No. 16-308

In the Supreme Court of the United States

DOT FOODS, INC.,

Petitioner,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

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

BRIEF OF THE AMERICAN COLLEGE OF TAX COUNSEL AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

Peter L. Faber
Counsel of Record
McDermott Will & Emery LLP
340 Madison Avenue
New York, NY 10173
(212) 547-5585
pfaber@mwe.com

Stewart M. Weintraub
Chamberlain Hrdlicka
300 Conshohocken State Road
Suite 570
West Conshohocken, PA 19428
(610) 772-2322
Stewart.Weintraub@chamberlainlaw.com
Counsel for Amicus Curiae

Becker Gallagher · Cincinnati, OH · Washington, D.C. · 800.890.5001

QUESTION PRESENTED

This Court has held that a law applied retroactively that increases a taxpayer's tax liability satisfies the Due Process Clause of the United States Constitution[*] only if it furthers a legitimate legislative objective by rational means. See, *United States v. Carlton*, 512 U.S. 26, 30-31 (1994). The Washington Supreme Court in this case effectively held that raising additional revenue, by itself and without regard to the circumstances, is a "legitimate legislative purpose justifying a retroactive change to a tax statute." The question presented by this case is whether the Washington Supreme Court misapplied this Court's holding in *Carlton*. The question is particularly important because state legislatures throughout the United States are increasingly resorting to retroactive tax legislation to meet fiscal needs.

---

[*] United States Constitution, 5th and 14th Amendments.

TABLE OF CONTENTS

QUESTION PRESENTED i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iii

INTEREST OF AMICUS 1

INTRODUCTION AND SUMMARY 3

THE *CARLTON* CASE 5

ARGUMENT 9

CONCLUSION 16

TABLE OF AUTHORITIES

CASES

Caprio v. New York Dep't of Taxation and Finance,
25 N.Y.3d 744 (2015) 13

Dot Foods, Inc. v. Washington Dep't of Revenue,
215 P.3d 185 (Wash. 2009) 11

Gillette Commercial Operations N. Am. v. Dep't of Treasury,
2015 Mich. App. LEXIS 1818 (2015) 13

In re Bracken Estate,
175 Wash. 2d 549 (2012) 13

In re Hambleton Estate,
181 Wash. 2d 802 (2014), *cert. den*. 2015 U.S. LEXIS 6490 (2015) 13

Pension Benefit Guar. Corp. v. R.A. Gary & Co.,
467 U.S. 717 (1984) 3

United States v. Carlton,
512 U.S. 26 (1994) . . . . *passim*

STATUTES

26 U.S.C. §2057 5

Ky. Stats. §141.200 (16)-(18) 4

New York L. 2010, Ch. 57, Part C, §4 4

Va. Code §58.1-402(B)(8) 4

LEGISLATIVE

Act of April 23, 2010, ch. 23, sections 401 and 402, 2010 Wash. Sess. Laws 1st Spec. Sess. 1597 . . . 11

Act of June 13, 1983, ch 66, section 5, 1983 Wash. Sess. Laws, 1st Ex. Sess. 2021-22 (codified at Wash. Rev. Code section 82.04.423) 10

Act of September 11, 2014, No. 282, 2014 Mich. Pub. Acts 139 4

Laws of 2010, 1st Spec. Sess. ch. 23, section 401(3) 11

Tax Reform Act of 1986 . . . . 5, 7, 8

OTHER AUTHORITIES

Allan Murray and Jeffrey H. Birnbaum, "New Loophole May Help Many Beat Estate Tax," The Wall Street Journal (December 31, 1986) 6, 7

Brief for petitioner United States of America at 4-6, *United States v. Carlton*, 512 U.S. 26 (1994) . . . 8

I. Hellerstein, State Taxation. ¶4.17 (3rd ed. 2001 and 2016 Supp.) 13

Lee. A. Sheppard, "Senator Long leaves a Loophole for Post-Mortem Estate Planning," State Tax Notes (January 9, 1987) 6

Notice 87-13, 1987-1 C.B. 438, 442 7

Steve R. Johnson, "Retroactive Tax Legislation," State Tax Notes pp. 535-36 (August 15, 2016) . 13

