Nos. 16-698, 16-687, 16-688, 16-697, 16-699, AND 16-736

IN THE
Supreme Court of the United States

INTERNATIONAL BUSINESS MACHINES CORPORATION,
Petitioner,
v.
MICHIGAN DEPARTMENT OF TREASURY,
Respondent.

SONOCO PRODUCTS COMPANY, ET AL.,
Petitioners,
v.
MICHIGAN DEPARTMENT OF TREASURY,
Respondent.

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

GILLETTE COMMERCIAL OPERATIONS NORTH AMERICA & SUBSIDIARIES, ET AL.,
Petitioners,
v.
MICHIGAN DEPARTMENT OF TREASURY,
Respondent.

GOODYEAR TIRE & RUBBER COMPANY, ET AL.,
Petitioners,
v.
MICHIGAN DEPARTMENT OF TREASURY,
Respondent.

DIRECTV GROUP HOLDINGS, LLC,
Petitioner,
v.
MICHIGAN DEPARTMENT OF TREASURY,
Respondent.

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

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

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INTRODUCTION AND STATEMENT OF INTEREST

Amicus curiae Tax Executives Institute, Inc. ("TEI") respectfully files this brief in support of the petitioners in *International Business Machines Corporation v. Michigan Department of Treasury,* No. 16-698, *Sonoco Products Company, et al. v. Michigan Department of Treasury,* No. 16-687, *Skadden, Arps, Slate, Meagher & Flom, LLP, v. Michigan Department of Treasury,* No. 16-688, *Gillette Commercial Operations North America and Subsidiaries, et al. v. Michigan Department of Treasury,* No. 16-697, *Goodyear Tire & Rubber Company, et al. v. Michigan Department of Treasury,* No. 16-699, and *DIRECTV Group Holdings*, *LLC v. Michigan Department of Treasury*, No. 16-736 (the "Michigan Petitions").[1]

The Michigan Petitions stem from the Michigan Court of Appeals' decision in *Gillette Commercial Operations North America and Subsidiaries v. Department of Treasury*, 878 N.W.2d 891 (Mich. Ct. App. 2015) ("*Gillette*"). *Gillette* upheld a six-year retroactive tax amendment ("Retroactive Legislation") that retroactively withdrew Michigan as a party to the Multistate Tax Compact ("Compact").

TEI is a voluntary, nonprofit association of corporate and other business executives, managers, and administrators responsible for the tax affairs of

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[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.

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 pursue refund claims denied by taxing authorities. 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.

TEI and its members also have much at stake to ensure the tax system is fair, administrable, and efficient. This need is particularly profound in the area of state and local taxation, where taxpayers must navigate the myriad of state tax statutes, regulations, and ordinances that affect their businesses. *Gillette* threatens to return multistate taxpayers to the state of inconsistency and uncertainty that existed prior to the Compact's enactment. TEI thus has a vital interest in the Michigan Petitions for this reason as well.

SUMMARY OF REASONS FOR GRANTING THE PETITIONS

Gillette is the latest in a series of state court decisions that have used an extraordinarily permissive

standard to evaluate the validity of retroactive tax legislation. *Gillette* purports to be based upon this Court's decision in *United States v. Carlton*, 512 U.S. 26 (1994). However, *Gillette* extends this Court's holding in *Carlton* beyond recognition. This Court's intervention is necessary to reconfirm due process imposes meaningful constraints on retroactive tax legislation, especially when such legislation is enacted to overturn judicial decisions.

The pressing need for this Court's guidance is further evidenced by a separate petition, *Dot Foods, Inc. v. Department of Revenue of the State of Washington,* No. 16-308, awaiting this Court's review. The Dot Foods petition challenges the Washington Supreme Court's decision in *Dot Foods, Inc. v. State of Washington, Dep't of Revenue*, 372 P.3d 747 (Wash. 2016) ("*Dot Foods*"), which upheld a 27-year retroactive tax amendment using a similarly lenient standard. TEI also filed a separate *amicus* brief in support of the Dot Foods petition.

Gillette and *Dot Foods* are inconsistent with fundamental principles of sound tax policy. It is axiomatic that 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 such changes will have significant financial effects on taxpayers. This is especially true when the courts have been called upon to interpret the laws as written and the legislation disproportionately affects out-of-state taxpayers.

