No. 16-688

IN THE
Supreme Court of the United States

SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP,
Petitioner,

v.

MICHIGAN DEPARTMENT OF TREASURY,
Respondent.

On Petition For A Writ Of Certiorari To The Michigan Court of Appeals

REPLY BRIEF OF PETITIONER

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REPLY BRIEF

As Skadden explained in its Petition, Michigan's Public Act 282 ("PA 282") is brazen in scope and effect. It solves a $1.1 billion budget shortfall by targeting out-of-state businesses for the benefit of in-state businesses. It does so retroactively, imposing heightened tax liability for transactions executed up to six-and-one-half years before the law's enactment. And it effects a retroactive repeal of the Multistate Tax Compact ("Compact"), an agreement critical to ensuring fair and predictable taxation of the income of multistate businesses. With its far-reaching effects, PA 282 is an extreme example of the increasingly troubling trend of state laws that impose enormous retroactive tax liability on businesses. If left unchecked, states undoubtedly will follow the lead of Michigan, producing a race to the bottom in which states plug budgetary holes by reaching farther and farther back in time to retroactively increase the tax liability of disfavored out-of-state businesses—imperiling bedrock principles animating this Court's Commerce Clause and due process jurisprudence.

In the face of these important and recurring constitutional issues, the State relies principally on a jurisdictional head fake. According to the State, this Court lacks jurisdiction to review the judgment below because the Michigan Court of Appeals rested its decision on an adequate and independent state ground: that, even though PA 282 was enacted in 2014, it really should be considered as having been enacted in 2007 because it purported to express the original legislative intent behind a 2007 statute, the Business Tax Act ("BTA"). But the Michigan Court of Appeals nowhere mentioned—let alone rested its federal con-

stitutional holdings on—the State's creative argument raised in this Court. The determination whether a statute operates retroactively for purposes of the U.S. Constitution is, in any event, a federal question, and this Court's precedents require a functional analysis that looks to the retroactive effect of a law, rather than formal statements of the legislature. There is, in short, no jurisdictional barrier to this Court's review.

Shorn of jurisdictional artifice, the State's argument offers no meaningful response to the merits of Skadden's constitutional challenge to PA 282 and the Court of Appeals' decision upholding it. Nor can it. As established in the Petition, the Michigan Legislature's retroactive increase of the tax liability of disfavored out-of-state businesses violates the Commerce Clause, Due Process Clause, and Contract Clause. Review is needed to clarify and reaffirm this Court's precedents on these fundamental and recurring constitutional issues. This Petition presents the ideal vehicle to consider all of these issues, as it involves a clear, straightforward set of facts—a single taxpayer whose tax liability increased nearly 80,000% as a result of PA 282.

I. The Judgment Below Does Not Rest On An Adequate And Independent State Ground.

The State suggests that the Court has no jurisdiction to review any questions premised on the retroactivity of PA 282 because that statute supposedly "was not, under Michigan law, retroactive at all." Opp'n 16. The State's apparent theory is that the ruling below can be sustained on state-law grounds because, under Michigan law, PA 282 (enacted in 2014) must be treated as though it were enacted in

2007 because it "clarified" that the intent of the BTA (enacted in 2007) was to repeal the Compact's three-factor apportionment methodology. *Id.* at 16–17, 19.

The State's jurisdictional challenge fails for two fundamental reasons.

First, the Court of Appeals did not even mention the State's theory, much less rely on it when deciding the questions presented. To the contrary, the Court of Appeals anchored its due process analysis in federal law. Rather than reasoning, as the State does before this Court, that PA 282 satisfies due process because it is not actually retroactive, the Court of Appeals time and again noted the retroactive effect of the statute as uncontested. *See, e.g.*, App. 64a (explaining that PA 282 "retroactively eliminates a taxpayer's ability to elect a three-factor apportionment formula in calculating tax liability"); App. 59a, 67a. And for good reason. The Legislature itself expressly stated that the Compact "is repealed retroactively" through PA 282. PA 282, Enacting § 1.