William E. Mattingly and Zarina O'Hagin, Into the Future-ESOPs After 1986, Taxes-the Tax Magazine (November 1, 1986) 5, 6

INTEREST OF AMICUS

The American College of Tax Counsel (the "College") respectfully submits this brief as *amicus curiae* in support of Petitioner.[1]

The College is a nonprofit professional association of tax lawyers in private practice, in law school teaching positions, and in government, who are recognized for their excellence in tax practice and for their substantial contributions and commitment to the profession. The purposes of the College are:

- To foster and recognize the excellence of its members and to elevate standards in the practice of the profession of tax law
- To stimulate development of skills and knowledge through participation in continuing legal education programs and seminars;
- To provide additional mechanisms for input by tax professionals in development of tax laws and policy; and
- To facilitate scholarly discussion and examination of tax policy issues.

---

[1] Pursuant to Rule 37.6, counsel for *amicus curiae* states that no counsel for a party authored this brief in whole or in part, and no party or counsel for a party made a monetary contribution intended to fund the preparation or submission of this brief. Other than the *amicus curiae*, its members, or its counsel, the only monetary contributions to preparation or submission of its brief were made by individual tax practitioners acting in their individual capacities, not as representatives of their firms or other organizations. Petitioner and respondents have consented to the filing of an amicus brief by the College.

The College is composed of approximately 700 Fellows chosen in recognition of their outstanding reputations and contributions in the field of tax law and is governed by a Board of Regents consisting of one Regent from each federal judicial circuit, two Regents at large, the Officers of the College, and the last retiring President of the College.

This *amicus* brief is submitted by the College's Board of Regents and does not necessarily reflect the views of all members of the College, including those who are government employees.

The College submits this *amicus* brief because it is concerned that state courts have been misapplying the standards established by this Court in order to raise revenue through retroactive tax legislation. The uncertainty of when tax legislation may be applied retroactively does great harm to the fair and equitable administration of state and federal taxes. Taxpayers who, in good faith, relied upon the terms of a statute, in accordance with the interpretation of such statute by the state taxing authority, should not be subject to the upheaval caused by a retroactive change in the tax law that imposes new, unexpected fiscal burdens upon the taxpayer and that requires re-thinking of business operations and of personal and investment decisions. This is not only a problem for businesses. Individuals often rely on existing tax laws, for example in making charitable contributions and taking out home mortgages. Their reasonable expectations should not be retroactively upset.

INTRODUCTION AND SUMMARY

The seminal case addressing the question of whether retroactive tax legislation satisfies the constitutional requirement of due process is this Court's decision in *United States v. Carlton*, 512 U.S. 26 (1994). This Court held that retroactivity was justified only if it served a "legitimate legislative purpose furthered by rational means."[2] The Washington Supreme Court in this case, by holding that raising revenue itself was a "legitimate legislative purpose," misapplied this test and established a principle that, taken to its logical conclusion, would justify virtually any retroactive tax increase. Other than legislation granting an exemption or exclusion or reducing rates, virtually all tax legislation can be justified as "raising revenue." The Washington Supreme Court ignored the unique circumstances of the *Carlton* case, which involved the correction of an obvious legislative error that was identified very soon after the statute was enacted and which the taxpayer was admittedly exploiting for its own benefit. Conversely, in the case at bar, as described more fully below, the statute at issue was enacted 27 years earlier, the taxing authorities had agreed with the taxpayer upon its application to their facts, and the Washington Supreme Court had affirmed the taxpayer's interpretation of the law. Undaunted by this set-back, the Washington State legislature revised the statute to the taxpayer's detriment, with 27 years retroactivity.

---

[2] 512 U.S. at 30-31, quoting *Pension Benefit Guar. Corp. v. R.A. Gary & Co.*, 467 U.S. 717, 733 (1984).

As a result, the matter returned to the judicial arena and the Washington Supreme Court upheld the retroactive elimination of the tax exemption based upon its reading of *Carlton* that simply raising revenue satisfies "a legitimate legislative purpose furthered by rational means." If the standard articulated by the Washington Supreme Court is a correct statement of the law, legislatures would have a blank check to impose retroactive tax increases upon taxpayers who had relied upon prior law to structure their affairs. In light of such a potential broad application of this Court's standard in *Carlton* to tax and non-tax cases, the College believes that it is imperative that the scope of this Court's "legitimate legislative purpose" concept be clarified.

