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No. 14-1436

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

MICHAEL HAMBLETON, IN HIS CAPACITY AS SUCCESSOR PERSONAL REPRESENTATIVE OF THE ESTATE OF HELEN M. HAMBLETON, ET AL.,

Petitioners,

v.

STATE OF WASHINGTON,

Respondent.

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

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Under the Due Process Clause, a law enlarging tax liability may be applied retroactively only insofar as it rationally furthers a legitimate legislative objective. *See, e.g., United States v. Carlton*, 512 U.S. 26, 30-31 (1994). Applying that test, this Court has never endorsed a retroactive period of more than a year or two—that is, a period covering the year preceding the legislative session in which the law was enacted—as a rational means of furthering revenue goals or correcting asserted legislative mistakes in drafting tax laws. In the only case it has heard involving a longer period (twelve years), this Court invalidated the law. *Nichols v. Coolidge*, 274 U.S. 531, 542-43 (1927).

The question presented is whether, or under what circumstances, imposing additional tax beyond the year preceding the legislative session in which the law was enacted violates due process.

PARTIES TO THE PROCEEDING

In addition to the parties on the cover, there are two other petitioners: Thomas H. Macbride III and Philip C. Macbride, in their capacities as personal representatives of the Estate of Jessie Campbell Macbride.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Michael Hambleton ("Hambleton"), in his capacity as successor personal representative of the Estate of Helen M. Hambleton (the "Hambleton Estate"), and Thomas H. Macbride III and Philip C. Macbride ("Macbrides"), in their capacities as personal representatives of the Estate of Jessie Campbell Macbride (the "Macbride Estate"), respectfully petition for a writ of certiorari to review the judgment of the Washington Supreme Court.

OPINIONS BELOW

The opinion of the Washington Supreme Court is reported at 335 P.3d 398 and is reproduced at Pet. App. 1a-37a. The Washington Supreme Court's denial of the Macbrides' petition for reconsideration is unpublished and is reproduced at Pet. App. 38a-39a. The relevant orders of the state trial courts are unpublished and are reproduced at Pet. App. 40a-42a (Hambleton) and at Pet. App. 43a-49a (Macbrides).

JURISDICTION

The Washington Supreme Court issued its decision on October 2, 2014. The Washington Supreme Court denied the Macbrides' timely petition for reconsideration on January 9, 2015. On March 31, 2015, Justice Kennedy extended the time for filing a petition for a writ of certiorari to and including June 8, 2015. *See* No. 14A1012. This Court has jurisdiction under 28 U.S.C. § 1257(a).

RELEVANT CONSTITUTIONAL AND STATUTORY PROVISIONS

The Due Process Clause of the Fourteenth Amendment to the U.S. Constitution provides: "[N]or

shall any state deprive any person of life, liberty, or property, without due process of law."

The relevant statutory provisions of Washington law are reproduced at Pet. App. 50a-58a.

INTRODUCTION

Helen Hambleton died in 2006, and Jessie Macbride died in 2007. Each was the passive lifetime beneficiary of a trust established in her deceased husband's estate, and neither possessed a power under the trust instrument to dispose of the trust assets. Under the Washington estate tax law in effect at the time of their deaths, the tax did not apply to the value of those trust assets. In 2013, however, the Washington Legislature amended the estate tax statutes retroactively back to 2005, exposing their estates to nearly two million dollars of back taxes.

This Court has never decided whether the Constitution permits a legislature to upend financial planning and expectations of repose in this manner. This Court has held that legislatures may make tax laws retroactive by matters of months, in order to correct mistakes in drafting and to provide uniform rules over a tax year. *See, e.g., United States v. Carlton*, 512 U.S. 26 (1994). But this Court has never approved a retroactivity period of more than a year or two, and Justice O'Connor opined last time the Court confronted the subject that "[a] period of retroactivity longer than the year preceding the legislative session in which the law was enacted would raise, in my view, serious constitutional questions." *Id.* at 38 (O'Connor, J., concurring in the judgment).

Over the twenty years since the *Carlton* case, conflict and confusion have emerged over the issue that Justice O'Connor highlighted. The Washington Supreme Court held here that an *eight-year* retroactive expansion of a tax comported with the Due Process Clause. Pet. App. 19a-24a. In doing so, the Washington Court found support in case law from other jurisdictions. But it also broke from the holdings of courts of last resort in two other states, which have held that retroactivity periods over one year exceed the limits of due process. *See James Square Assocs. LP v. Mullen*, 993 N.E.2d 374, 382-83 (N.Y. 2013) (retroactivity period between 16 and 32 months is "excessive"); *Rivers v. State*, 490 S.E.2d 261, 265 (S.C. 1997) (retroactivity period between two and three years is "simply excessive"). Meanwhile, the Congressional Research Service is currently advising Congress that the period for a valid retroactive change in tax law is "not clear." Cong. Research Serv., R42791 CRS, *Constitutionality of Retroactive Tax Legislation* 3 (2012).

