

No. 09-981

IN THE
Supreme Court of the United States

JOHNSON CONTROLS, INC., *et al.*,
Petitioners,

v.

JONATHAN MILLER, SECRETARY, FINANCE AND
ADMINISTRATION CABINET, *et al.*,
Respondents.

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

**BRIEF OF TAX EXECUTIVES INSTITUTE, INC.
AS *AMICUS CURIAE*
IN SUPPORT OF THE PETITIONERS**

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INTEREST OF AMICUS CURIAE

Pursuant to Rule 37 of the Rules of this Court, Tax Executives Institute, Inc. respectfully submits this brief as *amicus curiae* in support of the petition for a writ of certiorari.¹ Tax Executives Institute

¹ Pursuant to Rule 37.6, *amicus* Tax Executives Institute, Inc. 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*, its members, or its counsel, has made a monetary contribution to the preparation or submission of this brief. Pursuant to Rule 37.2(a), counsel of record for both parties received timely notice of the intent to file an *amicus* brief under this rule and both parties have consented to its submission in letters filed with the Clerk.

(hereinafter “TEI” or “the Institute”) is a voluntary, nonprofit association of corporate and other business executives, managers, and administrators who are 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 (26 U.S.C.). The Institute is dedicated to promoting the uniform and equitable enforcement of the tax laws, reducing the costs and burdens of administration and compliance to the benefit of both the government and taxpayers, and vindicating the Commerce Clause and other constitutional rights of all business taxpayers.

TEI has approximately 7,000 members who represent more than 3,000 of the leading corporations in the United States, Canada, Europe, and Asia, including many domiciled or doing business in the Commonwealth of Kentucky. As tax professionals who recognize the States’ right to collect properly levied taxes and who respect the legitimacy of state assessments, TEI members have a significant interest in the standards applied in assessing the adequacy of remedies accorded taxpayers for unlawfully imposed and collected state taxes.

The Kentucky Supreme Court’s decision below threatens to undermine the protections afforded by the Due Process Clause against States retaining improperly collected taxes. By upholding legislation that retroactively stripped taxpayers of the ability to obtain a refund, the decision raises fundamental questions about the availability of remedies where taxpayers have paid taxes that are subsequently found invalid. In *Reich v. Collins*, 513 U.S. 106 (1994), the Court held that a State may not hold out what plainly appears to be a “clear and certain” post-

deprivation remedy—its tax refund statute—and then, after taxpayers have relied on it and paid over the disputed tax, gamely declare that no such remedy exists. That is exactly what the Kentucky legislature did here. It first induced petitioners (hereinafter collectively referred to as “Johnson Controls”) to pay taxes by providing a tax refund statute as a mechanism for recovering taxes improperly collected, and then it retroactively rescinded the refund option—completing the “bait and switch” this Court found constitutionally repugnant in *Reich*. Allowing the decision of the Kentucky Supreme Court to stand could undermine both *Reich* and sound tax administration. In the longer term, it could even diminish the States’ financial security by discouraging taxpayers from paying suspect taxes rather than paying those taxes and then seeking a refund that they may never receive. And, although the need for state revenues is especially pronounced given the current recession, this need cannot rightly trump the taxpayer’s right to a constitutionally adequate remedy to recover wrongfully imposed and collected taxes.

The Institute’s members and the businesses by which they are employed have a keen and vital interest in ensuring the sufficiency of remedies accorded taxpayers subjected to invalid state rules and regulations. Unless reversed, this case will affect far more than the Commonwealth of Kentucky’s authority to retain the taxes wrongfully exacted from Johnson Controls; it will inevitably have a deleterious effect on the administration of other States’ taxing schemes.