The Michigan and Washington cases demonstrate that state legislatures, if left unchecked, will not exercise restraint voluntarily and will continue this practice of retroactively overruling taxpayer-favorable

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 precedent.

This Court should also grant the Michigan and Washington petitions to resolve the significant differences among state courts purporting to apply *Carlton*. *Carlton* 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* generally take one of two approaches. Courts applying the first approach adhere closely to the analysis this Court conducted in *Carlton* and consistently hold that taxes with retroactive periods exceeding one or two years are invalid because the period is not "modest."

Courts employing the second approach (such as Michigan and Washington) posit that retroactive tax legislation is constitutional as long as the legislature had a legitimate purpose for the retroactive amendment and the retroactive period is rationally related to that legislative purpose. These courts reason that raising revenue is a legitimate purpose and uphold 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."

Finally, this Court's review is warranted because the legislation at issue in *Gillette* seeks to retroactively withdraw Michigan from the Compact. The Compact is a multistate agreement enacted by the States in the 1960s and 1970s to forestall then-imminent federal legislation that would have mandated uniform apportionment rules to calculate multistate taxpayers' state income tax liabilities. States sought to avoid the federal legislation by entering into the Compact and providing taxpayers with the right to calculate their state income tax liabilities using the State's own formula or the Compact's equally-weighted, three factor formula.

Gillette holds that the Compact was not a binding agreement and thus Michigan's retroactive withdrawal from the Compact does not violate the Contract Clause. U.S. Const., Art. I, § 10, cl. 1. This determination is directly contrary to the terms and purpose of the Compact. Moreover, allowing States to retroactively withdraw from the Compact and avoid the obligations they have already incurred undermines fundamental principles of tax policy. TEI urges the Court to grant the Michigan Petitions for this reason as well.

REASONS FOR GRANTING THE PETITIONS

I. *GILLETTE* IS AN IMPERMISSIBLE EXTENSION OF THIS COURT'S DECISION IN *CARLTON*.

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 unlimited power to tax retroactively, years after taxpayers have relied upon the law as written, is even more dangerous. Yet, the Michigan Court of Appeals' decision in *Gillette* blesses its

legislature's wish to impose retroactive tax obligations at will. This is not only unjust, but is at odds with this Court's ruling in *Carlton*.

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." *E. Enters. v. Apfel*, 524 U.S. 498, 501 (1998) (*citing Gen. 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, § 1398 (5th ed. 1891), ("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*; U.S. Const., Amend. V, § 1.

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 used to evaluate 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).

However, the Court confirmed that the tests applied to prospective and retroactive tax legislation are, in fact, different: "[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)).

When upholding the legislation in *Carlton*, 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 in the Tax Reform Act of 1986," which "granted 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 on his or her death for his or her estate to sell stock in this manner and obtain the tax deduction. 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. Shortly after its passage, however, 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 an 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. *Gillette* Cannot Be Reconciled with this Court's Analysis in *Carlton*.

Carlton presented a relatively easy case: the retroactive amendment fixed a simple and obvious drafting error, which, if left uncorrected, would have allowed a deceased's estate to claim tax benefits from the sale of stock the deceased individual never owned. *Id*. at 27-28 (opinion of the Court). The IRS provided notice of the error to the public within months, and Congress immediately thereafter proposed legislation to correct it and limited the retroactive period to slightly over one year. *Id*. at 29. The Michigan legislature's actions upheld in *Gillette* are easily distinguishable from Congress' prompt action to correct a drafting mistake in *Carlton*.

1. The Michigan Supreme Court Determined in *IBM* that the Legislature Intended to Provide Taxpayers with the Compact Election Prior to 2011.

Michigan became a party to the Compact in 1970, through which it provided taxpayers with the option to apportion their income using the State's formula or the Compact's equally-weighted, three-factor apportionment formula. 1969 Mich. PA 343; Mich. Comp. Laws § 205.581, Art. III(1). At the time, Michigan's Single Business Tax ("SBT") also used an equally-weighted, three-factor apportionment formula to apportion income. *Int'l Bus. Machs. Corp. v. Dep't of Treasury*, 852 N.W.2d 865, 874 (Mich. App. 2014) ("*IBM*").