Resolving the uncertainty over the permissible length of retroactivity periods for tax laws is critical to settle expectations for taxpayers, tax agencies, and legislators alike. Individual and business taxpayers need to know whether they can count on legislative tax schemes to provide a relatively stable background for transactions arising in family or business planning. They also need to understand whether the exercise of other privileges in the reasonably distant past will be taxed in accordance with the law existing at that time. Legislators and agencies similarly need guidance concerning the limitations on applying their tax power retroactively in order to responsibly

forecast government revenues and establish budget priorities and tax policy.

Only this Court can provide that guidance. And this Court should take this opportunity to provide it.

STATEMENT OF THE CASE

1. This case arises from the financial planning of two married couples: Thomas and Jessie Macbride, and Floyd and Helen Hambleton. While married, both couples arranged various property dispositions to occur upon their respective deaths. One step they took was to create trusts for the benefit of the surviving spouses. In particular, one spouse created a trust for the lifetime benefit of the surviving spouse, with no power to dispose of trust assets, and with a remainder interest for the children.

Thomas Macbride died on October 20, 1999, and Floyd Hambleton died on April 13, 2005. Pet. App. 8a-9a. Upon their deaths, their estates elected to treat some or all of the assets in the trust as "qualified terminable interest property" ("QTIP") for federal estate tax purposes under 26 U.S.C. § 2056(b)(7). "The advantage of QTIP trusts is that no [federal] estate tax is paid on the death of the first spouse; the property is taxed only upon the death of the surviving spouse." Pet. App. 2a. And at the time these elections were made, Washington state law imposed no tax upon the death of the first spouse either.[1]

[1] When Thomas Macbride died, Washington had no independent estate tax. Instead, state law simply captured a portion of the federal estate tax liability. *See Estate of*

2. Effective May 17, 2005, Washington enacted the Estate and Transfer Tax Act—a new, "stand-alone state estate tax" that was intended to operate independently of federal law. Act of May 17, 2005, ch. 516, 2005 Wash. Sess. Laws 2496 (codified at Wash. Rev. Code §§ 83.100.010-.906); Pet. App. 3a; *see also In re Estate of Bracken*, 290 P.3d 99, 114 (Wash. 2012) (Madsen, C.J., concurring and dissenting). "The 2005 Act imposed a tax on 'every transfer of property located in Washington' and applied prospectively" only. Pet. App. 4a-5a (quoting § 3(1), 2005 Wash. Sess. Laws at 2497 and citing § 20, 2005 Wash. Sess. Laws at 2508).

When the Washington Department of Revenue ("DOR") first wrote regulations to implement the new estate tax, the regulations excluded trust property from Washington estates where, as here, a federal QTIP election had been made prior to May 17, 2005. *See Bracken*, 290 P.3d at 110. Under the regulations, the only "transfer" that ever occurred with respect to

Hemphill v. Wash. Dep't of Revenue, 105 P.3d 391, 394 (Wash. 2005). This state-law "pickup tax" did not operate as a separate tax, but instead was "administered complementary to federal law to guarantee that a separate state tax [did] not burden estates." *Id.* (citing *Estate of Turner v. Wash. Dep't of Revenue*, 724 P.2d 1013, 1015-16 (Wash. 1986)).

In 2001, Congress phased out the federal credit program with full termination effective December 31, 2004. *See id.* at 393 (citing Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16, 115 Stat. 38). As a result, from January 1, 2005 to May 17, 2005, during which Mr. Hambleton died, Washington had no estate tax in effect at all. Pet. App. 8a; *Bracken*, 290 P.3d at 103; *id.* at 114 n.7 (Madsen, C.J., concurring and dissenting).

such property as a matter of state law was the initial creation of the QTIP trust, which at once gave the surviving spouse a life interest in the income or use of the trust property and a remainder interest to the children (or other beneficiaries). *See id.* at 110-11.

3. In 2006 and 2007, Mrs. Hambleton and Mrs. Macbride died. Consistent with the DOR regulations, the Hambleton Estate excluded any QTIP assets from the Washington taxable estate on its tax return. Pet. App. 9a. The Macbride Estate likewise took the position that it had no liability for estate tax on the value of QTIP assets. Pet. App. 9a-10a.

