

No. 16-308

IN THE
Supreme Court of the United States

—————
DOT FOODS, INC.,
Petitioner,
v.

DEPARTMENT OF REVENUE OF THE
STATE OF WASHINGTON,
Respondent.

—————
**On Petition for Writ of Certiorari
to the Supreme Court of Washington**

—————
**BRIEF FOR TAX EXECUTIVES INSTITUTE,
INC. AS *AMICUS CURIAE*
IN SUPPORT OF PETITIONER**

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INTRODUCTION

Amicus curiae Tax Executives Institute, Inc. (“TEI”) respectfully files this brief in support of the petitioner.¹ *Dot Foods, Inc. v. State of Washington, Department of*

¹ All parties received at least 10 days’ notice of TEI’s intention to file this brief, and the brief is filed with the consent of all parties. No party or counsel for a party authored this brief in whole or in part. No party, counsel for a party, or person other than TEI, its members, or its counsel made a monetary contribution intended to fund the preparation or submission of this brief.

Revenue, 372 P.3d 747 (Wash. 2016) (“*Dot Foods II*”), upholds 2010 legislation amending Washington’s business and occupation (“B&O”) tax in response to the Washington Supreme Court’s decision regarding the interpretation of a statute in *Dot Foods, Inc. v. Department of Revenue*, 215 P.3d 185 (Wash. 2009) (“*Dot Foods I*”). The 2010 amendment did not only apply prospectively—as is the legislature’s clear province—but also applied retroactively back to 1983 to eliminate taxpayers’ right to claim an exemption from tax, except for cases in which a final judgment had been entered. In petitioner’s case, the amendment denied refund claims retroactively for four years.

Dot Foods II is the latest in a line of state court decisions upholding retroactive tax legislation under the Due Process Clause. Indeed, next month, numerous taxpayers will seek this Court’s review of a Michigan Court of Appeals’ decision upholding a six-year retroactive amendment to that state’s business tax.² The standard employed by the Washington and Michigan courts to assess the constitutionality of such retroactive amendments imposes virtually no limit on retroactive tax legislation.³

As a result of this extraordinarily permissive standard, several state legislatures have chosen to use

² See, e.g., *Gillette Commercial Operations North America v. Dep’t of Treasury*, (“*Gillette Commercial Operations*”) and *Sonoco Products Co. v. Dep’t of Treasury*, 878 N.W. 2d 891 (Mich. App. 2015); applications (16A250 and 16A263) granted by Justice Kagan extending the time to file until November 21, 2016.

³ TEI intends to file a separate amicus brief in support of the Michigan petitioners and urges this Court to grant the petitions for a writ of certiorari in *Dot Foods II* and the Michigan cases so the issue of retroactivity can be addressed efficiently and with finality for all affected taxpayers.

retroactive tax legislation to overrule specific court decisions rather than prospectively amending their tax codes at the earliest reasonable opportunity. Fairness dictates that taxpayers know what the law is when they enter into transactions and make business decisions. This Court's intervention is necessary to halt this disturbing and shocking trend and reconfirm that due process imposes meaningful constraints on retroactive tax legislation, especially when such legislation is enacted to overturn a judicial decision.

Intervention is also necessary to resolve a conflict among state courts interpreting this Court's decision in *United States v. Carlton*, 512 U.S. 26 (1994), the seminal case addressing the constitutionality of retroactive tax legislation. In contrast to the approach taken by Washington and Michigan, other state courts have considered the factors analyzed in *Carlton* as fundamental tenets of a fair tax, and thus have concluded retroactive tax legislation is permissible only if the legislature had a legitimate purpose, acted promptly, and applied a modest period of retroactivity. These courts have reached dramatically different conclusions regarding acceptable periods of retroactivity compared to Washington and Michigan's approach. This Court's review is also necessary to resolve this conflict and clarify the proper test for retroactive tax legislation, which is becoming alarmingly common.

STATEMENT OF INTEREST

TEI is a voluntary, nonprofit association of corporate and other business executives, managers, and administrators responsible for the tax affairs of their employers. TEI was organized in 1944 under the laws of the State of New York and is exempt from taxation under section 501(c)(6) of the Internal

Revenue Code. TEI is dedicated to the development of sound tax policy, the uniform and equitable enforcement of tax laws, the minimization of administration and compliance costs for governments and taxpayers, and the vindication of taxpayers' constitutional rights.