In 2007, the legislature repealed Michigan's SBT and enacted the Michigan Business Tax ("MBT"). The MBT required taxpayers to apportion their income using an apportionment formula based on sales. 2007 Mich. PA 36; Mich. Comp. Laws § 208.1101 *et seq*. (effective January 1, 2008); Mich. Comp. Laws § 208.1301(1) ("2007 Legislation"). However, the legislature did not repeal the Compact or the Compact's election provision when it enacted the MBT. Mich. Comp. Laws § 205.581, Art. III(1).

In 2010, the Michigan legislature considered, and rejected, a bill that would have expressly repealed the Compact's election provision to the beginning of 2008. 2010 Mich. HB 6351. In 2011, the legislature replaced the MBT with the Michigan Corporate Income Tax ("CIT") and expressly provided that taxpayers could not apportion their income using the Compact's formula for the CIT. 2011 Mich. PA 38; 2011 Mich. PA 39 (effective Jan. 1, 2012). The legislature also amended Michigan's laws to provide that the Compact's election and apportionment provisions were not applicable to the MBT as of January 1, 2011. 2011 Mich. PA 40 ("2011 Legislation"). The 2011 Legislation thus purported to end taxpayers' right to use the Compact's apportionment formula as of 2011.

Numerous taxpayers had elected to apportion their income using the Compact's three-factor apportionment formula on originally filed or amended returns for tax years prior to 2011. The Department of Treasury ("Department") denied those taxpayers' rights to make this election, claiming the 2007 legislation implicitly repealed this right, and recalculated taxpayers' liabilities based on the MBT's sales-based apportionment formula. IBM's case involving its 2008 tax year was the first to proceed through the Michigan

courts and all other Compact cases (including IBM's 2009 and 2010 cases) were held in abeyance pending the resolution of IBM's 2008 appeal.

On July 14, 2014, the Michigan Supreme Court decided *IBM*, which held that IBM was entitled to use the Compact's three-factor apportionment formula when calculating its 2008 tax liability. A plurality of the Court concluded "the Legislature . . . had full knowledge of the Compact and its provisions. Even with such knowledge . . . the Legislature left the Compact's election provision intact." *Id*. at 657.

The plurality further found that its "interpretation allows the Compact's election provision to serve its purpose of providing uniformity to multistate taxpayers in light of Michigan's enactment of an apportionment formula different from the Compact's formula." *Id*. at 661. The plurality also noted the 2011 Legislation, which ended taxpayers' rights to elect Compact apportionment as of January 1, 2011, supported this conclusion and implied taxpayers could use the Compact's apportionment formula for tax years prior to that date. *Id*. at 658-59. Thus, while *IBM* only involved IBM's 2008 tax year, the court's reasoning applies equally to all taxpayers for all tax years prior to 2011.

2. The Retroactive Legislation Seeks to Reverse the Michigan Supreme Court's Findings in *IBM*.

Before judgment was entered in *IBM*, the Governor signed the Retroactive Legislation into law. The Retroactive Legislation states:

> "[The Compact] is repealed retroactively and effective beginning January 1, 2008. It is the intent of the legislature that the repeal of [the

> Compact] is to express the original intent of the legislature regarding the application of [the MBT's apportionment provision], and the intended effect of that section to eliminate the [Compact's election provision], and that the 2011 amendatory act that amended the [Compact's election provision] was to further express the original intent of the legislature regarding the application of [the MBT's apportionment provision] and to clarify that the [Compact's election provision] is not available under the income tax act of 1967. . . ."

2014 Mich. PA 282., Enacting Section 1.

Thus, the Retroactive Legislation retroactively repealed the Compact for over six years, retroactively eliminated taxpayers' right to apportion their income using the Compact's three-factor apportionment formula, eliminated refund claims that would have been due, and revived assessments that would have been invalidated under the *IBM* decision. Moreover, the Retroactive Legislation boldly claims that it reflects the intent of the 2007 legislature when it enacted the MBT and the intent of the 2011 legislature when it repealed the Compact's election provision to the beginning of 2011. These claims are directly contrary to the Michigan Supreme Court's determination in *IBM* that the 2007 legislature did not repeal the Compact's election provision by implication and that the 2011 legislature intended to provide the election to taxpayers for their 2008 – 2010 tax years.

3. The Retroactive Legislation Does Not Meet the Standards Set by *Carlton*.

Litigation challenging the Retroactive Legislation ensued, culminating in the Michigan Court of Appeals'

decision in *Gillette*. However, *Gillette* cannot be squared with this Court's analysis in *Carlton*.

a. The Retroactive Legislation Lacked a Legitimate Legislative Purpose.