"DOR thereafter changed its position." *Bracken*, 290 P.3d at 108. Under DOR's new interpretation of the 2005 law, QTIP assets could *not* be excluded from the Washington taxable estate on the theory that they were, in fact, "transferred" upon the deaths of surviving spouses.

Petitioners, along with other estates in Washington, disputed DOR's attempts to collect money under its new interpretation, and the issue ultimately landed in the Washington Supreme Court. In *Bracken*, the Washington Supreme Court unanimously agreed with petitioners' view of state law. That is, the Washington Supreme Court held that the 2005 state law did not allow taxation of property that was designated under federal law before May 17, 2005 as QTIP trust property. Under the 2005 law, "the only 'transfer' occurred at the husbands' deaths when they created the QTIP trusts." Pet. App. 5a. (citing *Bracken*, 290 P.3d at 101). "Therefore, DOR exceeded its authority under the [2005] Act, which require[d] a transfer, by

creating regulations that allowed taxation of fictional transfers." *Id.* (citing *Bracken*, 290 P.3d at 101).

At about the same time, the Washington Supreme Court held that the State had failed to meet its constitutional obligation to provide funding for basic public education and retained jurisdiction of the case to monitor the State's education funding system in the future. *See McCleary v. State*, 269 P.3d 277 (Wash. 2012). Thus, within a space of weeks, the Washington Supreme Court construed state tax law in a manner that denied revenue to the State that the executive branch was trying to collect and held that the State needed to spend far more money on public education.

4. In 2013, in response to the Washington Supreme Court's *Bracken* decision (and with *McCleary* fresh on its mind), the Washington Legislature enacted the tax law at issue here. Claiming that it was "necessary to reinstate [its] intended meaning when it enacted the estate tax" and to "reaffirm[] its intent that the term 'transfer' as used in the Washington estate and transfer tax is to be given its broadest possible meaning," Act of June 13, 2013, ch. 2, § 1(5), 2013 Wash. Sess. Laws 2d Spec. Sess. 2072 (codified at Wash. Rev. Code §§ 83.100.010–.906), the Washington Legislature changed the definition of "Washington taxable estate" to include specifically "the value of any property included in the gross estate under section 2044 of the internal revenue code"—that is, QTIP assets under only a federal election. § 2, 2013 Wash. Sess. Laws 2d Spec. Sess. at 2074 (amending Wash. Rev. Code 83.100.020(14)). The Legislature made the change applicable "regardless of whether the decedent's

interest in such property was acquired before May 17, 2005"—the original effective date of the stand-alone estate tax. *Id.*

There is no evidence that the budgetary assumptions of the 2005 law contemplated taxing the value of QTIP assets in the context at issue here. *See* §§ 1-2, 2013 Wash. Sess. Laws 2d Spec. Sess. at 2072-75. Nor did the legislative statement of intent in the 2013 law claim that the revenue impact of *Bracken* was unexpected. *Id.* The Legislature nevertheless claimed in its statement accompanying the 2013 law that the law's eight-year retroactivity period was necessary because the *Bracken* decision:

> (a) [c]reate[d] an inequity never intended by the legislature because unmarried individuals did not enjoy any similar opportunities to avoid or greatly reduce their potential Washington estate tax liability; and (b) may create disparate treatment between QTIP property and other property transferred between spouses that is eligible for the marital deduction.

§ 1(4), 2013 Wash. Sess. Laws 2d Spec. Sess. at 2073. The retroactivity period would therefore purportedly "reinstate the legislature's intended meaning when it enacted the estate tax, restore parity between married couples and unmarried individuals, restore parity between QTIP property and other property eligible for the marital deduction, and prevent the adverse fiscal impacts of the *Bracken* decision." § 1(5), 2013 Wash. Sess. Laws 2d Spec. Sess. at 2073.

5. Petitioners' challenges to their estate taxes were working their way through the Washington court system while the Washington Supreme Court

decided *Bracken* and the Washington Legislature responded with the 2013 retroactive law. Pet. App. 9a-10a. The Washington Supreme Court ultimately allowed petitioners to challenge the legality of the 2013 law as applied to them. As is relevant here, petitioners argued that the retroactivity period that the 2013 law imposes upon them violates the Fourteenth Amendment's Due Process Clause.

The Washington Supreme Court rejected that argument, holding that the 2013 law "meets the rational basis standard" enunciated in this Court's precedents. *Id.* at 23a. In particular, the Court concluded that the law has a "legitimate purpose" of "[p]reventing unanticipated and significant fiscal shortfall" and is "rationally related to preventing the fiscal shortfall." *Id.* at 23a, 24a.

