No. 91-794

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of Virginia

BRIEF OF THE NATIONAL GOVERNORS' ASSOCIATION, NATIONAL CONFERENCE OF STATE LEGISLATURES, NATIONAL LEAGUE OF CITIES, INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION, U.S. CONFERENCE OF MAYORS, NATIONAL ASSOCIATION OF COUNTIES, NATIONAL INSTITUTE OF MUNICIPAL LAW OFFICERS AND COUNCIL OF STATE GOVERNMENTS, JOINED BY THE MULTISTATE TAX COMMISSION, AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

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QUESTION PRESENTED

Whether this Court's decision in *Davis* v. *Michigan Dep't of Treasury*, 489 U.S. 803 (1989), should be applied retroactively.

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INTEREST OF THE *AMICI CURIAE*

The *amici* are organizations whose members include state, county, and municipal governments and officials throughout the United States. They have a compelling and continuing interest in the issue presented here: When should a judicial decision invalidating a state tax on federal constitutional grounds be applied retroactively?

This case concerns the retroactivity of the Court's decision in *Davis* v. *Michigan Dep't of Treasury*, 489 U.S. 803 (1989). *Davis* held that a State violates the intergovernmental tax immunity doctrine when it exempts retirement income paid to former state employees from tax-

ation but fails to grant a similar exemption to federal pensioners. The impact on *amici* of the Court's decision in this case cannot be overstated. At the time of *Davis*, twenty-three States had statutory exemptions similar to Michigan's; the potential refund liability of these States runs into the billions of dollars. In urging affirmance, *amici* thus seek to avert a fiscal disaster for many States. As state and municipal officials, *amici* well understand the profound, adverse impact that would follow from the retroactive application of *Davis* and are uniquely qualified to explain that impact. *Amici* also have a broader interest in the smooth operation of government, an interest jeopardized by the retroactive application, in the area of state taxation, of decisions establishing new rules of law. For all of these reasons, *amici* respectfully submit this brief to assist the Court in the resolution of this case.[1]

STATEMENT

In 1942, Virginia enacted a statute that exempted the retirement benefits of state employees from state income tax. Va. Code § 58.1-322(c)(3) (Michie 1988). For forty-seven years, the law remained intact and unchallenged. In 1989, this Court issued its decision in *Davis* v. *Michigan Dep't of Treasury*, 489 U.S. 803 (1989), holding that a Michigan statute similar to Virginia's violated the intergovernmental tax immunity doctrine because it did not grant a similar tax exemption to federal pensioners. After *Davis* was decided, petitioners, former federal employees, filed suit in state court seeking a refund of Virginia taxes levied on their federal retirement benefits. The Circuit Court denied the refunds on the ground that *Davis* applied prospectively only.

On appeal, the Supreme Court of Virginia affirmed. Pet. App. 7a. As a threshold matter, the court explained that this Court in *Davis* "did not decide whether its decision * * * had retrospective application," but rather relied

[1] The parties' letters of consent to the filing of this brief have been filed with the Clerk pursuant to Rule 37.3 of the Rules of this Court.

on a concession by the State of Michigan that Davis, individually, was entitled to a refund. *Id.* at 8a. *Davis*'s retroactivity, the Virginia Supreme Court held, accordingly was "governed by the three-pronged test announced in *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971)." Pet. App. 8a.

Applying that test, the court concluded that *Davis* should not be applied retroactively. *Davis* satisfied the first prong of *Chevron Oil*, the Virginia Supreme Court explained, because it " 'decid[ed] an issue of first impression whose resolution was not clearly foreshadowed.' " Pet. App. 10a (quoting *Chevron Oil*, 404 U.S. at 106). The court further explained that the second *Chevron Oil* factor—whether retrospective application would further the purposes of the intergovernmental tax immunity doctrine—also favored prospective application because the immunity doctrine's purpose was not to "prevent legitimate taxation," and because Virginia's statute, prior to *Davis*, authorized such legitimate taxation. Pet. App. 12a. In addition, the court noted, the Virginia General Assembly had taken immediate steps after *Davis* to amend the statute and thereby to equalize taxation of state and federal pensioners. *Ibid.* The third *Chevron Oil* factor also "weigh[ed] heavily in favor of" Virginia, the Virginia Supreme Court explained, since retroactive application of *Davis* would place inequitable burdens on the State. *Id.* at 14a. The court emphasized the fact, established by record evidence, that "retroactive application of the *Davis* decision would give rise to a potential tax refund liability * * * of $440,000,000." *Id.* at 13a-14a. "This liability," the court elaborated, "would come at a time when the Commonwealth is already struggling to meet enormous fiscal deficits" and thus "would have a potentially disruptive and destructive impact on the Commonwealth's planning, budgeting, and delivery of essential state services." *Id.* at 14a. Lastly, the Virginia Supreme Court also rejected petitioners' contention that they were entitled to a refund as a matter of state law. *Id.* at 14a-16a.

After this Court vacated the judgment and remanded for reconsideration in light of *James B. Beam Distilling Co.* v. *Georgia*, 111 S. Ct. 2439 (1991), the Supreme Court of Virginia reaffirmed its prior decision "in all respects." Pet. App. 5a. The court first summarized Justice Souter's approach to retroactivity, which provides that once a rule is applied to the litigants in a particular case, the rule also must be applied retroactively to all similarly situated litigants. That rule, the Virginia Supreme Court explained, had no application to the present case because this Court in *Davis* did not apply its ruling retroactively to the parties before it. *Id.* at 3a-4a. The court reiterated its earlier view (see *id.* at 8a) that "the issue of retroactivity was not considered by the Supreme Court in *Davis* because Michigan previously had agreed to the payment of a refund to Davis if its taxing scheme were invalidated." *Id.* at 4a. Finally, the court held that its prior resolution of the remedial issue as a matter of Virginia law was in no way affected by *Beam*. *Ibid.*

SUMMARY OF ARGUMENT

This case presents an issue of paramount importance to the States: When should a decision invalidating a state tax on federal constitutional grounds be applied retroactively? The implications of the Court's answer are far-reaching. To be sure, even under the test of *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971), the great majority of constitutional decisions issued by this and other federal courts in the area of state taxation will *not* announce a new rule of law, much less a new rule whose retroactive application would both thwart the rule's underlying purposes and, on balance, create inequitable burdens. But where, as here, all of these criteria are amply satisfied, retroactive effect can and often will force States and localities to make enormous refunds that threaten the availability of essential services and the fiscal well-being of government.

Given this potential for enormous liability, we submit that the Court should apply the three-part test articulated

in *Chevron Oil* to decide whether decisions in the area of state taxation are retroactive. As the Court has consistently recognized, "taxes are the life-blood of government." *Bull* v. *United States*, 295 U.S. 247, 259 (1935). When properly applied in this case, *Chevron Oil* requires a finding that *Davis* may be applied prospectively only. Accordingly, the judgment of the Virginia Supreme Court must be affirmed.