The problem is not limited to this case. A number of legislatures in other states, perhaps recognizing the political difficulties involved with raising tax rates, are resorting to legislation that retroactively increases taxes.[3] Individuals and businesses who relied upon the tax laws that applied when they structured their affairs are seeing those expectations retroactively upset without warning and through no fault of their own.

There are circumstances in which retroactive tax legislation is both constitutional and appropriate as a matter of tax policy, but those circumstances need clarification for the benefit of state and local governments as well as for taxpayers.

---

[3] *See*, e.g., Act of September 11, 2014, No. 282, 2014 Mich. Pub. Acts 139; Va. Code §58.1-402(B)(8); New York L. 2010, Ch. 57, Part C, §4; Ky. Stats. §141.200 (16)-(18).

THE *CARLTON* CASE

Carlton involved a unique set of circumstances that required Congress to correct an obvious drafting error through retroactive tax legislation.

The Tax Reform Act of 1986 ("Act") was enacted by Congress in October 1986 as a complete replacement of the 1954 Internal Revenue Code. It was a massive piece of legislation, extending over several hundred pages. Among other changes, it totally overhauled the manner by which corporations and their shareholders were taxed. Buried within the Act (§1172 of the Act, codified as 26 U.S.C. §2057) was a special provision that provided an estate tax deduction for sales of employer securities to an employee stock ownership plan ("ESOP"). As enacted, the deduction equaled 50% of the proceeds received by the estate from a qualified sale of employer securities to an ESOP. The provision did not require that the employer securities sold to the ESOP be owned by the decedent at the time of his or her death. This was an acknowledged clear oversight by Congress. The mistake may have resulted from a failure of the drafters to focus upon this aspect of the provision. The ESOP provision was a very small part of this massive piece of legislation involving major tax policy changes.

The mistake was immediately apparent once commentators began to focus upon the Act's estate tax provisions. An article in Taxes-The Tax Magazine, published on November 1, 1986, nine days after the Act was signed by President Reagan, observed that "[t]he availability of this deduction appears to be virtually unlimited. There is no restriction that it apply to stock that is not readily tradable on an established market,

that the decedent have been an employee of the employer maintaining the ESOP, or that the decedent have owned the employer securities at the time of death."[4] Another article, published in Tax Notes, a leading tax journal, pointed out that the provision allowed an executor to use the proceeds of a qualifying sale of stock to an ESOP to buy still more stock and sell the new stock to the ESOP, thus "rolling over" the same funds multiple times and effectively eliminating the estate tax.[5] The article quoted one investment advisor as saying "It's a ridiculous loophole, a complete screw-up… there is no way to defend it. It's embarrassing." The Tax Notes article indicated that the ESOP proposals (and this was one of several) were presented as a package to the Senate Finance Committee and were added to the bill by the Committee without discussion. A Wall Street Journal article dated December 31, 1986, made the same point. It reported that Washington tax officials had started referring to the provision as "the repeal of the estate tax." A tax advisor was quoted as saying "This is the loophole you could drive a truck through… when I first saw it, I said boy, this is a real giveaway." The article indicated that an aide to the Senate Finance Committee observed that Senator Russell Long, who had sponsored the provision, did not intend for it to allow an estate to buy stock after a decedent's death. "It wasn't the intention to allow people to do post-death

---

[4] William E. Mattingly and Zarina O'Hagin, Into the Future-ESOPs After 1986, Taxes-the Tax Magazine (November 1, 1986).

[5] Lee. A. Sheppard, "Senator Long leaves a Loophole for Post-Mortem Estate Planning," State Tax Notes (January 9, 1987).

estate planning."[6] Although intended to encourage the expansion of ESOPs, the provision permitted the executor of the estate of a decedent who had owned no employer securities and who had no connection with the company to buy employer stock on the open market, sell it to the employer's ESOP, and receive a substantial estate tax deduction.