Gillette erroneously concluded the Retroactive Legislation satisfied *Carlton*'s legitimate legislative purpose requirement 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 that interpretation." *Gillette*, 878 N.W.2d at 910 (emphasis added). *Carlton*, however, supports neither of these propositions.

First, *Carlton* held Congress had a legitimate legislative purpose when it enacted a retroactive amendment to promptly correct a drafting error that Congress determined it had made. *Carlton*, 512 U.S. at 32. In contrast, the Michigan legislature amended a statute retroactively to obviate a court decision it disliked. A current legislature should not be permitted to do what it wishes a prior legislature had done years ago.

The Michigan Supreme Court made express findings in *IBM* regarding the legislature's intent when it entered into the Compact (1970), when it enacted the MBT (2007), and when it first purported to end taxpayers' rights to use the Compact's apportionment formula (2011). Specifically, the *IBM* court held that "the Compact's election provision, by using the terms 'may elect,' contemplates a divergence between a party state's mandated apportionment formula and the Compact's own formula – either at the time of the Compact's adoption by a party state or at some point in the future. Otherwise, there would be no point in

giving taxpayers an election between the two." *IBM*, 852 N.W.2d at 874. Further, "the Legislature, in enacting the [MBT] had full knowledge of the Compact and its provisions" but "left the Compact's election provision intact" while expressly repealing or amending other inconsistent acts. *Id*. at 874-75. "The Legislature could have—but did not—extend this retroactive repeal to [2008]" and thus "created a window in which it did not expressly preclude use of the Compact's election provision. . . ." *Id*. at 876.

It is the role of the Michigan courts, not the legislature, to interpret Michigan's statutes. Under a system of divided government and the Michigan Constitution, the legislature writes the laws, the executive branch administers them, and the courts interpret them as written. Mich. Const. 1963, art. 3, § 1; art. 4, § 1; art. 5, § 1; *In re Manufacturer's Freight Forwarding Co*., 292 N.W. 678 (Mich. 1940). While it is legitimate for the legislature to amend its statutes prospectively in response to judicial interpretations, it is not a legitimate exercise of legislative power to overrule a judicial interpretation retroactively simply because the legislature dislikes the result.

Second, the Michigan legislature's desire to mitigate the prospect of significant revenue loss arising from the *IBM* decision does not salvage its legislative purpose. The revenue loss in *Carlton* was unanticipated because it arose from a drafting error. *Carlton*, 512 U.S. at 31-32. Indeed, any reasonable person evaluating the legislation at issue in *Carlton* should have known that Congress did not intend to extend the deduction to post-death purchases of stock because the tax benefit was too good to be true. In contrast, the revenue loss in *Gillette* arose from what the Michigan Supreme Court determined was a purposeful decision

to provide taxpayers with the right to apportion their income using the Compact's three-factor apportionment formula prior to 2011. *IBM*, 852 N.W.2d. at 875. Moreover, no claim of surprise is supportable here, as Michigan had notice regarding the potential revenue loss when taxpayers made the election on their original or amended tax returns and when the legislature deliberately decided not to repeal the Compact election retroactively in the 2010 and 2011 legislation.

b. The Michigan Legislature Did Not Act Promptly or Establish a Modest Period of Retroactivity.

Gillette also cannot be reconciled with *Carlton*'s requirement of prompt action and a modest period of retroactivity. In *Carlton*, the U.S. Supreme Court lauded the IRS and Congress for the actions taken within months of the original statute's enactment, the legislation's passage shortly thereafter, and the establishment of a retroactive period slightly greater than one year. *Carlton*, 512 U.S. at 33.

However, the Michigan legislature's action was anything but prompt. For *Gillette* to be comparable to *Carlton*, the Michigan legislature would have repealed the Compact's election provision in 2008, shortly after the MBT was enacted. Instead, the legislature stood by idly as the Department litigated the Compact election cases for years and amended the statute only after *IBM* was decided, six years later.

The Michigan legislature's failure to act promptly is compelling evidence that the legislature was not simply correcting a mistake. Rather, the 2014 legislature's actions were a bald attempt to substitute the 2007 legislature's policy decision with the 2014

legislature's policy decision and to overrule this Court's decision in *IBM*.

