

1991

Wendell E. Brumley, et al. v. Utah State Tax Commission, et al. : Brief of Appellant

Utah Supreme Court

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UTAH SUPREME COURT

BRIEF

910242

IN THE UTAH SUPREME COURT

WENDELL E. BRUMLEY, et al.,)	
)	
Plaintiffs/Cross-Appellants,)	
)	Appeal No. 91-0242
vs.)	
)	
UTAH STATE TAX COMMISSION,)	Priority No. 11
et al.,)	
)	
Defendants/Appellants.)	

BRIEF OF DEFENDANTS

Interlocutory Appeal of Summary Judgment granted
Plaintiffs in the Tax Division of the Third Judicial District
Court, the Honorable David Young presiding.

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UTAH

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LIST OF PARTIES

Plaintiffs

1. Wendell E. Brumley
2. Utah National Association of Retired Federal Workers
3. American Federation of Government Employees, Local 1592
4. American Federation of Government Employees, Utah Counsel
5. Class Members Named (R. 81-4) and Unnamed

Defendants

1. Utah State Tax Commission
2. Clyde Nichols
3. Hal Hansen
4. Joe Pacheco
5. Roger Tew
6. Blaine Davis
7. State of Utah

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IN THE UTAH SUPREME COURT

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Plaintiffs/Cross-Appellants,)	
)	Appeal No. 91-0242
vs.)	
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UTAH STATE TAX COMMISSION,)	Priority No. 11
et al.,)	
)	
Defendants/Appellants.)	

BRIEF OF DEFENDANTS

JURISDICTION AND NATURE OF PROCEEDINGS

The Court has jurisdiction to hear this matter pursuant to Utah Code Ann. § 59-1-608 (1987), section 5 of Article VIII of the Utah Constitution, Utah Code Ann. § 78-2-2(3)(j) (1991 Supp.), and Rule 5 of the Utah Rules of Appellate Procedure.

STATEMENT OF ISSUES

ISSUE 1. The District Court erred in defining Plaintiff Class. The Class is overbroad to the extent that it includes persons receiving federal retirement benefits for the year 1984; it includes persons who failed to pay under protest for the years 1985 through 1987; it includes persons barred by the six month statute of limitation; and it includes military retirees who do not receive pension income.

Standard of Review: This Court will reverse a trial court decision on class certification "when it is shown

that the trial court misapplied the law or abused its discretion.

. . . " Call v. West Jordan, 727 P.2d 180, 183 (Utah 1986).

ISSUE 2. The District Court erred in denying Defendants' Motion to Dismiss because Plaintiffs failed to exhaust administrative remedies; It further erred in granting injunctive relief without findings of fact and conclusions of law and in violation of the Tax Injunction Act.

Standard of Review: Dismissal. The standard of review is correction of error. The ruling by a trial court on "the propriety of a 12(b)(6) dismissal is a question of law . . . the trial court's ruling [is given] no deference and [the court will] review it under a correctness standard." St. Benedict's Dev. Co. v. St. Benedict's Hospital, 811 P.2d 194 (Utah 1991). The reviewing court must construe the complaint in the light most favorable to the Plaintiff and resolve all inferences in its favor in reviewing the ruling on a motion to dismiss. Arrow Indus. v. Zions First National Bank, 767 P.2d 935, 936 (Utah 1988). Injunction. The reviewing Court reviews the District Court's decision in granting the injunction to determine if it has abused its discretion, or if its judgment is clearly against the weight of the evidence. See Systems Concepts, Inc. v. Dixon, 669 P.2d 421, 425 (Utah 1983) (citing John v. Ward, 451 P.2d 182, 188 (Okla. 1976)).

ISSUE 3. The District Court erred in granting Plaintiffs' Motion for Summary Judgment and ruling, without precedent, that State and Federal law mandate income tax refunds for all members of the class for the years 1985 through 1988.

Standard of Review: When reviewing a ruling on motion for summary judgment, the Court should determine "whether there is a genuine issue of material fact and, if there is not, whether the moving party is entitled to judgment as a matter of law. . . ." Arrow Indus. v. Zions First National Bank, 767 P.2d 935, 937 (Utah 1988). The reviewing Court should view the facts and inferences to be drawn therefrom in the light most favorable to the losing party. Hamblin v. City of Clearfield, 795 P.2d 1133 (Utah 1990).

ISSUE 4. The District Court erred in crafting a remedy that is overbroad and overinclusive.

Standard of Review: This is a question of law reviewed for correctness. Ward v. Richfield City, 798 P.2d 757, 759 (Utah 1990).

ISSUE 5. The District Court erred in not allowing Defendants the prescribed time to file objections to Plaintiffs' Amended Proposed Findings, Conclusions, and Partial Summary Judgment and by making findings when ruling on Plaintiffs' Motion for Summary Judgment that are unsupported by the record.

Standard of Review: Time for Objection. This is a question of law reviewed for correctness. Id. Findings. The reviewing court views the evidence in a "light most favorable to the losing party and affirms only where it appears there is no genuine dispute as to any material fact . . ." D & L Supply v. Saurini, 775 P.2d 420 (Utah 1989).

ISSUE 6. The District Court erred in awarding Plaintiffs attorney fees and reimbursement for tax return preparation.

Standard of Review: Attorney Fees. "[W]here attorney fees are awarded to a prevailing party on summary judgment, the undisputed, material facts must establish, as a matter of law, (1) the parties are entitled to the award and (2) the amount awarded is reasonable. Taylor v. Estate of Taylor, 770 P.2d 163, 169 (Utah Ct. App. 1989) (citation omitted). Costs. Whether Plaintiffs should have received reimbursement for tax return preparation and court costs is a conclusion of law. Conclusions of law are given no deference, but are reviewed for correctness. Ward v. Richfield City, 798 P.2d 757, 759 (Utah 1990).

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES

1. Utah Code Ann. § 59-1-301 (Supp. 1989).
2. Utah Code Ann. § 78-12-31 (1987).
3. Utah Code Jud. Admin. R4-504(2).
4. Utah Rule Civ. P. 54.
5. Utah Rule Civ. P. 52.
6. Utah Code Ann. § 59-1-704 (1987).
7. Utah Code Ann. § 78-27-56(1) (Supp. 1991 and 1987).
8. 4 U.S.C. § 111.

STATEMENT OF CASE

1. NATURE OF THE CASE

This appeal is from a District Court order. (R. 1119-20.) On November 7, 1991, this Court found that the District Court order was not final, but accepted the case as an interlocutory appeal. The order grants summary judgment for Plaintiffs in a tax refund action pursuant to state law, and denies summary judgment for the Defendants. The Plaintiffs' tax refund action is based on 4 U.S.C. § 111. (R. 1156 tr. 6.)

2. COURSE OF PROCEEDINGS

In Davis v. Michigan, 489 U.S. 803 (1989), the Supreme Court held that the constitutional doctrine of intergovernmental tax immunity embodied in 4 U.S.C. § 111 required that the State of Michigan treat federal and state retirement income the same for state income tax purposes. Prior to this decision, Michigan, and many other states, allowed a tax exemption for state retirement pensions but not for federal retirement pensions.

The Supreme Court did not decide the question of retroactive application of its Davis decision because the State of Michigan had conceded that a tax refund would be provided to Mr. Davis.

On June 9, 1989, a number of Plaintiffs ("Plaintiffs") filed a complaint in the Third Judicial District Court, in and for Salt Lake County, against the Utah State Tax Commission and various named officers of the Tax Commission ("Defendants"),

seeking a refund for all taxes paid on retirement benefits received from federal sources for tax years 1984-1988. The complaint alleged that the Defendants were in violation of a variety of federal and state statutes and court decisions.

On November 8, 1989, the case was reassigned to the Honorable David S. Young, District Judge of the Tax Division of the Third Judicial District Court.

On October 10, 1989, Defendants filed a motion to dismiss Plaintiffs' complaint. Defendants argued (1) lack of subject matter jurisdiction; (2) failure to exhaust administrative remedies; (3) governmental immunity; and (4) failure to state a claim upon which relief could be granted.

On January 29, 1990, Plaintiffs filed a motion to certify a class consisting of all living persons and estates of deceased persons who had paid Utah state income tax on federal retirement pensions for tax years 1984-1988.

On February 20, 1990, the District Court entered an order denying Defendants' Motion to Dismiss except as it related to Plaintiffs' claim for relief under 42 U.S.C. § 1983. (R. 250.) The grounds stated for denying the motion were that the Court had jurisdiction for the years in question, that Plaintiffs were not required to exhaust administrative remedies pursuant to Utah Code Ann. § 63-46b-14, and that the Utah State Tax Commission had no procedure for dealing with a class action suit.

On March 12, 1990, Defendants filed a petition for permission to appeal from an interlocutory order with the Utah Supreme Court, (Case 90-0109), seeking review of the District Court's denial of Defendants' Motion to Dismiss. Permission to prosecute that appeal was denied.

On March 23, 1990, the District Court entered an order certifying a class consisting of all federal retirees and estates of deceased persons who had paid Utah state income tax on federal pensions. (R. 289.)

Further, On March 23, 1990, Plaintiffs filed a motion to enjoin the Utah State Tax Commission from considering appeals filed by members of the Plaintiff Class. (R. 292.)

On June 8, 1990, the District Court entered an order against the Utah State Tax Commission enjoining it from considering appeals filed by members of the Plaintiff Class. (R.367.)

On September 5, 1990, Plaintiffs filed a Motion for Summary Judgment against the Tax Commission for refund of income taxes. (R. 395.) On October 15, 1990, Defendants filed a Cross-Motion for Summary Judgment. (R. 616.)

On November 15, 1990, Plaintiffs filed a Motion to Strike certain of the affidavits submitted by Defendants in support of Defendants' Cross-Motion for Summary Judgment. (R. 803.) On December 27, 1990, Defendants filed a Motion to Strike one of Plaintiffs' affidavits. (R. 946.)

On March 4, 1991, a hearing was held on both Plaintiffs' Motion for Summary Judgment and Defendants' Cross-Motion for Summary Judgment and the respective Motions to Strike. (R. 1156.) At the conclusion of the hearing, Judge Young ruled from the bench, and granted Plaintiffs' Motion for Summary Judgment. (R. 1156 tr. 73.) Judge Young denied Defendants' Cross-Motion for Summary Judgment. (Id. tr. 74.)

At the hearing on March 4, 1991, Judge Young granted Defendants' Motion to Strike from the bench. Judge Young, also from the bench, granted Plaintiffs' Motion to Strike on relevancy grounds as it related to the affidavits of Mr. Knowlton, Mr. Christensen, and Mr. Memmott. (Id. tr. 75.) However, Judge Young subsequently entered an order striking not only the three affidavits mentioned in the bench ruling as irrelevant, but all of Defendants' affidavits that were requested stricken by Plaintiffs. (R. 1113.)

On April 3, 1991, Defendants filed with the District Court objections to Plaintiffs' Proposed Findings of Fact, Conclusions of Law, and Partial Summary Judgment. (R. 1087.) Among the matters contested was that the proposed Order exceeded the bench ruling made by Judge Young. (R. 1113.)

Subsequently, Plaintiffs submitted amended proposed findings and conclusions. On April 15, 1991, Judge Young made a minute entry providing that "[t]he court has reviewed the Amended Proposed Findings, Conclusions and Partial Summary Judgement as

submitted. The same are approved to be the final order of the court. The Defendants' objections thereto are thus denied. . . ."

(R. 1110.)

On April 16, 1991, Judge Young signed Plaintiffs' Amended Proposed Findings, Conclusions and Partial Summary Judgment. The Amended Findings, Conclusions and Partial Summary Judgment were filed with the court clerk on the same day. At this time, Defendants had not had the opportunity to file objections to Plaintiffs' Amended Proposed Findings, Conclusions, and Partial Summary Judgment. Defendants' Objections to Plaintiffs Amended Proposed Findings, Conclusions and Partial Summary Judgment were protectively filed on April 18, 1991. (R. 1143.)

On May 10, 1991, Defendants filed a Notice of Appeal in the Tax Division of the Third District Court. (R. 1147.)

On November 7, 1991, this Court determined that the District Court's order was not appealable pursuant to rule 54(b), Utah R. Civ. P. However, the case was accepted as an interlocutory appeal.

STATEMENT OF FACTS

Prior to 1989, Utah law provided that retirement benefits received from the state retirement fund by former state and local government employees were exempt from state individual income taxes, while retirement benefits received by all others,

including former employees of the federal government, were not exempt. (See predecessors to current Utah Code Ann. § 49-1-608.) Prior to March 1989, the legality of this exemption had never been contested in a Utah administrative or court proceeding. (R. 701, 707, 713-14, 717, 1031, 1054-55.)

The Utah State Tax Commission believed that it was acting lawfully in taxing federal retirement income based upon the laws existing at that time. (R. 713.)

The State of Utah relied in good faith on the preferential treatment of state employees as part of a benefit program for state employees and part of a revenue raising program for the State. (R. 701, 707.)

In 1984, Davis, a Michigan resident and former federal civil service employee, petitioned the Michigan Department of Treasury for a refund of state taxes paid on his federal retirement benefits. He argued that Michigan's inconsistent tax treatment of state and federal retirement benefits violated 4 U.S.C. § 111 (Section 111). This petition was denied by the Michigan Department of Treasury. Davis brought suit in the Michigan Court of Claims; it denied relief. Davis, 489 U.S. at 807.

The case was appealed to the Michigan Court of Appeals. Asserting the longstanding view that retired federal workers are not employees of the United States, it ruled that Michigan's tax system did not contravene Section 111, holding that the statute

only applied to current federal employees. The Michigan Court also held that the tax did not discriminate against the federal government since the exemption was rationally related to the legitimate state objective of attracting and retaining qualified employees. Davis v. Michigan Dep't of Treasury, 408 N.W.2d 433 (Mich. 1987). The Michigan Supreme Court denied leave to appeal. Davis v. Michigan Dep't of Treasury, 412 N.W.2d 22 (Mich. 1987).

The Supreme Court reversed, holding that the constitutional doctrine of intergovernmental tax immunity embodied in Section 111 required Michigan to treat federal and state retirement income the same for state income tax purposes. Davis, 489 U.S. at 808-814.

Prior to the decision in Davis v. Michigan, 489 U.S. 803 (1989), the Utah Legislature had been advised by its legal counsel that state pension and taxation issues were issues of state's rights and not federal questions. (R. 720.)

As a result of the decision in the Davis case, in the fall of 1989, the Governor of Utah called a special session of the legislature to amend both Utah's retirement act and the state individual income tax act dealing with state income tax basis and rates, and additions and subtractions to federal individual income tax. The legislature met in special session and passed legislation bringing Utah's laws into compliance with the Davis decision. (R. 701, 707.)

All federal, state, local, and private retirement income is now treated identically, except as provided under IRS regulations and/or federal statutes. (R. 713.)

Prior to the special session, a complaint was filed by a number of named Plaintiffs ("Named Plaintiffs") in the Third Judicial District Court in and for Salt Lake County, against the Utah State Tax Commission and various named officers of the Tax Commission ("Defendants"), seeking a refund for all taxes paid on federal retirement benefits received from federal sources for tax years 1984 through 1988. This complaint alleged that the Defendants were in violation of a variety of federal and state statutes and court decisions.

At the time the action was filed, it was estimated that if Plaintiffs prevailed, approximately \$99,944,000 in taxes paid and \$37,206,000 in accumulated interest, totalling \$137,150,000, must be refunded to U.S. Government and military retirees. (R. 724.) Interest on the potential income tax refund accumulates at approximately \$750,000 a month. (R. 724.) Plaintiffs stipulated below that they could not prevail on any cause of action for the 1984 year. (R. 1156 tr. 8.) The potential refund is now estimated to be approximately \$104 million. (R. 725.) This is in contrast to \$8.3 million, which is the "best estimate benefit" received by state retirees for the years 1985-1988. (R. 1059.)

The relief requested in this case could seriously impact the state's budget, requiring program reductions, tax increases, or both. (R. 702, 708.)

State revenue projections have been characterized in the following manner.

Revenue forecasts for the next five years indicate that the state revenues will not keep pace with the state's budgetary needs due to tax policy changes, expenditures for federally-mandated human services, and critical law enforcement and educational needs. . . .

(R. 702, 708.) The extraordinary relief sought by Plaintiffs could cause great financial harm to the state and its citizens.

(R. 702, 708.) The current services expenditure approach developed by the Office of the Legislative Fiscal Analyst shows that the state will incur budget deficits in each year from 1992 through 1996. (R. 728.) The combined deficit for the years 1992 through 1996 is projected to be \$196 million. Id.

The taxes paid by federal retirees for tax years 1985-1988 have been expended by the state in appropriations and are no longer available for refunds. (R. 702, 708.) Under the current taxing system, the relief sought will result in insufficient funds for the state's budgeted needs. (R. 702, 708.)

SUMMARY OF ARGUMENTS

1. The District Court erred in defining Plaintiff Class. Plaintiff Class, as defined by the District Court, is

overbroad. First, Plaintiffs have conceded that they cannot prevail under any theory for the year 1984. Notwithstanding, the class presently includes persons who received federal benefits or annuities for 1984. Second, included in Plaintiff Class are persons who have failed to pay under protest for the tax years 1985-1987. Because payment under protest is mandatory under Utah law for a suit for refund in District Court, these persons were improperly included within Plaintiff Class. See Utah Code Ann. § 59-1-301 (Supp. 1989). Third, the class improperly includes individuals barred by the applicable six month statute of limitations. Utah Code Ann. § 78-12-31 (1987). Finally, the class includes federal military retirees who do not receive pension income. They receive current compensation for reduced services. Accordingly, Davis v. Michigan, 489 U.S. 803 (1989) does not speak to that group. For the these reasons, this Court should remand this case to the District Court for a narrower class definition.

2. The District Court erred in denying the Defendants' Motion to Dismiss and in granting injunctive relief. Because Plaintiff Class failed to exhaust administrative remedies as required by Utah law, the District Court improperly denied Defendants' Motion to Dismiss. Plaintiffs introduced no evidence that exhaustion of administrative remedies would result in irreparable harm disproportionate to the public benefit. At a minimum, this Court should find concurrent jurisdiction between

the Tax Court and the Tax Commission. Under concurrent jurisdiction, the doctrine of primary jurisdiction applies requiring initial agency review.

The District Court erred in entering an order enjoining the Tax Commission from proceeding administratively on refund claims filed by individual class members. First, the Court is without jurisdiction to enjoin the Commission from hearing tax refund cases pursuant to the Tax Injunction Act. Second, the District Court failed to make the requisite findings supporting its injunction. Hence, the Court's order should be remanded for such findings.

3. Neither Utah nor Federal law mandate refunds to Plaintiff Class. The District Court could not have concluded from state statutes or cases prior to the Davis decision that Utah's taxing scheme was illegal or unconstitutional. In fact, no Utah case law had ever addressed those issues involved in Davis. Accordingly, in the absence of any state statutory or precedential guidance on the issue, the District Court erred by not turning to and applying appropriate federal law.

Further, federal law does not require refunds. The Davis decision did not mandate refunds; it only required equal treatment. Furthermore, the seminal case in determining whether a Supreme Court decision has retroactive application is Chevron Oil Co. v. Huson, 404 U.S. 97 (1971). That case requires that Davis be applied prospectively only. In Chevron, the Supreme

Court set forth three factors to be considered in determining whether a judicial decision should operate prospectively only. A decision will operate only prospectively:

- (1) if it establishes a new principle of law by overruling clear past precedent by deciding an issue of first impression whose resolution was not clearly foreshadowed;
- (2) if prospective only application will not retard the operation of the rule in question; and
- (3) if retroactive application would result in inequity, injustice or hardship.

Davis clearly established a new principle of law.

Application of the Davis rule prospectively will not retard the operation of the rule that federal employees' pensions receive equal tax treatment. Retroactive application of the Davis decision will result in inequity, injustice, and hardship to the state. Therefore the decision should be applied prospectively only.

Further, relying on the Supreme Court's decision in American Trucking Ass'n v. Smith, 110 S. Ct. 2323, 2335 (1990) "the prospective application of a new principle of law begins on the date of the decision announcing the principle." Accordingly, because the Davis Decision has prospective application from March 27, 1989, Plaintiffs' relief is barred for the years 1985-1988.

4. The District Court's remedy is overbroad and overinclusive. Davis did not mandate refunds for taxes paid by federal retirees; rather, that case only required equal treatment of federal and state retirement income for state income tax purposes. Accordingly, Utah complied with the Davis decision when it revised its income tax statute to provide for identical treatment of state and federal pensioners.

In McKesson Corp. v. Division of Alcoholic Beverages, 110 S. Ct. 2238 (1990), the Supreme Court set out the minimum procedural standards that a state remedy must provide to satisfy Fourteenth Amendment Due Process. Utah has satisfied these minimum Due Process requirements by providing both predeprivation and postdeprivation remedies for those taxpayers contesting payment of taxes. Moreover, despite precedential direction to the contrary, the District Court failed to balance equities in crafting its remedy. Hence, the District Court's refund remedy was inequitable and should be reversed.

5. The District Court erred in not allowing Defendants the prescribed time to object to the proposed final order and by making findings unsupported by the record.

Defendants' prescribed period of time in which to file objections to Plaintiffs' proposed final order had not lapsed prior to entry of the order. Therefore, by signing and entering the order, the Court deprived Defendants of their right to object under Rule 4-504(2) of the Utah Code of Judicial Administration.

Because the Defendants were denied their right to object, the Amended Findings, Conclusions, and Partial Summary Judgment must be set aside.

Further, the District Court erred in making findings of material facts in ruling on Plaintiffs' Motion for Summary Judgment that are completely unsupported by the record. Because the findings were unsupported and therefore technically in dispute, logically they could not be the basis for the Court's granting summary judgment. Accordingly, this Court must remand for findings consistent with the record.

6. The District Court erred in awarding Plaintiffs' attorney fees and court costs and in granting reimbursement to Plaintiffs for the costs of preparing amended tax returns. In order to justify the award of attorney fees, this Court has ruled that a claim or defense be without merit or not brought in good faith. There is no evidence whatsoever that Defendants actions or defenses are without merit and not brought in good faith. Because this threshold requirement is not satisfied, attorney fees assessed against Defendants are not justified.

Similarly, the District Court erred in granting costs to Plaintiffs for preparing amended returns and court costs. Utah R. Civ. P. 54 directs that "costs against the state of Utah shall be imposed only to the extent permitted by law." The District Court failed to articulate any basis in law for imposition of costs; hence the award should be reversed.

ARGUMENT

POINT I

INTRODUCTION

THE DISTRICT COURT'S CLASS DEFINITION IS OVERBROAD.

Over Defendants' objections, and without an evidentiary hearing, the District Court certified the class as:

All persons and the estates of deceased persons who received federal retirement benefits or annuities and who have paid Utah state income tax on their federal retirement benefits for the 1984, 1985, 1986, 1987 and/or the 1988 tax years.

(R.289.)

As defined by the District Court, the class is overbroad. (R. 281.) There was no finding by the District Court that there are questions of law or fact common to the class. The class includes persons having claims for 1984. Plaintiffs have admitted these persons could not prevail under any theory. The class includes Plaintiffs who have not paid under protest and therefore have no proper jurisdictional basis for their claims. At the time Plaintiffs filed their Motion for Summary Judgment, they included former full-time military personnel who do not receive pension income. These individuals receive current compensation for reduced services. The class should have been limited to those persons who paid their taxes under protest and therefore brought a timely action in District Court. (R. 225.)

It is for those persons only that the District Court has jurisdiction.

A. The Class Definition Is Overbroad Because Plaintiffs Have Admitted They Cannot Prevail Under Any Theory For The 1984 Year.

Plaintiffs conceded below that they could not prevail for the 1984 year under any theory. (R. 1156 tr. 7-8.) As the class is now defined, all persons receiving federal benefits or annuities for 1984 are included in the class. However, there is no theory under which this 1984 group could be included in the class. Therefore, this case must be remanded so that the Plaintiff class can be correctly defined.

