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No. 85556-1

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

TESORO REFINING AND MARKETING COMPANY,

Respondent,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE

Petitioner.

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BRIEF OF AMICUS CURIAE COUNCIL ON STATE TAXATION

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I. INTRODUCTION

This case concerns Washington's use of retroactive legislation to look back 24 years and deprive a specific taxpayer of any post-deprivation remedy for disputing previously paid taxes on the eve of a ruling on its Motion for Summary Judgment. The retroactive amendments to RCW 82.04.433 violate due process under the standards established by the United States Supreme Court. This period of retroactivity is neither modest nor is there any rational legislative purpose for the retroactivity. To be sure, the retroactive period of 24 years is significantly longer than any ever allowed to stand by the United States Supreme Court. Moreover, the purported justification for enacting such retroactive legislation – presumably protecting the state treasury against legitimate claims for refunds of disputed taxes paid by Washington taxpayers – is a far cry from the U.S. Supreme Court's acceptance of such justification for legislation with a limited retroactive period of one to two years, as warranted by the necessary time for the legislative process and Congress' customary practice of sometimes correcting its acts.

II. IDENTITY AND INTEREST OF AMICUS

COST is a non-profit trade association formed in 1969 to promote equitable and nondiscriminatory state and local taxation of multi-jurisdictional business entities. COST represents nearly 600 of the largest multistate businesses in the United States—companies from every industry doing business in every state. COST has participated as amicus curiae in many of the United States Supreme Court's significant cases over the past 20 years involving remedies and retroactive state taxes, including *Newsweek, Inc. v. Florida Department of Revenue*, 522 U.S. 442, 118 S.Ct. 904, 139 L.Ed.2d 888 (1998); *Reich v. Collins*, 513 U.S. 106, 115 S.Ct. 547, 130 L.Ed.2d 454 (1994); and *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18, 110 S.Ct. 2238, 110 L.Ed.2d 17 (1990). COST has also appeared as amicus curiae before this Court (*e.g.*, *Texaco Refining and Marketing Co. v. Department of Revenue*, 158 Wn.2d 1012, 145 P.3d 1214 (2006) (denying review of 131 Wn.App. 385, 127 P.3d 771 (2006))).

COST asks this Court to uphold the decision of the Court of Appeals, especially to the extent that the Court of Appeals held that the retroactive statute at issue violated the Due Process Clause. The retroactive imposition of tax is one of the most oppressive tax realities facing taxpayers today. That is particularly true for businesses, such as COST's members, that operate in several states. When deciding to undertake or expand operations, hire employees or make capital investments, businesses depend on the stability and certainty of applicable tax laws. For a government to ask taxpayers to voluntarily comply with a set of rules, and then retroactively change the rules long after the tax period is closed, flies in the face of common sense, good government, and most importantly, the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

This case concerns whether a 2009 amendment to RCW 82.04.433 may act retroactively over a 24 year period in order to prevent the taxpayer (Tesoro) from receiving a refund of Business and Occupation (B&O) taxes paid on manufacturing bunker fuel. Former RCW 82.04.433(1) provided:

> In computing tax there may be deducted from the measure of tax amounts derived from sales of fuel for consumption outside the territorial waters of the United States, by vessels used primarily in foreign commerce.

The day before the trial court was to hear arguments on the taxpayer's Motion for Summary Judgment, the Governor signed into law an amendment to former RCW 82.04.433 that read:

> (1) In computing tax there may be deducted from the measure of tax imposed under RCW 82.04.250 [retailers] and 82.04.270 [wholesalers] amounts derived from sales of fuel for consumption outside the territorial waters of the United States, by vessels used primarily in foreign commerce.
>
> (2) The deduction in subsection (1) of this section does not apply with respect to the tax imposed under RCW 82.04.240 [manufacturers], whether the value of the

> fuel under that tax is measured by the gross proceeds derived from the sale thereof or otherwise under RCW 82.04.450 [retailers].

