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

REPLY BRIEF FOR PETITIONER

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"Retroactivity is generally disfavored in the law in accordance with the fundamental notions of justice that have been recognized throughout history." *Eastern Enters. v. Apfel*, 524 U.S. 498, 532 (1998) (plurality opinion) (citations omitted). Yet here, the Washington Supreme Court has upheld a statute with a sweeping period of retroactivity, enacted for the flimsiest of reasons: to salvage financial planning that depended on tax revenues to which the State should well have known it was not entitled under its own law. Furthermore, the Washington Supreme Court's decision directly implicates an unsettled question Justice O'Connor highlighted the last time this Court considered the permissibility of retroactive tax legislation, *see United States v. Carlton*, 512 U.S. 26, 38 (1994), and deepens a conflict in the lower courts over that issue.

Attempting to stave off this Court's review, the State tries (1) to obfuscate the conflict over – and need for guidance regarding – the question presented; (2) to downplay the importance of the issue; (3) to distort the factual and procedural background of this case that make this case an excellent vehicle for review; and (4) to defend the Washington Supreme Court's holding on the merits. But none of these arguments works. Courts are deeply divided over that issue, and – as governmental, academic, and business commentators have recognized – this Court's guidance is sorely needed. This case is an excellent vehicle to give it. And the Washington Supreme Court's holding is wrong.

1. The State's contentions that the high courts of New York and South Carolina might have upheld the four-year retroactivity period applicable to petitioner are unavailing – as are the State's related suggestions that this Court has already "provide[d] ample guidance" concerning the constitutionality of statutes like the one involved here. BIO 8.

a. The State tries to harmonize *James Square Assoc. LP v. Mullen*, 993 N.E.2d 374 (N.Y. 2013), with the Washington Supreme Court's decision here by quoting the New York Court of Appeals' conclusion that the legislature there "did not have an important public purpose to make the law retroactive." BIO 11 (quoting *James Sq.*, 993 N.E.2d at 383). But the New York State Legislature had the same goal as the Washington Legislature had here: "raising money for the state budget." 993 N.E.2d at 383; *compare* Pet. App. 38a (ameliorating "the state's existing budget," which was "facing a two billion six hundred million shortfall").

And like the situation in *James Square*, the alleged "loss of revenue" here, *see* Pet. App. 39a, cannot plausibly be characterized as "unexpected." 993 N.E.2d at 383. In *Dot Foods, Inc. v. Dep't of Revenue*, 215 P.3d 185 (Wash. 2009) ("*Dot Foods I*"), the Washington Supreme Court merely construed the 1983 exemption statute in accordance with its "plain and unambiguous language," Pet. App. 2a – as well as the Washington Department of Revenue's own long-standing initial regulations, *Dot Foods I*, 215 P.3d at 189. Indeed, the Washington Supreme Court went out of its way to avoid this issue in the decision below by saying there is no need that the revenue

loss be "unanticipated" to justify a retroactive tax increase. Pet. App. 8a-9a.

That leaves the State's assertion that the New York Court of Appeals has more recently upheld a different tax law with "a retroactive reach of three and one-half years." BIO 11-12 (citing *Caprio v. N.Y. Dep't of Taxation & Fin.*, 37 N.E.3d 707 (N.Y. 2015)). But the law in that case was not truly retroactive at all. Rather, the new legislation was consistent with how the New York Court of Appeals ultimately construed prior law. *See Caprio*, 37 N.E.3d at 714 ("plaintiffs' . . . interpretation [of the original statute] is not, in itself, reasonable"). The *Caprio* case thus did not present the scenario here and in *James Square* – namely, applying a new statue that *changed* the law to past conduct.

The State's attempt to distinguish *Rivers v. State*, 490 S.E.2d 261 (S.C. 1997), also fails. The State claims that the South Carolina Supreme Court "did not note any legislative purpose for amending the tax." BIO 12. But the court assumed that the legislation – like the 2010 law here – was aimed at "achieving certain revenue goals," *Rivers*, 490 S.E.2d at 265, and noted in an earlier case that it had that "public purpose," *State ex rel. Carter v. State*, 481 S.E.2d 429, 430 n.1 (S.C. 1997), *cited in Rivers*, 490 S.E.3d at 262 n.1. The South Carolina Supreme Court simply deemed the goal of meeting budget insufficient to sustain the law, reasoning that "[a]t some point, . . . the government's interest in meeting its revenue requirements must yield to taxpayers' interest in finality regarding tax liabilities and credits." *Rivers*, 490 S.E.2d at 265. In *Rivers*, that

point was reached after as little as two years – half as long as the four years at issue here.

