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Connecting the Dot: Retroactive State Tax Statutes Revisit *United States v. Carlton*

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CONNECTING THE DOT: RETROACTIVE STATE TAX
STATUTES REVISIT *UNITED STATES V. CARLTON*

*Michael T. Fatale**

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INTRODUCTION

Retroactive state tax statutes have been controversial in recent years. During its 2016-2017 term the U.S. Supreme Court denied certiorari in two cases that probed the constitutionality of a retroactive state tax statute that legislatively reversed the analysis in a state supreme court decision.¹ One of the two cases was *Dot Foods, Inc. v. Dep't of Revenue*.² These determinations followed by one year the Supreme Court's denial of certiorari in a third, similar state tax case,³ and comes in the aftermath of several other recent comparable state tax cases — almost all of which have been decided in favor of the states.⁴

1. The cases were *Dot Foods, Inc. v. Dep't of Revenue*, 372 P.3d 747 (Wash. 2016), *cert. denied*, 137 S. Ct. 2156 (2017) and six consolidated cases from the state of Michigan pertaining to the Multistate Tax Compact that were filed on behalf of 22 companies: *Sonoco Prod. Co. v. Mich. Dep't of Treasury*, 137 S. Ct. 2157 (2017); *Skadden, Arps, Slate, Meagher & Flom, LLP v. Mich. Dep't of Treasury*, 137 S. Ct. 2157 (2017); *Gillette Commer. Operations N. Am. v. Mich. Dep't of Treasury*, 137 S. Ct. 2157 (2017); *Int'l Bus. Mach. Corp. v. Mich. Dep't of Treasury*, 137 S. Ct. 2157 (2017); *Goodyear Tire & Rubber Co. v. Mich. Dep't of Treasury*, 137 S. Ct. 2157 (2017); and *DIRECTV Grp. Holdings LLC v. Mich. Dep't of Treasury*, 137 S. Ct. 2157 (2017). The petitions in the consolidated Michigan cases all derived from the Michigan court of appeals' decision in *Gillette Commer. Operations N. Am. v. Dep't of Treasury*, 878 N.W.2d 891 (Mich. Ct. App. 2015), *rev. denied*, 880 N.W.2d 230 (Mich. 2016), *cert. denied*, 137 S. Ct. 2157 (2017). See Amy Hamilton, *U.S. Supreme Court Extends Deadline for Michigan Response in Retroactivity Cases*, STATE TAX TODAY: TAX ANALYSTS (Feb. 3, 2017), 2017 STT 22-7. A seventh case that sought to appeal the result in *Gillette*, *R.J. Reynolds Tobacco Co. v. Mich. Dep't of Treasury*, 137 S. Ct. 2273 (2017), was denied certiorari by the U.S. Supreme Court on June 19, 2017. See Amy Hamilton, *U.S. Supreme Court Again Declines to Hear Challenge to Michigan Multistate Tax Compact Case*, STATE TAX TODAY: TAX ANALYSTS (June 20, 2017), 2017 STT 117-2. For a discussion of *Gillette* and the resulting consolidated Michigan cases, see *infra* notes 363-400 and accompanying text.

2. 372 P.3d 747 (Wash. 2016), *cert. denied*, 137 S. Ct. 2156 (2017). The second "case" was the consolidated Michigan cases referenced *supra* note 1.

3. *In re Estate of Hambleton*, 335 P.3d 398 (Wash. 2014), *cert. denied*, 136 S. Ct. 318 (2015).

4. The other recent state tax cases where a retroactive tax statute reversed a judicial decision include: *Caprio v. Dep't of Taxation & Fin.*, 37 N.E.3d 707, *rehearing denied*, 38 N.E.3d 817 (2015); *General Motors Corp. v. Dep't of Treasury*, 803 N.W.2d 698 (Mich. Ct. App. 2010), *review denied*, 800 N.W.2d (Mich. 2011), *cert. denied*, 565 U.S. 1178 (2012); *Zaber v. City of Dubuque*, 789 N.W.2d 634 (Iowa 2010); *Miller v. Johnson Controls, Inc.*, 296 S.W.3d 392 (Ky. 2009), *cert. denied*, 560 U.S. 935 (2010); *Jefferson Cty. Comm'n v. Edwards*, 49 So.3d 685 (Ala. 2010); *Ford Motor Credit Co. v. Dep't of Treasury*, No. 289781, 2010 WL 99050 (Mich. Ct. App. 2010) (unpublished), *review denied*, 782 N.W.2d 771 (Mich. 2010), *cert. denied*, 562 U.S. 1178 (2011); *GMAC LLC v. Dep't of Treasury*, 781 N.W.2d 310 (Mich. Ct. App. 2009); *King v. Campbell County*, 217 S.W.3d 862 (Ky. Ct. App. 2006);

Frequently, the statute's arguable period of retroactivity has been lengthy. A broad coalition of interested parties, including several amici, supported each of the three recent certiorari petitions, highlighting the seeming disconnect between the taxpayer concerns and the Supreme Court's inaction.⁵ Other commentators have also criticized the results in these recent cases.⁶

The controlling U.S. Supreme Court precedent with respect to retroactive tax legislation is *United States v. Carlton*.⁷ *Carlton* upheld a retroactive federal tax statute against a claim that the statute violated the Due Process Clause.⁸ The practitioners seeking certiorari in the recent state cases have argued that the courts have misapplied *Carlton* in upholding a retroactive tax statute.⁹ These practitioners have also

Allegis Realty Inv'rs v. Novak, 860 N.E.2d 246 (Ill. 2006); and Moran Towing Corp. v. Urbach, 1 A.D.3d 722 (N.Y. App. Div. 2003). In *City of Modesto v. Nat'l Med, Inc.*, the court refused to allow a retroactive statute to reverse a judicial decision. 27 Cal. Rptr. 3d 215 (Cal. Ct. App. 2005). The reasoning in *City of Modesto* was later questioned in *River Garden Retirement Home v. Franchise Tax Bd.* 113 Cal. Rptr. 3d 62, 79-81 (Cal. Ct. App. 2010).

5. For example, in *Dot Foods* amicus briefs were filed by the Council on State Taxation ("COST"), the Tax Executives Institute, Inc. ("TEI"), the Institute for Professionals in Taxation ("IPT") and the American College of Tax Counsel ("ACTC"). See Amy Hamilton, *U.S. Supreme Court Asks Washington For Response in Dot Foods Retroactivity Case*, STATE TAX TODAY: TAX ANALYSTS (Nov. 7, 2016), 2016 STT 215-2. COST, TEI and ACTC also filed amicus briefs in the recent, consolidated Michigan cases and were joined in those filings by the National Association of Manufacturers. See Brief Amicus Curiae of Council on State Taxation in Support of Petitioners, *Sonoco Prod. Co. v. Mich. Dep't of Treasury*, 137 S. Ct. 2157 (2017) (No. 16-687), 2016 WL 7438844; Brief for Tax Exec. Inst., Inc. as Amicus Curiae in Support of Petitioners, *Sonoco Prod. Co., v. Mich. Dep't of Treasury*, 137 S. Ct. 2157 (2017) (No. 16-687), 2016 WL 7423020; Brief of the Am. Coll. of Tax Counsel as Amicus Curiae in Support of Petitioners, *Sonoco Prod. Co., v. Mich. Dep't of Treasury*, 137 S. Ct. 2157 (2017) (No. 16-687), 2016 WL 7473977; Brief for the Nat'l Assoc. of Mfr. et al. as Amici Curiae Supporting Petitioners, *Sonoco Prod. Co., v. Mich. Dep't of Treasury*, 137 S. Ct. 2157 (2017) (No. 16-687), 2016 WL 7451284. COST, TEI and IPT are organizations with significant business memberships. See Brief Amicus Curiae of Council on State Taxation in Support of Petitioner at 1, *Dot Foods, Inc. v. Dep't of Revenue of Wash.*, 137 S. Ct. 2156 (2017) (No. 16-308), 2016 WL 5930234 at *1 ("COST represents nearly 600 multistate businesses in the United States"); TAX EXECUTIVES INSTITUTE, INC., https://www.tei.org/Organization/Pages/about_tei.aspx (last visited Mar. 23, 2018) (TEI website describes that organization as "the preeminent association of in-house tax professionals worldwide" with "nearly 7,000 members ... representing over 2,800 leading businesses in the United States, Canada, Europe, and Asia"); Brief for the Inst. for Prof'ls in Taxation as Amicus Curiae in Support of Petitioner at 1, *Dot Foods, Inc. v. Dep't of Revenue of Wash.*, 137 S. Ct. 2156 (2017) (No. 16-308), 2016 WL 5957539 at *1 ("IPT has more than 4,100 members including ... most of the Fortune 500 companies.").

6. See, e.g., Amy Hamilton, *Year in Review: Tax Retroactivity*, STATE TAX TODAY: TAX ANALYSTS (Dec. 30, 2016), 2016 STT 251-6 (quoting commentators); Amy Hamilton, *Retroactive State Tax Laws Questioned at NYU Conference*, 79 STATE TAX NOTES 9 (Jan. 4, 2016) (same); Doug Sheppard, *Should States be Allowed to Retroactively Change Tax Laws?*, 77 STATE TAX NOTES 545 (Aug. 10, 2015) (same).

7. 512 U.S. 26 (1994).

8. See *id.* at 30-35.

9. The ACTC states that state courts have been misapplying *Carlton* and "we do not believe that the formulation of the test in *Carlton* was correctly interpreted and applied to the case at bar." Brief of the Am. Coll. of Tax Counsel as Amicus Curiae in Support of Petitioner at 9-10, *Dot Foods, Inc. v. Dep't of Revenue of Wash.*, 137 S. Ct. 2156 (2017) (No. 16-308), 2016 WL 5904959 at *9-10. TEI

alternatively claimed that the state cases — in particular *Dot Foods* — demonstrate that *Carlton* needs to be revisited.¹⁰

A review of *Carlton* is necessary to evaluate the claimants' arguments. *Carlton* addressed a situation in which Congress first conferred a tax incentive — a tax deduction for certain activity undertaken by an estate — then, a little over one year later, retroactively narrowed this incentive on the theory that its prior breadth was mistakenly broad.¹¹ The Supreme Court's prior cases on retroactive tax legislation had been very deferential, on the theory that tax and fiscal policy-making is rightfully and ultimately the province of a government's legislative function.¹² But the Court's prior precedent arguably did not approve of such statutes where they negatively affected taxpayers who had reasonably relied upon pre-existing law and who had no notice of any impending change.¹³ This was particularly so with respect to estate and gift tax where three Supreme Court cases from the 1920's ruled in favor of a taxpayer.¹⁴ The Ninth Circuit, which rendered the lower court decision in *Carlton*, found in favor of an estate that sought the deduction, citing the taxpayer's reasonable reliance and lack of notice.¹⁵ The Supreme Court reversed, however, and clarified that the relevant constitutional test does not focus narrowly on the aggrieved taxpayer.¹⁶

Carlton clarified that the applicable due process test evaluates the governmental action. The Court stated: "provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches."¹⁷ When this two-part rational basis standard is met, as it was in *Carlton*, the statute "meets the requirements of due

states that taxpayers need guidance "clarifying the boundaries of *Carlton*." Brief for the Tax Exec. Inst., Inc. as Amicus Curiae in Support of Petitioner at 22, *Dot Foods, Inc. v. Dep't of Revenue of Wash.*, 137 S. Ct. 2156 (2017) (No. 16-308), 2016 WL 5957540 at *22.

10. The ACTC states that if *Dot Foods* is correct, "legislatures would have a blank check to impose retroactive tax increases upon taxpayers who had relied upon prior law to structure their affairs." Brief of the Am. Coll. of Tax Counsel as Amicus Curiae in Support of Petitioner, *supra* note 9, at 4. COST states, "Guidance is particularly important in cases such as this one, where legislative action has violated principles of fair play and the rule of law." Brief Amicus Curiae of Council on State Taxation in Support of Petitioner, *supra* note 5, at 4.

11. See 512 U.S. at 28-32.

12. See *infra* notes 68-75.

13. See *infra* notes 60-67 and accompanying text.

14. See *infra* notes 64-65 and accompanying text.

15. *Carlton v. United States*, 972 F.2d 1051, 1059-62 (9th Cir. 1992).

16. *Carlton*, 512 U.S. at 33-34.

17. *Id.* at 30-31.

process.”¹⁸

Carlton concluded that the statute met the first test because the legislation was “neither illegitimate nor arbitrary.”¹⁹ Congress “acted to correct what it reasonably viewed as a mistake in the original [legislation] that would have created a significant and unanticipated revenue loss.”²⁰ The statute also met the second test because “Congress acted promptly and established only a modest period of retroactivity.”²¹ Thus, the legitimate legislative purpose was furthered by a rational means.²²

Those critiquing the recent state cases have emphasized the factual differences.²³ These critics have noted that, unlike in *Carlton*, the state statutes at issue were not enacted to correct a legislative mistake and that the periods of retroactivity greatly exceeded *Carlton*’s one-plus year. But *Carlton* does not hold that the only legitimate purpose for a retroactive statute is the correction of a mistake.²⁴ *Carlton* did suggest that the period of retroactivity could be relevant to the rational means determination. But *Carlton* did not hold that implementation of a retroactive tax statute necessarily requires a limited period of retroactivity — certainly not one to be evaluated under a bright line rule. Rather, *Carlton* stated that the issue as to a statute’s retroactive length is ultimately one that considers not formalistic criteria, but rather the statute’s “actual retroactive effect.”²⁵

One of the virtues of *Carlton* is that it respects the fact that the validity of a retroactive tax statute depends on the specific circumstances, which the decided cases reveal are variable. An important factual difference from *Carlton* in the recent state cases is exemplified by *Dot Foods*. In *Dot Foods*, the tax statute that was retroactively amended was not obviously infirm when adopted. It was only later understood, in hindsight, that the statute was ambiguous in an important respect. This latent ambiguity later permitted the taxpayer to posit an interpretation that the state revenue agency briefly accepted, but subsequently disputed.²⁶ The taxpayer’s position ultimately prevailed,

18. *See id.* at 32.

19. *Id.* at 31.

20. *Id.* at 32.

21. *Id.*

22. *Id.* at 30-33.

23. *See generally* the briefs cited at *supra* notes 5, 9.

24. Any “legitimate public purpose” will suffice. *Carlton*, 512 U.S. at 30-31. Also, *Carlton* suggests a broad ability on the part of a legislature to revisit or fix pre-existing tax statutes. *See infra* notes 97-100 and accompanying text.

25. *Carlton*, 512 U.S. at 33-34.

26. *See infra* notes 136-160 and accompanying text.

5-4, in a state supreme court decision.²⁷ Prior to that time, however, state law reflected the revenue agency's position — which was, for a ten year period, stated in a regulation that was twice upheld by the state's lower courts.²⁸

Seven months after the state supreme court decision in *Dot Foods*, the Washington legislature acted to retroactively correct the statute to conform to the revenue agency's prior interpretation.²⁹ Consequently, the actual retroactive effect of the Washington legislation was minimal — even though the legislation post-dated the original statute by 27 years.³⁰ It was in part on this basis that the Washington Supreme Court later upheld the retroactive statute.³¹

The result in *Dot Foods*, like that in the other recent state cases, not only comports with the flexible *Carlton* standard, but is consistent with the rationale that underlies that standard. It would be problematic if a retroactive tax statute could only be retroactive for a short period of time as measured from the original enactment of the amended statute. If that were so, a legislature would almost never be able to retroactively address the consequences of a questionable court case since — as suggested by *Dot Foods* — it frequently takes many years for a statute to be judicially construed.³² And, of course, court interpretations of a tax statute are themselves typically retroactive.³³ Conversely, *Carlton* was predicated on the theory that tax policy is an essential component of fiscal policy, which policy-making ultimately resides with the government's legislative and executive branches. The Court's rationale would be significantly undermined if a legislature could not address a questionable court decision; court decisions can be extremely costly to the governmental fisc, as *Dot Foods* and the recent state tax cases make clear. This concern is especially relevant in the state tax context since state governments are required to balance their budgets annually.

Carlton concluded that the taxpayer in question had “no vested right in the Internal Revenue Code,” thus enabling Congress to retroactively fix its legislative error.³⁴ The critics of the recent state cases have argued that these cases are more suspect than *Carlton* because state legislatures have acted, not to fix a clear error, but rather to overrule a

27. See generally *Dot Foods*, 215 P.3d 185 (2009).

28. See *infra* notes 154-178 and accompanying text.

29. See *infra* notes 179-185 and accompanying text.

30. See *infra* notes 239-254 and accompanying text.

31. See *infra* notes 202-212 and accompanying text.

32. See generally *infra* notes 136-178 and accompanying text.

33. See generally cases cited *supra* note 4.

34. *Carlton v. U.S.*, 512 U.S. 26, 33 (1994).

judicial determination.³⁵ But a court decision construing a tax statute confers no additional rights — other than with respect to the taxpayer who has prevailed in a final court case.³⁶

This article proceeds in five sections. The first section discusses *Carlton*, its historical context and its logical implications. The second section considers the history of and analysis in *Dot Foods*. The third section evaluates *Dot Foods* as compared to *Carlton*, and considers more generally the cases that consider a curative, ratifying statute like that in *Dot Foods*. The fourth section examines other recent high-profile situations in which a state amended a tax statute to reverse the analysis in a court case, as in *Dot Foods*. The fifth section offers some concluding thoughts.

I. UNITED STATES V. CARLTON

A. The Facts and Procedural Background

The retroactive legislation in *United States v. Carlton* pertained to an estate tax provision enacted by the Tax Reform Act of 1986.³⁷ The provision, codified at 26 U.S.C. § 2057 (“§ 2057”), applied to an estate that filed a timely tax return after the date of the Act, October 22, 1986.³⁸ It 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.”³⁹ But it required that to qualify for the deduction, the sale of securities had to be made “before the date on which the [estate tax] return . . . [was] required to be filed (including any extensions).”⁴⁰

Carlton was the executor of an estate for a woman who died almost one year prior to the effective date of the Act, September 29, 1985.⁴¹ Her estate tax return was due December 29, 1986, after Carlton had obtained a six-month filing extension.⁴² On December 10, 1986, Carlton used estate funds to purchase 1.5 million shares of MCI Communications Corporation for \$11,206,000, at an average price of

35. See, e.g., Brief for the Tax Exec. Inst., Inc. as Amicus Curiae in Support of Petitioner, *supra* note 9, at 2-3, 23 (stating that “[r]etroactive tax legislation is particularly suspect when the legislation retroactively overrules a judicial decision” and that “[t]his Court’s intervention is necessary to halt this disturbing and shocking trend and reconfirm that due process imposes meaningful constraints on retroactive tax legislation, especially when such legislation is necessary to overturn a judicial decision”).

36. See generally *infra* notes 213-217 and 402 and accompanying text.

37. 512 U.S. at 28.

38. *Id.*

39. *Id.* (citing § 2057(b)).

40. *Id.* (citing § 2057(c)(1)).

41. *Id.*

42. *Id.*

\$7.47 per share.⁴³ Two days later, Carlton sold the MCI stock to the MCI employee stock ownership plan (“ESOP”) for \$10,575,000, at an average price of \$7.05 per share.⁴⁴ Thus, the total sale price was \$631,000 less than the original purchase price.⁴⁵ When Carlton filed the estate tax return on December 29, 1986, he claimed a deduction under § 2057 of \$5,287,000, for half the proceeds of the sale of the stock to the MCI ESOP.⁴⁶ The deduction reduced the estate tax by \$2,501,161.⁴⁷ The parties stipulated that Carlton engaged in the MCI stock transactions specifically to take advantage of the § 2057 deduction.⁴⁸

On January 5, 1987, the Internal Revenue Service (“IRS”) announced that, “[p]ending the enactment of clarifying legislation,” it would treat the § 2057 deduction as available only to estates of decedents who owned the securities immediately before death.⁴⁹ A bill enacting such an amendment to § 2057 was introduced in each chamber of Congress on February 26, 1987.⁵⁰ On December 22, 1987, the amendment to § 2057 was enacted.⁵¹ As amended, the statute provided that, to qualify for the deduction, the securities sold to an ESOP must have been “directly owned” by the decedent “immediately before death.”⁵² The 1987 amendment was made effective as if it had been contained in the statute as originally enacted in October 1986.⁵³

The IRS disallowed the deduction claimed by Carlton under § 2057 on the theory that the MCI stock had not been owned by the decedent “immediately before death.”⁵⁴ Carlton paid the assessed tax deficiency, plus interest, filed a claim for refund, and instituted a refund action in U.S. District Court.⁵⁵ He conceded that the estate did not qualify for the deduction under the 1987 amendment.⁵⁶ He argued, however, that retroactive application of the 1987 amendment to the estate’s 1986 transactions violated the Due Process Clause.⁵⁷ The district court rejected his argument and entered summary judgment in favor of the

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.* at 28-29.

49. *Id.* at 29 (citing IRS Notice 87-13, 1987-1 C.B. 432, 442).

50. *Id.* (citing 133 Cong. Rec. 4145 and 4293 (1987)).

51. *Id.*

52. *Id.* (citing the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 10411(a), 101 Stat. 1330, 1330-432).

53. *Id.* (citing § 10411(b), 101 Stat. at 1330-433).

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.*

United States.⁵⁸ On appeal, a divided panel of the Ninth Circuit reversed.⁵⁹

The Supreme Court's review in *Carlton* ultimately focused on whether the analysis to be applied to a retroactive tax statute focuses on the governmental action taken or, alternatively, on the impact of that action on the affected taxpayer. The Ninth Circuit noted that the Supreme Court's "modern" precedent was a series of cases where the Court had repeatedly affirmed retroactive tax statutes.⁶⁰ Nonetheless, the Ninth Circuit concluded that the Court's "harsh and oppressive" test, first stated in 1938 in *Welch v. Henry*⁶¹ and then referenced in two later Court decisions, allowed lower courts to consider the impact of retroactive tax legislation on a taxpayer and to reject such statutes in certain instances.⁶² The Ninth Circuit further noted that three older Supreme Court cases, decided in 1927 and 1928, had rejected such statutes.⁶³ The three older cases cited by the Ninth Circuit pertained to gift and estate taxes, like the tax in *Carlton*, and thereby suggested that retroactive legislation could be particularly harsh and oppressive in the gift and estate tax context.⁶⁴ The Ninth Circuit also relied on *Welch v. Henry*, which distinguished between gift and estate taxes and other types of taxes with respect to retroactive tax legislation.⁶⁵

58. *Id.*

59. *Id.* at 29-30 (citing *Carlton v. United States*, 972 F.2d 1051 (9th Cir. 1992), *rev'd*, 512 U.S. 26 (1994)).

60. *Carlton*, 972 F.2d at 1057-58.

61. 305 U.S. 134 (1938).

62. *Carlton*, 972 F.2d at 1056-57 (referencing *Welch*, 305 U.S. 134, *United States v. Hemme*, 476 U.S. 558 (1986) and *United States v. Darusmont*, 449 U.S. 292 (1981) (per curiam)). See David Burton, *The Constitutionality of Retroactive Changes in the Code: United States v. Carlton*, 48 TAX LAW. 509, 511 n. 13 (1995) (noting that the Ninth Circuit attempted to define "harsh and oppressive," a standard that had not previously been applied to strike down a retroactive tax statute).

63. *Carlton*, 972 F.2d at 1055-1057.

64. *Id.* at 1056-1057 (citing *Nichols v. Coolidge*, 274 U.S. 531 (1927); *Blodgett v. Holden*, 275 U.S. 142 (1927); *Untermeyer v. Anderson*, 276 U.S. 440 (1928)). The three cases, the so-called "*Nichols* line of cases," were ones where gifts were made and had vested prior to the time of the enactment of a retroactive tax statute imposing a gift tax. See Robert R. Gunning, *Back from the Dead: The Resurgence of Due Process Challenges to Retroactive Tax Legislation*, 47 DUQ. L. REV. 291, 300-01 (2009). Prior to those cases, the Supreme Court had repeatedly and without exception upheld numerous retroactive tax statutes. See, e.g., *Untermeyer*, 276 U.S. at 446-50 (Brandeis, J., dissenting).