TEI's members are employed by a broad cross-section of the business community. As tax professionals, TEI's members must evaluate tax laws, advise their companies regarding the tax consequences of various transactions and business decisions, and make practical decisions regarding whether to challenge tax assessments and refund claims that taxing authorities have denied. TEI's members thus have a vital interest in ensuring a legislature's power to enact retroactive tax legislation is properly constrained and remedies for unlawfully imposing and collecting taxes are adequate.

SUMMARY OF REASONS FOR GRANTING THE PETITION

This Court should grant the taxpayer's petition for a writ of certiorari to resolve the significant differences among state courts applying *Carlton* and to prevent state legislatures from overturning judicial decisions with legislation employing extended retroactive periods.

In *Carlton*, this Court held that retroactive tax legislation must be "supported by a legitimate legislative purpose furthered by rational means" and gave meaning to that test by analyzing whether the legislative purpose was "illegitimate" or "arbitrary," whether the legislature acted promptly, and whether the legislature established a "modest" period of retroactivity.

State courts examining the constitutionality of retroactive tax statutes since *Carlton* have taken one of two approaches. The first approach questions (1) whether the legislative purpose is “arbitrary” or “illegitimate,” and (2) whether the legislature acted “promptly” and established a “modest” period of retroactivity as a means to determine whether the legislation is, in fact, “supported by a legitimate legislative purpose furthered by rational means.” Courts employing this approach have consistently held that taxes with retroactive periods exceeding one or two years are invalid because the period is not “modest.”

The second approach posits that retroactive tax legislation is constitutional as long as the legislature has a legitimate purpose for the retroactive amendment and the retroactive period is rationally related to that legislative purpose. Courts employing the second approach have concluded that increasing taxes to raise revenue constitutes a legitimate purpose and lengthy retroactive periods are permissible if they are necessary to fully undo a revenue shortfall.

By conflating the analysis, these courts have upheld retroactive tax legislation against constitutional challenges even if the legislature did not act promptly or the period of retroactivity exceeds any reasonable interpretation of “modest” – in some cases, exceeding ten years. Thus, the two approaches have resulted in dramatically different state court determinations regarding an acceptable retroactive period for tax legislation under the Due Process Clause. Moreover, legislatures in states adopting the second approach, Washington and Michigan in particular, have seized upon this apparent opportunity and regularly use

retroactive legislation to overrule taxpayer-favorable court decisions.

Taxpayers should be able to rely upon the legislation and regulations in existence at the time they enter into business transactions and other taxable events. Retroactive changes to the law should be made sparingly, particularly if they will have significant financial effects on taxpayers. This is particularly true where the courts have been called to interpret the laws as written.

Dot Foods II demonstrates that state legislatures, if left unchecked, will not exercise restraint voluntarily and will continue this practice of retroactively overruling court decisions. This ploy creates uncertainty for taxpayers, undermines their ability to make informed business judgments and decisions, is inconsistent with sound tax policy and administration, and wastes judicial resources. It also threatens to treat similarly-situated taxpayers differently and allows legislatures to trump judicial decisions. TEI thus respectfully urges this Court to grant the petition.

REASONS FOR GRANTING THE PETITION

As Chief Justice Marshall famously declared, “[a]n unlimited power to tax involves, necessarily, a power to destroy. . . .” *M’Culloch v. Maryland*, 17 U.S. 316, 327 (1819). The power to tax retroactively, years after taxpayers have relied upon the law as written, is even more dangerous. Yet the Washington Supreme Court’s decision in *Dot Foods II* blesses its legislature’s wish to impose retroactive tax obligations at will. This is not only unfair; it is at odds with this Court’s ruling in *Carlton*.

**I. INCONSISTENT INTERPRETATIONS OF
CARLTON HAVE CREATED A STRIKING
CONFLICT AMONG STATE COURTS.**

**A. Due Process Imposes Meaningful
Limits on Retroactive Tax Legislation.**

This Court has repeatedly stated that retroactive legislation is disfavored and “presents problems of unfairness because it can deprive citizens of legitimate expectations and upset settled transactions.” *Eastern Enterprises v. Apfel*, 524 U.S. 498, 501 (1998) (citing *General Motors Corp. v. Romein*, 503 U.S. 181 (1992)); see also Broom, *A Selection of Legal Maxims*, 24 (8th ed. 1911) (“Retrospective laws are, as a rule, of questionable policy, and contrary to the general principle that legislation by which the conduct of mankind is to be regulated ought to deal with future acts, and ought not to change the character of past transactions carried on upon the faith of the then existing law.”); 2 Story, *Commentaries on the Constitution* (5th ed. 1891), § 1398 (“Retrospective laws are, indeed, generally unjust; and, as has been forcibly said, neither accord with sound legislation nor with the fundamental principles of the social compact.”).