In reaching these conclusions, the Washington Supreme Court implicitly acknowledged that the period of retroactivity here is substantial. But it noted that it and the Ninth Circuit had previously upheld retroactivity periods "spanning more than seven years." *Id.* at 22a (citing *W.R. Grace & Co. v. Wash. Dep't of Revenue*, 973 P.2d 1011, 1013-14 (Wash. 1999), and *Mont. Rail Link, Inc. v. United States*, 76 F.3d 991, 993-94 (9th Cir. 1996)). The Court offered no response to the cases petitioners cited disallowing periods of more than a year or two.

6. The Macbrides filed a timely motion for reconsideration with the Washington Court, which was denied on January 9, 2015. *Id.* at 38a-39a.

REASONS FOR GRANTING THE WRIT

I. Courts Are Sharply Split Over the Due Process Limits on Retroactive Tax Laws.

In *Nichols v. Coolidge*, 274 U.S. 531 (1927), this Court held a 12-year retroactive imposition of an estate tax provision violated the Due Process Clause. More recently, in *United States v. Carlton*, 512 U.S. 26 (1994), the Court distinguished that holding from a situation in which a legislature imposes a "modest" or "limited" period of retroactivity that renders tax law consistent back to the previous legislative session. *Id.* at 32-34.

Courts are deeply divided over where the line is between those two situations. How long, in other words, may a retroactive revenue measure reach back before it violates the Due Process Clause? Two state courts of last resort have held that due process forbids periods of retroactivity that extend beyond the previous legislative session, whereas three such courts and the Ninth Circuit have held that longer periods of retroactivity are permissible.

1. In *James Square Assocs. LP v. Mullen*, 993 N.E.2d 374 (N.Y. 2013), the New York Court of Appeals held that a retroactive tax period of only 16 to 32 months "should be considered excessive." *Id.* at 382. The court recognized that the goals of the retroactive law were to stem abuses in an incentive program and "to increase tax receipts." *Id.* at 383. Stemming abuses could not change behavior retroactively, however, and "absent an unexpected loss of revenue, . . . [the] legislative purpose [of raising revenue] is insufficient to warrant retroactivity in a case where the other factors

militate against it." *Id.* The 16-to-32-month period was therefore "long enough in the present case so that plaintiffs gained a reasonable expectation that they would 'secure repose' in the existing tax scheme." *Id.* at 382 (citations and internal quotation marks omitted).

In *Rivers v. State*, 490 S.E.2d 261 (S.C. 1997), the South Carolina Supreme Court likewise held the retroactive period of "at least two years and possibly as long as three years" was "simply excessive." *Id.* at 265. The court noted that in *Carlton* this Court upheld a one-year period of retroactivity. *Id.* at 264-65. But, picking up on Justice O'Connor's concurrence in that case, the South Carolina Supreme Court explained that "[a]t some point, however, the government's interest in meeting its revenue requirements must yield to taxpayers' interest in finality regarding tax liabilities and credits." *Id.*; *see also Carlton*, 512 U.S. at 37-38 (O'Connor, J., concurring in the judgment) ("The governmental interest in revising the tax laws must at some point give way to the taxpayer's interest in finality and repose.").[2]

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[2] Other pre-*Carlton* cases have similarly invalidated retroactive tax increases for three-to-four-year periods where, just like the instant case, the State's highest court had interpreted a statute against the position of the tax agency and the legislature subsequently amended the statute to adopt the agency's position retroactively. *Comptroller of the Treasury of Md. v. Glenn L. Martin Co.*, 140 A.2d 288 (Md. 1958); *Lacidem Realty Corp. v. Graves*, 43 N.E.2d 440 (N.Y. 1942); *see also City of Modesto v. Nat'l Med, Inc.*, 128 Cal. App. 4th 518, 529 (2005)

2. In contrast, the Washington Supreme Court here joined other courts that have validated longer periods of retroactive change to protect state and local revenue bases.

In *Miller v. Johnson Controls, Inc.*, 296 S.W.3d 392 (Ky. 2009), *cert. denied*, 560 U.S. 935 (2010), the Kentucky Supreme Court upheld a retroactive amendment reaching back six to ten years. The amendment was enacted some three to four years after a court decision allowing corporate groups to file combined income tax reports and not just separate returns. *Id.* at 395-96. The length of the period was justified, in the court's view, because "the legislature had no means of knowing who would wish to combine their separate returns" in the years immediately following the court decision clarifying the meaning of the law and the legislature acted as soon as the scope of the "unanticipated revenue loss" became known. *Id.* at 400-01.

