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## *Harper and Its Aftermath*

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## I. INTRODUCTION

In *Davis v. Michigan Department of Treasury*,<sup>1</sup> the Supreme Court ruled that states may not tax the pensions of former federal workers without imposing a like tax on the retirement income of former state employees. Noting that Michigan had agreed to refund the state income taxes Paul Davis had paid on his federal pension over the years in controversy, the Court stated that he was entitled to a refund.<sup>2</sup> It then remanded the case to allow the Michigan courts and state lawmakers to determine how state and federal retirees were to be treated equally in the future—both taxed according to the same schedule or exempted from tax—and to resolve the thousands of refund claims by federal pensioners that had been or might be filed.<sup>3</sup>

*Davis* provoked a whirlwind of activity in state courts and legislatures across the country, because two dozen states taxed state retirement income more lightly than federal pensions, contrary to the Supreme Court's understanding of the doctrine of intergovernmental tax immunity.<sup>4</sup> *Davis* left no doubt that states must equalize the taxation of federal and state retirees following the issuance of the Court's opinion. But the Court's bare mention of Michigan's concession to refund Davis's taxes failed to answer clearly the question of whether states owed some form of retroactive relief to all similarly situated federal retirees who had paid higher taxes than had state pensioners. Not surprisingly, in view of the number of courts that issued rulings, the enormous sums at stake,<sup>5</sup> and the confusion swirling around the Supreme Court's recent retroactivity rulings, state courts disagreed over whether the Fourteenth Amendment's Due Process Clause mandates a remedy for past wrongs. Many, including Virginia's Supreme Court, concluded that

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1. 489 U.S. 803 (1989).

2. *Id.* at 817.

3. *Id.* at 817-18. The Court has since declared that its reasoning also applies to retirement benefits paid by the federal government to former military personnel, not only to former civil servants like Davis. See *Barker v. Kansas*, 112 S. Ct. 1619 (1992).

4. A list of those states may be found in *Harper v. Virginia Dep't of Taxation*, 401 S.E.2d 868, 871 n.2 (Va.), vacated and remanded, 111 S. Ct. 2883, *aff'd*, 410 S.E.2d 629 (Va. 1991), *rev'd* and remanded, 113 S. Ct. 2510 (1993). See also *Davis v. Michigan Department of Treasury: A Review of the Subsequential Litigation*, LEXIS, FEDTAX library, STN file, elec. cit. 92 STN 121-23; Jasper L. Cummings, Jr., et al., *Status of Davis-Type State Court Litigation*, Special Report, 51 Tax Notes 631 (May 6, 1991).

5. By one estimate, the aggregate cost of refunding the unconstitutionally excessive portion of state income taxes on federal pensions for all open tax years exceeds \$2 billion. See Ian K. Loudon, *High Court Remands Federal Retiree Benefits Cases; Lets Stand Charitable Organization Gambling Case*, LEXIS, FEDTAX library, STN file, elec. cit. 91 STN 133-17. This estimate preceded the Court's decision in *Barker*, which greatly exacerbates states' fiscal difficulties. Virginia alleged that its refund liability alone would amount to approximately \$440 million. See *Harper*, 401 S.E.2d at 873.

*Davis* established a requirement of equal treatment solely for the future.<sup>6</sup> Accordingly, they refused to order refunds to federal retirees or to impose a retroactive tax on state pensions to secure equality after the fact.

In *Harper v. Virginia Department of Taxation*,<sup>7</sup> decided June 18, 1993, the Supreme Court reduced, but by no means eliminated, the considerable uncertainty over *Davis*'s retroactive impact. Five justices held that, because the Court applied its ruling retroactively to *Davis* himself in sanctioning the refund Michigan offered to make, all state courts must apply *Davis* retroactively and offer relief consistent with the Court's earlier account of due process in *McKesson Corp. v. Division of Alcoholic Beverages*.<sup>8</sup> Two justices concurred in the judgment, not because they considered the Court bound by the perfunctory application of its holding to the parties before it in acknowledging Michigan's concession to refund *Davis*'s taxes, but because they adjudged the Court's interpretation of the intergovernmental tax immunity doctrine in *Davis* insufficiently novel to warrant purely prospective application.<sup>9</sup> Finally, two justices dissented, arguing that *Davis* was so surprising a decision and the burden on the states of affording retroactive relief so onerous that retroactive application could not be justified.<sup>10</sup>

This Article describes and assesses the Court's reasoning in *Harper* and examines the decision's likely ramifications. Although the Court's holding might well be correct, its explanation of that result is unconvincing. Justice Thomas's majority opinion is also disappointing, because it leaves for another day—at what will predictably be a significant cost for states and private litigants—the looming question of what principles should steer courts in determining whether unexpected civil decisions applying federal law have retroactive effect.

After outlining the larger retroactivity battle to come, the Article explores the sketchy remedial requirements that *McKesson* imposes and sets forth the principal controversies that await resolution as *Harper*'s implications are debated in the various state courts. Several of these matters, such as the amount of equitable remedial discretion state courts enjoy and whether interest on tax refunds is constitutionally mandatory, will probably wend their way to the Supreme Court eventually. The Court might also feel compelled to rule, probably in a future Commerce Clause case, on whether states may reduce their refund obligations insofar as commercial taxpayers have passed part or all of the tax burden on to suppliers or consumers.

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6. *Harper*, 401 S.E.2d at 874.

7. 113 S. Ct. 2510 (1993).

8. 496 U.S. 18 (1990).

9. *Harper*, 113 S. Ct. at 2526 (Kennedy, J., concurring in part and concurring in the judgment) (joined by White, J.).

10. *Id.* at 2535 (O'Connor, J., dissenting) (joined by Rehnquist, C.J.).

Whether any of these issues returns to the Supreme Court through *Harper*-inspired litigation depends, in part, on Congress. Because the purpose of the intergovernmental tax immunity doctrine, codified at 4 U.S.C. § 111, is to protect the federal government and the states from discriminatory levies on one another's activities, Congress may waive or lessen any claim to compensation for *Davis*-type discrimination. It may do so whether that claim is lodged directly by the federal government or whether it takes the form of refund suits by former federal employees. Congress could thus save the states hundreds of millions of dollars in refunds (if states chose refunds as a remedy, which in at least some cases they need not do) at little or no cost to the federal treasury. It might thereby align, with more precision than any other constitutionally permissible remedy, the cost of providing retroactive relief by the states with the economic harm that the federal government suffered at their hands.

Even if Congress did not act, states might avail themselves of a similar solution. To the extent that state law and the Due Process Clause allow, states might impose retroactive taxes on state retirees while paying them an offsetting bonus to cover the state and federal tax liability resulting from those retroactive taxes and the bonus itself. Or, less awkwardly, states might enter into a settlement agreement with the federal government to pay Washington approximately the amount that the Internal Revenue Service would receive from state pensioners through that formally complicated and administratively much more troublesome series of interlocking transactions. Should a state and federal executive officials choose this course, without congressional authorization, another trip to the Supreme Court might be necessary.

I conclude by examining a number of state-law issues that are likely to shape *Harper*'s impact in at least some jurisdictions. Although challenges under state constitutions' Extra Compensation and Gift Clauses to legislative attempts to increase pensions while subjecting them to state income tax will probably come to naught, breach-of-contract actions against states that begin taxing retirement pay might significantly constrain states' remedial options.

## II. THE COURT'S OPINIONS IN *HARPER*

*Harper* produced four opinions, representing two conflicting views about the significance of a single sentence in the Court's opinion in *Davis*: "The State having conceded that a refund is appropriate in these circumstances, see Brief for Appellee 63, to the extent appellant has paid taxes pursuant to this invalid tax scheme, he is entitled to a refund."<sup>11</sup> Five justices

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11. *Davis*, 489 U.S. at 817.

believed that this statement constituted a ruling that the Court's holding in *Davis* applied retroactively to the parties in that case, and that, because it would be inappropriate to rule in favor of one plaintiff without ruling similarly on all equally meritorious claims, *Davis* applies retroactively in *Harper* and in all other cases presenting the same intergovernmental tax immunity issue. The four remaining justices disagreed. They denied that this casual sentence in *Davis* foreclosed further consideration of the decision's retroactive effect. The four divided, however, over whether the Due Process Clause compels *Davis*'s retroactive application.

Writing for a bare majority,<sup>12</sup> Justice Thomas concluded that *Davis* applies to pre-decisional tax disparities between state and federal retirees in nearly half the states. He rested his conclusion on two distinct propositions. The first is that the Court applied its ruling in *Davis* retroactively as well as prospectively. Justice Thomas justified this reading of the Court's earlier opinion by reference to a general presumption about constitutional adjudication, as well as by an inference from the Court's language. The presumption is that the Court's decisions apply retroactively, approving or invalidating conduct that antedates those decisions, unless the Court stipulates otherwise.<sup>13</sup> In *James B. Beam Distilling Co. v. Georgia*,<sup>14</sup> Justice Souter wrote that when the Court "did not reserve the question whether its holding should be applied to the parties before it, . . . it is properly understood to have followed the normal rule of retroactive application in civil cases."<sup>15</sup> Justice Thomas explicitly endorsed this "express reservation" rule in *Harper*.<sup>16</sup>

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12. Justice Thomas's opinion was joined by Justices Blackmun, Stevens, Scalia, and Souter.

13. See *Harper*, 113 S. Ct. at 2516-17.

14. 111 S. Ct. 2439 (1991).

15. *Id.* at 2445 (citation omitted) (opinion of Souter, J.). Although only Justice Stevens joined Justice Souter's opinion, the quoted sentence can fairly be read to represent the views of a majority of the justices when *Beam* was decided because three justices then maintained that the Court's holdings *always* apply retroactively. *Id.* at 2449-50 (Blackmun, J., concurring in the judgment) (joined by Marshall and Scalia, JJ.); see *id.* at 2450-51 (Scalia, J., concurring in the judgment) (joined by Marshall and Blackmun, JJ.).

16. *Harper*, 113 S. Ct. at 2518. There is no foundation for the claim that: Because *Beam* assigns determinative consequence to the manner in which a new rule is applied when first announced, it effectively requires that a court consider the retroactivity issue in the same case in which the rule is promulgated, rather than simply grant relief and defer extensive analysis of retroactivity to subsequent cases.

Note, The Supreme Court, 1990 Term—Leading Cases: Application of New Rules in Civil Cases, 105 Harv. L. Rev. 339, 344 n.47 (1991). Nothing in the opinions written or joined by Justices Souter, Stevens, and White in *Beam* indicates that a new rule need be applied either retroactively or prospectively when first announced. A court could, in their view, apparently decide the merits issues and leave the question of retroactive application for a later day. Of

Plainly, nowhere in *Davis* did the Court expressly postpone judgment on the backward reach of its holding. By default, it therefore applied retroactively. Indeed, Justice Thomas contended, the Court's statement in *Davis* that the appellant was entitled to a refund, in accordance with Michigan's announced intention to pay him one if he prevailed on the merits, was an affirmative indication of the Court's desire to apply its holding to past conduct, not merely fateful silence. It "constituted a retroactive application of the rule announced in *Davis* to the parties before the Court."<sup>17</sup>

The second proposition on which the Court's decision hinged is that the equal treatment of similarly positioned parties, so far as the retroactive impact of a decision about federal law is concerned, is more important than correcting any error that might have been made in applying the initial merits decision retroactively or only prospectively. Again relying on Justice Souter's separate opinion in *Beam*, which Justice Thomas said "controls" the outcome in *Harper* on this point,<sup>18</sup> the majority held that "the legal imperative 'to apply a rule of federal law retroactively after the case announcing the rule has already done so' must 'prevai[l] over any claim based on a *Chevron Oil* analysis.'"<sup>19</sup> Thus, whether or not the Court was right to retroactively apply

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the sitting justices, only Justices Blackmun and Scalia would, judging from their opinions in *Beam*, unfailingly dispose of the retroactivity issue with the merits, and then only because they regard *all* decisions as retroactive. Justice Thomas's opinion in *Harper*, by echoing the "express reservation" rule that Justice Souter set forth in *Beam* and by not condemning the Court's procedure in *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266 (1987), which left the retroactivity question for resolution in *American Trucking Ass'ns v. Smith*, 496 U.S. 167 (1990), confirms that the Court *can* put the retroactivity issue aside for future determination after tackling the merits of a case. Perhaps it will someday abandon this view in favor of the rule of automatic retroactivity that some justices favor. See *infra* part IV. But the Court has not done so yet.

17. *Harper*, 113 S. Ct. at 2518.

18. *Id.* at 2517. *Beam* involved the retroactive impact of the Court's decision in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984). *Bacchus* declared unconstitutional a Hawaii statute that taxed locally produced alcoholic beverages less heavily than imported alcoholic beverages. *Id.* at 265. *Beam* concluded that the Court had applied its decision in *Bacchus* retroactively to the parties in that case, and that "principles of equality and *stare decisis*" required that a decision invalidating a similar Georgia preference for alcoholic beverages produced from Georgia-grown products likewise apply retroactively. *Beam*, 111 S. Ct. at 2446 (opinion of Souter, J.).

19. *Harper*, 113 S. Ct. at 2518 (quoting *Beam*, 111 S. Ct. at 2446 (opinion of Souter, J.)). In *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), the Court had to decide whether a state statute of limitations, which federal law had incorporated, should apply retroactively. Prior to the Court's decision recognizing the state statute of limitations as the proper one, precedent suggested that a longer, federal limitations period existed. In deciding whether the longer or the newly recognized shorter statute of limitations should govern suits filed before the shorter limitations period was announced, the Court weighed three sets of considerations culled from earlier cases. First, "the decision to be applied nonretroactively

its ruling in *Davis* to the parties before it—and it did so, as Justice O'Connor pointed out in her *Harper* dissent, without briefing or even any recognition at oral argument that the issue was properly presented<sup>20</sup>—all states facing refund actions premised on *Davis* are bound to give the decision retroactive effect. “Selective prospectivity”—the practice of applying a ruling retroactively to the parties whose suit resulted in a decision on the merits but prospectively to all others—once favored to facilitate dramatic law-changing criminal decisions but since repudiated, is now dead in civil cases too.

After declaring *Davis* retroactive, the Court summarily rejected Virginia's claim that it had an adequate and independent state ground for its refusal to apply *Davis* retroactively.<sup>21</sup> Virginia had maintained that it need not provide compensation because, as a matter of state law, rulings striking down state tax statutes are given only prospective effect.<sup>22</sup> This claim, as Justice Thomas noted, was an affront to the Supremacy Clause, which “does not allow federal retroactivity doctrine to be supplanted by the invocation of a contrary approach to retroactivity under state law.”<sup>23</sup>

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must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed.” *Id.* at 106 (citation omitted). Second, the history, purpose, and effect of the new rule should be consulted to determine whether retroactive application would advance or hinder its operation. *Id.* at 106-07. Third, the equities must be weighed, particularly any hardship or unfairness that retroactive application might work. *Id.* at 107. The Court has recently made clear that the first consideration operates as a threshold: if it is not satisfied, a decision applies retroactively, regardless of how it rates along the other two dimensions (although there is plainly a substantial overlap between an assessment of novelty and the third prong's balancing of the equities). See *Ashland Oil, Inc. v. Caryl*, 497 U.S. 916, 918 (1990) (*per curiam*); *National Mines Corp. v. Caryl*, 497 U.S. 922, 923 (1990) (*per curiam*).

20. See *Harper*, 113 S. Ct. at 2530 (O'Connor, J., dissenting).

21. The Virginia Supreme Court originally held that *Davis* applies purely prospectively under the Supreme Court's three-pronged test for the retroactive application of civil decisions in *Chevron Oil*. *Harper v. Virginia Dep't of Taxation*, 401 S.E.2d 868 (Va. 1991). The Supreme Court vacated and remanded in light of *Beam*. 111 S. Ct. 2883 (1991). On remand, the Virginia Supreme Court affirmed its earlier holding, concluding that the Court did not apply its ruling in *Davis* retroactively. 410 S.E.2d 629 (Va. 1991). The Supreme Court then reversed and again remanded. 113 S. Ct. 2510 (1993).

22. *Harper*, 410 S.E.2d at 873-74.

23. *Harper*, 113 S. Ct. at 2519 (citation omitted). By contrast, “the Federal Constitution has no voice upon the subject” of states' decisions to make judicial rulings on *state-law* issues entirely prospective; to apply them to the parties in court but otherwise to enforce them prospectively; or to render them fully retroactive, thereby affording relief to future litigants whose claims remain ripe and those whose cases are pending at the time of decision. See *Great N. Ry. v. Sunburst Oil & Refining Co.*, 287 U.S. 358, 364 (1932); see generally Walter V. Schaefer, *The Control of “Sunbursts”: Techniques of Prospective Overruling*, 42 N.Y.U. L. Rev. 631 (1967).

Finally, the Court addressed the question of remedies. *McKesson* held that if a state provided “a form of ‘predeprivation process,’ for example, by authorizing taxpayers to bring suit to enjoin imposition of a tax prior to its payment, or by allowing taxpayers to withhold payment and then interpose their objections as defenses in a tax enforcement proceeding initiated by the State,” it need not provide refunds or impose a retroactive tax on favored taxpayers should a tax statute be declared unconstitutional.<sup>24</sup> Virginia had argued in its brief that federal retirees had a constitutionally adequate pre-payment remedy if they wished to challenge the constitutionality of the state’s tax on federal pensions. However, because the Virginia courts had not adjudicated this claim, the Supreme Court declined to construe the relevant statutes and pass judgment on their sufficiency as a matter of federal law.

If Virginia did not offer a pre-payment remedy satisfying due process requirements—which the Court did nothing to specify, beyond quoting from *McKesson*—then it must, Justice Thomas wrote, provide the “meaningful backward-looking relief” that *McKesson* demands.<sup>25</sup> Extending the tax preference for retired state workers retroactively to federal retirees, and refunding the excess tax the latter paid, would certainly fulfill this obligation. But, as the Court explained in *McKesson*, other options are available. A state could, for example, tax state retirees retroactively at the same rate that applied to federal pensioners (assuming that retroactive taxes were compatible with due process guarantees and state-law constraints). Or it could combine retroactive taxes and refunds to achieve “in hindsight a nondiscriminatory scheme.”<sup>26</sup> Because it was for the state, not the Supreme Court, to choose among the various alternatives that would remedy the earlier wrong, the Court reversed and remanded the case to the Virginia Supreme Court for further proceedings.<sup>27</sup>

In a separate opinion, Justice Kennedy, joined by Justice White, concurred in the Court’s result but not in the pivotal section of its reasoning. He first expressed his conviction that the purely prospective application of civil decisions is sometimes appropriate. Then, in what might be an overly anxious reading of the majority opinion (although Justice Thomas evidently did not rewrite his draft to quiet the worry that both Justice Kennedy and Justice O’Connor voiced), Justice Kennedy denounced “the Court’s broad

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24. *McKesson Corp. v. Division of Alcoholic Beverages*, 496 U.S. 18, 36-40 (1990).

25. *Harper*, 113 S. Ct. at 2519 (quoting *McKesson*, 496 U.S. at 31).

26. *Id.* at 2520 (quoting *McKesson*, 496 U.S. at 40).

27. *Id.* Justice Scalia, who joined the Court’s opinion in full, added a long concurrence criticizing Justice O’Connor’s dissent. *Id.* (Scalia, J., concurring). He reiterated his antipathy to purely prospective decisionmaking and repeated his call, see *Beam*, 111 S. Ct. at 2450 (Scalia, J., concurring in the judgment), for a return to a rule of automatic retroactivity for civil cases.



dicta . . . that appears to embrace in the civil context the retroactivity principles adopted for criminal cases in *Griffith v. Kentucky*.”<sup>28</sup> Justice Kennedy further agreed with the dissent that *Chevron Oil*’s tripartite test should be used to determine whether a civil decision applies retroactively. That test, he asserted, should take precedence over a litigant’s claim to the same treatment as the parties to an earlier case in which the Court announced a ruling on the merits without fully considering the retroactivity issue. Employing the *Chevron Oil* test, Justice Kennedy concluded that *Davis* should be given retroactive effect.<sup>29</sup> Far from announcing a new principle of law, *Davis* was, in Justice Kennedy’s view, “a mere application of plain statutory language and existing precedent.”<sup>30</sup> Hence, he agreed with the Court’s disposition of the case if not its rationale.

Justice O’Connor’s dissent, which Chief Justice Rehnquist joined, parted company with Justice Kennedy’s assessment of *Davis*’s novelty. She argued at length that *Chevron Oil* was better read to deny retroactive effect to *Davis*, particularly in light of the burden that applying *Davis* retroactively would impose on states if they had to tender refunds to former federal workers.<sup>31</sup> Justice O’Connor also emphasized the unexpected character of the Court’s order striking down tax disparities that had been on the books of nearly half the states for decades and that had hitherto passed unchallenged.<sup>32</sup>

The most powerful section of Justice O’Connor’s dissent assailed the Court’s assumption that its resolution of *Harper* was dictated by its retroactive application of *Davis*. The debate over the import of that single cryptic sentence in *Davis*—“The State having conceded that a refund is appropriate . . . [Davis] is entitled to a refund.”<sup>33</sup>—she said, “is as meaningless as it is indeterminate.”<sup>34</sup> The Court’s longstanding rule, which it affirmed earlier that very Term in *Brecht v. Abrahamson*,<sup>35</sup> is that the Court is not bound by its tacit resolution of issues that it did not squarely address following briefing and oral argument.<sup>36</sup> The record, she noted, revealed plainly that the Court did not give adequate consideration to the retroactivity

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28. *Harper*, 113 S. Ct. at 2525 (Kennedy, J., concurring in part and concurring in the judgment) (citation omitted). *Griffith v. Kentucky*, 479 U.S. 314 (1987), held that federal criminal decisions apply retroactively to all cases awaiting trial or still on direct review.

29. *Harper*, 113 S. Ct. at 2525 (Kennedy, J., concurring in part and concurring in the judgment).

30. *Id.* at 2526 (Kennedy, J., concurring in part and concurring in the judgment).

31. *Id.* at 2526-27 (O’Connor, J., dissenting).

32. *Id.* at 2533 (O’Connor, J., dissenting).

33. *Davis*, 489 U.S. at 817.

34. *Harper*, 113 S. Ct. at 2529 (O’Connor, J., dissenting).

35. 113 S. Ct. 1710 (1993).

36. See *id.* at 1718.

question when it decided *Davis*.<sup>37</sup>

In conclusion, after defending the possibility of purely prospective constitutional holdings, Justice O'Connor turned to remedial issues. She noted that the Court, most clearly since its decisions in *McKesson* and *American Trucking Ass'ns v. Smith*,<sup>38</sup> has distinguished between declaring that a ruling has retroactive application—retroactivity as “choice of law”—and specifying what remedies, if any, its retroactive application entails. Because *Harper* passed judgment on only the first type of retroactivity, she chided the Court for its brief remarks about Virginia's possible remedial obligations, an issue she thought not yet before the Court.<sup>39</sup> More specifically, she disparaged Justice Thomas's suggestion that if Virginia failed to provide taxpayers with a constitutionally adequate prepayment remedy, it would have to provide some type of compensation for its misdeeds, whether by way of a refund to federal retirees or a retroactive tax on former state workers:

In my view, and in light of the Court's revisions to the law of retroactivity, it should be constitutionally permissible for the equities to inform the remedial inquiry. In a particularly compelling case, then, the equities might permit a State to deny taxpayers a full refund despite having refused them predeprivation process.<sup>40</sup>

Justice O'Connor claimed that Justice Stevens's dissent in *American Trucking* and Justice Souter's separate opinion in *Beam* should be read as applauding the notion that courts have broad equitable discretion in crafting remedies when rulings apply retroactively. In cases more compelling than Florida's predicament in *McKesson*, the views of Justices Stevens and Souter, as Justice O'Connor construed them, would allow courts to take actions that lie outside *McKesson*'s narrow compass. Whether or not her reading of their opinions is correct,<sup>41</sup> Justice O'Connor ended by announcing her view that

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37. *Harper*, 113 S. Ct. at 2530 (O'Connor, J., dissenting).

38. 496 U.S. 167 (1990). *American Trucking* held that the Court's earlier Commerce Clause decision in *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266 (1987), did not apply retroactively.

39. *Harper*, 113 S. Ct. at 2530 (O'Connor, J., dissenting).

40. *Id.* at 2537 (O'Connor, J., dissenting).