The seminal case examining whether retroactive tax legislation is constitutional is *United States v. Carlton*, 512 U.S. 26, where this Court addressed whether Congress could enact a “curative measure” that retroactively amended and limited a federal estate tax deduction. *Id.* at 27. The taxpayer in *Carlton* alleged that the retroactive amendment violated the Due Process Clause of the Fifth Amendment. *Id.*

This Court noted that prior decisions examining the constitutionality of retroactive tax legislation turned

on whether the “retroactive application [was] so harsh and oppressive as to transgress the constitutional limitation.” *Id.* at 30 (quoting *Welch v. Henry*, 305 U.S. 134 (1938) (internal quotation marks and other citations omitted)). This is the test applied to retroactive economic legislation generally and mandates that such legislation be “supported by a legitimate legislative purpose furthered by rational means.” *Carlton*, 512 U.S. at 30-31 (citations omitted). The Court confirmed that the tests applied to prospective and retroactive tax legislation are not identical: “[R]etroactive legislation *does* have to meet a burden not faced by legislation that has only future effects....and the justifications for the latter may not suffice for the former.” *Id.* at 31 (citing *Pension Benefit Guarantee Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 729-730 (1984) (emphasis added)).

In upholding the legislation, this Court first determined that Congress’ legislative purpose was not “illegitimate” or “arbitrary” because “Congress acted to correct what it reasonably viewed as a mistake in the original 1986 provision that would have created a significant and unanticipated revenue loss.” *Carlton*, 512 U.S. at 32.

Notably, *Carlton* involved a flaw in one of the “major revisions of the Internal Revenue Code,” which involved “grant[ing] a deduction for half the proceeds of ‘any sale of employer securities by the executor of an estate’ to ‘an employee stock ownership plan.’” *Id.* at 28. Congress’ mistake was neglecting to include language stating the obvious: the deceased person actually had to own the stock at his or her death. Otherwise, “any estate could claim the deduction simply by buying stock in the market [after the decedent’s death] and immediately reselling it to an

[employee stock ownership plan], thereby obtaining a potentially dramatic reduction in (or even elimination of) the estate tax obligation.” *Id.* at 31.

This scrivener’s error had a hefty price tag. When Congress initially enacted the deduction, it estimated a revenue loss of \$300 million over five years. *Id.* at 32. However, shortly after its passage it became clear that the deduction as drafted would result in a revenue loss of over \$7 billion. *Id.* Simply put, this Court gave Congress wide latitude in *Carlton* in part because the retroactive legislation fixed a clear error that was too good to be true.

Second, this Court found that Congress accomplished this legitimate legislative purpose via rational means because it acted “promptly” and “established only a modest period of retroactivity.” *Id.* In reaching this determination, the Court emphasized the retroactive period was “slightly greater than one year” and “the amendment was proposed by the IRS in January 1987 and by Congress in February 1987, within a few months of [the statute’s] original enactment.” *Id.* at 33.

Justice O’Connor’s concurrence further repudiated the notion that legislatures have unfettered authority to enact retroactive tax legislation, declaring “[t]he governmental interest in revising the tax laws must at some point give way to the taxpayer’s interest in finality and repose.” *Id.* at 37-38 (O’Connor, J., concurring). Indeed, “[b]ecause the tax consequences of commercial transactions are a relevant, and sometimes dispositive, consideration in a taxpayer’s decisions regarding the use of his capital, it is arbitrary to tax transactions that were not subject to taxation at the time the taxpayer entered into them.” *Id.* at 38 (citations omitted). Justice O’Connor thus concluded “[a] period of retroactivity longer than the

year preceding the legislative session in which the law was enacted would raise, in my view, serious constitutional questions.” *Id.*

B. State Courts Purporting to Follow *Carlton* Have Utilized Different Standards to Analyze Retroactive Taxes and Reached Inconsistent Conclusions.