Rather than applying state law and holding that PA 282 comports with due process because it was not actually retroactive, the Court of Appeals applied federal standards and held that the "retroactive impact of [PA 282] did not violate the due process clauses of either the state or federal constitutions." App. 82a; *see also* App. 76a–80a (setting forth federal due process standards and noting that "Michigan law is . . . in accord"). In particular, the Court interpreted the standard set forth in this Court's decision in *United States v. Carlton*, 512 U.S. 26 (1994), and held that "[t]he retroactive application of [PA 282] was . . . a rational means to further . . . legitimate [legislative] purposes." App. 84a.

In arguing to the contrary, the State relies heavily on the Court of Appeals' rejection of Skadden's challenge to PA 282 based on state-law separation-of-powers principles. *See* Opp'n 18. But even the Court of Appeals' discussion of this state-law challenge—irrelevant to this Petition—does not support the argument raised by the State here. The court simply noted that the Legislature has authority under state law to "retroactively correct the judiciary's misinterpretation of legislation." App. 88a, 91a n.10. It did not, as the State apparently posits, hold that such a retroactive correction does not really operate retroactively.[1]

Because the decision below "fairly appears to rest primarily on federal law," the Court has jurisdiction to review the questions presented. *See, e.g.*, *Michigan v. Long*, 463 U.S. 1032, 1040–41 (1983).

Second, even assuming that the Court of Appeals' decision as to retroactivity rests on state law—which it does not—this Court still would have jurisdiction to review the decision because federal law governs the retroactivity analysis for federal constitutional purposes. "The Supremacy Clause does not allow federal retroactivity doctrine to be supplanted by the invocation of a contrary approach to retroactivity under state law." *Harper v. Va. Dep't of Taxation*, 509

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[1] The State's suggestion that the Michigan Supreme Court's decision in *International Business Machines Corp. v. Department of Treasury*, 852 N.W.2d 865 (Mich. 2014), "retroactively gave out-of-state businesses a *new right*" is startling. Opp'n 16 (emphasis added). The court did not create a "new" right out of thin air. Rather, as the authoritative expositor of the meaning of Michigan law, it held that state law continued to give businesses the right to use the Compact's three-factor apportionment formula through and after enactment of the BTA.

U.S. 86, 100 (1993); *see also Stogner v. California*, 539 U.S. 607, 610–11 (2003) (applying federal standards to determine whether law "produce[d] the kind of retroactivity that the Constitution forbids" under the Ex Post Facto Clause). In the context of tax statutes, federal law requires looking to the "actual retroactive effect" of the statute. *Carlton*, 512 U.S. at 33; *see also, e.g.*, *Martin v. Hadix*, 527 U.S. 343, 357 (1999) ("The inquiry into whether a statute operates retroactively demands a commonsense, functional judgment about 'whether the new provision attaches new legal consequences to events completed before its enactment.'") (citation omitted). Because a court must apply federal standards when determining whether PA 282 operates retroactively in violation of the U.S. Constitution, any state-law basis for the Court of Appeals' decision would not constitute an adequate and independent ground "to support the judgment." *See Coleman v. Thompson*, 501 U.S. 722, 729 (1991).

II. The Court Should Consider Whether The Commerce Clause Permits States To Target Out-Of-State Taxpayers For The Imposition Of Substantial Retroactive Tax Liability.

Because it imposes over $1 billion of retroactive tax liability on disfavored out-of-state businesses while leaving in-state businesses unaffected, and because it was unambiguously motivated by protectionist purposes, PA 282 violates the Commerce Clause. *See Granholm v. Heald*, 544 U.S. 460, 472 (2005); *Amerada Hess Corp. v. Dir., Div. of Taxation, N.J. Dep't of Treasury*, 490 U.S. 66, 75 (1989); *see also* Pet. 18–26. The Court's review of this issue, moreover, is necessary to forestall states from pursu-

ing legislation that could jeopardize the free movement of goods and services in interstate commerce. Pet. 24–26.