1. As an initial matter, the approach to retroactivity propounded by Justice Souter in *James B. Beam Distilling Co.* v. *Georgia*, 111 S. Ct. 2439 (1991)—which rejects "selective prospectivity"—does not mandate retroactive application of *Davis*. In *Davis*, the Court did not resolve a *federal* choice-of-law issue by applying the new constitutional rule announced in that case to Davis himself; instead, the Court simply noted Michigan's concession as a matter of *state law* that Davis (although not other Michigan taxpayers) would be entitled to a refund if he prevailed on the constitutional issue. Resolution of the federal choice-of-law question accordingly would have been not only unnecessary but also inappropriate. Needless to say, the Court did not purport to address that question.

2. The appropriate standard for determining retroactivity is set forth in the plurality opinion in *American Trucking Ass'ns, Inc.* v. *Smith*, 496 U.S. 167 (1990) (*"ATA"*), which employs the *Chevron Oil* test. That approach which is derived from longstanding principles of *stare decisis*, accords with what has been the general understanding of the Court's retroactivity decisions. It also takes account of the compelling considerations "of a practical sort" (*Beam*, 111 S. Ct. at 2443 (opinion of Souter, J.)) that always have led the Court to limit the retroactive scope of its decisions in both the civil and criminal contexts.

3. Under the *Chevron Oil* test, *Davis* should not be applied retroactively. So far as the first prong of that test is concerned, *Davis* "disrupt[ed] a practice long accepted and widely relied upon." *United States* v. *Johnson*, 457 U.S. 537, 552 (1982) (citation omitted). Until that decision, tax exemptions such as the one in Michigan universally had been thought constitutional by taxing officials and taxpayers alike. Such exemptions had been on the books in States across the country for almost half a century. Yet so far as we are aware, until the *Davis* litigation *no* taxpayer in *any* jurisdiction had *even brought a challenge* to such a tax on intergovernmental immunity grounds, much less prevailed on such a claim. In such circumstances, taxing officials plainly were entitled to rely on the constitutionality of their statutes. That is particularly so because the Court's modern intergovernmental tax immunity decisions seemed to validate state levies—like those in Michigan and Virginia—that treated federal employees no less favorably than the ordinary run of state taxpayers. Since the other two prongs of *Chevron Oil* also point away from retroactive application of *Davis*, the Court should accord the *Davis* decision purely prospective effect.

ARGUMENT

THE RULE ANNOUNCED BY *DAVIS* SHOULD NOT BE APPLIED RETROACTIVELY

At the outset, two points warrant emphasis. *First*, it is useful to bear in mind those issues that are *not* involved here. This case does not present any challenge to the established understanding that refunds are unavailable to taxpayers who fail to comply with state statutes of limitations or rules requiring notice, payment under protest, or exhaustion of administrative remedies. Petitioners do not dispute the force of this principle, which was reaffirmed in *McKesson* v. *Florida Alcohol & Tobacco Div.*, 496 U.S. 18, 45 & n.28 (1990). See also, *e.g.*, *Ward* v. *Love County*, 253 U.S. 17, 22-23, 25 (1920). Similarly, this case does not pose the question whether *McKesson*—

which generally obligates States to provide "meaningful backward-looking relief" when their taxing schemes are held unconstitutional under clearly established law (496 U.S. at 31)—requires States to provide a refund remedy if they allowed taxpayers to protest the imposition of the unconstitutional tax prior to payment, as Virginia did in this case. If the Court holds *Davis* to apply retroactively, it accordingly should remand this case to the state courts for consideration of that remedial question. And if such "backward-looking" relief is held necessary here, it is, of course, for the individual States to determine whether the unconstitutionality should be remedied through the payment of refunds or through retroactive tax *increases* on the beneficiaries of the unconstitutional discrimination. See *McKesson*, 496 U.S. at 40.

Second, the Court should be cognizant of the practical consequences that would follow from retroactivity. On the one hand, it is plain that retroactive application of *Davis* (assuming that States are unable to increase taxes retroactively on state pensioners) would impose massive refund obligations on the States that would disrupt state operations across the country and throw the budgetary planning of many state and local governments into chaos. And on the other, retroactive application of *Davis* would offer petitioners a wholly unexpected and unwarranted windfall.

The liability that States would face if *Davis* is applied retroactively is, in the words of a leading commentator, "truly frightening." Hellerstein, *Preliminary Reflections on McKesson and American Trucking Associations*, 48 Tax Notes 325, 336 (July 16, 1990). As the Virginia Supreme Court found, Virginia *alone* would face liability of $440 million. Pet. App. 14a. But Virginia is decidedly not alone. Twenty-three States have statutes similar to those invalidated in *Davis*.[2] At least five of these

[2] Those States were Alabama, Arizona, Arkansas, Colorado, Georgia, Iowa, Kansas, Kentucky, Louisiana, Michigan, Mississippi, Missouri, Montana, New Mexico, New York, North Carolina,

States have potential refund liabilities of $100 million or more.[3] In all, our canvass of state taxing authorities suggests that the amount at stake across the country is on the order of $2 billion.

This massive liability, moreover, would come "at a time when most States are struggling to fund even the most basic services." *Beam*, 111 S. Ct. at 2455 (O'Connor, J., dissenting). See Dickson, *New Study Quantifies States' Losses From Federal Cuts in Revenue Sharing*, The Bond Buyer, Mar. 19, 1992, at 2; Howlett, *A Coast to Coast Crisis: States Chase Every Penny of Revenue*, USA Today, Jan. 23, 1992, at A1; Armstrong, *Recession-Hit States Brace for Second Year of Budget Gaps*, Christian Science Monitor, Jan. 21, 1992, at 1. Even in times of fiscal health, it is difficult for States or localities suddenly to make unexpected outlays (or make up for unexpected revenue shortfalls) of many millions of dollars. With state treasuries already weakened, the potential liability following from retroactive application of *Davis* could cripple the essential operations of many state governments. The court below found that tax refund liability "would come at a time when the Commonwealth is already struggling to meet enormous fiscal deficits" and thus "would have a potentially disruptive and destructive impact on the Commonwealth's planning, budgeting, and delivery of essential state services." Pet. App. 14a. See

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Oklahoma, Oregon, South Carolina, Utah, Virginia, West Virginia and Wisconsin. See also Pet. App. 10a-11a n.2. For an explanation of each State's exemptions, see Eckl, Felde, Wolfe & Zimmerman, *State Taxation of Public Pensions: The Impact of* Davis v. Michigan, 47 Tax Notes 1119, 1122 (May 28, 1990).