B. The District Court Erred In Including Within The Class The Tax Years 1985 Through 1987 Because There Is No Evidence In The Record Showing Payment Of Tax Under Protest For Those Years.

Plaintiffs conceded below that, "[i]f a class is not certified, only the named Plaintiffs will have met the six month statute of limitations to pursue a claim of payment under protest." (R. 216.) Plaintiffs also conceded, "[w]e did not protest '87, '86, '85, '84 taxes." (R. 1158 tr. 27.) The District Court found that "all of the 1988 participants in this action, which includes the entire class, shall be deemed to have paid "under protest" . . . " (R. 1156 tr. 74.) This finding was made even though contrary evidence was in the record. (R. 561.) (Charles L. Miller stated in his affidavit in support of Plaintiffs' Motion for Summary Judgment: "I protested the

collection of Utah State income tax on my 1988 federal retirement income by not paying my 1988 Utah State income tax." (Emphasis added)). Plaintiff Class claims for years 1985-1987 are therefore barred, inasmuch as the record is devoid of evidence showing that Plaintiffs have paid their tax under protest and brought a suit within the six month limitation period for years 1985-1987.

Utah Code Ann. § 59-1-301 (Supp. 1989)¹ sets forth the requirement of payment under protest:

In all cases of levy of taxes, licenses, or other demands for public revenue which is deemed unlawful by the party whose property is taxed, or from whom the tax or license is demanded or enforced, that party may pay under protest the tax or license, or any part deemed unlawful, to the officers designated and authorized by law to collect the tax or license; and then the party so paying or a legal representative may bring an action in the tax division of the appropriate district court against the officer to whom the tax or

¹ This statute first appeared on the books in Utah in 1898. See R.S. § 2684 (1898). It was placed among the miscellaneous taxation provisions, thus making it applicable to all types of taxes. This is evidenced by the expansiveness of its language.

During the next 80 years, it remained among the miscellaneous provisions. See C.L. § 2684 (1907); C.L. § 6094 (1917); R.S. § 80-11-11(1933); Utah Code Ann. § 80-11-11(1943). Id. at § 59-11-11(1977). Then in 1987, as part of a property tax recodification effort, it was renumbered and placed within the property tax chapter. See 1987 Utah Laws Ch. 4 § 260. It is important to recognize that the legislative debate accompanying this change gave no indication that any substantive change had occurred in the statute. See transcript of S.B. 71, January 16, 1987. (R. 783.) Thus, by renumbering the statute, the legislature did not intend substantive changes in it. A court should look to the intent of the legislature at the time of a statute's enactment and not infer substantive changes in it, when it is merely moved from one location in the code to another. See Atlas Corp. v. Tax Comm'n 415 P.2d 208, 209 (Utah 1966) (it was incorrect for the Tax Commission to conclude that delinquent occupation taxes for mining could be collected using tax warrants where the occupation tax provisions had been moved from their original place in the code and placed among provisions regarding the assessment of property that allowed collection by warrant).

In 1988, the section was reenacted and again moved to its current place in the miscellaneous chapter. See 1988 Utah Laws, Ch. 3, § 88. The foregoing legislative history makes clear that § 59-1-301 was in existence during the tax years in question, and was applicable to income tax.

license was paid, or against the state, county, municipality, or other taxing entity on whose behalf it was collected, to recover the tax or license or any portion of the tax or license paid under protest.

(Emphasis added.)

In order for Plaintiffs to receive a refund through an original action in District Court for allegedly illegal taxes, they must have first paid these taxes under protest. The requirements of this statute are mandatory.

The Supreme Court made this clear in State v. District Court, 102 Utah 290, 115 P.2d 913 (Utah 1941) (overturned on other grounds in State v. District Court, 102 Utah 2d 57, 128 P.2d 471 (1942) (hereinafter "District Court II").² In District Court, the Utah Supreme Court addressed the issue of whether the District Court had jurisdiction over the State of Utah in a tax refund action where state taxes had been paid under protest and were later declared unconstitutional. The Court found: "payment under protest is a condition precedent to the recovery of taxes paid to the state." District Court, 115 P.2d at 915.

The Utah Supreme Court also addressed this issue in Shea v. Tax Comm'n, 101 Utah 209, 120 P.2d 274 (Utah 1941). Shea

² On rehearing, the Utah Supreme Court in District Court II, 128 P.2d 471 (Utah 1942), reviewed and overturned State v. District Court, 115 P.2d 913 (Utah 1941). However, only on the procedural issue regarding service of summons was the decision overturned.

involved a refund action by a freight line for fuel taxes; the tax was not paid under protest, and the tax was later declared unconstitutional by the Court. Id. at 274-75. The Court rejected the taxpayer's refund argument and found that taxes alleged to be illegal must be paid under protest to be recoverable:

In cases in which legality or illegality of tax sought to be recovered by taxpayer necessarily involves determination of questions of law calling for exercise of strictly judicial functions, payments under protest and compliance with other provisions of the statutes afford the exclusive remedy. . . . We are fortified in this position because there has been upon the statute books for over forty years a provision similar to Section 80-11-11, R.S.U. 1933 [the forerunner of § 59-1-301], providing "In all cases of levy of taxes, licenses or other demands for public revenue which is deemed unlawful" it may be paid under protest and suit brought to recover.

Id. at 275 (emphasis added). Thus, Plaintiffs must have paid all contested taxes under protest as a prerequisite to a refund suit. This has not been done. Therefore, the relief they seek must be denied.

Plaintiffs have failed to provide any evidence that payment under protest was made, except by isolated individuals for tax year 1988. No payment under protest and suits for refund were made until after the Davis decision was handed down in 1989. As discussed above, protest after payment is not provided for under Utah law. Thus, the case must be remanded to the District

Court with instructions to redefine the class to exclude any taxpayers who did not pay under protest.

C. The District Court Erred In Not Barring All Plaintiff Class Claims For Years 1985-1987 Pursuant To The Statute Of Limitations.

The limitations period for suits for refund of state taxes that have been paid under protest is governed by Utah Code Ann. § 78-12-31 (1987).³ It provides:

³ This statute has been in force since 1888. See C.L. § 3147.198 (1888). The legislature has renumbered the statute; however, it has never changed the statute so as to affect the Utah Supreme Court's interpretation of it in State v. District Court, 102 Utah 290, 115 P.2d 913 (Utah 1941) (discussed supra). Thus, it should be presumed that this interpretation is consistent with the intent of the legislature:

Where the legislature amends a portion of a statute, leaving other portions unamended, or re-enacts a portion without change, absent substantial evidence to the contrary, the legislature is presumed to have been satisfied with prior judicial constructions of the unaltered portions of the statute and to have adopted those constructions as consistent with its own intent.

American Coal Co. v. Sandstrom, 689 P.2d 1, 3 (Utah 1984); see also Black Bull Inc. v. Industrial Comm'n, 547 P.2d 1334, 1335-36 (Utah 1976).

Thus, under the American Coal Co. rule of statutory construction, it is presumed that the legislature intended the six-month limitations period to apply to refund actions against the state. This was made clear with the Utah Supreme Court's judicial construction of the statute in District Court, supra. See also Shea v. State Tax Comm'n, 101 Utah 209, 120 P.2d 274 (Utah 1941) (diesel taxes not paid under protest to the State are subject to six-month limitations period); State v. District Court, 102 Utah 290, 115 P.2d 913 (Utah 1941) (taxes paid under protest to the State are subject to 6 month limitations period); Sperry & Hutchinson Co. v. Matson, 64 Utah 214 (1924) (illegal taxes paid to the Secretary of State in his official capacity are subject to the six-month limitations provision).

Within six months:

an action against an officer . . .:

- (2) for money paid to any such officer under protest, or seized by such officer in his official capacity, as a collector of taxes, and which, it is claimed, ought to be refunded.

Payment of taxes falls within the scope of Utah Code Ann. § 78-12-31(2) (1987). The Utah Supreme Court addressed the scope of this statute in Ponderosa One Limited Partnership v. Suburban Sanitary Dist., 738 P.2d 635 (Utah 1987).

In Ponderosa, the Plaintiff paid a sewer service charge under protest. Id. at 636. Nine months later it sought a refund. Id. The sanitary district argued the six-month limitations period as a defense. Id. The Court rejected that argument, holding that the sewer service was not a tax and thus a different limitations period was applicable. Id. at 637. However, in reaching that decision, the Court declared that tax actions properly fall within the six-month period. Id. at 638.

As previously stated, Plaintiffs conceded below that "if a class is not certified, only the named Plaintiffs will have met the six month statute of limitations to pursue a claim of payment under protest." (R. 216.) Plaintiffs also conceded "[W]e did not protest '87, '86, '85, '84 taxes." (R. 1158 tr. 27.) Plaintiffs have attempted to use payment under protest by a

few individuals as a basis for jurisdiction for many individuals who do not have claims:

It is axiomatic that no class action may proceed on behalf of class members whose claims are barred by the applicable statute of limitations. If F.R.Civ.P.23 were otherwise, it would give the class action method of litigation the ability to revive stale claims that could not otherwise be brought on an individual basis. Viewed in this light, the applicable statute of limitations marks the outer boundary for class membership.

Schmidt v. Interstate Fed. Savings and Loan Ass'n, 74 F.R.D. 423, 428 (U.S.D.C., D.C. 1977).

Hence, the class must be limited to those persons paying their 1988 taxes under protest and bringing an action in District Court within six months.

D. Payment Under Protest And A Short Statute of Limitations for an Alleged Illegal Tax Meet Federal Due Process Requirements.

In McKesson Corp. v. Div. of Alcoholic Beverages, 110 S. Ct. 2238 (1990), the Supreme Court validated a payment under protest and short limitations period for the purpose of denying a refund for a tax later held to be unconstitutional:

[I]n the future, States may avail themselves of a variety of procedural protections against any disruptive effects of a tax scheme's invalidation, such as providing by statute that refunds will be available to only those taxpayers paying under protest, or enforcing relatively short statutes of limitation applicable to refund actions. See *supra*, at 2254. Such procedural measures would sufficiently protect States' fiscal security when weighed against their

obligation to provide meaningful relief for their unconstitutional taxation.

Id. at 2257 (emphasis added) (In McKesson, the Court "assume[d] for present purposes that petitioner satisfied whatever protest requirements might exist." Id. at 2243-44, n.4.). Therefore, payment under protest and the six-month statute of limitations meet federal constitutional concerns.

E. The Rule In Davis Does Not Apply To Federal Military Retirees; Hence, They Should Not Be Included In The Class.

The Court in Davis declared the Michigan statute to be in conflict with federal law because it treated federal civilian retirees less favorably than state and local retirees when there was no significant difference between the Michigan state and local government retirees sufficient to justify the different treatment. The Utah Public Employee's Retirement Act, like most retirement programs, provides for regular retirement at 65 years. Utah Code Ann. § 49-2-103(6) (1989 and Supp. 1990). The federal Civil Service Retirement Act (5 U.S.C. § 8331, et seq.) is similar, providing for regular retirement at age 62 or 60, depending on the years of service, and early retirement at age 55 with 30 years of service.

However, the retirement system for regular United States military personnel is entirely different; rather than providing deferred compensation, it provides current compensation

for reduced services.⁴ United States v. Tyler, 105 U. S. 244 (1882). In Costello v. United States, 587 F. 2d 424 (9th Cir. 1978), cert. denied, 442 U.S. 929 (1979), the court held that a change in plaintiff's pay after retirement did not offend Due Process, because military retirement pay was pay for continuing military service, not deferred compensation; and in Watson v. Watson, 424 F. Supp. 866 (E.D.N.C. 1976), the court held that retired military pay is remuneration for employment and subject to garnishment the same as active duty pay. Most service personnel may retire after 20 years of service, regardless of age, which means that many are retired before the age of 40. See, eg., 10 U.S.C. § 1293; 10 U.S.C. § 3911; 10 U.S.C. § 6323. In return, retired military personnel remain subject to the Uniform Code of Military Justice (10 U.S.C. § 802) and must be prepared for recall at any time (10 U.S.C. § 688).

Because military retirement pay is current compensation, it is fundamentally different from the Utah State and local government pensions which were exempted from Utah

⁴ In determining whether military retirees are includable under the Davis ruling, this court must apply federal law. See ATA, 110 S.Ct. at 2330 ("whether a constitutional decision of this Court is retroactive . . . is a matter of federal law.") "[T]he antecedent choice-of-law question is a federal one where the rule at issue itself derives from federal law, constitutional or otherwise." James B. Beam Distilling Co. v. Georgia, 111 S.Ct. 2439, 2443 (1991)(Souter, J. Lead opinion). Hence, the Utah Court of Appeal's dictum in Greene v. Greene, 751 P.2d 827 (Utah Ct. App. 1988), cert. denied, 765 P.2d 1278 (Utah 1988) (quoting Gardner v. Gardner, 748 P.2d 1076 (Utah 1988)) that military retirement is "deferred compensation" should not be considered.

income tax during the taxable years in question. There is no comparable class of state retirees who have received current pay for reduced services. Individuals receiving military retirement pay, current pay for reduced services, should not be included in the class with federal civil service retirees receiving current pay for past services.

This case should be remanded to the District Court with instructions to issue a narrower class definition on four grounds: (1) the class cannot include persons receiving federal retirement benefits or annuities for the 1984 tax year; (2) the class cannot include persons who failed to pay their tax under protest; (3) the class cannot include those persons barred by a six month statute of limitations; and (4) finally, the class should not include federal military retirees.

POINT II

THE DISTRICT COURT ERRED IN DENYING THE DEFENDANTS' MOTION TO DISMISS AND IN GRANTING INJUNCTIVE RELIEF.

A. Even If the District Court Had Jurisdiction, Plaintiffs Must First Exhaust Administrative Remedies.

Defendants moved to dismiss on the basis that Plaintiffs had not exhausted administrative remedies. The District Court found that "requiring the Plaintiffs to exhaust administrative remedies would result in irreparable harm

disproportionate to the public benefit derived from requiring exhaustion." (R. 251.)⁵

The policies underlying the exhaustion doctrine are well articulated in Estate of Friedman v. Pierce County, 768 P.2d 462 (Wash. 1988):

[T]o (1) insure against premature interruption of the administrative process, (2) allow the agency to develop the necessary factual background on which to base a decision, (3) allow the exercise of agency expertise, (4) provide a more efficient process and allow the agency to correct its own mistakes, and (5) insure that individuals are not encouraged to ignore administrative procedures by resort to the courts.

Id. at 467 (quoting Orion Corp. v. State, 103 Wash.2d 441, 456-57, 693 P.2d 1369 (Wash. 1985)).

The Utah legislature has provided a means whereby the underlying purpose of the exhaustion doctrine can be met. This Court has affirmed the exhaustion doctrine. The administrative remedies provided at Utah Code Ann. § 59-10-531 through 535 are complete, adequate, and speedy. Plaintiffs failed to show that "irreparable harm disproportionate to the public benefit" would result in requiring adherence to the exhaustion doctrine. Allowing Plaintiffs to circumvent the statutory and common law requirements of exhaustion in this case will set a dangerous precedent.

⁵ See also Utah Code Ann. § 63-46b-14(2)(b)(i) (no exhaustion required where it could result in irreparable harm disproportionate to the public benefit).

The District Court also held that there was no need to exhaust administrative remedies because there was no means to certify a class before the Commission. (R. 251.) However, no class was needed for a plain and speedy resolution of the case. Declaratory relief was available through the Commission pursuant to Utah Code Ann. § 63-46b-21 (1989) and Utah Admin. R. 861-1-5A(Q). The Commission could have considered the issues in this case and made a declaratory ruling on the facts before it. (R. 1158 tr. 8.) This ruling would then have applied to all similarly situated persons, thus avoiding the costly and cumbersome class litigation now before the Court.

Finally, the District Court found that Plaintiffs need not exhaust administrative remedies because "of indications that the Utah State Tax Commission has preliminarily decided that Davis v. Michigan Dept. of Treasury, 109 S. Ct. 1500 (1989) does not mandate refunds in Utah."⁶ (R. 252.) The only decision

⁶ In fact, it appears that a premature decision was made by the District Court. The District Court, prior to any legal arguments on the application of the Davis decision, stated:

It seems to me when a case comes down that shows that there has been an interpretation different than the Tax Commission thought should be applied to, in this case, retirement funds, and that now makes it likely that the State Tax Commission should take a different view and take a different position than it has previously, it seems to me that the State Tax Commission, or that the government, ought to step forward and be the first to say, we've misunderstood this, we're willing now to apply it consistent with the decision of the United

that had been made was made by the Auditing Division of the Tax Commission. (R. 1158 tr. 25.) However, the Tax Commissioners had never heard the case. Only they could render a decision on behalf of the Tax Commission. No such determination had in fact been made as Plaintiffs implied.

The policy and legal requirements underlying the exhaustion doctrine require Plaintiffs to first utilize the administrative process.

B. Even If the District Court had Jurisdiction, It Was Concurrent Jurisdiction. Hence, The Doctrine of Primary Jurisdiction Vests Jurisdiction in the Commission.

The Commission does not concede that it shares jurisdiction with the District Court over this matter. However, if this Court finds that the District Court had jurisdiction, it should find that there is concurrent jurisdiction between the District Court and the Tax Commission. Where both an administrative agency and the court have concurrent jurisdiction

States Supreme Court, and this is the way we think we'll interpret this decision, and apply it. Then there's a beginning point for everybody to look at.

(R. 1158 tr. 9.)

Why should all of these, potentially 34,000 people, be put in a position that they have to continue to jump through hoops that may not be necessary? It seems to me that the government is playing an ignoble role and the government should not be playing that.

(R. 1158 tr. 7.)

over the same matter, the doctrine of primary jurisdiction applies. This doctrine provides: "[I]n cases raising issues of fact not within the conventional experience of judges or cases requiring the exercise of administrative discretion, the agencies created by the legislative branch for regulating the subject matter should first be heard." Union Pacific R.R. Co. v. Structural Steel & Forge Co., 344 P.2d 157, 158 (Utah 1959). The underlying rationale for this doctrine is "uniformity in decisions" and "expertise of the agencies." Id.

The state constitution and statutes specifically empower the Commission to hear income tax matters, with the declared intent to promote consistency in tax treatment. See Utah Const. art. XIII § 11; see also Utah Code Ann. §§ 59-10-102, 501 to 548 (1987). This is in accord with the uniformity rationale of Structural Steel & Forge Co., supra.

Before any refunds may be given, the Commission must make a factual determination on whether taxes were paid to the state by class members, whether payment was made under protest, whether proper refund procedures were followed, and whether this was done within the statutory time limits. The Commission and its staff possess the requisite skill and expertise to fairly and efficiently determine these factual matters.

Further, tax assessment questions are under the jurisdiction of the Commission. "The Commission shall make the inquiries, determinations, and assessments of all taxes . . .

[and chapters that impose] income taxes." Utah Code Ann. § 59-10-527 (1987). This would include a determination by the Commission of how taxes should be assessed for the tax years involved in this case.

Further, the Commission has been granted discretion in examining records of taxpayers to ascertain "the correctness of any return." Utah Code Ann. § 59-10-544 (1987). This would include the correctness of a petition for refund. Because the Commission has been granted discretion over these matters, the Court should find that the Commission has jurisdiction.

Plaintiffs argued below that no issues may go before the Commission because it "cannot rule that the laws of the state of Utah are illegal or unconstitutional." (R. 299.) This Court in Johnson v. Retirement Bd., 621 P.2d 1234, 1237-8 (Utah 1980) found: "the mere introduction of a constitutional issue does not obviate the need for exhaustion of administrative remedies. As stated in Public Utilities Comm. v. U.S., 355 U.S. 534, 539-40, 78 S. Ct. at 450, 'if . . . an administrative proceeding might leave no remnant of the constitutional question, the administrative remedy plainly should be pursued.'"

The Commission could avoid the constitutional question by finding that the statute of limitations has expired or that Davis does not apply retroactively. These findings would not exceed the Commission's authority or expertise. Hence, the

Commission should not be enjoined from exercising its jurisdiction.

C. There Is No Basis For An Extraordinary Writ In This Case.

The District Court erroneously relied on writ of mandamus as a basis for jurisdiction. (R. 1126.) This Court in Ogden City Corp. v. Adam, 635 P.2d 70, 71-2 (Utah 1981), stated that an extraordinary writ will issue only where no other plain, speedy, or adequate remedy exists. Such a remedy exists: Plaintiffs were free to seek refund through the Tax Commission for refund of taxes.

D. Before The District Court Could Issue Declaratory Relief It Must Have Had Jurisdiction.

The District Court erred in holding that it had jurisdiction pursuant to the authority to issue declaratory judgments. (R. 1125.) Utah Code Ann. § 68-33-1 (1987) sets forth the power of District Courts to issue a declaratory judgment:

The District Courts within their respective jurisdiction shall have power to declare rights, status, and other legal relations, whether or not further relief is or could be claimed. No action or proceeding shall be open to objection on the ground that a declaratory judgment or decree is prayed for. The declaration may be either affirmative or negative in form and effect; and such declaration shall have the force and effect of a final judgment or decree.

Hence, for a District Court to issue a declaratory judgment, the rights, status, and other legal relations must be within its

respective jurisdiction. As set forth above, the District Court was without jurisdiction to address rights of any of the parties except for the limited number that had paid their 1988 taxes under protest.

E. The District Court Erred In Entering An Order Enjoining The Utah State Tax Commission From Proceeding Administratively In Adjudicating Petitions Filed By Individual Class Members.

1. The District Court Erred In Not Making Findings Or Conclusions Supporting Its Injunction Order.

The District Court failed to make findings supporting the order enjoining the Utah State Tax Commission from considering appeals filed by members of the Plaintiff Class. This Court should remand that decision for the requisite findings.

Rule 52 of the Utah Rules of Civil Procedure states:
Findings by the court.

(a) Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58A; in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. . . .

(Emphasis added.)

The District Court failed to enter oral or written findings as the basis for its decision to enjoin the Tax

Commission from hearings involving the Plaintiff Class or any members. (R. 367-368.) Consequently, Defendants are without articulable grounds to seek review of the District Court's decision. This Court should remand with instructions to make findings to support the District Court's order.

2. The Tax Injunction Act Bars The District Court From Enjoining Commission Proceedings.

The District Court is without jurisdiction to enjoin the Commission from hearing a tax refund case. Where a legislative declaration clearly and unequivocally deprives a court of jurisdiction, it may not adjudicate although it would normally have jurisdiction. See Dimmitt v. City Court of Salt Lake City, 444 P.2d 461, 463 (Utah 1968). Utah Code Annotated § 59-1-704 (1987) provides:

(1) Except as otherwise provided in Parts 5, 6, and 7 of Chapter 1 and Chapter 2, 6, 7, 10, and 12 and the rules promulgated thereunder, no suit for the purpose of restraining the assessment or collection of any tax, penalty, or interest imposed under Chapter 1, 2, 6, 7, 10, or 12 may be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.

(2) No suit may be maintained in any court for the purpose of restraining the assessment or collection of the amount of the state tax liability, of a transferee or of a fiduciary of property of a taxpayer.

None of the exceptions in Chapter 10 apply to this proceeding. Chapter 10 mentioned in this statute governs individual income tax. That is the subject of this proceeding.

Further, the determination of taxes and tax refunds is an integral part of the tax assessment and collection process. Plaintiffs' complaint admits that this action involves tax assessment and collections. See Amended Complaint at ¶¶ 25, 31, 37, 54, 58, and 67. (R. 81-102.) This statute specifically enjoins the Court from restricting the Commission from exercising jurisdiction over this matter.

POINT III

NEITHER STATE NOR FEDERAL LAW MANDATE REFUNDS.

The District Court Ruling.