State courts purporting to apply *Carlton* have taken one of two approaches. Several courts have interpreted *Carlton* as establishing a two-pronged test to determine whether retroactive tax legislation is “supported by a legitimate legislative purpose furthered by rational means.” *See Carlton*, 512 U.S. at 30-31. These courts have considered the factors analyzed in *Carlton* to be fundamental tenets of a fair tax and thus find retroactive tax legislation constitutional only if (1) the legislative purpose is not “arbitrary” or “illegitimate,” and (2) the legislature acted “promptly” and established a “modest” period of retroactivity. Courts hewing closely to *Carlton*’s analysis have generally concluded that the retroactive tax legislation violated the taxpayer’s due process rights.

For example, in *Rivers v. State*, 490 S.E.2d 261 (S.C. 1997), the court evaluated the constitutionality of a retroactive amendment decreasing the amount of a taxpayer’s capital gains refunds. The court acknowledged that retroactive tax legislation could be “an appropriate means for accomplishing certain revenue goals.” *Id.* at 265. The court nonetheless held that “[a]t some point...the government’s interest in meeting its revenue requirements must yield to taxpayers’ interest in finality regarding tax liabilities and credits.” *Id.* The court thus invalidated a tax

amendment with a two to three-year retroactive period. *Id.*

The California Court of Appeal also invalidated a retroactive amendment to the City's gross receipts tax in *City of Modesto v. National Med, Inc.*, 128 Cal. App. 4th 516 (2005). The court held the City had a legitimate legislative purpose in amending the ordinance. *Id.* at 528. Nonetheless, the court concluded that "due process precludes reforming the amended ordinance to apply it retroactively to [the taxpayer]" because it took more than two years for the City to adopt guidelines and the eight-year period of retroactivity was not "modest." *Id.* at 529.

In contrast, other state courts interpreting *Carlton*, including the Washington Supreme Court and the Michigan Court of Appeals, have sidestepped or rejected the factors considered in *Carlton's* analysis. These courts have, in essence, concluded retroactive legislation is constitutional if the legislature had a legitimate purpose for the retroactive amendment and the retroactive period was rationally related to that purpose. Courts employing this approach have either wholly ignored or attempted to rationalize their legislatures' failure to take "prompt" action or limit the retroactive period to a "modest" amount of time and instead focus on whether the retroactive period is "arbitrary."

For example, in *Dot Foods II*, 372 P.3d at 751-52, the Washington Supreme Court maintained that "there is no 'absolute temporal limitation on retroactivity'" and "it is the function—rather than the length—of a retroactive period that should determine whether it comports with due process protections." The court thus focused on the four-year retroactive impact of the legislation on the taxpayer's refund claim rather than

the actual twenty-seven-year change to statute. *Id.* at 752. The court determined there was no due process violation because the legislation’s retroactive period was rationally related to the legislative purpose of preventing revenues “lost” from that court’s interpretation of the exemption in *Dot Foods I*. *Id.* at 752.

Dot Foods II relied heavily on the Washington Supreme Court’s analysis in *Estate of Hambleton*, 335 P.3d 398 (“*Hambleton*”), decided last year. In *Hambleton*, the court did not address whether the eight-year retroactive amendment to Washington’s estate tax was “modest” per se but instead on whether it was arbitrary. The court determined the length of retroactivity was warranted because it was “directly linked with the purpose of the amendment, which is to remedy the effects of [*In re Estate of Bracken*, 290 P.3d 99 (Wash. 2012)].” 335 P.3d at 411. Thus, the court found that “any period less than eight years would be arbitrary” and upheld the retroactive amendment on that basis. *Id.*

In *Gillette Commercial Operations*, 878 N.W. 2d 891, the Michigan Court of Appeals similarly relied upon its own prior decisions in *GMAC LLC v. Department of Treasury*, 781 N.W.2d 310 (Mich. App. 2009), and *General Motors Corp. v. Department of Treasury*, 803 N.W.2d 698 (Mich. App. 2010), to justify a six-year retroactive period. However, *GMAC* and *General Motors* simply sidestepped the modesty requirement the U.S. Supreme Court articulated in *Carlton*.