[3] See *Bass* v. *South Carolina*, 395 S.E.2d 171, 174 (S.C. 1990) ($200 million), petition for cert. filed, 60 U.S.L.W. 3755 (U.S. Apr. 24, 1992) (No. 91-1687); *Bohn* v. *Waddell*, 790 P.2d 772, 789 (Ariz. Tax 1990) ($261 million), aff'd on reconsideration, 807 P.2d 1 (Ariz. Tax 1991); *Swanson* v. *North Carolina*, 407 S.E.2d 791, 794 (N.C.) ($140 million), on rehearing, 410 S.E.2d 490 (N.C. 1991), petition for cert. filed, 60 U.S.L.W. 3655 (U.S. Mar. 4, 1992) (No. 91-1436). See also Resp. Br. Supp. App. A (listing estimated liability of $120 million for Utah and $100 million for Georgia).

also *Bass*, 395 S.E.2d at 174 ($200 million refund liability would "endanger the fiscal integrity" of South Carolina); *Bohn*, 790 P.2d at 789 ($261 million in refunds would "endanger [Arizona's] financial integrity"). Needless to say, the ultimate burden of this liability would fall on "the shoulders of blameless or unknowing taxpayers" (*City of Newport* v. *Fact Concerts, Inc.*, 453 U.S. 247, 267 (1981)) in the form of higher taxes, reduced benefits, or both. See also *ATA*, 496 U.S. at 183 (plurality opinion).

At the same time, the beneficiaries of a refund in this case would receive an obvious windfall. Taxpayers such as petitioners, of course, already have benefited from a higher level of state services funded in part by their past tax payments. And as Justice O'Connor noted in a similar setting, "[b]efore [*Davis*], the legitimate expectation of [petitioners] was that they had to pay the tax here at issue and that it was constitutional. * * * There is little hardship to these [taxpayers] from not receiving a tax refund they had no reason to anticipate." *Beam*, 111 S. Ct. at 2455 (O'Connor, J., dissenting).

It seems plain that these untoward consequences are earnestly to be avoided. The question in this case is whether they nevertheless are constitutionally compelled. We submit that they are not.

I. THE COURT SHOULD APPLY THE *CHEVRON OIL* TEST TO DETERMINE WHETHER NEW PRINCIPLES OF LAW CONTROL THE CASE BEFORE IT

Whether unsettling and disruptive retroactive consequences are avoidable when the law takes a radical change in direction, of course, is a matter that has closely divided the Court in recent years. In *ATA*, the plurality was of the view that decisions announcing new rules of law may not "appl[y] to conduct or events that occurred before the date of the decision" (496 U.S. at 177), and that retroactivity in such circumstances is governed by the three-part *Chevron Oil* test; as the plurality

saw it, determining which rule to apply was a "choice of law" question. See *id.* at 178. The *ATA* dissent, in contrast, concluded that the Court must apply its current understanding of the law in every case, while adding that equitable principles may be invoked in certain cases to limit the relief available to the prevailing party when the law has been changed. *Id.* at 209-210 (Stevens, J., dissenting).[4] One year after the decision in *ATA*, a different alignment of three Justices, without resolving the disagreement between the *ATA* plurality and dissent, added an additional level of inquiry: they rejected the use of "selective prospectivity," reasoning—entirely apart from the question whether pure prospectivity ever is permissible—that a new rule must be applied to all similarly situated litigants once it has been applied to one. See *Beam*, 111 S. Ct. at 2446 (opinion of Souter, J., joined by Stevens, J.); *id.* at 2448-2449 (White, J., concurring in the judgment).

The arguments bearing on all of the positions advanced in *ATA* and *Beam* were addressed at length in those decisions, and we do not propose to rehearse them here. Instead, we offer three propositions: 1) Accepting as correct the *Beam* plurality's rejection of selective prospectivity, we suggest that its position does not warrant retroactive application of *Davis*; 2) we maintain that the approach taken by the *ATA* plurality is the preferable one; and 3) we propose that the *Chevron Oil* test compels purely prospective application of *Davis*.

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[4] Petitioners are simply mistaken in asserting that "in *McKesson*, five justices of this Court rejected nonretroactive decisionmaking." Pet. Br. 19. The only discussion in *McKesson* of the retroactivity issue occurs in a brief footnote. See 496 U.S. at 31 n.15. Far from supporting petitioners' claim, that passage states in passing (and for a unanimous Court) that the decision of the Florida Supreme Court under review "clear[ly]" must be applied retroactively under any of the various "approaches advanced" in *ATA*. There was no need for the Court in *McKesson* to choose among those approaches since all yielded the same result: retroactivity.

A. *Beam* Is Inapplicable Because the *Davis* Court Did Not Apply the New Rule It Announced to the Parties in that Case

In *Beam*, three justices concluded that "it is error to refuse to apply a rule of federal law retroactively after the case announcing the rule has already done so." 111 S. Ct. at 2446 (opinion of Souter, J., joined by Stevens, J.); *id.* at 2448-2449 (White, J., concurring in the judgment). Finding this approach dispositive in *Beam*, Justice Souter explained that the rule announced in *Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263 (1984), the decision whose retroactivity was at issue in *Beam*, had been applied in that case to the litigants, and thus also had to be applied retroactively in *Beam* to events predating *Bacchus*. 111 S. Ct. at 2441 (opinion of Souter, J.).

Contrary to petitioners' suggestion (Pet. Br. 6-10), Justice Souter's approach to retroactivity does not determine the outcome of this case. The reason is straightforward: the premise for that approach is absent here. In *Davis*, unlike in *Bacchus*, this Court did not "apply" its ruling of unconstitutionality to Davis within the meaning of *Beam*.

In fact, the Court simply had no occasion to reach or resolve the federal choice-of-law issue in *Davis*. Michigan there conceded—as a matter of *state law*—that Davis would be entitled to a refund if the state tax were held unconstitutional. The Court expressly accepted that concession, explaining: "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." 489 U.S. at 817 (citation omitted). Resolution of the federal question whether the holding of *Davis* should be given retroactive application therefore simply was unnecessary.[5] Needless to say, the Court did not

[5] That Michigan premised its position on state law rather than on its understanding of the proper choice of federal law is made mani-

purport to resolve that question. Cf. *Desist* v. *United States*, 394 U.S. 244, 258 (1969) (Harlan, J., dissenting) ("This Court is entitled to decide constitutional issues only when the facts of a particular case *require* their resolution for a just adjudication of the merits.") (emphasis in original).

In this regard, the contrast with *Beam* is instructive. There, Justice Souter reasoned that *Bacchus* "is fairly read to hold as a choice of law that its rule should apply retroactively to the litigants then before the Court." 111 S. Ct. at 2445. In reaching this conclusion, Justice Souter noted both that "the *Bacchus* opinion did not reserve the question whether its holding should be applied to the parties before it" (*ibid.*)—a reservation that was rendered unnecessary in *Davis* by Michigan's concession as

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fest by the limited nature of its concession. Michigan acknowledged liability only to Davis; it expressly declined to make a similar concession in regard to any of the other 24,000 or so Michigan taxpayers whom the State predicted might seek the benefit of the Court's constitutional ruling. No. 87-1020, Br. Appellees 59, 63-64 ("Even assuming this [refund] remedy is appropriate for Appellant Davis, however, it is not necessarily appropriate for all others who may be similarly situated."). In addition, it was emphasized at argument that the concession did not settle the choice-of-law issue. At the close of his argument, Michigan's attorney stated, "[s]hould we lose all our substantive arguments, we admit that Mr. Davis should get his tax refund with interest, but the question arises what about these other 24,000 people." Tr. Or. Arg. 37. In response, the following exchange took place:

Court: So, why do we have to answer that at all?