ARGUMENT

I. BACKGROUND

This case tests the constitutional limitations on a State's ability to retroactively deny a taxpayer's right to claim a refund of taxes paid pursuant to a state administrative pronouncement found to contravene state law. The underlying tax rule has a tortuous past. Beginning in the early 1970s, the Kentucky Revenue Cabinet (the agency charged with administering Kentucky's income tax laws) interpreted Kentucky law as allowing taxpayers to file unitary "combined" corporate tax returns.² From 1972 to 1988, the Revenue Cabinet followed this position, consistently reiterating its position that combined returns were permissible. *Castner Knott Dry Goods*

² Under this filing method, groups of affiliated corporations engaged in an integrated "unitary" business enterprise characterized by "functional integration, centralization of management, and economies of scale," *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 438 (1980), are permitted to file a single "combined" corporate income tax return. The Kentucky legislature adopted model legislation in 1966 that had been drafted by the National Conference of Commissioners on Uniform State Laws in 1957. More than 20 States eventually adopted this model statute entitled the Uniform Division of Income for Tax Purposes Act ("UDITPA"). Kentucky was not alone in interpreting UDITPA to allow or require unitary combined filing; Idaho, Illinois, Kansas, Montana, Nebraska, and Oregon also found unitary combined reporting valid under UDITPA. *Pioneer Container Corp. v. Beshears*, 684 P.2d 396 (Kan. 1984); *PMD Inv. Co. v. State Dep't of Revenue*, 345 N.W.2d 815 (Neb. 1984); *Caterpillar Tractor Co. v. Lenckos*, 417 N.E.2d 1343 (Ill. 1981); *American Smelting & Refining Co. v. Idaho State Tax Comm'n*, 592 P.2d 39 (Idaho 1979); *Montana Dep't of Revenue v. American Smelting & Refining Co.*, 567 P.2d 901 (Mont. 1977); *Coca Cola Co. v. Oregon Dep't of Revenue*, 533 P.2d 788 (Ore. 1975).

Co. v. Revenue Cabinet, K90-R-31 to K90-R-34, Ky. B.T.A. (Dec. 6, 1991).

More than a decade and a half after establishing its position on combined reporting, the Revenue Cabinet reversed itself and promulgated Revenue Policy 41P225 (September 27, 1988), which prohibited the filing of unitary combined returns by taxpayers other than sham or shell corporations established to lower a group's tax liability. (App. 4.) Taxpayers challenged the policy reversal, arguing it contravened longstanding Kentucky law. In 1994, the Kentucky Supreme Court agreed, rejecting the Commonwealth's attempts to rewrite the law administratively and holding that taxpayers and their unitary subsidiaries "have a *right*, pursuant to KRS 141.120, to file their Kentucky Income Tax Return[s] on a combined unitary basis." *GTE v. Revenue Cabinet*, 889 S.W.2d 788, 793 (Ky. 1994) (emphasis added). Soon after the decision in *GTE*, Johnson Controls filed amended returns for tax periods from 1990 through 1994 to reflect the unitary combined methodology upheld in that case and sought the tax refunds that filing status clearly entitled it to.

In 1996, in response to *GTE* and the refund claims it spurred, the Kentucky legislature passed legislation prohibiting the filing of unitary combined returns for years ending on or after December 31, 1995. Two years later, the Kentucky legislature enacted a statute temporarily barring the payment of refunds claimed on amended returns where a taxpayer changed its filing method from separate company returns to a unitary combined return. Finally, in 2000, the legislature retroactively prohibited the use of combined reporting for tax years ending *before* December 31, 1995, and made perma-

ment its refusal to pay refunds to taxpayers that exercised their right to utilize a unitary combined filing methodology on an amended return. The legislature's action effectively turned back the clock five years and eliminated Johnson Controls' right to file amended returns for 1990 through 1994. KRS § 141.200(9) & (10) (2000).