The Plaintiffs below argued at length that their cause of action was not based upon the Davis case, but was based upon a violation of the plain and unambiguous meaning of 4 U.S.C. § 111. (R. 1156 tr. 6.) The District Court in its bench ruling found that Plaintiffs were entitled to a refund under state law. (R. 1156 tr. 73.) ("the Court finds that the Petitioners are entitled to a refund under state law. . . ."). In the proposed Findings, Conclusion, and Partial Summary Judgment, drafted by Plaintiffs' counsel, the bench ruling was stretched to include federal as well as state grounds. Defendants noted in their objections to the proposed Order that the District Court had expressly stated that its ruling was based on state grounds. (R. 1091, 1145.) The Court provided no rationale from the bench whatsoever that it

was considering any other basis for its ruling. (R. 1156 tr. 73-4.)

Yet in the Amended Order, the District Court found a violation of 4 U.S.C. § 111 as well as a violation of the doctrine of federal sovereign immunity. (R. 1129.) Although the written ruling adopted by the District Court discusses the federal retroactivity analysis at length, it blithely suggests that even without Davis, it would find the State's actions unlawful and unconstitutional. (R. 1135.)

The ruling then forges ahead to state that nonetheless, Davis must be accorded full retroactive effect, in spite of the fact that under the rubric adopted by the Supreme Court, prospectivity is appropriate. For the reasons set forth below, the District Court erred in its analysis of state and federal law regarding its interpretation of Section 111 and the effect of the Davis decision.

A. Under a State Analysis, the Court Could Not Have Concluded the State's Taxing Scheme Was Illegal or Unconstitutional.

1. State Law prior to Davis.

The District Court could not have concluded from state statutes or cases prior to the Davis ruling that the State's taxing scheme was illegal or unconstitutional. In point of fact, no state or federal cases had ever construed Section 111 within the context of those issues raised in Davis. The interpretation

of this statute by the Davis Court was, therefore, a matter of first impression.

The only law on the books prior to the Davis ruling was the heretofore unchallenged and presumptively valid taxing scheme now challenged by the Plaintiffs. This Court examined the Utah exemption in Christensen v. Tax Comm'n, 591 P.2d 445 (Utah 1979). Although not dealing with the issue of federal pensioners, the Court provided a strong basis for reliance under Utah law:

The retirement income in issue here was paid from the Utah State Employees Retirement System. Sections 49-1-28 and 49-10-47 specifically exempt this retirement income from any state, county, or municipal tax of the State of Utah. The correct construction of the statutes involved results in the following interpretation: Retirement benefits received by a state employee are exempt from taxation by virtue of the provisions of U.C.A., 1953, 49-1-28 and 49-10-47, thus not subject to section 59-14A-13, and that the income is not reportable. Retirement benefits received by any individual through a pension plan other than the state retirement system are not exempt.

. . . .

When the tax reform act was first introduced to the legislature in 1971 (Senate Bill 108 which was later passed as the 1973 Tax Reform Act), companion bills were also introduced to repeal the exemption provisions for state employees. The companion bills were defeated, and this indicates a strong intent on the part of the legislature to continue the preferential treatment afforded state employees over other recipients of retirement income.

Id. at 448-49 (emphasis added).

Additionally, a significant body of law existed outside of the State which had considered the issue of federal/state and state/federal relations involving preferential or discriminatory treatment. As discussed above, none of these cases construed Section 111 in the same context as Davis, but all involved the issue of differential treatment. However, viewing these precedents, ample reason existed for the State to believe that it could adopt a preference for its employees. Far from "dictating" the result in Davis, the cases addressing retirement income had uniformly upheld the validity of exempting some pension benefits even though other pension benefits were taxed.⁷ Utah had every reason to rely on this longstanding, unchallenged, and widespread practice.

In Clark v. United States, 691 F.2d. 837 (7th Circuit 1982), the Court concluded that the disparate treatment of federal and state retirement provisions did not constitute discriminatory treatment. In that case, which considers a challenge to the federal statute providing a cost of living allowance to federal retirees, the court held that federal pensioners constituted a legitimate class of similarly situated

⁷ See, e.g., Huckaba v. Johnson, 573 P.2d 305 (Or. 1977) (state may discriminate in imposing state income tax on some federal pensions as opposed to other federal pensions and state pensions); Butzbach v. Director, Div. of Taxation, 3 N.J. Tax 462 (N.J. Tax Ct. 1981) (state inheritance tax may be imposed on transfer of private annuity even though public employment annuity transfer is exempt from same tax); Gritzmacher v. Director, Div. of Taxation, 2 N.J. Tax 489 (N.J. Tax Ct. 1981) (same result).

persons distinct from state and private pensioners and to which "[t]he United States . . . has special responsibilities and obligations . . . that it does not have to non-federal retirees." Id. at 841-42. Should the State have concluded from Clark that only the Federal Government had special responsibilities and obligations to its employees, but the State did not?

From the State's viewpoint, and apparently from the viewpoint of the Utah federal retirees, none of whom ever mounted a legal challenge to the Utah tax system prior to March 28, 1989, it appeared prior to Davis that, even if Section 111 applied to federal retirees, the validity of Utah's taxes under the discrimination component of Section 111 would be tested by the traditional equal protection standard:

Where taxation is concerned and no specific federal right, apart from equal protection, is imperiled, the States have large leeway in making classifications and drawing lines which in their judgement produce reasonable systems of taxation. . . .

Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356, 359 (1973) (footnote omitted); see also Carmichael v. Southern Coal Co., 301 U.S. 495, 509 (1937) (inequalities which result from singling out one particular class for taxation or exemption infringe no constitutional limitations). Under traditional equal protection analysis, the Michigan tax would have been almost certainly upheld. Now the District Court, in hindsight, suggests that the

offending statute was plainly and unambiguously wrong and had been from its inception in 1947. (R. 1156 tr. 38.)

In its ruling, the District Court suggests that it is free to examine Section 111 apart from the impact of Davis and that it may make its own independent analysis of that section. The illogical nature of this notion is evident. What if the District Court had concluded Utah's future imposition of the different tax treatment to be valid in the face of the Davis decision? Is the District Court so bold as to suggest that it is free of federal court precedent and may consider this issue in a vacuum?

The District Court's striking of the affidavits which went to the heart of the federal analysis demonstrate clearly that it based its ruling on purely state, not federal grounds. On state grounds, there was no basis for the District Court's ruling. In the absence of any state statutory or precedential guidance on this issue, the District Court erred by not turning to and applying the appropriate federal law.

2. Laches and Waiver.

Under a state analysis, the District Court further erred in not finding Plaintiffs' claims are barred by laches and waiver. (R. 275-6.)

The Utah Supreme Court held in Leaver v. Gross, 610 P.2d 1262 (Utah 1980) that laches is contingent upon the establishment of two elements: (1) the lack of diligence on the

part of the Plaintiffs and (2) an injury to the Defendant owing to such lack of diligence. Id. at 1264. Moreover, this same Court held in Papanikolas Brothers Enter. v. Sugarhouse Shopping Center Assoc., 535 P.2d 1256 (Utah 1975) that:

[l]aches is not mere delay, but delay that works a disadvantage to another. To constitute laches, two elements must be established: (1) The lack of diligence on the part of plaintiff; (2) An injury to defendant owing to such lack of diligence. Although lapse of time is an essential part of laches, the length of time must depend on the circumstances of each case, for the propriety of refusing a claim is equally predicated upon the gravity of the prejudice suffered by defendant and the length of plaintiff's delay.

Id. at 1260 (footnote omitted).

In reliance on the above mentioned cases, the District Court should have dismissed Plaintiffs' action as barred by laches. The facts in the present action satisfy the laches requirements. First, if the statute was clear as held by the Court there has been a lack of diligence and/or unexplained delay in Plaintiffs' assertion of their claims. Plaintiffs below asserted that Utah's statute allowing for disparate treatment between state and federal retirees was a clear violation of 4 U.S.C. § 111 on its face. (R. 1156 tr. 6.) Yet at the time Plaintiffs brought this action, this statute had been in place for over forty years. Prior to 1989, the statute was unchallenged. Below, Plaintiffs' repeatedly stated that they were cognizant of the inconsistent treatment. (R. 852.) If such

treatment was a "clear violation" of 4 U.S.C. 111 Plaintiffs were obliged to file an action challenging the statute within some reasonable time of the statute's enactment. Since they did not, laches is a bar to their claims now.

Importantly, Plaintiffs' lack of diligence in asserting their claims has injured the State and its taxpayers. If Plaintiffs, based on their alleged knowledge of a violation of Section 111, had asserted their claims in the early years following the legislation, the statute now threatened by the Davis decision could have been reassessed at a much earlier date. The State and its taxpayers are now subject to a substantially greater financial injury than if this suit had been commenced years ago, or immediately following the statute's enactment.

Moreover, laches effectuates a waiver of the claim against the state: "[t]he defense of laches is a form of waiver, or if not strictly waiver, conduct of the type which equity will deem sufficient to bar application of a remedy otherwise available." Packarski v. Smith, 147 A.2d 176 (Del. Ch. 1958).

Plaintiffs' delay in asserting their claim constitutes a waiver of that claim. In Hoffa v. Hough, 30 A.2d 761 (Md. 1943), the Court of Appeals of Maryland held that "[e]quity will not aid a claimant who has slept on his right for an unreasonable and unexplained length of time, thereby suffering his claim to become stale and causing prejudice to an adverse party, such manifest neglect constituting an implied waiver." Id. at 763 1

(emphasis added).

For the same reasons, Plaintiffs now should be precluded from maintaining an action against Defendants. As previously stated, the statute was enacted over forty years ago, and Plaintiffs claim long-term cognizance of its illegality. It is fair to conclude that Plaintiffs have "slept on their rights" during this long period of time, and hence have impliedly waived the right to bring an action now that would surely prejudice Defendants. Accordingly, under state law analysis, Plaintiffs' claims should have been dismissed based on laches and waiver.

B. Federal Analysis.

The federal issue before this Court is whether there is an obligation by the State to provide retroactive relief for an alleged federal constitutional violation for years 1985-1988. ATA, 110 S. Ct. at 2330-1 (1990). This requires the Court to determine whether the holding of Davis applies retroactively to mandate that the state provide a remedy for years 1985-1988. State courts are free to determine the retroactivity of their own decisions; however, state courts must adhere to Supreme Court retroactivity decisions when determining whether a decision of the Supreme Court is retroactive. ATA, 110 S. Ct. at 2330. Retroactivity in civil cases is governed by a three-pronged test. Chevron Oil Co. v. Huson, 404 U.S. 97 (1971).

Only after it is decided that Davis applies retroactively using the three pronged test of Chevron must the

Court consider the constitutional remedial provisions for state tax refunds as set forth in McKesson, 110 S. Ct. 2238 (1990).

1. Requirements of the Davis case.

Defendants do not dispute that the Davis interpretation of 4 U.S.C. § 111 required re-examination of Utah's individual income tax. That re-examination has already been undertaken and completed by the Utah State Legislature. See Utah Code Ann. § 49-1-608 (Supp. 1991) (benefits of state retirees are subject to state income tax). Plaintiffs' claim for retroactive monetary relief is another matter entirely. At the outset, it must be remembered that the Supreme Court in Davis did not mandate refunds; it only mandated equal treatment. Davis held that under Section 111 a state's tax system cannot provide an exemption for state retirement income while not providing an exemption for federal retirement income. Davis, 489 U.S. at 810. Any system which does so may be corrected either by exempting both state and federal retirement income or by taxing both. Id. at 817-18. Neither Davis nor Section 111 grants former federal employees a cause of action for monetary relief.⁸ Accordingly, Utah, by amending its statute to provide equal treatment, has completely

⁸ The Supreme Court's decisions in Pennsylvania v. Union Gas Co., 109 S. Ct. 2273 (1989); Dellmoth v. Muth, 109 S. Ct. 2397, 2308 (1989); and Will v. Michigan Dept. of State Police, 109 S. Ct. 2304, 2308 (1989), uniformly hold that in order to subject states to retroactive monetary awards, Congress must manifest its intention through clear and unambiguous language on the face of the statute.

satisfied Section 111 as interpreted by the Supreme Court in Davis. Federal law compels no further action by the State.

2. The Chevron Test for Determining Whether a Court Ruling Operates Prospectively Only.

In Chevron, supra, the Supreme Court set forth three factors to be considered in determining whether a judicial ruling should operate prospectively only. A decision will operate prospectively only:

(1) if it establishes a new principle of law by overruling clear past precedent or by deciding an issue of first impression whose resolution was not clearly foreshadowed;

(2) if prospective only application will not retard the operation of the rule in question; and

(3) if retroactive application would result in inequity, injustice or hardship. Chevron, 404 U.S. at 106-107.

a. Davis Operates Prospectively Only Under the Chevron Factors.

i. Davis Unquestionably Established a New Principle of Law.

The first Chevron factor is straightforward. The judicial decision must establish a new rule of law either by overruling clear past precedent "or by deciding an issue of first impression whose resolution was not clearly foreshadowed." Id. There can be no doubt that Davis satisfies this requirement. When a decision "disrupts a practice long accepted and widely

relied upon,"⁹ it constitutes a new rule of law.¹⁰ At the time of the Davis decision at least twenty-three states, more than one-half of the states that impose an individual income tax, had statutes similar to the Michigan statute.¹¹ The practice of exempting state pension income was widespread and in place for decades. Indeed, Utah's exemption was first enacted over forty years ago. See 1947 Utah Laws Ch. 131, § 13.

Moreover, as the result "was not dictated by precedent existing at the time" of the decision, it is clearer still that a new rule of law has been announced. Teague v. Lane, 109 S. Ct. 1060, 1070 (1989) (plurality opinion) (emphasis in the original).

⁹ Milton v. Wainwright, 407 U.S. 371, 381-82 n.2 (1972) (Stewart, J., Dissenting) (quoted with approval in United States v. Johnson, 457 U.S. 537, 552 (1982)).

¹⁰ See First of McAlester Corp. v. Oklahoma Tax Comm'n., 709 P.2d 1026, 1034 (Okla. 1985) (finding a tax might reasonably be assumed to be constitutional "based on the longstanding and widespread practice of various states to which the United States Supreme Court has not specifically spoken").

¹¹ See Ala. Code §§ 36-27-28 and 40-18-19 (Supp. 1988); Ariz. Rev. Stat. Ann. § 43-1022 (Supp. 1988); Ark. Code Ann. § 26-51-3026; Colo. Rev. Stat. § 39-22-104(4)(f) and (g) (Supp. 1988); Ga. Code Ann. § 48-7-27(a)(4)(A) (Supp. 1988); Iowa Code Ann. § 97A.12 (West 1984); Kan. Stat. Ann. § 74-4923(b) (1985); Ky. Rev. Stat. Ann. § 16.690 (Michie/Bobs-Merrill Supp. 1988); La. R.S. 42545, 47:44.1 (Supp. 1989); Mich. Comp. Laws. Ann. § 206.30 (1988); Miss. Code Ann. §§ 21-29-51 and 25-11-129 (1972); Mo. Rev. Stat. §§ 86.190 and 104.540 (1986); Mont. Code Ann. § 15-30-111(2) (1987); N.M. Stat. Ann. §§ 10-11-145 and 22-11-42 (1978); N.Y. Tax Law § 612(c)(3) (McKinney 1987); N.C. Gen. Stat. § 135-9 (1988); Okla. Stat. § 68 2358 (1988); Ore. Rev. Stat. § 316.680(1)(c) and (d) (1987); S.C. Code § 12-7-435(a), (d) and (e) (Supp. 1988); Utah Code Ann. § 49-1-608 (1989); Va. Code § 58.1-322(C)(3) Supp. 1988); W.Va. Code § 11-21-12(c)(5) and (6) (Supp. 1988); Wis. Stat. § 71.05(1)(a) (Supp. 1988).

With respect to Section 111, not a single case dealing with the issue had cast the slightest doubt on the state tax systems then in place. See supra Note 7.

The Supreme Court's interpretation of 4 U.S.C. § 111,¹² likewise, could not have been reasonably anticipated. The Court's interpretation, and thus the ruling in Davis, rested upon three findings, none of which was foreshadowed, much less dictated the result in Davis. The Court found:

(1) Section 111 applies not only to pay or compensation of current employees of the United States but also to pension benefits received by previous employees, 489 U.S. 808;

(2) Congress intended that the immunity from discriminatory state taxation embodied in Section 111 be coextensive with the constitutional doctrine of intergovernmental tax immunity, id. at 813; and

(3) the proper standard for determining whether the state tax statute discriminates against federal retirees is a "significant difference" standard. Id. at 815-16.

Each of those findings constitute a departure from prior interpretations and hence, a new rule of law.

¹² 4 U.S.C. § 111 provides in relevant part:

The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

- a) The holding that the "pay or compensation for personal service as a officer or employee of the United States" applies to pension benefits received by previous employees was a new rule of law.

The Supreme Court determined that retirement benefits of former federal employees were within the language of Section 111. The statute by its terms, applies only to compensation for service as a federal "employee". Because the petitioner in Davis was not a current employee, the statute appeared inapplicable on its face. Michigan argued that a federal retiree is no longer an "employee" of the United States and, therefore, is not covered by Section 111. The Supreme Court stated that because retirement benefits constitute "deferred compensation for past years of service rendered to the Government," Mr. Davis received the pay "as" a federal employee. . . ." Davis, 489 U.S. 808 (quotation marks in original). This statutory construction of Section 111 was not based on precedent but constituted a new rule of law; indeed, this was the first time Section 111 had been construed in the context of those issues dealt with in Davis. The Supreme Court itself remarked that Congress could have used more precise language in Section 111. Id. at 810.

The Supreme Court cited three Federal Courts of Appeals decisions to support the conclusion that Section 111 applied because federal retirement income is a form of deferred compensation. Zucker v. United States, 758 F.2d 637 (Fed. Cir. 1985), cert. denied, 474 U.S. 842 (1985); Kizas v. Webster, 707

F.2d 524 (D.C. Cir. 1983), cert. denied, 464 U.S. 1042 (1984); and Clark v. United States, 691 F.2d 837 (7th Cir. 1982).¹³

None of these Circuit Court decisions relied upon by the Supreme Court dictated or clearly foreshadowed the outcome in Davis; indeed, those cases did not discuss Section 111.

The decisions cited contain no analysis of whether retirement benefits constitute deferred compensation. In so holding in Davis, the Supreme Court established a new rule of law. The adoption of this new rule was a necessary prerequisite to the holding that federal retirees are included within the

¹³ In Zucker, plaintiffs argued that because retirement benefits are deferred compensation they had a property interest in them which prohibited adjustments to the benefits. While the Court did not reach the issue, it remarked in dicta that "[t]he legislative history lends some support to the view that the basic annuity was intended as deferred compensation." Zucker, supra at 639.

In Kizas, federal employees argued that the Federal Bureau of Investigations' "special preference" previously accorded its clerical and support employees when making appointments as Special Agents constituted deferred compensation and thus vested contractual rights. Without discussing the deferred compensation issue, Kizas merely held that federal employees' rights are determined by statutes and regulations rather than by ordinary contract principles. Kizas, supra at 535.

In Clark, state and private pensioners challenged the constitutionality of a federal statute providing cost-of-living adjustments to federal retirees when state and private retirees received no such benefit from the federal government. The Seventh Circuit, without discussion, simply referred to the Civil Service Retirement system as "a deferred compensation plan." Clark, supra at 842.

class protected by Section 111 which led to the invalidation of Michigan's statute.¹⁴

¹⁴ Plaintiffs below mistakenly relied on Fitzpatrick v. Tax Comm'n, 386 P.2d 896 (Utah 1963) for the assertion that the Tax Commission has already taken the position that retirement income is deferred compensation. (R. 840-841). This case dealt with retirement benefits from a private contract. 386 P.2d 896, 897.

That case was decided under ordinary contract principles:

 Insofar as we have been able to find from our research, the authorities uniformly hold that payments pursuant to a contract for personal services constitute income to the recipient; and that there is a presumption that additional payments provided for in such a contract are further compensation for services and are, therefore, income.

Id. at 898 (footnote omitted).

However, that type of analysis does not apply to federal workers:

 [F]ederal workers serve by appointment, and their rights are therefore a matter of "legal status even where compacts are made." In other words, their entitlement to pay and other benefits "must be determined by reference to the statutes and regulations governing [compensation], rather than to ordinary contract principles."

Kizas, 707 F.2d at 535, footnotes omitted (relied on by the Supreme Court in its Davis decision). Hence, federal workers are governed by statutes and regulations, whereas private pensioners, under Utah law, are governed by ordinary contract principles. Thus, defendants' position in Fitzpatrick dealing with a private pensioner is not inconsistent with their treatment of federal retirees.

- b) The holding that the Section 111 immunity from discriminatory taxation is coextensive with the constitutional doctrine of intergovernmental tax immunity was a new rule of law.

Under traditional Equal Protection analysis, the Utah statute would not have been threatened.¹⁵

The Supreme Court in Davis supported its conclusion that Michigan's tax scheme should not be analyzed under established standards for determining whether a state tax is discriminatory on the basis of another preliminary finding. The finding by the Court that Congress intended that the scope of immunity embodied in Section 111 be coextensive with the protection afforded by the constitutional doctrine of intergovernmental immunity is a new rule of law. Nothing in the legislative history of Section 111 nor its background would have alerted Utah to this conclusion of the Supreme Court.

The doctrine of intergovernmental tax immunity had its genesis in McCulloch v. Maryland, 4 Wheat. 616, 4 L.Ed. 579 (1819). After expanding the doctrine to bar federal taxation of state employees and state taxation of federal employees,¹⁶ the

¹⁵ Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356, 359 (1973) (footnote omitted); See also Carmichael v. Southern Coal Co., 301 U.S. 495, 509 (1937) (inequalities which result from singling out one particular class for taxation or exemption infringe no constitutional limitations).

¹⁶ See Collector v. Day, 11 Wall. 113, 78 U.S. 113 (1871); Dobbins v. Commissioners of Erie County, 16 Pet. 435, 41 U.S. 435 (1942). This expansion of the doctrine was based on the theory that, because a government employee receives his income under a

Supreme Court began to retreat from that interpretation. Thus, in Helvering v. Gerhardt, 304 U.S. 405 (1938), the Supreme Court held that the federal government could tax the income of most state employees, and in Graves v. New York ex rel. O'Keefe, 306 U.S. 466 (1939), that the states could tax the income of federal employees. Although the legislative history of Section 111 does not mention Graves, the proximity in time and the similarity of issues between Graves and Section 111 led the Supreme Court in Davis to conclude that Section 111 incorporates the intergovernmental tax immunity doctrine as embodied in Graves. It follows, the Davis Court reasoned, that Congress intended the nondiscrimination clause of Section 111 to be elevated to and coextensive with the nondiscrimination component of the constitutional intergovernmental tax immunity doctrine.¹⁷

This connection between Section 111 and the intergovernmental tax immunity clause was determined for the first time in Davis and was neither dictated nor foreshadowed by prior precedent. The Court itself in Davis uses no stronger language than to say that "it is reasonable to conclude that

contract with the government, a tax on the income of the employee constitutes a tax on the government itself.

¹⁷ The Court apparently did not find it problematical that the discrimination standard which the Court inferred Congress intended to be applied, i.e., the "significant difference" standard set forth in Phillips Chem. Co. v. Dumas Indep. School Dist., 361 U.S. 376 (1960), was not established at the time of the enactment of Section 111.

Congress drew upon the constitutional doctrine in defining the scope of the immunity retained in § 111." Davis, 489 U.S. at 813.

- c) The holding that whether the state tax statute discriminates against federal retirees is determined by a "significant difference" standard was a new rule of law.