Michigan: —if, if this Court issues an opinion stating that the current Michigan classification is unconstitutional or in violation of the statute, there are these 24,000 taxpayers out there.

* * * *

Court: But that's not—it's not here, is it? Is that question here?

Michigan: It is not specifically raised, no.

Id. at 37-38. This conclusion is not disputed by petitioners, who recognize that "Michigan did not concede that the Court's decision would apply retroactively." Pet. Br. 8 n.3.

to the import of its state law—and that the Court in *Bacchus* expressly addressed the matter of remedies. As he explained, "any consideration of remedial issues necessarily implies that the precedential question has been settled to the effect that the rule of law will apply to the parties before the Court. Because the Court in *Bacchus* remanded the case solely for consideration of [a remedial question], it thus should be read as having retroactively applied the rule there decided." *Ibid.* (citation and footnote omitted).[6] The *Davis* Court, in contrast, while remanding for consideration of *prospective* remedies (see 489 U.S. at 817-818), said nothing about retroactive remedies for parties not covered by the State's concession.

It should be added that treating such a state-law concession as settling the choice-of-law issue for all parties in all future litigation would have patently absurd results. It would mean that the discretionary refund policy of the first State to engage in litigation would bind all other States. It also would lead all parties with an interest in the retroactivity of a constitutional rule to participate in all litigation involving that rule so that they could have a say on the choice-of-law issue.

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[6] Justice Souter also noted, but did not rely upon, the additional fact that in *Bacchus* the defendant discussed the applicability of *Chevron Oil* in its brief and urged the Court to apply any new constitutional rule prospectively only, and that, accordingly, the issue "can * * * be said actually to have been litigated and by implication actually to have been decided" by the Court. See 111 S. Ct. at 2445 n.2. In contrast, the issue of retroactivity was not even properly *presented* to the Court in *Davis*. The question presented by *Davis*'s Jurisdictional Statement was: "Whether Section 30(1)(h) of the Michigan Income Tax Act * * * *is invalid*, as applied to Federal retirees * * *." No. 87-1020 Juris. Statement i (emphasis added). This Court does not decide issues that are not presented. See S. Ct. Rule 14.1(a); *San Francisco Arts & Athletics, Inc.* v. *United States Olympic Comm.*, 483 U.S. 522, 547 n.30 (1987). In addition, in *Davis* the issue of retroactivity had not been reached by the Michigan Supreme Court. "Ordinarily," of course, "the Court does not decide questions not raised or resolved in the lower court." *Youakim* v. *Miller*, 425 U.S. 231, 234 (1976).

What is more, neither of the two rationales advanced by Justice Souter for his approach—"that similarly situated litigants should be treated the same" and *stare decisis* (111 S. Ct. at 2446)—has any application in a case such as this, where a court declines to reach or resolve an issue solely because of one party's concession. Self-evidently, Davis's "treat[ment]" resulted from Michigan's concession. It accordingly would offend no principle of equality to decline to extend the benefit of Michigan's concession to other taxpayers with identical claims: Davis is not situated similarly to other litigants, such as petitioners here, who have not obtained concessions from their adversaries in litigation and who are not entitled to refunds under the law of their States.

Nor does the principle of *stare decisis* support retroactive application of *Davis*. A prior decision of this Court "is not a binding precedent" on an issue that was not "raised in briefs or arguments nor discussed in the opinion." *United States* v. *L.A. Tucker Truck Lines*, 344 U.S. 33, 38 (1952). See also *Webster* v. *Fall*, 266 U.S. 507, 511 (1925) ("Questions which merely lurk in the record, neither brought to the attention of the court nor ruled upon, are not to be considered as having been so decided as to constitute precedents."). Indeed, this Court has not considered itself bound even by prior rulings that *necessarily decided* an issue *sub silentio*. *New* v. *Oklahoma*, 195 U.S. 252, 256 (1904) (citing *United States* v. *More*, 7 U.S. (3 Cranch) 159, 172 (1805) (Marshall, C.J.)). *A fortiori*, there is no binding force to a decision with respect to an issue that is not resolved. See Re, *Stare Decisis*, 79 F.R.D. 509, 511 (1975). Any benefit that Davis received from this Court's constitutional ruling in his case resulted not from the Court's resolution of the retroactivity or refund issue but from the voluntary action of his adversary in litigation. There is simply no *stare decisis* concern implicated under these circumstances. Cf. *Local No. 93, Int'l Ass'n of Firefighters* v. *Cleveland*, 478 U.S. 501, 522 (1986) (obligations in a consent decree are created by "the agreement

of the parties, rather than the force of the law upon which the complaint was originally based").

Because Justice Souter's approach in *Beam* has no application here, this case presents the Court with the choice left unresolved in *ATA*: between *Chevron Oil* and automatic retroactivity. It is to that question that we now turn.

B. The *ATA* Plurality's Application of the *Chevron Oil* Test Should Govern This Case

The controlling precedent here is *ATA*, and the dispositive question is whether to apply the approach to retroactivity taken by the *ATA* plurality or the *ATA* dissent.[7] We submit that the *ATA* plurality's approach

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[7] In an effort to escape the force of *Chevron Oil*, petitioners attempt to recast this case in purely statutory terms. Pet. Br. 11-18. Thus, they argue that this case is "not about retroactive versus prospective application of *Davis*" at all, but rather is "about application of 4 U.S.C. § 111," the Public Salary Tax Act of 1939. Pet. Br. 17. They further suggest that "separation of powers require[s] this Court to honor and enforce" that statute, which took effect in 1939, according to what petitioners view as its "unambiguous" terms. *Id.* at 17-18.

These arguments are meritless. In *Davis*, this Court found the Public Salary Act to be *coextensive* with the immunity granted by the Constitution. *Davis*, 489 U.S. at 813-814 (the "immunity in [the Act] is coextensive with the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity. * * * [T]he scope of the immunity * * * is to be determined by reference to the constitutional doctrine."). Indeed, the *Davis* Court found it unnecessary even to resolve the question "whether § 111 provides an independent basis for finding immunity or merely preserves the traditional constitutional prohibition against discriminatory taxes." 489 U.S. at 813. Because the scope of the Salary Act is determined by the scope of the Constitution, petitioners' argument is simply inapplicable in this case.