41. Justice O'Connor's reading of *McKesson*, and by extension Justice Souter's references to *McKesson*, stands in marked contrast to her interpretation of the Court's holding in *McKesson* when it was decided. At that time she wrote: “The dissent [in *American Trucking*] suggests that federal courts should weigh equitable considerations only in determining the scope of relief a federal court should award. This is precisely backwards. As previously discussed, *McKesson* makes plain that equitable considerations are of limited significance once a constitutional violation is found.” *American Trucking*, 496 U.S. at 184 (plurality opinion). Apparently, Justice O'Connor believes it important that equitable

if the equities of a dispute are to play no part, via *Chevron Oil's* analysis, in determining whether a holding applies retroactively, they ought to be considered in ascertaining what relief retroactive rulings permit or require.<sup>42</sup>

### III. RETROACTIVITY BY DEFAULT OR EQUAL TREATMENT

Whether a finding that a decision applies retroactively has any practical effect naturally depends upon the remedial implications of that finding. If, for example, equitable considerations are ignored in assessing the retroactive impact of a decision, as Justice O'Connor fears will happen if the Court abandons *Chevron Oil*, but they are permitted to shape the remedial calculus and even in some instances to block all compensation for past wrongs, then declaring a decision retroactive might be of little consequence. What matters is the bottom line: which actions, if any, a party must take as a result of having behaved in a way that the Court's current understanding of federal law prohibits. Assuming, however, that at least in the case of state taxes that discriminated against a group of taxpayers in violation of federal law, either refunds to victims or retroactive taxes on beneficiaries or some blend of the two is constitutionally required—as *McKesson* might be read to hold and as Justice Thomas's references to *McKesson* in *Harper* further suggest<sup>43</sup>—the Court's opinion in *Harper* is striking in two ways.

First, its approval of the view, first expressed by Justice Souter writing for only himself and Justice Stevens in *Beam*, that all of the Court's rulings apply retroactively unless the Court expressly reserves judgment on the issue, is enormously important. To be sure, the Court's embrace of this view was not wholly novel. Five justices subscribed to this principle in *Beam*, as the three who concurred in the judgment without joining Justice Souter's opinion would automatically have applied all rulings retroactively. But in *Harper*, for the first time, five members of the Court signed a single opinion certifying this principle. They did so, moreover, notwithstanding the departure of Justice Marshall, who cast one of the votes for automatic retroactivity in *Beam*. Because Justice White has never assented to this view, his replacement by Justice Ginsburg will not endanger the slim majority that professes it;

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considerations inform the relief that a court finally awards in a civil case. If those considerations are to play no role at the first stage of the Court's analysis, contrary to Justice O'Connor's preferred approach, then they warrant consultation at the next stage. If *Chevron Oil* is not to furnish the test for retroactivity, she would read the Court's precedents to permit lending the equitable considerations it enunciates some force in molding a remedy.

42. *Harper*, 113 S. Ct. at 2538 (O'Connor, J., dissenting).

43. See *infra* part V for detailed consideration of the remedial implications of *McKesson* and *Harper*. As I explain in sections C and D of that part, intergovernmental tax immunity cases are in some ways special.

whether the future resignation of Justice Blackmun or another member of the majority coalition will have that result cannot yet be known.

The Court's newly gilded "express reservation" rule will apparently have an immediate and patently unfair impact in at least one case recently before the Supreme Court. In *Kraft General Foods, Inc. v. Iowa Department of Revenue*,<sup>44</sup> the Court held that by granting a state corporate income tax deduction for dividends received from domestic subsidiaries but not for dividends received from foreign subsidiaries, Iowa facially discriminated against foreign commerce in violation of the Commerce Clause. The Court's opinion did not mention remedies or the holding's retroactive application; the justices merely reversed and remanded for further proceedings not inconsistent with their opinion.<sup>45</sup> After *Harper*, however, it seems clear that *Kraft* applies retroactively to the parties in that case, because the Court did not preserve the issue for future litigation. Yet, under the circumstances, that result is procedurally offensive.

In its brief, Iowa noted that the retroactivity issue, though raised by the state, had not been passed on by the lower courts.<sup>46</sup> Consideration of the issue would have been inappropriate because they had, without exception, upheld the challenged provision. Nor had *Kraft* addressed the issue either in its petition for certiorari or in its merits brief. Aware of *Beam*'s holding, however, that because the Court did not reserve the retroactivity question in *Bacchus*, its decision in that case applied retroactively, Iowa explicitly "urge[d] that, if the Iowa law is held to be unconstitutional, this Court expressly state that the Court is not ruling on the question of retroactivity but is expressly reserving the question for the Iowa courts to decide on remand."<sup>47</sup> In addition, although Iowa did not advance an argument under *Chevron Oil* or some other precedent for prospective application of the Court's decision should it lose on the merits, the state noted that the retroactivity question was complicated. Iowa had agreed, as a condition of receiving payment of the disputed taxes, that *Kraft* and a former affiliate would receive refunds if *Kraft* prevailed. This agreement, the state alleged, harbored significant ambiguities. It also antedated *Beam*'s repudiation of selective prospectivity, and thus might have been premised on an understandable mistake of law. Iowa asked that the state courts be allowed to sift these matters before the Supreme Court pronounced on them.<sup>48</sup> In its Reply Brief, *Kraft* contended, in one short paragraph invoking two dusty and apparently irrelevant precedents it did not discuss specifically, that prospective applica-

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44. 112 S. Ct. 2365 (1992).

45. *Id.* at 2372.

46. Brief for Respondent at 36, *Kraft* (No. 90-1918).

47. *Id.* at 37.

48. *Id.*

tion of the Court's Commerce Clause holding, if Kraft should win, was not warranted under *Chevron Oil*.<sup>49</sup> It further stated that Iowa's agreement to refund Kraft's taxes if Iowa lost went to the issue of remedies, not retroactivity, and so could be ignored when the Court passed on the choice-of-law issue—a questionable claim after *Beam* and, still more it now appears, after *Harper*.

Despite this inadequate briefing on the question of retroactivity, despite the absence of any state court consideration, despite Iowa's plea that the Court not decide the issue if it ruled against Iowa on the merits, and despite any mention of this crucial issue by the Court itself, *Harper's* "express reservation" rule seems to require that the retroactivity question be decided against the state. Yet it is hard to believe that the Court intended this result when it reversed and remanded without even mentioning Iowa's agreement with Kraft or flagging the wider question of whether the Court's decision reaches backwards as well as forwards. If, moreover, this was the Court's silent intention, the absence of any explanation for the ruling betrayed its duty of candor.<sup>50</sup>

The second, perhaps more astonishing, innovation in *Harper*, and the source of much of the injustice that *Harper* might work when annexed to the "express reservation" rule, is the Court's unbending insistence that once a

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49. See Reply Brief for Petitioner at 16, *Kraft* (No. 90-1918) (citing *Cook v. Pennsylvania*, 97 U.S. 566 (1878); *Hale v. Bimco Trading, Inc.*, 306 U.S. 375 (1939)). *Cook* found that a Pennsylvania tax on auctioned goods imported from abroad that did not apply to domestic goods violated the Commerce Clause. *Cook*, 97 U.S. at 573. Because the auctioneer who challenged the tax had not paid it, no retroactivity issue arose, and the Court did not discuss the matter. See *id.* at 570. Likewise, in *Hale* the Court upheld an injunction on the collection of an inspection fee and minimum quality standards that applied solely to imported cement. *Hale*, 306 U.S. at 380-81. No question of retroactive application was presented and no dicta were offered on the question.

50. Unfortunately, shirking is not unprecedented. The practice of hiding premises essential to the Court's holding, though beyond condoning in the vast bulk of cases, had an alarming forerunner in one of its decisions from the preceding Term. In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773 (1991), the Supreme Court established a uniform federal statute of limitations for suits under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. Despite the fact that the parties briefed the retroactivity issue, that the United States, in an amicus brief, asked the Court to remand so that the lower courts might address the question in the first instance, and that until that decision the Court "ha[d] never applied a new limitations period retroactively to the very case in which it announced the new rule so as to bar an action that was timely under binding Circuit precedent," *id.* at 2786 (O'Connor, J., dissenting), five members of the Court held that the plaintiffs' claims were untimely, *without even mentioning the retroactivity issue*. See *id.* at 2782. Nor could the majority claim ignorance of the import of its unexplained action, given that *Beam* was decided the very same day and that, as Justice O'Connor noted in dissent, the Court's election to apply its decision retroactively contravened several of its earlier decisions. *Lampf*, and now *Kraft*, might be regrettable anomalies, without heirs. One hopes that they are. The worry is that they signal a more dire trend towards rule by fiat rather than reason.

decision is applied retroactively to one set of parties, it must be applied retroactively to all similarly situated litigants. In the case of *Kraft* itself, this principle of equal treatment might cost Iowa \$30 million,<sup>51</sup> without its now being able to offer any objection to the decision's retroactive reach. And the holding in *Kraft* could well impose additional liabilities on other states, again without their being able to challenge this result because the die was cast in *Kraft* and they were not parties to the action.<sup>52</sup> In most circumstances, of course, the principle of treating like cases alike is a just and venerable one. Litigants are, moreover, frequently affected by legal actions contested by others. But the principle of treating like cases alike cannot be applied blindly, without considering the correctness of the initial decision to be extended to all. That would be to raise *stare decisis* to an absolute command, blocking the reconsideration and overruling of obsolescent or misguided holdings. Furthermore, the principle seems neither sensible nor fair when the rule being applied universally was not the considered choice of a court of law following briefing and argument, but was rather the accidental result of an unobserved background presumption.<sup>53</sup>

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51. See Rick Phillips, Iowa: DOR Says *Kraft* Will Cost \$30 Million in Refunds, 3 State Tax Notes 884 (Dec. 14, 1992) (reporting Iowa Department of Revenue and Finance's estimate that its potential refund liability stemming from *Kraft* is \$25-30 million and that it would deny refunds, pending the Court's decision in *Harper*, on the theory that *Kraft* applies prospectively only). Phillips's article does not say what fraction of the total figure is covered by Iowa's prior refund agreement with *Kraft* and its one-time affiliate.

52. According to a report by one lawyer, Pennsylvania altered a provision of its corporate income tax that resembled Iowa's unconstitutional treatment of foreign dividend income following the decision in *Kraft*. See Joseph Bright, Pennsylvania Revenue Department Issues Policy Statement on *Kraft* Decision, 3 State Tax Notes 527 (Oct. 12, 1992). It would not be surprising if a refund suit, in which the retroactivity of *Kraft* must be presumed, were filed in *Harper*'s wake (if none already has been filed), assuming that a suit would still be timely in Pennsylvania. Another lawyer writes that a provision of Florida's income tax relating to Subpart F income might also fall after *Kraft*. See K. Lawrence Gragg, United States: *Kraft* Should Help Resolve Florida Issue of Foreign-Source Income Deductions, 5 Tax Notes Int'l 131 (July 20, 1992). If *Kraft* controls on the merits, it would be difficult to argue that its retroactivity holding also does not govern any subsequent litigation in Florida. It is, naturally, a further question whether the same *remedial* requirements would apply in all these cases, even if all the tax provisions were invalid retroactively. I discuss this issue in part V.B.

53. This presumption does have the advantage of providing states with an incentive to litigate the retroactivity issue from the start, lest it be resolved against them, and might be defended insofar as it expedites the resolution of disputes. But that general justification hardly extends to Iowa's conduct in *Kraft*, because the state did raise the issue in Iowa's courts. They simply had no occasion to pass on it because they, unlike the Supreme Court, held in Iowa's favor. From the Supreme Court's perspective, there is good sense in permitting state courts to offer an initial judgment on questions of this kind, after briefing by *both* sides. The Court's holding in *Harper*, however, denies them that opportunity if, as seems inevitable, the "express reservation" rule applies. *Lampf* provides an equally stunning example of the injustice of

A second example of egregious unfairness comes from *Harper* itself. When *Davis* was argued, nobody connected with the case had any inkling that a concession in Michigan's brief—that *Davis* himself deserved a refund if Michigan's tax scheme was unconstitutional—could conceivably cause the retroactive application of the Court's decision to hundreds of thousands of taxpayers in two dozen states. As Justice O'Connor noted in her *Harper* dissent, the issue of *Davis*'s implications for past conduct was not decided by the Michigan courts, the question presented did not seem to encompass it,<sup>54</sup> and a short colloquy at oral argument appeared to indicate that the matter was not before the Court.<sup>55</sup> Of all the parties and amici, Michigan alone discussed the question of remedies in its brief, almost as an afterthought. Yet the Court has now found that brisk reference by a single party sufficient to bind Michigan and a sea of other states battling over perhaps two billion dollars. What is most puzzling, in view of the Court's action in *Harper*, is that Michigan's one-paragraph statement that *Davis* was entitled to a refund,<sup>56</sup> to which the Court fastened its holding in *Harper*, was succeeded by a far longer argument that the Court ought *not* to decide the refund issue with respect to the state's many other federal retirees.<sup>57</sup> Rather, Michigan contended, the Court should remand so that the state courts and the Michigan legislature could address the question first.<sup>58</sup> What the Court never attempted to explain in *Harper* is why its silence with respect to *this* plea in its *Davis* opinion should be construed as a rejection of Michigan's more carefully argued point.<sup>59</sup>

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applying this background presumption in favor of retroactivity thoughtlessly. See *supra* note 50. There, too, the Court entirely ignored the parties' discussion of the appropriateness of ruling retroactively.

54. *Harper*, 113 S. Ct. at 2530 (O'Connor, J., dissenting).

55. *Id.* (O'Connor, J., dissenting) (citing Transcript of Oral Argument at 37-38, *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989) (No. 87-1020)).

56. Brief for Appellee at 63, *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989) (No. 87-1020).

57. *Id.*

58. *Id.*

59. In fact, Michigan's claim that *Iowa-Des Moines Nat'l Bank v. Bennett*, 284 U.S. 239 (1931), compelled a refund for *Davis* himself was *incorrect*. Brief for Appellee at 63, *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989) (No. 87-1020). The Court's later opinion in *McKesson* made this clear. Michigan had read the case to mean that the taxpayer who brought suit in a case like *Davis* was entitled to a cash refund. However, the *McKesson* Court construed *Iowa-Des Moines National Bank* to corroborate its holding that *either* refunds or retroactive taxes would remove the earlier unconstitutional tax disparity satisfactorily. See *McKesson*, 496 U.S. at 39-40. So the state's concession that an adverse ruling should automatically trigger retroactive relief to a single taxpayer was founded on a legal error the Court did not, at least in advance of *McKesson*, detect. To be sure, a stronger claim is that *Iowa-Des Moines National Bank* stands for the proposition that *some* form of retroactive relief

Finally, *Davis* was decided prior to the Court's announcement in *Beam*—if “announcement” is the right term for the collective implication of statements scattered across three separate opinions—that a resolution of the retroactivity issue for one set of parties, no matter how ill-considered, holds for all similarly placed litigants.<sup>60</sup> Michigan was not on notice that its concession might have the dramatic impact *Harper* assigns it. The unfairness of extrapolating so wildly from Michigan's concession in *Davis* is manifest.<sup>61</sup>

As Justice O'Connor noted,<sup>62</sup> that extrapolation was also inconsistent with the Court's precedents. The Supreme Court has never considered itself constrained by rulings it has made *sub silentio*, whether through inadvertence or knowing inattention. For the reasons just given, as well as the huge monetary sums at stake, *Davis* seems a particularly poor case in which to abandon this practice. Justice Thomas's failure to speak to this issue, after Justice O'Connor raised it pointedly, testifies to the absence of any sound reply.

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is required. But the host of intervening retroactivity decisions surely took precedence or at least had to be distinguished or overruled before the Court could reach the conclusion it now says it reached in *Davis*.

60. See *Beam*, 111 S. Ct. at 2443-48 (opinion of Souter, J.); *id.* at 2449-50 (Blackmun, J., concurring in the judgment); *id.* at 2450-51 (Scalia, J., concurring in the judgment).

61. This last argument from unfair surprise would perhaps pack less punch if, in *Harper*, the Court had relied not on Michigan's concession in *Davis* but rather on its own disposition of *Barker v. Kansas*, 112 S. Ct. 1619 (1992). *Barker* extended *Davis*'s holding to federal military retirees, and it was decided almost a year after Justice Souter set forth the “express reservation” rule in *Beam*, although before the significance of his statement was generally recognized. In *Barker*, the Court reversed and remanded *without* reserving the retroactivity question. *Id.* at 1626. After *Beam*, this simple remand apparently entails that all *Davis*-type rulings have retroactive effect. The Court could have strengthened its argument in *Harper* had it grounded its ruling in *Barker* as well as, or instead of, in *Davis*. For reasons it did not state, however, the Court did not cite *Barker* in this respect.

Perhaps the explanation is that, although *Barker* and *Beam* together entail *Harper*, the Court offered no more *justification* for its implicitly retroactive holding in *Barker* than it did in *Davis*. Indeed, although *Barker* postdated *Beam*, the unfairness of the Court's tacit resolution of the retroactivity issue under the “express reservation” rule in *Barker* rivals the unfairness it worked in *Kraft*. In *Barker*, too, the lower courts had not passed on the retroactivity question because the state had consistently prevailed on the merits. The question was not explicitly posed in the parties' petitions for certiorari, nor was it broached in their briefs to the Court. A single amicus brief, relying on Justice Souter's reference in *Beam* to the significance of reserving the retroactivity issue, requested that the Court do precisely that—reserve the issue—because of the question's complexity and the absence of adequate briefing and argument. Brief of Arizona, Arkansas, Georgia, Iowa, Montana, Oklahoma, Utah, Virginia, & Wisconsin as Amici Curiae in Support of Respondents at §§ II-III, *Barker* (No. 91-611). As in *Kraft*, the Court ignored this plea to withhold judgment, by its new rule resolving the issue definitively without attempting any vindication.

62. See *Harper*, 113 S. Ct. at 2529-30 (O'Connor, J., dissenting).



Perhaps *Davis* should, in the end, be applied retroactively in every state. Powerful arguments have been advanced for a rule of automatic retroactive application in civil cases, perhaps accompanied by more flexibility in the choice of remedies than *McKesson* appears to license.<sup>63</sup> But the Court's opinion hardly justifies this conclusion. It does not even try.

*Harper* is, however, the law of the land. And it offers three immensely important lessons for future litigants in civil cases that present what might be considered novel federal legal issues—at least so long as *Chevron Oil* escapes overruling. First, parties ought, without fail, to argue the retroactivity question along with the merits of the case. It would be folly to expect the Court explicitly to reserve judgment on this question on its own initiative. There is, in fact, no guarantee that the Court will do so even if one or more of the parties requests that the retroactivity issue be left for another day. Remember Iowa's plea in *Kraft*. Second, when arguing the retroactivity point, litigants should stress the importance of the Court's addressing it directly and carefully. *Kraft* and *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*,<sup>64</sup> in which the Court ruled on the merits without mentioning the question of retroactivity despite briefing by the parties, ought to remain exceptions, not establish a new norm of unaccountability. Third, if a novel substantive argument is presented in a case that is before the Supreme Court or an appellate court with jurisdiction over one's own case, and if its resolution might control the disposition of a similar issue in one's own case, one should consult with counsel in that potentially controlling case to ensure that the retroactivity issue is argued satisfactorily. If it is not, consider seeking leave to file an amicus brief. Recall the price that Virginia and many other states paid in *Harper* for Michigan's brief in *Davis*.

#### IV. THE FUTURE OF *CHEVRON OIL*

*Harper* cemented *Beam's* repudiation of *selective* prospectivity in civil cases.<sup>65</sup> The Court made clear that henceforth it will not apply a novel civil ruling to the parties before it while declaring its ruling prospective with respect to all other similar claims.<sup>66</sup> One disappointing aspect of *Harper* is that the Court did not also settle the fate of *pure* prospectivity in civil cases—a ruling that a statute or action will violate federal law only *after* the ruling has been announced.<sup>67</sup> This issue goes well beyond the situation

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63. See *infra* parts IV, V.B.

64. 111 S. Ct. 2773 (1991). See *supra* note 50 for discussion of *Lampf*.

65. *Harper*, 113 S. Ct. at 2517.

66. *Id.* at 2516-17.

67. A purely prospective ruling, as the Court ordinarily understands the term, *can* and generally *does* supply declaratory or injunctive relief.

presented in *Davis* and *Harper*. It affects virtually all important Commerce Clause cases that pose new legal questions or that seek to upset current doctrine,<sup>68</sup> as well as changes in the rules governing statutes of limitations<sup>69</sup> and sundry other matters.<sup>70</sup> Many Commerce Clause cases involve refund claims amounting to millions of dollars, and successful challenges to the constitutionality of electoral or administrative procedures that break new ground could prove enormously disruptive if courts are barred from softening their impact on completed events.<sup>71</sup> Had the Court not chosen to yoke the fate of a multitude of states to Michigan's careless concession in *Davis*, the future of pure prospectivity would almost certainly have been resolved in *Harper*. The opportunity was squandered, but it will come round again.

When it does, one cannot say with confidence what the Court will do, partly because a justice's views about retroactivity are invariably intertwined with views about the proper scope of a court's remedial discretion in cases in which a ruling does apply retroactively. Justices O'Connor and Kennedy, along with Chief Justice Rehnquist, would use *Chevron Oil's* three factors<sup>72</sup>

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68. See, e.g., *American Trucking Ass'ns v. Smith*, 496 U.S. 167, 187 (1990) (plurality opinion) (concluding that *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266 (1987), does not apply retroactively); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 276-77 (1984) (implicitly deciding, as the Court later found in *Beam*, that the Court's ruling invalidating a Hawaii tax that discriminated against alcoholic beverages produced outside the state applied retroactively); *National Can Corp. v. Washington Dep't of Revenue*, 749 P.2d 1286, 1295 (Wash.), cert. denied and appeal dismissed, 486 U.S. 1040 (1988) (finding that *Tyler Pipe Indus. v. Washington Dep't of Revenue*, 483 U.S. 232 (1987), applies only prospectively).

69. See, e.g., *Goodman v. Lukens Steel Co.*, 482 U.S. 656, 662-64 (1987) (finding statute-of-limitations ruling under 42 U.S.C. § 1981 retroactive, because no contrary, misleading precedent existed when plaintiffs filed suit); *Saint Francis College v. Al-Khazraji*, 481 U.S. 604, 608-09 (1987) (declaring statute-of-limitations ruling under 42 U.S.C. § 1981 prospective because plaintiff relied on circuit precedent that was later overturned); *Chevron Oil*, 404 U.S. at 97 (holding statute-of-limitations ruling not retroactive). See *infra* note 159 for a discussion of *Chevron Oil* and later statute-of-limitations cases.

70. See, e.g., *Arizona Governing Comm. v. Norris*, 463 U.S. 1073, 1105-07 (1983) (holding state retirement plan violated Title VII because the state, through intermediaries, discriminated on the basis of sex by paying lower monthly retirement benefits to women; ruling declared prospective to forestall severe financial hardship for state); *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 87-89 (1982) (declaring unconstitutional a broad congressional grant of jurisdiction to bankruptcy courts but staying judgment for three months to permit Congress to repair the defect without disrupting the interim administration of the bankruptcy laws).

71. See, e.g., *Buckley v. Valeo*, 424 U.S. 1, 142-43 (1976) (refusing to invalidate retrospectively decisions of the Federal Election Commission); *Cipriano v. City of Houma*, 395 U.S. 701, 706-07 (1969) (*per curiam*) (invalidating bond authorization process but applying ruling only to bond issues that had not yet been authorized and for which time specified by state law for challenge had not yet expired).

72. See *supra* note 19 (outlining *Chevron Oil's* three factors).

to determine whether a ruling has retroactive effect. If they lost on this point, however, at least two of them would attempt to take these same factors into account in assessing remedies.<sup>73</sup> In contrast, Justices Blackmun, Stevens, and Scalia favor applying all civil decisions retroactively, just as all criminal decisions apply retroactively following the Court's decision in *Griffith v. Kentucky*.<sup>74</sup> At least Justices Stevens and Blackmun, however, seem prepared to continue employing *Chevron Oil* as "a remedial principle for the exercise of equitable discretion by federal courts and not . . . a choice-of-law principle."<sup>75</sup> This declaration suggests that their view might not be so far apart from that of the *American Trucking* plurality, except that they would apparently restrict the use of this principle to nontax cases.<sup>76</sup> Justices Souter, Thomas, and Ginsburg have not revealed their views. In his opinion in *Beam*, Justice Souter wrote that "[w]e do not speculate as to the bounds or propriety of pure prospectivity"<sup>77</sup>—an ambiguous statement that Justice White read, without contradiction by Justice Souter, to suggest that pure prospectivity might be an atavism doomed soon to perish.<sup>78</sup> And Justice Thomas, in his

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73. See *Harper*, 113 S. Ct. at 2537-38 (O'Connor, J., dissenting) (joined by Rehnquist, C.J.).

74. 479 U.S. 314, 328 (1987).

75. *American Trucking Ass'ns v. Smith*, 496 U.S. 167, 220 (1990) (Stevens, J., dissenting). For criticism of Justice Stevens's characterization of *Chevron Oil*'s three-part test as remedial, see David F. Shores, *Recovery of Unconstitutional Taxes: A New Approach*, 12 Va. Tax Rev. 167, 192-94 (1992).

76. See *American Trucking*, 496 U.S. at 220-24 (Stevens, J., dissenting). Justice Stevens, in an opinion joined by Justice Blackmun, *seemed* to indicate that relief in tax cases should be governed by *McKesson*'s more restrictive remedial scheme, without any weight being given to equitable discretion by state courts on remand. See *id.* at 225 (Stevens, J., dissenting) (asserting in *American Trucking* that *Scheiner* should be applied retroactively and that relief should be gauged in light of *McKesson*). For further discussion of the place of equitable discretion in fixing remedies under *McKesson*, see *infra* part V.B. Justice Blackmun's failure to engage in a *Chevron Oil* analysis in his opinion for the Court in *Lampf* perhaps reflects a change of heart about the discretion that federal courts have in fixing the retroactive impact of statute-of-limitations decisions, although it is risky to infer anything from silence. See *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 2782 (1991).