In *Zaber v. City of Dubuque*, 789 N.W. 2d 634 (Iowa 2010), the Iowa Supreme Court upheld a retroactive tax law that reached back five and one-half years before its enactment. Assuming that *Carlton* applied to a curative measure that ratified municipal authority, the Iowa Supreme Court held that the period was rationally related to the goal of

("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 (1974)).

protecting the financial stability of municipalities. *Id.* at 655.

In *Montana Rail Link, Inc. v. United States*, 76 F.3d 991 (9th Cir. 1996), the Ninth Circuit likewise rejected a due process challenge to a congressional prohibition of refunds for a six-year period after the statutory ambiguity arose. The Ninth Circuit held that the Due Process Clause permits a legislature to make a tax law retroactive for as long as it takes to cover a period of "ambigu[ity]" created by a poorly drafted statute and thereby to "prevent[] a loss of government revenue." *Id.* at 993-94.[3]

3. The confusion in the law with respect to the acceptable period of retroactivity has not escaped notice of commentators. A leading tax treatise, for example, notes that "the court decisions provide little concrete guidance." 1 Jerome Hellerstein et al., *State Taxation* ¶ 4.17[1][a][i] (3d ed. 2001–15 & Supp. 2015); *see also id.* at S4-34 to -37 (reviewing the contrasting court approaches in recent cases).

[3] A number of intermediate appellate courts have issued similar decisions, validating the withdrawal of refund claims for remote periods when the claims were filed only after a court decision changed the common understanding of the law or a court decision or a new statute raised new consciousness of an ambiguity under prior law. These decisions include *General Motors Corp. v. Michigan Department of Treasury*, 803 N.W.2d 698 (Mich. App. 2010), *cert. denied*, 132 S. Ct. 1143 (2012) (five years); *GMAC LLC v. Michigan Department of Treasury*, 781 N.W.2d 310 (Mich. Ct. App. 2009) (seven years); *Atlantic Richfield Co. v. Oregon Department of Revenue*, 14 Or. Tax 212 (1997), *aff'd per curiam*, 958 P.2d 840 (Or. 1998) (eight years).

Furthermore, in a recent report for Congress, the Congressional Research Service assessed potential due process limitations on tax legislation. The report explained that "[t]he most common potential concern with respect to substantive due process is the length of the retroactivity." Cong. Research Serv., R42791 CRS, *Constitutionality of Retroactive Tax Legislation* 2 (2012). To illustrate the point, the report contrasted this Court's opinions upholding short periods of retroactivity (one to two years) in *Carlton*, *United States v. Darusmont*, 449 U.S. 292 (1981), *Welch v. Henry*, 305 U.S. 134 (1938), and *Milliken v. United States*, 283 U.S. 15 (1931), with the decision in *Nichols* invalidating a 12-year retroactive period. *Id.* at 2-3. Noting that *Carlton* "unfavorably compared the 12-year period with periods where the 'retroactive effect is limited,'" the authors concluded:

> This suggests that due process concerns are raised by an extended period of retroactivity. However, *it is not clear* how long a period might be constitutionally problematic. The Court has recognized retroactive liability for periods beyond one or two years in non-taxation contexts, but *it is not clear* how a similar situation arising under the tax laws would be addressed.

Id. at 3 (emphasis added) (footnote omitted).

Practitioners, too, note the inconsistency of the decisions and the unpredictability of litigating the issue.

> In the years following *Carlton*, courts across the nation have come to various conclusions when understanding and applying the Supreme Court's decision. This has led courts to approve statutes with a retroactive effect of up to 10 years, and to strike down statutes with a retroactive effect of approximately 16 months.

Retroactivity Revisited: Has Anything Changed?, 2015 Tax Mgmt. Wkly. St. Tax Rep. (BNA) 3, at 3 (Apr. 17, 2015), *available at* http://www.bna.com/uploadedFiles/BNA_V2/Tax/Knowledge_Center/Blogs/SALT_Talk/SALT_Talk/Insight_Article_4_17_15.pdf (footnotes omitted) (citing *Miller v. Johnson Controls, Inc.*, 296 S.W.3d 392 (Ky. 2009), and *James Square Assocs. LP v. Mullen*, 993 N.E.2d 374 (N.Y. 2013)). The authors conclude:

> Twenty years after *Carlton*, it seems more questions than answers remain on the constitutionality of retroactive tax legislation. . . . In the midst of all the confusion, taxpayers are left to wonder whether these differences can be explained. Perhaps, by the time another article is written on this subject, the U.S. Supreme Court will have offered some guidance in this murky area of the law.

Id. at 8-9.

II. The Question Presented Is Important And Should Be Resolved Now.

For two overarching reasons, there is a pressing need for this Court to resolve the conflict over the extent to which states (or Congress) may impose higher taxes retroactively. First, permitting longer retroactive tax increases encourages political gamesmanship at the expense of proactive budgeting and of taxpayer repose. Second, retroactive changes

in state tax laws are currently in dispute in numerous important cases around the country, for which guidance is needed.