The State responds to PA 282's textbook violation of the Commerce Clause by elevating form over substance and ignoring the severe retroactive effect of the statute. As an initial matter, the State argues that PA 282 does not discriminate against out-of-state businesses because "it *levels* the playing field so that out-of-state businesses are not receiving a tax advantage over in-state businesses." Opp'n 29; *see also id.* at 31. Of course, "the fact that the tax might have the advantage of appearing nondiscriminatory does not save it from invalidation." *Comptroller of Treasury of Md. v. Wynne*, 135 S. Ct. 1787, 1804–05 (2015). Far from "*level*[*ing*] the playing field," Opp'n 29, PA 282 was enacted for the sole purpose of ensuring that out-of-state businesses provided the $1.1 billion necessary to remedy the State's budgetary shortfall while favored in-state businesses faced no comparable burden. *See* Pet. 8–9, 21–22. The State does not dispute—nor can it—that the retroactive effect of PA 282 increases the tax liability only of out-of-state businesses, leaving in-state businesses untouched. PA 282 thus violates the Commerce Clause because it "rais[es] the costs of doing business" in the Michigan market for out-of-state companies, while "leaving those of their [Michigan] counterparts unaffected," *Hunt v. Wash. State Apple Advertising Comm'n*, 432 U.S. 333, 351 (1977), and because it has the "obvious effect" of "extend[ing] a financial advantage" to in-state businesses "at the expense of" out-of-state businesses, *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 331 (1977).

Not only that, PA 282 violates the Commerce Clause for the additional reason that it "has a discriminatory intent." *See Amerada*, 490 U.S. at 75. As the Petition explained, legislators supported PA 282 at least in part because they sought to eliminate the benefit that the Compact's three-factor apportionment methodology conferred on out-of-state taxpayers as compared to in-state taxpayers. Pet. 11–12. The State offers no response to this argument, which is an independent reason for granting review and holding that PA 282 violates the Commerce Clause.

In addition to focusing on formalism rather than the practical effect of PA 282, the State ignores the extraordinary defining feature of the statute: it imposes a ***retroactive*** increase of tax liability—covering a six-and-one-half-year period—and does so only on out-of-state businesses. For example, the State argues that finding a Commerce Clause violation here would "prevent[] States from taking corrective action when their law inadvertently *benefits* out-of-state businesses and burdens in-state benefits [sic]." Opp'n 32. Not so. Skadden's position is that a State may not ***retroactively*** impose "corrective action" in such a scenario. Skadden does not argue that a state is barred from taking ***prospective*** action to fix what the legislature perceives as a mistake in judicial interpretation of a statute. It is the retroactive imposition of increased tax liability on out-of-state businesses that serves as PA 282's telltale feature and poses fundamental and recurring

constitutional questions. *See* Pet. 24–26; Br. of Nat'l Ass'n of Mfrs. *et al.* 10–13.[2]

III. This Court Should Clarify The Due Process Limitations On The Retroactive Imposition Of Tax Liability.

The Court should grant review to consider whether PA 282's tax increase, which carries a six-and-one-half-year period of retroactivity, violates the Due Process Clause. Pet. 26–30. The State disputes the need for review on two bases. Neither is persuasive.

First, the State argues that "[t]his case is fully consistent with *Carlton*." Opp'n 23. But PA 282's period of retroactivity is roughly five-and-one-half years greater than the one-year period of retroactivity in *Carlton*. Unlike *Carlton*, then, this case raises "serious constitutional questions" because the "period of retroactivity" is "longer than the year preceding the legislative session in which the law was enacted." 512 U.S. at 38 (O'Connor, J., concurring). And, indeed, the retroactive effect of PA 282 is extraordinary in that it outstrips by roughly four years the maximum period of retroactivity upheld by this Court in the tax context. Pet. 27. While *Carlton* might not have held "that a law is per se unconstitutional if the retroactive reach exceeds a period of more than a few years," Opp'n 21, at the same time this Court never

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[2] The State asserts that Skadden cannot claim reliance on the Compact because Skadden did not "seek to use the Compact's repealed three-factor apportionment formula until the relevant tax years had already passed." Opp'n 25. But the State's logic is nonsensical, given that ***every*** taxpayer files its returns only after the relevant tax year has passed and this temporal relationship does not destroy reliance interests.

has approved a tax statute with such an outsized period of retroactivity as PA 282.

This case differs from *Carlton* for the additional reason that the Michigan Legislature did not have a "legitimate legislative purpose" in enacting PA 282. *See Carlton*, 512 U.S. at 30–33. Quite the contrary, the Legislature enacted PA 282 with the improper purpose of burdening out-of-state businesses for the benefit of in-state businesses.