77. *Beam*, 111 S. Ct. at 2448 (opinion of Souter, J.).

78. See *id.* at 2449 (White, J., concurring in the judgment). The significance for Justice Souter of rejecting pure prospectivity, if he decides that it should be rejected, is unclear. In *Beam*, for example, he stated that even when a ruling does apply retroactively, that still "permits litigants to assert, and the courts to consider, the equitable and reliance interests of parties absent but similarly situated. Conversely, nothing we say here precludes consideration of individual equities when deciding remedial issues in particular cases." *Id.* at 2448 (opinion of Souter, J.). Whether Justice Souter would say that this general rule must give way to the stricter remedial requirements that *McKesson* seems to impose in all cases of discriminatory state taxation is a distinct, and unanswered, question. For a discussion of Justice Souter's views, see *infra* text accompanying notes 141-56.

opinion for the Court in *Harper*, went out of his way to avoid taking sides in the debate,<sup>79</sup> although his references to *Griffith* might betray a leaning towards automatic retroactivity.<sup>80</sup> Likewise, the views of Justice Ginsburg are a mystery, as are those of whoever else joins the Court before it returns to this controverted issue. The longevity of *Chevron Oil* as the decisive test for retroactivity, as well as the implications of its demise, are therefore uncertain.

There is something to be said for adopting a rule of automatic retroactivity, at least if flexibility is built into the doctrine of constitutional remedies under the Due Process Clause. But there is less than some have claimed. Justice Stevens argued in *American Trucking*, for example, that if a state tax was unconstitutional under case law that preceded a novel Supreme Court decision permitting taxes of that kind, and if taxpayers filed a timely challenge to the tax, then applying *Chevron Oil* as the *American Trucking* plurality favored—as a choice-of-law rule—would apparently decree that the novel decision not be given retroactive effect.<sup>81</sup> Thus, he said, a court would have no choice but to force the state to correct, through refunds or otherwise, what in a more benighted day were deemed misdeeds, even though the Supreme Court had since pronounced the tax constitutional.<sup>82</sup> It would, however, be odd, indeed perverse, to hold a state liable for anticipating improvements in the Court's constitutional understanding, and to make it pay for actions that the Constitution in fact permits. A rule of automatic retroactive application, by contrast, would not offend intuition in this way.

I wonder whether Justice O'Connor and the other members of the *American Trucking* plurality would, or ought to, be discomfited by Justice Stevens's argument. Most likely, they would conclude that, in the circumstances described, the new rule's purposes, together with equitable concerns, militate in favor of its retroactive application. Thus, they too would probably excuse the state from paying refunds or providing some other type of redress. Why, they might ask, does their mere consideration of the *Chevron Oil* factors in determining whether a rule applies retroactively expose them to ridicule? Aren't these the factors on which the determination of retroactivity ought, in all cases, to turn?

Nevertheless, in other respects the *American Trucking* plurality's approach is more difficult to defend. A rule of automatic retroactivity in civil cases, such as Justice Stevens advocated, would establish uniformity with the Court's routine approach to deciding criminal cases. And uniformity would have an appeal beyond whatever aesthetic advantage accrues to symmetry or

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79. See *Harper*, 113 S. Ct. at 2516 n.9.

80. See *id.* at 2516-18.

81. See *American Trucking*, 496 U.S. at 218-19 (Stevens, J., dissenting).

82. *Id.*

simplicity. Suppose that the plaintiffs in *American Trucking* had refused to pay Arkansas's highway use tax, that they had subsequently lost in both civil and criminal proceedings, and that the civil and criminal cases were both still pending when *Scheiner* was decided. *Griffith* would mandate the reversal of their criminal convictions. But, as Richard Fallon and Daniel Meltzer point out, the *American Trucking* plurality's view would render those taxpayers civilly liable, notwithstanding the dismissal of the criminal charges against them.<sup>83</sup> Of course, civil and criminal remedies need not keep step, as Fallon and Meltzer note. But what seems incomprehensible is the reason that Justice O'Connor must give for their divergence in this hypothetical case: *Griffith* makes clear that the criminal penalty associated with the tax was unconstitutional when it was imposed, but the tax itself, according to her theory, was not then unconstitutional, even though both rested on the same precedents and both were invalidated by the Court's unforeseen ruling in *Scheiner*. This explanation is nonsensical.

Justice O'Connor might reply that this theoretical embarrassment is of trivial importance. Under the reading that she and several other justices share of *Chevron Oil*, remedial concerns explicitly influence judgments of retroactive constitutionality as a choice-of-law matter; under the approach that Justice Stevens prefers, they do not, but they exercise equal force at the next stage of the remedial calculus. Hence, she might rejoin, there is not necessarily any *functional* difference between her view and his. If Justice O'Connor were to reply in this way, however, she would need to explain why, if the two approaches converge functionally, there is any reason to insist on her interpretation of *Chevron Oil* and its allied test for determining retroactivity, conceived as a choice-of-law rather than as a remedial principle. What little she does say is unconvincing.

In *American Trucking*, and more recently in her *Harper* dissent, Justice O'Connor offered two reasons for distinguishing criminal cases, in which a rule of automatic retroactivity is appropriate, from civil cases, in which, she thinks, it is not.<sup>84</sup> First, she said, allowing a court to hold that the retroactive application of a new criminal rule would be inequitable and therefore cannot be required would typically favor the government's reliance interests over the criminal defendant's interests in vindicating his constitutional rights, relative to a rule that always decreed new criminal rules retroactive.<sup>85</sup> As the constitutional rights of criminal defendants were interpreted more expansively in the late 1960s and early 1970s, it was the government

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83. Richard H. Fallon, Jr. & Daniel J. Meltzer, *New Law, Non-Retroactivity, and Constitutional Remedies*, 104 Harv. L. Rev. 1731, 1767-68 (1991).

84. See *American Trucking*, 496 U.S. at 198-99 (plurality opinion); *Harper*, 113 S. Ct. at 2530-31 (O'Connor, J., dissenting).

85. *American Trucking*, 496 U.S. at 198 (plurality opinion).

alone that benefitted from prospective changes in the law, relative to a baseline of automatic retroactivity.<sup>86</sup> But novel civil holdings, she contended, are not apt to favor defendants over plaintiffs. Moreover, Justice O'Connor argued, there is no reason for according special protection to any set of civil litigants, as there is for safeguarding criminal defendants.<sup>87</sup> Second, and more important, civil plaintiffs often gain from a purely prospective ruling, because they usually seek a more advantageous legal regime for the future as well as relief for past wrongs. Most criminal defendants, however, care only about avoiding or reversing their convictions. Hence, Justice O'Connor asserted, they would have little incentive to fight if they might not profit from any new ruling established in their case.<sup>88</sup> No comparable carrot is needed in civil cases.

Neither of these reasons is persuasive. To the extent that the empirical claim regarding criminal cases that underpins Justice O'Connor's first argument is sound, it need not hold for the future. As Justice Scalia observed, that criminal prospectivity generally benefitted public authorities in a given case "was a consequence, not of the nature of the doctrine, but of the historical 'accident' that during the period prospectivity was in fashion legal rules favoring the government were more frequently overturned."<sup>89</sup> History need not repeat itself. If it did not, then the contrast Justice O'Connor wished to draw between civil and criminal cases would vanish.

Of course, it was, as Justice Scalia suggested, no accident that the Court's use of nonretroactivity during the Johnson and Nixon years eased the pain of its rulings on law enforcement officials. That was the perceived price of securing greater freedom for the future. What is more important than Justice Scalia's logical point is that the governmental bias of nonretroactivity in criminal cases is paralleled by a governmental bias in a critical group of civil cases. As Fallon and Meltzer have remarked, "in many important classes

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86. At least the government benefitted in the very short term, if a particular decision was applied nonretroactively and so did not upset prior convictions. Over time, the government's interests—if it makes sense to treat the state's interests as adverse to the rights of its citizens—arguably were frustrated because the availability of prospective holdings removed the deterrent that severe governmental dislocation presented, thereby enabling the Court to rule against the government more freely in widening the scope of personal liberties. It is precisely that consequence of nonretroactivity that Justice Scalia and others have deplored. See, e.g., *Harper*, 113 S. Ct. at 2522-24 (Scalia, J., concurring); *Beam*, 111 S. Ct. at 2444 (opinion of Souter, J.).

87. *Harper*, 113 S. Ct. at 2530-31 (O'Connor, J., dissenting).

88. *Id.* (O'Connor, J., dissenting).

89. *Id.* at 2521 n.1 (Scalia, J., concurring) (citation omitted). Justice Scalia perforce assumes that the Due Process Clause does not block the application of novel, law-changing criminal rules against defendants—at least not to any greater degree than it prevents their application to civil plaintiffs or defendants. This assumption might be questioned.

of civil cases—including both tax refund cases and constitutional tort actions—nonretroactivity rules systematically favor the government (or its officials) at the expense of constitutional rightholders.”<sup>90</sup> As a logical matter, this need not be so. It is theoretically possible that a state will lose from the *Chevron Oil* rule in some tax refund cases. If, for example, an unexpected ruling declared constitutional a state tax that was unlawful under earlier precedents, the state could conceivably be harmed by a *Chevron Oil* approach if the ruling were not retroactive and the state was therefore required to pay back the money it had collected or offer some other type of relief to those who had paid the tax. The number of these cases, however, is apt to be tiny, because few states enact taxes that they expect, under established law, to be found unconstitutional, and because a consideration of the equities under *Chevron Oil* might often counsel against applying the new, tax-upholding rule prospectively only. Fallon and Meltzer’s point is therefore sound, as a practical observation. Hence, even if Justice O’Connor is correct in discerning a bias in favor of the government when a cousin of *Chevron Oil* furnished the retroactivity rule for criminal cases, that bias exists, at least as persistently, in the civil cases that most concern her. If “the generalized policy of favoring individual rights over governmental prerogative can justify the elimination of prospectivity in the criminal area,”<sup>91</sup> it should also be able to do so in civil tax cases of constitutional stature.<sup>92</sup>

Justice O’Connor’s second reason for treating civil retroactivity differently from criminal retroactivity is equally infirm. It is undoubtedly true that criminal defendants are usually interested only in retroactive relief, whereas civil litigants frequently desire injunctive relief as well. But this statistical difference surely cannot justify denying retroactive relief to taxpayers and other civil plaintiffs who do *not* request injunctive relief, perhaps because the offending tax has already been repealed, or who, as in *Harper*, will likely achieve no more tangible benefit in the future than seeing state retirees taxed more heavily or additional sums of money passing from the state treasury to the Internal Revenue Service. Conversely, criminal defendants can be expected to pursue legal challenges even if it is not certain, but only possible, that if they prevail, the court’s ruling will apply retroactive-

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90. Fallon & Meltzer, *supra* note 83, at 1769 n.208.

91. *Harper*, 113 S. Ct. at 2530 (O’Connor, J., dissenting).

92. If the fact that *individual rights* are at stake is what matters to Justice O’Connor, it is worth noting that the Court has held that plaintiffs do have a *right*, under 42 U.S.C. § 1983, to sue and recover for taxes that violate the Commerce Clause. See *Dennis v. Higgins*, 111 S. Ct. 865 (1991). The Commerce Clause, the Court concluded, does not merely empower the federal government and tacitly limit state chauvinism: it confers rights on people and businesses to ply their trades free from certain types of discrimination. See *id.* at 870-71. Justice O’Connor joined the Court’s opinion in full.

ly to them. What have they to lose by litigating?

Justice O'Connor's distinction appears especially vulnerable because there seems to be no reason to establish a bright-line rule in this area. Certainly, Justice O'Connor has not suggested one. And simply to say that half a loaf—some protection in the future—is enough without addressing the merits of the claim that a whole loaf is constitutionally required, for the same reasons that the Court found compelling in revising its approach to criminal cases, is plainly inadequate. As Justice Scalia complained, it is unclear why, “if a receipt-of-some-benefit principle is important, we should use such an inaccurate proxy as the civil/criminal distinction, or how this newly-discovered principle overcomes the ‘basic norms of constitutional adjudication,’ on which *Griffith v. Kentucky*, 479 U.S. 314, 322 (1987), rested.”<sup>93</sup> Perhaps Justice O'Connor's real concern is with litigants' incentives to sue, which affect the celerity with which constitutional errors are corrected. But if her contention is that the *Chevron Oil* approach to retroactivity in civil cases produces the optimal level of constitutional challenges, she needs to show how she arrived at this conclusion, and why a rule of automatic retroactivity would prompt *too many* civil suits. Her opinions have thus far offered no clues.

These arguments are all negative in character. They parry attempts to justify using one rule to ascertain civil retroactivity and another to determine whether new federal criminal decisions apply retroactively. Are there persuasive positive arguments for univocal treatment, apart from uniformity's capacity to avoid what seems a theoretical anomaly in the hypothetical variant of *American Trucking* described above? In my opinion, there are. But these reasons are ethereal, more considerations of naturalness and simplicity than of constitutional necessity or concrete advantage to judicial decisionmakers or any group of potential litigants. Article III's command that federal courts decide cases or controversies cannot plausibly be read to bar applying a decision purely prospectively, if that means resolving the merits of a case but offering no remedy for past wrongs.<sup>94</sup> What the *Griffith* Court called “the

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93. *Harper*, 113 S. Ct. at 2522 n.1 (Scalia, J., concurring) (citation omitted).

94. Justice Scalia stated in his *American Trucking* concurrence that “the case-or-controversy requirement of Article III, § 2, cl. 1, . . . surely requires retroactivity with respect to the parties immediately before the Court.” *American Trucking*, 496 U.S. at 204 (Scalia, J., concurring in the judgment). Although this view was articulated forcefully 30 years ago, see Note, Prospective Overruling and Retroactive Application in the Federal Courts, 71 *Yale L.J.* 907, 930-33 (1962), the Court rejected it soon thereafter. See *Linkletter v. Walker*, 381 U.S. 618, 622 n.3 (1965). The Court's initial repudiation of this reading of Article III was rightly criticized. See Paul J. Mishkin, Foreword: The High Court, The Great Writ, and the Due Process of Time and Law, 79 *Harv. L. Rev.* 56, 59 n.13 (1965). But after three decades of retroactivity rulings, it is clear that Justice O'Connor was correct in replying to Justice Scalia that “this Court [has] never held that nonretroactivity violates the Article III requirement that



nature of judicial review,"<sup>95</sup> however, buoys the thought that the Court's announcement of what the law is resounds in all directions, into the past as well as forward into the future.

Justice Scalia, in his separate opinions in recent retroactivity cases,<sup>96</sup> has articulated forcefully the traditional, Blackstonian understanding that in issuing a ruling, courts declare their reasoned belief about what some legal provision means. Although that belief might be erroneous, it nevertheless remains a belief about what the interpreted provision requires and, so long as its legal surroundings have not changed decisively, therefore necessarily *did* require. This view has, I think, an immediate appeal, at least when married to the conviction that past errors in judges' understanding of some legal provision, on which people might prudently but mistakenly have relied, can sometimes justify not penalizing past illegalities. The view championed by Justice O'Connor—that an action is constitutional if taken prior to a declaration by the Court that the Constitution forbids it, so long as previous precedents strongly encouraged what is concededly a *misreading* of the Constitution—is, by contrast, almost bizarre. The more natural approach is to ask first what federal law requires and then, if a party's past conduct was inconsistent with that interpretation, to ask whether the drafting of the provision or established practice or contrary judicial readings of the law justify or excuse what is now considered illegal behavior, and thus mitigate

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this Court adjudicate only cases or controversies." *American Trucking*, 496 U.S. at 200 (plurality opinion). To be sure, Justice O'Connor took just the opposite view of Article III only one year before, when she argued against considering novel claims raised by habeas petitioners because awarding retroactive relief to one who persuaded the Court to author a new constitutional rule would be " 'an unavoidable consequence of the necessity that constitutional adjudications not stand as mere dictum.' " *Teague v. Lane*, 489 U.S. 288, 315 (1989) (plurality opinion) (quoting *Stovall v. Denno*, 338 U.S. 293, 301 (1967)). But as Richard Fallon and Daniel Meltzer have convincingly shown, Justice O'Connor's view in *American Trucking* is unquestionably the right one. See Fallon & Meltzer, *supra* note 83, at 1797-1807. The Court has often decided the merits of a case and then denied relief—for example, by concluding, after finding some constitutional error, that the error was harmless or that relief was barred by sovereign immunity. Indeed, as Justice Douglas noted in denouncing the suggestion that Article III requires a court to grant relief to the prevailing party as a "pretense . . . too transparent to need answer," the tradition of "producing only dictum through a 'case or controversy' " dates back to *Marbury v. Madison*. *Desist v. United States*, 394 U.S. 244, 256 (1969) (Douglas, J., dissenting). Justice Scalia's reading of Article III would be a radical departure from past practice, unless the sovereign immunity and harmless error cases were treated as consistent with it. If they were so read, however, the fight over the import of Article III's case-or-controversy requirement would apparently become empty.

95. *Griffith v. Kentucky*, 479 U.S. 314, 322 (1987).

96. See *American Trucking*, 496 U.S. at 200 (Scalia, J., concurring in the judgment); *Beam*, 111 S. Ct. at 2450 (Scalia, J., concurring in the judgment); *Harper*, 113 S. Ct. at 2520 (Scalia, J., concurring).

whatever relief would ordinarily be due.<sup>97</sup>

A majority of the justices seems to be coming around to this view. Justices Blackmun and Scalia enunciated it in *Beam*, and Justice Thomas's repeated references in *Harper* to the *Griffith* Court's reasons for making all criminal rulings automatically retroactive suggest that he and Justices Stevens and Souter, who joined his opinion in full, might be ready to declare their allegiance to it as well. Perhaps significantly, the worries expressed by Justices O'Connor and Kennedy about the Court's dicta on this point were not quelled by any accommodating changes in Justice Thomas's opinion for the Court.<sup>98</sup>

To repeat, the arguments on behalf of this approach are not overwhelming *if* a finding of retroactivity does not foreclose the choice of remedies, for Justice O'Connor's reading of *Chevron Oil* could be functionally equivalent to the view that retroactivity is automatic but that *Chevron Oil* supplies the overarching remedial principle in all civil cases. The paramount question is always what actions are constitutionally required as a result of a party's having acted in a way that the best current understanding of the Constitution or federal statutory law does not countenance. Whether it is framed solely as a question of remedies, or as a question of retroactivity *and* of remedial discretion, is of small importance. Simplicity and logic favor bringing all the remedial considerations together at one analytical stage rather than two. But there may be little practical benefit to doing so. Substance is what matters. It is therefore essential, whether questions of retroactivity or remedies are partitioned or combined, that the Court confront them *together*, as it did in deciding *American Trucking* and *McKesson* simultaneously. This time, however, it must speak more plainly.<sup>99</sup>

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97. See, e.g., Fallon & Meltzer, *supra* note 83, at 1764-77; Shores, *supra* note 75, at 215-16.

98. See *Harper*, 113 S. Ct. at 2525 (Kennedy, J., concurring in part and concurring in the judgment); *id.* at 2527-28 (O'Connor, J., dissenting).

99. Among the questions the Court will have to answer is whether to continue using *Chevron Oil*'s three-factor test—either to determine whether old or new law applies to pre-decisional conduct or to determine, at the remedial stage, what relief to order—or whether to replace it with a different set of considerations for making these determinations. *Chevron Oil* has earned abundant criticism over the years, partly because the novelty of a new decision has been all but decisive in every case in which the Court has applied it, partly because it is unclear how the other factors are to be weighed in reaching an overall assessment, and partly because, whatever sense they make in statute-of-limitations cases, *Chevron Oil*'s three factors do not, in the opinion of some writers, apply naturally or helpfully to other types of cases. See, e.g., Carl D. Ciochon, Note, Nonretroactivity in Constitutional Tax Refund Cases, 43 *Hastings L.J.* 419, 453 (1992). Alternative approaches have been suggested. See, e.g., Fallon & Meltzer, *supra* note 83, at 1824-33; Shores, *supra* note 75, at 213-16.

Until the Court dispels the confusion fogging these matters, is *Chevron Oil* good law? This is a complicated question, partly because the Court's holding in that case is hardly pellucid. Lower courts may not, of course, rule inconsistently with a Supreme Court holding that is precisely on point, even if that precedent is doddering and almost certain to fall. As the Court said just a few years ago in reprimanding a court that anticipated the march of legal history: "If a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the Court of Appeals should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions."<sup>100</sup> The difficulty in heeding this injunction, so far as *Chevron Oil* is concerned, is twofold: whether the Court has overruled or significantly limited its holding in *Chevron Oil* is not clear, just as it is obscure what the Court takes *Chevron Oil* to hold. These issues are intertwined.

*Chevron Oil* has never been explicitly overruled, and in *Harper* the Court continued to treat it as a live precedent.<sup>101</sup> If, however, the decision is regarded as establishing a threshold test for the retroactive application of a civil decision, as Justice O'Connor has consistently understood it, then *Chevron Oil* enjoys, at best, a twilight existence. In *American Trucking*, five justices expressly rejected the view that this reading of *Chevron Oil* encapsulates. Their doing so, albeit not in a single opinion, arguably (though insecurely) satisfies the *Rodriguez de Quijas* standard for overruling<sup>102</sup>—assuming that an interpretation, rather than a holding, can be said to have been "overruled." It is true that two of the five justices who broke with Justice O'Connor in *American Trucking* have since resigned. But their votes are not expunged by their departure, and their replacements have shown no sympathy for Justice O'Connor's interpretation of *Chevron Oil*, even if they have not openly disavowed it. One of Justice O'Connor's allies—Justice White—has also left. To the extent that *Chevron Oil* continues to shape decisionmaking, it appears to be as a principle for resolving the issue presented in *Chevron Oil* itself: whether to dismiss a claim that fell within the limitations period as the legal community understood it when the claim was filed, but that fell outside that limitations period as it came to be defined after the claim was filed but before the case was finally decided. And even there, *Chevron Oil*'s directive has grown garbled.<sup>103</sup> Whether *Chevron Oil* survives, and what import it has if it does, are thus highly debatable questions.

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100. *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989).

101. See *Harper*, 113 S. Ct. at 2516 & n.9.

102. See *Rodriguez de Quijas*, 490 U.S. at 484.

103. See *infra* note 159 for a discussion of the confusion surrounding the Court's approach to the retroactive reach of statute-of-limitations decisions.

## V. THE REMEDIAL REQUIREMENTS OF THE DUE PROCESS CLAUSE

After deciding the retroactivity question against Virginia, the Supreme Court remanded in *Harper* so that the state courts might consider an assortment of remedial issues. Much litigation in states in which *Davis*-type suits are pending will now focus on the implications of the Due Process Clause, in tandem with the doctrine of intergovernmental tax immunity, for remedying the wrong that Virginia and other states committed by taxing state and federal retirees differently. These remedial issues might also prompt legislative debate and action, either by state lawmakers or by Congress. Of course, the problem of remedies under the Due Process Clause is more capacious than *Davis*-inspired tax refund suits alone suggest. In other instances, too, particularly in connection with Commerce Clause cases like *Kraft* and statute-of-limitations cases like *Lampf*, courts are bound to probe the remedial demands of the Due Process Clause. The sunset of *Chevron Oil* as a choice-of-law principle should augment controversy. This part explores the major remedial issues that *McKesson*, *Beam*, and *Harper* have spawned. Several of these issues, such as the constitutional necessity of paying or charging interest on awards that are constitutionally mandated and the legitimacy of pass-on defenses in cases in which the nominal taxpayer did not bear the full burden of an unlawful tax, will almost surely return to the Supreme Court. This part also outlines what might well be less costly ways for states to respond to *Davis* violations than they may have explored thus far.

### A. Pre- and Post-Deprivation Due Process

In *McKesson*, the Court held unanimously that “[i]f a State places a taxpayer under duress promptly to pay a tax when due and relegates him to a postpayment refund action in which he can challenge the tax’s legality, the Due Process Clause of the Fourteenth Amendment obligates the State to provide meaningful backward-looking relief to rectify any unconstitutional deprivation.”<sup>104</sup> The question of whether duress is present is plainly one of federal law.<sup>105</sup> Although the Supreme Court has defined “duress” increasingly liberally, to include financial sanctions for nonpayment even if they are not imminent,<sup>106</sup> the Court has not read the Due Process Clause to prohibit

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104. *McKesson*, 496 U.S. at 31 (footnotes omitted).

105. See, e.g., Philip M. Tatarowicz, Right to a Refund for Unconstitutionally Discriminatory State Taxes and Other Controversial State Tax Issues Under the Commerce Clause, 41 Tax Law. 103, 121-23 (1987).