65. *Carlton*, 972 F.2d at 1058 (discussing *Welch*, 305 U.S. 134). *Welch* reasoned that gift taxes are imposed with respect to a voluntary act and that if the donor knew that the tax law would be changed the donor would not necessarily undertake the act. See *id.* at 1058. In contrast, the Court noted that a tax on the receipt of income is not comparable to a gift tax because a court "cannot assume that stockholders would refuse to receive corporate dividends even if they knew that their receipt would later be subjected to a new tax or to the increase of an old one." See *id.* (quoting *Welch*, 305 U.S. at 148); *id.* at 1063 (Norris, J., dissenting) (quoting this same language). See also Matthew D. Slepikow, *Resurrecting the Challenge Against Retroactive Estate Tax Legislation: Acquiescing to the Holding of United States v. Carlton—Over My Dead Body*, 3 ROGER WILLIAMS U. L. REV. 119, 142-45 (1997) (arguing that estate tax deserves heightened retroactivity scrutiny); Pat Castellano, *Retroactively Taxing*

In considering the three 1927-1928 Supreme Court cases where retroactive tax legislation had been struck down, the Ninth Circuit focused on the fact that the taxpayer did not have actual or constructive notice that the relevant statute would be amended and also that the taxpayer had reasonably relied upon the pre-existing statute.⁶⁶ The court ultimately concluded that a retroactive statute could be impermissibly harsh and oppressive in these circumstances, and struck down the retroactive statute on that basis.⁶⁷

B. The Supreme Court's Analysis

In its opinion, the Supreme Court distinguished its three 1927-1928 cases relied upon by the Ninth Circuit. It cited six of its subsequent cases and stated that “[t]his Court repeatedly has upheld retroactive tax legislation against a due process challenge.”⁶⁸ The Court noted that its earlier cases “were decided during an era characterized by exacting review of economic legislation under an approach that ‘has long since been discarded.’”⁶⁹ The Court further observed that those prior cases did not “stand for the proposition that retroactivity is permitted with respect to income taxes, but prohibited with respect to gift and estate taxes.”⁷⁰

Carlton recognized that the “harsh and oppressive” verbiage that the Ninth Circuit extracted from some of the Court’s modern cases⁷¹ suggested that the judicial focus is to be on a taxpayer affected by retroactive legislation and not on the government enacting such legislation.⁷² Therefore, the Court clarified and refocused the test.⁷³ The

Done Deals: Are There Limits? 43 KAN. L. REV. 417, 447 (1995) (similar).

66. *Carlton*, 972 F.2d at 1059-62.

67. *Id.*

68. *Carlton v. United States*, 512 U.S. 26, 30 (1994) (citing *United States v. Hemme*, 476 U.S. 558 (1986); *United States v. Darusmont*, 449 U.S. 292 (1981); *Welch*, 305 U.S. 134; *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)).

69. *Id.* at 34. Subsequent to those earlier cases, the Court’s analysis evolved towards an approach favoring “judicial deference to economic legislation” on the theory that “the courts should not act as a ‘superlegislature.’” Matthew A. Schwartz, *A Critical Analysis of Retroactive Economic Legislation: A Proposal for Due Process Revitalization in the Economic Arena*, 9 SETON HALL CONST. L.J. 935, 981, 982 n.292 (1999) (citing cases). This approach presumes that the legislature “possesses the necessary expertise and competence to enact laws that will maximize social utility.” *Id.* at 981.

70. *Carlton*, 512 U.S. at 31.

71. *Id.* at 30 (citing the standard as stated in *Welch*, 305 U.S. at 147 and later quoted in *Hemme*, 476 U.S. at 568-69).

72. *Id.* at 29-30, 33-35. Justice Scalia in his concurrence stated that a harsh and oppressive test lacks “precision” and arguably would consider the dollar cost of a taxpayer’s loss, which in *Carlton* was significant. 512 U.S. at 39 (Scalia, J., concurring).

73. *Id.* at 30-31, 35. See *The Supreme Court, 1993 Term: Leading Cases*, 108 HARV. L. REV.

Court stated that the “harsh and oppressive” formulation “does not differ from the prohibition against arbitrary and irrational legislation” that applies generally to enactments in the sphere of economic policy.⁷⁴ The due process standard to be applied to tax statutes with “retroactive effect,” therefore,

is the same as that generally applicable to retroactive economic legislation: “Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches”⁷⁵

As applied to retroactive legislation, *Carlton* recognized that the due process test involves an additional step not required in the context of prospective legislation. This is because retroactive legislation has to satisfy the standard as to both its retroactive and prospective aspects and, as the Court noted, “the justifications for the latter may not suffice for the former.”⁷⁶ Nonetheless, the Court made clear that the test is one that is limited to the question of whether there is a “rational legislative purpose” in either instance.⁷⁷ *Carlton* therefore clarified that the standard that a government must meet when defending retroactive tax legislation is a low bar, as Justice Scalia’s concurrence and several commentators have noted.⁷⁸

139, 225 (1994) (“...by abandoning the ‘harsh and oppressive’ test, *Carlton* altered the focus of the Court’s scrutiny from the effect of the retroactive tax provision on the taxpayer to the reasonableness of the legislature’s action. This shift in emphasis allowed the Court to avoid any analysis of the complex social and economic policy issues that bear on the merits of tax retroactivity”).

74. *Carlton*, 512 U.S. at 30 (citing *Pension Benefit Guar. Corp. v. R. A. Gray & Co.*, 467 U.S. 717, 733 (1984)). To support its conclusion that the “harsh and oppressive” standard is identical to the rational basis test applied more generally to retroactive economic legislation, the Court invoked the authority of two cases, *Pension Benefit Guaranty*, 467 U.S. 717 and *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976), neither of which pertained to a tax statute. See *Carlton*, 512 U.S. at 30-31. *Pension Benefit Guaranty* upheld retroactive employer liability for withdrawal from federal pension plan insurance, 467 U.S. at 729-30, 733, whereas *Turner Elkhorn* upheld retroactive imposition of black lung disease costs on employers as a means to spread the cost of the disabilities, 428 U.S. at 16-17.

75. *Carlton*, 512 U.S. at 30-31 (quoting *Pension Benefit Guaranty*, 467 U.S. at 729-30, in turn quoting *Turner Elkhorn*, 428 U.S. at 16). See *Leading Cases*, *supra* note 73, at 226 (noting that *Carlton* transformed the “‘harsh and oppressive’ standard into a generic ‘arbitrary and irrational’ test” — a “shift in emphasis from the taxpayer to the legislature”), 228 (stating that the Court’s “arbitrary and irrational” test shifts the Court’s gaze from the taxpayer to the legislature and thus de-emphasizes, if not precludes consideration of the magnitude of the tax”).

76. *Carlton*, 512 U.S. at 31 (quoting *Turner Elkhorn*, 428 U.S. at 16-17).

77. *Id.*

78. See *id.* at 40 (Scalia, J. concurring) (“The reasoning the Court applies to uphold the statute in this case guarantees that all retroactive tax laws will henceforth be valid. To pass constitutional muster the retroactive aspects of the statute need only be ‘rationally related to a legitimate legislative purpose.’

Moreover, *Carlton* made clear that the application of the due process test with respect to retroactive tax statutes is highly fact-dependent. For example, *Carlton* repeatedly referenced the Court's prior decision in *Welch v. Henry*.⁷⁹ *Welch* established that the analysis in a case evaluating a retroactive tax statute necessarily depends upon the specific facts and circumstances: "In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid"⁸⁰ Consistent with *Welch*, the Supreme Court in *Carlton* duly analyzed the specific facts, as discussed below.

1. Legitimate Legislative Purpose

As enacted in October 1986, § 2057 contained no requirement that the decedent, whose estate later sold company stock to an ESOP, must have owned the stock before dying to qualify for the ESOP proceeds deduction.⁸¹ As a result, any estate could claim the deduction simply by buying company stock in the market and immediately reselling it to the company's ESOP, thereby obtaining a potentially dramatic reduction in, or even elimination of, the estate tax obligation.⁸² Based on these facts, and its review of the 1986 and 1987 legislative history, the Supreme Court in *Carlton* noted that there "is little doubt that the 1987 amendment to § 2057 was adopted as a curative measure,"⁸³ and concluded that this was a legitimate purpose. The Court specifically noted that Congress acted appropriately "to correct what it reasonably viewed as a mistake in the original 1986 provision that would have created a significant and unanticipated revenue loss."⁸⁴

Revenue raising is certainly a legitimate legislative purpose . . . and any law that retroactively adds a tax, removes a deduction, or increases a rate rationally furthers that goal." (citations omitted); Stewart Hastings, *Gambling with the IRS: The Enforcement of Retroactive Tax Statutes in United States v. Carlton*, 47 MERCER L. REV. 1163, 1179 (1996) ("A tax statute would presumably always satisfy the Court's 'low scrutiny' due process test, since all tax statutes are for the 'legitimate purpose' of generating revenue and retroactive taxation is rationally related to that purpose"); Burton, *supra* note 62, at 512 (citing GERALD GUNTHER, CONSTITUTIONAL LAW 462 n. 1 (12th ed. 1991) (noting that the rational basis standard adopted by the court is one that traditionally results in "minimal scrutiny in theory and virtually none in fact"). See also *Dot Foods, Inc. v. State, Dep't. of Revenue*, 372 P.3d 747, 750 (Wash. 2016) ("The rational basis test is the most relaxed form of judicial scrutiny.") (citation omitted); *Gillette Commer. Operations N. Am v. Dep't of Treasury*, 878 N.W.2d 891, 907 (Mich. Ct. App. 2015) (referring to *Carlton's* "relatively easy two-part test"), *rev. denied*, 880 N.W.2d 230 (Mich. 2016), *cert. denied*, 137 S. Ct. 2157 (2017).

79. See *Carlton*, 512 U.S. at 30, 33-34 (citing *Welch v. Henry*, 305 U.S. 134 (1938)).

80. *Welch*, 305 U.S. at 148. The Court's full quote was that: "In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation." *Id.*

81. *Carlton*, 512 U.S. at 31.

82. *Id.*

83. *Id.*

84. *Id.* at 33.

Much of the recent criticism pertaining to retroactive state tax statutes has focused on a comparison between the legislative action in the recent state cases and what the critics have contended was the correction of an obvious mistake in *Carlton*.⁸⁵ The critics have argued that, while Congress legitimately addressed a clear mistake in *Carlton*, no similar mistake has been the statutory predicate in the state cases; hence, the argument goes, the legislation in the state cases is more questionable.⁸⁶ But *Carlton* did not hold that the only legitimate purpose for a retroactive tax statute is the correction of a legislative mistake. After analyzing Congress' asserted rationale for the legislation, the Court suggested that the key determinant is that the purpose of the law is neither "illegitimate nor arbitrary."⁸⁷ The Court also stated, "there is no plausible contention that Congress acted with an improper motive, as by targeting estate representatives such as Carlton after deliberately inducing them to engage in ESOP transactions."⁸⁸ Ultimately, the Court concluded, "We cannot say that [Congress'] decision was unreasonable."⁸⁹

Carlton also suggests that permissible "curative measures" are not limited to the circumstance where the legislature fixes a mistake, because even in *Carlton* the statute that was amended was not obviously a "mistake."⁹⁰ Mr. Carlton read the clear language of § 2057 and concluded that the statute provided an incentive for an estate to sell stock in a company to the company's ESOP, whether or not the decedent owned the stock at the time of death. The Ninth Circuit concluded that, when read in this manner, the statute was not so

85. See, e.g., Brief of the Am. Coll. of Tax Counsel as Amicus Curiae in Support of Petitioner, *supra* note 9, at 3, 10-12 (stating that the recent cases diverge from *Carlton* which pertained to "the legislative correction of an acknowledged drafting error"); Brief for the Tax Exec. Inst., Inc. as Amicus Curiae in Support of Petitioner, *supra* note 9, at 8-9 (referring to *Carlton* as pertaining to "clear error," a "scrivener's error"). But see *infra* notes 90-96 and accompanying text (noting that the Supreme Court did not clearly consider the prior legislative language at issue in *Carlton* to be a mistake and that the Ninth Circuit specifically rejected this interpretation).

86. See, e.g., Brief for the Tax Exec. Inst., Inc. as Amicus Curiae in Support of Petitioner, *supra* note 9, at 14 (arguing that *Carlton* involved "an easy case" fixing "an obvious drafting error," unlike in *Dot Foods* where the court would have to consider what is an "illegitimate" or "arbitrary" legislative purpose").

87. *Carlton*, 512 U.S. at 32.

88. *Id.* The Court acknowledged that Congress could have chosen to address "the unanticipated revenue loss through general prospective taxation," but observed that choice would have burdened equally "innocent" taxpayers." *Id.* The Court also suggested that it was logical for Congress to decide "to prevent the loss by denying the deduction to those who had made purely tax-motivated stock transfers." *Id.*

89. *Id.*

90. The majority's only reference to the term "mistake" was its statement that "Congress acted to correct what it *reasonably viewed* as a mistake." *Id.* (emphasis added). Therefore, even the majority allowed for the interpretation that, irrespective of the post hoc Congressional characterization, the predecessor language was not a mistake in fact.

different from other “huge tax incentives . . . Congress [had] created to encourage the development of ESOPs.”⁹¹ The Ninth Circuit also concluded that there was very little evidence in the bill-writing process to suggest that the language was unintentional, as the bill was enacted without changes as first proposed two and a half years before it was finally adopted.⁹² Finally, the Ninth Circuit noted that the only relevant legislative history — “two passing references in congressional documents” — merely stated that ESOP deductions “would be available to a decedent who sold his company to an employee group,” not that they would be limited to that situation.⁹³

In separate concurrences, Justices O’Connor and Scalia (the latter joined by Justice Thomas) both dismissed the *Carlton* majority’s suggestion that what Congress fixed was a legislative mistake. Justice Scalia noted that the Court relied mostly on “some post-legislation legislative history” that was at odds with “the uncontested plain meaning of the statute.”⁹⁴ Justice O’Connor noted that despite what some “prominent members of the tax writing committees” may have observed in printed materials, the “subjective motivation” of Congress as a whole in passing a law is difficult to discern and logically irrelevant.⁹⁵ Justice O’Connor stated that determining that a legislative fix was meant to correct a mistake is illogical because “[e]very law touching on an area in which Congress has previously legislated can be said to serve the legislative purpose of fixing a perceived problem with the prior state of affairs — there is no reason to pass a new law, after all, if the legislators are satisfied with the old one.”⁹⁶

91. *Carlton v. United States*, 972 F.2d 1051, 1060 (1992). The court noted that “[t]he federal Government [had] long sought to promote employee ownership of shares in their employees” and that § 2057 as originally enacted furthered “the public policy of employee ownership.” *Id.* See Burton, *supra* note 62, at 520 (noting the example of a seemingly similar mistake in the Internal Revenue Code that was not later fixed). See also *Carlton*, 972 F.2d at 1060 (“when the private actor had completed the socially desirable action of selling shares at a discount to an ESOP, the government reneged on its end of the deal”); Andrew C. Weiler, *Has Due Process Struck Out? The Judicial Rubberstamping of Retroactive Economic Laws*, 42 DUKE L.J. 1069, 1103-1103 (1993) (“[I]t is difficult to disagree with the *Carlton* majority’s characterization that Congress created an incentive and then dismantled it after the fact because it was dissatisfied (and surprised) with the result.”).

92. *Carlton*, 972 F.2d at 1060 (stating, *inter alia*, “*Carlton* had little reason to think Congress had made a drafting error”). Compare comments referenced *supra* note 85.

93. *Carlton*, 972 F.2d at 1059. Burton, *supra* note 62, at 516 (noting that *Carlton* determined that Congress made a mistake in 1986 by relying “on the legislative history of the 1987 amendment, not on the legislative history of the 1986 amendment,” and “[b]ecause the Court did not consider evidence of what the anticipated revenue loss was in 1986, it was forced to take Congress’ word in 1987 that it anticipated a significantly smaller revenue loss in 1986”) (emphasis in original).

94. *Carlton*, 512 U.S. at 39 (Scalia, J., concurring).

95. *Id.* at 36-37 (O’Connor, J. concurring). The Ninth Circuit noted that the legislative history consisted largely of a “pamphlet written by the staff of the Joint Committee on Taxation” and that this pamphlet did “not purport to speak for Congress.” 972 F.2d at 1059.

96. *Id.* at 36 (stating, *inter alia*, “this mode of analysis proves too much”), 37 (“It is sufficient for

Carlton concluded that the statute met the legitimate purpose standard since Congress acted to prevent “a significant and unanticipated revenue loss.”⁹⁷ Justices O’Connor and Scalia both emphasized that a retroactive tax statute could always be justified by the need to raise tax revenue. Justice O’Connor further stated that “[r]etroactive application of revenue measures is rationally related to the legitimate governmental purpose of raising revenue.”⁹⁸ She explained that:

In enacting revenue measures, retroactivity allows “the legislative body, in the revision of tax laws, to distribute increased costs of government among its taxpayers in the light of present need for revenue and with knowledge of the sources and amounts of the various classes of taxable income during the taxable period preceding revision.”⁹⁹

Justice Scalia also stated, “Revenue raising is certainly a legitimate legislative purpose . . . and any law that retroactively adds a tax, removes a deduction, or increases a rate rationally furthers that goal.”¹⁰⁰

2. Rational Means

Carlton also concluded that the retroactive legislation met the second requirement, that the government’s legitimate legislative purpose was furthered by a rational means.¹⁰¹ The Court found that “Congress acted promptly and established only a modest period of retroactivity.”¹⁰² The Court analogized the statute to “general revenue statutes” that are enacted by Congress, which it noted “almost without exception” are given “effective dates prior to the dates of actual enactment.”¹⁰³ It also cited *Welch v. Henry*,¹⁰⁴ where the Court upheld a statute that had “retroactive effect” of two-plus years.¹⁰⁵ Lastly, the Court noted that,

due process analysis if there exists some legitimate purpose underlying the retroactivity provision.”).

97. *Id.* at 32 (majority opinion).

98. *Id.* at 37 (O’Connor, J., concurring).

99. *Id.* at 37 (quoting *Welch v. Henry*, 305 U. S. 134, 149 (1938)).

100. *Id.* at 40 (Scalia, J., concurring).

101. *Id.* at 30-33 (majority opinion).

102. *Id.* at 32.

103. *Id.* at 32-33 (quoting *United States v. Darusmont*, 449 U.S. 292, 296-97 (1981)). The Court noted that this “customary congressional practice” generally has been “confined to short and limited periods required by the practicalities of producing national legislation.” *Id.* at 33 (quoting *Darusmont*, 449 U.S. at 296-297).

104. *Welch v. Henry*, 305 U.S. 134 (1938).

105. *Carlton*, 512 U.S. at 33 (noting that in *Welch*, 305 U.S. 134, the Court “upheld a Wisconsin income tax adopted in 1935 on dividends received in 1933”). *See also Welch*, 305 U.S. at 141 (noting that the legislature enacted a tax in March of 1935 that increased the rate of tax on dividends paid in

while “the actual retroactive effect” of the statute was a period slightly in excess of one year, it was relevant that “the amendment was proposed by the IRS in January 1987 and by Congress in February 1987, within a few months of § 2057’s original enactment.”¹⁰⁶

Much of the criticism pertaining to the recent retroactive state tax statutes has focused on the length of the statutes’ retroactivity as compared to that in *Carlton*. Critics have argued that retroactive tax statutes that are significantly longer than the one-plus year in *Carlton* should be struck down.¹⁰⁷ However, *Carlton* did not hold that the length of retroactivity was a specific test to be applied to a retroactive tax statute; it merely suggested that this length was one factor to consider when determining whether a legitimate purpose is effected by a rational means. Also, *Carlton* did not conclude that when the length of a statute is a consideration, one year is the logical limit. The Court merely observed that Congressional practice generally assumes that tax statutes can be made retroactive to the prior year and that the Court’s prior cases have typically approved that result.

Significantly, the imposition of a bright-line temporal limit on the retroactive period of a tax statute would be inconsistent with the Court’s intended focus on whether the legislative action was rational.¹⁰⁸ This is necessarily a facts and circumstances test that evaluates the “actual retroactive effect” of the tax statute, which the Court indicated could be at variance with the formal length of the statute’s retroactivity.¹⁰⁹ In *Carlton*, the Court suggested that the actual retroactive effect of the amendment to § 2057 mirrored the statute’s formal length of retroactivity, but that other considerations — like the fact that the forthcoming legislation was signaled beforehand, first, by the IRS and then by Congress — were also relevant.¹¹⁰

In her concurrence, Justice O’Connor expressed concern with the

1933). *But see Carlton*, 512 U.S. at 38 (O’Connor, concurring) (noting that although the retroactive period in *Welch* was two years, the legislature that enacted the law met only every two years).

106. *Id.* at 33 (majority opinion). *See also id.* at 34 (noting that the statute’s “period of retroactive effect is limited”).

107. *See, e.g.*, Brief Amicus Curiae of Council on State Taxation in Support of Petitioner, *supra* note 5, at 15 (“The Court’s precedents in *Carlton* and similar decisions make it clear that the Due Process Clause prevents retroactive tax legislation from reaching back indefinitely.”).

108. *See Leading Cases*, *supra* note 73, at 230 (“The Court’s use of two stages of rational basis review (for the prospective and retroactive aspects of a tax provision) accords with its focus on the actions of the legislature rather than on the impact on the taxpayer. However, the imposition of a bright-line temporal limit on the presumptively permissible period of retroactivity is inconsistent with that focus.”).

109. *Carlton*, 512 U.S. at 33-34. The Court repeatedly cited to *Welch*, which stated, *inter alia*, that the analysis depends upon “the nature of the tax and the circumstances in which it is laid.” *See id.* at 30, 33-34 (citing *Welch*, 512 U.S. at 138).

110. *Id.* at 33 (noting that the amendment had been proposed by the IRS in an administrative release in January of 1987 and by Congress itself in February 1987, prior to the law’s enactment).

potential implications of the Court's holding. She stated that the "governmental interest in revising tax laws" should be balanced against a taxpayer's "interest in finality and repose" and that due regard should be accorded to a taxpayer's "settled expectations."¹¹¹ Justice O'Connor noted that the Court's relevant prior decisions all focused on retroactive tax statutes that had relatively short retroactive periods; she further stated, "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."¹¹² But no other member of the Court expressed sympathy with Justice O'Connor's point, and Justice Scalia's two-person concurrence flatly rejected it.¹¹³ Also, Justice O'Connor did not state that a statute reflecting a longer period of retroactivity should necessarily be struck down, only that such statutes require greater scrutiny.¹¹⁴

3. Reasonable Reliance and Constructive Notice

The Ninth Circuit in *Carlton* struck down Congress' retroactive tax statute because the law was "harsh and oppressive," both because the taxpayer had reasonably relied upon the statute and also because he had no actual or constructive knowledge that a corrective retroactive law would be adopted.¹¹⁵ The Ninth Circuit concluded that not only did the taxpayer rely upon the statute's clear language, but that he also had cause to believe that Congress meant to provide an incentive for the very

111. *Id.* at 37-38 (O'Connor, J., concurring). Justice O'Connor's mention of "settled expectations" apparently referred to the judicial doctrine that applies to retroactive statutes that are curative, ratifying legislation. See *infra* notes 256-278 and 281-301 and accompanying text.

112. *Carlton*, 512 U.S. at 38 (O'Connor, J., concurring) (citations omitted) ("In every case in which we have upheld a retroactive federal tax statute against due process challenge, however, the law applied retroactively for only a relatively short period prior to enactment.")

113. See, e.g., *id.* at 40 (Scalia, J., concurring) ("The reasoning the Court applies to uphold the statute in this case guarantees that all retroactive tax laws will henceforth be valid ... I welcome this recognition that the Due Process Clause does not prevent retroactive taxes.")

114. In a case decided by the Supreme Court two years before *Carlton*, Justice O'Connor authored the decision upholding a retroactive economic statute where the retroactive period was six years. *General Motors Corp. v. Romein*, 503 US 181 (1992). *Carlton* analogized the analysis to be applied to retroactive tax statute to that applicable to retroactive economic statutes, 512 U.S. at 31-32, and *Romein* applied the two-step test later applied in *Carlton*, 503 U.S. at 191. For a discussion of *Romein*, see *infra* notes 281-301 and accompanying text. See also *infra* notes 403-423 and accompanying text (discussing *Caprio v. New York State Dep't of Taxation & Finance*, 37 N.E.3d 707, *rehearing denied*, 38 N.E.3d 817 (2015), in which New York's highest court approved a statute that had a retroactive length of 3½ years, despite the fact that one of the court's tests applied to determine the validity of a retroactive tax statute was a focus on the length of the retroactivity); *River Garden Retirement Home v. Franchise Tax Bd.*, 186 Cal. App. 4th 922, 948-49 (Cal. Ct. App. 2010) (similar).