b. The conflict over the question presented alone should dispel the State's suggestion that "this Court has provided ample guidance" regarding the permissibility of retroactive tax legislation. BIO 14 (capitalization omitted). At any rate, this Court has recognized across a variety of constitutional doctrines that simply announcing the general standard of review applicable to certain kinds of legislation does not provide sufficient guidance to lower courts. We have known for years, for example, that race-conscious legislation is subject to strict scrutiny; yet this Court has continued to issue opinions refining those principles. *See, e.g., Fisher v. Univ. of Texas at Austin*, 136 S. Ct. 2198 (2016). We also learned decades ago that intermediate scrutiny applies to commercial speech restrictions; yet this Court has continued to hear and decide cases since. *See, e.g., Sorrell v. IMS Health, Inc.*, 564 U.S. 552 (2011). The same need for elucidation exists here.

Any doubt on that score is confirmed by consulting neutral observers. Commentators of all stripes – ranging from the Congressional Research Service to treatise authors and law professors – have highlighted the muddle that pervades this realm. *See* Pet. 13-14. Knowledgeable *amici* echo those descriptions of current case law. *See* Br. of Tax Execs. Inst. at 10-13; Br. of Council on State Taxation at 5-10; Br. of Am. Coll. of Tax Counsel at 12-13.

Furthermore, the conflict among state courts over how the Due Process Clause applies to retroactive tax increases continues to deepen. In *Ainley Kennels & Fabrication, Inc. v. City of*

Dubuque, 2016 WL 5480688 (Iowa Ct. App. Sept. 28, 2016), *application for further review filed*, Docket No. 15-1213 (Iowa Oct. 14, 2016), the Iowa Court of Appeals held that the retroactive revocation of a franchise fee exemption violated due process. Citing *Carlton* and quoting a decision from the Iowa Supreme Court – which, in turn, was based on this Court's due-process case law – the Iowa Court of Appeals explained that "[t]he period of retroactivity" for a tax law "can extend 'no further than two years or up to the adjournment of the last previous legislative session.'" *Id.* at *6 (quoting *City Nat'l Bank v. Iowa State Tax Comm'n*, 102 N.W.2d 381, 384 (Iowa 1960) (citing, in turn, *Welch v. Henry*, 305 U.S. 134 (1938))). The Iowa Court of Appeals also stressed that "the City's current budgetary considerations do not justify the retroactive application of the 2014 ordinance." *Id.* This reasoning demonstrates that, like the high courts of New York and South Carolina, the Iowa courts would not have upheld the revocation of petitioner's refund claims here.[1]

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[1] Petitions for certiorari challenging the Michigan Court of Appeals' decision in *Gillette Commercial Operations N. Am. & Subsidiaries v. Dep't of Treasury*, 878 N.W.2d 391 (Mich. Ct. App. 2015), *app. for leave to appeal denied*, 880 N.W.2d 230 (Mich. 2016), upholding the retroactive tax legislation at issue there, have now been filed. *See Sonoco Prods. Co. v. Mich. Dep't of Treasury*, No. 16-687, *Skadden, Arps, Slate, Meagher & Flom LLP v. Mich. Dep't of Treasury*, No. 16-688; *Gillette Commercial Operations N. Am. & Subsidiaries v. Mich. Dep't of Treasury*, No. 16-697, *Int'l Bus. Machines Corp. v. Mich. Dep't of Treasury*, No. 16-698; *Goodyear Tire & Rubber Co. v. Mich. Dep't of Treasury*, No. 16-699; *see also* Pet. 12 n.3 (discussing

2. The importance of clarifying limits on retroactive tax legislation should be manifest. Millions, if not billions, of dollars are at stake. The issue affects everything from personal financial planning to legislative budgeting to business investment to confidence in the integrity of government. *See* Br. of Inst. for Professionals in Taxation at 14-18; Br. of Tax Execs. Inst. at 22-23; Br. of Am. Coll. of Tax Counsel at 2, 15-16. None of the State's attempts to undermine these realities withstands scrutiny.