1. Accurate and efficient governmental budgeting depends on healthy and open dialogue between the executive and legislative branches about realistic revenue expectations based on existing law. Yet the trend in cases such as this to allow long periods of retroactivity encourages the executive branch to obscure or ignore legal threats to the revenue base that arise from ambiguous or otherwise poorly drafted tax laws. Under the Washington Supreme Court's reasoning, the "fiscal train wreck" that the executive's silence later causes always provides an excuse for making the retroactive changes to the laws in question.

The Washington political branches are the poster children for selective communications that lead to late resolution of asserted legislative mistakes. For example, in *Tesoro Refining & Marketing Co. v. Washington Department of Revenue*, 246 P.3d 211 (Wash. Ct. App. 2010), *rev'd on other grounds*, 269 P.3d 1013 (Wash. 2012), an oil refiner sought a refund of Washington's business and occupation tax under a certain deduction. One day before the summary judgment hearing, the governor signed an amendment expressly limiting the deduction retroactively to 1985, when the deduction was originally enacted. *Tesoro Ref. & Mktg. Co. v. Wash. Dep't of Revenue*, 269 P.3d 1013, 1015 (Wash. 2012) (citing Act of May 14, 2009, ch. 494, § 4, 2009 Wash. Sess. Laws 2641). The appellate court held that the amendment violated due process because of the lengthy period, but the Washington Supreme Court

held the deduction was not available under the original law, thereby avoiding the due process retroactivity issue. *Id.* at 1015-16.

By contrast, in the estate tax controversy that led to the retroactive amendment here, the DOR advised the Washington Governor's office that there was no need for emergency legislation. The DOR instead continued to litigate its position on the issue against dozens of estates, inconsistently with its own regulation, until its unanimous loss in the Washington Supreme Court in *Bracken*. At that point, the DOR informed the Washington Legislature that it had an opportunity to collect $118 million through a retroactive amendment adopting the DOR's interpretation. Pet. App. 23a.

The dynamic of failed-litigation-followed-by-retroactive-amendment transpired in another Washington case as well. In *Dot Foods, Inc. v. Washington Department of Revenue,* 215 P.3d 185 (Wash. 2009), a taxpayer disputed DOR's assertion that it was ineligible for an exemption. Years later, the Washington Supreme Court held that the exemption unambiguously applied to the taxpayer. *Id.* at 191-92. The DOR then requested and obtained from the Legislature an amendment to prevent "large and devastating revenue losses," retroactive to the original enactment of the exemption, disallowing the exemption for taxpayers in Dot Foods' position. Act of Apr. 23, 2010, ch. 23, §§ 401, 402, 1704, 2010 Wash. Sess. Laws 1st Spec. Sess. 2574.

Clear and meaningful due process restrictions on retroactive tax legislation can help avoid these "fiscal train wrecks" and help fiscal agencies fulfill their legal responsibilities to provide accurate revenue

forecasts. The Washington Legislature, as in other states, is required to "enact a balanced omnibus operating appropriations bill" in each biennium "that leaves, in total, a positive ending fund balance in the general fund and related funds," and the spending must not exceed "the available fiscal resources for the next ensuing fiscal biennium." Wash. Rev. Code 43.88.055(1)(a)-(b). Such budgeting is not necessarily a straitjacket under the state laws. But it should not depend on the political branches' bait-and-switch tactics in litigating a tax controversy for many years and then, after the taxpayers' position is upheld, pulling the rug out from under taxpayers retroactively.

2. Numerous other disputes are currently churning through state courts concerning the permissible length of time for a retroactive increase in tax revenues. Providing guidance now will bring order to this litigation and stave off further injustices.

For example, in New York, an appeal by the State from *Caprio v. New York State Department of Taxation & Finance*, 987 N.Y.S.2d 4 (N.Y. App. Div. 2014), is pending under New York Court of Appeals No. APL-2014-00177 (N.Y. argued June 4, 2015). The amendment in question retroactively imposed tax on gains realized by nonresidents on the sale of stock of corporations' doing business in New York. The intermediate appellate court held that the 43-month period of retroactivity was excessive in light of the New York Court of Appeals' *James Square* decision. *Id.* at 10.