115. *Carlton v. United States*, 972 F.2d 1051, 1059, 1062 (9th Cir. 1992). The court concluded that he had no actual knowledge of the later change, "[n]or is there any basis upon which Carlton could have had constructive notice [of such change]." *Id.* at 1059 (square brackets added).

action that he took since the “federal government had long sought to promote employee ownership of shares in their employers.”¹¹⁶

In response, the Supreme Court clarified that the legal focus must be on the legitimacy of the action taken by the government, not on its impact on the aggrieved taxpayer.¹¹⁷ The Court conceded that the taxpayer had relied upon the statute, but concluded that “his reliance alone is insufficient to establish a constitutional violation.”¹¹⁸ It stated that “[t]ax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code.”¹¹⁹ The Court also quoted *Welch v. Henry*, stating “Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens.”¹²⁰ The Court noted that “[s]ince no citizen enjoys immunity from that [tax] burden, its retroactive imposition does not necessarily infringe due process”¹²¹

Carlton also cited prior Supreme Court cases for the conclusion that the taxpayer’s lack of notice regarding the retroactive tax amendment was irrelevant.¹²² The Court stated that a taxpayer “should be regarded as taking his chances of any increase in the tax burden which might

116. *Id.* at 1060.

117. *Carlton*, 512 U.S. at 30-35.

118. *Id.* at 33.

119. *Id.*

120. *Id.* (quoting *Welch v. Henry*, 305 U.S. 134, 146-47 (1938)).

121. *Id.* (quoting *Welch*, 305 U.S. at 146-47) (brackets added). *Welch*’s more detailed statement on the point was that:

The equitable distribution of the costs of government through the medium of an income tax is a delicate and difficult task. In its performance experience has shown the importance of reasonable opportunity for the legislative body, in the revision of tax laws, to distribute increased costs of government among its taxpayers in the light of present need for revenue and with knowledge of the sources and amounts of the various classes of taxable income during the taxable period preceding revision. Without that opportunity accommodation of the legislative purpose to the need may be seriously obstructed if not defeated. We cannot say that the due process which the Constitution exacts denies that opportunity to legislatures; that it withholds from them, more than in the case of a prospective tax, authority to distribute the increased tax burden in the light of experience and in conformity with accepted notions of the requirements of equal protection; or that in view of well established legislative practice, both state and national, taxpayers can justly assert surprise or complain of arbitrary action in the retroactive apportionment of tax burdens to income at the first opportunity after knowledge of the nature and amount of the income is available.

Welch, 305 U.S. at 149-50.

122. *Carlton*, 512 U.S. at 34 (citing *Welch*, 305 U.S. 134; *Milliken v. United States*, 283 U.S. 15 (1931)). One commentator has argued that the Court’s prior precedent had been less than clear on the point, but that *Carlton* “put an end to the notice debate.” See Ronald Z. Domszy, *Retroactive Taxation: United States v. Carlton—The Taxpayer Loses Again!*, 16 N. ILL. U. L. REV. 77, 87-88 (1995). That commentator observed that in *Carlton*, “the taxpayer did not have any type of notice, not even the loose constructive notice of pending legislation.” *Id.*

result from carrying out the established policy of taxation.”¹²³ Effectively, the Court concluded that a taxpayer is always on notice that the tax law may be changed.¹²⁴

The one circumstance where the Court acknowledged that taxpayer reliance interests should be respected, and therefore that a retroactive tax statute could be struck down, is where the statute can be properly characterized as creating “a wholly new tax.”¹²⁵ But even here, the Court’s allowance was limited since the Court’s concept of a wholly new tax was not one that results from the amendment of a pre-existing statute.¹²⁶ Thus, for example, one state supreme court, reviewing *Carlton*, concluded that the tax in *Carlton* was in fact a “new tax” — one that was “assessed and collected after enactment of the new statute” in a context in which the “tax is imposed after the event being taxed has occurred.”¹²⁷ But in *Carlton*’s view the retroactive tax at issue — an amendment to a pre-existing statute — was, if new, not “wholly” new.

Commentators have criticized *Carlton* for not respecting the taxpayer’s reliance interests and for positing a test that refuses to consider such interests more generally.¹²⁸ *Carlton* concluded, however, that a judicial focus on taxpayer reliance would subject retroactive tax

123. *Carlton*, 512 U.S. at 34 (quoting *Milliken*, 283 U. S. at 23).

124. See Domsky, *supra* note 122, at 88.

125. *Carlton*, 512 U.S. at 34. The Court noted that its three gift and estate tax cases from 1927 and 1928 finding for the taxpayer, which were relied upon by the Ninth Circuit, could be distinguished on this basis. *Id.*

126. See Domsky, *supra* note 122, at 90 (noting that “One exception that remains from the [sic] successful challenges on retroactivity is the prohibition on retroactive ‘wholly new taxes,’” and citing as a possible example that “Congress could not pass the VAT (value added tax) or a national sales tax on February 1 and then make it retroactive to the first of the year”); Gunning, *supra* note 64, at 300 (wholly new taxes are distinct from “amendments to existing tax schemes that retroactively impact prior transactions”).

127. *Zaber v. City of Dubuque*, 789 N.W.2d 634, 645 (Iowa 2010).

128. Faith Colson, *Constitutional Law Due Process—The Supreme Court Sounds the Death Knell for Due Process Challenges to Retroactive Tax Legislation: United States v. Carlton*, 27 RUTGERS L. J. 243, 265 (1995) (arguing for the use of a balancing test in place of the test adopted by *Carlton* and stating, “In determining the weight to be given to the taxpayer’s interest, reliance is key”); Domsky, *supra* note 122, at 81 (stating that ideally “a balance must be struck between legislative change and reasonable reliance by the taxpayer”); Castellano, *supra* note 65, at 447 (agreeing with the Ninth Circuit in *Carlton* that “in the gift and estate tax arena, [retroactivity should require] that the taxpayer have fair notice of the nature and amount of the tax to be imposed before the transaction could be affected.”); Robert C. DeGaudenzi, *Death is Still Certain, But Are Taxes?: An Examination of the Due Process Limitations on Retroactive Tax Legislation After Carlton v. United States*, 67 ST. JOHN’S L. REV. 327, 344 (1993) (“policy would dictate against retroactivity to the extent a taxpayer has reasonably relied on an existing law”); Andrew G. Schultz, *Graveyard Robbery in the Omnibus Budget Reconciliation Act of 1993: A Modern Look at the Constitutionality of Retroactive Taxes*, 27 J. MARSHALL L. REV. 775, 796-799 (1994) (the review of retroactive tax legislation should focus in part on whether there is reasonable detrimental reliance on the part of the taxpayer). Jill E. Fisch, *Retroactivity and Legal Change: An Equilibrium*, 110 HARV. L. REV. 1055, 1056 (1997) (noting that in some instances where “reliance interests are at their peak ... [r]etroactivity ... presents serious fairness and efficiency concerns and should be disfavored.”).

laws to an “unduly strict standard.”¹²⁹ By allowing the analysis to focus on the plight of a taxpayer, such an approach would enable the judiciary to frustrate the fiscal determinations made by the legislative and executive branches and otherwise engage in policy-making that is the general province of those governmental branches.¹³⁰

Carlton concluded that so long as the legislative action is reasonable, the resulting statute cannot be claimed to be unfair within the meaning of the Due Process Clause. Lawmakers are elected officials and one can presume, as *Carlton* implicitly did, that the political process will generally forestall retroactive tax measures that are unfair.¹³¹ Some commentators have expressed concern that certain classes of taxpayers might not have the lobbying clout to prevent retroactive taxes from being applied to them.¹³² In general, concern for taxpayers that lack political clout is an important consideration when the judiciary evaluates the constitutionality of any legislative enactment.¹³³ But when

129. *Carlton*, 512 U.S. at 35.

130. *Carlton* quoted *Ferguson v. Skrupa*, 372 U.S. 726, 730 (1963), for the proposition that its prior approach engaging in “exacting review of economic legislation . . . has long since been discarded.” 512 U.S. at 34. See *Leading Cases*, *supra* note 73, at 227 (*Carlton*’s “emphasis on the reasonableness of the legislature’s actions indicates that the Court will not ‘substitute [its] social and economic beliefs for the judgment of legislative bodies, who are elected to pass laws.’”) (quoting *Ferguson v. Skrupa*, 372 U.S. at 730). See also *Eastern Enterprises v. Apfel*, 524 U.S. 498, 437-538 (1998) (“The day is gone when this Court uses the Due Process Clause . . . to strike down . . . laws, regulatory of business and industrial conditions, because they may be unwise, improvident, or out of harmony with a particular school of thought”) (quoting *Williamson v. Lee Optical of Okla., Inc.*, 348 U.S. 483, 488 (1955)).

131. See *Fisch*, *supra* note 128, at 1111 (“Several scholars have argued that the political process constrains the use of retroactive legislation.”); James M. Puckett, *Embracing the Queen of Hearts: Deference to Retroactive Tax Rules*, 40 FLA. ST. U.L. REV. 349, 379 (2013) (noting that protections for taxpayers that would be affected by retroactive tax statutes are provided by the political process).

132. See generally the articles referenced *supra* note 128.

133. The “harsh and oppressive” formulation of *Welch v. Henry* and the judicial logic of that case — an important predecessor to *Carlton* — was rooted in the reasoning in *U.S. v. Carolene Products*, 304 U.S. 144 (1938). See *Carolene Products*, 304 U.S. at 148, 152-53 (evaluating a due process challenge to economic legislation and concluding that the legislation was entitled to a “presumption of constitutionality” and would be upheld so long as it had a “rational basis”). *Burton*, *supra* note 62, at 514 (noting that *Welch* and *Carolene Products* were decided in the same year within 7 months of each other, were both written by Justice Harlan Stone, and each state similar standards of review). The well-known footnote 4 of *Carolene Products* explained that economic legislation is evaluated under a more deferential standard of review — as compared with legislation that targets “discrete and insular minorities” — because the political process can be trusted to guard against inequitable such legislation. See 304 U.S. at 153, n. 4 (“political processes . . . can ordinarily be expected to bring about repeal of undesirable legislation”). See also M. Bryan Schneider, *The Supreme Court’s Reluctance to Enforce Constitutional Prohibitions Against Retroactive Income Tax Statutes*, 40 WAYNE L. REV. 1603, 1617 n.75 (1994) (“The deferential standard afforded Congress in passing retroactive tax laws . . . stems from the Court’s reliance on the famous, or, depending on your view, infamous, footnote 4 of *Carolene Products*, which the Court has used extensively for justification in reviewing economic legislation under a more deferential standard than other types of legislation.”) (full citation omitted). In *Carlton*, the Court likened retroactive tax legislation to retroactive economic legislation more generally — suggesting that taxpayers’ typical means to oppose such laws is the political process. See 512 U.S. at 30. See also *General Motors Corp. v. Dep’t of the Treasury*, 803 N.W.2d 698, 710 (Mich. Ct. App.

retroactive tax statutes are used to address budgetary concerns, as was true in *Carlton* and has been the typical circumstance in the recent state tax cases, almost invariably the affected taxpayers will have significant economic resources and lobbying clout. This point is demonstrated by *Dot Foods* and the recent Michigan consolidated cases pertaining to the Multistate Tax Compact — the cases that resulted in Supreme Court certiorari petitions that were denied in 2017 — as those cases pertained to large companies with significant lobbying clout.¹³⁴

Before turning to *Dot Foods* and state tax retroactivity more generally, it is noteworthy that it was the taxpayer's reasonable reliance on the pre-existing unambiguous statute in *Carlton* that instigated the Supreme Court case since that reliance prompted the Ninth Circuit to break from decades of Supreme Court precedent to rule for the taxpayer. Also, as has been noted, it was the Supreme Court's refusal to respect this taxpayer reliance that engendered the most criticism.¹³⁵ In contrast, *Dot Foods* and the other recent state tax cases generally pertained to pre-existing legislation that was not clearly-worded and only later clarified by a court decision in a manner that was inconsistent with the state's prior interpretation. Therefore, *Dot Foods* and the other recent state tax cases do not reflect the same reliance concerns that were suggested by *Carlton*.

II. *DOT FOODS, INC. v. DEP'T OF REVENUE*

A. Background

The legislation in *Dot Foods* pertained to Washington's Business & Occupation (B&O) tax, a tax that is imposed "for the act or privilege of engaging in business activities" in the state.¹³⁶ The legislation was enacted in 1983, and provided an exemption from the tax when an entity made "sales in this state exclusively to or through a direct seller's representative."¹³⁷ A "direct seller's representative" was defined as a

2010) (the *Carlton* rational basis test is a "negative statement of the substantive due process requirement that legislation that does not affect a suspect classification or involve the deprivation of a fundamental right must merely bear a reasonable relationship to a permissible legislative objective").

134. *Dot Foods* and the Michigan consolidated cases are discussed *supra* notes 1-2 and accompanying text. For a listing of some of the amici that supported the Supreme Court certiorari petitions filed for the taxpayers in these cases, see *supra* note 5 and accompanying text. See also David Brunori, *Who Are The Most Influential People in State Tax?* STATE TAX TODAY: TAX ANALYSTS (May 6, 2008) (noting the particular lobbying clout of the Council on State Taxation, one of the amici in both cases).

135. See *supra* note 128 and accompanying text.

136. *Dot Foods, Inc. v. Dep't of Revenue*, 173 P.3d 309, 311-12 (Wash Ct. App 2007), *rev'd*, 215 P.3d 185, 187 (2009).

137. *Dot Foods, Inc. v. Wash. Dep't of Revenue*, 215 P.3d 185, 187 (Wash. 2009) (citing Former

person who buys consumer products on a buy-sell basis or for commission for resale and that makes sales “in the home or otherwise than in a permanent retail establishment.”¹³⁸ A “permanent retail establishment” (“PRE”) referred to retail locations such as grocery stores.¹³⁹

The language in the Washington exemption was derived from a 1982 Internal Revenue Code provision that similarly pertained to “direct sellers.”¹⁴⁰ In that context, the IRS described “direct sellers” as individuals who sold products “person to person,” i.e., as a consumer “alternative to shopping centers, department stores, or the like.”¹⁴¹ Although there was a dispute in the *Dot Foods* case about the application of the state’s “direct seller” exemption to the taxpayer, there was “no dispute that [the] exemption was designed to provide a tax exemption for those engaged in direct sales of consumer products, in each case ‘in the home or otherwise than in a permanent retail establishment.’”¹⁴² The record in the *Dot Foods* case “identified some well-known direct selling companies, including Mary Kay, Avon, Pampered Chef, Longaberger and Creative Memories.”¹⁴³

B. Dot Foods’ In-state Activity and Washington’s Approach to the Exemption

During the tax period in question, Dot Foods was the largest food distributor in the United States.¹⁴⁴ It was an Illinois corporation that produced food products outside Washington and sold those food products in Washington to dairies, meat packers, food processors and other food service companies.¹⁴⁵ During the relevant tax period Dot

RCW 82.04.423(1)(d)).

138. *Id.* (citing RCW 82.04.423(2)). Specifically, that statutory section applied to: “[A] person who buys consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment, or who sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment.” *Id.*

139. *Id.*

140. See Brief of Respondent, at 14-15, *Dot Foods v. Dep’t of Revenue*, 173 P.3d 309 (Wash. Ct. App. 2007) (No. 357330-II).

141. See Supplemental Brief for Respondent at 14, *Dot Foods, Inc. v. Dep’t of Revenue*, 215 P.3d 185 (Wash. 2009) (No. 81022-2).

142. 215 P.3d at 192 (Stephens, J., dissenting). See Brief in Opposition to Petition of Writ of Certiorari to the U.S. Supreme Court at 17-18 n.2, *Dot Foods, Inc. v. Dep’t of Revenue*, 137 S. Ct. 2156 (No. 16-308), 2016 WL 7156378 at *17 n.2 (noting that “The underlying purpose for the direct seller’s exemption was well known to the 2010 Legislature, and Dot Foods does not argue otherwise in its petition for certiorari.”).

143. 215 P.3d at 192 (Stephens, J., dissenting).

144. See Brief of Respondent, *supra* note 140, at 1, 4.

145. 215 P.3d at 187. See 173 P.3d at 310-311.

Foods effected those sales through its wholly owned subsidiary, DTI.¹⁴⁶ The companies to which DTI sold products in turn (1) used these products as ingredients to make other products, which were then sold to PREs (e.g., grocery stores) or (2) resold the products to other food service operators or institutions (e.g., nursing homes, schools, hospitals and cafeterias).¹⁴⁷

Because Dot Foods sold products into Washington that were eventually sold in PREs, it was apparently not the type of seller that was intended to be included under the statutory exemption. However, the literal language of the statute was not explicit on this point.¹⁴⁸ Moreover, Dot Foods took the position that it was entitled to the exemption sometime after its enactment and that position was not initially contested by the Washington Department of Revenue (the “DOR” or “Department”).¹⁴⁹ At some point, however, the company recognized that its position was at least questionable, and in 1997, it requested a letter ruling from the Department confirming its entitlement to the exemption.¹⁵⁰

The DOR issued Dot Foods a private letter ruling in October 1997, stating that the company qualified for the direct seller exemption.¹⁵¹ The DOR does not publish letter rulings¹⁵² and there is no suggestion in

146. 215 P.3d at 187. *See* 173 P.3d at 311.

147. 215 P.3d at 187. *See* 173 P.3d at 311 (“some of the consumer products ultimately ended up in permanent retail establishments”). Dot Foods also sold a small amount (< 1%) of non-consumer products — cash register receipt rolls, pretzel display cabinets, straw dispensers and chefs’ hats, etc. 215 P.3d at 187.

148. *See* 173 P.3d at 314.

149. The several decided cases and various briefs filed are unclear on the specific facts. The 2009 Washington Supreme Court decision states that up through 1999 “For many years, Dot received a B&O exemption for 100 percent of its sales pursuant to [the exemption].” 215 P.3d at 187. But the court clearly included in the “many years” the 1997-1999 period for which the Washington DOR had issued Dot Foods a letter ruling that it subsequently revoked. *See id.* Also, a related case decided in 2001, *The Stroh Brewery Co. Dep’t of Revenue*, 15 P.3d 692, 696 (Wash. Ct. App. 2001), *rev. denied*, 29 P.3d 718 (2001), concluded that no prior Washington DOR administrative guidance had specifically addressed the issue. *See id.* at 696. The Washington DOR in a filing with the state’s supreme court “readily admit[ted] that before 2000 it erroneously allowed some taxpayers, including Dot [Foods], to take the direct seller’s exemption.” *See* Supplemental Brief of Respondent, *supra* note 141, at 2 (brackets added). Taxpayers routinely take the position that unaudited tax returns constitute precedential action on the part of a tax agency but this is not correct as a matter of law. *See, e.g., Comptroller v. Gore Enterprise Holdings*, 60 A.3d 107, 117-18 (Md. Ct. Spec. App. 2013). Consistent with this notion, the court’s statement in *Dot Foods* seems to suggest the court’s view that Dot Foods “received” the exemption prior to 1997, in the sense that it claimed the exemption on its tax returns for some of those years and was not contested with respect to those filings by the Washington DOR.

150. 173 P.3d at 311. The inquiry was at first anonymous; only later did the inquirer identify itself as Dot Foods. *See* Brief of Respondent, *supra* note 140, at 5.

151. 173 P.3d at 311. Dot Foods created its subsidiary DTI to take advantage of the ruling. *See* Brief in Opposition to Petition of Writ of Certiorari to the U.S. Supreme Court, *supra* note 142, at 17-18 n.2.

152. Jennifer Carr, *Washington Guidance Policies May Affect Tax Avoidance Provision*, STATE

any of the later cases or briefs that any other taxpayers became aware of, or acted in reliance on, this ruling. Certainly, Dot Foods itself would have had no incentive to advise its competitors of its favored tax status. The 1997 letter ruling specified that it was binding on both Dot Foods and the Department but that it would only remain binding until: "the facts change; the law (either by statute or court decision) changes; the applicable rule(s) change; the Department of Revenue publicly announces a change in the policy upon which this ruling is based; or Dot Foods, Inc. is notified in writing that this ruling is not valid."¹⁵³

In 1999, the Washington DOR issued a regulation, effective December 31 of that year, which effectively rescinded the Dot Foods private letter ruling.¹⁵⁴ That regulation clarified that "in order to qualify for the exemption, out-of-state sellers could never sell any consumer products that anyone will eventually sell in a permanent retail establishment anywhere in the chain of distribution."¹⁵⁵ One impetus for the regulation was that the state had become involved in a judicial dispute with Stroh Brewery, in which the state opposed Stroh Brewery's claim that it qualified for the direct seller's exemption.¹⁵⁶ The state's argument in that case — which was later upheld by the state's appeals court — was that Stroh Brewery did not qualify for the exemption because its beverages were resold by unrelated in-state distributors to retail outlets such as restaurants and taverns, rather than being sold through in-home parties or door-to-door marketing.¹⁵⁷

In February 2000, the Department issued a "Special Notice for Direct Sellers," which informed taxpayers that the Department had updated its interpretation of the B&O tax.¹⁵⁸ The notice directed taxpayers to the revised regulation. It specifically stated that "[i]f a consumer product is sold by anyone in a permanent retail establishment, the direct seller's

TAX TODAY: TAX ANALYSTS (Feb. 4, 2013), 2013 STT 23-7 (noting that Washington does not publish redacted versions of the private letter rulings it issues to taxpayers).

153. 173 P.3d at 311.

154. *Id.*; 215 P.3d at 193-94 and n.3 (Stephens, J., dissenting).

155. 215 P.3d at 186-87.

156. *Stroh Brewery Co. v. Dept. of Rev.*, 15 P.3d 692 (Wash. Ct of App., 2001), *rev. denied*, 29 P.3d 718 (2001).

157. *See id.* at 696. *See also* Brief in Opposition to Petition of Writ of Certiorari to the U.S. Supreme Court, *supra* note 142, at 4-5. *Stroh Brewery* concluded that "When a direct seller sells through a wholesaler, the seller can qualify for the B & O tax exemption in RCW 82.04.423 only if its products are never sold in a permanent retail establishment." 15 P.3d at 696. The case also concluded that "even if the statute's language is ambiguous, we must resolve the ambiguity in favor of taxation." *Id.* at 695. *Stroh Brewery* was later "relied heavily on" by the trial court in *Dot Foods* and was also relied upon by the court of appeals, 173 P.3d at 312, 315-16. The Washington Supreme Court later distinguished *Stroh Brewery* and concluded it was "unhelpful" on the theory that, unlike in *Stroh Brewery*, *Dot Foods* did not make final sales to an in-state wholesaler that then resold the products to retailers. 215 P.3d at 191-92.

158. 173 P.3d at 311.

exemption is not available to the direct seller.”¹⁵⁹ The Department sent a copy of the notice to Dot Foods, which Dot Foods received.¹⁶⁰

Despite specific notice of the state’s 1999 regulation, Dot Foods continued to claim the direct seller exemption. The Department audited Dot Foods with respect to the exemption for the tax years 2000 through 2004.¹⁶¹ Because some of Dot Food’s products eventually ended up in permanent retail establishments, like grocery stores, the Department assessed a B&O tax against Dot Foods for the tax periods January 1, 2000 through December 31, 2003, for 100 percent of its in-state sales.¹⁶²

C. Dot Foods’ Litigation with Respect to the Exemption

Dot Foods paid the tax and filed a refund action in Thurston County Superior Court.¹⁶³ Both sides filed motions for summary judgment. In support of its motion, the Department argued Dot Foods did not qualify for the exemption because (1) its sales were not exclusively consumer products and (2) some of its products eventually ended up in permanent retail establishments.¹⁶⁴ The Department’s “consumer goods” argument was new; it had not previously focused on that argument in either the Dot Foods letter ruling or its tax assessment.¹⁶⁵

In 2006, the trial court agreed with the Department on both grounds and entered summary judgment in its favor.¹⁶⁶ Dot Foods appealed, and in 2007 the court of appeals affirmed the trial court’s decision on the basis that the exemption required that the vendor engage exclusively in

159. *Id.* at 311-12.