106. See *McKesson*, 496 U.S. at 38-39 & nn.20-21. At one time, a formal protest at the time of payment was also required, either as a matter of statute or of federal common law, to render payment to the federal treasury involuntary. See, e.g., *United States v. New*

the denial of refunds for taxes paid "voluntarily" in this shrunken sense. For this purpose, a tax is paid voluntarily when it might have been challenged before payment without incurring a serious penalty for nonpayment.<sup>107</sup> Thus, the Court said in *McKesson*, so long as a state chooses "to provide a form of 'predeprivation process,' for example, by authorizing taxpayers to bring suit to enjoin imposition of a tax prior to its payment, or by allowing taxpayers to withhold payment and then interpose their objections as defenses in a tax enforcement proceeding initiated by the State,"<sup>108</sup> it need not offer any retroactive relief if the tax is found to be constitutionally infirm, although a state is free to supply redress beyond the constitutional minimum if it wishes. The Court referred to these passages from its opinion in *McKesson* when it remanded in *Harper*, noting that "the 'availability of a predeprivation hearing constitutes a procedural safeguard . . . sufficient by itself to satisfy the Due Process Clause.'" <sup>109</sup>

Unless the various state legislatures act swiftly to cure the constitutional harm that statutes inconsistent with *Davis* worked in past years, two issues relating to the sufficiency of taxpayers' pre-deprivation opportunities to challenge the differential taxation of state and federal retirees might surface in state courts following *Harper*. Both are ubiquitous concerns. They arise regularly in challenges to state taxes based on the Commerce Clause, the

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York & Cuba Mail S.S. Co., 200 U.S. 488 (1906); *Chesebrough v. United States*, 192 U.S. 253 (1904). This precondition to recovery was later abandoned at the federal level. See *George Moore Ice Cream Co. v. Rose*, 289 U.S. 373, 375-76 (1933). The duress needed to render a tax payment involuntary also had to be imminent, "to release [a taxpayer's] person or property from detention, or to prevent an immediate seizure of his person or property." *New York & Cuba Mail S.S.*, 200 U.S. at 494 (quoting *Railroad Co. v Commissioners*, 98 U.S. 541, 544 (1878)).

107. See *McKesson*, 496 U.S. at 38-39 n.21. At common law, taxpayers could sue only for payments made to the government under duress, so far as such suits were consistent with sovereign immunity. Because payments made under a mistake of law—as opposed to those resulting from factual errors—were deemed voluntary, taxpayers generally could not recover payments under statutes later declared invalid. This doctrine led to harsh and inequitable results. See, e.g., Clifford L. Pannam, *The Recovery of Unconstitutional Taxes in Australia and the United States*, 42 *Tex. L. Rev.* 777, 779-89 (1964) (criticizing the artificiality of the voluntary payment rule); John D. McCamus, *Restitutionary Recovery of Moneys Paid to a Public Authority Under a Mistake of Law: Ignorantia Juris in the Supreme Court of Canada*, 17 *U. Brit. Colum. L. Rev.* 233, 234 (1983) (decrying the voluntary payment rule as "ill-designed to capture within its rubric those cases touched by its underlying rationale"). Many states have, as a matter of state law, repealed the voluntary payment rule and permitted refund suits for taxes paid voluntarily or involuntarily. See, e.g., Note, *The Voluntary-Payment Doctrine in Georgia*, 16 *Ga. L. Rev.* 893, 900-03 (1982) (describing Georgia's statutory repudiation of the voluntary payment rule with respect to tax payments). For discussion of the rule's recent reincarnation in Georgia, see *infra* text accompanying notes 121-28.

108. *McKesson*, 496 U.S. at 36-37.

109. *Harper*, 113 S. Ct. at 2519 (quoting *McKesson*, 496 U.S. at 38 n.21).

Equal Protection Clause, and other constitutional provisions, not just in *Davis*-related litigation. Conflicts among state court approaches to these issues might well elicit further guidance from the Supreme Court, especially if more states enact prepayment challenge mechanisms to forestall potentially devastating refund suits.

The first issue is whether the existence of some procedure for contesting the constitutionality of a state tax prior to payment and without penalty permits a state to deny retroactive relief for a constitutional infraction if a taxpayer did *not* raise such a challenge but elected instead to pay the tax and seek a refund pursuant to an alternative procedural route. The Court's language in *McKesson* suggests that the mere existence of an adequate pre-deprivation procedure does relieve a state from the obligation of providing refunds, even if state law furnishes taxpayers with the additional option of pursuing a refund after paying the tax. Two precedents from ninety years ago—*United States v. New York & Cuba Mail Steamship Co.*<sup>110</sup> and *Chesebrough v. United States*<sup>111</sup>—which the Court has not disowned, buttress this conclusion.<sup>112</sup> Neither *McKesson* nor these older precedents, however, license states that do have pre-deprivation procedures for challenging a tax's constitutionality to deny refunds *unfairly* if a taxpayer forgoes a pre-deprivation challenge. Thus, if a state refund statute *requires* rather than *permits* state tax officials to refund unconstitutional taxes—unlike the federal statutes under which refunds were sought in *New York & Cuba Mail* and *Chesebrough*—the state's refusal to pay refunds in *Davis*-type cases could presumably be attacked on state-law grounds as well as under the Due Process or Equal Protection Clause. Likewise, if *Davis*-type refund claims were singled out for unfavorable treatment under a refund statute that grants discretion to state tax officials—and the magnitude of these claims might make denials tempting—federal retirees who were adversely affected could

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110. 200 U.S. 488 (1906).

111. 192 U.S. 253 (1904).

112. Both cases involved suits by taxpayers who had paid federal taxes without protesting what they alleged was the unconstitutionality of the taxes. Both taxpayers sought refunds under statutes authorizing the Commissioner of Internal Revenue to repay taxes that were wrongfully collected; when their requests were denied, they entered pleas in federal district court. The Supreme Court ruled in both cases that the taxpayers had paid the taxes voluntarily, in part because they had failed to satisfy the common-law precondition of protesting the illegality of the taxes when they paid them. See *New York & Cuba Mail S.S.*, 200 U.S. at 494-95; *Chesebrough*, 192 U.S. at 263-64. The Court therefore found that no refund was required. The Court noted that the refund statutes *permitted rather than mandated repayment*—the Commissioner was “authorized” to refund illegally collected taxes or “may” make allowance for taxes that were wrongfully collected—and it held that the Commissioner was therefore not compelled to refund taxes that were paid without putting the government on notice of the taxpayers’ allegations of unconstitutionality.

probably sue under state law or under one or both of these constitutional provisions. It is too early to say whether any post-*Harper* litigation is likely to track this course.<sup>113</sup>

The second issue that might spur litigation, as state officials try to avoid prising large refunds from embattled treasuries, is whether there in fact existed a prepayment remedy, of which federal retirees could have availed themselves, that was constitutionally sufficient to warrant the denial of retroactive relief to those who ignored that pre-deprivation procedure. This issue might well come to the fore on remand in *Harper* itself. In its brief to the Supreme Court, Virginia contended that it had no obligation to provide refunds or to tax state retirees retroactively because federal pensioners could have challenged their tax assessments administratively prior to paying state income tax. By forgoing this possible remedy, the state argued, they relinquished any federal constitutional claim they might have had to backward-looking relief.<sup>114</sup> In response to the federal retirees' claim that the Department of Taxation lacked authority under state law to declare a tax unconstitutional, hence that meaningful prepayment relief could not be obtained, Virginia countered that the Commissioner could nevertheless exonerate a taxpayer from paying taxes, even if the Commissioner could offer no official pronouncement on the tax's constitutionality. But the state produced no authority for this claim in its brief. The federal retirees, for their part, denied that the Commissioner could excuse payment on the basis of a constitutional flaw that only the courts could recognize officially.<sup>115</sup> The

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113. One opinion granting partial but not full refunds for *Davis* violations under an interpretation of the state law of remedies, based on the premise that *McKesson's* remedial scheme does not apply because state law allows pre-deprivation challenges, is that of the Arizona Tax Court in *Bohn v. Waddell*, 807 P.2d 1, 3 (Ariz. T.C. 1991), aff'g 790 P.2d 272 (Ariz. T.C. 1990). The court's decision ordering partial refunds was later vacated on the ground that the taxpayers had first to exhaust their administrative remedies before suing in state court. See *Estate of Bohn v. Waddell*, 848 P.2d 324 (Ariz. Ct. App. 1992). By contrast, in *Sizemore v. Rinehart*, 611 So. 2d 1064 (Ala. Civ. App. 1992), writ quashed as improvidently granted, 611 So. 2d 1069 (Ala. 1993), the court ordered that refunds be paid despite the availability of pre-deprivation relief that the taxpayers had apparently chosen to pass up.

114. Brief for Respondents at § II.C, *Harper* (No. 91-794).

115. See Reply Brief for Petitioners at § II, *Harper* (No. 91-794). The taxpayers' brief also raised the first issue identified: even if a prepayment remedy was available, they averred, that fact was irrelevant, because state law also provided a refund mechanism. Indeed, after *Davis* the Virginia legislature extended the statute of limitations for filing refund claims to accommodate federal retirees seeking post-payment redress. The petitioners in *Harper* maintained that denying retroactive relief because an administrative challenge was possible prior to payment (if a meaningful challenge was indeed possible) would contravene the legislature's plain intention to afford relief. It appears that they might further argue that denying refunds when refunds are routinely made available to other taxpayers who decline to seek administrative relief before paying would constitute unlawful discrimination under the

Supreme Court declined to rule on this point, because remedial issues were not properly before it and the state-law question of the Commissioner's powers had not been decided below.<sup>116</sup> It may now fall to the Virginia courts to resolve the issue.

It is important to stress that while the *existence* of an avenue for prepayment challenge is a question of state law, the *sufficiency* of any prepayment procedure to absolve a state from providing retroactive relief must be measured under the Due Process Clause, according to standards that the Supreme Court has not yet articulated in detail. Certainly, the prepayment procedure must promise complete relief without being unduly tortuous or costly. As the Court said in *Atchison, Topeka & Santa Fe Railway Co. v. O'Connor*,<sup>117</sup> "It is reasonable that a man who denies the legality of a tax should have a clear and certain remedy."<sup>118</sup> Equally plainly, it cannot be a remedy that the state or its courts discovered or created and made a precondition to relief for constitutional flaws only *after* taxpayers had paid their taxes and filed claims for refunds. As the Supreme Court stated without dissent in *Brinkerhoff-Faris Trust & Savings Co. v. Hill*,<sup>119</sup> after Missouri had attempted to do precisely that: "Whether acting through its judiciary or through its legislature, a State may not deprive a person of all existing remedies for the enforcement of a right, which the State has no power to destroy, unless there is, or was, afforded to him some real opportunity to protect it."<sup>120</sup>

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Equal Protection Clause. If the rule of prepayment challenge, on pain of losing all chance of relief, was unheralded until the retirees' large refund claims rolled in, they might also contest the newly announced policy under the Due Process Clause. State law might furnish some additional basis for suit.

116. *Harper*, 113 S. Ct. at 2520.

117. 223 U.S. 280 (1912).

118. *Id.* at 285. The Court quoted this sentence with approval repeatedly in *McKesson*, 496 U.S. at 32, 39, 40, 43, 51.

119. 281 U.S. 673 (1930).

120. *Id.* at 682 (footnote omitted). *Brinkerhoff-Faris* involved a suit alleging that a state tax violated the Equal Protection Clause. The taxpayer had sued in equity to enjoin collection of the tax, maintaining that no relief was available at law, either by way of defense in an enforcement proceeding or by paying the tax under protest and claiming a refund. The taxpayer further alleged that it had not sought an administrative remedy because, just six years before, the Missouri Supreme Court had declared it "preposterous" and "unthinkable" that the Tax Commission could grant the relief the taxpayer sought. *Id.* at 676. On appeal, the Missouri Supreme Court declared, contrary to its earlier holding, that the taxpayer *could* have obtained a remedy from the Tax Commission, yet that it could no longer secure relief because too much time had elapsed for it to bring its claims before the Commission. *Id.* at 677. The United States Supreme Court held that "in refusing relief because of the newly found powers of the commission, the court transgressed the due process clause of the Fourteenth Amendment." *Id.* at 677-78. The Missouri Supreme Court's surprising reversal of its earlier holding had left the



The question of how much surprise regarding the proper procedural route for contesting a tax's unconstitutionality is consonant with federal due process standards can arise with respect to post-payment procedures too. Georgia provides an example. In *Reich v. Collins*,<sup>121</sup> the Georgia Supreme Court correctly anticipated the holding in *Harper*, concluding that *Davis* applies retroactively under the Court's analysis in *Beam*.<sup>122</sup> Because the taxpayer who challenged Georgia's tax on federal but not state retirement income sued for a refund under a statute specifying that a taxpayer "shall be refunded any and all taxes or fees which are determined to have been erroneously or illegally assessed and collected from him under the laws of this state," and because the refund statute applied to taxes "whether paid voluntarily or involuntarily,"<sup>123</sup> a refund order seemed the natural resolution of the case. Instead, the Georgia Supreme Court announced, without citing precedent or legislative history or related statutory language, that the statute "does not address the situation where the law under which the taxes are assessed and collected is itself subsequently declared to be unconstitutional or otherwise invalid."<sup>124</sup> The court continued:

We take this opportunity to hold that in cases in which a taxing statute is declared unconstitutional or otherwise void, a taxpayer must have made a demand for refund at the time the tax is paid or at the time his tax return is filed, whichever occurs last. Failure to do so bars any future claim.<sup>125</sup>

In *McKesson*, the Court reaffirmed the established principle that states may permissibly require taxpayers to file a protest as a precondition to claiming a refund.<sup>126</sup> The refund statute under which Reich sued, however, contained no protest requirement. And the Georgia Supreme Court pointed to no prior authority for the prerequisite it announced. It may be that some authority exists, which the court overlooked or chose not to cite. But assuming that none does, it is hard to see how the court's decision comports with due process. One would expect the taxpayer to raise that due process objection—which appears to be timely<sup>127</sup>—now that the Supreme Court has

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taxpayer without any genuine opportunity to prosecute its claim.

121. 422 S.E.2d 846 (Ga. 1992), vacated and remanded, 113 S. Ct. 3028, cert. denied, 113 S. Ct. 3037 (1993).

122. *Reich*, 422 S.E.2d at 847.

123. Ga. Code Ann. § 48-2-35(a) (1993).

124. *Reich*, 422 S.E.2d at 849.

125. *Id.*

126. See *McKesson*, 496 U.S. at 45.

127. See, e.g., *Brinkerhoff-Faris*, 281 U.S. at 673 (finding a due process claim

remanded the case to the Georgia Supreme Court for reconsideration. In *Brinkerhoff-Faris*, the Court did say that “[h]ad there been no previous construction of the statute [governing the Tax Commission’s powers] by the highest court, the plaintiff would, of course, have had to assume the risk that the ultimate interpretation by the highest court might differ from its own.”<sup>128</sup> But the Court was there referring to a statute setting forth the Tax Commission’s responsibilities that on its face did not preclude the Commission from considering a constitutionally based refund claim. Had the Missouri Supreme Court not ruled as it did several years before, administrative redress would have appeared a sensible option to taxpayers. In Georgia, there appears to have been no reason at all for taxpayers to have supposed, prior to the Georgia Supreme Court’s decision in *Reich*, that a protest was essential to recovery.

Whatever the merits of a due process attack on the court’s holding in *Reich*, state officials who wish to persuade a court in cases like *Harper* to excuse the state from paying large refunds or from imposing retroactive taxes might invoke *Reich* as a suggestive precedent for creating hitherto unknown procedural obstacles to recovery.<sup>129</sup> These issues will have to be litigated

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timely when filed after a court’s surprising ruling effectively denied the taxpayer any opportunity to challenge the constitutionality of a tax).

128. *Id.* at 682 n.9.

129. South Carolina offers a somewhat different example of unfairness to taxpayers so far as refund procedures are concerned. In *Bass v. South Carolina*, 395 S.E.2d 171 (S.C. 1990), vacated and remanded, 111 S. Ct. 2881 (1991), *aff’d*, 414 S.E.2d 110 (S.C. 1992), vacated and remanded, 113 S. Ct. 3025 (1993), the South Carolina Supreme Court held that taxpayers who had sued for a refund under a refund statute with a three-year statute of limitations were not entitled to any relief. Most of the court’s initial holding was devoted to an argument that *Davis* did not apply retroactively. But the court added that, were it to examine issues of state law, it would hold that the suit was barred because the only avenue to recovery was under a *different* refund statute that carried a protest requirement. After the Supreme Court vacated and remanded following its decision in *Beam*, the South Carolina Supreme Court reaffirmed its prior holding on the basis of the procedural bar it had mentioned earlier. Its former decisions, the court said, could not have misled the retirees as to the correct route to relief. The court then noted, however, that “the Tax Commission has issued administrative interpretations stating that [the refund statute under which the retirees had sued] applies to income tax refunds.” 414 S.E.2d at 113. Not only that: “after the *Davis* decision was announced, the Tax Commission issued several press releases in which it advised the retirees that they could ‘protect themselves against the expiration of the three-year statute of limitation’ by writing a letter to the Tax Commission or by filing an amended return for the 1985 tax year.” *Id.* Nevertheless, the court refused to estop the state from arguing that the retirees’ claims were barred: “While we agree with the retirees that it is very unfortunate the Tax Commission has instilled false hopes . . . , we are not bound by [its] misinterpretation . . . .” *Id.* The court refrained from saying why equitable considerations did not impel it to apply its decision prospectively. It is also not clear from the court’s opinion whether the Tax Commission regularly granted income tax refunds under the statute that formed the basis for

state by state, with little chance of review by the Supreme Court. The question of whether notice of the proper remedial course in a given state was constitutionally sufficient is too specific, and the standard by which it must be answered too hazy, to tempt the Court to reconsider state courts' determinations, except perhaps when they appear truly egregious. Taxpayers may find the going hard.<sup>130</sup>

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the federal retirees' suit or, if it did, whether the retirees have challenged, or may still challenge, the denial of their refunds under the Equal Protection Clause.

One commentator, after recounting taxpayers' difficulties in obtaining redress for illegal taxes in South Carolina since the nineteenth century, noted that the refund statute under which the federal retirees had sued was intended, in the words of the Tax Study Commission that drafted it, to establish an equitable system for claiming refunds "without vast technicality." William J. Quirk, *Taxpayer Remedies in South Carolina*, 37 S.C. L. Rev. 489, 509 (1986) (quoting the First Annual Report of the Tax Study Commission). Designed to replace a tax system "so fraught with technicality and expense as to be practically unavailable for the vast majority of taxpayers," *id.* at 510 (quoting Report), the statute, as construed by the South Carolina Supreme Court, appears to have been a conspicuous failure.

130. A recent case from Vermont yields a cautionary tale. In *American Trucking Ass'n v. Conway*, 508 A.2d 408 (Vt. 1986), cert. denied, 483 U.S. 1019 (1987), the Vermont Supreme Court held that taxpayers could not recover fees paid under a statute it found to violate the Commerce Clause because "the state cannot be sued without its consent for injuries resulting from the exercise of functions essentially governmental in character," and imposing taxes "could be performed only by a governmental entity." *Id.* at 413. This result was manifestly unjust and, it appears, unconstitutional, because state law also provided no vehicle for challenging the tax prior to payment. See Louis E. Wolcher, *Sovereign Immunity and the Supremacy Clause: Damages Against States in Their Own Courts for Constitutional Violations*, 69 Cal. L. Rev. 189 (1981) (arguing that the Supremacy Clause obligates state courts to order constitutionally adequate remedies notwithstanding the failure of state law to provide for them).

In *Williams v. Vermont*, 589 A.2d 840, reh'g denied, 589 A.2d 840 (Vt. 1990), cert. denied, 112 S. Ct. 81, and cert. denied, 112 S. Ct. 590 (1991), the Vermont Supreme Court overruled that portion of its opinion in *American Trucking Ass'n* that left plaintiffs with no opportunity to contest a tax prior to payment and no chance to obtain refunds after a successful challenge, reasoning that this complete foreclosure of relief violated the Due Process Clause as construed in *McKesson*. See *id.* at 848-49. In doing so, however, the court appeared to require taxpayers to pay a tax they considered unconstitutional, to seek prospective relief in state court, and then, if they prevailed, to seek a refund from Vermont's Commissioner of Motor Vehicles that he was only doubtfully authorized to provide and whose decision might not even be reviewable in the Vermont courts. Again, the Supreme Court refused to hear the case on writ of certiorari.

Only now, in yet another case, does some straightforward path to relief seem available. In *Barringer v. Griffes*, 964 F.2d 1278 (2d Cir. 1992), the court of appeals granted an injunction on Vermont's collection of a motor vehicle tax by a taxpayer challenging its constitutionality. The court concluded that the Tax Injunction Act of 1937, 28 U.S.C. § 1341 (1988), does not bar federal court interference in the face of Vermont's intransigence: "A careful reading of the opinion in *Williams* leaves the reader with the uneasy feeling that if there is a judicial remedy available to the [plaintiffs] in Vermont, it cannot fairly be said to be plain."

## B. Equitable Discretion in Choosing Remedies

Beyond peradventure, the most salient question after *Harper* is the extent to which states have discretion in choosing a suitable remedy in cases in which a federal constitutional ruling applies retroactively. The transfer of hundreds of millions of dollars depends on the correct answer to this question in Virginia alone. But the question has wider significance, because its answer affects the disposition of all civil holdings that do not overrule precedent or are not doctrinally surprising. It will, of course, become even more pressing if, as seems increasingly likely, the Court holds that all civil decisions apply retroactively, and thereby either overturns *Chevron Oil* or interprets it, as Justice Stevens suggested in his *American Trucking* dissent, as “a remedial principle for the exercise of equitable discretion by federal courts and not . . . a choice-of-law principle applicable to all cases on direct review.”<sup>131</sup>

Following the Court’s paired decisions in *American Trucking* and *McKesson*, the scope of a state’s discretion in remedying the wrongs worked by an unconstitutional tax appeared narrow once the Supreme Court held that its ruling applied retroactively. These cases fell within *McKesson*’s iron remedial frame. If a state failed to provide an adequate prepayment procedure for challenging a tax, it must, at a minimum, either: (1) refund the tax paid by those whose claims were not procedurally barred, if the tax was beyond the state’s power to impose, or, in the case of an unconstitutional tax disparity, pay sufficient refunds to remove the unlawful difference in treatment after the fact; or (2) in the case of an unlawful disparity (as opposed to a tax beyond the state’s power to levy), collect back taxes from those who benefitted from the unconstitutional preference in whatever amount would “create in hindsight a nondiscriminatory scheme,” to the extent that the Due Process Clause permits retroactive taxes of this kind;<sup>132</sup> or (3) in the case

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*Barringer*, 964 F.2d at 1284. Perhaps this decision will goad the Vermont legislature into devising a clearer remedy in order to forestall taxpayers from obtaining injunctions in federal court. Whether or not it does, it illustrates the difficulty that taxpayers sometimes encounter in attempting to secure redress for unconstitutional taxation in recalcitrant state courts.

131. *American Trucking*, 496 U.S. at 220 (Stevens, J., dissenting).

132. Because taxation “is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract,” but rather “a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits[,] . . . its retroactive imposition does not necessarily infringe due process.” *Welch v. Henry*, 305 U.S. 134, 146-47 (1938). The general due process test for retroactive legislation is whether it has “a legitimate legislative purpose furthered by rational means.” *General Motors Corp. v. Romein*, 112 S. Ct. 1105, 1112 (1992). The most important factor in assessing the constitutionality of retroactive taxation is the degree to which it unfairly surprises a taxpayer in circumstances in which he might have acted differently to avoid or reduce the tax had he known it would be imposed. Compare *United States v. Heinszen & Co.*, 206 U.S. 370 (1907) (upholding statute ratifying

of an unconstitutional disparity, combine retroactive taxes and refunds to remove the past inequality as completely as would the first two options.<sup>133</sup> Both the plurality and the dissent in *American Trucking* agreed that this rule left states with little or no leeway. It is, Justice O'Connor said, precisely because "*McKesson* makes plain that equitable considerations are of limited significance once a constitutional violation is found,"<sup>134</sup> that is, it is because "*McKesson*'s holding . . . places substantial obligations on the States to provide relief, [that] the threshold determination whether a new decision should apply retroactively is a crucial one, requiring a hard look at whether retroactive application would be unjust."<sup>135</sup> Justice Stevens, dissenting in *American Trucking*, said nothing to contradict Justice O'Connor's reading of *McKesson*. *Chevron Oil*, in his view, was a remedial principle applicable to statute-of-limitations cases, not tax cases. "[C]onsideration of reliance might be appropriate" if the period for filing suit changes and in certain other instances, but not when state taxes violate the Constitution.<sup>136</sup>

There are, to be sure, passages in *McKesson* itself suggesting that the remedial rule it endorsed for tax cases was not as draconian as it appeared. The Court did not, for example, dismiss equitable considerations as irrelevant to ascertaining a state's constitutional obligation to remedy its mistakes. Indeed, it acknowledged that "within our due process jurisprudence, state interests traditionally have played, and may play, some role in shaping the contours of the relief that the State must provide to illegally or erroneously deprived taxpayers."<sup>137</sup> The Court also spent several pages discussing Florida's claim that the Court's order of retroactive relief was unjust.<sup>138</sup> The Court's conclusions, however, were uncompromising. *At least with respect to taxes collected after McKesson's announcement*, it averred unambiguously

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technically illegal collection of tariffs six years before) and *Anderson v. Mt. Clemens Pottery Co.*, 328 U.S. 680 (1946) (rejecting challenge to Portal-To-Portal Act, which amended earlier legislation retroactively by nine years to correct misunderstanding that would have been costly to employers) with *Coolidge v. Long*, 282 U.S. 582 (1931) (invalidating retroactive succession tax that trust settlor could not reasonably have anticipated) and *Untermeyer v. Anderson*, 276 U.S. 440 (1928) (striking down retroactive gift tax).