In Michigan, an important retroactivity dispute has arisen following the Michigan Supreme Court's

decision in *International Business Machines Corp. v. Michigan Department of Treasury*, 852 N.W.2d 865 (Mich. 2014). In that case, the Michigan Supreme Court held that Michigan's enactment of the Multistate Tax Compact ("MTC") permitted corporate taxpayers to use the standard three-factor formula for apportioning interstate income notwithstanding a different formula applicable under the state's business tax statutes. The Michigan Legislature then retroactively repealed its MTC apportionment statutes back through 2008 (six-plus years). Act of Sep. 11, 2014, No. 282, 2014 Mich. Pub. Acts 139. The Michigan Court of Claims has endorsed the retroactive repeal in numerous cases, the leading opinions being *Yaskawa America, Inc. v. Michigan Department of Treasury*, No. 11-000077-MT (Mich. Ct. Cl. Dec. 19, 2014), and *Ingram Micro Inc. v. Michigan Department of Treasury*, No. 11-000035-MT (Mich. Ct. Cl. Dec. 19, 2014). The cases are on appeal. *See Yaskawa America, Inc. v. Mich. Dep't of Treasury*, No. 325475 (Mich. Ct. App. appeal docketed Jan. 8, 2015); *Ingram Micro Inc. v. Mich. Dep't of Treasury*, No. 325507 (Mich. Ct. App. appeal docketed Jan. 9, 2015).

Likewise, in the *IBM* case itself, the Michigan Court of Claims recently ruled that the retroactive repeal of the MTC applied to IBM, even though IBM had prevailed at the state supreme court before the law was repealed. *See Int'l Bus. Machs. Corp. v. Mich. Dep't of Treasury*, No. 11-000033-MT (Mich. Ct. Cl. Apr. 28, 2015). IBM has appealed this decision as well. *Int'l Bus. Machs. Corp. v. Mich. Dep't of Treasury*, No. 327359 (Mich. Ct. App. appeal docketed May 13, 2015).

These and other latent disputes exemplify the need for prompt guidance. Are the New York and South Carolina high courts correct that merely increasing public revenues from a source not previously taxed does not self-justify a period of retroactivity long enough to supply the desired additional revenue amount, or is Washington Supreme Court's permissive approach the correct one?

III. This Case Is An Ideal Vehicle For This Court To Resolve The Issue.

For two reasons, this case affords this Court a particularly suitable opportunity to resolve the question presented.

1. The extremely long retroactivity period at issue cleanly presents the question whether there are any genuine temporal limits on a legislature's ability to reach back to tax events and transactions, not previously subject to tax, simply in order to secure current revenues. The law at issue here reaches back eight years, and the retroactivity period in this case (depending on exactly how one measures it) is at least *seven years* for one petitioner and *six years* for the others. If, as Justice Scalia asserted in his separate opinion in *Carlton*, "any law that retroactively adds a tax, removes a deduction, or increases a rate rationally furthers th[e] goal" of "[r]evenue raising," 512 U.S. at 40 (Scalia, J., concurring in the judgment), then there is nothing wrong with Washington's law. But if, as Justice O'Connor opined in that case, "[t]he governmental interest in revising the tax laws must at some point give way to the taxpayer's interest in finality and repose," *id.* at 37-38 (O'Connor, J., concurring in the

judgment), then it is readily apparent that the retroactive amendment in this case crosses that line.

2. The question presented also is outcome-determinative here. The New York Court of Appeals has held that "raising money for the state budget is not a particularly compelling justification. Absent an *unexpected* loss of revenue, such a legislative purpose is insufficient to warrant retroactivity in a case where the other factors militate against it." *James Square Assocs. LP v. Mullen*, 993 N.E.2d 374, 383 (N.Y. 2013) (emphasis added). Given that here, as in the New York and South Carolina cases, the inability of prior law to tax the assets at issue cannot be called "unexpected," the New York as well as the South Carolina courts would have ruled against the Washington DOR. Accordingly, the validity of petitioners' claim that retroactive imposition of tax on a new kind of "transfer" violated due process turns squarely and exclusively on which side of the conflict at issue is correct.

IV. The Washington Supreme Court's Holding Is Incorrect.

The Washington Court's holding drains *Carlton*'s "rational means" test of any vitality. Legislatures may quickly correct mistakes in tax laws and make those corrections effective back to the preceding legislative session. But legislatures may not saddle taxpayers with retroactive liability years after the fact—particularly where, as here, the financial shortfall the amendment seeks to address was not a surprise to the State.

1. The high water mark in this Court in terms of permitting a retroactive tax increase is *Welch v.*

Henry, 305 U.S. 134 (1938). In that case, this Court upheld a two-year period of retroactivity because the amended law applied no more than to "the year of the legislative session preceding that of its enactment." *Id.* at 150. Similarly, this Court in *United States v. Carlton*, 512 U.S. 26 (1994), upheld a period of retroactivity of about a year. This Court emphasized the prompt discovery of the drafting error of the original law, which was proven by legislative history and the original estimate of the revenue costs of the provision in question. *See id.* at 31-32. "Congress acted to correct what it reasonably viewed as a mistake in the original [statute] that would have created a significant and unanticipated revenue loss." *Id.* at 32.

