cabinet at the time Petitioners filed their original returns for the years in question was that they were *required* to file separate returns, Revenue Policy 41P225, and they complied. *Johnson Controls,* 296 S.W.3d at 393-394. The Cabinet's position was repudiated by the Kentucky Supreme Court in *GTE v. Revenue Cabinet,* which held that the income of a unitary group "*must* be calculated on the combined unitary business for the group as a whole." *GTE,* 889 S.W.2d at 793 (emphasis added).[6] Petitioners

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[6] The *GTE* opinion also inconsistently stated that "KRS 141.120 and the decisions of this court *authorize* multiple corporations

thereupon complied with the Kentucky Supreme Court's interpretation of the law and filed amended returns, which in their circumstances resulted in lower aggregate tax liabilities and consequent claims for refund.

Simply stated, the essence of the situation was this: Petitioners had overpaid their taxes due to compliance with an erroneous directive from the Revenue Cabinet. Kentucky has a refund statute for taxpayers to recover overpaid taxes, which, if given effect, would be responsive to the requirements of *McKesson* and *Reich* for meaningful backward-looking relief. Petitioners timely sought this remedy.

The opinion below states that Petitioners' original separate returns "were not illegal, and certainly could have been the chosen method, even under *GTE,* if they would have been to the [Petitioners'] advantage." *Johnson Controls,* 296 S.W.3d at 402. That statement does not square with the same court's "must" language in *GTE*. It is also beside the point under *McKesson* and its progeny. *GTE* established that unitary groups had a right to file combined returns, which in Petitioners' case resulted in reduced tax liabilities and therefore refund claims. Despite the forceful entreaties of the Commonwealth in the proceedings below, the Kentucky Supreme Court has not overruled *GTE*. Under Kentucky law Petitioners' right (if not the

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engaged in a unitary business to file combined income tax returns." *GTE*, 889 S.W.2d at 791 (emphasis added).

duty) to file on a combined basis was unaffected by whether they did so originally or by timely amended returns filed before or after *GTE*. Petitioners have a due process right to the refunds that they properly claimed under the Kentucky refund statute. [7]

Had Petitioners filed their original returns on a combined basis, they would have acted in direct contravention of the Revenue Cabinet's admonition against doing so and risked sanctions. The sanctions reflect Kentucky's preference that taxpayers pursue post-deprivation remedies. As this Court observed in commenting on the Georgia system, "this preference is significant in that it would seem especially unfair to penalize taxpayers who may have ignored the possibility of pursuing predeprivation remedies out of respect for that preference." *Reich*, 513 U.S. at 112.

Kentucky's action in this case is precisely what the Court admonished against in *Reich* If in filing their original returns Petitioners had not deferred to the Commonwealth's preference that taxpayers pursue post-deprivation remedies but instead

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[7] Whether combined or separate reporting is more advantageous to a unitary group depends upon group characteristics. However, *GTE* is fairly read as requiring all unitary groups to file combined returns. The opinion below does not disclose whether there were any unitary groups that originally filed separately, but amended their returns and paid additional taxes after *GTE* in compliance with the "must" language of that decision, with the result that the Commonwealth benefited from that language.

disregarded Revenue Policy 41P225, they would never have parted with the monies that are in dispute here. They would have filed originally on a combined basis, in compliance with the law as later announced in *GTE*. They would have been unaffected by the amendments to KRS 141.200 several years later, which permitted groups that filed original returns on a combined basis to retain the benefits of combined reporting. In short, they would not have been deprived of property.

Petitioners' decision to pay first and then seek refunds does not deprive them of the post-payment refund rights that were available to them. They had as much reason to rely on the refund statute as the taxpayers in *Newsweek* and *Reich*. The remedy appeared "clear and certain." *See McKesson,* 496 U.S. at 39 (citing *Atchison T. & S.F.R. Co. v. O'Connor*, 223 U.S. 280, 285) (1912)). The Commonwealth had the prerogative to inquire into whether Petitioners' groups were truly unitary, but if they were unitary it had no prerogative to deny the claims. The refund claims are valuable property rights. They came into existence because the taxes were paid under duress, because Kentucky law expressly provided a refund remedy, and because of the constitutional imperative that Kentucky afford taxpayers meaningful backward-looking relief.

The refund claims received no action for years, although refunds were apparently issued to other unitary groups filing amended returns to report on a combined basis for the same tax years. Then, in the year 2000, KRS 141.200 was amended and ordained that these refund claims were not to be "effective or recognized for any purpose." So, rather than the "meaningful backward-looking relief" to which Petitioners were entitled under the Due Process Clause and under Kentucky law as it existed at all times prior to the 2000 enactment, they received no relief.

The facts here are more egregious than in *Reich*. Here, the clear and certain refund remedy existed, but was eradicated after a protracted period of inaction. Petitioners were essentially penalized for complying with the published edict of the revenue agency, while unitary groups acting contrary to that edict were rewarded. Kentucky's position here amounts to saying that Petitioners should have invoked the pre-deprivation remedy of filing its original returns on a combined basis. But Kentucky held out a post-deprivation remedy, its own Supreme Court describes its statutory scheme as coercing taxpayers to use the post-deprivation remedy, and that same Supreme Court upheld the right of unitary groups to file combined returns. This is not merely "bait and switch," *Reich,* 513 U.S. at 11. It is bait, coerce, bait again, switch, and discriminate.