133. See *McKesson*, 496 U.S. at 40-41. States are free to provide more relief than the constitutional minimum. *Id.* at 52 n.36. But few are likely to show such magnanimity. Indeed, in the case of an unconstitutional tax disparity, additional compensation will typically not be an option at all, for granting more relief than a party is due could easily create an inequality in treatment that itself discriminates unlawfully against former beneficiaries of the tax disparity.

134. *American Trucking*, 496 U.S. at 184 (plurality opinion).

135. *Id.* at 181 (plurality opinion).

136. See *id.* at 221-23 (Stevens, J., dissenting).

137. *McKesson*, 496 U.S. at 50.

138. *Id.* at 44-51.

that a state's ability to hedge tax payments and refund actions with procedural requirements "suffices to secure the State's interest in stable fiscal planning when weighed against its constitutional obligation to provide relief for an unlawful tax."<sup>139</sup> In addition, the Court held that Florida lacked a persuasive claim to special treatment for its conduct—which of course preceded the Court's ruling—because its discriminatory liquor excise tax was conspicuously unconstitutional.<sup>140</sup>

What the Court's discussion of the equities surrounding backward-looking relief in Florida's own case *possibly* suggests, however, is that while states have at their disposal adequate procedural protections for the future, now that *McKesson's* holding is plain for all to study, states might not have had adequate warning in the past. According to this reading, each claim that retroactive relief would be inequitable for this pre-*McKesson* period must be assessed separately. From the Court's reasoning in *McKesson*, one might infer that any case that failed to satisfy *Chevron Oil's* first prong—because it did not establish a new principle of law by overruling precedent or by deciding an issue of first impression whose resolution was not clearly foreshadowed—would probably not qualify for a full or partial exemption from *McKesson's* remedial requirements. But cases that passed that test, perhaps along with some that were surprising but not quite surprising enough to meet *Chevron Oil's* test for nonretroactivity, *might* qualify.

I advance this possible reading of *McKesson* tentatively, for the Court's opinion is enigmatic. This interpretation allows one to understand most of what the Court said. But it might not be the only plausible gloss, and perhaps some of what it explains was mere confusion or what the justices would now regard as error. One obvious difficulty it encounters is that, at least when *McKesson* was decided, it is hard to imagine many cases involving pre-*McKesson* unconstitutional taxation that *satisfied Chevron Oil's* first prong—by laying down a new principle of law in defiance of precedent or other legal indicators—yet still reached the stage at which *McKesson's* analysis became relevant. Tax cases that meet *Chevron Oil's* threshold requirement for nonretroactivity will ordinarily not prompt any remedial inquiry, because the remaining considerations (the purpose of the new rule, equitable arguments) are unlikely to tip the verdict in favor of retroactive application. Likewise, it is difficult to conceive of many rulings that *would*

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139. *Id.* at 45 (emphasis added); see also *id.* at 50 ("Such procedural measures would sufficiently protect States' fiscal security" in the future.).

140. "[E]ven were we to assume that the State's reliance on a 'presumptively valid statute' was a relevant consideration to Florida's obligation to provide relief," *id.* at 45-46, the Court said—suggesting, perhaps, that a state's reliance was *never* relevant (but then why consider the hypothetical?)—Florida's liquor excise tax could hardly be so characterized because it was transparently unlawful after *Bacchus*.

apply retroactively under *Chevron Oil* but be so dimly foreshadowed as to warrant an exemption from *McKesson's* remedial obligations. Perhaps, however, the Court was not concerned about how widespread the problem was: it simply wanted to cover all possible cases. And there is at least one set of cases—those in which the Court, perhaps carelessly, applied its ruling retroactively to pre-*McKesson* conduct and later felt bound to do the same in a relevantly similar situation, despite the possibility that *Chevron Oil's* test for nonretroactivity was satisfied—that it might have thought deserved more careful scrutiny for justified reliance and other equitable factors. Counting against the thesis that the Court had these cases specially in mind is the hard fact that it never mentioned them as an object of concern.

Notice that *if* this reading is correct—a large “if”—it leaves open the possibility that states guilty of *Davis* infractions might not have to comply with *McKesson's* requirements even if they collected state income taxes under duress, because the challenged conduct in *Davis*-related cases almost invariably occurred before *Davis* was decided, and thus also before *McKesson* was announced. It would not be surprising if states that continue to litigate after *Harper* advance an argument along the lines I have sketched. To the extent that *Davis's* novelty lies at the core of any weighing of the equities that the Court might have deemed appropriate, it is worth recalling that only four justices have offered opinions as to whether *Davis* satisfies *Chevron Oil's* first condition. In *Harper*, Justices Kennedy and White said that it did not, whereas Justice O'Connor and Chief Justice Rehnquist disagreed. The remaining five did not address the question.

Based on a fairly strict reading of *McKesson* as the Court seemed to understand its ruling when the case was decided, one could argue that remedial considerations *might* excuse states—the equitable case would still have to be made<sup>141</sup>—from offering complete refunds, fully compensatory

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141. Justice O'Connor attempted to build such a case in her *Harper* dissent, emphasizing the surprising character of *Davis*, the good faith of state officials, yawning budget deficits in many states, the burden that refunds would place on innocent taxpayers not complicit in the government's wrong, and the alleged injustice in forcing a state like Virginia to pay refunds that are ten times larger than the benefit it reaped from its constitutional violation. See *Harper*, 113 S. Ct. at 2534-38 (O'Connor, J., dissenting). The tenfold difference between benefit and penalty that Justice O'Connor claimed was taken from statements at oral argument by counsel for Virginia. See Tr. of Oral Argument at 33, 36, *Harper* (No. 91-794) (Dec. 2, 1992). Virginia's Deputy Attorney General did not say how she arrived at the benefit figure, which is absent from the state's brief.

It does not seem possible to square Justice O'Connor's claim that Virginia realized some benefit with the assertion in her *Harper* dissent that “it makes no difference to the State or the [state] retirees whether the State increases state retirement benefits in an amount sufficient to cover taxes it imposes, or whether the State offers reduced benefits and makes them tax-free. The net income level of the retirees and the impact on the state fisc is the

retroactive taxes, or some union of the two for conduct that antedated *McKesson*. Several passages in Justice Souter's opinion in *Beam* appear either to strengthen this reading (or at least not to contradict it) or to constitute a subtle recasting of *McKesson*'s understanding of the scope of remedial discretion in state tax cases, one that amplifies the discretion that states have in choosing a suitable remedy. For example, after rejecting "relying on the equities of the particular case" to determine whether a decision applies retroactively *at the first, choice-of-law stage*,<sup>142</sup> Justice Souter said that courts may nevertheless consider at that stage "the equitable and reliance interests of parties absent but similarly situated."<sup>143</sup> That is to say, they may, in Justice Souter's judgment, consider equitable and reliance interests *generally*, across the range of affected cases, in determining whether a decision applies retroactively.<sup>144</sup> In addition, Justice Souter continued, "nothing we say here [about ignoring the equities of the particular case in determining whether, as a choice-of-law matter, a decision applies retroactively] precludes consideration of individual equities when deciding remedial issues in particular cases."<sup>145</sup>

What Justice Souter meant by this last sentence is obscure. It is possible that he merely intended to refer to the apparently small role that equitable considerations might play within *McKesson*'s straitjacket. After all, he nowhere suggested, when referring to *McKesson* by name, that he considered the Court's circumscribed approach deficient. He did say that the bearing of these unspecified "reliance interests" on the selection of a suitable remedy was "a matter with which *McKesson* did not deal."<sup>146</sup> But he could there have been alluding to the fact that the Court said nothing in *McKesson* about how these reliance interests, in the rare instances in which they come

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same." *Harper*, 113 S. Ct. at 2534 (O'Connor, J., dissenting). What Justice O'Connor overlooks is that increases in state retirement benefits are subject to federal income tax as well as state income tax, so that it costs the state *more*, if it desires to keep state retirees in the same after-tax position, to pay higher pensions while taxing them than it does to pay lower pensions while exempting them from tax, at least if state retirees claim the standard deduction instead of itemizing their deductions on their federal income tax return. This difference is presumably the benefit to the state to which Virginia's Deputy Attorney General alluded, as well as the federal government's loss. For further discussion, see *infra* part V.C.

142. *Beam*, 111 S. Ct. at 2447 (opinion of Souter, J.).

143. *Id.* at 2448 (opinion of Souter, J.).

144. Justice Souter did not explain how a court should go about making this general judgment. His opinion seems to contemplate the parties' introducing, and the court's evaluating, evidence about a range of cases not currently before the court—a highly unusual proposal. For additional reflections on Justice Souter's discussion of equitable discretion, see *infra* note 159.

145. *Beam*, 111 S. Ct. at 2448 (opinion of Souter, J.).

146. *Id.* (opinion of Souter, J.).



into play, may shape the choice of remedies, because the Court there concluded that Florida's invocation of equitable concerns was unavailing.<sup>147</sup> In that case, Justice Souter would not have been trying to expand the minor part that the Court allotted to equitable considerations. He would, instead, have been underlining an omission that the Court did not need to consider in *McKesson* and that might need to be addressed only very infrequently.

If, however, Justice Souter's sentence about considering "individual equities when deciding remedial issues in particular cases" is read broadly, its thrust appears incompatible with *McKesson*. Construed in this way, it would also yield what one commentator described as "a conceptually confusing and redundant two-tiered approach to retroactivity questions."<sup>148</sup> Justice Souter might then be seen as contemplating an untidy, two-step process:

A court announcing a new rule must first determine whether the rule applies prospectively or retroactively for purposes of adjudicating the rights of the parties. If the rule is applied retroactively, the court must then fashion a remedy, based in part on consideration of the same reliance interests that are likely to influence the retroactivity decision.<sup>149</sup>

It is impossible to say whether Justice Souter—and presumably Justice Stevens, the only colleague who joined his opinion<sup>150</sup>—contemplated this approach. Its silliness, together with Justice Stevens's unwillingness to advocate anything like a double look at equitable considerations in his *American Trucking* dissent,<sup>151</sup> count against this reading. But Justice Souter's reference to the role of reliance interests in fashioning a remedy as "a matter with which *McKesson* did not deal"<sup>152</sup> is admittedly ambiguous. One can expect some litigants, most notably state attorneys arguing against

147. *McKesson*, 496 U.S. at 44-51.

148. Note, *supra* note 16, at 346.

149. *Id.* (footnote omitted).

150. None of the other justices spoke to the question of a court's discretion in ordering remedies in constitutional tax cases should a decision apply retroactively.

151. In *American Trucking*, Justice Stevens argued that the Court's decision in *Scheiner* should apply retroactively to the parties in *American Trucking* because the Court had already applied its decision retroactively to the parties in *Scheiner* itself. *American Trucking*, 496 U.S. at 212 (Stevens, J., dissenting) (discussing *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266, 297-98 (1987)). Thus, Justice Stevens believed that *American Trucking* should be decided by the same logic that later prevailed in *Beam* and *Harper*. He concluded, without further argument, that *McKesson*'s remedial constraints therefore applied. *Id.* at 224 (Stevens, J., dissenting). He said nothing about reviewing equitable considerations not mentioned in *McKesson* itself.

152. *Beam*, 111 S. Ct. at 2448 (opinion of Souter, J.).

refund orders after *Harper*, to try to draw support from these words, even though Justice Souter did not speak for more than two justices, and spoke only doubtfully for Justice Stevens if his words are given this wider extension. In view of their unclarity and the lack of five justices on the opinion, and in the absence of further elaboration by a majority of the justices, courts surely ought to ignore Justice Souter's statements, and continue to regard *McKesson* as determinative. It would not be surprising, however, if some ascribed unmerited significance to Justice Souter's words, particularly given the perceived blow to state coffers—regardless of whether that perception is inaccurate<sup>153</sup>—that refund orders would entail.

The error of doing so after *Harper* is all too evident. *Harper* did little to clarify the Court's understanding of civil retroactivity. The Court shied away from adopting a rule of per se retroactivity, which would—quite sensibly—focus discussion of any constitutionally relevant equitable concerns at the remedial stage of the analysis.<sup>154</sup> Nor did the Court endorse taking reliance interests and fairness into account in determining whether a decision applies retroactively, as Justice O'Connor favors. Instead, Justice Thomas's opinion took no stand on how *Chevron Oil* should be read; it merely tracked *Beam*'s equal treatment argument. What the Court did accomplish, however, though small, is nonetheless significant. A majority of the Court seemed, after the disarray that *Beam* produced, to reaffirm its commitment to *McKesson*'s rigid remedial constraints. In discussing Virginia's remedial obligations, the Court eschewed citing, quoting, or rephrasing Justice Souter's confusing statements in *Beam* about the possible role that reliance interests might play in molding a state's duty to repair its wrongs. To the contrary, the Court referred, without qualification, to *McKesson*'s palette of remedial options, saying plainly that if a state failed to offer a satisfactory pre-deprivation remedy, it "may either award full refunds to those burdened by an unlawful tax or issue some other order that 'create[s] in hindsight a nondiscriminatory scheme.'"<sup>155</sup> Whatever the purport of Justice Souter's musings in *Beam*—and perhaps they stemmed from a misreading of *McKesson*—a

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153. In some instances the cost to the state of retroactive relief might be considerably less than the cost of refunding taxes paid by federal retirees, because the legislature might, if state law permits, impose retroactive taxes on former state workers that it offsets with retroactive pension increases to cover the increase in state workers' state and federal taxes. See *infra* part V.C. If *McKesson* gives state courts some discretion to mitigate remedies in view of equitable considerations, they ought to review the options available to lawmakers—including the one described—in deciding what relief is judicially appropriate. So far, however, state courts have indicated no readiness to do so.

154. The Court might well do this in time. See *supra* part IV.

155. *Harper*, 113 S. Ct. at 2520 (quoting *McKesson*, 496 U.S. at 40) (emphasis added). Part V.C. of this article describes how little states might in fact have to do to render their past conduct nondiscriminatory in retrospect.

majority of the Court appears in *Harper* to have reestablished that *McKesson's* narrow choice of remedies governs the provision of relief in *Davis*-type cases.<sup>156</sup>

Whether *McKesson* will continue to supply the blueprint for remedies in constitutional tax cases if the Court adopts a rule of automatic retroactivity for civil and criminal cases alike is a matter for speculation. Although six of the present justices joined the Court's opinion in *McKesson*, including those sentences stating that in the future states' ability to establish various procedural requirements for claiming tax refunds or challenging a tax deprives them of compelling equitable arguments for loosening *McKesson's* remedial restrictions, Justice O'Connor's plurality opinion in *American Trucking* suggests that three of the justices nevertheless thought that equitable concerns should have some bearing on the ultimate resolution of constitutional tax cases, at the very least those cases involving pre-*McKesson* taxation.<sup>157</sup> The Court will surely have to take up this question again, to determine how retroactivity as a choice-of-law matter is to be ascertained and, relatedly, if retroactivity is established, how states may go about rectifying their unconstitutional actions. Some commentators have argued that states should be granted more liberty to deny relief in tax cases than *McKesson* appears to allow if retroactivity as a choice-of-law matter becomes automatic,

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156. Justice O'Connor's contrary claim in dissent is based on a tendentious reading of *McKesson*, Justice Stevens's *American Trucking* dissent, and Justice Souter's opinion in *Beam*. Evidently, her object is to achieve, via an expansion of the role that equitable considerations play in *McKesson's* remedial analysis, the same final result that she believes would, or should, have emerged had the Court not begun to drift away from using the *Chevron Oil* test to determine retroactivity as a choice-of-law matter and had it not refused, wrongly, to reconsider its decision to apply *Davis* retroactively to the parties in that case. This aim leads her to read earlier opinions selectively, omitting passages her view cannot accommodate. For example, she quotes Justice Stevens's statement in his *American Trucking* dissent that *Chevron Oil* furnishes a principles of remedial discretion for the federal courts, without acknowledging that he did not consider it the appropriate remedial test in tax cases, for which, he thought, *McKesson* provided a complete analytical framework. She also overlooks the Court's statement in *McKesson* that the state's ability to employ various procedural protections generally suffices to preclude any mitigation of its remedial obligations. Nor is her attempt to give decisive significance to Justice Souter's puzzling statements about reliance interests in *Beam*—by referring to his opinion for only himself and perhaps Justice Stevens as "controlling"—even the least bit persuasive. See *Harper*, 113 S. Ct. at 2526-39 (O'Connor, J., dissenting).

157. Justice O'Connor's plurality opinion in *American Trucking* did not, however, confront the question of whether the *Chevron Oil* analysis for determining retroactivity that she endorses would, for all post-*McKesson* taxation, necessarily weigh against the state and therefore in favor of retroactive taxation because states can protect themselves procedurally against unfair surprise. By joining Justice Brennan's opinion in *McKesson*, she might be thought to have committed herself to this position. But her *Harper* dissent suggests the reverse. What the other justices who sided with her in *American Trucking* think appropriate is unknown.

even though flexibility might tend to erode the discipline imposed by *McKesson's* stiff rule.<sup>158</sup> But the justices have not spoken to this suggestion or said anything that indicates how far they believe states may go in tempering *McKesson's* remedial strictures with such equitable considerations as the unpredictability of a new ruling or the cost of retrospective compliance. The justices have also been sphinx-like with respect to whether *McKesson's* reasoning is limited to tax cases or perhaps only to Commerce Clause cases, with the underlying substantive constitutional provision furnishing the remedial content to the Due Process Clause requirement of backward-looking relief, or whether *McKesson's* at once categorical and tentative remedial analysis is intended to sweep more broadly. The sooner the Court settles these matters, the better, not only because of their importance to much Commerce Clause litigation, on which large sums of tax revenue or refunds turn, but because of the disordered state in which the Court's recent decisions have left the law governing retroactivity and remedies in statute-of-limitations cases and other nontax disputes.<sup>159</sup> In the meantime, the remedies states may

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158. See Shores, *supra* note 75, at 214-15; Fallon & Meltzer, *supra* note 83, at 1832.

159. When *American Trucking* was decided, at least eight justices appeared convinced that *Chevron Oil's* tripartite test was the proper standard for measuring whether a statute-of-limitations decision impinged on a claim filed prior to that decision, either because it governed the choice of law (the *American Trucking* plurality's view) or because it governed the choice of remedies (Justice Stevens in dissent). It also was clear that the question of whether a law-changing statute-of-limitations decision applied to a party's claim depended upon the extent to which *that particular party* had reasonably relied on a different rule, not on whether *most* actual or potential plaintiffs had or might have reasonably relied on the old rule in filing when they did or in waiting to sue. Compare *Saint Francis College v. Al-Khazraji*, 481 U.S. 604 (1987) (holding race discrimination claim not time barred under 42 U.S.C. § 1981, despite intervening Supreme Court decision shortening the statute of limitations, because plaintiff relied on Third Circuit precedent declaring, inconsistently with the intervening Supreme Court decision, that a longer statute of limitations applied) with *Goodman v. Lukens Steel Co.*, 482 U.S. 656 (1987) (holding section 1981 claim time barred because, unlike in *Saint Francis College*, there was not yet any Third Circuit precedent contrary to the Supreme Court's later decision when the plaintiffs filed their claim).

Three recent opinions have disturbed the settled order. In *Beam*, Justice Souter stated that "the *Chevron Oil* test cannot determine the choice of law by relying on the equities of the particular case." *Beam*, 111 S. Ct. at 2447 (opinion of Souter, J.). The Court's opinion in *Harper* quoted this sentence, giving it an authority it lacked in Justice Souter's opinion for two justices in *Beam*. *Harper*, 113 S. Ct. at 2516 n.9. However, the meaning of this sentence is murky. Justice Souter followed it with a citation to a First Circuit decision and a student Note that rejected the notion that statute-of-limitations cases should be decided by reference to the reliance interests of individual plaintiffs. *Beam*, 111 S. Ct. at 2447 (opinion of Souter, J.). This decision and Note appear inconsistent with the Court's approach in *Saint Francis College* and *Goodman*, which the Court decided *after* both were written. But Justice Souter did not mention *Saint Francis College* and *Goodman*, let alone explicitly cast doubt on them. So have they been overruled *sub silentio*? Or did Justice Souter in *Beam*, and perhaps the majority in

embrace for *Davis* infractions are bounded by the rules that *McKesson* announced.

### C. Offsetting Bonuses and Retroactive Tax Increases

Many states feared a ruling that *Davis* applies retroactively because they believed that *McKesson* would leave them with no practicable option other than ordering large refunds to federal retirees. The alternative of taxing state pensioners retroactively would be unfair and politically difficult; it might also breach former state workers' employment contracts or otherwise violate state law.<sup>160</sup> In a recent article, I argued that *McKesson* gives states a third option: states may impose a retroactive tax on state retirees sufficient to eliminate the tax disparity between them and federal retirees for all open tax years, and simultaneously issue to those same state retirees a bonus to offset the increased state tax they would owe on their pension payments during the open tax years and on the bonus itself, as well as to offset the additional federal income tax they would owe on the bonus.<sup>161</sup>

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*Harper*, intend to reject selective prospectivity at the choice-of-law stage, but to permit a case-by-case weighing of reliance interests in statute-of-limitations cases at the second, remedial stage, which is where Justice Stevens said in his *American Trucking* dissent that *Chevron Oil* comes into play? Justice Souter's denial, later in the same paragraph in *Beam*, that he did not intend to "preclude[ ] consideration of individual equities when deciding remedial issues in particular cases," *Beam*, 111 S. Ct. at 2448 (opinion of Souter, J.), lends support to this reading. But then his citations to the First Circuit decision and Note are unfathomable. The lower federal courts have already begun to split on this question. Compare *Cooperativa Ahorro y Credito Aguada v. Kidder, Peabody & Co.*, 777 F. Supp. 153, 156 & n.4 (D.P.R. 1991) (rejecting case-by-case approach), rev'd on other grounds and remanded, 993 F.2d 269 (1st Cir. 1993) with *Robinson v. Caulkins Indiantown Citrus Co.*, 771 F. Supp. 1205, 1211-14 (S.D. Fla. 1991) (concluding that the Court's rejection of selective prospectivity at the choice-of-law stage did not overrule *Saint Francis College* or repudiate case-by-case equitable determinations at the remedial stage).

Adding to the uncertainty is the Supreme Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773 (1991), which applied its novel statute-of-limitations decision retroactively without performing a *Chevron Oil* analysis or considering equitable considerations in any way, despite being chastised on this score by a dissenting opinion to which the Court did not respond. Did the Court intend to jettison the approach it adopted in *Saint Francis College*, even though it did not refer to that decision? That conclusion seems unlikely. But then why did the Court ignore altogether the plaintiff's argument for nonretroactive application? Only the Court can unscramble this imbroglio.

160. See *infra* parts VI.B-C.

161. See Eric Rakowski, *Harper and Retroactive Remedies: Why States' Fears Are Exaggerated*, 59 Tax Notes 555 (Apr. 26, 1993) [hereinafter Rakowski, *Harper and Retroactive Remedies*]. The article also appeared under the same title in 4 State Tax Notes 983 (Apr. 26, 1993). I defended these conclusions further in Eric Rakowski, *Rakowski Responds: There's More to Harper than Large Refund Payments*, Letter to the Editor, 4 State Tax Notes 1318

These paired measures would in some, though perhaps not in all, states cost less on balance than paying full refunds to federal retirees. Whether they would be cheaper depends upon a number of variables, including the ratio of one-time federal workers claiming refunds to state pensioners who would qualify for bonuses, the marginal federal and state income tax rates that state workers face or faced, and the necessity or absence of any need to increase the bonus to cover interest on the retroactive taxes imposed on state workers.<sup>162</sup> Each state interested in responding to *Davis* in this manner must perform its own calculation.

Critically important for the majority of states is a variable from which my earlier analysis abstracted: the number of state pensioners who *would* itemize their deductions for the tax years at issue if they were to receive a retroactive bonus and have that bonus and their income from those earlier years taxed at the same state income tax rate that applied to federal retirees.<sup>163</sup> As David Richardson has pointed out,<sup>164</sup> the federal government suffers no disadvantage in hiring employees, and thus appears to have no claim of any substance under the intergovernmental tax immunity doctrine as the Court understood it in *Davis*,<sup>165</sup> if a state exempts state retirees'

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(May 31, 1993) (replying to Eugene O. Duffy, Suggested Approach for States After *Harper* Faces 'Host of Legal Barriers,' Letter to the Editor, 4 State Tax Notes 1246 (May 24, 1993)) [hereinafter Rakowski, Letter to the Editor].