A retroactive change to a state statute of this magnitude seriously threatens the certainty and finality that underlie an effective functioning tax system. While the United States Supreme Court has held that retroactive application of tax laws may be constitutional in certain limited circumstances, a 24-year retroactive period is unprecedented and violates due process under any circumstance. The Court of Appeals' analysis effectively recognizes the due process constraints established by the U.S. Supreme Court.

Most COST members have been subjected to the application of some type of retroactive tax in the conduct of their trade or business. Both individually and collectively, COST members have been disadvantaged in their business operations and planning by the impermissible application of retroactive taxation. In this case, the Legislature passed tax legislation with retroactive periods significantly longer than those ever sanctioned by the United States Supreme Court.

COST believes that the Court of Appeals' correct interpretation and application of the constitutional standard below must be upheld to protect taxpayers' due process rights against similar retroactive legislation.

III. STATEMENT OF THE CASE

COST adopts the Statement of the Case set forth by Respondent in its Appellant's Opening Brief filed with the Court of Appeals. Appellant's Br. at 5 – 10.

IV. ARGUMENT

Washington and some other states have occasionally turned to retroactive tax legislation as a way to protect against budget gaps by changing the law for prior tax periods. Most often, the period of retroactivity is modest and supported by a permissible legislative purpose. But in limited instances, the retroactive application of tax legislation has been extended beyond any time period permitted by the Supreme Court—like the 24 years at issue here. Legislation altering the rules for such a long period cannot be justified even if the Legislature perceives the need to "prevent a potential ongoing estimated revenue loss."[1] If the Court of Appeals' decision is overturned, the rational legislative purpose test previously announced by the United States Supreme Court for determining whether the period of retroactivity violates due process would be rendered meaningless. New taxes could be imposed, deductions and exemptions could be rescinded, and refunds could be disallowed whenever the

[1] *Agency Fiscal Note to S.B. 6096 at 2.*

Legislature decided that the state needed revenue or could not afford to pay legitimate refunds.

The Fourteenth Amendment of the United States Constitution grants substantive protection against deprivation of life, liberty, or property without due process of law. U.S. Const. amend. XIV, § 1. The United States Supreme Court set the standard for determining whether the retroactive imposition of tax infringes upon due process in *Welch v. Henry,* 305 U.S. 134, 59 S. Ct. 121, 83 L. Ed. 87 (1938). According to *Welch,* 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.* at 147. More recently, the U.S. Supreme Court has also factored the notice and consequences to affected taxpayers into the determination whether the retroactive application of tax laws violates due process. *United States v. Hemme,* 476 U.S. 558, 106 S. Ct. 2071, 90 L. Ed. 2d 538 (1986). In that case, the Court stated that "one of the relevant circumstances is whether, without notice, a statute gives a different and more oppressive legal effect to conduct undertaken before enactment of the statute." *Id.* at 569.[2] Another relevant circumstance was that the

[2] The lack of notice, while relevant to the due process analysis under *Hemme*, is not dispositive. *United States v. Carlton,* 512 U.S. 26, 34, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994).

taxpayers were "no worse off than they would have been without the enactment" of the retroactive legislation. *Id.* at 570. The Washington Legislature's retroactive law change raises serious constitutional concerns under the standards set out in *Welch, Hemme* and similar cases.

Those concerns are even more evident under *United States v. Carlton,* 512 U.S. 26, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994), which is the most recent and influential case dealing with this issue. In *Carlton*, the Supreme Court articulated a two-part test to determine if retroactive tax legislation violates due process. First, the Court looked at whether the purpose of adopting the law was illegitimate, arbitrary, or based on an improper motive such as targeting taxpayers after deliberately inducing them to engage in a transaction. *Id.* at 32. Second, the Court looked at whether the period of retroactivity was modest. *Id.* at 32-33.

These tests, when applied to the Legislature's amendments of RCW 82.04.433 support the conclusion that the retroactive amendments violate due process. The Court of Appeals' interpretation of *Carlton* tightly conforms with the United States Supreme Court's application of the test in cases where legitimate reasons existed for imposing "short and limited periods" of retroactivity that were the result of the customary legislative process. *Carlton*, 512 U.S. at 33. Moreover, the period of retroactivity of RCW 82.04.433 far exceeds any period ever allowed by the United States Supreme Court.