In *GMAC*, the Michigan Court of Appeals dismissed *Carlton* out of hand, stating “we conclude that plaintiffs’ reliance on the *Carlton* decision is misplaced. Plaintiffs are not challenging the retroactive amendment to MCL 205.54i; rather, plaintiffs are

challenging the Legislature's disapproval and corrective action with regard to the *DiamlerChrysler* decision." 781 N.W.2d 320. The court thus upheld a seven-year period of retroactivity. *Id.*

In *General Motors*, the Michigan Court of Appeals acknowledged that *Carlton* examined the length of the retroactive period and evaluated whether it was modest. 803 N.W.2d at 711. Nonetheless, that court held that a modest period of retroactivity was not per se required by *Carlton* because this Court "did not specifically include a temporal 'modesty' requirement" when it "summarize[d] its holding." *Id.* The Michigan court opted instead to apply a test balancing "the government's interest in retroactive application of a statute against that of the taxpayer's interest in finality...to determine whether the limit of modest retroactivity is reached." *Id.* Applying that test, the court held that the five to eleven-year retroactive period was constitutional. *Id.* at 712-13.

The Kentucky Supreme Court similarly circumvented the modesty analysis articulated in *Carlton* when deciding *Miller v. Johnson Controls*, 296 S.W.3d 392 (Ky. 2009). That court instead opined that "[t]he pertinent question is whether the period of retroactivity is one that makes sense in supporting the legitimate governmental purpose (rationally related)." *Id.* at 399. Using this rationale, the court upheld a six-to ten-year retroactive period. *Id.*

In sum, these two approaches have led to dramatically different results regarding the acceptable period of retroactivity and created a split among state courts. These differences are striking given that each decision purports to emanate from and be consistent with this Court's decision in *Carlton*. This Court's review is

necessary to resolve the conflict regarding the proper interpretation and application of *Carlton*.

**II. GUIDANCE IS ESSENTIAL TO DETER
THE EMERGING PRACTICE OF OVER-
RULING STATE COURT DECISIONS
WITH RETROACTIVE LEGISLATION.**

Carlton presented a relatively easy case: the retroactive amendment fixed an obvious drafting error, the IRS provided notice of the error to the public within months, and Congress immediately thereafter proposed legislation to correct it. 512 U.S. at 29. This prompt action by the executive and legislative branches ensured that the retroactive period was limited to slightly over a year. *Id.* Consequently, *Carlton* did not require this Court to delve into what constitutes an “illegitimate” or “arbitrary” legislative purpose, or what sets the outer bound for an acceptable retroactive period.

Dot Foods II and the upcoming Michigan cases squarely present that question. State legislatures are increasingly using the gray area created by *Carlton* to defer correcting statutes susceptible of multiple interpretations because they know they can legislatively overrule court cases by enacting retroactive legislation. This Court’s intervention is necessary to halt this disturbing practice and return meaning to the judicial process.

A. *Dot Foods II* Encourages and Validates Retroactive Tax Legislation to Overrule Court Decisions.

1. The *Dot Foods* Litigation

In 1983, the Washington legislature exempted out-of-state sellers from the State's B&O tax if such sales were made exclusively to or through a direct seller's representative. Former Wash. Rev. Code § 82.04.423(1)(d), (2). From 1983 to 1999, the Washington Department of Revenue ("Department") took the position that out-of-state representatives qualified for this exemption if they themselves did not solicit the sale of products in permanent retail establishments. *Dot Foods I*, 216 P.3d at 186. In 1997, the Department also expressly confirmed that *Dot Foods* qualified for the exemption via a letter ruling. *Dot Foods, Inc. v. Dep't of Revenue*, 173 P.3d 309, 311 (Wash. App. 2007).

In late 1999, sixteen years after the legislature enacted the original exemption, the Department revised its interpretation of the statute defining "direct sellers" and declared that out-of-state sellers would no longer be eligible for the direct seller's exemption if their products were sold by another party with a permanent retail establishment in the state. *Dot Foods I*, 216 P.3d at 189-190. *Dot Foods* litigated the issue for its January 2000 to April 2006 tax periods. *Id.*

The Washington Supreme Court decided *Dot Foods I* in 2009. The court concluded the Department's new interpretation was "contrary to the statute's plain and unambiguous language" and confirmed that *Dot Foods* qualified for the direct seller exemption. *Id.* In December 2009, *Dot Foods* filed a refund claim for its

later tax periods based on *Dot Foods I*. *Dot Foods II*, 372 P.3d at 748.