II. DUE PROCESS PROHIBITS STATES FROM RETROACTIVELY AMENDING THEIR LAWS TO DEPRIVE TAXPAYERS OF THEIR RIGHT TO A "CLEAR AND CERTAIN" REMEDY TO OBTAIN REFUNDS OF UNLAWFULLY COLLECTED TAXES

The issue presented is whether due process prohibits the Commonwealth of Kentucky from retroactively extinguishing the right of Johnson Controls and other taxpayers to seek refunds for taxes found to have been collected in contravention of state law. From the outset, Johnson Controls and other affected taxpayers followed the rules established by Kentucky: They paid taxes the Commonwealth insisted they owed, and when the Supreme Court of the Commonwealth upheld a challenge to Kentucky's efforts, they followed extant procedures to seek a refund of what Kentucky improperly extracted. This basic truth—that the Commonwealth has funds properly belonging to Johnson Controls—impels reversal of the decision below.

The Due Process Clause of the Fourteenth Amendment prohibits States from depriving any person of property without due process of law. U.S. Const. amend. XIV, § 1. "The essence of this guarantee is that citizens must be given an opportunity, at a

meaningful time and in a meaningful manner, to challenge the legality of the government's impositions." (App. 54 (Abramson, J., dissenting) (citing *Mathews v. Eldridge*, 424 U.S. 319 (1976)).) "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 Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 36 (1990).

The Constitution demands that the relief fashioned by the States accord with federal due process principles. *American Trucking Ass'ns v. Smith*, 496 U.S. 167, 181 (1990) (plurality opinion); accord *Harper v. Virginia Dep't of Taxation*, 509 U.S. 86, 100 (1993). As Justice Holmes noted almost a century ago: "It is reasonable that a man who denies the legality of a tax should have a clear and certain remedy." *Atchison, T. & S.F. Ry. Co. v. O'Connor*, 223 U.S. 280, 285 (1912). Only by providing a remedy can a State secure the due process rights of taxpayers. Indeed, "[t]o say that . . . [a] county [or State] could collect . . . unlawful taxes by coercive means and not incur any obligation to pay them back is nothing short of saying that it could take or appropriate the property of [the taxpayers] . . . arbitrarily and without due process of law." *Ward v. Love County Bd. of Comm'rs*, 253 U.S. 17, 24 (1920).

"Once it is determined that due process applies, the question remains what process is due." *Morrissey v. Brewer*, 408 U.S. 471, 481 (1972). With respect to tax refund procedures, the Court provided its clearest guidance in the seminal case of *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 36 (1990). In that case involving the constitu-

tionality of Florida's liquor excise tax, the Court explained that, to satisfy the requirements of due process, "the State must provide taxpayers with not only a fair opportunity to challenge the accuracy and legal validity of their tax obligation, but also a 'clear and certain remedy' for any erroneous or unlawful tax collection to ensure that the opportunity to contest the tax is a meaningful one." *Id.* at 39 (quoting *Atchison, T. & S.F. Ry. Co. v. O'Connor*, 223 U.S. at 285). Kentucky's actions here ignored this principle by rescinding its refund provision and denying Johnson Controls a meaningful opportunity to contest the tax and secure refunds.

Before the legislature retroactively changed its law in 2000, Kentucky's statutory scheme comported with due process. Specifically, section 134.580(2) of the Kentucky Revised Statutes states:

When a bona fide controversy exists between the agency and the taxpayer as to the liability of the taxpayer for the payment of tax claimed to be due by the agency, . . . and it is finally adjudged that the taxpayer was not liable for the payment of the tax or any part thereof, the agency shall authorize the refund or credit as the Kentucky Board of Tax Appeals or courts may direct.

KRS § 134.580(2). Absent the legislature's action, Johnson Controls was indisputably entitled to refunds under this provision. Despite *McKesson's* mandate, Kentucky stripped Johnson Controls and other taxpayers of their right to claim refunds for taxes paid pursuant to an invalid pronouncement of the state revenue agency.