The decedent in the *Carlton* case, Willametta K. Day, had no connection with MCI Communications Corporation ("MCI"). She had never been employed by it and owned none of its stock at her death. The executor of her estate, Jerry W. Carlton, bought $11.2 million of MCI stock on the open market and sold it to the MCI ESOP two days later at a $631,000 loss. Thus, the transaction had no economic significance and Mr. Carlton stipulated that the transaction was engaged in purely to manufacture an estate tax deduction.

Recognizing that transactions like this would happen, the Internal Revenue Service, soon after the Act's passage, stated that it would seek corrective legislation. Within three months of the Act's enactment, during January 1987, the Service announced that it would apply the provision as if it required that the decedent own the ESOP stock on the date of death "[p]ending the enactment of clarifying legislation."[7] The Treasury Department estimated that the drafting mistake would result in "sham

---

[6] Allan Murray and Jeffrey H. Birnbaum, "New Loophole May Help Many Beat Estate Tax," The Wall Street Journal (December 31, 1986).

[7] Notice 87-13, 1987-1 C.B. 438, 442.

transactions" and a revenue loss of more than $7 billion, which was twenty times more than what had been anticipated.[8] Congress amended the statute on December 22, 1987, effective as if it had been enacted fourteen months earlier when the Act became law. The likelihood that corrective retroactive legislation would be enacted was apparent to many from the date on which the Act became law, and the public at large was advised that such changes would occur within three months of the enactment of the law.

When this Court addressed the retroactivity issue in *Carlton*, it was within the context of the unusual circumstances of the case. The Court said that it was "clear that Congress did not contemplate such broad applicability of the deduction when it originally adopted section 2057."[9] The Court noted that Senator Bentsen, when introducing the corrective legislation, stated that "Congress did not intend for estates to be able to claim the deduction by virtue of purchasing stock in the open market and simply reselling the stock to an ESOP."[10]

Upholding the corrective legislation, this Court stated that "Congress' purpose in enacting the amendment was neither illegitimate nor arbitrary. Congress acted to correct what it reasonably viewed as a mistake in the original 1986 provision that would

---

[8] Brief for petitioner United States of America at 4-6, *United States v. Carlton*, 512 U.S. 26 (1994).

[9] 512 U.S. at 31.

[10] 512 U.S. at 32.

have created a significant and unanticipated revenue loss."[11]

Thus, this Court in *Carlton* did not hold that raising revenue, without more, was a "legitimate legislative purpose" that could justify retroactive tax legislation.

ARGUMENT

The recent trend toward retroactive state tax legislation makes it all the more important that this Court clarify the circumstances when retroactive tax legislation will be permitted. Pronouncements by state courts, including the Washington Supreme Court in this case, that raising revenue by itself is sufficient to satisfy the "legitimate legislative purpose" test of *Carlton* reflects their respective beliefs that all retroactive tax legislation is justified regardless of the circumstances. This could mean that Congress, if it needed additional revenue, could retroactively repeal the personal income tax deductions for charitable contributions, home mortgage interest, or state and local taxes, thereby retroactively upsetting the financial plans of millions of taxpayers and creating totally unexpected tax bills. This case presents an opportunity for this Court to clarify the rules and to lay down guidelines so that legislators and their constituents have a better sense of what is permissible. Correcting an obvious drafting error, as in the *Carlton* case, is one of those circumstances. We do not suggest that this Court should lay down a comprehensive set of rules that would govern all future cases. No one's crystal ball is that good, but we do not believe that the

---

[11] 512 U.S. at 32.

formulation of the test in *Carlton* was correctly interpreted and applied to the case at bar.

Dot Foods, Inc. ("Dot") shows the mischief that can be caused when the legislature does not have an understanding of where the constitutional boundaries are laid. The case does not involve the correction of a drafting error or oversight. Rather, it involves a situation in which the legislature changed its mind as to whether certain sales operations should be exempt from tax and retroactively applied that change to unsuspecting taxpayers that had relied upon prior law to structure their business arrangements.

The Washington business and occupation ("B&O") tax generally applies to the gross receipts of companies doing business in the state. In 1983, the Washington legislature enacted an exemption from the B&O tax for out-of-state companies that sold consumer products and agreed to limit their in-state presence to sale solicitations by separate representatives.[12] The exemption established a tax policy that eliminated the pyramiding effect that could result from imposing the B&O tax at every level of the distribution chain and encouraged out-of-state sellers of consumer products to hire in-state sales representatives.