162. See Rakowski, Letter to the Editor, *supra* note 161, at 1319. For a discussion of the constitutional significance of interest, see *infra* part V.F. State law might require the payment of interest even if the Due Process Clause does not.

163. In my simplified numerical example, "I ignore[d] throughout the dependence of federal income tax liability on state income taxes when taxpayers itemize deductions on their federal returns." See Rakowski, *Harper* and Retroactive Remedies, *supra* note 161, at 559. That simplifying assumption now seems to me to distort significantly the likely impact of the possible response to *Davis* I sketched. The cost to states that embrace the plan I outlined probably would be much lower than the simple example in my earlier article might have been thought to suggest. States that did not perform the calculus I described might therefore find the plan more attractive—perhaps by tens of millions of dollars—than my article might have made it seem.

164. See David M. Richardson, Federal Income Taxation of States, 19 Stetson L. Rev. 411, 438-40 & n.168 (1990).

165. The vice of Michigan's tax scheme, according to the Court in *Davis*, was that the tax exemption for state workers' pensions allowed the state to pay them less than the federal government had to pay its workers, whose pensions were taxed in Michigan and other states. This purported edge in hiring was, of course, highly speculative. How many former state or federal employees considered the differential taxation of pensions in less than half the states in deciding whether to accept work with a state government or with the federal government? Nevertheless, it was this theoretical edge that the Court found offensive to the doctrine of intergovernmental tax immunity. The reason for the edge, according to the Court, was that the state could *not* have increased all state workers' pensions by some set amount while taxing those pensions (at the same rates to which federal pensions were subject) in

pensions from state income tax while taxing federal retirees' pensions (as Michigan and many other states did), so long as those state retirees would claim an itemized deduction for state income taxes they paid were their pensions taxed by the state. In their case, it should be practically irrelevant, for intergovernmental tax immunity purposes, whether the state provides a higher retirement benefit that is taxable by the state or a lower retirement benefit that is exempt from state tax. In either case, federal taxable income will be the same.

Consider a simple example. Suppose that a state pays a retired state worker an annual pension of \$50,000 that is exempt from state income tax. Suppose further, to keep the example transparent, that the retiree has no other income and that if the state had paid the former worker a pension of \$54,000 that *was* taxable, he would owe the state \$4,000 in state income tax. Does it matter at all to the federal government, either in its role of employer or in its role as tax collector, whether the state pays the retiree an untaxed pension of \$50,000 or whether it pays him \$54,000 but takes back \$4,000 in taxes? The answer is that it makes no difference, so long as the retiree deducts state taxes from his adjusted gross income in calculating his federal taxable income.<sup>166</sup> The federal government need not offer higher salaries or pensions to attract good workers if a state exempts state retirement income from tax than the federal government would have to offer were the state to tax state retirement pay but raise that pay by the amount of the tax, *provided that state retirees would claim a deduction for state income taxes they paid in the event that their pensions were taxed by the state*. The harm to the federal government on which the Court based its ruling in *Davis*<sup>167</sup> does not exist in these cases.<sup>168</sup>

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precisely the amount of the increase, and thus have created a wash from the perspective of the state treasury. Justice Kennedy explained:

In order to provide the same after-tax benefits to all retired state employees by means of increased salaries or benefit payments instead of a tax exemption, the State would have to increase its outlays by more than the cost of the current tax exemption, since the increased payments to retirees would result in higher federal income tax payments in some circumstances.

*Davis*, 489 U.S. at 815 n.4. While this statement is true in virtue of the qualifying clause "in some circumstances," its central claim is false whenever a state retiree claims a federal deduction for state income taxes he or she has paid. For a discussion of some minor discrepancies between a salary increase with an offsetting federal deduction and no salary increase at all, see *infra* note 168.

166. See IRC § 63(a) (defining "taxable income" as adjustable gross income minus allowed deductions); IRC § 164(a)(3) (authorizing a deduction for state income taxes paid).

167. See *supra* note 165.

168. A slightly higher salary coupled with an offsetting federal income tax deduction for state income taxes paid might not be *exactly* equivalent, for federal income tax purposes, to a lower salary not taxed at the state level. But the differences are likely to be

When would the federal government be harmed? The federal government could claim injury with respect to state workers who would continue to take the standard deduction on their federal income tax returns even if their state pensions were taxed and concurrently increased by the amount of the tax. Because their taxable income would rise by the amount of the pension increase and would not be reduced equally by an itemized deduction for state taxes paid, the United States treasury would profit by the amount of tax due on the increase, by comparison with a regime in which the state paid lower pensions and exempted them from state income tax. If the state, in competing with the federal government as an employer—the perspective for judging discrimination endorsed in *Davis*—were to return these nonitemizing state retirees to the same after-tax position as they would be in were their pensions lower but not taxed by the state, it would have to increase their pensions not only by the amount of state income tax they would owe, but also by the amount of the additional federal tax they would owe on additions to their pensions above the untaxed pension baseline. The amount of the additional federal tax is what the state would save by paying lower pensions and not taxing them, relative to a world in which it provided its retirees with the same after-tax income by paying higher pensions while subjecting them to state income tax. This, therefore, is the harm that the federal government can be said to suffer under *Davis*, which gives rise to a right of redress under the doctrine of intergovernmental tax immunity.

For example, suppose that a state retiree receives a pension of \$20,000 tax-free from the state. In addition, suppose that the state income tax ordinarily due on income of \$20,000 is \$500, that the marginal state income tax rate above \$20,000 is 5%, and that the marginal federal income tax rate above \$20,000 is 15%. Finally, set aside all other possibly relevant factors, such as personal exemptions and the panoply of state and federal income tax deductions. If the state had to tax the retiree's pension but wanted to leave her in the same after-tax position, how much more would the state have to

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minuscule. As David Richardson notes, because certain expenses are deductible only to the extent that they exceed two percent of adjusted gross income, IRC § 67, a higher salary will mean that less can be deducted under this section; conversely, because the ceiling on federal deductions for charitable contributions is tied to adjusted gross income, IRC § 170(b)(1), (d)(1), increasing a state retiree's gross salary raises the limit on these deductions. See Richardson, *supra* note 164, at 439 n.168. Most retirees, however, are unlikely to qualify for deductions under section 67 or bump up against the ceiling on charitable contribution deductions, particularly if carryovers are taken into account. Other deductions that depend upon adjusted gross income, such as the casualty loss deduction, IRC § 165(h)(2), and the medical expense deduction, IRC § 213(a), also are unlikely to be affected. In rare cases in which they do come into play, the increase in the federal government's tax revenue, if a state pays more and taxes away the addition rather than exempts retirement pay from tax, will almost always be piddling.



pay? If the retiree itemizes deductions on her federal return, the answer is \$526.32. On balance, making her income taxable would cost the state nothing, because it would recoup in full the increase in her pension. If the retiree does *not* itemize and *continues* to forgo itemization on her federal return despite having to pay state income tax, the answer is \$625. Of that amount, the retiree would return \$531.25 to the state (\$500 plus 5% of the \$625 addition). The difference of \$93.75 (15% of the \$625 addition) would cover the increase in the retiree's federal income tax liability as a result of raising her pension while subjecting it to state income tax. This difference of \$93.75 is the harm to the federal government that Justice Kennedy apparently had in mind in declaring a state income tax exemption for state but not federal workers a violation of the doctrine of intergovernmental tax immunity. It is, as I mentioned, debatable whether the federal government was harmed in any way, given that most potential employees are ignorant of the tax consequences of their retirement pay when choosing between state and federal employment, as well as unsure in which state they will retire. But no more accurate measure of the injury to the federal government has been proposed.

If the Court's analysis in *Davis* is correct, the federal government was injured by Michigan's discriminatory tax scheme only insofar as the state refrained from taxing the state pensions it paid to retirees who would have availed themselves of the standard deduction on their federal returns had their pensions been taxed. There are reasons for thinking that the Court's analysis overstates the federal government's injury; indeed, there are reasons for thinking that the federal government cannot properly be said to have suffered any harm at all, and thus that *Davis* was wrongly decided.<sup>169</sup> But if one

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169. David Richardson offers two reasons for this conclusion. First, he says, any harm that the federal government suffered as a result of the standard deduction was self-inflicted. Congress plainly could have enacted a tax code that required taxpayers to itemize all their deductible expenses in computing their taxable income. Under that regime, a state tax exemption for state retirees could not have disadvantaged the federal government in any significant way, because state taxes would routinely have been deducted. Instead, Congress adopted a standard deduction that made available to some taxpayers deductions to which they otherwise would not have been entitled, to save the Internal Revenue Service the administrative expenses that more complicated returns would entail and to ease the compliance burden on taxpayers. If Congress's generosity in this regard compelled the federal government to incur additional hiring costs in competing with public employers at the state level, Congress had only itself to blame. It can be presumed to have waived the federal government's right to nondiscrimination in state taxation to this extent. Second, Richardson argues, citing *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929), the federal government could have chosen to treat state tax exemptions for state retirees as a form of compensation, and could have imposed federal income tax on the value of this benefit. If, by deciding not to gross-up state pensions, it handicapped itself in its role as an employer, it cannot rightly require states to compensate it for its disability. See Richardson, *supra* note 164, at 439 n.168.

There is no evidence that the Court considered either of these intriguing arguments

in *Davis*. Should they have altered its conclusion? A careful answer to that question would require more extended argument than I can offer here. A few thoughts must suffice.

The first argument assumes that the federal government's consent to nondiscriminatory taxation of its employees in 4 U.S.C. § 111 does not take as given whatever provisions the Internal Revenue Code contains, and that the doctrine of intergovernmental tax immunity does not do so either. The second assumes that section 111 and the intergovernmental immunity doctrine do not operate against the backdrop of the federal government's established practices with respect to imputing taxable income. Both assumptions call for some justification. It is true that the standard deduction, introduced in 1944, postdated the Public Salary Tax Act of 1939, of which section 111 was a part, as well as the older doctrine of intergovernmental tax immunity. But there is nothing to suggest that Congress intentionally waived part of the protection that section 111 or the doctrine of intergovernmental tax immunity afforded when it created a standard deduction for the convenience of taxpayers and its own administrative officials.

Of course, intentional waiver might not be necessary: a court might hold Congress responsible for an unintended ramification of its action. The question here is which presumption to make. Richardson's argument might be strengthened by adducing some reason for the presumption he favors. Why should the federal government's magnanimity, in making available a standard deduction, commit it to a further generous act—the waiver of its right to equal treatment under 4 U.S.C. § 111 and the intergovernmental tax immunity doctrine? One wonders whether Congress can fairly be held fiscally responsible for not noticing that its protection against discrimination by states could be undermined by the enactment of a standard deduction that neglected to exclude state employees who are not subject to state income tax in states in which federal employees are.

Richardson's first argument also poses the question of how the relevant counterfactual judgment should be cast. After all, the federal government could presumably eliminate deductions for state income taxes. Thus, the only reason that there is no discrimination against the federal government in the case of state retirees who would itemize if state pensions were taxed by the state is that the federal government's tax policy creates that result. But why take that part of the tax code as given while treating the standard deduction as a variable, a removable source of the federal government's disadvantage in recruiting workers? There may be a sound answer to this question, but Richardson's article does not supply it.

Richardson's second argument encounters problems of scope and precedent. Because the value of the state income tax exemption received by state retirees was potentially taxable by the federal government under *Old Colony*, he contends, the federal government was not harmed by it, except insofar as it *allowed* itself to be harmed by not taxing that benefit. And any injury the federal government brings on itself, Richardson says, cannot ground a claim to compensation. The problem with this argument is that it threatens to make 4 U.S.C. § 111, and much of the intergovernmental immunity doctrine, a nullity. If the federal government's power to cure any instance of differential state income taxation by imputing income to the beneficiaries deprived it of any right to redress, section 111 would be an empty string of words.

Indeed, it is hard to see how the federal government could *ever* demand recompense, under the doctrine of intergovernmental tax immunity, for the discriminatory taxation of its employees or others with whom it deals. The federal government enjoys wide latitude in determining what benefits to treat as imputed income. Although a property tax benefit is farther from the facts of *Old Colony* than an income tax benefit for state workers, the federal government could surely impute income to the beneficiaries. If Richardson's argument were right, there apparently would never be any ground for suit under the intergovernmental

takes as given the Court's holding in *Davis*, the overall magnitude of the federal government's injury is difficult to assess. How large a fraction of the group of state retirees this set of would-be users of the standard deduction comprises in states guilty of discriminatory taxation under *Davis* is impossible to say without much more information than anybody except the Internal Revenue Service possesses. Retired workers frequently do not claim large deductions for home mortgage interest, and if pensions are comparatively small or the state income tax rate is low, state retirees might not amass itemized deductions large enough to induce them to forgo the standard deduction for an itemized listing of their federal income tax deductions. But some undoubtedly would.

It would be difficult for a state to take into account the impact of itemization by state retirees under the hypothetical scenario of higher past pensions coupled with state taxation of those pensions in calculating retroactive bonuses and retroactive taxes under the possible response to *Davis* I described, except in those simple cases—probably a small minority—in which the retroactive state tax would exceed the federal standard deduction for the relevant tax years. But this factor, along with the others mentioned above (such as the different marginal state and federal tax rates that apply to different categories of retirees), might be considered in reaching a settlement with the federal government for any harm that it suffered as a result of past discrimination against federal retirees. Striking such an agreement would, of course, be beyond the power of state courts considering refund claims. There is, however, no reason why state officials, under executive or legislative direction, could not propose one. Whether their federal counterparts would be inclined to cooperate cannot be known until a state attempts to initiate negotiations. If a state offered to pay more than the Internal Revenue Service stood to gain from taxes on state refunds to federal retirees<sup>170</sup> or on the

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immunity doctrine, except if a state imposed a tax that fell fairly directly on the federal government itself. But this understanding of the doctrine, based on the federal government's authority to impute income, enjoys no precedential support. The Supreme Court's tax immunity decisions all take as given the federal tax system, including current rules for imputing income, in divining discriminatory tax treatment by states. See, e.g., *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744 (1961) (enjoining state tax that fell more heavily on federal lessees than state lessees, instead of noting that the federal government could have taxed state lessees on imputed income); *Phillips Chemical Co. v. Dumas Indep. Sch. Dist.*, 361 U.S. 376 (1960) (same). Richardson's argument would hold the federal government to a standard that the Court has never shown any inclination to adopt.

These are unpolished reflections. But they serve to indicate why the Court might be reluctant to start down the path that Richardson has lighted.

170. The Internal Revenue Service would probably reap a meager harvest from refunds to federal retirees. Many of those retirees are likely to have taken the standard deduction on their federal income tax returns during the years that their pensions were taxed.

retroactive bonuses to state workers under the plan I sketched in my earlier article, the federal government would plainly have a financial incentive to come to terms.<sup>171</sup> Should a settlement of this kind be achieved, state courts would, it seems, be permitted, under the reasoning of *Davis*, to deny federal retirees' refund claims, because the harm to the federal government would have been repaired to its satisfaction.<sup>172</sup>

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If their state taxes are refunded, they will have no additional federal income tax liability, because they derived no tax benefit earlier from an itemized deduction for the state taxes they paid. See IRC § 111(a); Rev. Rul. 79-15, 1979-1 C.B. 80. The fact that the federal government—the entity that the intergovernmental immunity doctrine safeguards—would receive but a small fraction of this recovery highlights its poverty as a proxy for direct payments to the federal treasury. Although the prospect of having to pay refunds will deter states in the future, refunds will not set the federal government in the position it was entitled to occupy in the past. They would do so only if the federal government were not forced to pay higher salaries or pensions to make up for states' discriminatory tax treatment, because the federal government or its workers anticipated a successful law suit against the states. And that they clearly did not do. In addition, the fact that refunds to federal retirees would, in most states, probably dwarf the harm to the federal government over the years covered by the refunds, and thus vastly exceed the amount of direct compensation needed to repair the injury, throws into relief the wastefulness of this remedy from many states' perspective.

171. A number of considerations would predictably shape any settlement between a state and the federal government, in addition to the number of state retirees affected, the expected number of itemizers under the counterfactual scenario I described, federal and state marginal tax rates, the number of federal retirees who have sued or might still sue for refunds, and any interest that might be owed on refunds or that might be charged on back taxes and thus incorporated into retroactive bonuses to state workers. For example, the harm to the federal government stretches back decades in most cases. In negotiating a settlement, federal representatives would not be limited by the state statute of limitations applicable to refund actions by federal retirees, except insofar as the aggregate refund award set a ceiling to the amount that states would pay by way of settlement. Hence, the federal government need not take the harm that it suffered over the refund limitations period as an upper limit on the settlement amount. Another factor would be administrative costs. States would have an incentive to settle to avoid the cost of providing refunds to numerous federal retirees or of paying retroactive bonuses to state workers while taxing them simultaneously. States' desire to avoid incurring these costs would enhance the federal government's negotiating position. On the other side, the federal government would have to take into account the likelihood that, if states paid refunds to large numbers of federal retirees, a significant fraction of those retirees would not declare the income on their federal returns. Its negotiating stance would be correspondingly weakened.

172. State courts would not be *required* to deny refunds to federal retirees in the event of a settlement, so far as the doctrine of intergovernmental tax immunity is concerned. That doctrine serves as a shield to either a state government or the federal government. If a state chose, by way of a settlement *and* refunds, to treat the federal government *more* favorably than it treats itself, the federal government would be in no position, and have no incentive, to complain. Nor could the state invoke the doctrine against itself, because it protects a state only against the deprivations of its national counterpart. Prudence alone should, however, persuade a state to shun prodigality.

States that would save a substantial sum of money, relative to refunding the discriminatory portion of the taxes federal retirees paid, by taxing state workers retroactively while alleviating their tax burden through bonuses, should find that pair of steps an attractive option.<sup>173</sup> A settlement of the sort just described might be still more alluring. In either case, states should not have to fear opposition from state retirees, inasmuch as their after-tax position would not be worsened under either plan.

Federal pensioners would naturally oppose both of these possible responses. They would prefer to have their state income tax payments refunded, rather than see their position unchanged, even though relative to their past expectations any refund would be a windfall. One critic of the constitutionality of my original proposal—David Shores—has argued that the federal retirees' complaint would not be merely a rhetorical plea for a benefit to which they have no title: it would, he says, be justified.<sup>174</sup> If states are unwilling to impose a retroactive tax on former state workers *without* any offsetting bonus, he contends, then *McKesson* mandates that states pay the refunds for which federal retirees have sued. Presumably, he would object equally to any settlement between a state and the federal government that deprived federal retirees of refunds or the satisfaction of seeing their retired state counterparts pay retroactive taxes without any relief from their former state employer.<sup>175</sup>

For reasons I have detailed elsewhere,<sup>176</sup> Shores's argument seems to me misguided. The doctrine of intergovernmental tax immunity, on which the Court's holding in *Davis* was premised, developed to protect the federal government from discrimination by state authorities, and states from unjust treatment by Congress. It was not designed to protect individuals. To be sure, individuals would often benefit if they sued, in effect, in the federal government's stead. But they were not the doctrine's intended beneficiaries,

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173. Not surprisingly, Virginia, the state that will have to pay out the most money if refunds are ordered, is therefore considering implementing this plan. See Juliann Avakian-Martin, *Harper Decision Leaves Many Questions Unanswered, May Raise New Ones*, 59 Tax Notes 1740 (June 28, 1993) (quoting Virginia's Deputy Attorney General Gail Marshall). But see *infra* note 240.

174. See David F. Shores, *Unconstitutional State Taxes: Is There a Painless Remedy?*, 59 Tax Notes 1274 (May 31, 1993).

175. This conjecture is grounded in Shores's reading of *Davis*, according to which federal retirees were not "merely nominal parties." Because Shores believes that *Davis* "suggests even-handed treatment of state and federal retirees was itself a goal," he contends that "meaningful relief would seem to require either a refund to federal retirees or a tax on state retirees that is not rendered meaningless by a counterpayment." *Id.* at 1275 (footnote omitted).

176. See Eric Rakowski, *What Purpose Does Intergovernmental Tax Immunity Serve?*, 59 Tax Notes 1277 (May 31, 1993).

and the purpose of allowing them to bring suit was to vindicate the rights of the states and the federal government when governmental entities did not take action themselves. Because the options I described would compensate the federal government, through increased federal income tax revenue on the bonuses paid to state retirees or through a direct settlement payment, for the wrong that it suffered, it would satisfy *McKesson's* command to create what in hindsight is a nondiscriminatory scheme.<sup>177</sup> The federal government would in retrospect have suffered no disadvantage in hiring workers, because it would not, in retrospect, have had to pay them higher pensions than states did to put them on an after-tax par with state retirees. Any additional amount it paid in the past would have been recouped in the added federal income tax on state workers' bonuses, or through the settlement agreement in which it acquiesced. The situation, after either plan was implemented, would be exactly the same as if states had taxed state pensions all along, and had paid their workers higher pensions in recognition of their taxable character. Needless to say, notwithstanding the justice of these remedies,<sup>178</sup> federal

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177. In her *Harper* dissent, Justice O'Connor begins from the right premise: "The purpose of the intergovernmental immunity doctrine is to protect the rights of the Federal Sovereign against state interference. It does not protect the private rights of individuals . . ." *Harper*, 113 S. Ct. at 2534 (O'Connor, J., dissenting). But she draws an at least partly contestable conclusion: that retroactive relief "would not vindicate the interests of the Federal Government" but only "[line] the pockets of the Government's former employees." *Id.* With regard to state workers who would have itemized their federal deductions if their pensions had been subject to state income tax, Justice O'Connor is correct. With respect to other state retirees, the truth of her claim depends upon whether David Richardson's argument is right. See *supra* note 169. If it is not, then Justice O'Connor's claim is, so far as these retirees are concerned, erroneous. It is *by* lining the pockets of federal retirees, if a state chooses to refund illegally collected taxes, that the federal government's interest is vindicated. To be sure, the federal government would not itself collect the cash directly, and the state would end up paying far more than the harm that the federal government apparently suffered. But refunds would unquestionably serve the purpose of deterring states from enacting tax policies that compel the federal government to offer higher salaries or retirement benefits in a perfectly competitive market than states must offer to secure comparable employees. Some remedies cost more than others, and only some swell the federal treasury. But their object is identical.

178. One might think the scheme imperfectly just, because it would leave federal retirees who sued without compensation for bringing a law suit that redounded to the benefit of the federal government. Two points should, however, be borne in mind. First, attorneys' fees and costs might nevertheless be available under state or federal law, at least for the expense of obtaining injunctive relief (which would typically permit recovery of the bulk of litigation costs). Second, after *McKesson*, the risk of coming away empty-handed, because a state might choose retroactive taxes over refunds, is visible to all. Not rewarding those who gamble and come up dry is no more unfair than denying a prize to those who buy losing lottery tickets. Whether the resulting incentives to sue are optimal, and whether the federal government might do well to reimburse the costs of a successful suit from which it, but not the plaintiffs, prospers, are independent questions.

pensioners in some states may have enough political muscle to block their legislative adoption or approval. They might, instead, extract a better deal for themselves than the Constitution compels states to provide. That they are able to secure an advantageous result does not, however, demonstrate that they deserve all that they get.

It is worth repeating that the combinations of retroactive bonuses and taxes I sketched and the settlement arrangement I described are only two possible remedies that states may choose. They can certainly fulfill *McKesson's* mandate of equal treatment, instead, by paying refunds to federal workers, even if that would go further toward depleting the state treasury while yielding only a trickle of revenue to the federal government.<sup>179</sup> One should also bear in mind that these two options would probably have to be adopted by state *legislatures*, if they are to be selected at all. In the absence of a legislative initiative, state courts are generally confined to granting or denying refunds under applicable state and federal laws. Finally, it is possible, though not likely, that state law would stymie the implementation of the scheme incorporating retroactive pension increases for state workers even though the Federal Constitution sanctions this remedy.<sup>180</sup>

#### D. Possible Congressional Action

The *Davis* Court's analysis of Michigan's unequal taxation of state and federal retirees was predicated on a fact too obvious to merit discussion: "that intergovernmental tax immunity is based on the need to protect each sovereign's governmental operations from undue interference by the other."<sup>181</sup> The doctrine provides each sovereign with a drawbridge against discriminatory taxation by the other. In 4 U.S.C. § 111, which codifies the doctrine of intergovernmental tax immunity on the federal side,<sup>182</sup> the United States "consents to the taxation of pay or compensation for personal service as an officer or employee of the United States," so long as officers and employees are not disadvantaged by the taxing entity in virtue of having their salaries paid by the federal government. The United States can, however, consent to less favorable treatment by states as well: drawbridges can be lowered. The fiscal difficulties that many states fear if they pay refunds to federal retirees can be removed immediately and entirely through congressional legislation waiving retroactively the federal government's insistence on

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179. See *supra* note 170 (explaining why refunds would generate little federal income tax).

180. For a possible objection based on state constitutions' Extra Compensation or Gift Clauses, see *infra* part VI.C.

181. *Davis*, 489 U.S. at 814.