On the other hand, *Carlton* declined to disturb the holding in *Nichols v. Coolidge*, 274 U.S. 531 (1927), in which this Court invalidated "a novel development in the estate tax which embraced a transfer that occurred 12 years earlier." *Carlton*, 512 U.S. at 34. This Court contrasted the 12-year period in that case with the "modest" retroactivity period in *Carlton*, explaining that the latter was permissible because "its period of retroactive effect is limited." *Id.* at 32, 34.

The Washington Supreme Court made feints at trying to fit its analysis into the *Carlton* framework. For instance, the Washington Supreme Court cited *Carlton*'s statement about preventing unanticipated and significant revenue losses as a recognized legitimate purpose. Pet. App. 24a. But there is nothing in the legislative history of the original 2005 law remotely suggesting that the value of the trust assets subject to federal QTIP elections made before

2005 had been built into the State's revenue forecasts. To the contrary, the various lawsuits like these that were consistent with the DOR's initial interpretation of Washington law put the State amply on notice that the law did not say what the DOR later claimed. At the very least, when the State, even then, chose not to amend state law, it forfeited any power to do so and allowed petitioners' reasonable expectations of repose (in the event they prevailed in their litigation) to take hold.

2. The Washington Supreme Court also reasoned that multi-year retroactivity periods are rational when they provide the "revenue increase" necessary to cover the shortfall from a prior law the legislature seeks to change. Pet. App. 23a-24a. In other words, the revenue increase from the chosen period always justifies the amendment, which in turn always justifies the chosen period. The retroactive period is self-justifying.

If this were the law, there would be no due process limitation on retroactive taxes. As the New York Court of Appeals put it, "[r]aising funds is the underlying purpose of taxation, and such a rationale would justify every retroactive tax law." *See James Square Assocs. LP v. Mullen*, 993 N.E.2d 374, 383 (N.Y. 2013). This, of course, is the view that Justice Scalia championed in his separate opinion in *Carlton.*

Yet the majority in *Carlton* rejected Justice Scalia's theory. Under the majority's rule, the Due Process Clause permits a law enlarging tax liability to be applied retroactively only insofar as it rationally furthers a legitimate legislative objective. *See Carlton*, 512 U.S. at 30-31. This restriction honors the federal tradition—the "customary congressional

practice"—of enacting general revenue statutes with modestly retroactive effective dates generally "confined to short and limited periods required by the practicalities of producing national legislation." *Id.* at 33 (quoting *United States v. Darusmont*, 449 U.S. 292, 296-97 (1981)) (internal quotation marks omitted). But it prohibits "[a] period of retroactivity longer than the year preceding the legislative session in which the law was enacted." *Id.* at 38 (O'Connor, J., concurring in the judgment). This rule controls here and forbids applying the retroactive state law against petitioners.

3. Finally, the Washington Supreme Court asserted that any period shorter than eight years would have been irrational, stating that another period "would allow some estates to escape the tax while similarly situated estates would be subject to it." Pet. App. 24a. Yet the court did not say which estates it conceived to be "similarly situated" or why or how they are. Nor is there any plausible argument to that effect that could be made.

If the Washington Supreme Court was suggesting that the estate of a person who died in 2006 is situated similarly to the estate of a person who died in 2012, such that imposing a retroactive tax on only the latter estate would have been irrational, this suggestion is baseless. It is elementary that the constitutional value of repose increases over time, Carlton, 512 U.S. at 37 (O'Connor, J., concurring in the judgment), such that estates of persons who died six years earlier have much stronger claims to be taxed according to the laws in effect at that time.

If, on the other hand, the Washington Supreme Court was alluding to the Washington Legislature's stated goal of achieving "parity" between married couples and unmarried individuals, *see* Pet. App. 23a, there is no reason why the retroactivity period at issue related to that goal. The opinion (like the legislative statement of intent in the session law, Pet. App. 51a) never explained what characteristics of parity existed or that might have been achieved by any retroactivity, let alone eight years of it.

* * *

Tax law demands clarity, not obfuscation. Yet the Washington Supreme Court's interpretation and application of the Due Process Clause's limits on retroactive legislation provide anything but clarity. This Court should grant certiorari to bring order and predictability to this area of law that is so critical to our economy.

CONCLUSION

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

Respectfully submitted,

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APPENDIX