a. The State suggests this Court should deny review because it has denied previous petitions challenging retroactive tax laws. BIO 15 & n.1. Nearly all of those previous petitions, however, predated the New York Court of Appeals' decision in 2013 in *James Square* and the roughly contemporaneous Congressional Research Service report highlighting the lack of clarity concerning the validity of retroactive periods for tax increases. And none of these petitions presented the combination of facts in this case: a lengthy retroactive period; a legislative objective of avoiding a fiscal shortfall the State should have seen coming; and the revocation of a specific tax policy designed to induce specific taxpayer behavior.

b. The State also says there is no evidence of "a rash of *abusive* retroactive tax legislation." BIO 3 (emphasis added). Suffice it to say that "abusive" is in the eyes of the beholder. Petitioner believes that

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this litigation). This Court may wish to hold this petition and consider it alongside those, once they are fully briefed.

retroactivity periods longer than the previous legislative session – and that upend long-settled expectations of repose – are at least usually abusive. And there cannot be any doubt recent years have seen an explosion of retroactive tax laws. The Amicus Brief of the Council on State Taxation (at 7 n.3) produces a lengthy list of appellate decisions reviewing retroactive tax laws.

Even that list tells only part of the story. Given the cost of litigation and the confusion over applicable legal standards, some retroactive tax laws have thus far escaped judicial scrutiny. *See* Br. of Tax Execs. Inst. at 23. For instance, of at least seven such laws enacted by the Washington Legislature in recent years, four have not yet seen the appellate courts. *See* Act of June 30, 2013, ch. 8, §§ 101(4), 107, 111, 2013 Wash. Sess. Laws 2d Spec. Sess. 2436 (limiting sales tax exemption for residential telephone service); Act of April 11, 2011, ch. 23, §§ 1(3), 2, 3, 9, 2011 Wash. Sess. Laws 456 (restricting sales tax exemption for manufacturing equipment); Act of April 23, 2010, ch. 23, §§ 201, 1703, 2010 Wash. Sess. Laws 1st Spec. Sess. 2574 (imposing tax on newly identified "tax avoidance transactions"); Act of April 13, 2010, ch. 16, §§ 2, 15, 2010 Wash. Sess. Laws 1st Spec. Sess. 2542 (restricting eligibility for tax incentive programs). *See also In re Estate of Hambleton*, 335 P.3d 398 (Wash. 2014), *cert. denied*, 136 S. Ct. 318 (2015) (upholding 2013 retroactive change to 2005 estate tax); *Tesoro Ref. & Mktg. Co. v. Dep't of Revenue*, 269 P.3d 1013 (Wash. 2012) (interpreting 2009 amendment of 1985 tax deduction as a clarification).

3. Contrary to the State's protestations, this case is an excellent vehicle for addressing the limits of the retroactive tax legislation.

a. The State asserts that the 2010 law in this case was passed to respond to an "unexpected fiscal impact of a court decision, not to raise revenue." BIO 19 (capitalization omitted); *see also id.* at 6 (characterizing law as closing an "unexpected tax incentive for 'in-state businesses to move their operations outside Washington.'") (quoting Pet. App. 38a-39a). But as suggested above, calling the Washington Supreme Court's decision in *Dot Foods I* "unexpected" would drain that word of any meaning. For 16 years after the 1983 enactment, the Washington Department of Revenue interpreted the exemption consistent with the ultimate decision in *Dot Foods I*. *See Dot Foods I*, 215 P.3d at 189. And the Washington Supreme Court simply enforced the "plain and unambiguous language" of the exemption. *Id.* at 189, 191; Pet. App. 2a. In other words, the mere fact that a state agency abandons its prior understanding of a tax law and adopts an indefensible reading of it cannot make a court's later repudiation of that reversal "unexpected."