In April 2010, the Washington legislature amended Rev. Code Wash. § 82.04.423 to narrow the exemption retroactively and repeal it prospectively, except for cases in which a final judgment had been entered. Wash. Laws of 2010, 1st. Spec. Sess., ch. 23, §§ 401, 402. The legislature claimed the amendment was necessary to “retroactively conform the exemption to the original intent of the [1983] legislature,” “prevent the loss of revenues resulting from the [Washington Supreme Court’s] expanded interpretation of the exemption” in *Dot Foods I*, and restore parity for in-state and out-of-state businesses. *Id.* at § 401(4). The effect was to deny the direct seller exemption retroactively for all taxpayers, with the exception of Dot Foods, which was only entitled to claim it for the periods at issue in *Dot Foods I* (January 2000 to April 2006), for whom judgment already had been entered.

The Department thus denied Dot Foods’ refund claim for the May 2006 to December 2007 tax periods, and Dot Foods challenged the denial in court. *Dot Foods II*, 372 P.3d at 748. The Washington Supreme Court did not appear troubled by the legislature’s failure to enact curative legislation in 2000, when the Department demonstrated an interest in narrowing the direct seller’s exemption, or the legislature’s amendment of the statute retroactively for twenty-seven years. *Id.* at 750-752. Rather, the court determined that avoiding “large and devastating revenue losses” and restoring parity between in-state and out-of-state businesses constituted a legitimate legislative purpose. *Id.*

With respect to the period of retroactivity, the Washington Supreme Court acknowledged the “2010

amendment theoretically dates back to the [1983] enactment” but rationalized that “the actual retroactive application is limited by the particularities of this case as well as the applicable statute of limitations.” *Id.* at 751. The court found that the four-year impact on Dot Foods was within the range previously permitted by the court in *Hambleton*, 335 P.3d 398, which upheld an eight-year retroactive tax amendment. Moreover, the court declined to infer any temporal requirement from *Carlton* and held that the retroactive period was “rationally related to the legislature’s legitimate, stated purpose of ‘prevent[ing] the loss of revenues resulting from the [*Dot Foods I*]’s expanded interpretation of the exemption.” *Dot Foods II*, 372 P.3d at 752.

2. *Dot Foods II* is Inconsistent with *Carlton*.

Dot Foods II eviscerates *Carlton*. In *Carlton*, this Court held Congress had a legitimate legislative purpose when it enacted a retroactive amendment within months to correct an obvious drafting error. In *Dot Foods II*, the Washington legislature sought to make a retroactive policy change regarding the scope of an exemption and retroactively erase a court decision it disliked. It is the role of the Washington courts, not the legislature, to interpret Washington’s statutes. Moreover, a legislature should not be permitted to change a past legislature’s policy decision simply because the current legislature disagrees with it.

The Washington legislature’s desire to mitigate the prospect of significant revenue “loss” does not salvage its legislative purpose. The revenue loss in *Carlton*

arose from a drafting error and thus was unanticipated. *Carlton*, 512 U.S. at 31-32. Indeed, any reasonable person evaluating the legislation at issue in *Carlton* should have known the tax benefit was too good to be true. In contrast, the revenue “loss” in *Dot Foods II* arose from a purposeful decision of the 1983 legislature to provide out-of-state sellers with an exemption from B&O tax. Eliminating a deduction or exemption to increase tax revenues may constitute a legitimate legislative purpose for prospective tax legislation but it does not pass constitutional muster for retroactive tax amendments.

Moreover, the Washington legislature’s action was anything but prompt. The legislature stood by idly while the Department litigated *Dot Foods I*. The legislature could have amended Wash. Rev. Code § 82.04.423 in 1999, when the Department revised its interpretation of the exemption, if the legislature no longer wanted to provide the exemption as written. Instead it waited ten years.

Finally, the four-year period of retroactivity was not modest. In *Carlton*, this Court emphasized that the retroactive period was “slightly greater than one year.” *Carlton*, 512 U.S. at 33. Prompt action and modest periods of retroactivity go hand-in-hand. The period at issue in *Dot Foods II* goes far beyond *Carlton*’s reach.

The Washington Supreme Court’s holding creates a perverse invitation: it allows States to litigate questionable positions, and then legislatively and retroactively overrule court decisions they do not like. Allowing legislatures to act in this manner eliminates any incentive a legislature has to amend its tax code promptly. This result creates uncertainty for taxpayers and is at odds with the majority opinion

in *Carlton*, which lauded the IRS and Congress for acting promptly and establishing a modest period of retroactivity. 512 U.S. at 32-33.

B. Numerous State Legislatures Have Enacted Retroactive Legislation to Overrule Taxpayer-Favorable Decisions.

The practice of overruling state court decisions via retroactive tax legislation for business taxes is becoming more prevalent.