While States may satisfy their obligations under the Due Process Clause by providing taxpayers with

the opportunity to challenge the validity of a tax either prior to its payment or after the tax has been remitted, “what a State may *not* do . . . is to reconfigure its [refund] scheme, unfairly, in *mid-course*—to ‘bait and switch,’ as some have described it.” *Reich v. Collins*, 513 U.S. 106, 111 (1994). This case is no different from *Reich*. There, as here, the State provided a “clear and certain” post-deprivation remedy in the form of its refund statute. Only after Johnson Controls paid its taxes did the legislature eliminate the refund—its remedy. Thus, whereas the *bait* of Kentucky’s refund statute induced Johnson Controls to pay the taxes before challenging them, the State’s retroactive *switch* denied them the ability to obtain a refund for taxes determined to have been wrongfully collected.

Comparing Johnson Controls to the taxpayer that successfully challenged the validity of the Revenue Cabinet’s 1988 policy statement on combined reporting provides a stark contrast. Because the taxpayer in that case (*GTE*) filed its tax returns on a combined basis (later successfully defending its position in court), it paid less to the State than it would have if it had filed on a separate company basis. Johnson Controls, in contrast, paid more initially (in accord with the Commonwealth’s administrative policy) and filed amended returns (seeking refunds) only after the Kentucky Supreme Court affirmed the right to file on a unitary combined basis. This put Johnson Controls in a comparable position to the taxpayer in *Reich*, where the State argued that the taxpayer could not expect to make use of the State’s refund statute since he was unaware at the time he paid the tax that it was unconstitutional. This Court summarily dismissed that disingenuous claim, noting that:

[The Georgia] refund statute has a relatively lengthy statute of limitations period, and . . . contained no contemporaneous protest requirement. Under such a regime, taxpayers need not have taken any steps to learn of the possible unconstitutionality of their taxes at the time they paid them. Accordingly, they may not now be put in any worse position for having failed to take such steps.

Reich, 513 U.S. at 114.

Likewise, Johnson Controls should not be put in any worse a position for deciding not to employ a unitary combined methodology on its originally filed tax returns for the years at issue. Upholding the Kentucky legislature's actions here would embolden state departments of revenue and state legislatures to impose taxes without regard to their validity knowing that, even if the tax were struck down, they could retain whatever they collected. That Kentucky believes its actions pass muster under due process principles beggars the imagination.³

The Kentucky Supreme Court dismissed Johnson Controls' challenge with the back of its hand, averring that *Reich* and *McKesson* apply only in respect of refund claims for taxes found to be unconstitutional, which the court said "naturally impacts federal due process." (App. at 24.) This interpretation improperly diminishes the Fourteenth Amendment's

³ See *McKesson*, 496 U.S. at 39 (if a tax is beyond the State's power to impose, the State has no choice but to "undo" the unlawful deprivation by making refunds "because allowing the State to 'collect these unlawful taxes by coercive means and not incur any obligation to pay them back . . . would be in contravention of the Fourteenth Amendment.'" (quoting *Ward v. Bd. of Comm'rs of Love County*, 253 U.S. 17, 24 (1920))).

protections. The constitutional protection guaranteed by the Due Process Clause is not expressly or implicitly limited to violations of the Constitution. “Property interests are not created by the Constitution, ‘they are created, and their dimensions are defined, by existing rules or understandings that stem from an independent source, such as state law.’” *Cleveland Bd. of Educ. v. Loudermill*, 470 U.S. 532, 538 (1985) (quoting *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972)) (formatting altered). Many of the Court’s due process decisions involve disputes arising under state law. *See, e.g., Bishop v. Wood*, 426 U.S. 341 (1976) (policeman’s status as an employee under state law); *Board of Regents v. Roth*, 408 U.S. 564 (1972) (determination whether university teacher had a property right in his employment at a state university). *McKesson* itself cites two cases where the underlying tax at issue was found to be invalid not under the Constitution but a federal statute. *See Ward v. Love County Bd. of Comm’rs*, 253 U.S. 17 (1920) (involving county’s disregard of federal exemption from taxation); *Carpenter v. Shaw*, 280 U.S. 363 (1930) (same).