160. *Id.* at 312. In a brief filed in the case, the Washington DOR noted that “The notice further informed taxpayers that the Department had rescinded four *published* determinations that had been supplanted by the revised rule” — dating back to 1987. *See* Brief of Respondent, *supra* note 140, at 8 (emphasis added). It is not clear what these published determinations said. *Stroh Brewery* references four prior “written determinations that applied the direct seller’s exemption.” 15 P.3d at 696. Although published, it seems clear that these determinations were not precedential. The taxpayer in *Stroh Brewery* argued that they were, but the court cited a state regulation that stated such published documents would only be precedential if the Washington DOR so designated them. *Id.* at 696 and 696 n.1 (citing RCW 82.32.410(1)). Also, in any event, “none of the Department’s determinations directly address[ed] whether a direct seller may qualify for the exemption if its products eventually are sold in a permanent retail establishment.” *Id.* at 696 (brackets added).

161. *Dot Foods, Inc. v. Washington Dep’t of Revenue*, 215 P.3d 185, 187 (Wash. 2009).

162. *Id.*

163. *Id.*

164. *Id.* at 187-88.

165. 215 P.3d at 188 n.1. The argument was that, although almost all of Dot Foods’ sale products were consumer products such as dry foods, sauces, and refrigerated foods, the remainder of its sales were from non-consumer products, such as cash register receipt rolls, pretzel display cabinets, straw dispensers, and chef hats, and that the latter such non-consumer sales were disqualifying with respect to the exemption. *See id.*

166. *Id.* at 188.

selling consumer products.¹⁶⁷ The court of appeals also held that the Department's 1999 regulation was reasonable and supported by principles of statutory interpretation and legislative intent, both of which suggested that the exemption did not apply to vendors whose products ended up in permanent retail establishments.¹⁶⁸

Dot Foods petitioned for further review from the Washington Supreme Court, which granted the review and reversed in a 5-4 opinion.¹⁶⁹ The majority held that the language of the statute was unambiguous and supported the taxpayer's claim.¹⁷⁰ Because the Department's 1999 regulation was contrary to this meaning, the court rejected it.¹⁷¹ The court stated that "[w]hile we give great deference to how an agency interprets an ambiguous statute within its area of special expertise, such deference is not afforded when the statute in question is unambiguous."¹⁷² The court also concluded that deference to the Department's regulation was undermined by the fact that the Department's pre-regulation interpretation was to the contrary.¹⁷³ It stated that "[a]s a general rule, where a statute has been left unchanged by the legislature for a significant period of time, the more appropriate method to change the interpretation or application of a statute is by amendment or revision of the statute, rather than a new agency interpretation."¹⁷⁴

The four-person dissent disagreed with the majority's statutory construction.¹⁷⁵ That dissent concluded that the majority's statement that "the more appropriate method to change the interpretation or application of a statute is by amendment or revision of the statute, rather

167. *Id.*

168. *Dot Foods, Inc. v. Dep't of Revenue*, 173 P.3d 309, 315-16 (Wash Ct. App 2007), *rev'd*, 215 P.3d 185, 187 (2009).

169. *Dot Foods, Inc. v. Washington Dep't of Revenue*, 215 P.3d 185, 192 (Wash. 2009).

170. *Id.* at 190-191.

171. *Id.* at 189.

172. *Id.* (quoting *Densley v. Dep't of Ret. Sys.*, 173 P.3d 885, 890 (Wash. 2007)).

173. *Id.* at 189. Specifically, the Court stated:

The Department's argument for deference is a difficult one to accept, considering the Department's history interpreting the exemption. Initially, and shortly after the statutory enactment, the Department adopted an interpretation which is at odds with its current interpretation. One would think that the Department had some involvement or certainly awareness of the legislature's plans to enact this type of statute.

Id. The court cited no specific "interpretation" of the statute by the Department, and it is not clear what interpretation adopted "shortly after the statutory enactment," it was referring to. *See supra* note 149 and accompanying text.

174. *Id.* at 189.

175. *Id.* at 192-93 (Stephens, J., dissenting). Among other things, the dissent noted, "There is no dispute that this exemption was designed to provide a tax exemption for those engaged in direct sales of consumer products, typically through in-home parties or door-to-door marketing." *Id.* at 192.

than a new agency interpretation” was “dangerous language.”¹⁷⁶ The dissent stated that “[c]ertainly, the executive branch has the constitutional authority to interpret and implement statutes within its purview and it is not required to seek a legislative change whenever it determines a prior interpretation was erroneous.”¹⁷⁷ The dissent also stated that there “is no support for the majority’s refusal to defer to the Department’s interpretation of [the exemption] because it would have preferred that the agency seek a legislative amendment instead of exercising its rule-making power.”¹⁷⁸

D. The Retroactive Tax Legislation

The Washington Supreme Court’s decision in *Dot Foods* was rendered in September, 2009. Shortly thereafter, the Washington DOR estimated that the negative fiscal impact of the decision would be over \$150 million in the 2009-2011 biennium alone.¹⁷⁹ Although Dot Foods was the largest food re-distributor in the United States, only a small percentage of that amount would be due to Dot Foods.¹⁸⁰ Other non-litigant companies that presumably had been complying with the state’s 1999 regulation — which had twice been upheld by lower Washington courts — would now also be entitled to refunds.¹⁸¹

Washington, like most states and unlike the federal government, has a balanced budget requirement.¹⁸² In recognition of the negative fiscal impact of the *Dot Foods* decision, in February 2009, the Washington governor unveiled a budget proposal that would both prospectively and retroactively amend the exemption for a direct seller.¹⁸³ That bill was

176. *Id.* at 193-94.

177. *Id.* at 194.

178. *Id.* at 194.

179. *See* *Dot Foods v. Dep’t Revenue*, 372 P.3d 747, 751 n.3 (Wash. 2016).

180. *See* 372 P.3d at 751 n.3 (Wash. 2016) (“Dot Foods’ refund request was for just over \$500,000 ... indicating that other taxpayers would be affected by the 2010 amendment — not just Dot Foods.”) (citing *Dot Foods’* Respondent Brief at 9).

181. *See id.* The state had to estimate what companies would file claims and to what extent, as there was no evidence in the record as to any other taxpayer claims. *See* *Dot Foods’* Motion for Reconsideration, at 17, *Dot Foods, Inc. v. Wash. Dep’t of Revenue*, 2016 Wash. LEXIS 574 (Wash. 2016) (No. 92398-1).

182. *See* NATIONAL CONFERENCE OF STATE LEGISLATURES, <http://www.ncsl.org/research/fiscal-policy/state-balanced-budget-requirements.aspx>, updated April 12, 1999 (website of the National Conference of State Legislatures notes that 49 states — every state except Vermont — has a balanced budget requirement). *See also* Julie A. Roin, *Retroactive Taxation, Unfunded Pensions, and Shadow Bankruptcies*, 102 IOWA L. REV. 559, 573 and 573 n.39 (2017).

183. *See* Gregoire: Boost Taxes by \$605 Million, WASHINGTON SECRETARY OF STATE BLOG, <https://blogs.sos.wa.gov/FromOurCorner/index.php/2010/02/gregoire-boost-taxes-by-605-million/> (“[The Governor] said passing a bill to re-impose a tax on out-of-state companies would halt the loss of \$154 million due to a new state Supreme Court ruling called *Dot Foods*.”) (brackets added).

passed by the legislature in April 2010, seven months after the *Dot Foods* decision.¹⁸⁴ The statute prospectively and retroactively amended the exemption to prevent a “large and devastating” loss of state tax revenue and to remove an unintended tax incentive for “in-state businesses to move their operations outside Washington.”¹⁸⁵

The statute’s legislative history commented on its retroactive application.¹⁸⁶ The legislature concluded that its intent “in enacting this exemption was to provide a narrow exemption for out-of-state businesses engaged in direct sales of consumer products, typically accomplished through in-home parties or door-to-door selling.”¹⁸⁷ Therefore, the legislature concluded, “it is necessary to reaffirm the legislature’s intent in establishing the direct sellers’ exemption and prevent the loss of revenues resulting from the expanded interpretation of the exemption by amending [the statute] retroactively to conform the exemption to the original intent of the legislature.”¹⁸⁸ Specifically, the exemption was amended retroactively to clarify that it was limited to persons engaged in the *retail sale* of only *consumer* products.¹⁸⁹

E. Judicial Review of the Retroactive Tax Legislation

Subsequent to the enactment of the retroactive legislation, the Washington DOR denied Dot Foods’ claim for a tax refund for tax periods that were outside the tax periods at issue in the prior case, i.e., after April 2006.¹⁹⁰ Dot Foods then sued again, this time claiming that the retroactive legislation was invalid under the Due Process Clause, and also that the legislation was invalid under the legal theories of separation

184. 372 P.3d at 748.

185. See 372 P. 3d at 750 (quoting Wash. Legislature, 2010 1st Spec. Sess., 61st Legislature, ch. 23, § 401 (Wash. 2010); Brief in Opposition to Petition of Writ of Certiorari to the U.S. Supreme Court, *supra* note 142, at 6.

186. See Wash. Legislature Laws 2010 1st Spec. Sess., 61st Legislature, ch. 23, § 401 (Wash. 2010).

187. See *id.*

188. *Id.* (brackets added). The exemption was repealed entirely for future years. See *id.* (brackets added)

189. In particular, the exemption was retroactively limited to:

...a person who buys *only* consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment, or who sells *at retail*, or solicits the sale *at retail* of, *only* consumer products in the home or otherwise than in a permanent retail establishment...

Wash. Legislature, 2010 1st Spec. Sess., 61st Legislature, ch. 23, § 402 (Wash. 2010) (italicized terms mark the additions to the original statute). Effectively, the revised statute codified the position that the state had taken — for a ten-year period — by regulation. See *supra* notes 154-155 and accompanying text.

190. 372 P.3d at 749.

of powers and collateral estoppel.¹⁹¹ The suit pertained only to Dot Foods' tax periods beginning May 2006, as the state of Washington had refunded the tax at issue in the prior case.¹⁹² Thus, the 2009 *Dot Foods* decision remained in force as to Dot Foods for those prior tax periods. Because of the retroactive legislation, however, no other entity would be able to submit a tax refund claim based upon the 2009 case for any period, and Dot Foods itself would be foreclosed from seeking refunds for the subsequent tax periods.

In a letter opinion, a trial court granted summary judgment to the Washington DOR on Dot Foods' separation of powers and collateral estoppels claims, but found in favor of the taxpayer under the Due Process Clause.¹⁹³ Subsequently, a unanimous Washington Supreme Court reversed the trial court and upheld the 2010 retroactive statute on all counts.¹⁹⁴

1. Legitimate Legislative Purpose

In evaluating Dot Foods' due process challenge to the retroactive tax legislation, the Washington Supreme Court applied *Carlton's* two-part test. First, the court held that the amendment was for the legitimate legislative purposes of preventing the "large and devastating revenue losses" created by the court's 2009 decision and for "restoring parity" between in-state and out-of-state sellers of consumer goods.¹⁹⁵ The court stated that it was applying a similar rational basis analysis as it had in a case decided one year earlier, *In re Estate of Hambleton*,¹⁹⁶ where the court also upheld a retroactive tax statute that reversed one of its prior decisions.¹⁹⁷

The court dismissed the taxpayer's claim that because the legislature could not have known the 1983 legislature's "original intent," its asserted purpose was arbitrary and unreasonable.¹⁹⁸ The court stated that the taxpayer's suggested inquiry was inconsistent with the highly

191. *Id.* at 748.

192. *See id.* at 749 ("Dot Foods negotiated a settlement with the Department for over 97 percent of the B & O taxes paid from January 2000 through April 2006").

193. *See generally id.* at 749.

194. *See* 372 P.3d at 755.

195. *Id.* at 750.

196. 335 P.3d 398 (Wash. 2014), *cert. denied*, 136 S. Ct. 318 (2015). In *Hambleton*, the Court upheld retroactive estate tax legislation that dated back eight years. *See id.* That legislation reversed a prior decision by the same court that would have created "an inequity never intended by the Legislature" since it "would [have] allow[ed] some estates to escape the tax while similarly situated estates would be subject to it." *See id.* at 404-05, 411.

197. *See* 372 P.3d at 750 n.2. The court noted that the trial court below had rendered its decision without the benefit of the court's subsequent decision in *Hambleton*.

198. *Id.* at 751.

deferential *Carlton* test.¹⁹⁹ The court also rejected the taxpayer's claim that the asserted revenue losses have to be "unanticipated," because it concluded there was no such requirement stated in *Carlton*.²⁰⁰ Finally, the court rejected the taxpayer's claim that the legislature impermissibly "targeted" it within the meaning of *Carlton* simply because the legislature acted to reverse the analysis — though not the final decision favoring the company — in Dot Foods' prior judicial victory.²⁰¹

2. Rational Means

Second, the Washington Supreme Court concluded that the statute's period of retroactivity was rationally related to its legislative purpose, as required by *Carlton*.²⁰² The taxpayer argued that because the legislation amended a statute enacted in 1983, its retroactive period was 27 years and that this period rendered the statute unconstitutional under *Carlton*.²⁰³ In response, the court noted that the taxpayer's asserted retroactive length was overstated.²⁰⁴ The court stated that although "it is true that the 2010 amendment theoretically dates back to the enactment under the plain language [of the law], the *actual retroactive application* of the amendment is necessarily limited by the particularities of the case as well as the applicable statute of limitations."²⁰⁵ It noted that "[a]t issue here is whether the amendment, which went into effect on May 1,

199. *Id.* at 750-51. A specific criticism that has been made with respect to the case is that a retroactive state tax statute is somehow undermined when the legislators that are responsible for the statute are not substantially the same as those that were initially responsible for the statute. Brief Amicus Curiae of Council on State Taxation in Support of Petitioner, *supra* note 5, at 21-22 (stating that there was 100% turnover in the Washington legislature between 1983 and 2010); Brief for the Inst. for Prof'ls in Taxation as Amicus Curiae in Support of Petitioner, *supra* note 5 at 21-22 (stating that all but one of the 147 members of the two houses of Washington's legislature "moved on between the original passage of the statute and the 2010 amendments"). But this assumes that *Carlton* requires that later legislators have personal knowledge of the intentions of the earlier legislature, and *Carlton* stated no such requirement. See 512 U.S. at 30-35. Justice O'Connor's concurrence in *Carlton*, which was most sympathetic to the idea that there should be temporal limits imposed on retroactive tax statutes, specifically stated that even one year after the enactment of such laws the "subjective motivation" of the legislature is difficult to discern and logically irrelevant. *Id.* at 36-37 (O'Connor, J., concurring).

200. 372 P.3d at 751.

201. *Id.* at 751. The court noted that a comparison of the estimated revenue cost of the amendment with the refund request of Dot Foods — the latter of which was only a very small component of the former — "support[ed] the conclusion that the legislature was not improperly targeting Dot Foods but was enacting a statute of general application." *Id.* at 751 n.3 (brackets added). See *supra* notes 179-181 and accompanying text. The company retained the exemption for the tax years that were at issue in the case that it successfully litigated. See *supra* note 192 and accompanying text.

202. 372 P.3d at 751-52.

203. *Id.* at 751

204. *Id.* at 751-52.

205. *Id.* at 751 (emphasis added). The court noted that it is "the function — rather than the length — of a retroactivity period" that is key. *Id.* at 752.

2010, applies retroactively to the May 2006 through December 2007 interim tax periods.”²⁰⁶ Thus, the court concluded that “the retroactivity period *as applied to Dot Foods* is only four years.”²⁰⁷

The court also noted that, in any event, *Carlton* imposed “no absolute temporal limitation on retroactivity.”²⁰⁸ It stated that “[w]hile there are certainly constitutional limits on how far back laws may reach, whether the length of a retroactivity period breaches that limit should be determined by a qualitative analysis of the law, not solely by a quantitative measurement of time.”²⁰⁹ The Court also noted the Supreme Court’s language in *Welch v. Henry*: “In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid...”²¹⁰ Lastly, relying upon its prior decision in *Hambleton*, the court noted that the “*actual retroactive effect* of the amendment as applied to *Dot Foods* was rationally related to the legislature’s legitimate state purpose” of “preventing the loss of revenues resulting from the expanded interpretation of the exemption.”²¹¹ Therefore, the retroactive tax statute met the requirements of the Due Process Clause.²¹²

206. *Id.* at 751.

207. *Id.* (emphasis added).

208. *Id.* at 752. *See also* Temple Univ. v. United States, 769 F.2d 126, 135 (3d Cir. 1985) (“no federal court of appeals has yet adopted an absolute temporal limitation on retroactivity”), *cert. denied*, 476 U.S. 1182 (1986).

209. 372 P.3d at 751 (citing *State v. Pac. Tel. & Tel. Co.*, 113 P.2d 542 (Wash. 1941)).

210. *Id.*

211. *Id.* (emphasis added) (quoting LAWS OF 2010, 1st Spec. Sess., ch. 23, § 401(4) (brackets omitted)).

212. The Supreme Court has stated in the state tax context that “Due process centrally concerns the fundamental fairness of governmental activity.” *Quill Corp. v. North Dakota*, 504 U.S. 298, 312 (1992). But even applying this general concept, it is difficult to question the result in *Dot Foods*. As has been noted, the taxpayer took a position that was opposed by the state’s Department of Revenue, and rejected by the trial court, the appeals court and four of the nine judges on the state supreme court. *See supra* notes 163-178 and accompanying text. When the state supreme court found in favor of the taxpayer, 5-4 — reversing the determination reached by two lower courts — the state governor and the state legislature acted specifically and almost immediately to legislatively reverse that decision, and the state supreme court then unanimously upheld that legislation. *See supra* notes 179-194 and accompanying text. When one steps back from the nearly unanimous determinations made by each of the various components of Washington state government over the lifetime of the *Dot Foods* case, it seems hard to argue that this collective governmental consensus was unfair. *Compare* U.S. CONST. amend V and amend. XIV, § 1 (Due Process Clause requires that a person not be “deprived of ... property without due process of law”). The similar, consolidated Michigan cases for which the Supreme Court denied certiorari on the same day as *Dot Foods*, received similar, repeated state government consideration — with the various implicated state actors in that case also rejecting the taxpayers’ arguments with nearly unanimous antipathy. *See generally supra* note 1 and notes 363-402 accompanying text.

3. Separation of Powers; Collateral Estoppel

The court also dismissed the taxpayer's claim that the retroactive legislation violated separation of powers' principles by infringing on a judicial function.²¹³ It noted that there is no such violation where the legislature does not reverse a prior final decision *ex post facto*, and that the legislation did not curtail the judgment in the 2009 *Dot Foods* case.²¹⁴ Similar determinations have been made in other cases evaluating retroactive state tax statutes that have reversed the analysis in a court decision.²¹⁵

Lastly, the court rejected the taxpayer's argument that the Washington DOR was collaterally estopped from assessing taxes against it for tax periods that were not at issue in, and were concluded prior to, the decision in the 2009 *Dot Foods* case.²¹⁶ The court concluded that "tax appeals are very limited causes of action" and "tax appeals are confined to the specific taxes and associated time periods identified by the aggrieved taxpayer."²¹⁷

III. ANALYSIS OF *DOT FOODS* AND *CARLTON*

Some have argued that *Dot Foods* and the recent, similar state tax cases represent a particularly egregious application of a retroactive state tax statute, one that warrants re-consideration of the *Carlton* test.²¹⁸ In fact, *Dot Foods* reveals the merits of the *Carlton* approach in the state tax context — particularly with respect to the generic, recurring fact pattern that was at issue in *Dot Foods*. Unlike in *Carlton*, where the

213. 372 P.3d at 754.

214. *Id.* at 754-55.

215. *See, e.g.*, *Gillette Commer. Operations N. Am. v. Dep't of Treasury*, 878 N.W.2d 891, 912-15 (Mich. App. 2015), *rev. denied*, 880 N.W.3d 230 (Mich. 2016), *cert. denied*, 137 S. Ct. 2157 (2017); *In re Hambleton*, 335 P.3d 398, 406-09 (2014), *cert. denied*, 136 S. Ct. 318 (2015); *General Motors Corp. v. Dep't of Treasury*, 803 N.W.2d 698, 720 (Mich. 2010) (per curiam), *cert. denied*, 565 U.S. 1178 (2012); *Enterprise Leasing Co. of Phoenix v. Ariz. Dep't of Revenue*, 211 P.3d 1, 17 (Ariz. Ct. App. 2008); *Allegis Realty Investors v. Novak*, 860 NE 2d 246, 255-56 (Ill. 2006); *King v. Campbell County*, 217 S.W.3d 862, 870-71 (Ky. Ct. App. 2006). The claim that the legislative reversal of the analysis in a court case violates the separation of powers doctrine was also rejected in several federal court of appeals cases in the 1980's pertaining to FICA taxes. *See generally* *Michael Reese Hosp. and Med. Ctr. v. United States*, 684 F. Supp. 986, 990-91 (1988). These FICA tax cases are discussed in more detail *supra* notes 302-316 and accompanying text. *See also* *Battaglia v. General Motors Corp.*, 169 F.2d 254, 262 (2nd Cir. 1948), *cert. denied*, 335 U.S. 887 (1948) (no separation of powers issue where Congress retroactively reversed the analysis in several U.S. Supreme Court cases). *Battaglia* is discussed in greater detail *supra* notes 317-323 and accompanying text.

216. 372 P.3d at 752-53. This would have been the tax periods commencing in April, 2006. *See id.* at 749.

217. *Id.* at 753.

218. *See supra* notes 9-10 and accompanying text.

retroactive statute was one that amended an unambiguous tax statute to foreclose a deduction previously permitted, *Dot Foods*, like other recent state tax cases, involved a situation where the legislature sought to clarify a tax statute that it concluded had been wrongly construed by the judiciary.

As *Dot Foods* determined, the revised Washington statute met the *Carlton* test because there was a legitimate legislative purpose to remedy the consequences of a judicial decision that would result in “large and devastating revenue losses,” and there was no impermissible intent to “target” the taxpayer.²¹⁹ Also, the legislation was rationally related to this purpose, in part because its “actual retroactive effect” was limited to the tax period for which the taxpayer could file refund claims under the 2009 *Dot Foods* decision.²²⁰

Dot Foods repeatedly noted that the relevant inquiry under *Carlton* is a “rational basis” test,²²¹ an inquiry that is highly deferential to state legislation.²²² Perhaps in part because this is so, the court did not seek to further evaluate the distinctions between *Dot Foods* and *Carlton*. There are other important distinctions, however, between the two cases, discussed below, that further validate the court’s analysis.

A. Reliance

One important distinction between *Carlton* and *Dot Foods* is that the taxpayer in *Carlton* specifically relied upon an unambiguous tax incentive, with no knowledge at the time of this reliance that the provision would later be changed. When Congress retroactively amended the law, the taxpayer lost not only the tax benefit, but the related costs incurred in seeking the incentive.²²³ The Ninth Circuit in *Carlton* broke with decades of prior Supreme Court precedent to find in favor of the taxpayer because of the taxpayer’s reliance interest.²²⁴ It

219. See *supra* notes 195-201 and accompanying text.

220. See *supra* notes 202-212 and accompanying text.

221. 372 P.3d at 750-51 (referring to the rational basis standard seven times).

222. *Id.* at 750 (referring to the rational basis test as the “most relaxed form of judicial scrutiny,” one that results in judicial review that is “highly deferential”).

223. Laura Ricciardi, *The Aftermath of United States v. Carlton: Taxpayers Will Have to Pay for Congress’s Mistakes*, 40 N.Y.L. SCH. L. REV. 599, 634-35 (1996) (noting that the taxpayer lost \$631,000 on the stock that he purchased and then resold in an attempt to obtain the federal deduction).

224. The taxpayer also had no notice of any forthcoming change to the statute. See *supra* notes 115-116 and accompanying text. In this section of this article, the taxpayer’s lack of notice is assumed to be one aspect of the taxpayer’s more general reliance on prior law. See also Domskey, *supra* note 122, at 82 (1995) (noting that at the time of *Carlton*, “the United States Supreme Court, had since 1928, consistently upheld Congress’ retroactive tax measures.”); Weiler, *supra* note 91, at 1071-72 (“Significantly, since the origination of the tax deference doctrine in 1938, the Supreme Court not only has never sustained a due process challenge to the retroactive application of a tax law, but, more

was that specific result that was, in turn, the reason that the Supreme Court accepted the case for review.