A. The Rational Legislative Purposes Approved by the United States Supreme Court Do Not Justify a Retroactive Law Change Enacted Solely to Target a Specific Taxpayer by Eliminating Its Post-Payment Right to Dispute Tax Liability

The legislative purposes accepted by the United States Supreme Court for imposing retroactive tax legislation in other cases are not present in this case.

First, the U.S. Supreme Court has held that retroactivity can be justified if the legislative purpose of the enactment would have been undermined if not enacted with a short retroactive period. For example, in *Pension Benefit Guaranty Corp. v. R. A. Gray & Co*, 467 U.S. 717, 104 S. Ct. 2709, 81 L. Ed. 2d 601 (1984), Congress was concerned that employers, after learning that the liability for withdrawing from multi-employer pension plans would sharply increase under new legislation, would rush to withdraw from those plans prior to the effective date of the legislation. "Congress therefore utilized retroactive application of the statute to prevent employers from taking advantage of a lengthy legislative process and withdrawing while Congress debated necessary revisions in the statute." *Id.* at 731. In that case, the legislation would have been significantly less effective if employers were permitted to withdraw without liability before the legislation was passed, since the legislation was specifically designed to discourage withdrawal by imposing a harsher liability for doing so. *Id.* at 730-731. The legislation's effective date was "chosen so that it would encompass only that retroactive time period that Congress believed would be necessary to accomplish its purposes." *Id.* at 731.

In comparison, RCW 82.04.433 retroactively deprived Tesoro and other taxpayers of the ability to dispute liabilities for previously paid taxes. The Due Process Clause requires a "clear and certain remedy" that provides a meaningful opportunity to contest an erroneously or unlawfully collected tax. *McKesson Corp v. Div of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 39, 110 S. Ct. 2238, 110 L. Ed. 2d 17 (1990). Unlike *Pension Benefit*, there was no legitimate concern that the effectiveness of the B&O tax amendment would be undermined by changing the structure of their transactions in anticipation of pending legislative changes. Rather, the Legislature specifically targeted a single taxpayer and denied it a constitutionally guaranteed judicial remedy. Increasing a pension plan's withdrawal liability for a short retroactive period stands in stark contrast to stripping a group of taxpayers – or, in this case, a single taxpayer – of the due process right to contest tax liabilities.

Second, the U.S. Supreme Court has held that retroactivity can be justified on the basis of raising revenue in some contexts. For example, in holding that retroactive application of a federal estate tax amendment did not violate due process, the Supreme Court emphasized that "Congress' purpose in enacting the amendment was neither illegitimate nor arbitrary. Congress acted to correct what it reasonably viewed as a mistake in the original 1986 provision that would have created a significant and unanticipated revenue loss." *Carlton*, 512 US at 32 (1994). The estate tax provision at issue in *Carlton*, 26 U.S.C. 2057(b), was enacted in October 1986 and allowed estates a "deduction for half the proceeds of 'any sale of employer securities by the executor of an estate' to 'an employee stock ownership plan.'" *Id.* at 28. Congress enacted a retroactive amendment in December 1987, which limited the deduction to a certain group of decedents – those that owned the stock immediately before their death. The legislative history expressed Congress's concern that, unless amended, "taxpayers could qualify for the deductions by engaging in essentially sham transactions." *Id.* at 32. This led the Court to uphold the curative amendment with a short retroactive period, which allowed Congress to implement the legislation as originally planned. *Id.*

While *Carlton* accepted raising revenue as a rational legislative purpose, the Court did not hold that such a purpose entitled a state to enact any sort of retroactive tax legislation. The rational legislative purpose requirement would have no meaning if the desire to "prevent a potential ongoing estimated revenue loss" was sufficient by itself to satisfy due process.

The fact that raising revenue is a rational purpose that can justify retroactivity in certain cases does not mean that it justifies retroactivity in all cases. In this case, the Legislature sought to prevent revenue loss through a retroactive denial of the statutory judicial remedy for a small and specific group of taxpayers. The Legislature did not correct its own drafting mistake as in *Carlton* or try to protect revenues during the legislative process or transitional phase as in *Hemme* or *Pension Benefits*.