182. See *id.* at 810-14.

the nondiscriminatory taxation of its officers and employees.

To my knowledge, this resolution to the litigation and potential fiscal travails that succeeded *Davis* has not been suggested, let alone considered with any seriousness, by federal lawmakers. One wonders why not. Unlike national legislation governing the taxation by one state of incoming mail-order sales by businesses in other states, which the Court in *Quill Corp. v. North Dakota*<sup>183</sup> barred in most instances without congressional authorization, this issue does not necessarily pit one state against another. It is true that the aggregate of states is hurt to the extent that the federal government foregoes tax revenue it would otherwise have received on state refunds to federal retirees or on retroactive bonuses to state pensioners. Federal spending must decrease or the federal government's debts, which weigh on states and their citizens indirectly, must increase if less tax is collected. But if states not confronting refund suits refuse to bear this cost, there is an easy reply. Congress could pass a bill waiving the federal government's right to relief under the doctrine of intergovernmental tax immunity only if a state pays to the United States treasury an amount greater than or equal to what the Internal Revenue Service would likely collect in taxes on remedial payments by the offending state. Weighing the various considerations described in the preceding Section that bear on possible settlement agreements should allow the sum to be set fairly. It is hard to imagine any sound reason for federal lawmakers to oppose giving this option to states that were surprised by the *Davis* decision and now face financial dislocation if they must pay a penalty that far exceeds the harm suffered by the federal government.

States that have already written checks or given tax credits to federal retirees might, understandably, regret having acted as speedily as they did were Congress to enact legislation offering a cheaper remedy to states that moved more slowly. But they would in no way *benefit* if Congress refrained from passing this legislation: their position would remain unchanged. So what justification could they offer for blocking a law easing other states' burdens? Misery's partiality to company might explain, but it cannot excuse, some hesitation.

Even if some states, for whatever reason, stood in the way, possible beneficiaries might be able to bribe them to step aside. The legislative proposal sketched above could be modified to provide cash payments to states

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183. 112 S. Ct. 1904 (1992). *Quill* held in part that a state may not require a business based in another state to collect use tax for it on goods shipped into the state unless the business has the "substantial nexus" with the state necessary to empower the state to impose that tax collection obligation notwithstanding the limitations on extraterritorial taxation implicit in the dormant Commerce Clause. *Id.* at 1911-16. The Court noted that Congress has the power to lift mail-order businesses' Commerce Clause immunity from taxation by importing states if it chooses. *Id.* at 1916.



that have already settled with federal retirees, financed by levies on those states that benefit from the United States' partial waiver of its right to redress for the competitive disadvantage it suffered in hiring workers. Choose the amounts properly and a bill that benefits everybody—except federal retirees hoping to obtain a windfall in the form of unanticipated tax refunds—might be written. One may only speculate whether a failure of imagination or fear that the ire of federal retirees will outweigh the gratitude of other voters for saving the state money has thus far kept senators and representatives from proposing a legislative solution to the problems *Davis* has spawned.

#### E. States' Pass-On Defense

One remedial issue that merits discussion, though it is not cleanly presented in intergovernmental tax immunity cases, such as *Davis*, that do not involve commercial taxpayers, concerns the pass-on defense to a complete tax refund that some states' laws recognize. Does the Due Process Clause permit tax authorities that choose to remedy unlawful discrimination by refunding taxes they collected improperly to reduce refunds, insofar as the disadvantaged taxpayers succeeded in passing the illicit burden on to customers or sellers? States have sometimes sought to lessen their refund liability—*McKesson* and *Bacchus* offer two examples<sup>184</sup>—by contending that restoring the entire discriminatory portion of the tax would leave taxpayers with a windfall. The injury they suffered, the states' argument runs, was less than the unlawful amount of tax they paid, because taxpayers managed to pass part or all of it forward to consumers or intermediate purchasers or backward to workers or suppliers. Rewarding them with a refund that exceeds the harm they suffered is, in this view, more than justice requires, and therefore more than the Constitution should be read to mandate.<sup>185</sup>

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184. See *McKesson*, 496 U.S. at 46-49; *Bacchus*, 468 U.S. at 276-77.

185. There is some, albeit indirect, support for this claim. The Supreme Court has recognized that "the elimination of unforeseen windfall profits" is a legitimate state interest that can sustain state regulations that substantially impair contractual obligations. See, e.g., *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411-12 (1983); *United States Trust Co. v. New Jersey*, 431 U.S. 1, 31 n.30 (1977). When a state is itself a party to a contract, however, the Court has been reluctant to defer to state legislators' assessment of the reasonableness and necessity of impairing contracts to serve an alleged public purpose. Indeed, the Court has rarely considered a state's impairment of its own contractual obligation justified. See *Energy Reserves Group*, 459 U.S. at 412 n.14.

It is not clear whether the Court would look equally skeptically on states' claims that eliminating taxpayer windfalls is a legitimate state undertaking in Commerce Clause cases and related instances of unlawful taxation. That the states themselves, as tax collectors, would be the sole beneficiary of the policy should not be decisive. The Court has, after all, upheld statutes allowing the recovery of "excessive profits" on wartime contracts, when the federal

States that offer this argument often do so with little regard for consistency. If the damage that a taxpayer suffered is the proper measure of compensation, then in cases in which the taxpayer's injury exceeded the tax paid—which might happen, for instance, if the taxpayer lost goodwill or substantial market share or if the taxpayer went out of business—there seems no reason to limit the state's liability to the tax that was actually paid. Yet states advancing the pass-on defense never show any willingness to accept this tort measure of damages without qualification. Restitution, for them, sets a ceiling to compensation.

Likewise, if part of the burden of the tax has been passed on, it follows that *somebody* has suffered from the unconstitutional discrimination in addition to the taxpayer. Again, however, states invoking the pass-on defense have not acknowledged an obligation to repair *this* part of the injury caused by the discriminatory tax. Instead, they would deny the ultimate bearers of the tax standing to sue. It is, moreover, hard to find—one is tempted to say “impossible” to find—any example of a state's trying to justify the more fundamental claim that the Due Process Clause aims not at preventing a state's unjust enrichment—the retention of an unlawfully extracted tax—but only at relieving the harm (up to a limit) experienced by the nominal taxpayer (forget about others injured by it).

My goal in this section is not to appraise the sufficiency of these arguments as appeals to justice or as persuasive considerations in determining what the Due Process Clause demands. Nor shall I consider what role the creation of efficient incentives to lawful legislation or the conservation of

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treasury would alone gain from the tax. See *Lichter v. United States*, 334 U.S. 742 (1948). It has also refused to allow a plaintiff to obtain punitive damages against a municipality under 42 U.S.C. § 1983:

[P]unitive damages imposed on a municipality are in effect a windfall to a fully compensated plaintiff, and are likely accompanied by an increase in taxes or a reduction of public services for the citizens footing the bill. Neither reason nor justice suggests that such retribution should be visited upon the shoulders of blameless or unknowing taxpayers.

*City of Newport v. Fact Concerts, Inc.*, 453 U.S. 247, 267 (1981) (footnote omitted). However, the fact that any resulting tax refund windfall would owe its existence to the state's own illicit conduct in levying the tax and in not permitting the tax to be challenged prior to payment might, in conjunction with the considerations set forth in the text, outweigh or estop the state's claim that windfalls could not be justified at its expense. *Fact Concerts* by no means settles the question. The purpose of a refund order in constitutional tax cases is not to punish but to restore what a taxpayer was wrongly forced to pay. Unlike torts by government officials, moreover, states may protect themselves against liability by providing taxpayers with a forum for attacking possibly wrongful action before it occurs. The alleged analogy between punitive damages and total refunds is not without power, however, for the burden of complete refunds would indeed fall on unsuspecting citizens, and in some instances recipients would be compensated in excess of the harm they suffered.

judicial resources should play in teasing out the implications of the Due Process Clause. Nor, finally, is it my concern to say what value, if any, there is in maintaining consistency across legal domains that present similar problems. Thus, I shall not speculate here as to whether the Court's blanket rejection of the pass-on doctrine for both offensive and defensive purposes in its antitrust decisions should or would influence its approach to this remedial issue in constitutional due process cases.<sup>186</sup> These are topics for a separate article.<sup>187</sup> Instead, my object is to explore the extent to which this issue remains open after *McKesson*, and thus what latitude state courts might have in fashioning remedies until the Court provides more luminous guidance.

The Court opened its discussion in *McKesson* by saying that *if* a state were free to choose not to return tax payments that did not, in fact, burden the nominal taxpayers because they were able to pass the tax on to suppliers, consumers, or others with whom they did business, the defendant "State could not refuse to provide a refund based on sheer speculation that a 'pass-on' occurred."<sup>188</sup> Although the Court's discussion of this matter is ambiguous, this sentence might be read to say that a state may only reduce the refunds it pays in pass-on situations if the state is able to carry the evidentiary burden of showing that a pass-on occurred.<sup>189</sup> If this was the Court's view, the

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186. See *Hanover Shoe, Inc. v. United Shoe Mach. Corp.*, 392 U.S. 481 (1968) (repudiating defensive use of pass-on doctrine); *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977) (rejecting offensive use by indirectly injured party); *Kansas v. Utilicorp United, Inc.*, 497 U.S. 199 (1990) (declining to make an exception to *Illinois Brick* even though anticompetitive overcharge to regulated utility had been passed on entirely to consumers, on whose behalf state sued as *parens patriae*). For a powerful criticism of the Court's claim that judges cannot handle the issues of economic incidence presented by the pass-on theory and of the Court's decision to subordinate compensatory justice to adjudicative efficiency, see Robert G. Harris & Lawrence A. Sullivan, *Passing on the Monopoly Overcharge: A Comprehensive Policy Analysis*, 128 U. Pa. L. Rev. 269 (1979); see also William M. Landes & Richard A. Posner, *The Economics of Passing On: A Reply to Harris and Sullivan*, 128 U. Pa. L. Rev. 1274 (1980); Robert G. Harris & Lawrence A. Sullivan, *Passing on the Monopoly Overcharge: A Response to Landes and Posner*, 128 U. Pa. L. Rev. 1280 (1980).

187. Although it antedates *McKesson*, one helpful discussion of the state and federal case law regarding the pass-on defense in tax cases, as well as the moral and efficiency arguments supporting and opposing its recognition, is William J. Woodward, Jr., "Passing-on" the Right to Restitution, 39 U. Miami L. Rev. 873 (1985).

188. *McKesson*, 496 U.S. at 46 (footnote omitted).

189. One reason for the ambiguity is the Court's noting that *neither* side had had an opportunity to offer evidence regarding the economic burden of the tax. *Id.* at 46 n.30. In the absence of evidence, according to the Court, the Florida Supreme Court simply presumed that the tax had been passed on. *Id.* It is possible that the Court's main worry was that the plaintiff had not been afforded a chance to show that it bore some or all of the tax, or that it has not been fairly informed that it bore the burden of making that showing if it was to recover the tax that had been wrongfully extracted from it. But the Court's discussion *seemed*

omission of any authority for the proposition is strange, given that the one case the Court discussed in the next paragraph—*United States v. Jefferson Electric Manufacturing Co.*<sup>190</sup>—upheld a federal statute placing on *taxpayers* the burden of establishing that they did *not* pass the tax on to their customers. The Court made no attempt to reconcile its assertion that Florida could not presume or speculate that a tax was passed on with its earlier holding in *Jefferson Electric*. Nor did it say, more exactly, what burden of proof a state would have to sustain, if indeed it was centering the burden on states rather than taxpayers.

Perhaps these shortcomings are immaterial, however, because following this introductory discussion the Court's opinion suddenly shifted ground. The Court declared its earlier musings irrelevant: "[W]e reject respondents' premise that 'equitable considerations' justify a State's attempt to avoid bestowing this so-called 'windfall' when redressing a tax that is unconstitutional because discriminatory."<sup>191</sup> As were its speculations on issues of proof if states could enlist this defense, however, the Court's justification for this claim is puzzling. The inadequacy of the Court's justification makes one wonder whether the justices truly intended this principle to rule out weighing equitable considerations in all constitutional tax cases in which refunds would confer windfalls on wronged taxpayers. Even if the justices did intend the principle to apply universally, it remains to be seen whether they will revisit the issue more deliberately once the gaps in their reasoning are identified.

The Court first noted that in *Jefferson Electric* it enforced a rule laid down by Congress prohibiting a taxpayer from recovering taxes it had paid to the federal government to the extent that the taxpayer had passed those taxes on to its customers or business associates.<sup>192</sup> The Court then distinguished the Florida excise tax challenged in *McKesson* by pointing out that in *Jefferson Electric* the pass-on defense the Court had upheld applied to tax overassessments, that is, charges imposed by federal officials in excess of what the tax code authorized. In contrast, the taxpayer in *McKesson* challenged unconstitutionally high taxes authorized by statute.<sup>193</sup> But why should it matter whether the overcharge was statutorily authorized or contrary to some tax statute, so long as the taxpayer was forced to pay too much, in violation of applicable law?

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to focus not on procedural unfairness but rather on *Florida's* failing to show that the *McKesson* Corporation suffered less harm than the unlawful tax it had paid.

190. 291 U.S. 386 (1934).

191. *McKesson*, 496 U.S. at 47.

192. *Id.*

193. See *id.* at 47-48.

The Court's reply made no reference to the presumed or possible discriminatory intentions of tax collectors or legislators. It did not argue, for example, that the erroneous but good-faith assessment of a tax resembles a tort resulting from the performance of an essential governmental function, and thus that immunity might attach, whereas legislative action should be seen in a different, more culpable or at least less excusable, light. Rather, its answer was that the Florida tax preference not only left the McKesson Corporation poorer, "it placed petitioner at a relative disadvantage in the marketplace vis-à-vis competitors distributing preferred local products."<sup>194</sup> The Court explained:

To whatever extent petitioner succeeded in passing on the economic incidence of the tax through higher prices to its customers, it most likely lost sales to the favored distributors or else incurred other costs (e.g., for advertising) in an effort to maintain its market share. The State cannot persuasively claim that "equity" entitles it to retain tax moneys taken unlawfully from petitioner due to its pass-on of the tax where the pass-on itself furthers the very competitive disadvantage constituting the Commerce Clause violation that rendered the deprivation unlawful in the first place.<sup>195</sup>

The first of these two reasons for complete restitution—that a taxpayer's economic injury, in the form of additional costs, decreased market share, or smaller profit margins, might exceed whatever portion of the tax it failed to pass on—is hardly compelling. The Court was, of course, correct in saying that a taxpayer's injury might exceed that portion of the unconstitutional tax liability it bore. But this possibility in no way justifies a complete refund in each case. After all, these additional costs and reduced profits will sometimes be less than that portion of the tax the taxpayer managed to pass along, in which case the taxpayer's total injury would be less than the full amount of the unconstitutional portion of the tax it paid. Surprisingly, in view of the quoted sentence, the Court itself appeared aware of this possibility. It said, for example, that McKesson "*most likely* lost sales to the favored distributors or else incurred other costs" in the same amount that it passed on the unconstitutional portion of the tax,<sup>196</sup> not that McKesson *necessarily* suffered a setback of precisely this magnitude. And the Court explicitly noted that McKesson might have passed the full tax along without competitive injury if its sales were pursuant to cost-plus contracts, although it dismissed this

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194. Id. at 48.

195. Id. at 48-49 (footnotes omitted).

196. Id. (emphasis added).

concern by saying that Florida never argued that McKesson was itself in this position.<sup>197</sup> The Court's reference to this factual issue therefore raises an important question about the sweep of its analysis: does the apparently categorical rule it laid down admit of an exception if a state, unlike Florida in *McKesson*, could prove that a taxpayer would be made better off by a complete refund than it would have been had an equal tax been imposed on its competitors? The Court proffered no answer.<sup>198</sup>

The Court's second reason—that Florida lacked an equitable justification for retaining taxes that McKesson passed on because tax-shifting was a means by which Florida achieved its unconstitutional objective—is harder to evaluate because it is unclear precisely what the Court wished to claim. If its contention was that Florida lacked clean hands and that conferring a windfall on an innocent plaintiff is preferable to permitting a state to retain a like benefit to which it is not constitutionally entitled, then the assertion is not obviously correct. After all, allowing the state to keep the money meant allowing citizens as a group, who were *not* complicit in some intentional wrong, to profit from the mistake. Why they are less deserving of the money than businesses that were taxed excessively (but which, by hypothesis, were reimbursed for taxes they did not shift) is by no means evident. In fact, this conclusion seems dubious, because it is exactly those citizens who, in the guise of consumers, likely bore part of the burden of the tax that was passed on, yet who have no way of recovering the overcharge.

There is, however, a more persuasive reading of the second quoted sentence. The Court might have been arguing that even if a partial refund gives formerly disadvantaged taxpayers profits or losses equal to what they would have earned were they and their competitors subject to the same tax rates, their competitors are in at least some cases better off, because they have received an implicit subsidy, probably in the form of larger profit margins, during the period of differential taxation. If that is so, then anything short of a total refund will place those taxpayers who suffered from discriminatory treatment at a permanent disadvantage, and the Commerce Clause's guarantee of competitive parity will be flouted.

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197. See *id.* at 48 n.32.

198. Nor did the Court explain why, if removing taxpayer injury is the dominant worry, taxpayers who suffer harm more severe than their entire nominal tax liability—perhaps because they were placed at so serious a competitive disadvantage that they were driven out of business—may nevertheless obtain, under the Due Process Clause, no more relief than a refund of the illegal taxes they paid. See *id.* at 49 n.33. Here again, the Court did not venture beyond assertion. And, as in other instances, it confounded its apparently conclusive pronouncement on the reach of the Due Process Clause by saying, immediately afterwards: "Petitioner has not sought in this action to recover any actual damages it may have suffered." *Id.* Why note McKesson's omission unless it is relevant to future attempts to obtain relief, notwithstanding the Court's unqualified claim that the Due Process Clause rebuffs them all?

Although this argument has considerable merit,<sup>199</sup> it is not obviously the Court's argument.<sup>200</sup> Nor is it apparent that it succeeds. For one thing, it fails to distinguish the situation presented in *McKesson* from that which the Court faced in *Jefferson Electric*, where the Court approved the pass-on defense together with an evidentiary burden on the taxpayer.<sup>201</sup> Just as Florida's tax preference "placed petitioner at a relative disadvantage in the marketplace vis-à-vis competitors distributing preferred local products,"<sup>202</sup> so too the federal government's overassessments subjected Jefferson Electric to costs not suffered by those of its rivals who were not similarly over-assessed.

The power of this argument also depends upon the limits to permissible state subsidies, which the Court nowhere explores in *McKesson* and which remains a complex and unsettled area of Commerce Clause doctrine.<sup>203</sup> "Nothing in the purposes animating the Commerce Clause," the Court has said firmly, "prohibits a State, in the absence of congressional action, from participating in the market and exercising the right to favor its own citizens over others."<sup>204</sup> But if a state may discriminate in favor of its citizens through its purchases, may it also do so through unattached cash

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199. A clear statement of it may be found in Alan D. Viard, *Pass-On Defense Doesn't Pass Muster*, Letter to the Editor, 52 Tax Notes 1094, 1095-97 (Aug. 26, 1991). Viard's letter responds to a weak analysis of states' remedial obligations under *McKesson* and *Beam* in Martin Lobel, *Refunding Unconstitutional Taxes*, Special Report, 52 Tax Notes 581 (July 29, 1991).

200. One reason for reluctance in attributing it to the Court is the Court's hesitation, noted above, to require complete refunds if a state is able to show that a taxpayer suffered no competitive injury from the tax, perhaps because it passed on the entire tax pursuant to cost-plus contracts. See *McKesson*, 496 U.S. at 48 n.32. If a state may interpose the defense the Court considers, then the argument for a complete refund based on the competitive disadvantage suffered by taxpayers who were not able to reap the same subsidy or increased profits cannot be correct. What makes the Court's stance still more difficult to divine is that this hesitation in the second paragraph of footnote 32 of the Court's opinion follows the Court's acknowledgement in the footnote's first paragraph that a taxpayer might suffer competitive injury if a tax disparity allowed its competitors to boost their profits while the taxpayer's profits remained constant. If the footnote's first paragraph is correct, then the Court's hesitation in the second paragraph is unwarranted. Nothing in the Court's opinion indicates, however, whether the Court would stand by the first paragraph if the price were abandoning the possible exception it outlines in the second.

201. *United States v. Jefferson Elec. Mfg. Co.*, 291 U.S. 386, 400-02 (1934).

202. *McKesson*, 496 U.S. at 48.

203. Some of the connections between permissible tax policy and the Court's rulings on state subsidies under the Commerce Clause are discussed in Rakowski, *Harper* and Retroactive Remedies, *supra* note 161, at 560-61.

204. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 810 (1976) (upholding a legislative scheme that offered a bounty to processors of abandoned automobiles titled in Maryland but that favored in-state processors over out-of-state processors).

subsidies, as opposed to implicit subsidies that take the form of elevated prices that the state agrees to pay for goods produced within the state? And, if cash subsidies are permitted, what about tax breaks that serve the same purpose? If tax breaks are permissible, however, what distinguishes them from incomplete refunds of an unconstitutional tax to competitors of those who could, by hypothesis, have been given the tax breaks? The Court has been reluctant to step on this logical conveyor belt,<sup>205</sup> and it seems unlikely to allow this line of reasoning to dissuade it from demanding fully equal treatment, via refunds or retroactive taxes, for victims of discriminatory state action that infringed the Commerce Clause. A narrow construction of the market-participant doctrine—one that limits state subsidies to state purchases or near equivalents, as in *Alexandria Scrap*—seems the safest avenue for protecting the dormant Commerce Clause from the logical erosion just outlined. But the vagaries of the Court's few opinions in this area, and the shifting sentiments expressed by certain justices,<sup>206</sup> leave some play for doubt. In view of the ambiguities described above, the best that can be said is that *McKesson's* call for a complete refund in cases in which a tax has been passed on is halting and ill-explained.<sup>207</sup>

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205. For example, in *New Energy Co. v. Limbach*, 486 U.S. 269 (1988), the Court struck down a tax credit for ethanol sold by fuel dealers if the ethanol was produced in Ohio or in another state that granted an equivalent tax benefit for ethanol produced in Ohio. Without dissent, the Court distinguished this indirect subsidy from a permissible direct subsidy through the state's own sales or purchases: "To be sure, the tax credit scheme has the purpose and effect of subsidizing a particular industry, as do many dispositions of the tax laws. That does not transform it into a form of state participation in the free market." *Id.* at 277.

206. Justice Scalia, for example, has repeatedly denounced the Court's dormant Commerce Clause rulings as mistaken, the unhappy child of the Court's overreading of the Commerce Clause over a century and a half ago. See, e.g., *American Trucking*, 496 U.S. at 202-04 (Scalia, J., concurring in the judgment); *Tyler Pipe Indus. v. Washington Dep't of Revenue*, 483 U.S. 232, 259-65 (1987) (Scalia, J., concurring in part and dissenting in part). Yet he wrote the opinion for a unanimous Court constricting the reach of the market-participant doctrine in *New Energy Co.*, 486 U.S. at 271, even though a broadening of that doctrine would effectively eviscerate the dormant Commerce Clause, a goal he plainly desires.

At one time at least, Justice Stevens seemed to endorse the chain of reasoning that leads from a state's entry into the market to state subsidies to tax breaks and, presumably, to the economically equivalent withholding of tax refunds. In his concurring opinion in *Alexandria Scrap*, he stated that the Commerce Clause does not curtail "a State's power to experiment with different methods of encouraging local industry. Whether the encouragement takes the form of a cash subsidy, a tax credit, or a special privilege intended to attract investment capital, it should not be characterized as a 'burden' on commerce." *Alexandria Scrap*, 426 U.S. at 816 (Stevens, J., concurring). Perhaps, however, Justice Stevens has had a change of mind, for he joined the Court's opinion in *New Energy Co.* and has not reiterated his earlier view.

207. A further obscurity appears in the Court's response to Florida's argument that it may invoke the pass-on defense as a matter of state law, because Florida's waiver of



Any doubts that emerge from a close reading of *McKesson* concerning the Court's rejection of the pass-on defense in tax cases find corroboration in Justice Souter's opinion in *Beam*. In discussing the Court's remand order in *Bacchus Imports, Ltd. v. Dias*,<sup>208</sup> which explicitly left to the state courts the task of evaluating Hawaii's pass-on defense in the first instance, Justice Souter said nothing to suggest that the Court erred in remanding on *this* issue.<sup>209</sup> He might have noted in *Beam* that no pass-on defense was available, or at least would now be regarded as available, for the reasons the Court adduced in *McKesson*, whatever the Court might have thought when it remanded in *Bacchus*. But Justice Souter remained mute, as did the other justices in their three additional opinions.

Whether states may invoke the pass-on defense in constitutional tax cases after *McKesson* and *Beam* is therefore doubtful, but not absolutely certain. The Court's reasons for rejecting it, if that is what it did in *McKesson*, are also opaque. States eager to stanch the drain on their resources in Commerce Clause decisions and other commercial tax cases that go against them might yet test the soft spots in *McKesson*'s language and impel the Court to finish the job of decision and explication it started there. Because pensioners bear the entire burden of any income tax they pay, however, *Davis*-related cases will not furnish a proper springboard for challenges of this kind.