Responding to the Ninth Circuit's analysis, the Supreme Court in *Carlton* de-emphasized the circumstances where reliance — including lack of knowledge of a pending law change — is relevant to the determination of the validity of a retroactive tax statute.²²⁵ The Court suggested that a legislature cannot retroactively create a “wholly new tax,” but otherwise has wide discretion as to when and how to impose a retroactive tax.²²⁶ In the aftermath of *Carlton*, commentators debated the correctness of the Supreme Court's determination.²²⁷ Some concluded that the Court's deference to the legislature's fiscal policy-making determinations could be unfair where a taxpayer specifically relied upon a prior tax statute,²²⁸ but others argued that the political process would generally operate to limit these situations.²²⁹

The commentators' colloquy in the aftermath of *Carlton* suggests that it is appropriate to revisit the goals and merits of that case. But this re-visitation is not implicated in a case like *Dot Foods*. In *Dot Foods*, the tax exemption that was the basis for the taxpayer's case was not clearly worded such that, for example, the taxpayer itself was uncertain as to whether it qualified for the exemption.²³⁰ Also, after the Washington DOR promulgated a regulation stating that *Dot Foods* was not entitled to the exemption, the company quarreled with the state for ten years claiming that it should be treated as exempt nonetheless.²³¹ This litigation continued after the company lost two decisions in the Washington courts.²³² Even the company's ultimate victory at the Washington Supreme Court in 2009 was arguably not unequivocal, as it was 5-4, with the dissent calling the majority's decision not merely wrong but “dangerous.”²³³

remarkably, has not sustained a due process challenge to any retroactive economic law.”); Heather Lynn Gray, *Carlton v. United States: An Analysis of Retroactive Tax Legislation*, 24 STETSON L. REV. 765, 769 n.26 (1995) (noting that “[h]istorically, courts have overwhelmingly upheld retroactive tax legislation against due process challenges,” and citing a long list of prior Supreme Court and federal cases).

225. See *supra* notes 115-124 and accompanying text.

226. 512 U.S. at 33-35. See also Gunning, *supra* note 64, at 300 (2009) (noting that to the extent the reliance logic in the Court's “[1920's era] *Nichols* line of cases survives, it is limited to cases involving ‘wholly new tax[es], rather than amendments to existing tax schemes that retroactively impact prior transactions’) (brackets added).

227. See *supra* note 128 and accompanying text.

228. See *id.*

229. See *supra* note 131 and accompanying text.

230. See *supra* note 150 and accompanying text (noting that because of its uncertainty, the taxpayer requested a letter ruling from the Washington DOR confirming its entitlement).

231. See *supra* notes 161-178 and accompanying text.

232. See *id.*

233. 215 P.3d at 193-94 (Stephens, J., dissenting). See *supra* notes 175-178 and accompanying

More generally, the taxpayer in *Dot Foods* took no specific action in reliance on the Washington exemption, unlike the situation in *Carlton*. In *Carlton*, the taxpayer purchased stock that he would not otherwise have purchased, then sold that stock to a particular buyer — and thereby incurred a significant monetary loss — specifically to obtain a statutory deduction.²³⁴ In contrast, in *Dot Foods* there was no suggestion that the taxpayer’s day-to-day in-state commercial activities in any way depended upon the statutory exemption. The company generated income from these efforts; certainly, it would have been happy to offset the tax due on this income with the exemption, but its actions were not dependent upon this result.²³⁵

If, as numerous commentators have concluded, the primary concern with the *Carlton* rational basis test is that this test may not always be sufficiently sympathetic to taxpayer reliance interests,²³⁶ then, nonetheless, these concerns are irrelevant in a case like *Dot Foods*. The taxpayer in *Dot Foods* had no such reliance interest.²³⁷ Similarly, if the specific concern with respect to retroactive tax statutes and reliance more generally is that certain taxpayers may not have sufficient legislative influence to oppose such measures, then this concern also is not implicated in a case like *Dot Foods*. During the tax years at issue, *Dot Foods* was the largest food re-distributor in the United States, and the company and the other taxpayers ultimately impacted by the statute’s retroactive tax legislation apparently had significant lobbying clout.²³⁸

text.

234. See *supra* notes 41-48 and 223 and accompanying text.

235. Therefore, the situation in *Dot Foods* was not as sympathetic as that of the estate taxpayer discussed in *Welch v. Henry*, 305 U.S. 134 (1938) or later considered by the Ninth Circuit in *Carlton v. United States*, 972 F.2d 1051 (9th Cir. 1992), *rev’d*, 512 U.S. 26 (1994). An estate taxpayer may be sympathetic where it makes a gift as a voluntary act to take advantage of an unambiguous deduction with no knowledge that the tax law will be subsequently changed, in a context in which the taxpayer would not necessarily have undertaken the act if it had known that the tax change was forthcoming. See *Welch v. Henry*, 305 U.S. at 148; *Carlton v. United States*, 972 F.2d at 1058, *rev’d*, 512 U.S. 26. In contrast, *Dot Foods* pertained to an income-based tax, which is not comparable to an estate or gift tax, because the courts “cannot assume that stockholders would refuse to receive corporate dividends [or income] even if they knew that their receipt would later be subjected to a new tax or to the increase of an old one.” See *id.* (brackets added). See also *U.S. v. Carlton*, 512 U.S. at 40 (Scalia, J., concurring) (drawing a distinction between the “case of a tax incentive provision, as opposed to a tax on a continuous activity (like the earning of income)” since in the former case there may be reliance upon the incentive).

236. See *supra* note 128 and accompanying text.

237. See *generally* notes 144-168 and accompanying text.

238. See *supra* notes 134 and 144 and accompanying text.

B. Actual Retroactive Effect

Another important distinction between *Dot Foods* and *Carlton* pertains to the means of measurement of the length of a tax statute's retroactivity. As the Washington Supreme Court noted in *Dot Foods*, whether a retroactive tax statute is rationally related to a legitimate legislative purpose implies some consideration of this retroactive period.²³⁹ But as the court also noted, that evaluation is one that requires a consideration of the specific context in which the law operates and its "actual retroactive effect."²⁴⁰

Dot Foods argued — and some persons have recently claimed — that the retroactive tax statute extended backwards an impermissibly long 27 years.²⁴¹ It was this point in particular that has caused some to argue that *Dot Foods* suggests an especially egregious instance of a retroactive tax statute.²⁴² But the court in *Dot Foods* concluded that, although the retroactive amendment amended a statute that was enacted 27 years earlier, the "retroactivity period as applied to *Dot Foods* is only four years" (i.e., the open period of *Dot Foods*' statute of limitations).²⁴³ This was careful language that may have been intended to suggest that not only was the statute's retroactive effect — as to the taxpayer, *Dot Foods* — significantly shorter than the claimed 27 years, but that also the retroactivity period as applied to *all other affected taxpayers* was even shorter than the period as applied to *Dot Foods*.

Dot Foods' effort against the Washington DOR with respect to the direct sellers' exemption was not only lengthy, it was solitary. In 1997, the company requested and received a private letter ruling confirming its entitlement to the exemption conferred by the 1984 legislation.²⁴⁴ Two years later, the state revoked the letter ruling and promulgated a

239. 372 P.3d at 751-52.

240. *Id.* at 751-752 (evaluating the statute's "actual retroactive application" and stating the court's conclusion with respect to the statute's "actual retroactive effect"). *Cf. Carlton*, 512 U.S. at 33-34 (evaluating the statute's "actual retroactive effect" and noting that the statute's "period of retroactive effect" was limited).

241. 372 P.3d at 751 (noting *Dot Foods*' contention "that a 27-year retroactivity period is per se unconstitutional"). In their amicus briefs filed in support of *Dot Foods*' certiorari petition as filed with the Supreme Court, the organizations, COST, TEI, IPT and ACTA each claimed that the period of the tax statute's retroactivity was 27 years, despite the fact that the Washington Supreme Court, the very court whose 2009 decision each of these organizations sought to reinstate, concluded that this period was no more than 4 years. *See generally* the *Dot Foods* amicus briefs cited at *supra* notes 5, 9.

242. *See generally* the *Dot Foods* amicus briefs cited at *supra* notes 5, 9.

243. 372 P.3d at 751 (emphasis added). The court made two other references to the period of retroactivity being "as applied" to *Dot Foods*. *See id.* at 752. There were no other taxpayers claiming the exemption that were of record at the time of the court's decision. *See infra* note 181 and accompanying text.

244. *See supra* notes 150-151 and accompanying text.

corrective regulation, which Dot Foods refused to follow.²⁴⁵ In the aftermath of that refusal, Dot Foods embarked upon years of litigation with the state, culminating in three decisions — none of which included any reference to any other taxpayers that were asserting a similar position.²⁴⁶ Presumably, when the state promulgated its regulation in 1999 other similarly-situated taxpayers followed it, particularly since that regulation was twice upheld by the Washington courts, in 2006 and 2007.²⁴⁷ Therefore, it seems apparent that no taxpayer other than Dot Foods had a similar claim until the time of the 2009 *Dot Foods* decision — which was legislatively reversed 7 months later.²⁴⁸ This, in turn, suggests that the actual retroactive effect of that legislation for every similarly-situated taxpayer other than Dot Foods was only seven months, i.e., the time period measured from the date of the 2009 *Dot Foods* decision to that of the 2010 statutory amendment — approximately half the period of the actual retroactive effect of the tax statute at issue in *Carlton*.²⁴⁹

Also, and more significantly, the Washington legislation had no practical impact at all with respect to the affected taxpayers' actual activities prior to the 2009 *Dot Foods* case because all the statute did was codify the regulatory position of the Washington DOR that constituted the pertinent law during that prior time. Unlike in *Carlton*, the retroactive legislation neither required affected taxpayers to pay additional tax in connection with completed transactions nor caused taxpayers to lose funds expended to obtain a tax benefit that was then rescinded.²⁵⁰ These taxpayers engaged in in-state business activity during the period prior to the *Dot Foods* case without knowing that they might be later entitled to a refund, and the later Washington legislation merely confirmed that no refund would be forthcoming.²⁵¹ Therefore, there is no apparent basis on which to claim that the Washington legislation had any *actual* retroactive effect as to taxpayers other than

245. See *supra* notes 154-162 and accompanying text.

246. See *supra* notes 163-178 and accompanying text.

247. See *supra* notes 163-168 and accompanying text. The Washington appeals court decision in *Stroh Brewery Co. v. Dept. of Rev.*, 15 P.3d 692 (Wash. Ct of App., 2001), *rev. denied*, 29 P.3d 718 (2001), had also implicitly upheld the Department's position. See *supra* note 157 and accompanying text.

248. See *supra* notes 179-189 and accompanying text.

249. Cf. *Carlton*, 512 U.S. at 33 (“the actual retroactive effect of the 1987 amendment extended for a period only slightly greater than one year”). See Brief in Opposition to Petition of Writ of Certiorari to the U.S. Supreme Court, *supra* note 142, at 19 (“since the Legislature amended the law within months of the *Dot Foods I* decision, taxpayers had no longstanding reliance on the unexpected windfall of the Court's decision”).

250. Compare *Carlton*, 512 U.S. at 28-29.

251. Unlike in *Carlton*, there was no arguable claim that the taxpayers engaged in this business activity to obtain the tax benefit. See *supra* notes 234-235 and accompanying text.

Dot Foods, at least prior to the time of the *Dot Foods* decision.

Some have argued in favor of a bright-line limit with respect to the applicable period of a retroactive tax statute.²⁵² But as suggested by *Dot Foods*, such a limit would have the difficulty that — contrary to *Carlton* and its important predecessor case, *Welch v. Henry*²⁵³ — it would not be responsive to the context of a particular enactment.²⁵⁴ Moreover, *Dot Foods* suggests that blindly assuming that the actual retroactive effect of a retroactive tax statute dates back to the date of enactment of the statute that is amended will prove incorrect in certain circumstances. Further, this assumption will be a particular problem in any case in which retroactive tax legislation seeks to override or “cure” a questionable court decision that construes a statute, because that decision will generally post-date the statute that it construes by a significant period of years.²⁵⁵

C. Curative, Ratifying Legislation

A third important difference between *Dot Foods* and *Carlton* pertains to the specific “curative” aspect of the retroactive tax legislation in *Dot*

252. See, e.g., Petition For a Writ of Certiorari at 21, *Dot Foods, Inc. v. State of Washington*, 137 S. Ct. 2156 (2017) (No. 16-308), 2016 WL 4728801 at *21 (“the *Carlton* test surely cannot be satisfied where the period of retroactivity is several years”); Brief of Amicus Curiae of Council on State Taxation in Support of Petitioners at 10-13, *Hambleton v. Washington Dep’t of Revenue*, 136 S. Ct. 318 (2015) (No. 14-1436), 2015 WL 4572748 at *13 (arguing that “indefinite” periods of tax retroactivity should be proscribed and that the Court should provide “clarification on the permissible length of retroactive tax legislation”). See also Gunning, *supra* note 64, at 293 (proposing “that a presumptive line be drawn at the year preceding the legislative session in which the subject tax is enacted”); *Zaber*, 789 N.W.2d at 653-654 (noting the taxpayer’s argument that retroactive tax statutes should be subject to a one year bright line limit). But see *Temple Univ. v. United States*, 769 F.2d 126, 135 (3d Cir. 1985), cert. denied, 476 U.S. 1182 (1986) (“no federal court of appeals has yet adopted an absolute temporal limitation on retroactivity”).

253. 305 U.S. 134 (1938).

254. See *supra* notes 79-80 and 108-110 and accompanying text.

255. It is also possible that there will be instances where taxpayers might want to work with a state to pass retroactive legislation, and in these cases a bright line rule could prove problematic. See Jennifer McLoughlin, *Partnership Audit Bill Surfaces in Georgia*, BNA Weekly State Tax Report, Feb. 10, 2017 (citing comments of a representative of COST, which sought Supreme Court review of the 2016 *Dot Foods* decision, see *supra* note 5 and accompanying text, that “while COST opposes retroactive tax legislation,” it could support retroactive tax legislation that “will only impose a procedural change”); Shirley Sicilian, *Retroactive Tax Legislation — Considering Both Sides of the Sword*, 26 Journal of Multistate Tax’n and Incentives 37 (Mar./Apr. 2006) (noting that “retroactive tax laws can also work in favor of taxpayers” and citing some specific instances where this could be true); Roin, *supra* note 182, at 563 (arguing that current year taxpayers should sometimes support the imposition of retroactive taxes on prior year taxpayers, when those prior year taxpayers received the benefit of government overspending but were not responsible for their fair share of the government’s spending costs). See also *Battaglia v. General Motors Corp.*, 169 F.2d 254 (2nd Cir. 1948), cert. denied, 335 U.S. 887 (1948), discussed *infra* notes 317-323 and accompanying text (case in which the retroactive economic legislation extinguished dollar claims against both private parties and the U.S. government).

Foods. “A curative act is a statute passed to cure defects in prior law, or to validate legal proceedings, instruments, or acts of public or private administrative authorities.”²⁵⁶ *Carlton* referred to the retroactive statute at issue in that case as being a form of a curative statute.²⁵⁷ However, the statute at issue in *Dot Foods* reflected a different type of such statute — one that reinstates the legal status quo — and in these cases the deference to the statute should be even greater in certain respects.

Curative legislation generally includes the circumstance where a legislative act is intended to reverse a questionable judicial decision²⁵⁸ or to “remedy mistakes and defects in the administration of government.”²⁵⁹ This legislation often seeks to “ratif[y] a long-standing policy and [bring] the tax code in line with [persons’] expectations.”²⁶⁰ Such curative, ratifying legislation may be intended to prevent the refund of government monies previously collected,²⁶¹ or to create parity between different classes of persons, such that the application of the law

256. See *Zabar*, 789 N.W.2d at 644 (quoting 2 Norman J. Singer & J.D. Shambie Singer, STATUTES AND STATUTORY CONSTRUCTION, § 41:11, at 503 (7th ed. 2009); *Graham & Foster v. Goodcell*, 282 U.S. 409, 426-427 (1931) (noting also a prior case, *Forbes Pioneer Boat Line v. Bd. Of Comm’r*, 258 U.S. 338 (1922), “where the court recognized there is a class of cases in which defects in the administration of the law may be cured by subsequent legislation without encroaching upon a constitutional right”). See also Charles B. Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692, 703-706 (1960) (discussing the Supreme Court’s favorable treatment of “curative statutes,” generally those that “ratify prior official conduct of government officers who acted without the requisite authority” or are “designed to cure defects in an administrative system”).

257. *Carlton*, 512 U.S. at 31.

258. See, e.g., *General Motors Corp. v. Romein*, 503 U.S. 181, 191 (1992) (upholding a retroactive statute that reversed a decision of a state supreme court where the statute “was to correct the unexpected results” that derived from that case). See Nancy Morawetz, *Rethinking Retroactive Deportation Laws and the Due Process Clause*, 73 N.Y.U.L. Rev. 97, 133-134, 158 (1998) (referencing *Romein*, 503 U.S. 181, as reflective of a class of retroactive statutes where the legislature “justifies retroactivity as ‘curative’ of unexpected interpretations of prior law” and noting that such situations have included “situations in which the legislature was responding quickly to an unanticipated judicial construction”). See the discussion of *Romein*, *infra* notes 281-301 and accompanying text.

259. *Graham & Foster v. Goodcell*, 282 U.S. 409, 427 (1931) (ratifying the collection of taxes that were improperly collected after the taxpayers’ statutes of limitation had run). See Schultz, *supra* note 128, at 777-778 (citing *Goodcell* for the proposition that “when a legislative mistake gives a taxpayer a right to recover money from the Government, Congress may retroactively eliminate this right with a curative statute”). See the discussion of *Goodcell*, *infra* notes 324-332 and accompanying text.

260. *New England Baptist Hospital v. United States*, 807 F.2d 280, 285 (1986) (brackets added). See also *Zabar*, 789 N.W.2d at 645 (noting the purpose of curative legislation “to sustain the reliability of officials’ actions and secure expectations formed in reliance thereof”) (quoting 2 Norman J. Singer & J.D. Shambie Singer, STATUTES AND STATUTORY CONSTRUCTION, § 41:11, at 506 (7th ed. 2009)).

261. *Zabar*, 789 N.W.2d at 646 (noting that “the curative act at issue here was designed to avoid the refund of monies already collected and spent”). See also *id.* at 645-646 (noting curative legislation as to tax matters may be necessary “in order to safeguard the public treasury against the erosion of revenues”) (quoting 2 Norman J. Singer & J.D. Shambie Singer, STATUTES AND STATUTORY CONSTRUCTION, § 41:17, at 521 (7th ed. 2009)).

will be even-handed.²⁶² In these cases, “no settled rights [are] disturbed nor expectations defeated.”²⁶³ Therefore — given the respect due to the fiscal determinations made by legislative and executive policy-makers — there is generally no cognizable claim of due process unfairness.²⁶⁴ Moreover, the individual who claims that a vested right has arisen from an inadvertent defect in a statute or its administration may be “seeking a windfall since, had the legislature’s or administrator’s action had the effect it was intended to and could have, no right would have arisen.”²⁶⁵ Consequently, “the purpose of curative, ratifying legislation is sufficient to justify longer periods of retroactivity in contrast to the so-called modest period of retroactivity accorded the imposition of a new tax.”²⁶⁶

Dot Foods involved a type of such “curative, ratifying legislation.” The retroactive statute in *Dot Foods* was intended to reinstate the interpretation of a longstanding state regulation, which had twice been upheld by the state courts.²⁶⁷ Also, the statute was intended to reverse the effect of a state supreme court decision that was partially predicated on a prior erroneous position that had been briefly taken by state

262. *General Motors Corp. v. Romein*, 503 U.S. 181, 191-192 (1992) (noting that the retroactive legislation reversing a court case was justifiable in part because it equalized the payments made by employers who had “gambled” on the court case with those made by employers who had not). *Romein* cited *United States v. Sperry Corp.*, 493 U.S. 52, 64-65 (1989), for the proposition that it is “legitimate to legislate retrospectively in order to ensure that similarly situated persons bear similar financial burdens of [sic] program.” *Id.*

263. Laura Ricciardi & Michael B.W. Sinclair, *Retroactive Civil Legislation*, 27 U. Tol. L.Rev. 301, 345 (1996). See *id.* at 338 (“Such curative legislation affirms as proper what everyone had taken to be the law anyway: it restores a situation that was affirmatively anticipated and provided for.”).

264. See Fisch, *supra* note 128, at 1010 (noting with approval “the general tolerance for retroactive application of corrective or curative legislation”); Stephen R. Munzer, *A Theory of Retroactive Legislation*, 61 Tex. L. Rev. 415, 468-70 (1982) (stating that “[c]urative acts are statutes that retroactively adjust existing legislation to the putative intent of the legislature” — statutes that “are routinely upheld,” and opining that such legislation “should probably be upheld. It tends to confirm expectations and to protect those who rely on the underlying merits of a claim rather than grasp at legal technicalities.”); W. David Slawson, *Constitutional and Legislative Considerations in Retroactive Lawmaking*, 48 Cal. L. Rev. 216, 238 (1960) (“The [United States Supreme] Court has almost always upheld ‘curative’ legislation designed to restore what was believed to have been the status quo.”).

265. Hochman, *supra* note 256, at 705.

266. *Zaber*, 789 N.W.2d at 645. The principle has been broadly recognized by different courts. See, e.g., *Graham & Foster v. Goodcell*, 282 U.S. 409, 426-430 (1930); *Canisius College v. United States*, 799 F.2d 18, 27 (2d Cir. 1986) (“In light of its curative purpose, we find the provision constitutional notwithstanding the long period of retroactivity”); *Wiggins v. Comm’r of Internal Revenue*, 904 F.2d 311, 316 (5th Cir. 1990) (“Where legislation is curative, retroactive application may be constitutional despite a long period of retroactivity”); *Zaber*, 789 N.W.2d at 645-47 (same) (quoting *Wiggins*, 904 F.2d at 316).

267. See *supra* notes 154-168 and 186-189 and accompanying text. The regulation at issue was an interpretative regulation. See *Dot Foods*, 215 P.3d 185 at 193-194. Such rules “are de facto authoritative for the public until the public challenges them in court and the court agrees.” See *Ass’n of Wash. Bus. v. Dep’t of Revenue*, 120 P.3d 46, 54 (Wash. 2005). See also *id.* at 446-447 (discussing the difference between legislative and interpretive agency regulations in the state of Washington).

revenue officials.²⁶⁸ No “settled expectations” were disrupted by the retroactive legislation in *Dot Foods* in part because only one taxpayer — Dot Foods — received a “private” letter ruling to the effect that it could take advantage of the relevant exemption on the facts at issue,²⁶⁹ which was the position that the retroactive legislation later disavowed. Also, the state had a regulatory statement in place concerning the exemption for ten years prior to the state supreme court case that rejected this statement, and that position was twice upheld by the lower state courts.²⁷⁰ The claim in *Dot Foods* pertained only to the taxpayer, and it was not until the taxpayer ultimately prevailed at the state supreme court that the prospect of refunds for a more general class of taxpayers manifested.²⁷¹ It was this prospective event that the state foreclosed through retroactive legislation seven months later; Dot Foods itself was granted a refund for the tax period at issue in its case.²⁷² Therefore, taxpayers in general had “no longstanding reliance on the unexpected windfall of the [*Dot Foods*] decision.”²⁷³

In these respects, *Dot Foods* differed from *Carlton*. *Carlton* stated that the statute challenged in that case “was adopted as a curative measure.”²⁷⁴ That characterization, however, seemed intended to distinguish the specific situation in that case — where Congress amended an unambiguous pre-existing statute — from the enactment of a “wholly new tax.”²⁷⁵ The Court’s purpose in *Carlton* was to ensure that almost all forms of retroactive tax legislation would be subjected to deferential rational basis review.²⁷⁶ While the *Carlton* test is permissive, there is nonetheless a potentially important difference between the facts of *Carlton*, where Congress retroactively imposed tax on a past transaction where no tax would otherwise have been due, and “legislative ratification of a tax that has been previously assessed and collected.”²⁷⁷ Settled transactions or expectations will be disturbed in the former case but not the latter, and greater deference is, therefore, due in the latter case.²⁷⁸

268. See *supra* notes 151-153 and 169-174 accompanying text.

269. See *supra* notes 244-249 and accompanying text.

270. See *id.*

271. See *supra* notes 179-181 and accompanying text.

272. See *supra* note 192 and accompanying text.

273. Brief in Opposition to Petition of Writ of Certiorari to the U.S. Supreme Court, *supra* note 142, at 19. See *supra* notes 244-249 and accompanying text.

274. 512 U.S. at 31.

275. *Id.* at 31-34.

276. See *supra* notes 71-78 and accompanying text.

277. See generally *Zaber*, 789 N.W.2d at 642-645 (concluding that “the amendment at issue in *Carlton* was not a curative act, as that term of art is used in the context of retroactivity”).