In any event, petitioners' distinction between constitutional and statutory decisions has no substance. In fact, this Court often has refused to apply retroactively a decision that gives new meaning to a federal statute when the equities weigh against such application —as was true in *Chevron Oil* itself. The Court there declined to give retroactive effect to a prior decision, *Rodrigue* v. *Aetna Cas. &*

better accords both with this Court's precedents and with the general understanding of retroactivity, especially as applied to cases involving state taxation. Several points support this conclusion.

1. As an initial matter, whether or not the *ATA* dissent's characterization of retroactivity as a matter of remedy alone is, strictly speaking, consistent with the Court's prior holdings, that characterization appears out of step with the Court's past understanding of its decisions. The Court's civil rulings limiting retroactivity typically contain language indicating that the "the decision will not apply" to past conduct, or that "we will apply our decision in this case prospectively." *Cipriano* v. *City of Houma*, 395 U.S. 701, 706 (1969). See, *e.g.*, *Chevron Oil*, 404 U.S. at 106-107 ("'a holding of nonretroactivity'"); *Phoenix* v. *Kolodziejski*, 399 U.S. 204, 214 (1970) ("[o]ur decision in this case will apply only to" specified conduct). Cf. *Heckler* v. *Mathews*, 465 U.S. 728, 746 (1984) ("We have recognized, in a number of contexts, the legitimacy of protecting reasonable reliance on prior law even when that requires allowing an unconstitutional statute to remain in effect for a limited period of time."). This sort of language—stating that "a decision will not apply" to past conduct—surely is most naturally read as meaning that the *rule* announced in that decision will not apply. The lower courts, practitioners, and commentators therefore have understood the Court's retroactivity decisions to state "a doctrine or set of rules for determining when past precedent should be applied to a case before the court." *ATA*, 496 U.S.

Surety Co., 395 U.S. 352 (1969), which had construed the Outer Continental Shelf Lands Act in such a way as to create a new rule of law. See 404 U.S. at 99, 105-109. See also, *e.g.*, *Florida* v. *Long*, 487 U.S. 223, 235 (1988) (holding prior decision interpreting Title VII nonretroactive); *Chicot County Drainage Dist.* v. *Baxter State Bank*, 308 U.S. 371, 384 (1940) (recognizing that a later interpretation of a statute need not be given retroactive effect). Petitioners' belabored attempts to distinguish these cases (Pet. Br. 15-17) must be rejected.

at 196 (Scalia, J., concurring in the judgment). See also *id.* at 195-196 & n.2 (citing commentary).

The reasons that have impelled the Court to adopt that approach to retroactivity are manifest. Public officials and the citizenry at large are entitled to rely on this Court's statements of the law, and "[t]he utility of [the Court's] retroactivity doctrine in cushioning the sometimes inequitable and disruptive effects of law-changing decisions is clear." *ATA*, 496 U.S. at 200 (Scalia, J., concurring in the judgment). There accordingly is no compelling reason to depart from the long-settled understanding that, "'[w]here a decision of this Court could produce substantial inequitable results if imposed retroactively, there is ample basis in [the Court's] cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity.'" *Chevron Oil*, 404 U.S. at 107 (quoting *Cipriano*, 395 U.S. at 706).

It nevertheless has been suggested that the disruptive effects of mandatory retroactivity actually serve valuable purposes by discouraging departures from precedent and acting as a "check[] upon judicial law making." *Beam*, 111 S. Ct. at 2451 (Scalia, J., concurring in the judgment). For our part, however, we question whether society is well served by a rule that puts the Court to the choice of, on the one hand, retaining in force a concededly incorrect understanding of the Constitution (a choice that is particularly unpalatable to those who believe that judges should make law "as though they were 'finding' it" (*ibid.* (emphasis omitted)), or, on the other, causing potentially intolerable disruptive effects by its holdings.[8]

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[8] In any event, the *ATA* dissent itself acknowledges that the Court often will be able to cushion the impact of its decisions through the choice of a nonretroactive *remedy*. Its approach therefore is a very imperfect check upon judicial action: it is difficult to see how the force of precedent is significantly furthered by a choice-of-law rule that discourages the overruling of decisions only in those areas where the Court fortuitously has no remedial discretion. Allowing the nature of the choice-of-law rule to be dictated by the perceived

2. The principal challenge to the approach of the *ATA* plurality has been grounded upon the suggestion that limiting retroactivity somehow is inconsistent with the judicial role. See *Beam*, 111 S. Ct. at 2449-2450 (Blackmun, J., concurring in the judgment); *id.* at 2450-2451 (Scalia, J., concurring in the judgment). But there plainly is no Article III or other constitutional defect in the *ATA* plurality's approach. The Court repeatedly has held that there is no constitutional requirement of retroactivity. See, *e.g.*, *United States* v. *Johnson*, 457 U.S. 537, 542 (1982) (citing *Great Northern Ry.* v. *Sunburst Oil & Refining Co.*, 287 U.S. 358, 364 (1932)). And the formal notion that judges "find" rather than "make" rules does not dictate retroactivity; the Court consistently has refused to " 'indulge in the fiction that the law now announced has always been the law.' " *Chevron Oil*, 404 U.S. at 107 (citation omitted). See, *e.g.*, *Williams* v. *United States*, 401 U.S. 646, 651 (1971) (plurality opinion) (Court has "firmly rejected the idea that all new interpretations of the Constitution must be considered always to have been the law and that prior constructions to the contrary must always be ignored"); *Linkletter* v. *Walker*, 381 U.S. 618, 622 n.3 (1965).

There undeniably was, moreover, a real controversy between the parties in *Davis*—and there would have been such a controversy even had the Court there held its decision to be nonretroactive and even had Michigan not made the concession that entitled Davis to relief. In such circumstances, a holding of nonretroactivity is hardly advisory; the Court's opinion in such a case simply explains its rationale for choosing a particular rule and applying that rule (or failing to apply it) to particular facts. A decision of that sort is similar in principle to, and relies upon the same considerations of policy as, a conclusion that a prior holding was wrongly decided but should not be overruled so as to protect the litigants'

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value of retroactivity in those cases would have a very small practical tail wagging a very large theoretical dog.

(and the public's) reliance interests. See, *e.g.*, *Flood* v. *Kuhn*, 407 U.S. 258, 282-284 (1972).

In fact, as the *ATA* plurality explained, principles of nonretroactivity long have been understood to be an element of the doctrine of *stare decisis*. *ATA*, 496 U.S. at 196 (citing *Sunburst*, 287 U.S. at 364 (Cardozo, J.)). Certainly, if it is appropriate for the Court to protect the public's expectation interests by declining to overrule a decision that is thought to have been wrongly decided, cf. *Quill* v. *North Dakota*, 112 S. Ct. 1904, 1914-1916 (1992), it is equally proper to allow courts, by means of prospective overruling, "to respect the principle of *stare decisis* even when they are impelled to change the law in light of new understanding." *ATA*, 496 U.S. at 197 (plurality opinion). Justice Scalia offered a related analysis in *ATA*, where he concluded that a Justice who disagrees with a decision that overruled precedent may decline to apply that decision to conduct that had been undertaken in reliance on the precedent; in such circumstances, *stare decisis* principles permit a departure from the more recent decision so as not to "upset * * * settled expectations." *Id.* at 205 (Scalia, J., concurring in the judgment). We add only that if Justice Scalia's understanding of *stare decisis* is correct—and we believe it is—it is not at all clear why it is inconsistent with the judicial role for a judge who *agrees* with a decision to decline to apply that decision's rule so as to protect those same expectation interests.