Just last year, for example, the Washington Supreme Court upheld an eight-year retroactive amendment of Washington's estate tax in *Hambleton*, 335 P.3d 398. The legislature enacted the amendment in response to the Washington Supreme Court's decision in *Estate of Bracken*, 290 P.3d 99, 101, which held that Washington's governing statutes excluded federally-elected qualified terminable interest property ("QTIP") assets from Washington taxable estates. Like *Dot Foods II*, the amendment in *Hambleton* was prospective and retroactive, except for cases in which a final judgment had been entered. *Hambleton*, 335 P.3d at 411. The retroactive amendment had the effect of overruling the court's decision in *Estate of Bracken* for all similarly-situated taxpayers whose cases were stayed pending the outcome of that case. *Id.*

The legislation at issue in *Gillette Commercial Operations*, 878 N.W. 2d 891, also was enacted to overrule a taxpayer-favorable court decision. In *International Business Machines Corp. v. Department of Treasury*, 852 N.W.2d 865 (Mich. 2014) ("*IBM*"), the Michigan Supreme Court held that Michigan's enactment of the Multistate Tax Compact allowed

corporate taxpayers to elect a three-factor apportionment formula to apportion their income, even though the state's business tax statutes prescribed a different method. *Id.* at 868. The retroactive amendment, which was passed after the issuance of the Michigan Supreme Court's opinion but while the Department's motion for reconsideration was pending, sought to overrule the *IBM* decision as to IBM and other taxpayers with claims pending in the Michigan courts. *Gillette Commercial Operations*, 878 N.W. 2d at 900-01.

In *Gillette Commercial Operations*, the court concluded the retroactive legislation had a legitimate legislative purpose because: “[i]t is a legitimate legislative action to both (1) correct a perceived misinterpretation of a statute, and (2) eliminate a significant revenue loss resulting from [the Michigan Supreme Court's] interpretation.” *Id.* at 910. Thus, the decision sanctioned the Michigan legislature's overt attempt to substitute the legislature's judgment for the court's judgment regarding the interpretation of that statute.

The Michigan legislature also used retroactive legislation to overrule a taxpayer-favorable court decision in *GMAC LLC v. Department of Treasury*, 781 N.W.2d 310. In that case, the legislature enacted sales tax legislation with a seven-year retroactive period to combat the Michigan Court of Appeals' decision in *Daimler Chrysler Services North America LLC v. Department of Treasury*, 723 N.W.2d 569 (Mich. Ct. App. 2006). The *GMAC* court blithely acknowledged the legislative override, stating that “plaintiffs are challenging the Legislature's disapproval and corrective action with regard to the *DaimlerChrysler* decision. . . . [I]t is the province of the Legislature to acquiesce in the judicial interpretation of a statute

or to amend the legislation to obviate a judicial interpretation.” 781 N.W.2d at 320.

The Michigan Court of Appeals repeated similar language in *General Motors Corp. v. Department of Treasury*, 803 N.W.2d at 710. There, the Michigan court upheld the legislature’s enactment of a five-year retroactive use tax amendment to legislatively overrule the Michigan Court of Appeals’ decision in *Betten Auto Center, Inc. v. Department of Treasury*, 723 N.W.2d 914 (Mich. Ct. App. 2006).

Kentucky also permitted retroactive tax legislation in response to taxpayer-favorable judicial decisions. In *GTE v. Revenue Cabinet*, 889 S.W.2d 788, 791 (Ky. 1994), the Kentucky Supreme Court held that corporate taxpayers could file combined returns under Kentucky’s statutes. The Kentucky Legislature thereafter enacted a statute retroactively denying taxpayers this right back to 1998. See 2000 Ky. Act. ch. 543, § 1.

The Kentucky Supreme Court upheld that retroactive legislation in *Miller v. Johnson Controls*, 296 S.W.3d at 401. The court remarked that “the legislature reestablished the status quo as it saw it prior to *GTE*” and “the legislature in this case took away the dispute, and hence any illegality that might be claimed, by properly enacting a retroactive statute that mooted the question of whether the Appellees were entitled to a refund.” *Id.* at 403.

These cases demonstrate that state and local taxing jurisdictions will seize upon shallow interpretations of *Carlton* and misuse retroactive tax legislation. Legislatures are entitled to amend statutes prospectively in response to judicial decisions, but it is not reasonable for them to retroactively overrule judicial

interpretations simply because they dislike them. Guidance clarifying the boundaries of *Carlton* is therefore necessary to ensure this process is not further abused.