The fact that Kentucky's tax code, as established, implemented, and interpreted by its three branches of government, has exposed the Commonwealth to refund claims that were evidently not anticipated is a subject of appropriate legislative action. However, the solution is not to refuse payment of valid refund claims. Protecting the state treasury is an objective that serves Kentucky society as a whole, and is not properly made the burden of a few taxpayers. The Due Process Clause requirement for meaningful relief does not depend on its being convenient or inexpensive. As the dissent below observes, "Simply put, difficult economic consequences can never justify disregarding citizens' due process rights." *Johnson Controls,* 296 S.W.3d at 421 (Abramson, J., dissenting).

If the action of Kentucky is lawful, any state can improve its budget position by enacting a law that discontinues making tax refunds, including valid refunds to which taxpayers are entitled under state law and *McKesson.* These refunds are not a discretionary government program that a state can simply choose not to fund. They are obligations that must be honored. And although it may be possible to quantify the dollar amount of refund claims, this does not make any refund claimant, including Petitioners in this case, any more responsible for the condition of the treasury than thousands of other items of revenue and expense that affect it.

In the exercise of the taxing power, a state has the prerogative to prescribe whether corporations file returns on a separate or combined basis. But the power exercised in this case is of a different character. The Commonwealth simply decided first to delay action on claims that were legitimate under its own law, and then to extinguish them entirely. This was an appropriation of the property of a few for the benefit of the Commonwealth as a whole. It was not taxation, but confiscation.

In explaining that it views this case as distinguishable from *Reich* because here the legislature "took away the *dispute,*" *Johnson Controls,* 296 S.W.3d at 403, the Kentucky Supreme Court's choice of the verb "took" was correct. What was taken, however, were the valuable refund rights of every unitary group that had unsuccessfully sought such refunds. These are the dispositive facts that require relief.

This Court should grant certiorari and decide that the liquidation of a select group of refund claims, in direct contravention of pre-existing state law, is a confiscation of property, and is not properly clothed as an exercise of the taxing power.

D. <u>The amendments to KRS 141.200 are not "economic legislation" and *Carlton* is irrelevant.</u>

As discussed previously, the court below deemed *McKesson* inapplicable because "constitutionality was not involved" in *GTE,* and then proceeded to characterize the contested amendments to KRS 141.200 as "economic legislation, specifically revenue controlling legislation, under the *Carlton* line of cases." *Johnson Controls*, 296 S.W.3d at 402. The opinion below discusses *Carlton* and "retroactive tax legislation" at length and purports to apply the analysis to this case. However, *Carlton* is inapposite, and the lower court's reasoning is strained.

The 2000 amendments to KRS 141.200 are not "economic legislation" and do not "raise and control revenue," except in the same way that discontinuation of payments to a state's vendor for services or supplies would fit those characterizations. Petitioners' refund claims represent obligations of the State, and cannot, consistently with *McKesson*, be renounced. Similarly, to describe the 2000 amendments to KRS 141.200 as "tax legislation," retroactive or otherwise, is also a stretch. The amendments do not impose or repeal a tax, change a rate, or modify a tax base. They do not deem all combined returns unlawful or all separate returns lawful for the years at issue. They do little more than refuse to honor a specific category of valid claims, to vaporize, with a stroke of the political pen, refunds required under Kentucky law and the Constitution.

The opinion below deems this case comparable to *Carlton* and unlike *McKesson* and *Reich*. *Johnson Controls*, 296 S.W.3d at 402-403. This is backwards. *Carlton* involved a retroactive amendment to a generally applicable tax statute. It did not involve legislative obliteration of a valid claim against the government, or a government's action arbitrarily denying the benefits to some taxpayers of a filing position that was allowed to others, or a government action effectively penalizing some taxpayers for filing in accordance with an erroneous position of the revenue authorities. And it did not involve multiple "shifting interpretations," *Johnson Controls,* 296 S.W.3d at 394, regarding what was expected, required, or permitted from taxpayers.

Still further, in *Carlton* this Court took pains to explain how the amendment at issue there was curative; that it was intended to capture Congress' intent in enacting legislation a year earlier; and that to address its own error "Congress acted promptly and established only a modest period of retroactivity." *See Carlton*, 512 U.S. at 32. Here, Kentucky had allowed combined returns for sixteen years, with no legislative change. Then, its revenue agency's attempt to reverse that position was rejected in *GTE.* No relevant legislative change occurred during the pendency of that case. The Kentucky Supreme Court decided *GTE* on December 22, 1994, and the contested amendments to KRS 141.200 were not adopted until six years and three legislative sessions later. This can hardly be deemed "curative" or intended to reflect the legislature's original intent,[8] or "prompt," or establishing a "modest" period of retroactivity.