This assertion is further underscored by the 2010 legislature's consideration, and rejection, of a bill that would have expressly repealed the Compact's election provision back to 2008 and the 2011 legislature's amendment of Michigan's laws to provide that the Compact's election and apportionment provisions were not applicable to the MBT as of January 1, 2011. 2010 HB 6351; 2011 PA 40. It defies logic to contend that the 2014 legislature was correcting a mistake because, if it was, the 2010 and 2011 legislatures would have taken this action rather than creating a three-year window during which taxpayers could use the Compact's election.

Moreover, the Retroactive Legislation's six-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. *Gillette* skirts whether the Retroactive Legislation's six-year period of retroactivity is modest in light of *Carlton* by referencing the Michigan Court of Appeals' own prior decisions in *GMAC LLC v. Department of Treasury*, 781 N.W. 2d 310 (Mich. Ct. App. 2009) (upholding a seven-year period), and *General Motors Corp v. Department of Treasury*, 803 N.W.2d 698 (Mich. Ct. App. 2010), *cert. denied*, 132 S. Ct. 1143 (2012) (upholding a five-year period). However, the Michigan Court of Appeals did not apply the modesty requirement this Court articulated in *Carlton* when it decided *GMAC* or *General Motors* and *Gillette*'s reliance on these cases continues to put Michigan at odds with the *Carlton* decision.

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 Mich. Comp. Laws § 205.54i; rather, plaintiffs are challenging the Legislature's disapproval and corrective action with regard to the *DiamlerChrysler* decision." *GMAC*, 781 N.W. 2d at 320.

In *General Motors*, the Michigan Court of Appeals acknowledged *Carlton*'s relevance but nonetheless held that because this Court "did not specifically include a temporal 'modesty' requirement" when it "summarize[ed] its holding," a modest period of retroactivity was not per se required. *Gen. Motors*, 803 N.W.2d at 710-11. *General Motors* instead opted 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*. The court held the retroactive tax legislation at issue was constitutional under this test because "the period of retroactivity is consistent with the applicable statute of limitations" and "[b]y its waiving application of the statute of limitations, we conclude GM has waived any interest it may have had under the Due Process Clause to 'finality and repose.'" *Id*. at 712.

That test, of course, is not the standard articulated by this Court in *Carlton*, and for good reason. Statutes of limitation provide certainty to taxpayers and governments by limiting the time for governments to seek additional taxes and the time for taxpayers to recover tax overpayments. The question of how long it is appropriate to allow governments to assess or collect a liability established under existing law is entirely different than the question of how long governments

should be given to change the manner in which a taxpayer's liability is calculated in the first instance.

Gillette creates a perverse invitation: it allows a State to litigate questionable positions and then retroactively overrule court decisions it does not like with impunity. This result extends this Court's holding in *Carlton* beyond recognition and is inconsistent with statements this Court has made suggesting that retroactive legislation is subject to a higher standard than legislation that is only prospective.

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

This Court's review is also necessary to resolve the conflict among state courts interpreting *Carlton*. As set forth in greater detail in the *amicus curiae* brief that TEI filed in *Dot Foods, Inc. v. Department of Revenue of the State of Washington,* No. 16-308 (currently pending) (pp. 10-14), state courts have generally adopted one of two approaches to determine whether retroactive tax legislation complies with the Due Process Clause. U.S. Const., Amend. XIV, § 1. These two lines of cases have resulted in dramatically different conclusions regarding the acceptable period of retroactivity for retroactive tax legislation.

Courts adopting the first approach 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. *See*, *e.g.*, *Rivers v. State*, 490 S.E.2d 261 (S.C. 1997) (invalidating a tax amendment with a two to three-year retroactive period); *City of Modesto v. Nat'l Med, Inc.*, 128 Cal. App. 4th 516 (2005) (invalidating an amendment with an eight-year period of retroactivity that the City waited two years to adopt).

Courts adopting the second approach, including the Washington and Michigan courts, have sidestepped or rejected the factors considered in *Carlton*'s analysis. These courts have, in essence, concluded that retroactive legislation is constitutional if the legislature had a legitimate purpose for the retroactive amendment – such as reversing a court decision the State lost or raising revenue – and the retroactive period was rationally related to that purpose. This approach renders the second part of that test a nullity for all retroactive tax legislation.