The Kentucky legislature also attempted to extinguish Johnson Controls’ claims by retroactively prohibiting taxpayers from “fil[ing] a combined return under the unitary business concept . . . for any taxable year ending before December 31, 1995.” KRS 141.200(10) (2000). The court below approved this end run around due process noting “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 [Johnson Controls] were entitled to a refund.” (App. 26 (emphasis added).) Permitting this statute to stand would disregard this

Court's holdings in *Atchison* and *McKesson* and allow state legislatures to sidestep the constitutional obligation to provide a clear and certain remedy for wrongfully collected taxes. States may not do indirectly what they are constitutionally prohibited from doing directly.

Although this Court has countenanced retroactive tax legislation in the past, a legislature's power to enact retroactive laws is significantly circumscribed. In *United States v. Carlton*, 512 U.S. 26 (1994), for example, the Court upheld legislation that retroactively—barely one year—amended the federal estate tax to prevent a wholly unintended result. None of the Court's decisions, however, involved refunds of taxes that were wrongfully collected. See, e.g., *United States v. Hemme*, 476 U.S. 558 (1986); *United States v. Darusmont*, 449 U.S. 292 (1981); *Welch v. Henry*, 305 U.S. 134 (1938); *United States v. Hudson*, 299 U.S. 498 (1937); *Milliken v. United States*, 283 U.S. 15 (1931); *Cooper v. United States*, 280 U.S. 409 (1930). Here, Johnson Controls sought refunds of taxes collected pursuant to an invalid state revenue policy. In doing so, it did not exploit a flaw in Kentucky law, but rather filed amended returns using a filing methodology expressly authorized by the Revenue Cabinet for 16 years, which was upheld by the Kentucky Supreme Court. Upholding Kentucky's effort to deny refunds to Johnson Controls under the standard articulated in *Carlton* would effectively overrule *McKesson* and sweep away the constitutional protections accorded taxpayers against taxes collected under invalid laws.

III. BUDGET SHORTFALLS DO NOT GIVE STATE COURTS LICENSE TO DENY THE DUE PROCESS RIGHTS OF TAXPAYERS

In retroactively eliminating Johnson Controls' right to claim refunds, Kentucky rationalized its actions on "equity" grounds. (App. 7.) The State essentially argued that (1) the revenue policy wrongfully forbidding combined reporting was adopted in good faith; (2) the monies collected under the separate company reporting regime had been spent; and (3) the payment of refunds to Johnson Controls would threaten the fiscal well-being of the Commonwealth.⁴ While the economic recession weighs heavily on state finances, Kentucky should not be permitted to put its needs above the command of the Due Process Clause by refusing to return to taxpayers what the Commonwealth had no right to take in the first instance. Willful disregard of due process considerations cannot be rewarded.

More than two centuries ago, the Framers recognized the need for the federal courts to safeguard rights against the parochialism of the States. In *The Federalist No. 80*, Alexander Hamilton used the example of claims to land under grants of different States to underscore the need for diversity jurisdiction:

The courts of neither of the granting states could be expected to be unbiased. The laws may have even prejudged the question, and tied the courts

⁴ The Court has previously intervened to prevent States from putting revenue needs ahead of a taxpayer's right to a meaningful remedy. See, e.g., *South Central Bell Tel. Co. v. Alabama*, 526 U.S. 160 (1999); *Reich v. Collins*, 513 U.S. 106 (1994); *Harper v. Virginia Dep't of Taxation*, 509 U.S. 86 (1993).

down to decisions in favour of the grants of the state to which they belonged. And even where this had not been done, it would be natural that the judges, as men, should feel a strong predilection to the claims of their own government.