The Court's *Carlton* opinion also quotes from prior decisions which describe the due process test for retroactive tax legislation as whether "retroactive

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[8] Unlike Congress in the *Carlton* case, the 2000 Kentucky General Assembly amended a law several decades old, and was in no position to know the original legislative intent. Of course, it had acquiesced in combined filing for sixteen years.

application is so harsh and oppressive as to transgress the constitutional limitation." *See Welch v. Henry*, 305 U.S. 134, 147 (1938). It would seem that by any measure, a law extinguishing refund claims occasioned by a system that the State's own highest court describes as coercive, would qualify as harsh and oppressive.

In these material respects, this case is not like *Carlton*. And in the most important respect, the denial of meaningful backward-looking relief, it is just like *McKesson* and *Reich*. Indeed, to maintain that *Carlton* is applicable at all is to bring it into direct conflict with *McKesson* and all its progeny. Retroactive imposition of a tax is fundamentally different than destroying refund rights afforded under a longstanding statutory scheme.

This Court should grant certiorari and clarify that *Carlton* in no way undermines *McKesson* and that *McKesson* is the jurisprudence governing attempted retroactive stripping of refund rights. The political nullification of such rights is not "economic legislation."

II.
Equal Protection

In examining state action under the Equal Protection Clause, it is the *classification* that must rationally further a legitimate state interest. *Nordlinger v. Hahn*, 505 U.S. 1, 10 (1992). In giving short shrift to Petitioners' equal protection objections, the Kentucky Supreme Court treated the rational basis inquiry under the Equal Protection and Due Process Clauses as though they were identical, and afforded no analysis of the rationality of the classification.

Despite the unquestioned latitude states are allowed in classifying the subjects of taxation, the rational basis test is not a euphemism for no test at all. In *Williams v. Vermont,* 472 U.S. 14 (1985), the Court determined that a classification distinguishing resident and nonresident purchasers of vehicles for purposes of a tax credit was irrational under the Equal Protection Clause. Despite the contention that the discrimination should be sustained because it was rationally related to the legitimate state purpose of raising revenues, the Court found that "[t]he *distinction* between [the classes] bears no relation to the statutory purpose." *Williams,* 472 U.S. at 24 (emphasis added). In response to the contention that all within the disfavored class were treated the same, the Court observed:

> Yet the fact that all those not benefited by the challenged exemption are treated equally has no bearing on the legitimacy of that classification in the first place. A State cannot deflect an equal protection challenge by observing that in light of the statutory classification all those within the burdened class are similarly situated. The classification must reflect pre-existing

> differences; it cannot create new ones that are supported by only their own bootstraps.

Id. at 27. The quoted text is not limited to discrimination based on residency. A classification must be measured against the objective, and must be based upon pre-existing differences.

Kentucky's actions in this case produced many different classes. As the Petition points out, there is the class of corporate taxpayers that disregarded the Revenue Cabinet's 1988 directive and filed corporate returns on a combined basis. Their filing positions were left undisturbed, and those whose tax liabilities were lower on a combined reporting basis have retained the benefit that Petitioners have been denied through nullification of their refund claims. A second class consists of corporate groups that originally filed separate returns, then filed amended returns after *GTE* but before KRS 141.200 was amended in the year 2000. This group obtained refunds. Taxpayers in a third class also filed original separate returns and filed amended returns after *GTE,* but were issued refunds even after KRS 141.200 was amended in 2000. The fourth class identified in the Petition consists of claimants, including Petitioners, that filed original returns on a separate basis in compliance with the instruction of the Revenue Cabinet, filed amended returns shortly after *GTE* was decided, and have had their refunds denied following the 2000 amendments to KRS 141.200. These companies differ from the second class only in that their refunds were denied.

For the years at issue, the State's approach ultimately approved reporting and payments of Kentucky tax by any unitary group of corporations on a combined basis, *except* for a few disfavored companies. This "class" complied with the erroneous 1988 Revenue Cabinet directive and its timely amended returns, after having been pending for several years, were legislatively extinguished. The *classification* is entirely arbitrary, the antithesis of "rational."

Another classification inherent in this case is the distinction between Petitioners and all other Kentucky taxpayers that had meritorious refund claims pending at the time KRS 141.200 was amended. As a matter of Kentucky law they were identically situated. Carving out a few to effectively indemnify the state treasury was entirely arbitrary. This was not a classification that reflected "pre-existing differences," *Williams,* 472 U.S. at 27, under the governing statutes.

The Court should grant certiorari and reaffirm that even under the deferential rational basis level of scrutiny, purely arbitrary classifications that are not consistent with a state's own law violate the Equal Protection Clause.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

CASS D. VICKERS
State Tax Counsel
INSTITUTE FOR PROFESSIONALS
IN TAXATION
1200 Abernathy Rd. NE
Bldg. 600, Suite L-2
Atlanta, GA 30328
(850) 907-0692

ROBERT S. GOLDMAN *
MARK E. HOLCOMB
DEBORAH A. LACOMBE
MADSEN GOLDMAN &
HOLCOMB, LLP
1705 Metropolitan Blvd.
Suite 101
Tallahassee, FL 32308
(850) 523-0400
rgoldman@mgh-law.com

* Counsel of Record

Counsel for *Amicus Curiae*

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