278. See, e.g., *Zaber*, 789 N.W.2d at 645-647 (“where legislation is curative, retroactive

D. Similar Cases that Pre-date Carlton

One of the virtues of *Carlton* is that the case posited a flexible inquiry that recognized that the validity of a retroactive tax statute depends upon the specific context of the legislation and the “actual retroactive effect” of the statute reviewed. The contexts involving a retroactive tax statute can be very different, as the comparison between the facts in *Carlton* and *Dot Foods* reveals. While the legislative circumstances in *Carlton* were different from those in *Dot Foods*, *Carlton* was decided against a backdrop of divergent precedent that no doubt informed the Court’s flexible standard. Some of those cases, as in *Dot Foods*, were cases in which either Congress or a state sought to legislatively overturn a judicial decision using curative, ratifying legislation.²⁷⁹ In such cases, because the legislation did not upset settled expectations and merely reinstated the legal status quo, there was little or no actual retroactive effect within the meaning of *Carlton*.²⁸⁰ Some of those cases are discussed in greater detail below.

1. *General Motors Corp. v. Romein*

The Supreme Court’s decision in *General Motors Corp. v. Romein*²⁸¹ suggests that greater deference is afforded to curative, ratifying tax statutes. *Romein* pertained to workers’ compensation payments, not tax imposition, but *Carlton* likened the retroactivity analysis to be applied in the tax context to that applied to economic statutes more generally.²⁸² Also, *Romein* was decided only two years before *Carlton*, so the Court presumptively had the prior case in mind. Justice O’Connor, the author of *Romein*, specifically cited *Romein* in her later concurrence in *Carlton*.²⁸³

The Michigan Legislature enacted a statute in 1987 that required petitioners, General Motors Corporation (“GM”) and the Ford Motor

application may be constitutional despite a long period of retroactivity”) (quoting *Wiggins v. Comm’r of Internal Revenue*, 904 F.2d 311, 316 (5th Cir.1990)).

279. See *infra* notes 281-332 and accompanying text.

280. See Ricciardi & Sinclair, *supra* note 263, at 345 (observing that there is judicial precedent pertaining to retroactive “curative legislation ... which made the law conform retroactively to what people had mistakenly relied upon” and stating that “[i]t follows that where there is no reliance on the law of the moment, a retroactive change will do no harm”). One scholar has argued that typically retroactive tax statutes that are limited to a taxpayer’s open statute of limitations — in most cases either three or six years — should be permissible “since it is hard to argue that anyone can have ‘settled expectations’ regarding their tax liability until that year’s statute of limitations for tax adjustments has closed.” See Roin, *supra* note 182, at 597-598.

281. See *General Motors Corp.*, 503 U.S. 181 (1991).

282. *Carlton*, 512 U.S. at 30.

283. *Id.* at 36 (O’Connor, J., concurring).

Company (“Ford”), to repay workers’ compensation benefits that the companies had withheld relying on a 1981 state workers’ compensation statute.²⁸⁴ The 1981 statute allowed employers to decrease workers’ compensation benefits to those disabled employees eligible to receive wage-loss compensation from other employer-funded sources (so-called “benefit coordination”).²⁸⁵ The “benefit coordination provision did not specify whether it was to be applied to workers injured before its effective date, March 31, 1982.”²⁸⁶ GM and Ford both took the “position that the 1981 law allowed them to reduce workers’ compensation benefits to workers injured before March 31, 1982,” when these persons were receiving benefits from other sources.²⁸⁷ Other similarly-situated employers did not take this same position.²⁸⁸

GM and Ford subsequently contested lawsuits brought by individuals seeking workers’ compensation benefits who had been injured prior to the enactment of the Michigan law. The lower Michigan adjudications disagreed with the companies’ interpretation of the 1981 statute, holding that coordination was allowed only for employees injured after 1982.²⁸⁹ However, in 1985 the Michigan Supreme Court, in *Chambers v. General Motors Corp.*,²⁹⁰ ruled in favor of GM and Ford.²⁹¹ After that decision, employers who had not coordinated benefits for employees injured before 1982 began to demand reimbursement from those employees.²⁹² The Michigan legislature responded immediately, initiating legislation that would retroactively amend the 1981 statute and effectively overturn the state supreme court decision.²⁹³ The Michigan legislature enacted legislation 19 months later, in 1987, which resulted in a retroactive statute with actual impact dating back six years.²⁹⁴ As a result of the 1987 statute GM and Ford were ordered to refund nearly \$25 million to disabled employees.²⁹⁵

GM and Ford again brought suit, this time claiming that Michigan’s

284. *Romein*, 503 U.S. at 183.

285. *Id.* at 184.

286. *Id.*

287. *Id.*

288. *See id.* at 185-186.

289. *Id.* at 184 (citing *Franks v. White Pine Copper Div., Copper Range Co.*, 332 N.W.2d 447, 449 (1982)).

290. *Franks v. White Pine Copper Div., Copper Range Co.*, 375 N.W.2d 715, 720 (Mich. 1985).

291. 503 U.S. at 185 (citing *Chambers v. General Motors Corp.*, 375 N.W.2d 715, decided with *Franks v. White Pine*, 375 N.W.2d 715 (1985)). The court held that the benefit coordination provision applied to all payment periods after its effective date, regardless of the date the employee had been injured. *Id.*

292. *Id.*

293. *Id.* at 185-186.

294. *Id.*

295. *Id.* at 186.

retroactive legislation violated the Due Process Clause.²⁹⁶ The Michigan Supreme Court upheld the legislation and the U.S. Supreme Court affirmed.²⁹⁷ The Supreme Court remarked that retroactive legislation has the potential difficulty that “it can deprive citizens of legitimate expectations and upset settled transactions.”²⁹⁸ In dismissing the due process challenge, the Court stressed that the “purpose of the 1987 statute was to correct the unexpected results of the Michigan Supreme Court’s *Chambers* opinion.”²⁹⁹ The Court noted that the legislation “equalized the payments made by employers who had gambled on the *Chambers* decision with those made by employers who had not.”³⁰⁰ Although the court did not use the terms, it treated the legislation as both curative and ratifying in nature.³⁰¹

2. Mid-1980’s Federal Court of Appeals FICA Cases

Similar to *Romein*, a series of mid-1980’s federal court of appeals cases pertained to Federal Insurance Contributions Act (“FICA”) taxes.³⁰² In each instance, the taxpayer, relying on a 1965 IRS revenue

296. *Id.* The petitioners made an unsuccessful contract clause argument as well. *See id.* at 186-191.

297. *Id.* at 186.

298. *Id.* at 191.

299. *Id.*

300. *Id.* at 190-191. The Court referred to *United States v. Sperry Corp.*, 493 U.S. 52, 64-65 (1989), citing the case for the proposition that it is “legitimate to legislate retrospectively in order to ensure that similarly situated persons bear similar financial burdens of [the] program.” *Id.* at 192 (brackets added).

301. *See Weiler, supra* note 91, at 1081 (the Court “effectively treated the retroactive legislation as curative in nature and held that the approximately six-year period of retroactivity was a rational means of achieving the legitimate objective of correcting a court’s unexpected interpretation of a law”). A somewhat analogous case, decided by the Ninth Circuit after *Carlton*, is *Montana Rail Link, Inc. v. United States*, 76 F.3d 991 (1996). In that case, the court upheld the retroactive application of the Omnibus Budget Reconciliation Act of 1989 (“1989 OBRA”) to employer retirement contributions made to employees pursuant to the Railroad Retirement Tax Act (“RRTA”) in 1987 and 1988. *See id.* The employers had treated the contributions as taxable based upon their interpretation of the statute, but were later told by the governmental agency charged with enforcing the Act that these tax payments were made in error. *Id.* at 993. The employers began to refund the taxes to their employees and prepared to seek a federal tax refund. *Id.* Congress then acted to retroactively bar the refund claims. Congress’s rationale was in part that, without the period of retroactivity, the railroad workers’ retirement funds and benefits would have been jeopardized. *Id.* Indeed, some employees had already received benefits based on the amounts paid into the funds and credited to the accounts for the period in issue. *Id.* Although the employer-petitioner only challenged the retroactive application of the 1989 OBRA to its refund claims for tax years 1987 and 1988, the Act retroactively barred refund claims back to 1983, a period of up to seven years. *Id.* at 992-994. In upholding the retroactive application of the 1989 OBRA, the Ninth Circuit focused on the harm Congress attempted to prevent in protecting the retirement funds of the railroad workers and concluded that the 1989 OBRA met the two-part *Carlton* test. *Id.* at 994.

302. *See Canisius College v. United States*, 799 F.2d 18 (2d Cir. 1986), *cert. denied*, 481 U.S. 1014, (1987); *Temple University v. United States*, 769 F.2d 126 (3d Cir. 1985), *cert. denied*, 476 U.S. 1182 (1986); *New England Baptist Hosp. v. United States*, 807 F.2d 280 (1st Cir. 1986).

ruling, paid FICA taxes on amounts contributed to a voluntary salary reduction annuity plan administered for its employees.³⁰³ In 1981, the Supreme Court concluded in *Rowan Cos., Inc. v. United States*,³⁰⁴ however, that the reasoning in the IRS ruling was an incorrect interpretation of the statute.³⁰⁵

In 1983, Congress, concerned about the impact of *Rowan* on taxes previously collected, passed a law that in effect amended the governing statute to make it consistent with the 1965 revenue ruling.³⁰⁶ In 1984, Congress made the 1983 statute effective for tax years prior to 1983 “to preclude the possibility of refunds of FICA taxes paid in conformity with [the revenue ruling] on amounts contributed under [the] salary reduction plans.”³⁰⁷ As one court noted, Congress effectively “overruled [the Supreme Court] holding and codified Rev. Rul. 65-208 — a ruling that had been applied and enforced for over fifteen years.”³⁰⁸

In each of the court of appeals’ cases, the appellant sought a refund of the taxes paid on the theory that the federal statute was impermissibly retroactive under the Due Process Clause.³⁰⁹ As the refund requests in each of the cases dated back to 1979 or 1980, the retroactive reach of the legislation was four to five years.³¹⁰ The First, Second and Third Circuits each rejected the appellant’s argument.³¹¹ The courts held that the retroactive application of the legislation was not unconstitutional because it was not arbitrary and irrational, i.e., it merely ratified long-standing policy and brought the tax code in line with the appellants’ expectations at the time they paid the taxes.³¹² The Second and Third Circuits both specifically noted the fact that the legislation was curative in its character.³¹³ The First Circuit stated, “Legislation that merely

303. *See generally id.*

304. 452 U.S. 247 (1981).

305. *See id.*

306. *New England Baptist Hospital*, 807 F.2d at 283; *Canisius College*, 799 F.2d at 22-24; *Temple University*, 769 F.2d at 129.

307. *Canisius College*, 799 F.2d at 24 (brackets added).

308. *Temple*, 769 F.2d at 135. The case facts — the legislative codification of an administrative position previously struck down by the courts — resemble the facts in *Dot Foods*. *See supra* notes 186-189 and accompanying text.

309. *See generally Canisius College*, 799 F.2d at 19-22; *Temple University*, 769 F.2d at 127-129; *New England Baptist Hosp.*, 807 F.2d at 281.

310. *Id.*

311. *New England Baptist Hosp. v. United States*, 807 F.2d 280, 284-85 (1st Cir. 1986).

312. For example, *New England Baptist Hospital* noted that “Congress’ 1984 enactment ratified long-standing Treasury policy” and “therefore, brought the tax code in line with the Hospital’s expectations at the time it withheld and paid the taxes.” 807 F.2d at 285.

313. *Canisius* stated that “[i]n light of its curative purpose, we find the provision constitutional notwithstanding the long period of retroactivity.” 799 F.2d at 27 (the case stated also that “curative legislation is typically entitled to be liberally construed”). *Temple* remarked that “when such legislation is ‘curative’ in character, as in this instance, the retroactive application is typically entitled to be

validates a prior tax collection is less likely to violate the principles of due process than legislation that retroactively imposes a tax that had not been anticipated.”³¹⁴ The court further stated that the appellant “complied with the Treasury’s ruling and apparently did not have reason to believe that it might be incorrect until the Supreme Court decided *Rowan* in 1982.”³¹⁵ The Supreme Court later denied certiorari for both the Second and Third Circuit cases.³¹⁶

3. *Battaglia v. General Motors Corp.*

Also similar to *Romein* and the mid-1980’s federal FICA tax cases is *Battaglia v. General Motors Corp.*³¹⁷ *Battaglia* pertained to a series of lawsuits brought by employees against a defendant-employer to recover overtime pay.³¹⁸ The basis for the claims was three U.S. Supreme Court decisions that construed the Fair Labor Standards Act of 1938 to require that overtime pay be provided in connection with activities that were not directly work-related, so-called “portal-to-portal” time.³¹⁹

liberally construed.” 769 F.2d at 134.

314. *New England Baptist Hospital*, 807 F.2d at 285.

315. *Id.* See also *Robert Morris College v. United States*, 11 Cl.Ct. 546, 547 (Cl.Ct. 1987) (reaching a similar conclusion as to the same issue). There were also other lower federal court cases that similarly rejected these refund claims. See *Michael Reese Hosp. and Medical Center v. United States*, 684 F. Supp. 986, 991 n.3 (1988) (citing cases). Another similar case is *Long v. United States IRS*, 742 F.2d 1173 (Ct. App, 9th Cir. 1984). In *Long*, the Ninth Circuit reviewed an Act of Congress that retroactively overruled that court’s prior determination that certain IRS information concerning audit techniques was subject to public disclosure. See *id.* The court upheld the legislation because “Congress never intended to permit [the] public disclosure” of the information. *Id.* at 1183. The court noted that courts “have consistently upheld the retroactive application of ‘curative’ legislation which corrects defects subsequently discovered in a statute and which restores what Congress had always believed the law to be.” *Id.*

316. See *Canisius College v. United States*, 799 F.2d 18, 26-27 (2d Cir. 1986), *cert. denied*, 481 U.S. 1014, (1987); *Temple University v. United States*, 769 F.2d 126, 135 (3d Cir. 1985), *cert. denied*, 476 U.S. 1182 (1986). In the later Ninth Circuit decision in *Carlton*, the dissent — which reached a conclusion that was then later adopted by the Supreme Court, see *U.S. v. Carlton*, 512 U.S. at 30, 32-35 — cited the 1980’s FICA cases in support of its result. See 972 F.2d at 1064 (Norris, J., dissenting) (citing *New England Baptist Hospital*, 807 F.2d at 285; *Canisius College*, 799 F.2d at 26-27; and *Temple University*, 769 F.2d at 135). In citing these cases, the Ninth Circuit dissent noted that, as compared to retroactive taxes more generally, “[c]urative legislation, passed to effectuate the original intent of Congress, has been granted greater leeway.” *Id.*

317. 169 F.2d 254 (2nd Cir. 1948), *cert. denied*, 335 U.S. 887 (1948).

318. *Id.* at 255-256.

319. *Id.* at 255, 258. The three Supreme Court decisions in 1944, 1945, and 1946 that brought about the later retroactive legislation were *Anderson v. Mt. Clemens Pottery Co.*, 328 U.S. 680 (1946); *Jewell Ridge Coal Corp. v. Local No. 6167*, 325 U.S. 161 (1945); and *Tennessee Coal, Iron & R.R. Co. v. Muscoda Local No. 123*, 321 U.S. 590 (1944). See George C. Christie, *An Essay on Discretion*, 1986 Duke L.J. 747, 755 n.30. These cases generally held that the “work week” for miners included the time traveling from the mouth of the mine to the drill site and back (from “portal-to-portal”) and that, therefore, thousands of miners were entitled to significant overtime pay under the FLSA. See Stephen I. Vladeck, *Federal Courts, Practice & Procedure: Boumediene’s Quiet Theory: Access to Courts and the*

In the aftermath of the three Supreme Court cases, a large volume of back-year liability claims were filed. Nearly 25% of this potential liability would have been borne by the U.S. Government.³²⁰ In 1947, Congress retroactively amended FLSA to eliminate the retroactive claims.³²¹ Upon subsequent review, the Second Circuit Court of Appeals in *Battaglia* upheld the retroactive statute, thereby extinguishing the claims. *Battaglia* justified the retroactive law by noting that Congress had found that “the liabilities created by the Supreme Court decisions ... were ‘wholly unexpected’ and that under those decisions the ‘employees would receive windfall payments, including liquidated damages, of sums for activities performed by them without any expectation of reward beyond that included in their agreed rates of pay.’”³²² The taxpayers petitioned the Supreme Court for certiorari, which was denied.³²³

4. *Graham & Foster v. Goodcell*

The Second Circuit’s decision in *Battaglia* relied in part on the U.S. Supreme Court’s decision in *Graham & Foster v. Goodcell*.³²⁴ In *Goodcell*, a validly-due federal tax was mistakenly collected by Treasury Department agents for tax periods after the taxpayers’ statute of limitations had run.³²⁵ In a series of cases, the taxpayers sought refunds and, while those claims were in litigation, Congress passed a retroactive tax statute that effectively denied the taxpayers’ claims.³²⁶

Separation of Powers, 84 Notre Dame L. Rev. 2107, 2130-2133 (2009).

320. See Gordon G. Young, *United States v. Klein, Then and Now*, 44 Loy. U. Chi. L.J. 265, 288 (2012) (noting that the decisions would have resulted “in liabilities, both to private employers and to the government, by virtue of cost-plus contracts, which were a significant percentage of the nation’s gross domestic product”); Vladeck, *supra* note 319, at 2130-2131 (noting that the cases “produced a colossal private and public liability for retroactive pay of over \$6.5 billion” and that the “United States would have been liable for \$1.5 billion of that under cost-plus contracts.”); Christie, *supra* note 319, at 755 n. 30 (noting that the “cases construed the Fair Labor Standards Act of 1938 in a manner so as to impose huge potential liabilities upon employers. Between July 1, 1946 and January 1, 1947, almost six billion dollars worth of claims were filed.”).

321. The law was the Portal-to-Portal Act, which was based upon a finding that judicial interpretation of the Fair Labor Standards Act of 1938 had disregarded “long-established customs, practices, and contracts between employers and employees, thereby creating wholly unexpected liabilities.” *Battaglia*, 169 F.2d at 259 n.11. See Christie, *supra* note 319, at 755 n.30 (noting that the legislation retroactively overruled the three prior Supreme Court cases).

322. See *Battaglia*, 169 F.2d at 258-259. See also Ricciardi & Sinclair, *supra* note 263, at 345 (citing *Battaglia* as a “good example” of retroactive, curative legislation — where “no settled rights were disturbed nor expectations defeated”); Christie, *supra* note 319, at 755 n. 30 (1986) (citing *Battaglia* for the proposition that “a legislature may ‘overrule’ judicial decisions”).

323. *Battaglia v. General Motors Corp.*, 169 F.2d 254 (2d Cir.), *cert. denied*, 335 U.S. 887 (1948).

324. See 169 F.2d at 257 (citing *Goodcell*, 282 U.S. 409 (1931)).

325. 282 U.S. at 414-418.

326. *Id.*

The retroactive reach of the statute dated back to payments made four years earlier.³²⁷

The taxpayer cases eventually made their way to the Supreme Court, which conceded that the taxes had been collected by the Treasury in error.³²⁸ The Court noted that “[l]arge amounts had been paid into the Treasury in this way, and it was the purpose of the Congress that payments made in the circumstances described ... should not be refunded.”³²⁹ *Goodcell* held that the statute was constitutional despite the law’s retroactive operation.³³⁰ The Court concluded that the facts were a “case of a curative statute aptly designed to remedy mistakes and defects in the administration of government.”³³¹ It stated that in such cases the “legislature is not prevented from curing the defect in administration simply because the effect may be to destroy causes of action which would otherwise exist.”³³²

E. Summary of Carlton and Dot Foods

Carlton reaffirmed that retroactive tax statutes are entitled to significant judicial deference.³³³ *Carlton* dispensed with any focus on whether an aggrieved taxpayer challenging a retroactive tax statute reasonably relied upon the pre-existing law.³³⁴ The case clarified that, in determining whether a retroactive tax statute satisfies due process, the statute merely needs to be supported by a legitimate legislative purpose and be enacted through a rational means.³³⁵

The application of the *Carlton* test is one that depends upon the specific circumstances of the legislation.³³⁶ With respect to the rational means test, the inquiry considers a statute’s actual retroactive effect.³³⁷ In *Carlton*, the statute’s formal length of retroactivity and actual retroactive effect were identical — the statute extended back 14 months and nullified the benefit of taxpayer reliance costs dating back to such time.³³⁸ But as cases like *Dot Foods* reveal, that will not always be so.

327. *Id.*

328. *Id.* at 426.

329. *Id.* at 417-18.

330. *Id.* at 429-430.

331. *Id.* at 429.

332. *Id.* The Court also stated that this “power is necessary, that government may not be defeated by omissions or inaccuracies in the exercise of functions necessary to its administration.” *Id.* at 429-30.

333. *See Carlton*, 512 U.S. at 29-35.

334. *See Carlton*, 512 U.S. at 33-35; *supra* notes 115-131 and accompanying text.

335. 512 U.S. at 30-31.

336. *See supra* notes 79-80 and 108-110 and accompanying text.

337. *See Carlton*, 512 U.S. at 33-34; *supra* note 104-106 and accompanying text.

338. The tax deduction at issue in *Carlton* was enacted in October, 2006 and retroactively amended in December, 2007; Mr. Carlton incurred costs seeking to obtain that deduction in December

Carlton was decided against a backdrop of cases involving retroactive statutes that recognized certain statutes — unlike in *Carlton* — are curative, ratifying statutes where the formal length of the statute is long but the actual retroactive effect is minimal.³³⁹ Such statutes are entitled to greater judicial deference because they generally upset no settled expectations and merely reinstate the legal status quo.³⁴⁰ *Dot Foods* evaluated such a statute.³⁴¹

The statute in *Carlton* concededly upset reliance interests, but otherwise had minimal actual retroactive effect — in part because the statute affected only a “modest period of retroactivity.”³⁴² In contrast, the statute in *Dot Foods* upset no reliance interests or settled expectations as it was a curative, ratifying statute. Therefore, although the formal period of the statute’s retroactivity in *Dot Foods* was lengthy — significantly longer than in *Carlton* — the actual retroactive effect of the statute in *Dot Foods* was minimal.³⁴³ Consequently, both statutes were consistent with due process as evaluated under the deferential *Carlton* test.

IV. OTHER RECENT STATE CASES

The preceding sections of this article focused on a comparison between *Carlton* and *Dot Foods*. Those sections demonstrated that, contrary to critics’ claims, *Dot Foods* aligns with *Carlton* and reveals the continuing merits of the Supreme Court’s test. This section evaluates several of the other recent high-profile state tax cases where the states have enacted retroactive tax statutes, focusing in particular on situations comparable to *Dot Foods*, i.e., where the statute reversed the analysis in a court decision. However, before proceeding to the other state cases this section briefly evaluates two of the general critiques asserted against the states’ recent use of retroactive tax statutes — that the decided cases have rendered inconsistent results and that these cases reveal that the states have grown overly-dependent on retroactive statutes as a means of addressing budgetary concerns.

A. Inconsistent Results

Some have argued that the recent state cases that considered

of 2006, but other estates may have acted sooner. See *Carlton*, 512 U.S. at 28-29. See also *supra* notes 101-106 and 108-110 and accompanying text.

339. See *supra* notes 279-332 and accompanying text.

340. See *supra* notes 258-266 and accompanying text.

341. See *supra* notes 267-273 and accompanying text.

342. 512 U.S. at 34-37. See *supra* notes 102-105 and accompanying text.

343. See *supra* notes 202-212 and accompanying text.

retroactive tax statutes suggest a need to revisit *Carlton* in part because of the divergent results in these cases. In its petition for certiorari to the U.S. Supreme Court, *Dot Foods* specifically cited as problematic the divergent lengths of the states' statutes, which, upon being challenged, were typically upheld, but sometimes struck down³⁴⁴ — arguably, with no clear suggestion as to when it is that a statute will prove to have impermissible retroactive effect.³⁴⁵ The different results are, however, the necessary consequence of the factual variety of the cases, which will exist irrespective of the applicable inquiry. *Carlton* correctly recognized that there would be variations in the nature of the legislation and so created a facts and circumstances test.³⁴⁶ Such a test virtually ensures that there will be results that may seem inconsistent on a superficial level, but that consequence alone is not reason to question the legitimacy of the *Carlton* approach.