Courts applying this approach have thus upheld retroactive tax legislation even where the legislature waited years to take action or only took action after a judicial loss or the period of retroactivity was far from "modest." *See*, *e.g.*, *Dot Foods, Inc. v. State of Washington, Department of Revenue*, 372 P.3d 747 (Wash. 2016) (upholding a 27-year retroactive amendment with a four-year impact on the taxpayer to obviate a court's interpretation of a statute); *In re Estate of Hambleton*, 335 P.3d 398 (Wash. 2014), *cert. denied*, 136 S. Ct. 318 (2015) (upholding eight-year

retroactive amendment to obviate a court's interpretation of a statute); *Gillette Commercial Operations*, 878 N.W. 2d 891 (upholding six-year retroactive amendment to obviate a court's interpretation of a statute; *GMAC LLC v. Dep't of Treasury*, 781 N.W. 2d 310 (upholding seven-year retroactive amendment to obviate a court's interpretation of a statute); *Gen. Motors Corp. v. Dep't of Treasury*, 803 N.W. 2d 698 (Mich. App. 2010) (upholding five to eleven-year retroactive amendment to obviate a court's interpretation of a statute); *Miller v. Johnson Controls*, 296 S.W. 3d 392 (Ky. 2009), *cert. denied*, 560 U.S. 935 (2010) (upholding six- to ten-year retroactive amendment to obviate a court's interpretation of a statute).

The Court's review is thus necessary to resolve this conflict regarding the proper interpretation and application of *Carlton* and to provide guidance to state courts evaluating the constitutionality of retroactive tax legislation.

III. SOUND TAX POLICY AND ADMINISTRATION DEMAND THAT RETROACTIVE TAX LEGISLATION BE ENACTED SPARINGLY.

This Court's intervention is also necessary to ensure that retroactive tax legislation does not undermine sound tax policy.

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, as the Michigan Court of Appeals has done.

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. However, doing so retroactively after a court has interpreted the law, as the Michigan legislature has done, cannot be reconciled with basic tenets of sound tax policy because it disrupts taxpayer expectations.

Taxpayers will be discouraged from seeking judicial review of an adverse decision from a taxing agencies if legislatures have unlimited discretion to retroactively overrule any court decision 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, as well as the checks and balances the judiciary confers, and renders the judicial process illusory.

In addition, allowing state legislatures to retroactively overrule taxpayer-favorable decisions wastes judicial resources. Without question, the resources dedicated by courts on such matters has been significant. *Gillette* consolidated 50 separate Compact election cases, while additional cases were pending at the Michigan Tax Court, Court of Claims, and before the Department. It was patently irresponsible for the Michigan legislature to stand by for years while the Department litigated questionable issues and cluttered the courts with cases that the legislature then rendered obsolete via the Retroactive Legislation.

Moreover, *Gillette* has the unfortunate effect of treating similarly-situated taxpayers differently. IBM, as the lead litigant, was entitled to apportion its income using the Compact's three-factor apportionment formula for its 2008 tax year (the period litigated in *IBM*). *International Business Machines v. Dep't of Treasury*, No. 327359, 2016 WL 3941278 (Mich. Ct. App. Jul. 21, 2016). However, the Retroactive Legislation precludes taxpayers whose cases were held in abeyance while IBM's case was pending from using the Compact's apportionment election for their 2008 tax years, and neither IBM nor any other taxpayer were able to use this apportionment method for their 2009 or 2010 tax years.

This result is not only unjust; it 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 estoppel claims.

IV. THE RETROACTIVE LEGISLATION VIOLATES THE CONTRACT CLAUSE OF THE U.S. CONSTITUTION.

Finally, this Court's review is warranted because the Michigan legislature's attempt to retroactively withdraw the State from the Compact violates the Contract Clause. U.S. Const., Art. I, § 10, cl. 1. TEI refers the Court to the *amicus curiae* brief that TEI filed in support of the petitioner in *Gillette Company v. California Franchise Tax Board*, No. 15-1442 (denied Oct. 11, 2016) (pp. 4-16). That brief explains, in detail, why the Michigan Court of Appeals' determination that the Compact is not a binding agreement, and thus could be repealed retroactively, is directly contrary to the terms and purpose of the Compact and undermines fundamental principles of tax policy and administration. States that entered into the Compact are entitled to collectively amend it or withdraw from the agreement prospectively; however, States must comply with the Compact's terms and honor the commitments they made pursuant to that agreement unless and until they take such action.

CONCLUSION

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

Respectfully submitted,

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