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Retroactive Tax Laws Muddying Businesses' Future Decisions

By **Vidya Kauri**

Law360, New York (May 22, 2017, 9:36 PM EDT) -- The U.S. Supreme Court's refusal to review seven cases challenging the backdated application of amended state tax laws leaves businesses in the precarious position of not being able to confidently structure their operations based on either current statutes or earlier court victories.

The high court on Monday **declined** to review petitions from six companies — including IBM, Gillette and Skadden Arps Slate Meagher & Flom LLP — fighting Michigan's decision to retroactively modify its Business Tax Act in 2014 and shut down a three-year window the state Supreme Court had left open for eligible companies to receive a refund under an older formula for corporate franchise taxes.

In a **seventh similar case** out of Washington, food distributor Dot Foods Inc. was contesting the state's legislative action to narrow the list of out-of-state companies qualifying for a tax exemption, after the Washington Supreme Court had already declared that Dot Foods was entitled to the exemption.

The U.S. Supreme Court decided not to take up all seven petitions to review the constitutionality of the retroactive tax changes that were upheld by lower courts, and the high court's inaction on the issue is being criticized by experts as one that leaves the business community with several unanswered questions, such as the extent to which they can rely on earlier determinations from state taxing authorities and state court rulings, and if there is a limit to how far back states can retroactively amend their tax statutes.

According to Mardiros "Marty" Dakessian of Dakessian Law Ltd., the justices dropped the ball on offering clarity on a long-standing issue that has left businesses vulnerable to the "dangerous" possibility of states overturning court decisions through legislative action.

"Michigan has undermined the rule of law in their own state," Dakessian said. "In my opinion, by taking this sort of drastic measure, they have shaken the foundation of the judicial system and reasonable expectations on the part of taxpayers doing business in their state. This is very, very serious, and I thought the Supreme Court would look at it with the same level of gravity that I and others were looking at it."

The Dot Foods case is also particularly egregious, according to Jonathan Maddison, a state tax attorney with Reed Smith LLP, because the company had even received a letter ruling from the Washington Department of Revenue saying that it qualified for an exemption to the state's business and occupation taxes — three years before the revenue department went ahead and assessed the taxes anyway, and 12 years before the state Supreme Court weighed in.

"Taxpayers make decisions about how to organize, structure and operate their business according to what the law says today. When the law is retroactively changed, taxpayers who made a decision based on what the law apparently was are then punished for abiding by the law," Maddison said.

According to court documents, Michigan's retroactive tax change went back more than six years and Washington's retroactivity period could be as much as 27 years. The petitions before the Supreme Court relied on the high court's prior ruling in U.S. vs. Carlton, in which Justice Sandra Day O'Connor

wrote a concurring opinion to say that the majority decision upholding a retroactive law change was correct because it was for a "relatively short period" and that retroactivity beyond one year would be constitutionally suspect.

In Michigan, despite allegations the retroactive tax amendment violated the U.S. Constitution's contracts clause, due process clause and commerce clause, a split state Supreme Court ultimately blocked appeals from nearly 40 corporations last June. Justices Stephen Markman and David Viviano dissented to say that constitutional issues existed — such as whether the state's action was in line with federal and state protections for due process, and whether it impinged on the court's judicial powers after it had previously greenlighted businesses to take advantage of the old formula for calculating franchise taxes.

Even though the U.S. Supreme Court justices could have offered clarity to taxpayers on when retroactivity is permissible and for how long, Ronson Shamoun, principal attorney and CEO of RJS Law, said Monday's decision is consistent with how federal and state courts have viewed tax statutes.

"Across the country in federal and state courts, retroactive modifications to tax statutes have been ruled that they don't offend due process considerations so long as there is a legitimate legislative purpose that is furthered by a rational means," Shamoun said.

Tax practitioners and state revenue agencies have been closely watching the litigation over the backdated tax laws, and Dakessian said states should not take the U.S. Supreme Court's rejection of the petitions as a green light to "punish taxpayers retroactively."

"[They] should be guided by good tax policy and good conscience, which really means no retroactive application of laws in general," he said. "Businesses want predictability in the taxing system, and any degree of retroactivity undermines that."

Jamie Yesnowitz, a state and local tax principal at Grant Thornton LLP, said it is unfair when a taxpayer spends a significant amount of resources to get a positive verdict from the courts only to have that verdict completely overturned in the legislature.

"In any instance where a taxpayer is relying on a decision that's been made by a state supreme court ... the state should be bound by that decision," Yesnowitz said. "The Supreme Court needs to speak on these types of matters when there appears to be just a very inequitable result for taxpayers and the lack of guidance from the U.S. Supreme Court is going to make it, in my view, more likely for state legislatures and the executive branch to declare retroactivity on other taxpayer favorable cases."

--Editing by Philip Shea and Pamela Wilkinson.