There is also an irony in the fact that taxpayers have critiqued *Carlton* because the state cases have resulted in decisions that have effectively “gone both ways.” The *Carlton* test is a rational basis test, which in theory should favor the government in almost every instance.³⁴⁷ Since 1928, the Supreme Court has not struck down a retroactive tax statute, and, in his *Carlton* concurrence, Justice Scalia approvingly observed that “[t]he reasoning the Court applies to uphold the statute in this case guarantees that *all* retroactive tax laws will henceforth be valid.”³⁴⁸ The

344. COST claims that since *Carlton* states have prevailed in challenges to retroactive tax statutes about 15% of the time. See Stephanie Cumings, *Experts Disagree on Whether Retroactive Tax Legislation is Too Pervasive*, 82 STATE TAX NOTES 886 (Dec. 19, 2016) (COST representative states that taxpayers lose in about 85% of the state cases — and claims that this by itself reveals that the state courts' application of the *Carlton* test has been “fundamentally unfair”).

345. See, e.g., Petition For a Writ of Certiorari, *supra* note 252, at 9 (stating as problematic that the “courts are sharply split over the [due process] limits on retroactive tax legislation”). See also Brief Amicus Curiae of Council on State Taxation in Support of Petitioner, *supra* note 5 at 5-7 (stating the Supreme Court “needs to resolve the conflict among state and federal courts over the due process clause limitations of retroactive tax laws”); Brief for the Tax Exec. Inst., Inc. as Amicus Curiae in Support of Petitioner, *supra* note 9 at 4 (“This Court should grant the taxpayer’s petition for a writ of certiorari to resolve the significant differences among state courts applying *Carlton*.”).

346. See *supra* notes 79-80 and 108-110 and accompanying text. See also *Miller v. Johnson Controls*, 296 S.W.3d 392, 399 (Ky. 2009), *cert. denied*, 560 U.S. 935 (2010) (remarking that the *Carlton* test is one that evaluates the particular facts and circumstances); *River Garden Retirement Home v. Franchise Tax Bd.*, 186 Cal. App. 4th 922, 948-949 (Ct. App. 1st Dist. 2010) (similar).

347. See *supra* note 78 and accompanying text.

348. See, e.g., *id.* at 40 (Scalia, J., concurring) (emphasis in original). See also Puckett, *supra* note 131, at 374 (“retroactivity generally has not been suspect under the Constitution” ... even “generally beyond tax, the Supreme Court’s review of retroactivity has been extremely deferential”); *Eastern Enterprises v. Apfel*, 524 U.S. 498, 547 and 550 (1998) (Kennedy, J. concurring) (“due process requires an inquiry into whether in enacting the retroactive law the legislature acted in an arbitrary and irrational way”; “[s]tatutes may be invalidated on due process grounds only under the most egregious of circumstances”). See *supra* note 224 and accompanying text (citing articles noting that the Supreme Court has consistently upheld retroactive tax statutes). See also *supra* note 64 (noting that prior to three outlier cases in the 1920’s the Supreme Court had never struck down a retroactive tax statute).

irony is that, because taxpayers have fared better in the state tax cases than one might expect, the critics of these cases have suggested that the *Carlton* test should be reconsidered for having rendered inconsistent results.³⁴⁹

B. Frequent Use of Retroactive Tax Statutes as a Budgetary Tool

Another argument of those criticizing the states' recent retroactive tax statutes is that the states have too frequently relied upon these statutes as a tool to satisfy budgetary concerns.³⁵⁰ Certainly, many of the states' recent retroactive tax statutes have in fact been justified, at least in part, as intended to protect the state fisc.³⁵¹ However, *Carlton* was also justified on this basis, and *Carlton* was clear that the protection of the public fisc would generally suffice as a legitimate legislative purpose.³⁵² Moreover, budgetary concerns are of particular concern in the state tax context since, unlike the federal Government, every state except Vermont faces an annual balanced budget requirement.³⁵³ In other

349. See Gunning, *supra* note 64, at 314 (suggesting state courts are construing retroactive tax statutes more rigorously than *Carlton* requires). Susan C. Morse, Article: *A Corporate Offshore Profits Transition Tax*, 91 N.C. L. Rev. 549, 563 n.66 (2013) (citing cases where state courts have struck down retroactive tax statutes). In some cases, the more rigorous state review is due to the fact that the state has adopted an analytic standard that is more exacting than *Carlton*. See, e.g., *James Square Associates LP v. Mullen*, 993 N.E.2d 374, 382-383 (NY 2013) (striking down a retroactive tax statute under New York's three-part "balancing of the equities" of the test); *City of Modesto v. Nat'l Med., Inc.*, 128 Cal. App. 4th 518, 529 (Cal. Ct. App. 2005) ("Generally in California, courts have upheld the retroactive application of tax laws only where such retroactivity was limited to the current tax year.") (citing *Gutknecht v. City of Sausalito*, 43 Cal. App. 3d 269, 282 (Cal. Ct. App. 1974)). *But see* *River Garden Retirement Home v. Franchise Tax Bd.*, 186 Cal. App. 4th 922, 948-949 (Ct. App. 2010) (concluding that under the circumstances that a four year retroactive period was modest and stating "[w]e agree with *Modesto* that *Carlton* does call for a modest period of retroactivity, but we do not subscribe to the view that a period longer than one year in and of itself raises serious constitutional questions. Rather, we believe that the modesty of the period must be assessed under the facts and circumstances of the case."). The New York case, *James Square Associates*, is discussed in more detail *supra* note 424. See also *Rivers v. State*, 490 S.E.2d 261, 265 (S.C. 1997) (finding retroactive increase in capital gains rate "violates due process under both the *state and* federal constitutions") (emphasis added); *Zaber*, 789 N.W.2d at 654 (upholding a retroactive tax statute but noting that "[i]t is, of course, possible under the Iowa due process clause to adopt a different approach from the federal model.").

350. See Brief of the Am. Coll. of Tax Counsel as Amicus Curiae in Support of Petitioner, *supra* note 9, at 3 ("The Washington Supreme Court in this case, by holding that revenue raising itself was a 'legitimate legislative purpose,' misapplied [the *Carlton* test] and established a principle that, taken to its logical conclusion, would justify virtually any retroactive tax increase."); Brief Amicus Curiae of Council on State Taxation in Support of Petitioner, *supra* note 5, at 1 ("Far too frequently, courts have held that preventing any significant revenue loss can satisfy the 'legitimate legislative purpose' test in *Carlton*.").

351. See *infra* notes 185-188, 387-389, 419-422 and 430-436 and accompanying text.

352. *Carlton*, 512 U.S. at 31-32. See also *id.* at 40 (Scalia, J., concurring) ("Revenue raising is certainly a legitimate purpose"); *id.* at 37 (O'Connor, J., concurring) ("retroactive application of revenue measures is rationally related to the legitimate governmental purpose of raising revenue").

353. See Roin, *supra* note 182, at 573 ("A balanced budget 'is widely considered to be the

instances, the Supreme Court's constitutional precedent has been particularly sensitive to the states' budgetary predicament.³⁵⁴

The criticism that the states have used retroactive tax statutes too frequently in recent years as a budgetary tool is, of course, difficult to evaluate because it begs the subjective question as to how many legislative enactments is too many. Those who have denounced the states' on this basis have used as a proxy the number of recently-reported cases in which such statutes have been contested.³⁵⁵ But, even if one accepts a focus on the number of decided cases as a fair metric, whether the volume of such cases has recently been high — as measured in the abstract — is at least questionable.³⁵⁶ It would seem that if one is to apply the taxpayer's suggested metric, the determination as to whether the recent volume of cases has been excessive would logically require, at the very least, a comparison to the volume of similar cases from prior periods. As those who have critiqued the recent state cases have laid the blame on *Carlton*, it is logical to use the period from immediately before *Carlton* as a comparative standard. That comparison suggests that there has not been any significantly greater use of state retroactivity statutes in recent years.³⁵⁷

C. Case Analysis

The following discussion reviews other high-profile recent cases that evaluate a situation in which a state enacted a retroactive tax statute to reverse the impact of a judicial decision, as in *Dot Foods*. These cases

foundation of state fiscal practices.”) (quotes and citation omitted). Professor Roin argues that retroactive tax statutes can and should be utilized in a more general way to assist the states with their balanced budget requirements. *See id.* at 571-574, 603-604.

354. *See, e.g.,* *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18, 31 (1990) (where a state's statute violates a taxpayer's constitutional rights for prior periods, the state is only required to provide, not necessarily dollar refunds, but “meaningful backward-looking relief”); *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44 (1996) (under the 11th Amendment the states cannot be sued in federal court without their consent); *Armour v. City of Indianapolis*, 566 U.S. 673 (2012) (providing the states with flexibility in methods of governmental financing largely unimpeded by the equal protection clause); *Dep't of Revenue of Kentucky v. Davis*, 553 U.S. 328 (2008) (traditional government state functions such as the issuance of debt securities are immune from dormant Commerce Clause scrutiny).

355. *See, e.g.,* Stephanie Cumings, *Experts Disagree on Whether Retroactive Tax Legislation is Too Pervasive*, 82 STATE TAX NOTES 886 (Dec. 19, 2016).

356. *See id.*

357. A LEXIS search for the 20 year period preceding *Carlton*, January 1, 1974 to January 1, 1994 reveals 43 state tax retroactivity cases; a LEXIS search for the 20 year period, January 1, 1996 to January 1, 2016 reveals 50 such cases. This search employed the terms “retroactive” and “tax,” with appropriate search connectors, and included a search for a reference to the case *Welch v. Henry*, 305 U.S. 134, in the earlier period and *Carlton*, 512 U.S. 26, in the latter. A subsequent analysis verified which cases actually posed the issue as to the validity of a retroactive tax. Where more than one case evaluated the same statute, a case was counted only once.

are the recent Michigan “compact cases,”³⁵⁸ the New York case of *Caprio v. New York State Dep’t of Taxation & Finance*,³⁵⁹ and the Kentucky case of *Miller v. Johnson Controls, Inc.*³⁶⁰ The Michigan “compact cases” involved lawsuits that were initiated by a large number of taxpayers³⁶¹ and *Caprio* and *Johnson Controls* have each been singled out by taxpayer representatives for criticism.³⁶² As the analysis of the cases makes clear, however, each of the relevant statutes was effectively justified as a curative, ratifying statute, similar to the statute in *Dot Foods*.

1. The Michigan Compact Cases

When the Supreme Court denied certiorari in *Dot Foods* in April, 2017, it also denied certiorari in several consolidated Michigan cases.³⁶³ These Michigan cases were one permutation of a coordinated attempt by a large group of taxpayers to obtain state corporate income tax refunds in multiple states.³⁶⁴ In particular, the effort was directed at states that had become parties to the Multistate Tax Compact (“Compact”) several decades earlier.³⁶⁵ These states adopted the provisions of the Compact into their laws, including the provisions of the Uniform Division of Income for Tax Purposes Act (“UDITPA”).³⁶⁶ As adopted by these “Compact States,” UDITPA provided that a multistate taxpayer filing

358. See *supra* note 1 and accompany text.

359. 37 N.E.3d 707 (NY), *rehearing denied*, 38 N.E.3d 817 (2015).

360. 296 S.W.3d 392 (Ky. 2009), *cert. denied*, 560 U.S. 935 (2010).

361. Amy Hamilton, *Michigan Supreme Court Is Asked to Review Decisions on Retroactive Tax Laws*, 78 STATE TAX NOTES 697 (Dec. 7, 2015) (noting that there were 50 docketed Michigan cases that were eventually consolidated).

362. See, e.g., Timothy Noonan, et. al, *The Emperor Strikes Back in Caprio*, 77 STATE TAX NOTES 533 (Aug. 10, 2015) (critiquing *Caprio*); Erica L. Horn & Stephen A. Sherman, *Retroactive Tax Legislation: Where Is the Modesty?* Bloomberg BNA Weekly State Tax Report 11/23/2012 (critiquing *Johnson Controls*).

363. See *supra* note 1 and accompanying text.

364. See Amy Hamilton, *Deadlines Approaching in Several Multistate Tax Compact Cases*, 79 STATE TAX NOTES 827 (March 16, 2016); Amy Hamilton, *Multistate Tax Compact Refund Claims Pending in 4 New States*, 81 STATE TAX NOTES 920 (Sept. 19, 2016).

365. The strategy was set in motion by one of the big 4 accounting firms See *Best of 2012*, STATE TAX TODAY: TAX ANALYSTS (Nov. 12, 2012) (discussing the genesis of the strategy and the initial case); Billy Hamilton, *What Did the MTC Think and When Did They Think It?*, 66 STATE TAX NOTES 751 (Dec. 3, 2012) (noting that persons at the accounting firm “assisted in filing the claims at issue in the [initial refund] case before the California court, helped develop the litigation issues, and worked with counsel on the case”) (brackets added).

366. See John Swain, *Reforming the State Corporate Income Tax: A Market State Approach to the Sourcing of Service Receipts*, 83 Tul. L. Rev. 285, 295 (2008); The Multistate Tax Compact Suggested Legislation and Enabling Act, at [http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/About_MTC/MTC_Compact/COMPACT\(1\).pdf](http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/About_MTC/MTC_Compact/COMPACT(1).pdf).

corporate income tax returns was entitled to elect to use a three-factor apportionment formula consisting of the factors of property, payroll and sales.³⁶⁷

Beginning in the mid-1990's, the states — including the Compact States — started to move away from three-factor apportionment in favor of a single sales factor.³⁶⁸ In some states, this action raised a potential question concerning the state's power to impose a mandatory apportionment formula without withdrawing from the Compact. For years, the issue lay dormant. Then beginning with California in 2010, taxpayers that would benefit from the use of a three-factor formula started to file amended returns applying that methodology and claiming refunds.³⁶⁹ Similar refunds were subsequently claimed in Texas, Oregon, Minnesota, and Michigan.³⁷⁰

In Michigan, there was a unique wrinkle. Michigan adopted its first corporate income tax in 1967 and then adopted the Compact in 1970; however, in 1976, Michigan eliminated its corporate income tax in favor of a single business tax, which taxed activity and not income.³⁷¹ In 2008, Michigan repealed the single business tax and re-enacted a corporate income tax, which included a single sales factor apportionment formula.³⁷² During the period between 1976 and 2008, Michigan's membership in the Compact remained in place.³⁷³ However, state legislators believed that they impliedly repealed the Compact's three-factor election when they enacted the 2008 legislation.³⁷⁴ In 2009, IBM filed a return for tax year 2008 that sought to use the Compact's three-factor formula and the state rejected its filing.³⁷⁵ IBM subsequently brought suit challenging this denial.³⁷⁶ In 2011, Michigan

367. See Swain, *supra* note 366, at 292-295.

368. Brief of the Multistate Tax Commission as Amicus Curiae in Support of Defendant and Respondent, at 5-8, *Gillette Co. v. Franchise Tax Bd.*, 207 Cal. App. 4th 1369 (Cal. Ct. App. 2012) (No. A130803), 2011 WL 6260592, at *5-8.

369. See *The Gillette Co. v. Franchise Tax Board*, 209 Cal. App. 4th 938, 949 (2012), *rev'd*, 363 P.3d 94 (2015), *cert. denied*, 137 S. Ct. 294 (2016) (noting the company filed six claims for refund in January of 2010).

370. Each of the cases were litigated and ultimately resulted in a final decision for the state. The cases in Michigan are discussed *infra* notes 371-402 and accompanying text. See also *Health Net Inc. v. Dep't of Revenue*, 362 Or. 700 (Or. 2018); *Graphic Packaging Corp. v. Hegar*, 2017 Tex. LEXIS 1184 (Tex. 2017); *Kimberly Clark v. Comm'r*, 880 N.W.2d 844 (Minn. 2016); *The Gillette Co. v. Franchise Tax Bd.*, 363 P.3d 94 (Ca. 2015).

371. *IBM v. Dep't of Treasury*, 852 N.W.2d 865, 869-70 (Mich. 2014); *Gillette Commer. Operations N. Am. v. Dep't of Treasury*, 878 N.W.2d 891, 899 (Mich. 2015), *rev. denied*, 880 N.W.2d 230 (2016), *cert. denied*, 137 S. Ct. 2157 (2017).

372. 852 N.W.2d at 870, 873.

373. *Id.* at 871.

374. *Gillette*, 878 N.W.2d at 900-901. See *IBM*, 852 N.W.2d at 874.

375. *IBM*, 852 N.W.2d at 868.

376. *Id.*

repealed the Compact election effective January 1, 2011.³⁷⁷ The state's position was that this 2011 repeal expressly confirmed the state's 2008 implied repeal of that election.³⁷⁸

Similar to the litigation in *Dot Foods*, IBM's refund claim, for tax year 2008, failed at two lower state courts, the state's trial court and the court of appeals.³⁷⁹ But then — again similar to *Dot Foods* — the taxpayer succeeded in a split decision rendered by the state's supreme court, a case that was decided 3–1–3.³⁸⁰ In contrast to the lower court decisions, the Michigan Supreme Court's 2014 splintered decision concluded that the state's 2008 legislation did not impliedly repeal the Compact election, and also that the state's 2011 legislation expressly repealing the Compact election was retroactive only to the beginning of 2011.³⁸¹ Therefore, the court concluded that the state's three-factor apportionment formula could be applied by the taxpayer for its tax year 2008, and in theory could be applied by any taxpayer during the period January 1, 2008, to January 1, 2011.³⁸² However, the Court also recognized that the 2011 legislature “could have — but did not — extend [the] retroactive repeal to the start date of the [2008 legislation].”³⁸³

As the IBM litigation proceeded, between 2011 and 2015, numerous multistate Michigan corporate taxpayers filed suit seeking refunds due pursuant to the Compact election — refunds that had been previously denied by the state on the ground that the only apportionment method available was the single sales factor method established by the 2008 legislation.³⁸⁴ Most of these taxpayers filed their original returns using single-factor apportionment and did not seek to use the Compact's three-factor formula until the relevant tax years had passed.³⁸⁵ These cases were mostly filed prior to the Michigan Supreme Court's 2014 resolution in *IBM*, and were held in abeyance pending that decision.³⁸⁶

In the aftermath of the *IBM* decision, the state determined that its potential liability for refunds to IBM and to the other taxpayers that had

377. *Id.* at 875-876.

378. *Gillette*, 878 N.W.2d at 900-901 (noting the legislature's later statement that “the 2011 amendatory act . . . was to further express the original intent of the legislature regarding the application of [the earlier 2008 repeal]”) (brackets added).

379. *See IBM*, 852 N.W.2d at 869.

380. *See generally IBM*, 852 N.W.2d 865. A concurring judge, writing for himself, aligned himself with the majority for purposes of the holding; three of the judges dissented. *See generally id.*

381. *See generally id.* at 868-876; *id.* at 881-882 (Zahra, J., concurring).

382. *Gillette*, 878 N.W.2d at 902.

383. *IBM*, 852 N.W.2d at 876 (brackets added).

384. *See Gillette*, 878 N.W.2d at 902.

385. *See* Brief in Opposition at 25, *Sonoco Prod. Co. v. Dep't of Revenue*, 137 S. Ct. 2157 (2017) (No. 16-687), 2017 WL 1020032.

386. *Gillette*, 878 N.W.2d at 901.

filed amended returns with respect to taxes previously collected was \$1.1 billion.³⁸⁷ Given that Michigan has a balanced budget requirement and an annual budget of approximately \$50 billion,³⁸⁸ the impact of these refunds would have significantly affected the state's budgetary process. Within two months, the Michigan legislature acted with little dissent to retroactively repeal the Compact provisions dating back to 2008 — thus eliminating the taxpayers' retroactive tax claims.³⁸⁹ The bill noted that, in so doing, the legislature sought to reinstate the original intent of both the prior 2008 and the 2011 legislatures to disable the Compact election.³⁹⁰ The legislature acted on successive days, and one day later, the Governor signed the bill into law.³⁹¹

The numerous Michigan corporate taxpayers that filed refund claims pending, or subsequent to, the outcome in *IBM* then challenged the retroactive statute as unconstitutional under *Carlton*, citing, among other things, the fact that the 2014 legislation had a retroactive length that extended back to 2008.³⁹² However, the state trial court and appeals court upheld the law, and the state supreme court denied a request for further review.³⁹³ In rejecting the taxpayers' argument that the period of retroactivity was too lengthy, the appeals court noted that the legislature only realized that its prior law had failed to retroactively repeal the Compact election when the state supreme court decided *IBM* in 2014, and that “the Legislature acted promptly to correct the error” at that time.³⁹⁴ The court also noted that the “6½-year retroactive period was sufficiently modest relative to the length of other retroactive legislation that have been upheld by Michigan courts, federal courts, and other state

387. *Id.* at 910 (quoting Senate Legislative Analysis, SB 156, September 10, 2014, p. 5). A legislative analysis noted that the high cost derived from the fact that taxpayers who had not previously been allowed by the Michigan Department of Treasury to use the alternative 3-factor apportionment calculation would be permitted to do so under the *Gillette* decision. *See id.* That analysis also noted that the cost would be directly borne by the Michigan General Fund. *Id.*

388. *See* 2015-2016 MICH. EXEC. BUDGET, available at http://www.michigan.gov/documents/budget/Budget_final2_447264_7.pdf.

389. The vote in the House was 100-10; the vote in the Senate was 35-3. *See* Aryn L. McCumber, *Billion Dollar Decision: International Business Machines v. Michigan Department of Treasury*, 40 MICH. TAX L. 6 (2014).

390. The law provided that the legislature's “original intent” in both the prior 2008 and 2011 legislative acts was to eliminate the ability for taxpayers to use the Compact's three factor apportionment election provision as of 2008. *Gillette*, 878 N.W.2d at 900-901.

391. *See* Solo Cup Operating Corp. v. Dep't of Treasury, No. 327766, 2016 Mich. App. LEXIS 2358, at *31 (Mich. Ct. App. Dec. 20, 2016).

392. *See generally Gillette*, 878 N.W.2d at 899. *See also* Daniel L. Stanley & Brian T. Quinn, 2016-3 NYU INSTITUTE ON STATE & LOCAL TAXATION § 3.02, Multistate Tax Compact Litigation (noting a group of 50 pending appeals were eventually consolidated by the Michigan court of appeals).

393. *Gillette Operations N. Am. v. Dep't of Treasury*, 878 N.W.2d 891, 899 (Mich. 2015), *rev. denied*, 880 N.W.2d 230 (2016), *cert. denied*, 137 S. Ct. 2157 (2017).

394. *Id.* at 911.

courts.”³⁹⁵

The Michigan appeals court in *Gillette* made reference to the judicial doctrine that governs curative retroactive tax statutes.³⁹⁶ It relied upon the Michigan Supreme Court’s earlier decision in *General Motors Corp. v. Dep’t of Treasury*,³⁹⁷ in which the court noted that “it is legitimate for the Legislature to amend a law that it believes the judiciary has wrongly interpreted.”³⁹⁸ Further, the *Gillette* court noted that, as in *General Motors*, the legislature merely “confirmed a tax that had been assessed and paid for many years” to prevent “a significant loss of revenue.”³⁹⁹ Also, the court cited *General Motors* for the proposition that “the nominal period to which the amendment retrospectively applies cannot be said to extend beyond the taxpayers’ interest in finality and repose because the period of retroactivity is consistent with the applicable statute of limitations.”⁴⁰⁰

The Michigan court’s emphasis on the taxpayers’ statutes of limitation is consistent with the analysis in *Dot Foods*, where the Washington Supreme Court similarly concluded that the retroactive period of the statute in question, as applied to the taxpayer, *Dot Foods*, was limited by the taxpayer’s open statute of limitations.⁴⁰¹ This analysis also generally comports with the conclusion of Professor Julie A. Roin that, in general, retroactive tax statutes that are limited to a taxpayer’s open statute of limitations should be permissible since “it is

395. *Id.*

396. *See generally id.* at 899-925.

397. 803 N.W.2d 698 (Mich. 2010) (per curiam), *cert. denied*, 565 U.S. 1178 (2012).

398. *Gillette*, 878 N.W.2d at 909 (quoting *General Motors*, 803 N.W.2d at 710).