The holding that Section 111 is coextensive with the intergovernmental tax immunity doctrine was a necessary preliminary holding to the rejection of the rational basis test. The holding did not suggest, let alone mandate, the application of the "significant difference" standard. The surprising ruling that the significant difference standard should apply to the facts presented in Davis was a new rule of law.¹⁸

Neither Graves nor the legislative history of Section 111 dictated the discrimination test applied in Davis. Graves indicated only that a state tax on federal employees would not violate the intergovernmental tax immunity doctrine if the tax did not create such a burden on the national government as to

¹⁸ The "significant difference" standard applied by the majority in Davis requires that "[t]he imposition of a heavier tax burden on [those who deal with one sovereign] than is imposed on [those who deal with the other] must be justified by significant differences between the two classes." Davis, 489 U.S. 815-16 (citing Phillips, 361 U.S. at 383). The Court held that Michigan failed to establish that there were significant differences between a class composed of federal retirees and one composed of state retirees. The Court did not consider that the two classes established under Michigan's statute were (1) state retirees and (2) all other retirees, federal and private.

constitute that state's interference in the national government's performance of its functions.¹⁹

The legislative history of Section 111 merely indicates that a state tax on federal employees does not discriminate if it is not aimed at and does not threaten the operation of the federal government. Thus, the Committee Report states:

To protect the Federal Government against the unlikely possibility of State and local taxation of compensation of Federal officers and employees which is aimed at, or threatens the efficient operation of, the Federal Government, the consent [to taxation set forth in § 111] is expressly confined to taxation which does not discriminate against such officers or employees because of the source of their compensation.

(Emphasis added.)²⁰

This statement leads to the inescapable conclusion that the type of discrimination proscribed by Section 111 is that

¹⁹ The issue presented in Graves was whether the tax violated the doctrine of intergovernmental tax immunity, not whether the tax discriminated. The Court held that the imposition by New York of an income tax on the salary of a federal employee did not violate the intergovernmental tax immunity doctrine because the economic burden of the tax was not "passed on so as to impose a burden on the national government tantamount to an interference by one government with the other in the performance of its functions." Id. Graves, 306 U.S. at 480-81. While the Court in Graves describes the tax as non-discriminatory in that it is "laid on the income of all members of the community," as opposed to the tax in McCulloch which was imposed solely on the Bank of the United States, the Court does not discuss discrimination or suggest the proper standard for determining whether a tax is discriminatory. Id. at 483-84.

²⁰ See S. Rep. No. 112, 76th Cong., 1st Sess. (1939); H.R. Rep. No. 26, 76th Cong., 1st Sess. (1939).

aimed at or threatening the operation of the federal government. Under the aimed at or threatening standard, as under the traditional and established rational basis standard,²¹ the tax invalidated in Davis clearly would have been upheld. When the Supreme Court in Davis decided to repudiate both of these tests in this context, it created a new and much stricter rule of law.

There was no precedent indicating that the "significant difference" test should apply across the board in intergovernmental tax immunity cases. In fact, in the most recent Supreme Court decision considering the constitutionality of a state tax under the intergovernmental tax immunity doctrine, the discriminatory state tax was upheld. See United States v. County of Fresno, 429 U.S. 452 (1977).²²

²¹ Under this standard, a class of similarly situated taxpayers may be established. This class may be treated differently if the different treatment bears a rational relationship to a legitimate state goal. See Carmichael, 301 U.S. 495, 509. The Court's application of a similarly situated-rational basis standard would have resulted in upholding the exemption from taxation for state and local retirement benefits. See Allied Stores of Ohio v. Bowers, 358 U.S. 522 (1959) (statute which favors a certain class is not arbitrary if the discrimination is founded upon a reasonable distinction or difference in state policy); United States v. City of Detroit, 355 U.S. 466, 473 (1958) (proper standard is whether class defined is "an arbitrary or invidiously discriminatory one").

²² The Court in County of Fresno noted that the tax was not imposed solely on federal employees but also on "other similarly situated constituents of the State." Id. at 462 (emphasis added). This level of scrutiny differs greatly from the "significant difference" standard applied in Davis.

While the tax at issue in County of Fresno was imposed on the income of private users of both state and federally owned tax

The decision in County of Fresno is in accord with the legislative history of Section 111: so long as the tax is not aimed at or threatening to the federal government, it does not violate the intergovernmental tax immunity doctrine. Before Davis, a state would have been justified in relying on County of Fresno as a statement of the law on differential treatment in the area of state taxation of federal employees. Davis created new law in this area.

In light of the Court's changed interpretation in these three aspects of federal law, it is indisputable that Davis was not clearly foreshadowed, much less dictated. The first prong of the Chevron test, therefore, is satisfied.

ii. Prospective Only Application of Davis Will
Not Retard the Operation of the Rule in
Question.

Under the second Chevron factor, the Court must consider the purpose and effect of the newly announced rule in order to determine whether prospective only application will retard its operation. Chevron, 404 U.S. at 107. The rule

exempt property, this fact was not the basis for the Supreme Court's decision. Rather, the basis for the decision was that the tax did not single out federal employees but was imposed on the majority of the state's citizens and that it did not threaten the operation of the federal government. Id. at 462, 464. As Justice Stevens noted in his reliance on County of Fresno in his dissent in Davis, "[w]hen the tax burden is shared equally by federal agents and the vast majority of a State's citizens, . . . the nondiscrimination principle [of intergovernmental tax immunity] is not applicable and constitutional protection is not necessary." Davis, 489 U.S. at 803 (Stevens, J., dissenting).

announced in Davis was that a state may not tax federal retirement benefits if it exempts state retirement benefits, unless the state can establish a significant difference between state and federal retirees. By amending its statute, Utah has furthered the rule in question. No additional action by the State is needed to accomplish the purpose of the rule.

Moreover, retroactive application clearly is not needed to discourage the legislature from enacting future statutes that discriminate against federal employees. Federal employees are a significant political force in Utah, fully represented in the legislature. There is also no suggestion that the legislature acted in bad faith more than forty years ago in adopting the exemption, and its good faith is clearly evidenced by its prompt repeal of the exemption following the Davis decision. This was echoed by the District Court: "I don't think I would indicate to you that I have any belief that the state acted in bad faith." (R. 1156 tr. 40.)

Equal treatment is achieved with prospective application of Davis. Granting tax refunds does not advance that interest whatsoever. Retroactive application of Davis, rather than advancing the rule there announced, would be "more in the nature of a punitive award for misconstruing the constitutionality of the . . . tax." National Can Corp., 749

P.2d 1286, 1292 (Wash. 1988).²³ No punitive award can be justified by the facts of this case.

iii. Retroactive Application of the Davis Decision
Would Result in Inequity, Injustice, and
Hardship.

The third Chevron factor requires the Court to consider the inequity, injustice and hardship imposed by retroactive application. Id. at 107. This step in the Chevron analysis requires a court to balance and weigh various factors, including the state's justifiable reliance on the constitutionality of the statute, the relative benefit and harm to result from retroactive application, and the injustice in providing the benefit to the litigant.

Defendants justifiably relied on the constitutionality of the forty plus year old exemption, a variation of which was in effect in at least twenty-three other states. See note 11, supra. Prior to Davis, Utah simply had no reason to doubt the validity of the exemption.

This justifiable reliance on the exemption clearly was a sound basis for the State's reliance on the revenues collected under the tax system in operation at the time of the Davis decision. Those revenues have been budgeted and spent; any refunds would come from current or future revenues. This Court

²³ This would be particularly true with those persons receiving military pension benefits since such persons are members of a class not under the rule in Davis. See supra p. 10.

should balance the relative benefit to any individual plaintiff of an award for refunds against the relative harm to the State and all her citizens resulting from a decision of retroactive application of Davis.

The most serious ramification of the retroactive application of Davis is the obligation to provide refunds to all federal retirees for the relevant statutory periods at a cost of nearly \$104 million including interest. (R. 725.) A liability of this magnitude would create a financial hardship on the State. (R. 730.)

Moreover, the hardship attributable to this potential tax refund liability is compounded by the current fiscal problems confronting the State. (R. 700, 706, 730.)

The State's options for dealing with a resource demand of this magnitude are limited. (See R. 702, 707, 730.) If the Court were to require refunds, the magnitude of increased revenue needs would be staggering. Such a financial burden most likely would force reductions across all areas of state government, including education, aid to needy individuals, aid to localities, and other essential government services.

Prospectivity is particularly appropriate in the case now before this Court for additional equitable reasons as well. Utah's purpose in exempting state and local retirement income was legitimate -- to enhance state and local retirement benefits, and thus, to attract employees and to reward state and local civil

servants, without spending additional state revenues. The exemption violated no constitutional restraint of which the legislature should have been cognizant. The statutes did not single out federal retirees for taxation but taxed them as it did all other non-state retirees. Any discriminatory effect of the exemption was unintended, indirect and benign. No state could have reasonably predicted that its effort to reward its employees would be seen as discrimination against former federal employees.

Moreover, from the perspective of equity, Plaintiffs here are not in a special position. They are no more or less economically disadvantaged than thousands of other Utah citizens who received pension income from private employers and also paid their Utah individual income taxes.

In sum, Utah can clearly satisfy the third prong of Chevron. The State's finances would suffer excessive disruption from an award of tax refunds. Such refunds would have to be paid out of current revenues, such as revenues specifically dedicated to education, law enforcement or social programs. The current state taxpayers -- private, state, and federal retirees -- would wind up footing the bill in the form of reduced services and/or higher taxes. All of the equities support the prospective only application of Davis. The State has acted in good faith and with justifiable reliance from the time it adopted the exemption. Therefore, as a matter of law, Davis should apply prospectively only.

3. Recent Decisions of the U.S. Supreme Court Support Prospective Only Application of Davis: The ATA and Beam Cases.

a. The American Trucking Association Decision

The facts of American Trucking Ass'n v. Smith, 110 S. Ct. 2323 (1990) (plurality opinion), are analogous to the facts in this case. At issue in ATA was a Highway Use Equalization Tax ("HUE") that impermissibly discriminated against out-of-state truckers. Following denial of refund by the Arkansas Supreme Court, the Supreme Court held the decision pending the outcome of a similar case, American Trucking Ass'n v. Scheiner, 483 U.S. 266 (1987) ("Scheiner"). In Scheiner, decided June 23, 1987, the Supreme Court found the tax violated the Commerce Clause; ATA was remanded to the Arkansas Supreme Court for further consideration based on the Scheiner decision. Pending the outcome in ATA, Justice Blackmun on August 14, 1987, acting as Circuit Justice, ordered that all Arkansas HUE taxes should be placed in escrow prior to a decision by the Arkansas Supreme Court. The Arkansas Supreme Court invalidated the HUE tax based on the Scheiner decision, but refused to give any refunds for HUE taxes paid before Justice Blackmun's escrow order. The Arkansas Court applied the three-pronged test of Chevron, supra, to determine that Scheiner should not be applied retroactively. At issue in ATA was whether the Arkansas Supreme Court erred in its application of the Chevron test. The Court found that Chevron

mandated prospective only application except for taxes collected after the date that the Scheiner decision was handed down.

First, the Court concluded that Scheiner established a new principle of law. Id. ATA, 110 S. Ct. at 2332. It found that where a precedent having direct application in a case rests on reasons rejected in another line of decisions, District Court should apply that decision until the Supreme Court overrules it. The Court in ATA found that lower courts should follow the case which directly controls, leaving to the Supreme Court the prerogative of overruling its own decisions. Id. Thus, although the precedent which provided the underpinnings for the Scheiner decision had been called into question, it still retained its vitality as binding precedent.²⁴ Second, the Court observed that retroactive application of Scheiner would not deter future violations of free trade. It found that there was not "strong parochial" incentive to commit further violations because the "HUE tax was entirely consistent with the Aero Mayflower line of cases and it is not the purpose of the Commerce Clause to prevent legitimate state taxation of interstate commerce." ATA, 110 S. Ct. at 2332 (citations omitted).

²⁴ It is unclear how broadly or narrowly the current U.S. Supreme Court would interpret this first prong of Chevron. See Ashland Oil, Inc. v. Caryl, 110 S. Ct. 3202, 3204 (1990) (the court found that the decision applied retroactively in Ashland Oil, because it was not like other precedents "which arguably "overturn[ed] a lengthy list of settled decision" and "revolutionize[d] the law of state taxation.").

Finally, after carefully considering the equities, the Court determined that Scheiner should not be applied retroactively. ATA, 110 S. Ct. at 2333. In making this determination, the Court found:

Where a State can easily foresee the invalidation of its tax statutes, its reliance interests may merit little concern, see McKesson, ___ U.S., at ___, 110 S. Ct. at 2254-2258, 2257. By contrast, because the State cannot be expected to foresee that a decision of this Court would overturn established precedents, the inequity of unsettling actions taken in reliance on those precedents is apparent. Although at this point the burden that the retroactive application of Scheiner would place on Arkansas cannot be precisely determined, it is clear that the invalidation of the State's HUE tax would have potentially disruptive consequences for the State and its citizens. A refund, if required by state or federal law, could deplete the state treasury, thus threatening the State's current operations and future plans. Presumably, under McKesson, the State would be required to calculate and refund that portion of the tax that would be found under Scheiner to discriminate against interstate commerce, with the attendant potentially significant administrative costs that would entail.

ATA, 110 S. Ct. at 2333. Thus, Scheiner was not applied retroactively.

On the issue of whether a refund was due from the date of the Scheiner decision and not the date of Justice Blackmun's escrow order, the Court held: "[i]t is, of course a fundamental tenet of our retroactivity doctrine that the prospective application of a new principle of law begins on the date of the

decision announcing the principle. . . ." Id. at 2335 (emphasis added). The Court found that "the critical event for prospectivity is 'the occurrence of the underlying transaction, and not the payment of money therefor. . . .'" [citation]." Id. at 2336.

i. Application of ATA to this Case.

ATA reiterated the application of the three-pronged Chevron test. As set forth in detail above, the three-pronged Chevron test dictates prospective only application of the Davis decision. The only remaining question is when does the Davis decision bind the State? As set forth in ATA, "the prospective application of a new principle of law begins on the date of the decision announcing the principle." Id. 110 U.S. 2335. Thus, the Davis decision should have prospective application beginning on March 28, 1989. This would bar all relief as sought by Plaintiffs for years 1985-1988. It is irrelevant that the 1988 income tax filing date was April 17, 1989. As the Court made clear, it is "the occurrence of the underlying transaction, and not the payment of money therefor" that is the critical determination. Id. 110 U.S. at 2336. Hence, the closure of the tax year on December 31 of a given year is the governing date.

b. The Beam Decision.

i. Introduction.

The most recent pronouncement by the Supreme Court, in the area of retroactivity, was handed down on June 20, 1991.

James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439 (1991). The origins of that case are from a 1984 Supreme Court decision. In 1984, the Supreme Court held in Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 273 (1984) ("Bacchus"), that a Hawaii tax statute that distinguished between imported and local alcohol products violated the Commerce Clause. Prior to its amendment in 1985, Georgia state law imposed a similar tax. See Ga. Code Ann. § 3-4-60 (1982).

After the Bacchus decision, James B. Beam Distilling Co. filed suit in the Georgia trial court alleging that Georgia's law was likewise inconsistent with the Commerce Clause. It sought refunds of the amount paid for the years 1982, 1983 and 1984. The trial court and the Georgia Supreme Court held that in light of Bacchus, the Georgia law was unconstitutional for the years in question. Using a Chevron analysis, however, the Georgia Supreme Court refused to apply its ruling retroactively and thus denied the refund request. James B. Beam Distilling Co. v. State, 382 S.E.2d 95 (1989). On review, the Supreme Court reversed the judgment and remanded the case for further proceedings. Beam, 111 S. Ct. at 2448.

Five opinions were written in Beam, none of which commanded a majority of the Supreme Court.²⁵ The lead opinion,

²⁵ Three cases similar to the case now before the court were pending before the U.S. Supreme Court at the time of the Beam decision. They were remanded back to state Courts. A remand and reconsideration order means precisely what it says: the court is to

written by Justice Souter, was joined by only one other Justice, Justice Stevens. Justice White wrote a separate concurrence. Justices Blackmun, Marshall and Scalia -- in two separate opinions, each joined by the three of them -- also concurred separately. There was a dissent written by Justice O'Connor, joined by Chief Justice Rehnquist and Justice Kennedy.

ii. Dissenting Opinion by Justice O'Connor,
Joined by Chief Justice Rehnquist and Justice
Kennedy; Concurring Opinions of Justices
Blackmun, Marshall and Scalia.

An understanding of the Court's fractured vote is best understood by beginning with the dissent. Justice O'Connor writing for the three dissenters supports the Chevron analysis:

reconsider a decision in light of an intervening precedent which contains similar issues. The order does not compel the court to reach a different result. See R. Stern, E. Gressman & S. Shapiro, Supreme Court Practice 279-80 (6th ed. 1986) see also Bush v. Lucas, 647 F.2d 573, 575 (5th Cir. 1981), aff'd, 462 U.S. 367 (1983) (reconsideration order means that Supreme Court has merely "flagged" case as one upon which intervening decision may have some bearing but which Court has not concluded has a material effect; judgment for defendant). See also Hellman, "Granted, Vacated and Remanded": Shedding Light on a Dark Corner of Supreme Court Practice, 67 Judicature 389 (1984). In a study of 289 cases in which remand and reconsideration orders were issued, Professor Hellman found that the lower court affirmed its original ruling in a substantial number of cases and that few of these judgments were reversed on further appeal to the Supreme Court. Id. at 394-95. (reaffirmed). In fact, had it been the Supreme Court's view that Beam was controlling in these cases the Supreme Court could have issued a per curiam opinion, as it did in two cases pending on petitions for certiorari at the time the Supreme Court decided ATA in 1990. See National Mines Corp. v. Caryl, 110 S. Ct. 3205 (1990) (per curiam), and Ashland Oil, Inc. v. Caryl, 110 S. Ct. 3202 (1990) (per curiam) (state court judgments applying Armco Inc. v. Hardesty, 467 U.S. 638 (1984), prospectively-only reversed).

The equitable analysis of Chevron places limitations on the liability that may be imposed on unsuspecting parties after this Court changes the law. . . . To impose on Georgia and the other States that reasonably relied on this Court's established precedent such extraordinary retroactive liability, at a time when most States are struggling to fund even the most basic services, is the height of unfairness.

111 S. Ct. at 2455. Because these justices would support prospectivity only, they without question would not apply Davis retroactively to this case.

Justices Blackmun, Marshall, and Scalia disagree with the analysis of Justice O'Connor on the choice of law issue. Their position, staked out in two separate Beam concurrences, is that the equities cannot be considered because the Supreme Court lacks the authority to apply its constitutional decisions prospectively only. Justices Blackmun, Marshall, and Scalia do not discuss retroactivity as a remedial issue in Beam.

The resulting situation is that six Justices are equally divided on whether Chevron can be applied to determine if Davis is retroactive under the federal choice of law issue. The critical question on this issue, therefore, is how the other three Justices will vote when this question is presented to them. The answer to that question requires a close analysis of Justice Souter's and Justice White's opinions in Beam.

iii. Justice Souter's Opinion Announcing the
Judgment of the Court, Joined by Justice
Stevens.

It is important to note preliminarily that Justice Souter in Beam, like the four dissenting Justices in ATA,²⁶ distinguishes between retroactivity as a choice of law principle and retroactivity as a remedial principle. ATA, 111 S. Ct. at 2446. Following his distinction between retroactivity as a choice of law principle and as a remedial principle, Justice Souter outlines three potential answers to the "choice of law" issue. First, the new decision can be purely prospective in effect, that is, it can apply only to facts arising after the decision is announced. Justice Souter cites Chevron as an example of pure prospectivity. Chevron served to announce a new rule of law, but the new rule applied neither to the party before the Court nor to others who could assert the same claim prior to the decision. Second, the new rule can be fully retroactive, applying to the parties before the Court and to all others who could assert the same claim. Third, the new rule can apply prospectively to some litigants and retroactively to others. This latter possibility is referred to as "modified, or selective, prospectivity."

Justice Souter rejects the concept of selective prospectivity as a choice of law principle in the civil context.

²⁶ Justices Stevens, Brennan, Marshall, and Blackmun dissented in ATA.

111 S. Ct. at 2446. He further concludes that Bacchus by "implication" applied its new rule to the litigants there before the Court. Given that conclusion, and the illegitimacy of selective prospectivity, it followed to Justice Souter that the Bacchus rule applied to the litigants in Beam.

The important point to be made about Justice Souter's opinion is that in the end it addresses, in his own words, only a "narrow" point. What he concludes--and all he concludes--is that selective prospectivity is an illegitimate choice of law outcome. He does not decide when pure prospectivity might be appropriate. Nor does he address remedial issues. Justice Souter's own words best demonstrate the narrow reach of his opinion:

The grounds for our decision today are narrow. They are confined entirely to an issue of choice of law: when the Court has applied a rule of law to the litigants in one case it must do so with respect to all others not barred by procedural requirements or res judicata. We do not speculate as to the bounds or propriety of pure prospectivity.

Nor do we speculate about the remedy that may be appropriate in this case; remedial issues were neither considered below nor argued to this Court, save for an effort by petitioner to buttress its claim by reference to our decision last term in McKesson. As we have observed repeatedly, federal "issues of remedy ... may well be intertwined with, or their consideration obviated by, issues of state law." Bacchus, 468 U.S., at 277, 104 S. Ct., at 3058. Nothing we say here deprives respondent of his opportunity to raise procedural bars to recovery under state law or demonstrate reliance interests entitled to consideration in determining the nature of the remedy that must be provided, a

matter with which McKesson did not deal. See Estate of Donnelly, 397 U.S., at 296, 90 S. Ct., at 1039 (Harlan, J., concurring); cf. Lemon, 411 U.S., at 203, 93 S. Ct., at 1471.

111 S. Ct. at 2448.

iv. Justice White's Opinion Concurring in the Result.

Justice White in his concurrence agrees that Bacchus may be read as applying the benefit of the judgment to Bacchus Imports and agrees that it applies to other litigants whose cases were not final at the time of the Bacchus decision. 111 S. Ct. at 2448. But Justice White reaffirms his view, as expressed by Justice O'Connor for the plurality in ATA, that certain decisions of the Supreme Court will apply prospectively only under a Chevron analysis. Id. at 2449. Justice White does not discuss retroactivity as a remedial issue.

v. Conclusion: The Meaning of Beam.

The net result of the fractured voting in Beam is that only three Justices reject the application of a Chevron analysis to determine the choice of law in a case such as the one now before this Court. Four Justices clearly agree that in the proper case, based on a Chevron analysis, pure prospectivity is an appropriate way to reach an equitable resolution of a case before a court. Two Justices, while refusing to commit themselves in Beam, do not reject the application of Chevron.

None of the Justices reject prospectivity only in the remedial context.²⁷

vi. Retroactivity of Davis under Beam.

In Beam, Justice Souter's opinion explained that Bacchus was "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. This conclusion was based on the terms of the remand order in Bacchus. Specifically, Bacchus was remanded for consideration of a defense raised by the state in that case. There would have been no need to consider the defense, Justice Souter reasoned, if it had not already been implicitly decided that the new law announced by Bacchus applied to the claim stated by the plaintiffs in that case. Id.

The Supreme Court made no similar ruling in Davis. The question of retroactivity was not at issue in Davis because Michigan had previously agreed to the payment of a refund to Mr. Davis if the tax violated federal law. Specifically, the Court said in Davis:

For these reasons, we conclude that the Michigan Income Tax Act violates principles of intergovernmental tax immunity. . . . The State having conceded that a refund is appropriate in these circumstances, see Brief for Appellee 63, to the extent appellant has

²⁷ Of the three Justices who reject the application of Chevron to determine the choice of law issue, one, Justice Marshall, is no longer on the Court. Moreover, of the two uncommitted Justices, Justice Stevens has changed his position since the ATA decision.

paid taxes pursuant to this invalid tax scheme, he is entitled to a refund.