#### F. Interest on Refunds

One issue that states will inevitably confront in intergovernmental tax immunity cases, however—whether they pay refunds to federal retirees to correct past inequalities in taxation, whether they subject state pensioners retroactively to the same taxes that federal retirees paid, or whether they adopt the combination of retroactive taxes and offsetting bonuses outlined in part V.C.—is whether they must, as a constitutional matter, pay interest on the refunds to federal employees or charge interest on state workers' retroactive tax liability. *McKesson*, *Harper*, and, indeed, the entirety of the

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sovereign immunity extends only to the payment of refunds insofar as the incidence of a tax falls on the taxpayer. The Court rejoined that it "need not consider the import of this contention," because the state's brief, in the Court's opinion, misdescribed Florida law. *McKesson*, 496 U.S. at 49 n.34. The Court's reading of the Florida decision on which the state relied in its brief does, in fact, seem right. The state was overreaching. But the Court's refusal to pronounce on the *form* of Florida's argument invites wonder, because it calls into question the Court's assertion that a complete refund is *constitutionally* required. The Court ought to have explained the ground for its narrow rejection of Florida's argument more clearly, to ward off any doubts about the pass-on doctrine it did not intend to engender.

208. 468 U.S. 263 (1984).

209. See *Beam*, 111 S. Ct. at 2445 (opinion of Souter, J.).

Court's recent due process jurisprudence concerning retroactivity and remedies, are silent on this important point.<sup>210</sup>

Insofar as *Davis*-type suits are resolved judicially rather than legislatively, state courts will probably invoke provisions of state income tax laws that specify when interest is to be paid and describe how it is to be calculated on both refunds and retroactive taxes. In doing so, however, *McKesson's* reasoning obligates them to ask whether these provisions of state law satisfy whatever standard is implicit in the federal Due Process Clause.<sup>211</sup> If the Due Process Clause, as construed in *McKesson*, requires that interest be taken into account, then, to the extent that these provisions require that too little interest be paid on refunds, judges must, under the Supremacy Clause, ask more of the state than its laws currently offer. The same is true if interest is required on retroactive taxes imposed on state retirees: a figure that is too low could conceivably infringe the rights of federal retirees or of the federal government.<sup>212</sup> Needless to say, if a state did not provide for the payment of any interest on refunds or retroactive taxes, judges would have to face the question of *McKesson's* demands with even more earnestness in ordering relief under *Davis* and *Harper*.

Although the Court has not straightforwardly addressed this question, *McKesson's* reasoning strongly supports the conclusion that the payment of adequate interest is constitutionally mandatory to remedy typical instances of unlawful discriminatory taxation.<sup>213</sup> The Court's opinion stressed repeatedly the imperative of placing the two sets of taxpayers who had been treated

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210. Given the length of time that has elapsed since the tax years in dispute, the amount of interest at stake is large, both absolutely and relative to the initial amount of tax that formed the basis for suit. For example, if one assumes an interest rate of 8%, a refund with interest in 1993 of a \$10 tax paid in 1986 would total approximately \$17.14 in 1993 dollars.

211. In *Hagge v. Iowa Dep't of Revenue*, LEXIS, STTAX library, IOWA file, elec. cit., 1993 Iowa Sup. LEXIS 164 (July 21, 1993), the Iowa Supreme Court ruled, after *Harper*, that the state must refund taxes paid on their federal pensions by the retired federal workers who sued. The Court did, however, permit the state to pay the refunds over a period of four years, with interest. *Id.* at \*14. The court did not ask whether the rate of interest that state law prescribed was constitutionally adequate or excessive.

212. Although in intergovernmental tax immunity cases the only worry is whether the interest paid or charged is too *low*, because that doctrine does not forbid a state from handicapping itself, in Equal Protection and perhaps certain other tax cases, a state might also have to guard against paying too *much* interest. The danger is that it will replace one form of unlawful discrimination with another, privileging the group of taxpayers that was once disfavored.

213. The Court's references to "a refund of the excess tax paid," *McKesson*, 496 U.S. at 35, to "refunding the tax previously paid," *id.* at 39, to "a full refund of its tax payments," *id.*, and similar locutions, without any reference to interest, are plainly not dispositive, because the Court did not consider the question of interest explicitly.

differently on as nearly an equal footing as is still possible. A state's overriding obligation is to "calibrat[e] the retroactive assessment [or refund] to create in hindsight a nondiscriminatory scheme."<sup>214</sup> Unless interest is paid on refunds or demanded of those who are taxed retroactively, a large portion of the disparity would survive uncorrected. It seems unlikely that the Court would tolerate this discrepancy, given that the harm to one set of taxpayers from neglecting interest would be substantial and that the same pre-deprivation procedures that the Court thought sufficient to overcome states' equitable objections to retroactive relief would apply with equal force to states' objections to paying or charging interest.<sup>215</sup>

The Takings Clause offers a useful analogy. "Because exaction of a tax constitutes a deprivation of property," the state must provide taxpayers with a meaningful opportunity to recover their property if it has been taken unlawfully.<sup>216</sup> But the Takings Clause does not permit a state to return the property without paying the owner for the use it has temporarily made of it or for the use that the owner had to forgo while the property was kept from him by the state.<sup>217</sup> The state must furnish compensation even for temporary regulatory takings.<sup>218</sup> If the property taken is cash, the measure of its use value, and thus the compensation that is due, is some rate of interest.

The Court's insistence in *Harper*, *McKesson*, and a raft of earlier cases that states have some latitude in structuring a constitutionally acceptable solution, together with its readiness to settle for less than perfect remedies,<sup>219</sup> renders it unlikely that the Court would find that the Due Process Clause mandates a specific rate of interest. A band of interest rates, of uncertain breadth but roughly tracking a secure investment return, would

214. *Id.* at 40.

215. Richard Fallon and Daniel Meltzer advance a parallel argument regarding a state's decision to refund unlawfully collected taxes in installment payments, an option the Court mentioned in *McKesson*:

[U]nless the states are required to pay interest, stretching out refund payments would obviously reduce the real economic value of the remedy. It is unclear whether the Court, which said clearly that refunds cannot be denied because of fiscal dislocation, would allow them to be diluted for the same reason. To allow this sub rosa evasion, however, would force courts to wrestle with the same sorts of issues that *McKesson*'s principal holding seems wisely tailored to avoid.

Fallon & Meltzer, *supra* note 83, at 1829 n.554 (citation omitted).

216. *McKesson*, 496 U.S. at 36.

217. See *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304, 318-22 (1987).

218. *Id.*

219. See *McKesson*, 496 U.S. at 41 n.23 ("[A] good-faith effort to administer and enforce such a retroactive assessment [on previously favored taxpayers] likely would constitute adequate relief, to the same extent that a tax scheme would not violate the Commerce Clause merely because tax collectors inadvertently missed a few in-state taxpayers.").

probably pass constitutional muster. Where state law provides for interest on tax refunds and belated tax payments, the fact that the same rate holds both for and against the government and that it applies to all refund and nonpenalty late payment cases might bolster (if not conclusively) an argument for the rate's constitutional sufficiency. Unless a state unreasonably singled out certain classes of claimants for poor treatment, discriminated against all taxpayers seeking refunds without granting them the alternative of pre-deprivation relief, or stipulated an exceedingly low rate of interest on tax refunds, the Court would be loath to interfere with a state's effort to comply with the Constitution's remedial requirements. If interest were denied altogether, however, the Court might feel bound to grant certiorari to prevent a miscarriage of justice.<sup>220</sup>

Even if this analysis is correct in constitutional tax cases, it might conjure special doubts with respect to *Davis*-type litigation. Paying interest on refunds, or charging interest on retroactive taxes, seems constitutionally

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220. One state court has ruled that the payment of interest in *Davis*-type cases is not constitutionally required when refunds are made. *Pendell v. Department of Revenue*, 847 P.2d 846 (Or. 1993). In *Pendell*, the Oregon Supreme Court reached this conclusion because "[n]either *McKesson* nor other Supreme Court cases applying *McKesson*'s principles mention the subject of interest, much less indicate that interest would be required." *Id.* at 850. The court further reasoned that if the Supreme Court is prepared to allow states to enact short statutes of limitations for refund suits, "there is no reason to infer that a state's decision to decline to offer interest would be so egregious as to deprive the taxpayers of a meaningful remedy." *Id.*

This argument is unconvincing. By omitting a discussion of interest, the Court's opinion cannot plausibly be read to have decided *against* its constitutional necessity. Moreover, that states may require taxpayers to pay under protest to obtain a refund or to file for one shortly after paying a contested tax is irrelevant to the amount that states must pay back if they take a taxpayer's money under duress. If the Oregon Supreme Court's test of "egregiousness" were constitutionally allowable, then states should be permitted to return, say, 80 cents on each tax dollar collected in violation of the Federal Constitution. *McKesson* makes clear, however, that such a rule would not comply with the Due Process Clause because it would fail to remove the unconstitutional discrimination.

In *Chicago Freight Car Leasing Co. v. Limbach*, 584 N.E.2d 690, 694-95 (Ohio 1992), the Ohio Supreme Court also concluded that the failure of a state to pay interest on refunds of illegally collected taxes does not violate the Due Process Clause. The court's reasoning, however, is confused. A federal court ruled that, under a *federal statute*, it was prohibited from granting retroactive relief. *Id.* at 692. The Ohio court nevertheless held that a refund was required as a matter of *state law*. *Id.* at 693. Whether interest must be paid must therefore also be purely a matter of state law, because federal law, as the federal district court construed it without quarrel from the state courts, mandates no retroactive relief whatsoever. Hence, *McKesson*'s remedial requirements never came into play in that case. The Ohio Supreme Court, insofar as it believed itself to be ruling on the question of whether federal law requires that interest be taken into account whenever federal law demands retroactive relief, mistook the issue before it.

imperative if the aggrieved taxpayer bringing suit is the party that some constitutional provision—such as the Commerce Clause or the Equal Protection Clause—endeavors to protect against discriminatory treatment. In these cases, interest is necessary to set the injured party in the same position as its formerly favored counterpart. But intergovernmental tax immunity cases might seem different. The aim of the intergovernmental tax immunity doctrine is to protect *governments* from unfair taxation by one another. In *Davis* and *Harper*, the true claimant was the federal government, not the federal retirees who sued. Hefty interest payments to one-time federal workers, at great cost to a state, would vastly exceed the interest component of the federal government's past injury or, viewed in reverse, the monetary time value of the state's past advantage in hiring workers. Likewise, imposing burdensome interest charges on the retroactive tax liability of state retirees—a remedy that would add nothing to federal coffers—seems excessively demanding as a remedy for a far smaller harm to the federal government. The Constitution, the argument runs, surely cannot require this remarkable disparity between the harm to the sovereign and the price that the state or its workers must pay in recompense.

There is some truth in these reflections. Certainly, the interest due on the nominal value of the federal government's past injury is considerably less than the amount of interest that states would typically have to pay to federal retirees, if they decided to pay refunds. It is also likely to be less than the interest that states would have to impose on state workers' retroactive tax liabilities. It does not follow, however, that the preceding account of the Due Process Clause's requirements entails that states are condemned to unjust treatment, because they have no choice but to follow one of these two unattractive routes. States need not adopt either course. Just as states have a constitutionally permissible third option in correcting the underlying wrong—the option of compensating the federal government directly, as described in sections C and D above—so they have a third option here: making a payment directly to the United States in the amount of the interest that has accrued on the underlying injury to the federal government. Nothing requires a state to avail itself of a more expensive alternative. If a state elects instead to refund the taxes paid by federal workers, interest payments will be part of removing the disparity that formerly existed between the tax treatment of state and federal retirees. The logic of that manner of creating equality after the fact requires those payments, if the federal government is not compensated directly. It is, however, important to underscore that any interest paid by a state in excess of the interest owing on the monetary value of the federal government's injury is paid because a state, through action or inaction, *chooses* that more costly course over a less painful remedy.

## VI. ADDITIONAL STATE-LAW ISSUES AFFECTING REMEDIES

As state courts and state legislatures grapple with refund suits following the Court's decision in *Harper*, state law will in some instances add to the constraints that the Due Process Clause imposes. This part surveys the three most prominent state law issues that are likely to surface.

### A. *Extending vs. Invalidating Exemptions*

After *Davis*, the two dozen states affected by the decision altered their laws to comply with the Court's mandate of equal treatment for the future. Some extended the tax exemption formerly enjoyed by state retirees to federal retirees. Others withdrew the tax advantage that state pensioners had enjoyed. In these cases, lawmakers typically raised pensions for the future simultaneously so as to leave state retirees' after-tax position no worse than it would have been, out of a concern for fairness or because they dreaded the political or legal consequences of not doing so. States must now *retroactively* extend or remove the privilege that state retirees enjoyed, if they have not already supplied compensation for the earlier disparity or they are not shielded by having had in place an adequate pre-deprivation remedy. The choice of a retroactive exemption or retroactive tax will turn entirely on state law and legislative desire. State courts compelled to rule on the issue will generally find it beyond their power to withdraw the exemption from state workers retroactively, and thus will limit their inquiry to whether federal retirees are entitled to refunds; if they are, courts will also have to ask whether they may sue singly or as a class, for how many years they may claim relief, and how large their refunds ought to be. Legislatures are not similarly constrained in their choice of a remedy. They might consider the potentially far less costly alternatives described in part V.C. Both judges and lawmakers must navigate the legal shoals described below, however, in righting a state's earlier misdeeds.

### B. *Contractual Constraints on Taxing State Pensions*

The federal Due Process Clause, as interpreted in *McKesson*, permits a state to cure an unlawfully discriminatory tax by subjecting the beneficiaries to retroactive taxes to achieve parity after the fact, as well as by paying refunds to those victimized by the unequal treatment to attain the same end. Similarly, the Constitution allows states to erase the disparity in the future by spreading the benefit more widely or by shrinking it so far that the unlawful discrimination disappears. But *state* law might not permit state authorities to operate with so free a hand. Taxing the pensions of state workers, either retroactively or even solely in the future, might breach a state's contract with

its former workers or contravene statutory or state constitutional provisions barring the reduction or taxation of state retirement benefits.

*Hughes v. Oregon*<sup>221</sup> illustrates this fence of a state's own making. The Oregon legislature decided in 1991 to make state retirement benefits henceforth subject to state income tax, as federal retirement pay had been and would be.<sup>222</sup> At the same time, the legislature voted to increase state workers' pensions, although by an aggregate amount that was less than the newly imposed tax liability.<sup>223</sup> The Oregon Public Employees Union promptly sued.<sup>224</sup> In a complex opinion, the Oregon Supreme Court held in *Hughes* that one of two parallel statutory changes making retirement benefits taxable constituted an impairment of the state's contract with its workers.<sup>225</sup> In the court's view, amending a provision of the Public Employee Retirement Act, as codified, to remove state retirees' exemption from state income taxation violated the Oregon Constitution's Contract Clause.<sup>226</sup> The purported change was therefore a nullity insofar as it related to benefits accrued for work performed prior to the effective date of the legislation.<sup>227</sup> The court held, however, that a second statutory change, which removed state retirees' income tax exemption from the state income tax law (rather than the codified Retirement Act), did not *impair* the state's contract with its employees but that it did *breach* that contract.<sup>228</sup> The court declined to specify a remedy for breach of contract,<sup>229</sup> although an increase in pension benefits to fully offset their taxability should, one would think, be adequate compensation for the breach.

*Hughes* stands as a warning that some states—perhaps most states—will not be able to shift even part of the cost of complying with *Davis* onto state retirees, regardless of whether lawmakers are willing to brave the political tempest that lowering state workers' nominal after-tax wages typically unleashes. Pension agreements between states and their employees' unions usually cannot be abrogated by the state without cost, with respect to work that has already been performed and rights that have vested. Thus, laws

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221. 838 P.2d 1018 (Or. 1992).

222. *Id.* at 1023.

223. See State Developments: Oregon, Daily Rep. for Executives (BNA), at H-7 (July 5, 1991).

224. State Developments: Oregon, Daily Rep. for Executives (BNA), at H-4 (Oct. 4, 1991) ("The increased benefits . . . were not considered sufficient compensation for the pension taxation according to [the Oregon Public Employees Union], said James Coon, the Portland lawyer who filed the petition.").

225. 838 P.2d at 1033.

226. *Id.* at 1035.

227. See *id.* at 1024-35.

228. *Id.* at 1036.

229. *Id.* at 1036 n.36.

stripping state workers of their tax exemption for state pensions will likely be found to impair or breach those contracts or to run up against some other legal barrier. This restraint will rarely chafe in non-*Davis* cases. Taxes that discriminate unlawfully under the Commerce Clause, for example, can generally be stretched to cover a privileged group without fear of legal challenge, particularly insofar as the tax increase is prospective. But these restraints significantly narrow the range of responses that states might make to the Court's decisions in *Davis* and *Harper*.

### C. *Extra Compensation and Gift Clauses*

In coping with *Davis*, some states have found or will find it cheaper to withdraw the state income tax exemption for state retirees—retroactively or prospectively or both—and to increase pension payments to keep their after-tax retirement income constant than to confer a similar exemption on federal retirees. At least a few of the states that tread this path, whether for the future or retroactively,<sup>230</sup> might run up against a state constitutional obstacle, should they manage to skirt any difficulties posed by their contractual or statutory obligations to state workers not to tax their pensions. Unlike potential breaches of contract, this second hindrance cannot be removed by a consensual agreement between the state and its former employees.

The constitutions of numerous states, including many that were guilty of *Davis* infractions, contain provisions barring the state from granting additional compensation to employees or contractors after their services or the terms of their contract have been completed, or from bestowing gifts or gratuitously forgiving public debts.<sup>231</sup> The primary aim of these provisions is, of course, to prevent lawmakers from squandering public resources, whether by funnelling them to their cronies without any offsetting benefit to the state or by paying more than they must for some advantage the state has received. These constitutional provisions might nevertheless be enlisted in support of suits challenging increases in pensions after state workers have retired, even if those increases are intended merely to counterbalance the withdrawal of state pensioners' income tax exemptions. Those most likely to sue are federal retirees. Ironically, their purpose in invoking these constitu-

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230. Part V.C, *supra*, discusses the retroactive combination, which faces the same hurdles as its prospective twin, but which must also meet (as I argue it does) the objection that it is only a subterfuge that fails to provide constitutionally sufficient backward-reaching relief under the standard set forth in *McKesson*.

231. See, e.g., Ala. Const. art. IV, § 68; Ark. Const. art. V, § 27; Colo. Const. art. V, § 28; Ga. Const. art. III, § VI; Iowa Const. art. III, § 31; Mich. Const. art. XI, § 3; Miss. Const. art. IV, § 96; S.C. Const. art. III, § 30; Wis. Const. art. IV, § 26.



tional provisions designed to protect the public purse would be to rifle it. They stand to benefit financially if the state must exempt them from state income tax to the same degree that it exempted or continues to exempt state pensioners; they gain nothing if the state may discontinue state workers' exemptions and instead supplement their pensions while simultaneously taxing them.

One suit of this type has already been filed. It proved unsuccessful. In *McClead v. Pima County*,<sup>232</sup> the Arizona Court of Appeals ruled that the state's Extra Compensation and Gift Clauses<sup>233</sup> did not proscribe a prospective increase in state workers' pensions to cancel their new state income tax liability. The court based this result, however, on what might seem a tenuous ground. It did not declare that the taxpayers who brought suit lacked standing, although in the absence of a legislative amendment passed ten years before it might have done so.<sup>234</sup> The court held, rather, that the Extra Compensation Clause applied solely to payments made from the public treasury, and that the pension increases were instead paid from separate pension funds which the Arizona constitution's limitations did not reach.<sup>235</sup> This seems an odd happenstance on which to rest so crucial a ruling. Perhaps the court did not care, however, so long as the tool did the job.<sup>236</sup> In any event, the court's rejection of the plaintiffs' Gift Clause challenge was simpler and more predictable. Pension increases, it said, were not gratuities but deferred compensation.<sup>237</sup> Moreover, the announced increases did not offend the purpose of the Gift Clause because the legislature's goal was to avoid cheating state workers and to honor their pension rights while meeting the state's federal constitutional obligations in the least costly manner, not to raid the public fisc for the sake of lawmakers' friends.<sup>238</sup> The plaintiffs' claim was therefore doubly flawed.

It is hard to say how future suits will fare in other states, should they be launched. *McClead* might in retrospect appear prophetic; it might also seem an oddity. Given the large sums at stake, however, it would be curious if similar dramas were not played out in a host of other states. Whether the

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232. 849 P.2d 1378 (Ariz. Ct. App. 1992).

233. Ariz. Const. art. IV, pt. 2, § 17; art. IX, § 7.

234. See *McClead*, 849 P.2d at 1382-83.

235. *Id.* at 1385-88.

236. The court did note a possible alternative rationale for its decision which the California Supreme Court invoked long ago. See *Sweesy v. Los Angeles County*, 110 P.2d 37 (Cal. 1941). Once pension rights vest, the state of Arizona had argued, benefits may be increased without fear of violating the Extra Compensation or Gift Clause. The Arizona Court of Appeals withheld judgment on the issue, finding additional support for its holding unnecessary. *McClead*, 849 P.2d at 1389 n.19.

237. *McClead*, 849 P.2d at 1388.

238. *Id.* at 1388-89.

prospect of litigation will deter state legislatures from withdrawing income tax exemptions from state retirees while compensating them for the loss of this benefit will almost certainly depend upon the savings that states could reap from this action. A state's response is also likely to take account of any shadow that earlier constructions of the state's Extra Compensation or Gift Clause and its rules governing standing cast over this apparently economical choice.

## VII. CONCLUSION

"This Court's retroactivity jurisprudence has become somewhat chaotic in recent years," Justice O'Connor wrote in *Harper*.<sup>239</sup> Its most recent contribution to that jurisprudence does little to dissipate the confusion. By basing its decision on *Beam's* repudiation of selective prospectivity, the Court left uncertain the vitality of purely prospective holdings in civil cases. It also failed to clarify the role, if any, that *Chevron Oil* still plays in determining whether a new decision applies retroactively in statute-of-limitations cases or more generally. In addition, the Court's newly manufactured "express reservation" and "equal treatment" rules for retroactive application ensure that many litigants will suffer genuine and unfair hardship as the Court delays in deciding which approach to adopt towards civil retroactivity. Its cryptic assertions about the ways in which equitable considerations can shape remedies in particular cases if a new constitutional holding applies retroactively, both in state tax cases and in other civil disputes, will fuel much litigation, error, and annoyance.

There is some certainty. *Davis* itself applies retroactively. Moreover, despite some instability in the Court's opinion in *McKesson*, it also appears that states that are guilty of *Davis* violations must now eliminate in full the inequality they created for all open tax years, unless they provided federal retirees with a meaningful opportunity to contest the constitutionality of taxing their pensions while exempting pensions paid to state workers. Eliminating the inequality means paying refunds to federal retirees, taxing state pensions retroactively, or combining the two to erase past discrimination. In light of *McKesson's* reasoning, the payment or recovery of interest seems constitutionally mandatory, though some state courts are likely to demur.

Given many states' contractual liability to their retired workers, simply taxing pensions retroactively will be legally as well as politically impossible. Refunds to federal retirees may seem the only practicable option. One important exception to this conclusion, which state legislatures are constitutionally able to embrace, is to tax state pensions retroactively but to

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239. *Harper*, 113 S. Ct. at 2526 (O'Connor, J., dissenting).

offset those taxes and any resulting federal taxes by a bonus designed to keep state pensioners as well compensated as they were. This option would presumably provide adequate damages even if it breached the state's employment contracts with its former workers. Whether it would contravene state constitutional provisions barring the payment of extra compensation or gifts to workers whose employment contracts have been completed is a separate question—a question, however, that many state courts would probably answer negatively. Another attractive alternative to refunds, which might prove even less expensive than retroactive taxes and bonuses, is to enter into a settlement with the federal government.

These and other issues will now be litigated in state courts and debated in state legislatures. In light of the legal uncertainty surrounding the constitutional law of civil remedies and the potential political costs of continued sparring, settlements between state authorities and federal retirees can be expected.<sup>240</sup> Nevertheless, *Davis*-related cases are apt to generate enough novel case law to provide the Supreme Court with plentiful opportunities to disperse the mist enveloping civil retroactivity and remedial doctrine, unless Congress resolves the remaining disputes through national legislation. Congress could confer a large boon on a number of states, at no cost to the federal government, by allowing states to pay the federal government directly for the harm it likely suffered as a result of their having taxed federal pensions but not state retirement income. Whether Congress will place the interests of federal and state treasuries above some federal pensioners' desires for unearned gains remains to be seen.

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240. See, e.g., Andrea L.T. Peterson, *Governor Urges Settlement with Federal Pensioners*, 5 *State Tax Notes* 300 (Aug. 9, 1993) (reporting Governor Wilder's call for a post-*Harper* settlement with federal retirees in Virginia).