Dot structured its Washington sales efforts relying upon the statutory exemption and obtained a written ruling from the Washington Department of Revenue

---

[12] Act of June 13, 1983, ch 66, section 5, 1983 Wash. Sess. Laws, 1st Ex. Sess. 2021-22 (codified at Wash. Rev. Code section 82.04.423) App 2.

confirming that it qualified for the exemption. The Department later reversed itself and assessed B&O tax on Dot for the period 2000 through April 2006. Dot contested the assessment and the Washington Supreme Court held that the statute's plain language made Dot eligible for the exemption.[13] The Department of Revenue was unhappy with the court's affirmation of Dot's entitlement to the exemption and went to the legislature, which enacted legislation retroactive to 1983 (27 years earlier) repealing the exemption.[14] Although the legislature asserted that the Washington Supreme Court's upholding of the application of the exemption to Dot was inconsistent with the legislature's original intent, it cited no evidence in support of that contention. The Washington legislature identified the prevention of "large and devastating revenue losses" as the primary purpose for retroactively repealing the exemption.[15] Upholding the retroactive application of the law, the Washington Supreme Court mistakenly said that this was the same purpose that had been upheld by this Court in *Carlton*. The Washington Supreme Court dismissed as being irrelevant the facts that the revenue loss was anticipated and did not result from a legislative error, even though those circumstances were not present in

---

[13] *Dot Foods, Inc. v. Washington Department of Revenue*, 215 P.3d 185 (Wash. 2009).

[14] Act of April 23, 2010, ch. 23, sections 401 and 402, 2010 Wash. Sess. Laws 1st Spec. Sess. 1597; App. 3.8. This amendment did not apply to the refund that Dot had received from 2000 through 2006, but it otherwise applied to the exemption's entire history.

[15] Laws of 2010, 1st Spec. Sess. ch. 23, section 401(3).

Carlton. The Washington Supreme Court also said that a legitimate purpose for the retroactivity of the statute was to eliminate the incentive for in-state businesses to move operations outside Washington, although it is hard to see how that objective could justify retroactive legislation because companies that had previously moved operations outside of Washington obviously could not retroactively move them back into the state.

Unlike *Carlton's* legislative correction of an acknowledged drafting error, this case involves the retroactive legislative repeal of an exemption clearly allowed by the Washington legislature more than two decades before and the application of which to the taxpayer had been upheld by the state's highest court without any showing that the enactment of the original legislation was a mistake. Apart from the extended retroactive period of twenty-seven years, which, by itself, must be constitutionally suspect, this case presents a situation in which an exemption intentionally and consciously enacted by a state legislature and upon which taxpayers relied when structuring their businesses was retroactively repealed by the legislature almost three decades later for no reason other than to increase revenues.

As described *supra*, the need for clarification by this Court is all the more pressing because retroactive tax legislation has recently been enacted by other state legislatures and more can be expected. As Professor Steve R. Johnson has recently observed in a thoughtful article:

> The never-slaked thirst of governments – both federal and state – for additional revenue

> forebodes more retrospective tax legislation. Courts will be forced to decide whether to hold the line of constitutional restraint or to accommodate legislatures through more indulgent retroactivity doctrine. Some commentators have already seen a slide at the state level away from the former and toward the latter.[16]

While state court decisions reviewing these statutes have generally upheld retroactivity, to a great extent this has been attributable to the misapplication of this Court's ruling in *Carlton*. No clear principles have emerged from these cases addressing the constitutionality of retroactive tax legislation. The leading state and local tax treatise, authored by Professor Walter Hellerstein, observes that "the court decisions provide little concrete guidance."[17] The multiplicity of state tax cases addressing retroactive tax legislation is ample testimony to the frequency with which legislatures are resorting to retroactive tax legislation for the sole purpose of raising revenue.[18] There must be a limit. As Justice O'Connor's concurring opinion in *Carlton* observed, "[t]he

---

[16] Steve R. Johnson, "Retroactive Tax Legislation," State Tax Notes pp. 535-36 (August 15, 2016).

[17] I. Hellerstein, State Taxation. ¶4.17 (3rd ed. 2001 and 2016 Supp.).