III. Retroactive Tax Legislation Should Be Discouraged.

A. Sound Tax Policy and Administration Demand that Retroactive Tax Legislation Be Used Sparingly.

Sound tax policy and administration require governments to provide taxpayers with some degree of certainty and fairness. While retroactive tax legislation is permissible in limited circumstances, these principles are not met if legislatures are provided unlimited authority to enact retroactive tax legislation.

Fairness is an essential attribute in a sound tax system, particularly systems that rely upon voluntary compliance. For a tax system to be fair and perceived as fair, taxpayers must be able to rely upon the legislation and regulations in existence when business transactions and other taxable events occur. Governments may change their administrative tax policies and laws, but fairness demands these changes be enforced prospectively, especially if they will have significant financial effects on taxpayers. Indeed, retroactive legislation creates a climate of uncertainty that discourages investment, and is therefore detrimental to the economy in the long term. Legislatures should thus exercise that power sparingly and within narrow limits even when governments possess the authority to change tax laws retroactively.

Retroactive tax legislation is particularly suspect when the legislation retroactively overrules a judicial decision. Under a system of divided government, the legislature is charged with writing the laws, the executive branch is charged with administering them, and courts are charged with interpreting them as written. It is always within the legislature's province to change tax laws prospectively in response to a judicial decision. Doing so after a court has interpreted the law, however, cannot be reconciled with basic tenets of sound tax policy and administration because it disrupts taxpayer expectations.

Taxpayers will be discouraged from seeking judicial review of an adverse decision from a taxing agency if legislatures have unlimited discretion to overrule court decisions they dislike. There is little reason for taxpayers to spend the time and considerable expense to seek judicial redress if the legislature can change the law retroactively. Providing state legislatures unfettered power to overrule court decisions retroactively thus undermines the division of power among the three branches of government, and the checks and balances the judiciary confers.

In addition, allowing state legislatures to retroactively overrule taxpayer-favorable decisions wastes judicial resources. There is no need for courts to hear cases that will be retroactively overturned by a state legislature. Legislatures have an obligation to amend legislation promptly rather than litigating questionable issues and rendering judicial decisions obsolete via retroactive legislation.

B. Retroactive Tax Legislation Overruling Court Decisions Raises Other Legal Concerns.

The Washington Supreme Court's decision in *Dot Foods II* trades one problem for many others. Besides limiting retroactive tax legislation, due process mandates that taxpayers challenging suspect laws receive "a 'clear and certain remedy' for an erroneous or unlawful tax collection." *McKesson Corp. v. Div. of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 37-38 (1990). That requirement is not satisfied when taxpayers' refund claims are eliminated or invalid deficiency assessments are revived due to legislation retroactively overruling a court decision. Indeed, this result is no more valid than the bait-and-switch tactics this Court repudiated in *Reich v. Collins*, 513 U.S. 106 (1994) (state could not hold out what appeared to be clear and certain post-deprivation remedy and then declare, only after disputed taxes were paid, that no such remedy existed).

Dot Foods II also treats similarly-situated taxpayers differently. To circumvent separation of powers concerns, the Washington legislature carefully drafted the retroactive legislation to exclude cases in which a final judgment had been entered. *See* Wash. Laws of 2010, 1st Spec. Sess., ch. 23, §§ 401, 402. Thus, although *Dot Foods* was entitled to the exemption from January 2000 through April 2006, i.e., the period litigated in *Dot Foods I*, the retroactive amendment eliminated the exemption for other similarly-situated taxpayers whose cases may have been pending.

This result is not only unfair, it also creates perverse incentives. Treating similarly-situated taxpayers differently based upon whether they are the lead litigant will cause taxpayers to improperly expedite their

litigation and oppose stays pending the resolution of other cases. That reaction will wreak havoc on state courts administering multiple cases involving the same tax issue and undoubtedly raise a plethora of estoppel claims.

Finally, despite the Washington legislature's attempt to draft around it, the retroactive legislation undermines the role of the judiciary. State legislatures have the undeniable right to change their tax laws in response to a judicial decision prospectively. However, granting state legislatures the power to trump state courts by overruling judicial decisions with retroactive legislation frustrates the tripartite system of government this country has adopted.

CONCLUSION

For the foregoing reasons, TEI urges this Court to grant the taxpayers' petition for a writ of certiorari.

Respectfully submitted,

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