B. The 24-Year Period of Retroactivity Greatly Exceeds the Modest Periods of Retroactivity Previously Permitted by the United States Supreme Court.

What the United States Supreme Court referred to in *Carlton* as a "modest period of retroactivity" has never encompassed a change in tax law looking back 24 years. A review of the Supreme Court cases makes it clear that retroactive tax legislation cannot reach back 24 years as done in the amendments to RCW 82.04.433. *Carlton* upheld an amendment that "extended for a period of slightly greater than one year." 512 U.S. at 33. *Pension Benefit* upheld retroactive tax legislation reaching back "five months before the statute was enacted into law." 467 U.S. at 725. *Welch* upheld an amendment enacted in 1935 reaching back to the 1933 tax year.

305 U.S. at 141-142. Nothing in the Supreme Court's allowance of brief periods of retroactivity supports Washington's 24-year reach in this case.

Welch and other cases justified the short and modest periods of retroactivity by the time required for the legislative process. The Court for decades has approved modest periods of retroactivity as justified by the practicalities of producing legislation. See, *e.g.*, *United States v. Darusmont*, 449 U.S. 292, 297, 101 S. Ct. 549, 66 L. Ed. 2d 513 (1981). Specifically, the Court has permitted short retroactive periods based on the premise that the customary congressional practice is to pass legislation "to tax retroactively income or profits received during the year of the session in which the taxing statute is enacted, and in some instances during the year of the preceding session." *Welch, supra*, 305 U.S. at 148. These cases provide no support since the Washington legislature cannot justify a 24-year retroactive period by the "practicalities" of producing legislation.

C. Washington's Change in Its Law to Retroactively Deny Valid Tax Refunds Is an Unconstitutional "Bait and Switch" Tactic.

Washington's tax system, similar to the tax systems of other states, allows taxpayers to petition for a refund and requires the Department of Revenue to pay a refund if the taxes were erroneously collected. In other words, Washington provides taxpayers with a post-deprivation remedy when B&O taxes are overpaid so long as the refund was requested within the prescribed time. The Taxpayer exercised its statutory remedy in this instance.

In 2009, however, the day before the taxpayer was set to support its claim for refund in court, the Governor signed the bill amending to RCW 82.04.433. The legislation was made retroactive with the purpose of denying post-deprivation relief to those taxpayers that had legitimate claims for refunds. *See* Agency Fiscal Note to S.B. 6096, at 2.

The United States Supreme Court has previously held this type of legislative change violates the Due Process Clause. *Reich v. Collins*, 513 U.S. 106, 115 S. Ct. 547, 130 L. Ed. 2d 454 (1994). In *Reich*, the Court stated:

> However, what a State may *not* do, and what Georgia did here, is to reconfigure its scheme, unfairly, in *midcourse* – to "bait and switch," as some have described it. Specifically, in the mid-1980's, Georgia held out what plainly appeared to be a "clear and certain" postdeprivation remedy, in the form of its tax refund statute, and then declared, only after Reich and others had paid the disputed taxes, that no such remedy exists. In this regard, the Georgia Supreme Court's reliance on Georgia's predeprivation procedures was entirely beside the point (and thus error), because even assuming the constitutional adequacy of these procedures – an issue on which we express no view – no reasonable taxpayer would have thought that they represented, in light of the apparent

> applicability of the refund statute, the *exclusive* remedy for unlawful taxes.

Id. at 111.

Similar to *Reich*, the Legislature has taken away all post-deprivation relief by denying taxpayers any ability to seek or obtain refunds of taxes that were erroneously paid. The taxpayer in this case had the clear right to seek its refund until the Legislature changed the rules of the game midcourse. The Legislature's attempt at a midcourse deprivation of the taxpayer's rights violates the Due Process Clause.

V. CONCLUSION

For the foregoing reasons, COST respectfully urges the Court to affirm the decision of the Court of Appeals.

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