Second, the State claims that there is no conflict between state-court decisions regarding the permissible retroactivity of tax statutes because the decisions striking down statutes under the federal Due Process Clause purportedly "applied [*Carlton*'s] multi-step legal analysis . . . to a different set of facts and circumstances." Opp'n 24. The State's dismissive attitude toward the import of the state-court decisions finding federal due process violations masks the significant legal disputes between those decisions and the Court of Appeals' opinion below. As one example, the Court of Appeals held that PA 282 was a "legitimate legislative action" because it "eliminate[d] a significant revenue loss." App. 84a. The New York Court of Appeals, however, explained that "raising money for the state budget is not a particularly compelling justification." *James Square Associates LP v. Mullen*, 993 N.E.2d 374, 383 (N.Y. 2013). As another example, the Court of Appeals deemed PA 282's six-and-one-half-year period of retroactivity "sufficiently modest" to satisfy due process. App. 85a. But the South Carolina Supreme Court found a three-year period of retroactivity "excessive" because, "[a]t some point, . . . the government's interest in meeting its revenue requirements must yield to taxpayers' interest in finality regarding tax liabilities

and credits." *Rivers v. State*, 490 S.E.2d 261, 265 (S.C. 1997).[3]

In sum, given the increasing proliferation of state tax laws with substantial periods of retroactivity, the Court should clarify the applicable due process constraints and provide certainty and predictability to taxpayers. *See* Br. of Council on State Taxation 15 & n.7.

IV. This Court Should Review The Court Of Appeals' Deeply Flawed And Far-Reaching Interpretation Of The Contract Clause.

Finally, the Court should grant review to reaffirm the Court's Contract Clause jurisprudence, which the Court of Appeals disregarded. The State disputes the need for review on this score first by arguing that the Compact is not a contract and, as a result, the Contract Clause is not implicated. Opp'n 34–36. As Skadden has established, however, the text and history of the Compact amply demonstrate that it is a binding contract between states, Pet. 32–33, contrary to the State's supposition that the Compact "contains no words evidencing an intent to bind [Michigan] contractually," Opp'n 34. The State seeks to depart from the binding nature of the plain language of the

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[3] The State lists a series of certiorari denials in cases challenging the retroactivity of tax statutes. Opp'n 25–26. Only one of those, however, was issued after the decision in *James Square*, *supra*, sharpened the divide among state courts. *In re Estate of Hambleton*, 335 P.3d 398 (Wash. 2014), *cert. denied* 136 S. Ct. 318 (2015). In any event, this Court's denial of petitions presenting even identical issues says nothing of the merits of this Petition, which involves an extreme example of a protectionist statute carrying a lengthy period of retroactivity to the substantial detriment of only out-of-state businesses.

Compact by emphasizing "course of conduct," *id.* at 35, but this ignores that "the express terms of the compact" are "the best indication of the intent of the parties," *Tarrant Regional Water Dist. v. Herrmann*, 133 S. Ct. 2120, 2130 (2013). Finally, the State tries to import state contractual principles into the analysis, Opp'n 36, in violation of the cornerstone principle that "[t]he question whether a contract was made is a federal question for purposes of Contract Clause analysis," *Gen. Motors Corp. v. Romein*, 503 U.S. 181, 187 (1992).

The State fares no better in arguing that, even assuming that the Compact is a contract, PA 282 did not violate the Contract Clause. PA 282 represents a "substantial impairment of a contractual relationship." Pet. 33. Although the State endeavors to justify that impairment as necessary to "affirm[ing] Michigan's mandatory apportionment formula" and "avoid[ing] paying unanticipated refunds to the tune of $1 billion-dollars," Opp'n 37, this is far from a showing sufficient to forestall a Contract Clause violation. *See, e.g.*, *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 25–26 (1977) ("If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all.").

* * *

This Petition presents fundamental and recurring constitutional questions regarding the extent to which a state may use a retroactive application of its tax policy as an instrument to balance its budget and

promote in-state businesses while burdening out-of-state businesses with billions of dollars in increased tax liability. The Court should grant review to halt the steady creep toward a patchwork economic market that pits states against one another and carries the perpetual specter of whopping retroactive tax increases for transactions long ago completed.

CONCLUSION

The Court should grant the petition for a writ of certiorari.

Respectfully submitted,

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