[18] *See, e.g., Caprio v. New York Dep't of Taxation and Finance*, 25 N.Y.3d 744 (2015); *Gillette Commercial Operations N. Am. v. Dep't of Treasury*, 2015 Mich. App. LEXIS 1818 (2015); *In re Hambleton Estate*, 181 Wash. 2d 802 (2014), *cert. den*. 2015 U.S. LEXIS 6490 (2015), *In re Bracken Estate*, 175 Wash. 2d 549 (2012).

governmental interest in revising the tax laws must at some point give way to the taxpayer's interest in finality and repose."[19]

This Court stated in *Carlton* that the executor's reliance upon the state of the law as it existed when he entered into the transactions in question was not sufficient to establish a constitutional violation. It did not, however, state that reliance upon existing law should never be considered as a factor when challenging the constitutionality of a law, and the statement should be read in light of the facts of the case that was before this Court in *Carlton*. The executor in *Carlton* knew that he had taken advantage of a statutory provision enacted by mistake, that his transaction lacked economic significance, and that the transaction was designed solely to manufacture an artificial tax deduction. This should have been enough to put him on notice that retroactive repeal was a possibility. He did not enter into a legitimate business or investment arrangement relying upon then-existing law. He was relying upon an obvious "loophole" to obtain a tax benefit. That his particular reliance was viewed by this Court as being unjustified does not mean that taxpayer reliance should never be considered.

In the case at bar, a taxpayer conducting a legitimate business structured its sales operations in a manner that qualified for a B&O tax exemption that the Washington legislature had consciously adopted and that can by no stretch of the imagination be described as a mistake. Unlike the situation in

---

[19] 512 U.S. at 37-38.

Carlton, the taxpayer here had no reason to suspect that retroactive repeal of the exemption might be enacted.

The College submits that there is a major difference between reliance upon existing law erroneously and unintentionally enacted (*Carlton*) and reliance upon existing law properly and intentionally enacted. For the former the College acknowledges that reliance will usually be inappropriate but for the latter it submits that reliance will usually be justified.

Taxpayer reliance cannot be ruled out of the equation in all cases. There will be some cases in which it should be a bar against retroactive legislation. The reliance upon current tax laws placed by buyers of solar heating panel presents an obvious example. The Internal Revenue Code now provides a credit for buyers of solar heating panels for personal residences. The credit was designed to make it possible for people who could not otherwise afford it to heat their homes by solar energy. If Congress decided that the federal government needed more money and that a good way to obtain it would be to repeal this credit retroactively, the settled expectations and financial plans of thousands of Americans would be adversely affected. Taxpayers who relied upon the tax credit to buy and have the solar panels installed might not be able to pay their contractors. No one can reasonably say that their reliance upon prior law should not be taken into account when determining the constitutionality of any such retroactive repeal. Many people rely upon the deductibility of charitable contributions when deciding how much they can give to their church or their volunteer fire department. Should Congress be allowed

to retroactively repeal the charitable contributions deduction just because it needed to raise more money?

The College does not suggest that taxpayer reliance should always be a bar to retroactive tax legislation, but it believes that it should be a factor that should be considered, and that this Court should clarify the circumstances in which that will be the case.

CONCLUSION

State courts throughout the United States are misapplying this Court's decision in *Carlton* in connection with the circumstances when retroactive tax legislation will meet Due Process standards.

State legislatures, emboldened by court decisions that have given *Carlton* an unduly expanded reading, are enacting retroactive laws solely to increase revenues when no special circumstances justifying retroactivity are present. In this case, the period of retroactivity was 27 years. This case offers an ideal opportunity for this Court to clarify this important area of the law, and we respectfully request that the Court issue a writ of *certiorari* to the Supreme Court of Washington.

Respectfully Submitted

Peter L. Faber
Counsel of Record
McDermott Will & Emery LLP
340 Madison Avenue
New York, NY 10173
(212) 547-5585
pfaber@mwe.com

Stewart M. Weintraub
Chamberlain Hrdlicka
300 Conshohocken State Road | Suite 570
West Conshohocken, PA 19428
(610) 772-2322
Stewart.Weintraub@chamberlainlaw.com

For The American College of Tax Counsel