In any event, the facts of this case – however properly characterized – are perfect for review. Petitioner resisted what it viewed as an outrageous and unlawful change of tax-agency position after it had arranged its sales operations to comply with the express terms of the direct seller's exemption, with the express blessing of the tax agency's ruling letter. The state high court agreed with petitioner. Then the State responded by passing a statute retroactively changing the law to allow collection of

the tax. This Court ought to decide whether this sort of heads-I-win, tails-you-lose maneuver on the government's part is permissible. If it is, it is hard to imagine any real limits on the government's power to impose retroactive taxes.[2]

b. The State also contends that the retroactive law at issue here had a "minimal impact on taxpayer expectations" because the Washington Legislature passed the statute "a few months" after the Washington Supreme Court's decision in *Dot Foods I*. BIO 21-22 (capitalization removed). But this ignores the many years *before Dot Foods I*, when Dot Foods justifiably relied on the plain meaning of the 1983 law and its ruling letter in organizing its sales operations and then vindicating its exemption claim. The retroactivity period here, therefore, is unquestionably four years – the time between the acts for which the State is seeking to tax petitioner and the enactment of the law on which it is relying to do so.

4. Neither of the State's arguments concerning the merits withstands scrutiny.

a. The State argues that *General Motors Corp. v. Romein*, 503 U.S. 181 (1992), "already h[olds] that correcting or repudiating a court holding can be the rational economic purpose justifying a retroactive tax amendment." BIO 20. The Washington Supreme Court, however, did not rely on *Romein*, and for good

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[2] The pattern is set to be repeated. Counsel of record for the State has expressly informed one of petitioner's counsel, in a case involving a different issue, "If you win, I'm going to the Legislature."

reason: It is not a tax case. Rather, *Romein* involved retroactive legislation designed to recalibrate the financial obligations between *two private entities* (businesses and workers). *See* 503 U.S. at 183-86, 191-92. The State's reliance on *GPX Int'l Tire Corp. v. United States (GPX II)*, 780 F.3d 1136 (Fed. Cir. 2015), suffers from the same flaw. *See* BIO 13-14. Indeed the court in *GPX II* was careful to say that the retroactive change in countervailing duty law was valid in part because it was "directed to the remedial administration of trade duties, *as opposed to raising government revenue*." *Id.* at 1144 (emphasis added).

Where, as here, the government enacts retroactive legislation simply to benefit *itself* – that is, for the "purpose of raising revenue" – different considerations come into play. *See Carlton*, 512 U.S. at 37 (O'Connor, J., concurring in the judgment). In that situation, "[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.*; *see also Metro. Life Ins. Co. v. Ward*, 470 U.S. 869, 880 (1985) ("[P]romotion of domestic business within a State, *by* discriminating against foreign corporations that wish to compete by doing business there, is *not* a legitimate state purpose.") (emphasis added).

This Court's decision in *Forbes Pioneer Boat Line v. Bd. of Comm'rs of Everglades Drainage Dist.*, 258 U.S. 338 (1922), which the Petition discusses (at 23) but the State ignores, confirms this analysis. That decision rejects the pretense that a legislature can assert years after a statue was initially passed that it knows the (unstated) original intent of legislation; a court must assume the statute was intended to mean

what its "plain and unambiguous language" said, *Dot Foods I*, 215 P.3d at 189-90. *See* Amicus Br. of Inst. for Professionals in Taxation at 19-20. That being so, a law retroactively imposing tax liability cannot be salvaged on the ground that it is necessary to avoid losing money the State unreasonably anticipated collecting. BIO 18 (quoting Pet. App. 13a) (internal quotation marks and citation omitted)).

b. The State similarly insists that the four-year retroactivity period of the 2010 law as applied to Dot Foods is necessary to "prevent[] the loss of revenues resulting from" the Washington Supreme Court's earlier rejection of the State's construction of the B&O tax. *Id.* But this attempt to blame the State's high court improperly assumes that the Washington Legislature had to make the law retroactive at all. As this Court noted in another case involving legislation designed to repudiate judicial interpretations of a statute, "statutory retroactivity has long been disfavored." *Landgraf v. USI Film Prods.*, 511 U.S. 244, 267 (1994); *see also Apfel*, 524 U.S. at 532-33 (plurality opinion) (collecting historical sources); Br. of Inst. for Professionals in Taxation at 6-12 (same). Indeed, "[i]t is especially objectionable that a construction of a statute favorable to the individual citizen should be changed in such a manner as to become retroactive, and to require from him repayment of moneys to which he had supposed himself entitled." *United States v. Alabama Great S. R.R. Co.*, 142 U.S. 615, 621 (1892).

In short, if the Washington Legislature wanted to narrow or repeal the tax exemption here as a change in policy, it had every right to do so. But the State had no need to change the law retroactively –

and no constitutional authority to do so for the four-year period at issue here.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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