489 U.S. at 817.

Thus, the Supreme Court in Davis did not need to determine whether its decision was to have purely prospective or fully retroactive effect. Michigan had taken this issue out of the case by agreeing to pay refunds whatever the resolution of that issue, a decision the state was free to make. For, as stated by the Supreme Court in McKesson, 110 S. Ct. 2238 (1990), a state is free to pay refunds under state law even when federal law would not so require. Id. at 2240 (state has power to give a decision remedial effect greater than that which a federal court would require or provide).

The same point can be made another way. Justice Souter stated the question in Beam as "whether 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. That issue is not presented here. Davis, the case that announced the new rule sought to be applied here, has not "already" applied the new federal rule retroactively. There was not in Davis, as there was in Bacchus, an implicit decision on the retroactivity question.²⁸

²⁸ It is not clear, moreover, that the United States Supreme Court gave sufficient consideration to the prospective versus retroactive effect of its decision in Bacchus. See Beam, 111 S. Ct. at 2451-52 (O'Connor and Kennedy, JJ., Rehnquist, CJ., dissenting).

Because the Supreme Court did not decide the issue of retroactivity in Davis, this Court is free to determine the issue in this case. As has been demonstrated above, four Justices indicated in Beam that they favor the prospective only application of a Supreme Court decision in a proper case based on a Chevron analysis, and two leave open the possibility. 111 S. Ct. at 2448 (Souter and Stevens, JJ.) 111 S. Ct. at 2449 (White, J., concurring); 111 S. Ct. at 2451 (O'Connor and Kennedy, JJ., Rehnquist, CJ., dissenting). This Court should accept the invitation to apply Chevron by overturning the decision of the District Court.

In Swanson, 407 S.E.2d 791 (N.C. 1991), the Supreme Court of North Carolina applied the Chevron test to hold that Davis was not retroactive. Since Davis satisfies all three prongs of Chevron,²⁹ any other disposition would constitute a state court's overruling of Chevron, an action that the North Carolina court refused to take:

In Beam the Court had an opportunity to say that the rule of Chevron should no longer be applied in civil cases and declined to do so. We do not believe we should anticipate a change in the law by the United States

²⁹ The United States Fourth Circuit Court of Appeals, the only federal court to consider whether Davis constitutes a new rule of law, has recently ruled that prior to Davis a reasonable state official could not have known that such a tax system was unconstitutional. Swanson v. Powers, 937 F.2d 965 (4th Cir. 1991). As stated by the Circuit Court "a state official who examined North Carolina's tax system prior to Davis might easily have concluded that it worked no unconstitutional discrimination." Id. at 970.

Supreme Court, but should adhere to the opinions as they are now written. We believe we have done so.

Swanson, 407 S.E.2d 791, 795 (N.C. 1991). Hence, Beam supports a reversal of the District Court. The District Court erred in determining that pursuant to State law Plaintiffs are entitled to a refund. Under federal analysis, the Davis decision should be applied prospectively only. Therefore, the District Court decision should be reversed, and the case remanded with instructions that the Davis decision applies prospectively only.

4. The District Court Erred In Striking Defendants' Affidavits Which Are Relevant Under The Federal Analysis.

The District Court erred in signing an order granting Plaintiffs' motion to strike all Defendants' affidavits supporting cross motion for summary judgment. (R. at 1113-14.) The District Court granted "the . . . petitioner's motion to strike the affidavits of the defendant in relation to those of Mr. Knowlton, Mr. Christensen and Mr. Memmott." (R. 1156 tr. 5.) (emphasis added.) However, subsequent to the hearing, the District Court signed an order striking all of the affidavits supporting Defendants' cross-motion for summary judgment. (R. 1114.) The District Court struck four of Defendants'

affidavits³⁰ without a hearing. Accordingly, that order should be stricken as contrary to the bench ruling of the Court.

Defendants attached an additional four affidavits to their Reply Memorandum of Points and Authorities.³¹ Those affidavits were never ordered stricken by the District Court and hence remain in support of Defendants' reply memorandum. (R. 1048-1060, Exhibits A-D.)

The affidavits that were stricken concerned the fiscal impact that retroactive application of Davis would have on the State of Utah and the State's reliance on Plaintiffs' past inaction. (R. 699-789, Exhibits A-1.)

The District Court's rationale for granting Plaintiffs' motion was that the "scope of the affidavits was well beyond the factual basis upon which the court should be required to consider a basis for rendering this decision." (R. 1156 tr. 75.) The District Court improperly determined that the affidavits lacked relevance.

In striking the affidavits, the District Court completely ignored the third prong of the Supreme Court's

³⁰ In addition to the affidavits of Mr. Knowlton, Mr. Christensen, and Mr. Memmott, the Tax Commission had attached the affidavits of R.H. Hansen, Jerry E. Larabee, Kevin Howard, and Douglas A. MacDonald.

³¹ Those affidavits attached to Defendants' Reply Memorandum of Points and Authorities are affidavit of Steven S. Nelson, supplemental affidavit of Jerry E. Larabee, supplemental affidavit of R.H. Hansen, and affidavit of Thomas Michael Williams.

retroactivity analysis. That prong provides that "where a decision of this court would 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." Chevron, 404 U.S. at 107 (1971) (quoting Cipriano v. City of Houma, 395 U.S. 702 (1969)). Defendants' affidavits went to the issue of potential hardship to the State if the Davis decision were to be applied retroactively. Hence, the affidavits are relevant under Utah R. Evid. 401.

In arriving at its decision in ATA, the Supreme Court reasoned:

In determining whether a decision should be applied retroactively, this Court has consistently given great weight to the reliance interests of all parties affected by changes in the law. . . . To the extent that retrospective application of a decision burdens a government's ability to plan or carry out its programs, the application injures all of the government's constituents. These concerns have long informed the Court's retroactivity decisions. . . .

ATA, 111 S. Ct. at 2334-35 (emphasis added; citation omitted); see also Compensation Plans v. Norris, 463 U.S. 1073 (1983).

Finally, the affidavits that were stricken by the District Court should have been considered in crafting a remedy. Justice Souter, in his plurality decision in Beam found:

"[n]othing we say here deprives respondent of his opportunity to raise procedural bars to recovery under state law or demonstrate reliance interests entitled to consideration in determining the

nature of the remedy that must be provided, a matter with which McKesson did not deal." Beam, 111 S. Ct. at 2448.

Hence, the fiscal impact on the State and its reliance interests are relevant both in determining the choice of law and remedy issues. The affidavits also demonstrate beyond question the Plaintiffs' lack of state or federal challenge to the Utah statute until after the Davis decision was announced.

POINT IV

THE DISTRICT COURT'S REMEDY IS OVERBROAD AND OVERCLUSIVE.

A. The McKesson Case - Minimum Due Process Requirements.

The case before the Court requires a three step inquiry. First, this Court must determine whether litigants are procedurally barred by a statute of limitations or payment under protest requirement. Second, this Court must determine whether there has been a constitutional violation by applying the Davis decision retroactively using the three-pronged Chevron test. ATA, 110 S. Ct. at 2333. Third, if a violation has occurred, the Court then crafts a remedy pursuant to state law that satisfies minimum federal Due Process requirements.

The Supreme Court in McKesson, 110 S. Ct. 2238 (1990), set forth the minimum procedural standards that a state remedy must provide to satisfy Fourteenth Amendment Due Process. At issue in McKesson was whether a refund was due under a Florida

liquor excise tax found unconstitutional. For several decades, Florida had given preferred tax treatment to Florida-grown citrus products used in liquor production. The Supreme Court invalidated a similar Hawaii tax scheme as violating the Commerce Clause. Following the Hawaii decision, the Florida Legislature amended its liquor excise tax. However, the Court found that these amendments to "[t]he Liquor Tax reflected only cosmetic changes from the prior version of the tax scheme that itself was virtually identical to the Hawaii scheme." 110 S. Ct. at 2255. Given these egregious facts, the Court found that a refund must be given.

McKesson is important because it provides that "the root requirement of the Due Process Clause as being that an individual be given an opportunity for a hearing before he is deprived of any significant property interest." Id. at 2250. However, there is an exception to a predeprivation hearing for the payment of state taxes:

[I]t is well established that a State need not provide predeprivation process for the exaction of taxes. Allowing taxpayers to litigate their tax liabilities prior to payment might threaten a government's financial security, both by creating unpredictable interim revenue shortfalls against which the State cannot easily prepare, and by making the ultimate collection of validly imposed taxes more difficult.

Id. The Fourteenth Amendment concern arises because of the "coercive means" used to collect an illegal tax. Id. at 2251.

Accordingly, the Court ruled that a postdeprivation procedure which provided "an opportunity to contest the validity of the tax and a 'clear and certain remedy' designed to render the opportunity meaningful by preventing any permanent unlawful deprivation of property" would satisfy Due Process requirements. Id. at 2252.

In McKesson, the Supreme Court gave the following examples of postdeprivation remedies that satisfy minimum federal Due Process requirements:

1. Full refund of tax assessed over the amount competitors had been charged;
2. Collection of back taxes from those parties benefiting from lower tax rates; and
3. A combination of tax refunds to petitioners and retroactive taxation of those parties taxed at a lower rate.

Id. at 2252.

The Court also set forth procedural safeguards that could be employed by states to protect against the "disruptive effects" of an invalidated tax scheme:

- 1) Refunds only to taxpayers paying under protest; and
- 2) Short statutes of limitation. Id. at 2257.

Finally, the administrative costs -- separate from the refund cost -- may also be weighed. Id. at 2258.

On the other hand, if there are predeprivation safeguards, no Due Process concern exists. This is because the requirements of Due Process have already been satisfied:

If a State chooses not to secure payments under duress and instead offers a meaningful opportunity for taxpayers to withhold contested tax assessments and to challenge their validity in a predeprivation hearing, payments tendered may be deemed "voluntary." The availability of a predeprivation hearing constitutes a procedural safeguard against unlawful deprivations sufficient by itself to satisfy the Due Process Clause, and taxpayers cannot complain if they fail to avail themselves of this procedure. See Mississippi Tax Comm'n, supra, 412 U.S. at 368, n. 11, 93 S. Ct., at 2187, n. 11 "[W]here voluntary payment [of a tax] is knowingly made pursuant to an illegal demand, recovery of that payment may be denied".

Id. at 2251, n.21 (emphasis added); See also Mammoth City v. Snow, 253 P. 680 (Utah 1926) (payment of an improper tax is non-refundable).

B. The Remedy Below Was Draconian Under the McKesson Standard.

It is important to reemphasize that Davis did not mandate refunds for taxes paid by federal retirees; rather, Davis only required equal treatment of federal and state retirement income for state income tax purposes. Accordingly, the State of Utah complied with the Davis decision when it revised its income tax statute to provide for identical treatment for state and federal pensioners. Defendants below requested a remedial

hearing to submit evidence on the remedy issue. (R. 697.) This request was never entertained by the District Court.

Utah has already satisfied the minimum Due Process requirements of McKesson. A federal retiree could have omitted that portion of his income tax that he felt violated intergovernmental tax immunity. In fact, there is evidence in the record showing that this has been done. (R. 561.) Not until a determination of a deficiency would the taxes then be due under duress. At this time a predeprivation hearing would be available to the taxpayer. See Utah Code Ann. §§ 59-1-501 through 505. Hence, the minimum Due Process requirements have already been satisfied. Utah needs to do nothing more to satisfy federal Due Process requirements.

If this Court determines that Plaintiffs are entitled to some form of retroactive relief, an equitable remedy should be crafted. The Court could require Defendants to refund the amount of money that state and local retirees received in tax benefits (\$8.3 million best estimate benefit), see Bohn v. Waddell, 807 P.2d 1 (Ariz. Tax 1991) (opinion on rehearing), or it may require Defendants to grant tax credits against future tax liability.

Even if Utah had not complied with Due Process by providing a predeprivation remedy, it has established the necessary procedural safeguards to protect against economic disruption. It has a payment under protest statute. See Utah

Code Ann. § 59-1-301.³² That statute allows the taxpayer who considers a tax to be unlawful to pay under protest. Moreover, this statute authorizes a taxpayer to bring an action in court, thus providing the opportunity to adjudicate the lawfulness of the tax and preclude permanent deprivation of the tax paid. Utah likewise has a six month statute of limitations that applies to these types of actions.³³ Utah Code Ann. § 78-12-31 (1987). The District Court failed to contemplate these statutes as it crafted its remedy.

Both of these statutes provide more than sufficient protection to taxpayers against permanent deprivation without Due Process. Accordingly, the District Court abused its discretion in ordering refunds to Plaintiffs for the years 1985-1988. Such a remedy is severe and is neither prescribed by the Constitution nor state law.

Finally, the District Court in fashioning its remedy failed to consider the well documented reliance interests of the state. Justice Souter in Beam opined:

[N]othing we say here precludes consideration of individual equities when deciding remedial issues in particular.

. . .

Nothing we say here deprives respondent of his opportunity to . . . demonstrate reliance

³² This statute is discussed in detail, supra at p. 2-7.

³³ This statute is discussed in detail, supra at p. 7-9.

interests entitled to consideration in determining the nature of the remedy that must be provided, a matter with which McKesson did not deal.

Id. at 2448. In these passages, Justice Souter has invited this Court to consider the equities and to determine that, in his words, the taxpayers prevailing under the new rule announced in Davis may not "obtain the same relief that would have been awarded if the rule had been an old one." Beam, 111 S. Ct. at 2443. Accordingly, retroactivity as a remedial principle clearly recognizes the equitable and reliance interests of the parties. Beam, 111 S. Ct. at 2448. This view is also supported by the opinion of the dissenting Justices in ATA, 110 S. Ct. at 2347-56 (dissent).

C. The Utah Supreme Court Approach to Prospective Only Application of a New Decision Should Be Applied to Any Remedy Crafted By It.

Utah, like the Supreme Court, recognizes non-retroactivity.³⁴ The Utah test for non-retroactivity is well established:

We may in our discretion, prohibit retroactive operation where the "overruled law has been justifiably relied upon or where retroactive operation creates a burden." Loyal Order of Moose, 657 P.2d at 265. For example, we have limited or prohibited

³⁴ Utah has not formally adopted the rule found in Chevron.

retroactive application of decisions
invalidating or reinterpreting certain
statutes.

Malan v. Lewis, 693 P.2d 661, 676 (Utah 1984) (emphasis added).

Utah courts have recognized the immense burden that retroactive application of tax laws could place on government. This Court in Rio Algom Corp. v. San Juan County, 681 P.2d 184 (Utah 1984) considered the impact of a retroactive application of a ruling allowing refunds for state-assessed properties:

[L]ocal governments operate on very precise and often strained budgets that are carefully tied to these levies. Since 1981, a number of owners of state-assessed properties have paid their taxes under protest or have filed formal complaints with the Tax Commission. Retroactive effect to a decision altering the relative tax burdens between locally assessed and state-assessed properties would require reopening the assessment process as to tax obligations not yet final. To the extent that this might result in refunds of taxes paid on state-assessed properties, it would impose indebtedness for future repayments from locally assessed properties. Such indebtedness could be huge in counties that derive high proportions of their budgets from state-assessed properties.

Id. at 195; see also Loyal Order of Moose No. 259 v. County Bd. of Equalization, 657 P.2d 257, 265 (Utah 1982) (giving retroactive effect to the assessment of back taxes could result "in an unreasonable burden upon . . . governmental bodies associated with it."); Board of Educ. v. Salt Lake County, 659 P.2d 1030 (Utah 1983) (new law should not be given retroactive effect where it would require county government to make payments

for which it had not budgeted, and where its impact would fall heavily on taxpayers).

If the new rule of law stated in Davis is to be applied retroactively under the Utah Supreme Court analysis, any remedy should be prospective only.

POINT V

THE DISTRICT COURT ERRED IN NOT ALLOWING DEFENDANTS THE PRESCRIBED TIME TO OBJECT TO THE PROPOSED FINAL ORDER AND BY MAKING FINDINGS UNSUPPORTED BY THE RECORD.

Rule 4-504(2) of the Code of Judicial Administration

Copies of the proposed findings, judgments, and orders shall be served upon opposing counsel before being presented to the court for signature unless the court otherwise orders. Notice of objections shall be submitted to the court and counsel within five days after service.

(Emphasis added.)

In the instant case, the District Court did not allow Defendants the prescribed time to object to Plaintiffs' Amended Proposed Findings, Conclusions, and Partial Summary Judgment.

Plaintiffs mailed to Defendants the Amended Proposed Findings, Conclusions and Partial Summary Judgment on April 10, 1991. On April 15, the Court made a minute entry stating: "[t]he court has reviewed the Amended Proposed Findings, Conclusions and Partial Summary Judgment as submitted. The same are approved to be the final order of the Court. The Defendant's objections thereto are thus denied." (R. 1110.) In fact, Defendants had

not yet filed objections to the amended order. The Court subsequently signed and entered the order on April 16, 1991.

Rule 6(a) of the Utah Rules of Civil Procedure provides:

Computation. In computing any period of time prescribed or allowed by these rules, by the local rules of any district court, by order of court, or by any applicable statute, the day of the act, event, or default from which the designated period of time begins to run shall not be included. The last day of the period so computed shall be included, unless it is a Saturday, a Sunday, or a legal holiday, in which event the period runs until the end of the next day which is not a Saturday, a Sunday, or a legal holiday. When the period of time prescribed or allowed is less than seven days, intermediate Saturdays, Sundays and legal holidays shall be excluded in the computation.

Pursuant to Rule 6(a), the prescribed period in which to object to Plaintiffs' Amended Proposed Findings, Conclusions and Partial Summary Judgment had not lapsed prior to its entry. Accordingly, by signing and entering the order, the Court deprived Defendants of their right to object under Rule 4-504(2) of the Utah Code of Judicial Administration. Because Defendants were denied their right to object, the Amended Findings, Conclusions, and Partial Summary Judgment must be set aside.

The District Court also erred in making findings of material facts in ruling on Plaintiffs' Motion for Summary Judgment that are completely unsupported by the record. Had

Defendants been given the opportunity to raise objections, this may not have occurred.

First, the District Court made a finding that the "Plaintiff class consists of approximately 34,000 individuals and/or estates, the majority of whom are of advanced age." (R. 1121.) This finding is unsupported by the record.

Second, the District Court made a finding that the "size of each class member's claim is small in relation to the high cost of pursuing a resolution of the claim." (R. 1121.) There is absolutely no evidence introduced by the Plaintiffs into the record supporting this assertion.

Third, the District Court entered a finding that "[p]laintiffs will necessarily incur costs to prepare amended tax returns to be filed with the State Tax Commission as part of the refund process. The State Tax Commission has no mechanism to compute refunds for plaintiffs." (R. 1124.) Again there is absolutely no support for this finding in the record. Significantly, it is an illogical conclusion of the District Court that the Tax Commission is without the capacity to process refunds for the individual Plaintiffs. Particularly in light of its later order that it do exactly that.

Finally, the District Court made a finding that "[a]ttorney's fees have been incurred herein by Plaintiffs and by the Plaintiff class." (R. 1121.) While this is possible, the Plaintiffs introduced no evidence into the record that would

provide the Court a basis for this finding. Accordingly, the District Court erred in making the formal finding.

Each of the above findings was made by the District Court to support its granting Plaintiffs' Motion for Summary Judgment. The standard for summary judgment is provided in Rule 56(c) of the Utah Rules of Civil Procedure. The relevant portion of that rule provides: "[t]he [summary] judgment shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." It is significant that these issues of material fact remained unsupported when the Court entered Summary Judgment in favor of Plaintiffs.

POINT VI

THE DISTRICT COURT ERRED IN AWARDING PLAINTIFFS' ATTORNEY FEES WITHOUT A LEGAL BASIS FOR THE AWARD AND IN GRANTING COURT COSTS AND REIMBURSEMENT TO PLAINTIFFS FOR THE COSTS OF PREPARING AMENDED TAX RETURNS.

"Utah adheres to the well-established rule that attorney's fees generally cannot be recovered unless provided for by statute or by contract." See Canyon Country Store, 781 P.2d 414, 419 (Utah 1989); see also Turtle Management, Inc. v. Haggis Management, 645 P.2d 667 (Utah 1982); Amica Mutual Insurance Co. v. Schettler, 768 P.2d 950 (Utah Ct. App. 1989). There is no

contractual basis for an award of fees. The only relevant statutory provision is Utah Code Annotated 78-27-56(1)(Supp. 1991 & 1987) which provides:

In civil actions, the court shall award reasonable attorney's fees to a prevailing party if the court determines that the action or defense to the action was without merit and not brought or asserted in good faith.

The threshold question is whether a party's action or defense was without merit and not brought in good faith. The Utah Court of Appeals recently stated that "in order to recover fees under § 78-27-56, a trial court must make findings that 1) the claim or claims were 'without merit', and 2) the party's conduct was lacking in good faith." Amica Mutual Ins. Co. v. Schettler, 768 P.2d 950, 966 (Utah Ct. App. 1989). The findings with reference to bad faith need not be written. See Canyon Country Store v. Bracey, 781 P.2d 414, 422 (Utah 1989). Nevertheless, there must be some basis in the record to support findings of lack of merit and bad faith.

There is absolutely no basis in the present action, nor in the record, for findings of lack of merit or bad faith that would sustain an award of attorney fees.

This Court has found that "not only must there be substantial evidence that the claim was lacking basis in either law or fact and therefore frivolous, but there must also be sufficient evidence that the unsuccessful party lacked at least

one of the good faith elements. . . . "³⁵ Cady v. Johnson, 671 P.2d 149, 152 (Utah 1983). If the Court refused to find a lack of good faith in Cady, it can hardly be said that Defendants' onerous efforts to defend the present claim constitute bad faith on their part.

In the instant action, there is neither a contractual nor a statutory basis for attorney fees. Absent a basis to support an award, the Court's actions in awarding fees was improper and must be reversed.

The District Court granted reimbursement to Plaintiffs for tax return preparation and court costs. (R. 1141.) Rule 54 of the Utah Rules of Civil Procedure provides in part: "Costs against the state of Utah, its officers and agencies shall be imposed only to the extent permitted by law." Costs are fees paid to the Court and witnesses. See Frampton v. Wilson, 605 P.2d 771 (Utah 1980).

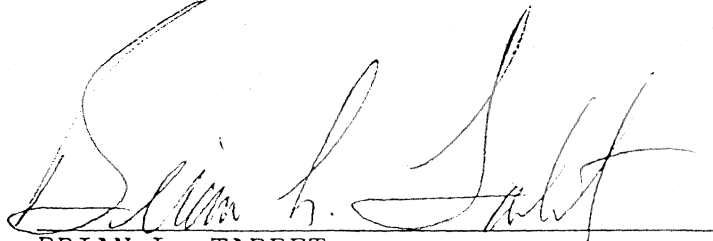
There is no basis in Utah law to impose on Defendants the costs of preparing amended tax returns or court costs. Accordingly, the District Court erred in granting them, and the award should be reversed.

³⁵ The court defined good faith as: "(1) An honest belief in the propriety of the activities in question; (2) no intent to take unconscionable advantage of others; and (3) no intent to, or knowledge of the fact that the activities in question will hinder, delay or defraud others. See Cady, 671 P.2d 149.

CONCLUSION

The class as defined below is overbroad. Accordingly, the District Court order certifying the class should be vacated, and the case should be remanded with instructions to redefine the class. Also, there is no basis under State law for a refund of income taxes. Pursuant to federal analysis, the new rule announced in Davis should not apply retroactively. Finally, there is no basis in law or fact for an award of attorney fees, court costs, or costs to prepare amended tax returns. Therefore, the case should be remanded to require the District Court to correct these mistakes of law.

DATED this 14th day of November, 1991.