There is nothing new in this conclusion. This Court consistently has taken into account such considerations "of a practical sort" in determining the retroactive reach of its decisions. *Beam*, 111 S. Ct. at 2443 (opinion of Souter, J.). In civil cases, for example, the Court will not allow "a new rule [to] reopen the door already closed" by principles of res judicata or by statutes of limitations, even though those limits on retroactivity are in some sense "arbitrary" (*id.* at 2446); the Court denies complete retroactive effect to the new rule so as to advance independent interests in finality. See *id.* at 2447. The

Court has applied the same sort of practical judgment in its application of retroactivity in the setting of habeas corpus, adopting an approach, first propounded by Justice Harlan in *Mackey* v. *United States*, 401 U.S. 667, 675 (1971) (opinion of Harlan, J.), that accords most constitutional decisions nonretroactive effect in habeas proceedings. *Teague* v. *Lane*, 489 U.S. 288, 299-310 (1989) (plurality opinion). And again, if considerations of finality and reliance may justify disregard of "current constitutional law" in such proceedings (*Mackey*, 401 U.S. at 686 (opinion of Harlan, J.)), there is no reason to find it inconsistent with the judicial function for a judge, looking to similar policies, to decline to apply new law in a case such as this one.

It hardly need be added that, as we explain above, there *are* compelling practical considerations that militate against retroactive application of new constitutional principles in cases involving state taxation. And this Court has taken such fiscal considerations into account in deciding cases that affected the financial well-being of States. In *Arizona Governing Comm.* v. *Norris*, 463 U.S. 1073, 1106-1107 (1983), for example, Justice Powell, writing for five Members of the Court, stressed the "devastating results" that would follow from imposing massive retroactive liability on state and local governments. *Id.* at 1106. As Justice Powell explained, "[i]mposing such unanticipated financial burdens would come at a time when many States and local governments are struggling to meet substantial fiscal deficits." *Id.* at 1106-1107. Here, as in *Norris*, there is "no justification * * * to impose this magnitude of burden retroactively on the public." *Id.* at 1107. See also *id.* at 1110 (O'Connor, J., concurring).

II. UNDER THE *CHEVRON OIL* TEST, *DAVIS* SHOULD NOT BE APPLIED RETROACTIVELY

If the Court follows the approach set out by the *ATA* plurality, it must apply the *Chevron Oil* test to its holding in *Davis*. The test's three parts are now familiar:

> First, the decision to be applied nonretroactively 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. Second, * * * we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective application will further or retard its operation. Finally, we [must] weigh[] the inequity imposed by retroactive application, for where a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the injustice or hardship by a holding of nonretroactivity.

404 U.S. at 106-107 (citations and internal quotation marks omitted). See *ATA*, 496 U.S. at 179 (plurality opinion). This test requires that *Davis* not be applied retroactively.

1. The *Chevron Oil* test is designed "to determine the equities of retroactive application of a new rule" (*Beam*, 111 S. Ct. at 2452 (O'Connor, J., dissenting)); its first prong is used to identify those parties who reasonably relied upon the old rule and who accordingly would be denied "basic * * * justice and fairness" if subjected to the new one. *Id.* at 2444 (opinion of Souter, J.). One way of establishing such reliance is by demonstrating that the decision whose retroactivity is at stake marked a break with the Court's existing doctrine—and we show below that *Davis* did mark such a break. But other features of the legal landscape, such as long-standing, universal acceptance of the old rule by affected persons, also may shed light on the reasonable expectations of the parties. Here, a review of that landscape makes clear that *Davis* did "decid[e] an issue of first impression whose resolution was not clearly foreshadowed." [9]

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[9] Notwithstanding petitioners' asertion to the contrary (see Pet. Br. 20-23), this formulation still expresses the first prong of the *Chevron Oil* Test. See, *e.g.*, *ATA*, 496 U.S. at 179 (plurality opin-

It is beyond dispute that *Davis* "disrupt[ed] a practice long accepted and widely relied upon." *United States* v. *Johnson*, 457 U.S. at 552 (citation omitted). Until the decision in *Davis*, taxes such as those in Virginia and Michigan universally had been thought constitutional by taxing officials and taxpayers alike. Virginia's tax had been on the books for almost half a century. Similar statutes were enforced by just under half the States.

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ion). Petitioners argue that this Court, in two brief *per curiam* opinions, abandoned the "clearly foreshadowed" standard in favor of an inquiry into whether a rule announced in a judicial decision is "revolutionary." See Pet. Br. 21-22 (citing *Ashland Oil, Inc.* v. *Caryl*, 110 S. Ct. 3202 (1990), and *National Mines Corp.* v. *Caryl*, 110 S. Ct. 3205 (1990)). Petitioners are mistaken. In fact, *Ashland Oil* expressly *reaffirmed* that "[t]he first prong of the *Chevron Oil* test requires that 'the decision to be applied nonretroactively 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.' " 110 S. Ct. at 3204 (quoting *Chevron Oil*, 404 U.S. at 106-107); see also *id.* at 3205 (applying this test); *National Mines*, 110 S. Ct. at 3206 (summarily adopting reasoning and result of *Ashland Oil*). The Court's observation, in *Ashland Oil*, that a certain decision may well have "revolutionized" an area of law was made in reference to a case decided *after* the decision whose retroactivity was under consideration. Nor does *Goodman* v. *Lukens Steel Co.*, 482 U.S. 656, 662-663 (1987), "demonstrate that decisions that do not overturn Supreme Court precedent are not even candidates for prospective-only application." Pet. Br. 20. In *Lukens*, this Court merely applied the traditional *Chevron Oil* test and held that a Third Circuit decision that had overruled several prior Third Circuit cases was nonetheless retroactive, because the conduct underlying the lawsuit occurred years before the earlier decisions had been rendered. 482 U.S. at 662-663. Finally, petitioners are incorrect in suggesting that under *Owen* v. *City of Independence*, 445 U.S. 622 (1980), "when[ever] governmental entities are involved, *Chevron* may only apply in cases overturning precedent of this Court." Pet. Br. 22. Similar arguments were rejected by eight members of the Court in *ATA*. See 496 U.S. at 184 (plurality) ("*Owen* is not applicable * * * here."); see also *id.* at 216 n.5 (Stevens, J., joined by Brennan, Marshall & Blackmun, JJ., dissenting) (explaining that plurality "is technically correct that *Owen* did not hold that constitutional decisions should always apply 'retroactively' ").