399. *Id.* (citing *General Motors*, 803 N.W.2d at 712). In *General Motors*, the Michigan legislature acted to retroactively clarify a state supreme court decision that it estimated would result in \$250.2 million in refunds. 803 N.W.2d at 706. That decision would have afforded car dealers a sale for resale exemption on the purchase of automobiles even though they made interim use of the automobiles before reselling them. *Id.* at 702-708. The law was enacted in 2007 shortly after the decision and was effective “beginning September 30, 2002, and for all tax years not barred by the applicable statute of limitations.” *Id.* at 703. The court upheld the statute in part because it only served to “confirm the application of a tax previously imposed” and the taxpayer had not detrimentally relied upon the prior language of the use tax (as evidenced by the fact that it was filing claims for refunds, not supporting an original return position). *Id.* at 712.

400. *Gillette*, 878 N.W.2d at 909-910 (quoting *General Motors*, 803 N.W.2d at 712). *Gillette* also cited *General Motors* for the proposition that “[a] legislature’s action to mend a leak in the public treasury or tax revenue — whether created by poor drafting of legislation in the first instance or by a judicial decision — with retroactive legislation has almost universally been recognized as ‘rationally related to a legitimate legislative purpose.’” *See id.* at 909 (quoting *General Motors*, 803 N.W.2d at 710, in turn quoting *United States v. Carlton*, 512 U.S. 26, 35 (1994)).

401. *See supra* notes 202-207 and accompanying text. *See* Brief in Opposition, *supra* note 385, at 16 (“Retroactivity only briefly came into the picture [as of 2011] three years after [the enactment of the statute in question], when a judicial misinterpretation of the law in July 2014 retroactively gave out-of-state businesses a new right. But the Legislature clarified and corrected that misinterpretation, restoring the status quo that had existed since 2008.”). For a more general comparison with *Dot Foods*, *see generally supra* note 212.

hard to argue that anyone can have ‘settled expectations’ regarding their tax liability until that year’s statute of limitations for tax adjustments has closed.”⁴⁰²

2. *Caprio v. New York State Dep’t of Taxation & Finance*

In *Caprio v. New York State Dep’t of Taxation & Finance*,⁴⁰³ New York’s highest court upheld a retroactive tax statute that reversed the analysis of two lower state court cases involving two unrelated taxpayers.⁴⁰⁴ Those cases, decided in 2009, evaluated New York’s personal income tax law and the relevant federal income tax law to which that New York law conformed.⁴⁰⁵ In each case, the taxpayer had taken the position that he could sell certain in-state assets and structure the sale such that the sale proceeds would not be subject to state income tax.⁴⁰⁶

In 2010, shortly after the two lower court cases were decided, the state legislature acted to retroactively address the applicable law, retroactive to 2007. The act was deemed “necessary to correct” the analysis in the two decisions, which the legislature concluded “erroneously overturned the longstanding policies of [the department of taxation and finance].”⁴⁰⁷ The court also noted a legislative intention “to clarify the concept of federal conformity in the personal income tax” and to prevent “unintended refunds.”⁴⁰⁸

402. See Roin, *supra* note 182, at 597-598. *Gillette* also, as in *Dot Foods*, rejected the taxpayers’ claim that the retroactive tax legislation violated the doctrine of separation of powers. 878 N.W.2d at 912-913. The court noted that it was the legislature’s power to make laws, and the judiciary’s power to construe them. *Id.* The court also concluded that there was little doubt that the legislature lacked the “authority to reverse a judicial decision . . . but [that] there is also little doubt that it has the authority — if not the obligation — to amend a statute that it believes has been misconstrued by the judiciary.” *Id.* at 913 (citing *Romein v. Gen. Motors Corp.*, 462 N.W.2d 555, 566 (Mich. 1990), *aff’d* 503 U.S. 181 (1992)). As in *Dot Foods*, IBM, the taxpayer that prevailed in the earlier case addressed by the retroactive legislation, ultimately received a refund for the tax years at issue — although not without a fight. See *IBM Corp. v. Dep’t of Treasury*, 891 N.W.2d 880 (Mich. 2016).

403. 37 N.E.3d 707 (N.Y. 2015), *rehearing denied*, 38 N.E.3d 817 (2015).

404. Those cases were *In re Baum*, No. 820837, 2009 WL 427425 (N.Y. Tax Trib. Feb. 12, 2009) and *In re Mintz*, No. 821807, 2009 WL 1657395 (N.Y. Div. of Tax App., June 4, 2009). See *Caprio*, 37 N.E.3d at 711.

405. *Caprio*, 37 N.E.3d at 711.

406. See *id.* New York law taxed non-residents’ income derived from New York sources, but not the income from the sale of stock unless the stock (as opposed to the underlying assets) was used in an in-state trade or business. *Id.* at 708-711. The taxpayers were nonresidents that sold stock and made an IRC § 338(h)(10) election to treat the sale of stock as the sale of assets for federal income tax purposes. *Id.* The taxpayers then elected installment sale treatment under federal law, which New York respects. See *id.* The taxpayers claimed that, although the assets deemed to be sold were New York assets, that they were not taxable on the gain because the gain actually derived from the sale of stock. *Id.*

407. *Id.* at 711-715.

408. *Id.* at 711.

New York has its own judicial test for evaluating a retroactive tax statute that is more rigorous than the two-part test in *Carlton*. New York's "balancing of the equities" test focuses on (1) the taxpayer's notice of the retroactive change and the reasonableness of its reliance on old law, (2) the length of the retroactive period, and (3) the public purpose for the retroactive application.⁴⁰⁹ The focus on taxpayer notice and reliance resembles the test applied by the lower court in *Carlton*, which the U.S. Supreme Court later rejected.⁴¹⁰ The focus on the length of the retroactive period mimics the concern of Justice O'Connor, who in her concurrence in *Carlton* was the only Justice to emphasize this factor.⁴¹¹ Even applying New York's more exacting standards, *Caprio* upheld the retroactive statute.

Caprio concluded that the state's retroactive statute passed each prong of New York's three-part test.⁴¹² The court determined that the taxpayers' reliance on the pre-existing law was unreasonable because it relied upon "an untested interpretation of prior law — unsupported by any actual experience, practice or professional advice."⁴¹³ It analogized the case to an earlier New York case that decided when "a long-standing policy has been changed by a nonbinding ruling, and then the old policy is codified by [a] statute," the retroactive tax legislation did not violate due process.⁴¹⁴ The court also stated that when a statute is ambiguous a subsequent legislative construction of that statute is entitled to great weight.⁴¹⁵ The court's conclusions resemble the conclusions in *Dot Foods*: the legislature possesses discretion to fix an ambiguous statute, and is also entitled to correct a judicial interpretation to reflect the law as it was generally understood prior to that interpretation.⁴¹⁶

As required by the state standard, *Caprio* also considered the retroactive length of the statute at issue. The court determined that the retroactive length of the statute was three and a half years (the period of an affected taxpayer's open statute of limitations), which it concluded was not unreasonable under the circumstances.⁴¹⁷ In so doing, the court noted a prior New York case that affirmed a retroactive tax statute that extended back six years.⁴¹⁸ The court considered the statute at issue to be "curative" because it was intended to correct the two prior erroneous

409. *Id.* at 708, 713.

410. *See supra* notes 66-67 and 115-124 and accompanying text.

411. *See supra* notes 111-112 and accompanying text.

412. *Caprio*, 37 N.E.3d at 713-717.

413. *Id.* at 714.

414. *Id.* (citing *Varrington Corp. v. City of N.Y. Dept. of Fin.*, 647 N.E.2d 746, 748 (N.Y. 1995)).

415. *Id.* at 714-715.

416. *See generally supra* notes 144-212.

417. *Caprio*, 37 N.E.3d at 711-12, 716-17.

418. *Id.* at 716-17.

court cases and to prevent the payment of “unintended refunds,” which the state estimated would be “many millions of dollars . . . without legislative intervention.”⁴¹⁹ This second test was therefore met, “[i]nasmuch as [the] purposes [of the statute] were curative and the period of retroactivity was rationally related thereto — the amendments applied retroactively to only those tax years that remained open.”⁴²⁰ As was true of its conclusions more generally, the court’s determination that the legislature could retroactively address the taxpayers’ open tax years was also similar to the analysis in *Dot Foods*.⁴²¹

Finally, the court concluded that the statute had the requisite public purpose — “attempting to correct an error or preventing significant and unanticipated revenue loss.”⁴²² The court noted that the “curative, rational public purposes set forth in the legislative findings” met this standard as they were “compelling.”⁴²³ In its conclusion, the court stated that “given the legislature’s curative purposes, the extension of the retroactive application of the statute to only those tax years for which a taxpayer could seek a refund and the lack of justifiable reliance by plaintiffs on prior law, the retroactivity period here is not excessive, arbitrary or irrational.”⁴²⁴

3. *Miller v. Johnson Controls, Inc.*

In the 2009 Kentucky case, *Miller v. Johnson Controls, Inc.*,⁴²⁵ the retroactive tax statute pertained to the state’s policy allowing affiliated corporate income taxpayers to file tax returns on a combined basis.⁴²⁶

419. *Id.* at 717.

420. *Id.*

421. *See supra* notes 202-207 and accompanying text.

422. *Caprio*, 37 N.E.3d at 717 (internal quotations omitted).

423. *Id.*

424. *Id.* In contrast, in *James Square Assocs. LP v. Mullen*, the same court struck down New York’s attempt to make retroactive changes to a tax credit program that was intended to stimulate economic development in less affluent areas. 993 N.E.2d 374, 382-83 (N.Y. 2013). The changes were intended to rein in abuses such as where a company transfers employees among related entities to appear to have created new jobs in a certain location. *Id.* at 377-378. The amendments were made retroactive and were to be used to de-certify persons that had previously qualified for the credit. *Id.* A number of taxpayers were subsequently de-certified and a series of cases ensued, in which the taxpayers each generally prevailed in the lower court case before reaching the state’s high court on a consolidated basis. *Id.* at 378-380. In striking down the legislation, the court noted that it was not a curative measure intended to fix a legislative error and was a statute that upset taxpayers’ justifiable reliance interests. *Id.* at 383-384. Also, the court concluded that the length of retroactivity — either 16 months or 32 months, as argued by the parties — was excessive in either event because it “was long enough . . . so that plaintiffs gained a reasonable expectation that they would ‘secure repose’ in the existing tax scheme.” *Id.* at 382.

425. 296 S.W.3d 392 (Ky. 2009), *cert. denied*, 560 U.S. 935 (2010).

426. *Id.* at 393.

While Kentucky had allowed this practice for a period of years, it responded to several state cases and adopted a policy in 1988, which limited this method of filing to circumstances where the state imposed it on a company for remedial purposes.⁴²⁷ A taxpayer, GTE Corp (“GTE”), which had filed on a combined basis for the tax years 1984-1987, but was now prevented from doing so, challenged the state’s new policy.⁴²⁸ GTE prevailed at the trial court, suffered a reversal at the state appeals court, and then succeeded at the state supreme court in 1994.⁴²⁹

In response to the 1994 *GTE* decision, GTE and other similarly-situated taxpayers who would benefit from the decision filed refund claims seeking to amend their tax filings on a retroactive basis.⁴³⁰ The Kentucky legislature meets biannually.⁴³¹ In 1996, the legislature prospectively prohibited the combined filings.⁴³² Then, in the period 1996 to 1998, the legislature realized that the decision in *GTE* created the prospect for the payment of substantial refunds for prior tax years.⁴³³ However, the legislature was not able to address the problem until late in the 1998 legislative session, and in that session was only able to act to suspend, rather than bar, all refund claims that were based upon *GTE*.⁴³⁴ This action was a “patch” that was to last two years, on the theory that the problem would be addressed by the legislature in its 2000 session.⁴³⁵ Finally, in 2000, the legislature retroactively prohibited all prior year refund claims that were based on a change in reporting as permitted by the *GTE* decision.⁴³⁶

427. *Id.*

428. *Id.* at 394. *See GTE v. Revenue Cabinet*, 889 S.W.2d 788, 790 (Ky. 1994).

429. *See GTE*, 889 S.W.2d at 788, 792-793.

430. *Johnson Controls*, 296 S.W.3d at 404 (Schroder, J., concurring). As explained by the court: The Appellees originally filed separate tax returns. In 1994, this Court decided *GTE v. Revenue Cabinet*, Commonwealth of Kentucky, 889 S.W.2d 788 (Ky.1994), which held that related corporations (such as a parent and subsidiary) could file a combined tax return under the unitary business concept. After *GTE* was decided, the Appellees in this case sought to amend their returns by substituting combined returns under the unitary business concept as allowed in *GTE*, because they would owe less tax under such an approach and could therefore claim a refund of taxes they claim to have overpaid.

Id. at 394 (majority opinion).

431. *See id.* at 395.

432. *Id.* The legislature also had limited actual retroactive effect, as it prohibited such filings for tax years ending on or after December 31, 1995. *Id.*

433. *Id.* The refunds would have resulted in a cost of “up to \$190 million,” which would have required that the legislature “cut the budget \$190 million.” *See id.* at 405 n.2 (Schroder, J., concurring) (quoting the legislative history).

434. *Id.* at 395 (majority opinion).

435. *Id.*

436. *Id.* at 395-396.

A group of taxpayers contested the retroactive legislation.⁴³⁷ Because taxpayers sought to file amended returns for open tax periods at the time of *GTE* (i.e., 1994), and the legislature was not able to address the refund issue until 2000, the length of the potential retroactivity as to some taxpayers was potentially nine years or more.⁴³⁸ The state court of appeals ruled for the taxpayers on the theory that the length of retroactivity was too long to be valid under *Carlton*.⁴³⁹ On appeal, the Kentucky Supreme Court reversed and affirmed the retroactive statute.⁴⁴⁰ The supreme court noted that, contrary to the appeals court's analysis, *Carlton* did not set forth a firm standard that limited a statute's retroactive length.⁴⁴¹ The state supreme court relied in part on the Ninth Circuit Court of Appeal's post-*Carlton* decision in *Montana Rail Link, Inc. v. United States*,⁴⁴² which upheld "a seven year retroactivity period."⁴⁴³

The supreme court also concluded that the statute's retroactive length was not disqualifying because: (1) the appellees were on notice of the state's position from 1988 and could not have had any "settled expectations" to the contrary; (2) the legislature acted to supersede *GTE* immediately after the decision but did not quickly address prior year refund claims only because it was too soon to know whether there would be such claims;⁴⁴⁴ and (3) the legislature met only bi-annually and still had not defined the refund problem in 1998.⁴⁴⁵

The length of the retroactive period was also justified, in the court's view, because "the legislature had no means of knowing who would

437. *Id.* at 393-394.

438. *See Johnson Controls*, 296 S.W.3d at 416, 418 (Abramson, J., dissenting) (noting a potential retroactivity period of "from five-and-a-half years to twelve years").

439. *See id.* at 400, 406 (Schroder, J., concurring).

440. *Id.* at 400 (majority opinion). The decision was 4-2. *See generally* Miller v. Johnson Controls, Inc., 296 S.W.3d 392 (Ky. 2009), *cert. denied*, 560 U.S. 935 (2010).

441. *Id.* at 400.

442. 76 F.2d 991 (9th Cir.1996).

443. *Johnson Controls*, 296 S.W.3d at 399-400 (discussing *Montana Rail Link*, 76 F.3d 991). *See also* the discussion of *Montana Rail Link*, *supra* note 301 and accompanying text.

444. This was "because the legislature had no means of knowing who would wish to combine their separate returns in order to request a refund, or even if a refund would be required after they did." *Johnson Controls*, 296 S.W.3d at 400-401.

445. *Id.* at 400-401. The court also stated:

While it might be tempting to require the legislature to be omniscient so as to immediately understand the ramifications of case law on statutory application, history tells us that often the development of law based on the holdings in cases takes time to go through process before the clear impact can be seen. Combine this with delays caused by a biennial legislative schedule, and it is rational that the legislature acted with reasonable diligence in this complicated matter.

Id. at 401. In contrast, the dissent concluded that the retroactive statute violated due process because the retroactive reach of the statute was impermissible. *Id.* at 416-419 (Abramson, J., dissenting).

wish to combine their separate returns” in the years immediately following the *GTE* decision, and the legislature acted as soon as the scope of the “unanticipated revenue loss” became known.⁴⁴⁶ The court also noted that “[w]hile due process is certainly a constitutionally protected right, it is not impacted under the facts of this case, given the clear and lengthy notice, the lack of settled expectations and lack of detrimental reliance.”⁴⁴⁷ Finally, it stated that “[a]ll the legislature did was clarify the statute after this Court interpreted it in *GTE*.”⁴⁴⁸

V. CONCLUSION

The 1994 Supreme Court case, *United States v. Carlton*, states a rational-basis, two-part test that evaluates the due process fairness of a retroactive tax statute.⁴⁴⁹ This test is deferential to such statutes because *Carlton* concurred with the Court’s longstanding precedent, concluding that determinations with respect to a government’s tax and fiscal policy-making are rightfully and ultimately the province of the legislative process.⁴⁵⁰

The *Carlton* case reached the Supreme Court because the Ninth Circuit Court of Appeals was sympathetic to a taxpayer who had relied upon the clear language of a statute, which Congress then changed.⁴⁵¹ *Carlton* specifically held that the judiciary is not to second-guess a legislature’s retroactive tax determinations even when the reliance interests of individual taxpayers are upset, i.e., so long as the Court’s due process standards are otherwise met.⁴⁵²

Much of the subsequent criticism of *Carlton* has been directed at the arguable unfairness that can result if a legislature is not bound to respect

446. *Id.* at 400-401 (majority opinion).

447. *Id.* at 401.

448. *Id.* at 401. A similar decision was rendered by the same court in *King v. Campbell County*, 217 S.W.3d 862 (Ky. 2006). In that case, as in *Johnson Controls*, the state legislature retroactively reversed a state supreme court decision that invalidated county taxes. *See generally King*, 217 S.W.3d 862. In affirming the retroactive statute, the court noted that “the taxpayers’ expectations arose only with [the court’s prior decision] and that within a few short months, . . . long before those expectations could be deemed ‘settled’ or ‘vested,’ the General Assembly had acted to revise the law and to shield [the counties] from what it believed could be the devastating consequences of the [court’s] decision.” *Id.* at 870. It stated that “[i]n these circumstances — where the General Assembly has not attempted to withdraw legislation upon which taxpayers have relied in structuring their affairs, but has promptly sought to foreclose refunds as the result of an unanticipated judicial interpretation of a constitutionally valid tax provision — the retroactive provisions of [the Act] do not run afoul of the timeliness concerns expressed by the United States Supreme Court in *Carlton*.” *Id.*

449. *Carlton*, 512 U.S. at 30-31.

450. *Id.*

451. *Id.* at 29-30, 33-35.

452. *Id.* at 33-35.

taxpayer reliance interests when imposing a retroactive tax.⁴⁵³ But *Carlton* concluded that when a statute is retroactively amended to prevent a significant revenue loss, the question of fairness is complex — and appropriate for legislative consideration — since, if the loss is not addressed through a retroactive statutory fix, the cost will ultimately be borne by an “innocent” general public.⁴⁵⁴ Also, *Carlton* reflects the view that the political process will generally prevent the government from improperly imposing unfair retroactive taxes.⁴⁵⁵

The *Carlton* two-part test is not only deferential, it is flexible, as it must be in order to grapple with a wide range of potential fact patterns.⁴⁵⁶ The recent state tax cases, including *Dot Foods*, where state legislatures have retroactively amended tax statutes to reverse the impact of a recently-decided court decision, reflect one set of such fact patterns. Although some have claimed that *Carlton* does not properly address these state cases, review of the cases, including *Dot Foods*, suggests otherwise.

Under *Carlton*, a statute must be supported by a legitimate legislative purpose, and the protection of the public fisc will suffice as such purpose.⁴⁵⁷ This is logical because a primary premise of *Carlton* was to respect the legislature’s difficult determination of how, and to whom, to distribute the costs of government.⁴⁵⁸ The recent state tax cases are consistent with this concern as many of the cases, including *Dot Foods*, have resulted because of a legislative response to a court decision that had the prospect of being extremely costly.⁴⁵⁹

Carlton also requires that retroactive tax legislation must be effected by a rational means.⁴⁶⁰ The length of a statute’s retroactivity is relevant to this determination, but the inquiry’s specific focus is on the statute’s “actual retroactive effect.”⁴⁶¹ Consistent with this notion, *Dot Foods* and the other recent state tax cases discussed in this article make clear that a retroactive tax statute can technically have a lengthy retroactive term, but minimal actual retroactive effect.⁴⁶² In these state cases the statutes were not imposing retroactive tax or denying a previously

453. See *supra* note 128 and accompanying text.

454. See *Carlton*, 512 U.S. at 32. See also *supra* notes 117-121 and accompanying text.

455. See *supra* note 131 and accompanying text.

456. See *supra* notes 79-80 and 108-110 and accompanying text.

457. *Carlton*, 512 U.S. at 31-32. See *supra* note 352 and accompanying text.

458. See *supra* notes 71-75 and 117-121 and accompanying text.

459. See *supra* notes 179-181, 387, 419 and 433 and accompanying text. The cases could have been costly because the decisions themselves had retroactive impact and would have allowed for refunds. See *id.*

460. *Carlton*, 512 U.S. at 30-31.

461. *Id.* at 33-34. See *supra* notes 105-106 and 336-343 and accompanying text.

462. See *supra* notes 202-207, 239-249, 392-402, 417-421, and 437-448 and accompanying text.

authorized tax benefit — as in the case of a law that retroactively impacts completed taxpayer transactions — but rather foreclosing refunds for prior years suddenly due under a questionable court decision.⁴⁶³ Given the prior general understanding of state law, the affected taxpayers had no “settled expectations” that they would be entitled to these refunds until the time of the court opinion, and in each case, the state acted quickly after that decision to legislatively re-impose the legal “status quo.”⁴⁶⁴ Because these statutes had minimal practical retroactive impact, they were generally consistent both with *Carlton* and the Supreme Court’s longstanding judicial doctrine that applies to curative, ratifying legislation.⁴⁶⁵

Some have also claimed that, because the recent state tax statutes pertained to the reversal of the impact of a judicial decision, this should somehow have insulated those statutes from review under the deferential *Carlton* test.⁴⁶⁶ However, if one accepts *Carlton*’s premise that the legislative process is generally the ultimate arbiter of proper retroactive taxation there is no reason to distinguish the circumstance where this taxation is effected through the response to a costly court case. Just as in the case of retroactive legislation more generally, it is fair for a legislature to determine whether the citizens of the state should bear the costs of a court decision, or whether the decision should be legislatively restricted. Such determinations are even more critical in the state tax context than they are nationally because state governments are required to balance their books annually.⁴⁶⁷ Furthermore, where the financial implications of a court decision are significant — as has been generally true in the recent state cases — there is even greater reason to think that the political process will operate to prevent the retroactive legislation if

463. Consequently, the recent state tax cases do not implicate *Carlton*’s analysis with respect to reliance — the aspect of *Carlton* that afterwards was the most frequently criticized. See *supra* note 128 and accompanying text.

464. See *supra* notes 267-273, 396-402, 412-416 and 446-448 and accompanying text.

465. See *supra* notes 239-278 and accompanying text. Justice O’Connor, the Justice who expressed the greatest concern with the length of a retroactive tax statute in *Carlton*, stated that what troubled her was the prospect of a legislature acting to “readjust rights and burdens . . . and upset otherwise settled expectations.” *Carlton*, 512 U.S. at 37 (O’Connor, J., concurring). In a case decided two years before *Carlton* she wrote the Court’s majority opinion upholding a retroactive state economic statute reversing a court case where the statute’s actual retroactive impact on two companies dated back six years. See *General Motors Corp. v. Romein*, 503 U.S. 181 (1992). In that case, which Justice O’Connor later cited in her concurrence in *Carlton*, 512 U.S. at 36, she concluded that “legitimate expectations and settled transactions” were not upset, because only the two companies — and not the business community more generally — had previously understood the law to be as ultimately construed by the court decision that the legislature then reversed. 503 U.S. at 191. The state tax cases discussed in this article generally reflect similar facts. *Romein* is discussed in more detail *supra* notes 281-301 and accompanying text.

466. See *supra* note 35 and accompanying text.

467. See *supra* note 182 and accompanying text.

it is inequitable.⁴⁶⁸ *Carlton* noted that taxpayers have no vested right in tax legislation and a judicial interpretation of such legislation confers no additional rights — other than with respect to a taxpayer that has prevailed in a final court case with respect to the tax years litigated.⁴⁶⁹

468. *See supra* notes 131-134 and accompanying text.

469. *See supra* notes 119, 213-217 and 402 and accompanying text.