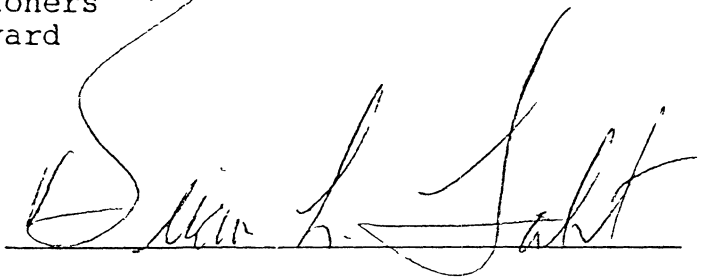
A handwritten signature in dark ink, appearing to read "Brian L. Tarbet", written over a horizontal line.

BRIAN L. TARBET
Assistant Attorney General

CERTIFICATE OF MAILING

I hereby certify that on the 14TH day of November, 1991, I caused 4 copies of the foregoing BRIEF OF DEFENDANTS to be mailed, postage prepaid, to:

Jack C. Helgesen, Esq.
Richard Jones, Esq.
LYON, HELGESEN, WATERFALL & JONES
Attorneys for Petitioners
4768 Harrison Boulevard
Ogden, Utah 84403

A handwritten signature in dark ink, appearing to read "David L. Jahn", is written over a horizontal line.

APPENDIX 1

JACK C. HELGESEN, #1451
RICHARD W. JONES, #3938
LYON, HELGESEN, WATERFALL & JONES, P.C.
Attorneys for Plaintiffs
4768 Harrison Boulevard
Ogden, Utah 84403
Telephone: (801) 479-4777

IN THE TAX DIVISION OF THE THIRD JUDICIAL DISTRICT COURT
SALT LAKE COUNTY, STATE OF UTAH

WENDELL E. BRUMLEY, et al.,	:	ORDER CERTIFYING CLASS
Plaintiffs,	:	
vs.	:	
UTAH TAX COMMISSION, et al.,	:	
Defendants.	:	Civil No. 89-0903618 CV Judge David S. Young

Plaintiffs' Motion to Certify Class having been filed by Plaintiffs with an accompanying memorandum, and Defendants having filed a memorandum opposing Plaintiffs' Motion to Certify Class and Plaintiffs' replying thereto, and the court having reviewed the above motion and memoranda;

IT IS HEREBY ORDERED, ADJUDGED AND DECREED:

1. Certification Civil action 89-0903618 CV, styled Wendell E. Brumley, et al. v. Utah State Tax Commission, et al. is hereby certified as a class action on behalf of the following class of Plaintiffs: All persons and the estates of deceased persons who received federal retirement benefits or annuities and who have paid Utah state income tax on their federal retirement benefits for the 1984, 1985, 1986, 1987 and/or the 1988 tax years.

2. Class certification is made pursuant to the provisions of Rule 23(A) and 23(b)(1)(B).

ORDER CERTIFYING CLASS

Brumley et al. vs. Utah Tax Comm'n. et al.

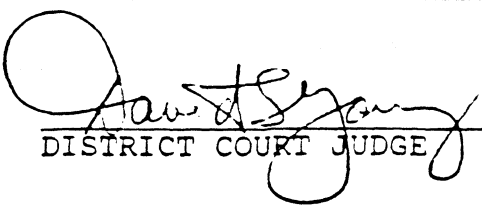
Page 2

3. All prior orders of the court shall apply to members of the class.

4. Class representatives; class counsel. Subject to further order of the court, Wendell E. Brumley and those 334 additional individuals named as Plaintiffs on Plaintiffs' Amended Complaint are designated class representatives and Jack C. Helgesen and Richard W. Jones of the firm of Lyon, Helgesen, Waterfall & Jones are designated as counsel for the class.

5. Notice. Counsel for Plaintiffs shall submit to the court a proposal to notify class members and to allow Class members to exclude themselves from the class by filing the appropriate notice in written form as directed by further order of the court.

DATED this 23rd day of March, 1990.


DISTRICT COURT JUDGE


00290

ORDER CERTIFYING CLASS
Brumley et al. vs. Utah Tax Comm'n. et al.
Page 3

NOTICE

Pursuant to Rule 4-504(2) of the Code of Judicial Administration, the undersigned will submit the foregoing Order Certifying Class to the Honorable David S. Young for signature upon the expiration of eight days from the date this notice is mailed to you, unless written objection is filed prior to that time.

DATED this 12 day of March, 1990.



RICHARD W. JONES
Attorney for Plaintiffs

CERTIFICATE OF MAILING

I hereby certify that I mailed a true and correct copy of the foregoing Order Certifying Class to R. Paul Van Dam, Attorney General, L. A. Dever, Esq., Brian L. Tarbet, Esq., Reed M. Stringham, III. Esq., Assistant Attorney Generals, Tax & Business Regulation, 130 State Capitol, Salt Lake City, Utah 84114, postage prepaid, this 12 day of March, 1990.



Secretary

00791

APPENDIX 2

CP

JACK C. HELGESEN, #1451
RICHARD W. JONES, #3938
LYON, HELGESEN, WATERFALL & JONES, P.C.
Attorneys for Plaintiffs
4768 Harrison Boulevard
Ogden, Utah 84403
Telephone: (801) 479-4777

IN THE TAX DIVISION, THIRD JUDICIAL DISTRICT COURT
SALT LAKE COUNTY, STATE OF UTAH

WENDELL E. BRUMLEY, et al.,)	
)	
Plaintiffs,)	ORDER ON DEFENDANTS'
)	MOTION TO DISMISS
vs.)	
)	Civil No. 89-0903618
UTAH STATE TAX COMMISSION, et)	
al.,)	Judge David S. Young
)	
Defendants.)	

Defendants' Motion to Dismiss was heard before the Honorable David S. Young on December 11, 1989, with attorneys Brian L. Tarbet and L.A. Dever representing defendants, and Richard W. Jones and Jack C. Helgesen representing plaintiffs.

The court, having considered the pleadings, memoranda, documents filed by the parties, and arguments of counsel, hereby enters its order as follows:

1. Defendants' Motion to Dismiss is denied as to all causes of action and all tax years claimed in plaintiffs' Amended Complaint except Count Five.

2. The denial of defendants' Motion to Dismiss is based on the following grounds:

A. The Tax Division of district court has jurisdiction for the tax years at issue.

B. This court specifically finds under Utah Code Ann. § 63-46(b)-14, that plaintiffs need not exhaust administrative remedies because requiring the plaintiffs to exhaust administrative remedies would result in irreparable harm disproportionate to the public benefit derived from requiring exhaustion.

C. In finding the administrative remedies to be disproportionate, this court has reviewed the pleadings, memoranda, documents filed by the parties, and arguments of counsel.

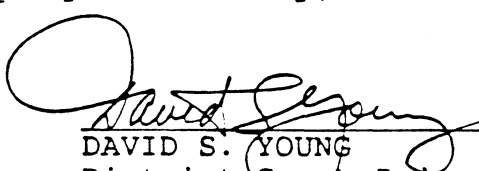
D. Defendants concede that the Utah State Tax Commission has no administrative procedures to consider and process a class action that would preserve and protect the rights of and grant the relief the representative members of the class seek.

E. In finding that the exhaustion of remedies will result in irreparable harm disproportionate to public benefit derived from requiring an exhaustion, this court has specifically considered the size of the proposed class, the older

age of many of the plaintiffs, and the relatively small amount of each claim for refund in relation to the cost to each taxpayer in pursuing a resolution of his or her claim through the State Tax Commission. The burden to each of the estimated 35,000 taxpayers in the described class is not justified by the incidental public benefit which might be gained by following the administrative remedies in the Tax Commission. This is especially true in light of indications that the Utah State Tax Commission has preliminarily decided that Davis v. Michigan Dep't of Treasury, 109 S.Ct. 1500 (1989) does not mandate refunds in Utah.

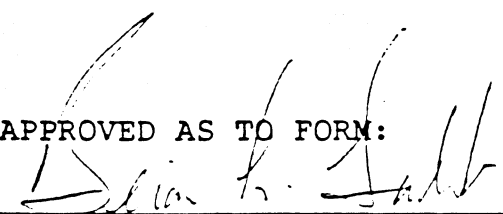
The Court accepts the parties' stipulation that defendants need not answer Counts Three and Four, which are misrepresentation for the 1985 tax year and fraud or misrepresentation pertaining to the 1988 tax year, until defendants' Motion for More Definite Statement of those claims is resolved.

DATED this 20th day of February, 1990.



DAVID S. YOUNG
District Court Judge
Tax Division

APPROVED AS TO FORM:



BRIAN L. TARBET
Assistant Attorney General
Attorneys for Defendants

APPENDIX 3

JACK C. HELGESEN, #1451
RICHARD W. JONES, #3938
LYON, HELGESEN, WATERFALL & JONES, P.C.
Attorneys for Plaintiffs
4768 Harrison Boulevard
Ogden, Utah 84403
Telephone: (801) 479-4777

FILED IN DISTRICT COURT
THIRD JUDICIAL DISTRICT

JUN 8 1990

By Deputy Clerk

IN THE TAX DIVISION OF THE THIRD JUDICIAL DISTRICT COURT
SALT LAKE COUNTY, STATE OF UTAH

WENDELL E. BRUMLEY, et al.,	:	ORDER ON PLAINTIFFS'
Plaintiffs,	:	MOTION FOR PRELIMINARY
	:	INJUNCTION
vs.	:	
UTAH TAX COMMISSION, et al.,	:	
Defendants.	:	Civil No. 89-0903618 CV
	:	Judge David S. Young

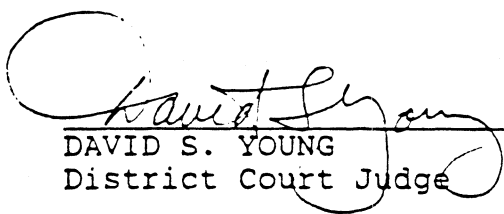
On June 4, 1990, before the Honorable David S. Young, District Court Judge, "Plaintiffs' Motion to Enjoin State Tax Commission from Proceeding with Administrative Hearings Involving Members of the Class" was heard. Plaintiffs were represented by Richard W. Jones and Jack C. Helgesen. Defendants were represented by Brian L. Tarbet and L.A. Dever. Arguments were heard, the court file was reviewed and the Court made the following order:

IT IS HEREBY ORDERED, ADJUDGED AND DECREED:

1. Plaintiffs' motion is granted. Defendant Utah State Tax Commission is hereby enjoined from proceeding with administrative hearings involving members of the plaintiff class. Forty-five (45) days following the publication of the

"Notice of Class Action," Defendants may proceed with administrative hearings for all federal retirees who paid taxes during the years in question and who elected to opt out of the plaintiff class.

DATED this 8th day of June, 1990.



DAVID S. YOUNG
District Court Judge

APPROVED AS TO FORM:

BRIAN L. TARBET

APPENDIX 4

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IN THE TAX DIVISION OF THE THIRD JUDICIAL DISTRICT COURT
IN AND FOR SALT LAKE COUNTY, STATE OF UTAH

* * *

Copy

WENDELL E. BRUMLEY, ET AL,)	
PLAINTIFFS,)	CIVIL NO. C-89-090-3618
-VS-)	<u>JUDGE'S RULING</u>
UTAH STATE TAX COMMISSION,)	
ET AL,)	
DEFENDANTS.)	

* * *

BE IT REMEMBERED THAT ON MONDAY, THE 4TH DAY
OF MARCH, 1991, COMMENCING AT THE HOUR OF 11:55 O'CLOCK
A.M., THE ABOVE-ENTITLED MATTER CAME ON FOR HEARING IN THE
COURTROOM OF THE THIRD JUDICIAL DISTRICT, IN AND FOR SALT
LAKE COUNTY, STATE OF UTAH; SAID CAUSE BEING HELD BY THE
HONORABLE DAVID S. YOUNG, JUDGE IN THE THIRD JUDICIAL
DISTRICT COURT, STATE OF UTAH.

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A P P E A R A N C E S

FOR THE PLAINTIFFS:

JACK C. HELGESEN,
RICHARD W. JONES
LYON, HELGESEN, WATERFALL &
JONES
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FOR THE DEFENDANTS:

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L. A. DEVER
ASSISTANT ATTORNEY GENERALS
36 SOUTH STATE, 11TH FLOOR
BENEFICIAL LIFE TOWER
SALT LAKE CITY, UTAH 84111

* * *

I N D E X

JUDGE'S RULING

PAGE 3

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1 PARTICIPANTS IN THIS ACTION, WHICH INCLUDES THE ENTIRE
2 CLASS, SHALL BE DEEMED TO HAVE PAID "UNDER PROTEST" AND
3 SHALL BE ENTITLED TO THE BENEFITS THAT THAT STATUS WOULD
4 BRING.

5 NOW, THE COURT FURTHER FINDS THAT THE DEFENDANT'S
6 MOTION FOR SUMMARY JUDGMENT SHALL BE, AND THE SAME IS
7 HEREBY DENIED.

8 THERE IS IN THE FILE A MOTION FROM THE PLAINTIFF
9 AND FROM THE DEFENDANT TO STRIKE THE AFFIDAVITS. I WOULD
10 BE WILLING TO RULE ON THAT MOTION BUT I WOULD INVITE COUN-
11 SEL TO GIVE ME YOUR IMPRESSIONS AS TO WHETHER YOU WOULD
12 DESIRE THE RULING ON THAT MOTION. LET ME SUGGEST TO YOU
13 THAT FROM MY REVIEW OF THE AFFIDAVITS MUCH OF THE MATERIAL
14 CONTAINED IN THE AFFIDAVITS IS IRRELEVANT TO THE BASIS OF
15 THIS RULING AND, THEREFORE, A NEED TO STRIKE WOULD BE
16 BEYOND THE SCOPE OF WHAT MIGHT BE NEEDED IN GRANTING SUMMA-
17 RY JUDGMENT.

18 DO EITHER OF YOU HAVE A VIEW THAT MIGHT BE OTHER-
19 WISE ON THE MOTIONS TO STRIKE?

20 MR. HELGESEN: OUR POINT, YOUR HONOR, WAS THAT IT
21 WAS IRRELEVANT. IF WE CAN SIMPLY HAVE THAT FINDING THERE'S
22 NO NEED TO DO ANYTHING ELSE.

23 JUDGE YOUNG: MR. TARBET?

24 MR. TARBET: YOUR HONOR, I'M NOT SURE SPECIFICALLY
25 WHAT AFFIDAVIT THE COURT IS SPEAKING TO. IN TERMS OF

1 THE KNOWLTON, CHRISTENSEN, MEMMOTT AFFIDAVIT WE THINK IT'S
2 HIGHLY RELEVANT TO CHEVRON.

3 JUDGE YOUNG: TO THE THIRD PRONG?

4 MR. TARBET: CORRECT.

5 JUDGE YOUNG: ALL RIGHT. THE COURT GRANTS THE
6 DEFENDANT'S--OR THE PETITIONER'S MOTION TO STRIKE THE
7 AFFIDAVITS OF THE DEFENDANT IN RELATION TO THOSE OF MR.
8 KNOWLTON, MR. CHRISTENSEN AND MR. MEMMOTT. I BELIEVE THAT
9 THE SCOPE OF THOSE AFFIDAVITS WAS WELL BEYOND THE FACTUAL
10 BASIS UPON WHICH THE COURT SHOULD BE REQUIRED TO CONSIDER A
11 BASIS FOR RENDERING THIS DECISION.

12 NOW, AS TO THE PLAINTIFF'S MOTION TO STRIKE.
13 WHAT IS YOUR PREFERENCE IN RELATION TO THAT? EXCUSE ME,
14 THE DEFENDANT'S MOTION TO STRIKE. THAT GRANTS THE PLAINTI-
15 FF'S MOTION TO STRIKE THE AFFIDAVIT. I SAID THAT WITH THE
16 WRONG PARTY. THE DEFENDANT'S MOTION TO STRIKE.

17 MR. HELGESEN: YOU HAD A MOTION TO STRIKE ONE
18 AFFIDAVIT FROM A GUY WHO CLAIMED TO PROTEST EARLY. THAT
19 SHOULD BE GRANTED. WE NEVER ALLEGED WE PROTESTED BEFORE
20 '88.

21 JUDGE YOUNG: ALL RIGHT. THAT IS NOT AN ISSUE
22 THAT GIVES RISE TO A CONCERN THAT WE HAVE AS A FACTUAL
23 BASIS FOR THIS RULING, IN ANY EVENT.

24 MR. HELGESEN: NO, IT IS NOT.

25 JUDGE YOUNG: ALL RIGHT. THE DEFENDANT'S MOTION

1 TO STRIKE IS LIKEWISE GRANTED. BOTH MOTIONS TO STRIKE ARE
2 GRANTED.

3 NOW, MR. HELGESEN, DOES THIS PROVIDE YOU WITH
4 ADEQUATE INFORMATION UPON WHICH YOU MAY PREPARE FINDINGS
5 AND A JUDGMENT?

6 MR. HELGESEN: IT DOES, YOUR HONOR. I'D ASK FOR
7 THE PREPARATION OF A COPY OF THE RULING, OF THE BENCH
8 RULING.

9 JUDGE YOUNG: ALL RIGHT. ANYTHING FURTHER?

10 MR. DEVER: JUST ONE QUESTION. YOU TALKED ABOUT
11 THE PARTIES SHOULD WORK TOGETHER TO FORMULATE A METHOD OF
12 DOING AMENDED RETURNS. COURT DIDN'T MEAN THAT THE COST IS
13 TO BE BORNE BY THE DEFENDANTS IN THIS MATTER, DID IT?

14 JUDGE YOUNG: I HAVE A CONCERN ABOUT THAT BECAUSE
15 I DON'T KNOW WHAT THOSE COSTS ARE AND I DO DESIRE TO MINI-
16 MIZE THOSE COSTS. I DO THINK THAT THE CLASS IS GOING TO BE
17 ENTITLED TO COMPENSATION FOR COUNSEL'S EFFORTS HERE BUT I
18 DON'T KNOW SPECIFICALLY WHAT THOSE FEES WILL BE THAT WILL
19 BE REQUESTED. PERHAPS THERE OUGHT TO BE MEMORANDA FILED
20 SPECIFICALLY IN RELATION TO THE ISSUES OF FEES AND I OUGHT
21 TO RULE ON THAT AS AN INDEPENDENT MATTER.

22 MR. DEVER: YOUR HONOR, COULD WE HAVE MR.
23 HELGESEN, SINCE HE IS THE PERSON IN CHARGE OF WHAT THE FEES
24 ARE, SUBMIT HIS MEMORANDA AND WE HAVE THREE DAYS TO RESPOND
25 FROM THAT?

1 JUDGE YOUNG: MR. HELGESEN?

2 MR. HELGESEN: IT SEEMS TO ME, YOUR HONOR,
3 THERE'S NO HURRY, IN THAT, OBVIOUSLY, THEY ARE GOING TO
4 APPEAL. WE HAVE A LOT MORE WORK TO DO BEFORE WE'RE THROUGH
5 HERE SO WE'D ASK WE BE ABLE TO RESERVE THAT UNTIL SOME
6 FINAL RESOLUTION AND THEN PRESENT THE COURT WITH WHAT WE
7 HAVE DONE. THAT SEEMS MORE EFFICIENT.

8 JUDGE YOUNG: I DON'T HAVE ANY OBJECTION TO THAT
9 PROCEDURE.

10 DO YOU HAVE ANY OBJECTION TO THAT?

11 MR. DEVER: I GUESS THE ONLY QUESTION I HAVE IS
12 IF THE COURT IS, IN ITS ORDER, IS SAYING THE DEFENDANTS ARE
13 RESPONSIBLE, I THINK THAT NEEDS TO BE IN OR OUT. IF YOU
14 ARE SAYING THAT SHOULD BE A MATTER LATER TO BE CONSIDERED
15 THEN I THINK THAT WAHT NEEDS TO BE--

16 JUDGE YOUNG: ALL RIGHT. I'M WILLING TO PUT IN
17 THE ORDER THAT THE DEFENDANTS ARE RESPONSIBLE FOR THE FEES
18 AND THE AMOUNTS WILL HAVE TO BE DETERMINED LATER. THAT WAY
19 WHEN THIS IS REVIEWED BY THE APPELLATE COURT THEY CAN
20 DETERMINE THAT ISSUE AS WELL. THAT SEEMS TO BE EFFICIENT.

21 ANY DIFFICULTY WITH THAT, MR. HELGESEN?

22 MR. HELGESEN: NO.

23 JUDGE YOUNG: ANYTHING FURTHER? COURT'S IN
24 RECESS.

25 (WHEREUPON, THE JUDGE'S RULING WAS CONCLUDED).

C E R T I F I C A T E

STATE OF UTAH

)

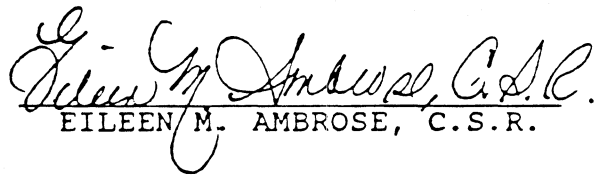
:

SS.

COUNTY OF SALT LAKE

)

I, EILEEN M. AMBROSE, HEREBY CERTIFY THAT I AM A
CERTIFIED SHORTHAND REPORTER OF THE STATE OF UTAH; THAT AS
SUCH CERTIFIED SHORTHAND REPORTER, I ATTENDED THE HEARING
OF THE ABOVE-MENTIONED MATTER AT THAT TIME AND PLACE SET
OUT HEREIN; THAT THEREAT I TOOK DOWN IN SHORTHAND THE
TESTIMONY GIVEN AND THE PROCEEDINGS HAD THEREIN; AND THAT
THEREAFTER I TRANSCRIBED MY SAID SHORTHAND NOTES INTO
TYPEWRITING, AND THAT THE FOREGOING TRANSCRIPTION IS A
FULL, TRUE, AND CORRECT TRANSCRIPTION OF THE SAME.


EILEEN M. AMBROSE, C.S.R.

MY COMMISSION EXPIRES:

JANUARY 14TH, 1992

APPENDIX 5

APR 16 1991

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By David S. Young
Judge

IN THE TAX DIVISION OF THE THIRD JUDICIAL DISTRICT COURT
SALT LAKE COUNTY, STATE OF UTAH

WENDELL E. BRUMLEY, et al., : FINDINGS, CONCLUSIONS
Plaintiffs, : AND PARTIAL SUMMARY
JUDGMENT

vs. :

UTAH TAX COMMISSION, et al., :
Defendants. :

Civil No. 89-0903618 CV
Judge David S. Young

On March 4, 1991 before the Honorable David S. Young, Tax Division, Third District Court, a hearing was held on Plaintiffs' Motion for Summary Judgment and on Defendants' Cross Motion for Summary Judgment. Jack C. Helgesen and Richard W. Jones were present representing Plaintiffs. Brian L. Tarbet, L.A. Dever and John C. McCarrey were present representing Defendants. Arguments were heard and exhibits were reviewed. Prior to the hearing, the Court reviewed and considered the memoranda and affidavits submitted by the parties supporting and opposing the motions.

At the conclusion of the hearing, the Court ruled granting Plaintiffs' Motion for Summary Judgment and denying Defendants' Cross Motion for Summary Judgment. The Court has not ruled on

a number of issues such as: notice to the class, deadlines for Plaintiffs to submit amended returns, amount of attorneys' fees awarded class counsel, etc. Consequently, this ruling is a partial summary judgment which the Court is willing to certify for appeal purposes.

In support of its ruling, the Court now enters its formal findings. Although some facts remain in dispute, the Court finds the disputed facts to be immaterial and finds the undisputed material facts to be dispositive of the issues as a matter of law. Specifically, the Court bases its decision on the following undisputed material facts.

UNDISPUTED MATERIAL FACTS

1. Plaintiffs and members of the Plaintiff class received pay or compensation as a result of personal services rendered as officers or employees of the United States.

2. 4 U.S.C. §111 reads in relevant part as follows:

The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

3. The State of Utah taxed the income of Plaintiffs and members of the Plaintiff class and did not tax the income of retired state employees.