Yet so far as we are aware, until the *Davis* litigation, *no* taxpayer in *any* jurisdiction had even *brought a challenge* to such a statute on intergovernmental tax immunity grounds, much less prevailed on such a claim. To the contrary, as Judge Wilkinson recently noted for the Fourth Circuit, "[t]he most pertinent judicial decisions had upheld comparable taxing schemes." *Swanson* v. *Powers*, 937 F.2d 965, 968 (4th Cir. 1991), cert. denied, 112 S. Ct. 871 (1992). See 937 F.2d at 969.

In such circumstances, where similar state statutes had stood across the nation for almost 50 years without so much as a single challenge, state taxing officials would have been entitled to rely on the constitutionality of their laws even had close analysis of this Court's pre-*Davis* authority arguably pointed toward the ultimate outcome in that case. See *Bohn*, 790 P.2d at 783; *Swanson* v. *North Carolina*, 407 S.E.2d at 794; *Bass*, 395 S.E.2d at 174. Indeed, to impose retroactive liability in such circumstances would subject state officials to extraordinarily awkward and conflicting obligations. "[A] regime requiring refunds even when a finding of unconstitutionality would be highly unpredictable could both discourage the states from exploring new tax policies and unreasonably penalize adherence to old ones." Fallon & Meltzer, *New Law, Non-Retroactivity, and Constitutional Remedies*, 104 Harv. L. Rev. 1733, 1831 (1991). State legislators hardly can be expected to repeal tax statutes that are in use across the nation, that are not plainly inconsistent with judicial authority, and that have not even had their validity called into question. And state taxing officials typically are bound under state law to enforce presumptively valid statutes until directed otherwise by the courts. If States may be forced to surrender funds collected pursuant to such statutes, their ability to plan or carry out government programs will be seriously compromised.

Noting just such considerations, the Court in a related setting rejected a constitutional challenge that "would

have [had] state officials stay their hands" until their programs were

> "ratified" by the federal courts, or risk draconian, retrospective decrees should the legislation fall. In our view, [this] position could seriously undermine the initiative of state legislators and executive officials alike. Until judges say otherwise, state officers * * * have the power to carry forward the directives of the state legislature.

Lemon v. *Kurtzman*, 411 U.S. 192, 207-208 (1973) (plurality opinion). In the absence of compelling constitutional considerations mandating retroactivity (see *id.* at 201-203), the *Lemon* plurality added that "[w]e do not engage lightly in post hoc evaluation of such political judgment, founded as it is on 'one of the first principles of constitutional adjudication—the basic presumption of the constitutional validity of a duly enacted state or federal law.'" *Id.* at 208 (quoting *San Antonio School District* v. *Rodriguez*, 411 U.S. 1, 60 (1973) (Stewart, J., concurring)). While the Court in *Lemon* was specifically addressing questions of remedy rather than choice of law, its underlying premise is equally applicable here: "[A]bsent contrary direction, state officials and those with whom they deal are entitled to rely on a presumptively valid state statute, enacted in good faith and by no means plainly unlawful." 411 U.S. at 208-209 (plurality opinion).

2. While that is enough to satisfy the first prong of *Chevron Oil*, it should be added that this Court's pre-*Davis* precedent did *not* "clearly foreshadow" the outcome there. To the contrary, as Judge Wilkinson explained, "the rationale behind the precedent might have suggested a different result in that case." *Swanson* v. *Powers*, 937 F.2d at 970. To begin with, as this Court has frequently observed, the doctrine of intergovernmental tax immunity has "been marked from the beginning by inconsistent decisions and excessively delicate distinctions." *United States* v. *New Mexico*, 455 U.S. 720, 730 (1982). See also *United States* v. *City of Detroit*, 355 U.S. 466, 473

(1958) (doctrine a "much litigated and often confused field").[10] But to the extent that there had been any trend in the law prior to *Davis*, it was away from an expansive view of immunity. Indeed, in the years preceding *Davis*, the Court repeatedly had restricted the scope of the immunity doctrine. See *Swanson* v. *Powers*, 937 F.2d at 970 ("the modern line of cases represents a shift in emphasis away from immunity and toward limitation of such immunity."). That trend began in 1937, with the Court's decision in *James* v. *Dravo Contracting Co.*, 302 U.S. 134 (1937), which held that even though a "tax may increase the cost to the Government, that fact would not invalidate the tax." *Id.* at 160. In more recent years, the Court repeatedly denied claims of immunity and granted the States broader authority to exercise their taxing powers.[11]

In nevertheless finding Michigan's statute unconstitutional, the *Davis* Court relied upon the principle, derived from *Phillips Chem. Co.* v. *Dumas Indep. School Dist.*, 361 U.S. 376 (1960), that " 'it does not seem too much to require that the State treat those who deal with the [federal] Government as well as it treats those with whom it deals itself.' " 489 U.S. at 815 n.4 (quoting *Phillips*,

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[10] Lower courts and commentators alike concur in this assessment. See, *e.g.*, *Swanson* v. *Powers*, 937 F.2d at 968 (before *Davis* "the doctrine of intergovernmental tax immunity was, at best, ambiguous"); *Bohn*, 790 P.2d at 784 (the doctrine of intergovernmental tax immunity is "a most esoteric of constitutional philosophies"); L. Tribe, *American Constitutional Law* § 6-31, at 514 (1988) (noting a "sometimes bewilderingly complex array of judicial decisions in this area"); P. Hartman, *Federal Limitations on State and Local Taxation* § 6:1, at 221 (1981) ("Since its inception, federal tax immunity has wound its way through a maze of shifting judicial interpretations and approaches. * * * In truth, during different eras in our constitutional history, there have been virtual judicial summersaults in the field * * * .").

[11] See, *e.g.*, *California State Board of Equalization* v. *Sierra Summit, Inc.*, 490 U.S. 844, 848 (1989); *United States* v. *New Mexico*, 455 U.S. at 742; *United States* v. *County of Fresno*, 429 U.S. 452 (1977); *City of Detroit*, 355 U.S. at 475.

361 U.S. at 385). But in its more recent pre-*Davis* intergovernmental tax immunity cases, the Court understood the doctrine's bar on discrimination against those doing business with the federal government to rest on a less formalistic principle. It explained that the doctrine is intended to preclude interference with the operations of the federal government by serving as a "safeguard against excessive taxation." *South Carolina* v. *Baker*, 485 U.S. 505, 526 n.15 (1988). And it found that such a safeguard is present when a state tax on those dealing with the federal government also "falls on a significant group of state citizens who can be counted upon to use their votes to keep the State from raising the tax excessively, and thus placing an unfair burden on the Federal Government." *Washington* v. *United States*, 460 U.S. 536, 545 (1983). See Comment, *Federal Immunity from State Taxation: A Reassessment*, 45 U. Chi. L. Rev. 695, 729 (1978).[12]

In the years leading to *Davis* that principle consistently guided the Court's determination whether a state tax is discriminatory. The Court's decision in *United States* v. *County of Fresno*, 429 U.S. at 463-464, is illustrative. There, several California counties had imposed a use tax on possessory interests in improvements on otherwise tax-exempt land. *Id.* at 455. Pursuant to the tax, federal employees were assessed on the fair rental value of the government-owned houses where they resided. Upholding the tax as nondiscriminatory, the Court expressly

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[12] That rationale for the doctrine harkened back to its origins in *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 159 (1819). With the famous observation "that the power to tax involves the power to destroy," the Court there explained that

> [t]he only security against the abuse of this power, is found in the structure of the government itself. In imposing a tax, the legislature acts upon its constituents. This is, in general, a sufficient security against erroneous and oppressive taxation.