THE FEDERALIST NO. 80, *reprinted in* II THE DEBATE ON THE CONSTITUTION 476, 479-80 (Library of America 1993). Justice Story elaborated in *Martin v. Hunter's Lessee*, 14 U.S. (1 Wheat.) 304, 347 (1816):

The constitution has presumed (whether rightly or wrongly we do not inquire) that state attachments, state prejudices, state jealousies, and state interests, might sometimes obstruct, or control, or be supposed to obstruct or control, the regular administration of justice.⁵

See John P. Frank, *Historical Bases of the Federal Judicial System*, 13 LAW & CONTEMP. PROBS. 3, 22-28 (1948) (diversity jurisdiction was the product in part of “[t]he desire to avoid regional prejudice against commercial litigants, based in small part on experience and in large part on common-sense anticipation.”).

To be sure, the insularity of the States has generally tempered over the years, and the concerns that led to the development of diversity jurisdiction are not wholly present here. Nevertheless, the animating principle remains the same and the result of turning a blind eye to the States’ undisguised self-interest just as pernicious. The Court “cannot leave

⁵ See THE FEDERALIST NO. 81 (Alexander Hamilton), *reprinted in* II THE DEBATE ON THE CONSTITUTION, at 487-88 (“The most discerning cannot foresee how far the prevalency of a local spirit may be found to disqualify the local tribunals for the jurisdiction of national causes . . .”).

to the States the formulation of the authoritative laws, rules, *and remedies designed to protect people from infractions by the States of federally guaranteed rights.*” *Chapman v. California*, 386 U.S. 18, 21 (1967) (emphasis added).

Amicus TEI submits that unless the Court affirms Johnson Controls’ right to meaningful relief in this case, the States will have an incentive to enact invalid state laws and regulations—“rolling the dice” with the due process rights of taxpayers, knowing that—at worst—they may have to mend their ways in the future.

Kentucky’s denial of refunds could also disrupt the orderly administration of the tax laws in the States by encouraging taxpayers not to pay a suspect tax (rather than to pay the tax and then seek a refund that they may never receive). Indeed, if sustained, the Kentucky legislature’s retroactive legerdemain would grant States a veritable license to have their departments of revenue promulgate regulations or policy statements with questionable statutory basis risking nothing but the possible need for retroactive legislation to avoid the payment of any refunds. To protect their rights, sophisticated taxpayers might feel compelled to make *all* payments under protest (if such an option existed) and then file protective claims for refunds in respect of the entire amount, a strategy that could overburden state revenue departments and ultimately the courts. The unwary, however, would likely find themselves deprived of any real remedy, undermining the fairness and integrity of the system. Thus, while a requirement to pay under protest might be constitutionally palatable on a going-forward basis (assuming the procedure is clear and certain), it could undermine the efficiency

of the tax collection system by making it far more adversarial.

Kentucky's actions cannot be viewed in isolation. With greater frequency, the States seem unwilling to abide by the rules and to face up to the consequences of their wrongful actions. Like the reprobate who continually promises to reform but repeatedly fails, the States should no longer be able to merely pledge fealty to the commands of the Constitution and the tenets of fair play. Their words should no longer be considered sufficient; they should be judged by their actions. And in this case, the actions of the Commonwealth of Kentucky should be found wanting. As the Court so forcefully, and rightfully, proclaimed in *Griffith v. Kentucky*, 479 U.S. 314 (1987): "The time for toleration has come to an end." *Id.* at 323 (quoting *United States v. Johnson*, 457 U.S. 537, 555-56 n. 16 (1982)).⁶

⁶ The Court applied the holding of *Griffith v. Kentucky* (a criminal procedure case) to refunds of improperly collected state taxes in *James M. Beam Distilling Co. v. Georgia*, 501 U.S. 529, 539 (1991).

CONCLUSION

For the foregoing reasons, the Court should grant the petition for a writ of certiorari and reverse the decision below.

Respectfully submitted,

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