4. The Plaintiff class consists of all persons and the estates of deceased persons who received retirement pay, or annuities from federal sources and who have paid Utah State income tax on such retirement income for the 1985, 1986, 1987, and/or the 1988 tax years.

5. The Plaintiff class consists of approximately 34,000 individuals and/or estates, the majority of whom are of advanced age.

6. The size of each class member's claim is small in amount in relation to the high cost of pursuing a resolution of the claim.

7. The Defendants became aware of the decision in Davis v. Michigan, when it was announced on March 28, 1989, and understood it to impact the Utah income tax scheme.

8. 1988 Utah income tax returns were due April 17, 1989.

9. Prior to April 17, 1989 Defendants received hundreds of phone calls from members of the Plaintiff class protesting the collection of 1988 Utah state income taxes on Plaintiffs' federal retirement compensation.

10. In a press release on April 5, 1989, the Utah Tax Commission through commissioner Roger Tew instructed members of the Plaintiff class who wished to protect "any legal rights for any year prior to 1989" to file amended returns. The Utah Tax

Commission received hundreds of such amended returns on or before April 17, 1989.

11. Representative Plaintiffs and more than 3,000 Utah members of the National Association of Retired Federal Employees (NARFE), protested for themselves and "all others similarly situated", the collection of state income tax on their federal retirement benefits by filing with Defendants on or before April 17, 1989 a "Notice of Claim", and "Class Claim for Refund", seeking a refund of all state income taxes paid on federal retirement benefits for the 1985 through 1988 tax years, specifically alleging the illegality of the state income tax under federal and state law.

12. Many representative Plaintiffs and hundreds of members of the Plaintiff Class also protested payment of their 1988 state income taxes by calling the Utah State Tax Commissioner, by filing written protests and by filing 1988 amended returns prior to the 1988 due date, or by filing claims for protection of rights in the form and manner prescribed by the tax commission.

13. Representative Plaintiffs for themselves and all others similarly situated, plus over 3,000 Utah members of the National Association of Retired Federal Employees (NARFE) filed

timely class claims for refund with the Utah State Tax Commission for the years 1985 through 1988.

Also, individual Class Members filed claims with the State Tax Commission for the years indicated below seeking a refund of state income taxes paid on federal retirement benefits. The number of such individual claims filed with the tax commission for each tax year are:

1985:	11,921
1986:	16,892
1987:	15,185
1988:	11,827

14. On March 30, 1990, Plaintiff class, by and through legal representatives, filed a "Protective Claim" with the State Tax Commission on a form prepared by the tax commission.

15. The State Tax Commission instructed Plaintiffs in February 1990 to file protective claims by April 16, 1990 to protect their claims for refund for the 1985 and 1986 tax years within the three-year statute of limitations.

16. The consistent practice of the Utah State Tax Commission has been to treat all claims for refund of income taxes as being timely filed under Utah Code Ann. § 59-10-529(7) if filed within three years of the due date of the return. In considering the timeliness of income tax refund claims, it has

not been the practice of the commission to distinguish between claims for refund by taxpayers who paid their tax before the due date from those who paid on the due date.

17. The original deadline for filing claims for refund for 1985 taxes was April 17, 1989. The 1990 Utah State Legislature extended this deadline to April 16, 1990.

18. Defendant Utah State Tax Commission has consistently and publicly taken the position since April 5, 1989 that refunds of state income taxes paid by federal retirees will not be paid.

19. In denying Plaintiffs' claims for refund Defendants have not relied upon prior case law interpretations of 4 U.S.C. §111.

20. Plaintiffs will necessarily incur costs to prepare amended tax returns to be filed with the State Tax Commission as part of the refund process. The State Tax Commission has no mechanism to compute refunds for Plaintiffs.

21. Attorney's fees have been incurred herein by Plaintiffs and by the Plaintiff class.

22. The Court makes no factual findings regarding hardship to the State of Utah in paying refunds.

I. Jurisdiction

This Court has jurisdiction to consider Plaintiffs' claim for recovery of taxes paid under protest for the 1988 tax year under Utah Code Ann. §59-1-301.

This Court has jurisdiction to determine the validity of Utah's tax scheme and to consider the remedy of tax refunds for all the tax years in question pursuant to the Utah Declaratory Judgment Act, Utah Code Annotated §78-33-1 et seq.

Plaintiffs claim tax refunds for the tax years 1985, 1986, 1987 and 1988 on the basis of overpayments under Utah Code Ann. §59-10-529(7). Plaintiffs pray for 1) a declaratory order that Utah's taxation of federal retirees was unlawful for all tax years in dispute, and 2) an order compelling Defendants to recognize Plaintiffs' class claims for refund, and to compute and pay refunds. The District Court has jurisdiction to determine the validity of the tax, the availability of refunds, the propriety of the class claims for refund and to issue a declaratory order resolving those issues pursuant to the Utah Declaratory Judgment Act.

Utah Code Ann. §78-33-1 states:

The district courts within their respective jurisdictions shall have power to declare rights, status, and other legal relations, whether or not further relief is or could be claimed. No action or proceedings shall be open to objection on the ground that a declaratory judgment or decree is prayed for.

The issues raised in Plaintiffs' claims for a refund of 1988 taxes paid under protest are similar to and in some instances identical to Plaintiffs' claims for a refund of overpayment of 1985, 1986, 1987 and 1988 taxes. Consequently, a declaratory order addressing the claims for a refund of taxes for all the tax years is in the interest of judicial economy.

Jurisdiction in the District Court to compel action by an administrative agency through writ of mandamus is protected by Article VIII, Section 5 of the Utah Constitution which provides the "district court shall have original jurisdiction in all matters except as limited by this constitution or by statute, and power to issue all extraordinary writs." This is recognized in Utah Code Ann. §78-3-4 which gives district court judges "power to issue all extraordinary writs necessary to carry into effect their orders, judgments, and decrees."

The Court also finds jurisdiction over Plaintiffs' claims in its interpretation of the Utah Administrative Procedures Act, Utah Code Ann. §63-46b-1, et seq. The clear legislative intent of this act is to allow taxpayers a full hearing and review. Due process requires as much. If the tax commission conducts the hearing, review will be in an appellate court, Utah Code Ann. §63-46b-16. Cases which are not heard in the tax commission receive a full hearing in District Court. Utah

Code Ann. §63-46B-15. This is such a case. This Court by prior order relieved Plaintiffs of the necessity of exhausting administrative remedies before the tax commission. Plaintiffs are entitled to a plenary hearing before this Court with appeal to the Utah Supreme Court.

II. 4 U.S.C. §111

Title 4, Section 111 of the United States Code reads in relevant part:

The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

Plaintiffs allege Utah's taxation of pay or compensation from federal retirement sources to be in violation of the plain meaning of 4 U.S.C. §111. The Court agrees and rules in favor of the Plaintiffs.

The federal statute is directed at state taxation "of pay or compensation for personal service as an officer or employee of the United States". Plaintiffs or their decedents were once employees or officers of the United States or received retirement pay from the federal government. Plaintiffs' prior personal service to the United States is the sole reason they now receive retirement pay. Although retired, Plaintiffs

continue to receive compensation from that personal service, and retirement pay is best characterized as deferred compensation.

This interpretation is consistent with the position taken by the Utah Tax Commission in Fitzpatrick v. Tax Commission, 386 P.2d 896 (Utah 1963), wherein the Utah Supreme Court agreed the taxpayer's retirement benefits were deferred compensation from former employment. Defendants now attempt to distinguish the private sector employee in Fitzpatrick from federal retirees with the explanation that private retirement is a matter of contract but federal retirement is a statutory entitlement. In the Court's view, this is a distinction without a difference. That federal employees' pay or compensation may arise from a statutory enactment does not destroy the nexus between retirement pay and the employees' previous service with the federal government. Most federal retirees would be justifiably offended at the State's view of their retirement pay, earned over many years of faithful service to the United States government, as an unearned statutory entitlement.

Under the plain reading of 4 U.S.C. §111, the State of Utah may tax Plaintiffs' retirement benefits only if the taxation does not discriminate against Plaintiffs "because of

the source of the pay or compensation". Until 1989, Utah's taxation of retirement benefits was based solely on the source of compensation; retirement pay from the State and its political subdivisions was exempt and retirement pay from the federal government was taxed. This is an unmistakable discrimination against federal retirees in violation of 4 U.S.C §111.

This Court reads 4 U.S.C §111 to be a limited waiver of federal immunity: "The United States consents to the taxation . . . if the taxation does not discriminate". Because the State of Utah did not meet the statutory condition of nondiscriminatory taxation, the consent of the United States was not given. Therefore, the State's taxation of federal retirement pay was not only in violation of 4 U.S.C. §111, but was also a breach of the constitutional doctrine of federal sovereign immunity.

III. Refunds of Tax Overpayments

The Utah legislature has made a clear choice to grant refunds to taxpayers who are improperly taxed.

Section 59-10-529 reads in relevant part as follows:

(1) In cases where there has been an overpayment of any tax imposed by this chapter, the amount of overpayment is credited as follows:

(7) (a) If a refund or credit is due because the amount of tax deducted and withheld from wages exceeds the actual

tax due, no refund or credit may be made or allowed unless the taxpayer or his legal representative files with the commission a tax return claiming the refund or credit:

(i) within three years from the due date of the return, plus the period of any extension of time for filing the return; or

(ii) within two years from the date the tax was paid, whichever period is later.

(b) In other instances where a refund or credit of tax which has not been deducted and withheld from income is due, no credit or refund may be allowed or made after three years from the time the tax was paid, unless, before the expiration of the period, a claim is filed by the taxpayer or his legal representative.

This statutory scheme demonstrates legislative intent to refund tax overpayments to taxpayers if the following conditions are met:

1. An overpayment of income tax occurs;
2. A claim is filed by the taxpayer or his legal representative before the expiration of a three year period.

Utah incorporates the federal definition of "overpayment" by specific reference to federal tax laws. Utah Code Ann. §59-10-103(2) reads:

"Any term used in this chapter has the same meaning as when used in comparable context in the laws of the United States relating to federal income taxes unless a different meaning is clearly required."

"Overpayment" in the federal tax laws has been defined to include the payment of a tax later declared to be unlawful. Jones v. Liberty Glass Company, 332 U.S. 524 (1948).

The federal definition of "overpayment" is consistent with the meaning used by the Utah State Tax Commission, when, in its press release of April 5, 1989 the tax commission directed federal retirees who wished to preserve "any legal rights" to file claims in the form of amended tax returns. This direction was followed by many members of the class. The commission later provided to federal retirees a simplified form, called a "protective claim", under which the taxpayer circled the tax year for which he or she claimed a tax refund and which contained a notice with this instruction to federal retirees in bold print:

"To protect claims for 1985 or 1986, this form or amended return(s) must be mailed to the Tax Commission by April 16, 1990. You may file this form for 1987 and 1988 at a later date, but it must be done within the three-year deadline."

The "three-year deadline" referred to by the Utah State Tax Commission refers to the three-year claim period for refunds of overpayments under Utah Code Ann. §59-10-529(7). Defendants' contention that a six-month statute of limitations bars Plaintiffs' claims is without merit.

Section 59-10-529, Utah Code Ann., provides for the refund of any overpayment of state income tax, including the refunding of taxes paid as a result of an error in law. "If there is no tax liability for a period in which the amount is paid as

income tax, the amount is an overpayment." Utah Code Ann. §59-10-529(12). A "liability" is a legal obligation. See Blacks Law Dictionary, 4th Ed. Rev., at p. 1059. Having determined Utah's tax scheme of Plaintiffs' retirement pay to have been unlawful and unconstitutional in the years 1985 through 1988, this Court finds the amounts collected unlawfully to be "overpayments" entitling Plaintiffs to refunds.

To deny Plaintiffs the opportunity of taking advantage of the refund process which the Utah legislature has granted to them would compound one illegal act with another. The State of Utah has consented to the refund of illegally collected taxes by inviting Plaintiffs to file a claim for refund within the three-year statute of limitations. This Plaintiffs have done.

It certainly would be a delusion to require a taxpayer to pay the tax, seek a review, and if he prevails, not allow him to get it back. The most elemental principles of justice dictate the implication that if he pays the tax and follows the procedure set out in the . . . Tax Act, and is sustained in this contention that the tax is unlawful, it must be refunded. (Emphasis added).

Pacific Intermountain Express Co. v. State Tax Comm'n, 316 P.2d 549, 552 (Utah 1957).

Plaintiffs are entitled to income tax refunds for years 1985, 1986, 1987 and 1988.

Because Utah provides a clear statutory remedy of refunds, this Court has not reached the issue of whether refunds should

be ordered as a breach of implied contract. If, however, a clear statutory remedy were not available, an implied contract as found in El Rancho Enterprises v. Murray City Corp., 565 P.2d 778 (Utah 1977) would also apply here.

IV. Refund of 1988 Taxes Paid Under Protest

Plaintiffs have invoked Utah Code Ann. §59-1-301 as an alternative remedy for the 1988 tax year. That provision allows a party to pay a tax under protest and then sue for a refund in District Court. Any action against the officer who collected the tax paid under protest must be commenced within six months. Utah Code Ann. §78-12-31.

No particular form of protest is required to challenge an unlawful tax, and the protest need not be in writing. Murdock v. Murdock, 113 P. 330, 332 (Utah 1911). The essence of a protest is notice to the tax collector that the taxpayer deems the tax unlawful.

Following announcement of the U.S. Supreme Court's decision in Davis v. Michigan, 489 U.S. 803, 109 S.Ct. 1500 (1989) on March 23, 1989, the Utah Tax Commission received hundreds of phone calls and letters from retirees concerning the issue. The Tax Commission instructed federal retirees through an April 5, 1989 press release to file amended returns if they wished to protect "any legal rights for any tax year

prior to 1989." Consequently, hundreds of retirees did so. Others filed individual claims for refund, filed written protests or noted their protest on their checks. On April 17, 1989, the last day for filing 1988 returns, the representative Plaintiffs were among more than 3,000 who filed, through class counsel, written notices of claim and claims for refund on behalf of themselves and "all others similarly situated". This Court finds these actions to be a sufficient protest for the 1988 tax year.

Plaintiffs filed their complaint herein on June 9, 1989. This met the six month statute of limitations of Utah Code Ann. §78-12-31, and the Court rules for Plaintiffs on this issue.

Defendants ask the Court to bar recovery to those members of the Plaintiff class who did not personally pay their taxes under protest. Presumably, these are primarily those taxpayers who paid their taxes prior to the time of the Davis decision. The Court sees no rational basis for penalizing those taxpayers who filed early. To do so would also ignore the law and consistent practice of the tax commission under which all returns "filed before the last day prescribed by statute . . . shall be deemed to be filed on such last day". Utah Code Ann. §59-10-536(2).

This ruling will extend to all members of the Plaintiff class.

V. Retroactivity of Davis v. Michigan

Defendants do not dispute that Utah's taxing scheme violated 4 U.S.C. §111 during the years 1985 through 1988. Defendants' principal defense is that the U.S. Supreme Court's ruling in Davis v. Michigan cannot be applied retroactively to any tax year prior to 1989.

In raising this argument, Defendants mistakenly assume that prospective-only treatment of the Davis decision will prohibit this Court from making its own independent analysis of 4 U.S.C. §111, a statute enacted in 1939. Defendants would give no meaning or effect to the statute for the first fifty years of its existence because no court during that time ruled on its application to federal retirement pay. This approach is flawed. Even without the Davis opinion, this Court would find the State's actions in taxing Plaintiffs unlawful and unconstitutional.

The federal doctrine of retroactivity is best understood as a rule of stare decisis; a rule to determine when law changing precedent will not be applied to prior acts. American Trucking Association v. Smith, 110 S. Ct. 2323 (1990). Therefore, making Davis prospective-only would strip the case

of any precedential value in judging earlier tax years, but it would not end our inquiry. Neither this Court nor the State of Utah needed Davis to reveal that federal retirement pay is "pay or compensation for personal service as an officer or employee of the United States" under 4 U.S.C. §111. Neither did Utah have any just basis for believing in the years 1985 through 1989 that 4 U.S.C. §111 would allow it to discriminate against federal retirees because of the source of their retirement pay. Giving prospective-only treatment to Davis would not relieve Utah of its duty in 1985 through 1989 to conform its taxing practice to federal law and would not deprive Plaintiffs of their statutory right to refunds.

But, Davis cannot be applied prospective-only. When the rules of federal retroactivity are properly applied, Davis must be accorded full retroactive effect.

Defendants do not claim to have relied to their detriment on any prior court interpretation of 4 U.S.C. §111. Neither do they claim to have relied on their own contrary reading of §111. Indeed, the real surprise to the State seems to have been the existence of §111, not its interpretation. Reliance on the practice of twenty-two other states, if indeed Utah did so rely, is not the type of reliance protected by the federal retroactivity doctrine. No person and no government can be

excused by ignorance of the law, even widespread ignorance.
". . . [M]unicipalities, like private individuals, [are]
responsible for anticipating developments in the law."
McKesson, 110 S.Ct. at 2334.

The federal doctrine of non-retroactivity is a rarely used
approach reserved for unforeseen law-changing decisions.
American Trucking, 110 S.Ct. at 2341. The first part of the
three-part federal test for retroactivity limits prospective
decision making to those new decisions which

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.

Chevron Oil Co. v. Huson, 404 U.S. 97, 106-107, (1971).

This first test, commonly called the "first prong", is a
threshold test which, if not met, will be dispositive of the
issue. Ashland Oil, Inc. v. Caryl, 110 S.Ct. 3202 (1990),
United States v. Johnson, 457 U.S. 537, 550 n.12 (1981). To
qualify for prospective-only treatment, a new decision must be
so clearly unforeshadowed, so unforeseeable, that its departure
from existing law can be termed "revolutionary." Ashland Oil
Co. v. Caryl, 110 S.Ct. 3202, 3205, (1990).

Because the clear reading of 4 U.S.C. §111 foreshadowed
the result in Davis v. Michigan, the Davis decision fails to

meet the first "prong" of the Chevron test and must be applied retroactively.

In so ruling, this Court is aware that some state courts have called Davis a "new principle of law." Every case in which the United States Supreme Court accepts certiorari will have elements of novelty, of "first impression", or newness. This is not the test. The issue is whether the Davis opinion so departs from the plain meaning of 4 U.S.C. §111 that its result was clearly unforeshadowed. In resolving this issue, the best authority is the U.S. Supreme Court itself, which found its opinion in Davis to be dictated by the "plain language of the statute", noting that the "overall meaning of §111 is unmistakable", answering arguments identical to those raised by Utah in this case by observing that "all precedent is to the contrary" and refusing to depart "from this settled rule." Davis v. Michigan, 109 S.Ct. at 1504-1507. The final arbiter of the retroactivity of a U.S. Supreme Court decision is the U.S. Supreme Court. American Trucking, 110 S.Ct at 2330. This Court is of the firm opinion that the U.S. Supreme Court would not view its decision in Davis as "unforeshadowed." Any doubt on that issue should have been dispelled when the Supreme Court refused to accept certiorari in the Missouri

case, upholding refunds. Hackman v. Director of Revenue, 771 S.W.2d 77 (Mo. banc 1989), cert. denied, 110 S.Ct. 718 (1990).

This Court has considered Utah's arguments that refunds in this case will place a great financial burden on the state treasury. A decision's impact on any litigant who comes before this Court is always a concern. But, the equities between the parties in this case, however they may lie, are not proper considerations in deciding whether to apply Davis retroactively. As the U.S. Supreme Court has said:

Where a State can easily foresee the invalidation of its tax statutes, its reliance interests may merit little concern, see McKesson, ___ U.S., at ___ — ___, ___, 110 S.Ct. 2238 at 2254-2255, 2257.

American Trucking Association 110 S.Ct. at 2333.

. . . the State's interest in financial stability does not justify a refusal to provide relief.

McKesson, 110 S.Ct. at 2257.

We reject respondent's intimation that the cost of any refund considered by the State might justify a decision to withhold it. . . . [A] State . . . cannot object to a refund here just because it has other ideas about how to spend the funds.

Id. at 2257, n.35.

Having found that the State acted unlawfully and unconstitutionally in taxing federal retirees, this Court is bound as a matter of federal due process to compel the State to issue refunds according to its plain statutory remedy.

In making this ruling, the Court does not find that the State of Utah acted in bad faith or intentional disregard of federal law when it exempted its own retirees from income tax. Indeed, the State seems to have simply overlooked the federal statute. But, this Court is of the opinion that the State has acted ignobly in refusing to pay refunds to retirees once the State's mistake was known. As an Arizona court has said, "No honorable governmental would keep taxes to which it is not entitled, and the legislative scheme supports that result." Pittsburgh & Midway Coal v. Dept. of Rev., 776 P.2d 1061 (Ariz. 1989).

Partial Summary Judgment

From the foregoing facts and conclusions, the Court:

1. Declares Utah's taxing scheme contained in §§49-1-28, 49-10-47, 49-1-608 during the years 1985 through 1988 to have been in violation of 4 U.S.C §111 and unconstitutional in that it discriminated against Plaintiffs and violated the constitutional doctrine of the sovereign immunity of the United States.

2. Declares Utah Code Ann. §59-10-529 to be an appropriate remedy mandating refunds to Plaintiffs for the 1985 through 1988 tax years and Utah Code Ann. §59-1-301 to be an additional remedy for the 1988 tax year.

3. Orders and compels the Utah State Tax Commission to issue refunds to all persons and estates of deceased persons who paid Utah State income tax on retirement income from federal sources in the years 1985, 1986, 1987 and/or 1988.

4. Further orders the payment of interest on all refunds at 12% per annum in accordance with Utah Code Ann. §59-10-538, 1987 as amended, with interest accruing ninety (90) days after the due date of each return, or the date each return was filed, whichever date is later, and continuing to a date not more than thirty (30) days preceding the issuance of refund checks to each member of the Plaintiff class.

5. Further orders Defendants to pay Plaintiffs' court costs and attorneys' fees in amounts to be determined later.

6. Further orders the parties to design and implement a simplified procedure for the filing of individual returns, the computing of refunds owed and the paying of refunds, with costs to be paid by Defendants.

7. Denies Defendant's Motion for Summary Judgment.

The Court specifically reserves for a final decision these issues:

1. The timing and content of notice(s) to the Plaintiff class concerning class members' rights and the procedure to obtain refunds, and all matters relevant to this issue.

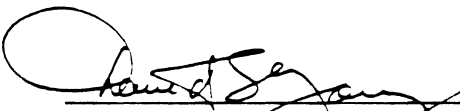
2. The amount of Plaintiffs' court costs and attorneys' fees to be paid by Defendants to the class and/or to be charged to the class, and all matters relevant to a proper determination of these issues.

3. Approval of the parties' simplified plan and procedure for filing individual returns, and the computing and paying of refunds, and all matters relevant to this issue.

Because the Court's reservation of certain issues necessitates a partial summary judgment at this time, the Court specifically directs, pursuant to Rule 54(b) of the Utah Rules of Civil Procedure, the entry of final judgment on all issues decided and not specifically reserved, there being no just reason for delay.

DATED this 16th day of April, 1991.

BY:



DAVID S. YOUNG
THIRD DISTRICT COURT JUDGE

APPENDIX 6

The text of Rule 6(e) contains no hint that a governmental violation of its prescriptions gives rise to a right not to stand trial. To be sure, we held last Term in *Bank of Nova Scotia v. United States*, 487 U. S. 250, 263 (1988), that a district court has authority in certain circumstances to dismiss an indictment for violations of Rule 6(e). But as just noted, that has nothing to do with a "right not to be tried" in the sense relevant here.