Id. at 209. See also L. Tribe, *supra*, at 512 (*McCulloch* based on the "principle that a government may not tax or control those whom it does not represent").

distinguished a tax imposed only on the federal government from the California use tax under review:

> A tax on the income of federal employees, or a tax on the possessory interest of federal employees in Government houses, *if imposed only on them*, could be escalated by a State so as to destroy the federal function performed by them either by making the Federal Government unable to hire anyone or by causing the Federal Government to pay prohibitively high salaries. This danger would never arise, however, if the tax is also imposed on the income and property interests *of all other residents and voters of the State.*

Id. at 463 n.11 (emphasis added).

Prior to *Davis*, this principle would have seemed to validate taxes such as those in Michigan and Virginia. Such taxes were assessed against the pensions of all citizens except former state employees, and thus provided an adequate political check on the State's taxing power. In fact, the check in *Davis* was very strong indeed. Of the four and one half million taxpayers in Michigan, only 130,000 were exempted from the tax. *Davis*, 489 U.S. at 821 (Stevens, J., dissenting). The outcome in *Davis* thus was anything but foreordained. See Mueller, *Rejection of the "Similarly Situated Taxpayer" Rationale:* Davis v. Michigan Department of Treasury, 43 Tax Lawyer 431, 441 (Winter 1990) ("The majority in *Davis* rejected a long-standing doctrine").[13]

In holding to the contrary and rejecting the argument that extension of the tax to the vast majority of the State's taxpayers obviated any threat to the federal

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[13] The lower courts thus generally have agreed that *Davis* established a new principle of law. See *Duffy* v. *Wetzler*, 579 N.Y.S.2d 684, 691 (N.Y. App. Div.), appeal dismissed, 583 N.Y.S.2d 190 (N.Y. 1992); *Sheehy* v. *Montana*, 820 P.2d 1257, 1260 (Mont. 1991), petition for cert. filed, 60 U.S.L.W. 3675 (U.S. Mar. 9, 1992) (No. 91-1473); *Bass, supra*; *Swanson* v. *North Carolina, supra*; *Bohn, supra.* See also *Swanson* v. *Powers*, 937 F.2d at 968.

government, the *Davis* Court relied entirely on *Phillips*. See 489 U.S. at 815 n.4. While we do not now take issue with the *Davis* Court's reading of that case, there certainly is room to doubt that the language of the *Phillips* opinion put States on notice that statutes such as the one at issue in *Davis* were unconstitutional—a conclusion that is confirmed by the failure of any taxpayer to launch a tax immunity-based challenge to such a statute for almost *three decades* after the *Phillips* decision was handed down.

Phillips involved a state scheme that imposed a more burdensome tax on lessees of federal property than fell on lessees of state property; it appeared that lessees of private tax-exempt property were altogether exempt from tax, although in such a case the value of the leased property became taxable to the lessor at the same rates as applied to lessees of federal property. 361 U.S. at 380-381. The Court noted that when property was leased from private tax-exempt owners "the lessee's *indirect* burden * * * is as heavy as the burden imposed directly on federal lessees" (*id.* at 381 (emphasis added)), and it therefore observed, as the Court subsequently noted in *Davis* (see 489 U.S. at 815 n.4), that "there appears to be no discrimination between the Government's lessees and lessees of private property." 361 U.S. at 381. It also is true, however, as Justice Stevens noted in his *Davis* dissent (see 489 U.S. at 825-826), that the *Phillips* Court's constitutional analysis proceeded to address as the relevant universe of taxpayers only lessees of public (either federal or state) land. See 361 U.S. at 382-383. It is accordingly unclear whether the Court meant to hold it irrelevant that taxpayers who dealt with neither the federal nor the state governments were accorded treatment similar to that felt by federal lessees. Subsequent decisions invalidating state taxes on immunity grounds did not involve levies that fell in substantial part on in-state taxpayers and therefore shed no light on the question. See *Memphis Bank & Trust Co.* v. *Garner*,

459 U.S. 392 (1983); *Moses Lake Homes, Inc.* v. *Grant County*, 365 U.S. 744 (1961).

Given the Court's subsequent emphasis on the political check provided by the extension of a levy to the ordinary run of taxpayers, state officials surely were entitled to presume the constitutionality of statutes such as the one ultimately invalidated in *Davis*. Again, the reaction of the affected parties is telling: until the time of the *Davis* litigation, none of the 23 States with such statutes moved to repeal its tax, and none of the innumerable affected taxpayers sought to challenge such a tax. Against this background, *Davis* established a new rule that had not been meaningfully foreshadowed.

3. The final two prongs of *Chevron Oil* also favor purely prospective application of *Davis*. The policies of the intergovernmental tax immunity doctrine plainly are not advanced by retroactivity. This Court has made it plain that the essential purpose of the doctrine is to protect the interests of the federal government and not, as petitioners suggest (Pet. Br. 32), to advance the personal interests of that government's employees:

> [T]he purpose of the immunity was not to confer benefits on the employees by relieving them from contributing their share of the financial support of the other government * * * but to prevent undue interference with the one government by imposing on it the tax burdens of the other.

Graves v. *New York ex rel. O'Keefe*, 306 U.S. 466, 483-484 (1939). See *Davis*, 489 U.S. at 814 ("[I]ntergovernmental tax immunity is based on the need to protect each sovereign's governmental operations from undue interference by the other."). A refund would serve only petitioners' interests, not those of the federal government—a conclusion that draws support from the federal government's participation in *Davis*, but not in this case, in support of the taxpayer. Similarly, of course, "[t]he imposition of liability in hindsight against a State that, acting reasonably would do the same thing again, will

prevent no unconstitutionality." *Beam*, 111 S. Ct. at 2455 (O'Connor, J., dissenting). See also Fallon & Meltzer, *supra*, at 1804.

The third prong of *Chevron Oil* is also clearly satisfied. As described above, retroactive application will "produce substantial inequitable results," 404 U.S. at 107, not only for Virginia but for many other States as well. And the windfall to petitioners would be manifest. In these circumstances, the Court should deny *Davis* retroactive effect.

CONCLUSION

The judgment of the Virginia Supreme Court should be affirmed.

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