As for the Grand Jury Clause of the Fifth Amendment, that reads in relevant part as follows: "No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury." U. S. Const., Amdt. 5. That does indeed confer a right not to be tried (in the pertinent sense) when there is no grand jury indictment. Undoubtedly the common-law protections traditionally associated with the grand jury attach to the grand jury required by this provision—including the requisite secrecy of grand jury proceedings. But that is far from saying that every violation of those protections, like the lack of a grand jury indictment itself, gives rise to a right not to be tried. We have held that even the grand jury's violation of the defendant's right against self-incrimination does not trigger the Grand Jury Clause's "right not to be tried." *Lawn v. United States*, 355 U. S. 339, 349 (1958). Only a defect so fundamental that it causes the grand jury no longer to be a grand jury, or the indictment no longer to be an indictment, gives rise to the constitutional right not to be tried. An isolated breach of the traditional secrecy requirements does not do so.

* * *

For these reasons, the Court of Appeals was correct to grant the Government's motion to dismiss the appeal, and its judgment is

Affirmed.

DAVIS v. MICHIGAN DEPARTMENT OF THE TREASURY

APPEAL FROM THE COURT OF APPEALS OF MICHIGAN

No. 87-1020. Argued January 9, 1989—Decided March 28, 1989

In each of the years 1979 through 1984, appellant, a Michigan resident and former federal employee, paid state income tax on his federal retirement benefits in accordance with the Michigan Income Tax Act, which exempts from taxation all retirement benefits paid by the State or its political subdivisions, but taxes retirement benefits paid by other employers, including the Federal Government. After the State denied appellant's request for refunds, he filed suit in the Michigan Court of Claims, alleging that the State's inconsistent treatment of retirement benefits violated 4 U. S. C. § 111, which authorizes States to tax "pay or compensation for personal services as [a federal] officer or employee . . . , if the taxation does not discriminate against the . . . employee because of the source of the pay or compensation." The Court of Claims denied relief, and the Michigan Court of Appeals affirmed, ruling that appellant is an "annuitant" under federal law rather than an "employee" within the meaning of § 111, and that that section therefore has no application to him. The Court of Appeals also held that the doctrine of intergovernmental tax immunity did not render the State's discriminatory tax scheme unconstitutional, since the discrimination was justified under a rational basis test: The State's interest in attracting and retaining qualified employees was a legitimate objective which was rationally achieved by a retirement plan offering economic inducements.

Held:

1. Section 111 applies to federal retirees such as appellant. The State's contention that the section is limited to current federal employees is refuted by the plain language of the statute's first clause. Since the amount of civil service retirement benefits is based and computed upon an individual's salary and years of service, it represents deferred compensation for service to the Government, and therefore constitutes "pay or compensation . . . as [a federal] employee" within the meaning of that clause. The State's contention that, since this quoted language does not occur in the statute's second, nondiscrimination clause, that clause applies only to current employees, is hypertechnical and fails to read the nondiscrimination clause in its context within the overall statutory scheme. The reference to "the pay or compensation" in the latter clause must, in context, mean the same "pay or compensation" defined in

the section's first clause and thus includes retirement benefits. The State's reading of the clause is implausible because it is unlikely that Congress consented to discriminatory taxation of retired federal civil servants' pensions while refusing to permit such taxation of current employees, and there is nothing in the statutory language or legislative history to suggest such a result. Pp. 808-810.

2. Section 111's language, purpose, and legislative history establish that the scope of its nondiscrimination clause's grant or retention of limited tax immunity for federal employees is coextensive with, and must be determined by reference to, the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity. Pp. 810-814.

3. Michigan's tax scheme violates principles of intergovernmental tax immunity by favoring retired state and local government employees over retired federal employees. Pp. 814-817.

(a) The State's contention that appellant is not entitled to claim the protection of the immunity doctrine is without merit. Although the doctrine is based on the need to protect each sovereign's governmental operations from undue interference by another sovereign, this Court's precedents establish that private entities or individuals who are subjected to discriminatory taxation on account of their dealings with a sovereign can themselves receive the protection of the constitutional doctrine. See, for example, *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U. S. 376, 387. Pp. 814-816.

(b) In determining whether the State's inconsistent tax treatment of federal and state retirees is permissible, the relevant inquiry is whether the inconsistency is directly related to and justified by "significant differences between the two classes." *Phillips, supra*, at 384-386. The State's claimed interest in hiring qualified civil servants through the inducement of a tax exemption for retirement benefits is irrelevant to this inquiry, since it merely demonstrates that the State has a rational reason for discriminating between two similar groups of retirees without demonstrating any differences between those groups themselves. Moreover, the State's claim that its retirement benefits are significantly less munificent than federal benefits in terms of vesting requirements, rate of accrual, and benefit computations is insufficient to justify the type of blanket exemption at issue here. A tax exemption truly intended to account for differences in benefits would not discriminate on the basis of the source of those benefits, but would, rather, discriminate on the basis of the amount of benefits received by individual retirees. Pp. 816-817.

4. Because the State concedes that a refund is appropriate in these circumstances, appellant is entitled to a refund to the extent he has paid

taxes pursuant to the invalid Michigan scheme. However, his additional claim for prospective relief from discriminatory taxation should be decided by the state courts, whose special expertise in state law puts them in a better position than this Court to fashion the remedy most appropriate to comply with the constitutional mandate of equal treatment. Pp. 817-818.

106 Mich. App. 98, 408 N. W. 2d 433, reversed and remanded.

KENNEDY, J., delivered the opinion of the Court, in which REHNQUIST, C. J., and BRENNAN, WHITE, MARSHALL, BLACKMUN, O'CONNOR, and SCALIA, JJ., joined. STEVENS, J., filed a dissenting opinion, *post*, p. 818.

Paul S. Davis, *pro se*, argued the cause and filed briefs for appellant.

Michael K. Kellogg argued the cause for the United States as *amicus curiae* urging reversal. With him on the brief were Solicitor General Fried, Assistant Attorney General Rose, Deputy Solicitor General Merrill, David English Carmack, and Steven W. Parks.

Thomas L. Casey, Assistant Solicitor General of Michigan, argued the cause for appellee. With him on the brief were Frank J. Kelley, Attorney General, Louis J. Caruso, Solicitor General, and Richard R. Roesch and Ross H. Bishop, Assistant Attorneys General.*

JUSTICE KENNEDY delivered the opinion of the Court.

The State of Michigan exempts from taxation all retirement benefits paid by the State or its political subdivisions, but levies an income tax on retirement benefits paid by all other employers, including the Federal Government. The question presented by this case is whether Michigan's tax scheme violates federal law.

I

Appellant Paul S. Davis, a Michigan resident, is a former employee of the United States Government. He receives re-

*Joseph B. Scott and Michael J. Kator filed a brief for the National Association of Retired Federal Employees as *amicus curiae* urging reversal.

irement benefits pursuant to the Civil Service Retirement Act, 6 U. S. C. § 8331 *et seq.* In each of the years 1979 through 1984, appellant paid Michigan state income tax on his federal retirement benefits in accordance with Mich. Comp. Laws Ann. § 206.30(1)(f) (Supp. 1988).¹ That statute defines taxable income in a manner that excludes all retirement benefits received from the State or its political subdivisions, but includes most other forms of retirement benefits.² The effect of this definition is that the retirement benefits of retired state employees are exempt from state taxation while the benefits received by retired federal employees are not.

In 1984, appellant petitioned for refunds of state taxes paid on his federal retirement benefits between 1979 and 1983. After his request was denied, appellant filed suit in the Michigan Court of Claims. Appellant's complaint, which was amended to include the 1984 tax year, averred that his federal retirement benefits were "not legally taxable under

¹ As a result of a series of amendments, this subsection has been variously designated as (1)(f), (1)(g), and (1)(h) at times relevant to this litigation. This opinion will refer only to the current statutory designation, § 206.30(1)(f).

² In pertinent part, the statute provides:

"(1) 'Taxable income' . . . means adjusted gross income as defined in the internal revenue code subject to the following adjustments:

"(f) Deduct to the extent included in adjusted gross income:

"(i) Retirement or pension benefits received from a public retirement system of or created by an act of this state or a political subdivision of this state.

"(iv) Retirement or pension benefits from any other retirement or pension system as follows:

"(A) For a single return, the sum of not more than \$7,600.00.

"(B) For a joint return, the sum of not more than \$10,000.00." Mich. Comp. Laws Ann. § 206.30(1)(f) (Supp. 1988).

Subsection (f)(iv) of this provision exempts a portion of otherwise taxable retirement benefits from taxable income, but appellant's retirement pay from all nonstate sources exceeded the applicable exemption amount in each of the tax years relevant to this case.

the Michigan Income Tax Law" and that the State's inconsistent treatment of state and federal retirement benefits discriminated against federal retirees in violation of 4 U. S. C. § 111, which preserves federal employees' immunity from discriminatory state taxation. See Public Salary Tax Act of 1939, ch. 59, § 4, 53 Stat. 575, codified, as amended, at 4 U. S. C. § 111. The Court of Claims, however, denied relief. No. 84-9451 (Oct. 30, 1985), App. to Juris. Statement A10.

The Michigan Court of Appeals affirmed. 160 Mich. App. 98, 408 N. W. 2d 433 (1987). The court first rejected appellant's claim that 4 U. S. C. § 111 invalidated the State's tax on appellant's federal benefits. Noting that § 111 applies only to federal "employees," the court determined that appellant's status under federal law was that of an "annuitant" rather than an employee. As a consequence, the court concluded that § 111 "has no application to [Davis], since [he] cannot be considered an employee within the meaning of that act." *Id.*, at 104, 408 N. W. 2d, at 435.

The Michigan Court of Appeals next rejected appellant's contention that the doctrine of intergovernmental tax immunity rendered the State's tax treatment of federal retirement benefits unconstitutional. Conceding that "a tax may be held invalid . . . if it operates to discriminate against the federal government and those with whom it deals," *id.*, at 104, 408 N. W. 2d, at 436, the court examined the State's justifications for the discrimination under a rational-basis test. *Ibid.* The court determined that the State's interest in "attracting and retaining . . . qualified employees" was a "legitimate state objective which is rationally achieved by a retirement plan offering economic inducements," and it upheld the statute. *Id.*, at 105, 408 N. W. 2d, at 436.

The Supreme Court of the State of Michigan denied appellant's application for leave to appeal. 429 Mich. 854 (1987). We noted probable jurisdiction. 487 U. S. 1217 (1988).

II

Appellant places principal reliance on 4 U. S. C. § 111. In relevant part, that section provides:

"The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation."

As a threshold matter, the State argues that § 111 applies only to current employees of the Federal Government, not to retirees such as appellant. In our view, however, the plain language of the statute dictates the opposite conclusion. Section 111 by its terms applies to "the taxation of pay or compensation for personal services as an officer or employee of the United States." (Emphasis added). While retirement pay is not actually disbursed during the time an individual is working for the Government, the amount of benefits to be received in retirement is based and computed upon the individual's salary and years of service. 5 U. S. C. § 8339(a). We have no difficulty concluding that civil service retirement benefits are deferred compensation for past years of service rendered to the Government. See, e. g., *Zucker v. United States*, 758 F. 2d 637, 639 (CA Fed.), cert. denied, 474 U. S. 842 (1985); *Kizas v. Webster*, 227 U. S. App. D. C. 327, 339, 707 F. 2d 524, 536, (1983), cert. denied, 464 U. S. 1042 (1984); *Clark v. United States*, 691 F. 2d 837, 842 (CA7 1982). And because these benefits accrue to employees on account of their service to the Government, they fall squarely within the category of compensation for services rendered "as an officer or employee of the United States." Appellant's federal retirement benefits are deferred compensation earned "as" a federal employee, and so are subject to § 111.¹

¹The State suggests that the legislative history does not support this interpretation of § 111, pointing to statements in the Committee Reports

The State points out, however, that the reference to "compensation for personal services as an officer or employee" occurs in the first part of § 111, which defines the extent of Congress' consent to state taxation, and not in the latter part of the section, which provides that the consent does not extend to taxes that discriminate against federal employees. Instead, the nondiscrimination clause speaks only in terms of "discriminat[ion] against the officer or employee because of the source of the pay or compensation." From this the State concludes that, whatever the scope of Congress' consent to taxation in the first portion of § 111, the nondiscrimination clause applies only to current federal employees.

Although the State's hypertechnical reading of the nondiscrimination clause is not inconsistent with the language of that provision examined in isolation, statutory language cannot be construed in a vacuum. It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme. See *United States v. Morton*, 467 U. S. 822, 828 (1984). When the first part of § 111 is read together with the nondiscrimination clause, the operative words of the statute are as follows: "The United States consents to the taxation of pay or compensation . . . if the taxation does not discriminate . . . because of the source of the pay or compensation." The reference to "the pay or compensation" in the last clause of § 111 must, in context, mean the same "pay or compensation" defined in the first part of the section. Since that "pay or compensation" includes retirement benefits, the nondiscrimination clause must include them as well.

that describe the scope of § 111 without using the phrase "service as an officer or employee." The language of the statute leaves no room for doubt on this point, however, so the State's attempt to establish a minor inconsistency with the legislative history need not detain us. Legislative history is irrelevant to the interpretation of an unambiguous statute. *United Air Lines, Inc. v. McMann*, 434 U. S. 192, 199 (1977).

Any other interpretation of the nondiscrimination clause would be implausible at best. It is difficult to imagine that Congress consented to discriminatory taxation of the pensions of retired federal civil servants while refusing to permit such taxation of current employees, and nothing in the statutory language or even in the legislative history suggests this result. While Congress could perhaps have used more precise language, the overall meaning of § 111 is unmistakable: it waives whatever immunity past and present federal employees would otherwise enjoy from state taxation of salaries, retirement benefits, and other forms of compensation paid on account of their employment with the Federal Government, except to the extent that such taxation discriminates on account of the source of the compensation.

III

Section 111 was enacted as part of the Public Salary Tax Act of 1939, the primary purpose of which was to impose federal income tax on the salaries of all state and local government employees. Prior to adoption of the Act, salaries of most government employees, both state and federal, generally were thought to be exempt from taxation by another sovereign under the doctrine of intergovernmental tax immunity. This doctrine had its genesis in *McCulloch v. Maryland*, 4 Wheat. 316 (1819), which held that the State of Maryland could not impose a discriminatory tax on the Bank of the United States. Chief Justice Marshall's opinion for the Court reasoned that the Bank was an instrumentality of the Federal Government used to carry into effect the Government's delegated powers, and taxation by the State would unconstitutionally interfere with the exercise of those powers. *Id.*, at 426-437.

For a time, *McCulloch* was read broadly to bar most taxation by one sovereign of the employees of another. See *Collector v. Day*, 11 Wall. 113, 124-128 (1871) (invalidating federal income tax on salary of state judge); *Dobbins v. Com-*

missioners of Erie County, 16 Pet. 435 (1842) (invalidating state tax on federal officer). This rule "was based on the rationale that any tax on income a party received under a contract with the government was a tax on the contract and thus a tax 'on' the government because it burdened the government's power to enter into the contract." *South Carolina v. Baker*, 485 U. S. 505, 518 (1988).

In subsequent cases, however, the Court began to turn away from its more expansive applications of the immunity doctrine. Thus, in *Helvering v. Gerhardt*, 304 U. S. 406 (1938), the Court held that the Federal Government could levy nondiscriminatory taxes on the incomes of most state employees. The following year, *Graves v. New York ex rel. O'Keefe*, 306 U. S. 466, 486-487 (1939), overruled the *Day-Dobbins* line of cases that had exempted government employees from nondiscriminatory taxation. After *Graves*, therefore, intergovernmental tax immunity barred only those taxes that were imposed directly on one sovereign by the other or that discriminated against a sovereign or those with whom it dealt.

It was in the midst of this judicial revision of the immunity doctrine that Congress decided to extend the federal income tax to state and local government employees. The Public Salary Tax Act was enacted after *Helvering v. Gerhardt*, *supra*, had upheld the imposition of federal income taxes on state civil servants, and Congress relied on that decision as support for its broad assertion of federal taxing authority. S. Rep. No. 112, 76th Cong., 1st Sess., 6-9 (1939); H. R. Rep. No. 26, 76th Cong., 1st Sess., 2-3 (1939). However, the Act was drafted, considered in Committee, and passed by the House of Representatives before the announcement of the decision in *Graves v. New York ex rel. O'Keefe*, *supra*, which for the first time permitted state taxation of federal employees. As a result, during most of the legislative process leading to adoption of the Act it was unclear whether state taxation of federal employees was still barred by inter-

governmental tax immunity despite the abrogation of state employees' immunity from federal taxation. See H. R. Rep. No. 26, *supra*, at 2 ("There are certain indications in the case of *McCulloch v. Maryland*, 4 Wheat. 316 (1819), . . . that . . . Federal officers and employees may not, without the consent of the United States, be subjected to income taxation under the authority of the various States").

Dissatisfied with this uncertain state of affairs, and concerned that considerations of fairness demanded equal tax treatment for state and federal employees, Congress decided to ensure that federal employees would not remain immune from state taxation at the same time that state government employees were being required to pay federal income taxes. See S. Rep. No. 112, *supra*, at 4; H. R. Rep. No. 26, *supra*, at 2. Accordingly, §4 of the proposed Act (now §111) expressly waived whatever immunity would have otherwise shielded federal employees from nondiscriminatory state taxes.

By the time the statute was enacted, of course, the decision in *Graves* had been announced, so the constitutional immunity doctrine no longer proscribed nondiscriminatory state taxation of federal employees. In effect, §111 simply codified the result in *Graves* and foreclosed the possibility that subsequent judicial reconsideration of that case might reestablish the broader interpretation of the immunity doctrine.

Section 111 did not waive all aspects of intergovernmental tax immunity, however. The final clause of the section contains an exception for state taxes that discriminate against federal employees on the basis of the source of their compensation. This nondiscrimination clause closely parallels the nondiscrimination component of the constitutional immunity doctrine which has, from the time of *McCulloch v. Maryland*, barred taxes that "operat[e] so as to discriminate against the Government or those with whom it deals." *United States v. City of Detroit*, 355 U. S. 466, 473 (1958). See also *McCulloch v. Maryland*, *supra*, at 436-437; *Miller*

v. Milwaukee, 272 U. S. 713, 714-715 (1927); *Helvering v. Gerhardt*, *supra*, at 413; *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U. S. 376, 385 (1960); *Memphis Bank & Trust Co. v. Garner*, 469 U. S. 392, 397, and n. 7 (1983).

In view of the similarity of language and purpose between the constitutional principle of nondiscrimination and the statutory nondiscrimination clause, and given that §111 was consciously drafted against the background of the Court's tax immunity cases, it is reasonable to conclude that Congress drew upon the constitutional doctrine in defining the scope of the immunity retained in §111. When Congress codifies a judicially defined concept, it is presumed, absent an express statement to the contrary, that Congress intended to adopt the interpretation placed on that concept by the courts. See *Midlantic National Bank v. New Jersey Dept. of Environmental Protection*, 474 U. S. 494, 501 (1986); *Morissette v. United States*, 342 U. S. 246, 263 (1962). Hence, we conclude that the retention of immunity in §111 is coextensive with the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity. Cf. *Memphis Bank & Trust*, *supra*, at 396-397 (construing 31 U. S. C. §742, which permits only "nondiscriminatory" state taxation of interest on federal obligations, as "principally a restatement of the constitutional rule").

On its face, §111 purports to be nothing more than a partial congressional consent to nondiscriminatory state taxation of federal employees. It can be argued, however, that by negative implication §111 also constitutes an affirmative statutory grant of immunity from discriminatory state taxation in addition to, and coextensive with, the pre-existing protection afforded by the constitutional doctrine. Regardless of whether §111 provides an independent basis for finding immunity or merely preserves the traditional constitutional prohibition against discriminatory taxes, however, the in-

quiry is the same. In either case, the scope of the immunity granted or retained by the nondiscrimination clause is to be determined by reference to the constitutional doctrine. Thus, the dispositive question in this case is whether the tax imposed on appellant is barred by the doctrine of intergovernmental tax immunity.

IV

It is undisputed that Michigan's tax system discriminates in favor of retired state employees and against retired federal employees. The State argues, however, that appellant is not entitled to claim the protection of the immunity doctrine, and that in any event the State's inconsistent treatment of Federal and State Government retirees is justified by meaningful differences between the two classes.

A

In support of its first contention, the State points out that the purpose of the immunity doctrine is to protect governments and not private entities or individuals. As a result, so long as the challenged tax does not interfere with the Federal Government's ability to perform its governmental functions, the constitutional doctrine has not been violated.

It is true that intergovernmental tax immunity is based on the need to protect each sovereign's governmental operations from undue interference by the other. *Graves*, 306 U. S., at 481; *McCulloch v. Maryland*, 4 Wheat., at 435-436. But it does not follow that private entities or individuals who are subjected to discriminatory taxation on account of their dealings with a sovereign cannot themselves receive the protection of the constitutional doctrine. Indeed, all precedent is to the contrary. In *Phillips Chemical Co.*, *supra*, for example, we considered a private corporation's claim that a state tax discriminated against private lessees of federal land. We concluded that the tax "discriminate[d] unconstitutionally against the United States and its lessee," and accordingly held that the tax could not be exacted. 361 U. S., at 387

(emphasis added). See also *Memphis Bank & Trust, supra*; *Moses Lake Homes, Inc. v. Grant County*, 365 U. S. 744 (1961); *Collector v. Day*, 11 Wall. 113 (1871); *Dobbins v. Commissioners of Erie County*, 16 Pet. 435 (1842). The State offers no reasons for departing from this settled rule, and we decline to do so.⁴

B

Under our precedents, "[t]he imposition of a heavier tax burden on [those who deal with one sovereign] than is im-

⁴The dissent argues that this tax is nondiscriminatory, and thus constitutional, because it "draws no distinction between the federal employees or retirees and the vast majority of voters in the State." *Post*, at 823. In *Phillips Chemical Co.*, however, we faced that precise situation: an equal tax burden was imposed on lessees of private, tax-exempt property and lessees of federal property, while lessees of state property paid a lesser tax, or in some circumstances none at all. Although we concluded that "[u]nder these circumstances, there appears to be no discrimination between the Government's lessees and lessees of private property," 361 U. S., at 381, we nonetheless invalidated the State's tax. This result is consistent with the underlying rationale for the doctrine of intergovernmental tax immunity. The danger that a State is engaging in impermissible discrimination against the Federal Government is greatest when the State acts to benefit itself and those in privity with it. As we observed in *Phillips Chemical Co.*, "it does not seem too much to require that the State treat those who deal with the Government as well as it treats those with whom it deals itself." *Id.*, at 386.

We also take issue with the dissent's assertion that "it is peculiarly inappropriate to focus solely on the treatment of state governmental employees" because "[t]he State may always compensate in pay or salary for what it assesses in taxes." *Post*, at 824. 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. This fact serves to illustrate the impact on the Federal Government of the State's discriminatory tax exemption for state retirees. Taxes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar.

posed on [those who deal with the other] must be justified by significant differences between the two classes." *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U. S., at 383. In determining whether this standard of justification has been met, it is inappropriate to rely solely on the mode of analysis developed in our equal protection cases. We have previously observed that "our decisions in [the equal protection] field are not necessarily controlling where problems of intergovernmental tax immunity are involved," because "the Government's interests must be weighed in the balance." *Id.*, at 385. Instead, the relevant inquiry is whether the inconsistent tax treatment is directly related to, and justified by, "significant differences between the two classes." *Id.*, at 383-385.

The State points to two allegedly significant differences between federal and state retirees. First, the State suggests that its interest in hiring and retaining qualified civil servants through the inducement of a tax exemption for retirement benefits is sufficient to justify the preferential treatment of its retired employees. This argument is wholly beside the point, however, for it does nothing to demonstrate that there are "significant differences between the two classes" themselves; rather, it merely demonstrates that the State has a rational reason for discriminating between two similar groups of retirees. The State's interest in adopting the discriminatory tax, no matter how substantial, is simply irrelevant to an inquiry into the nature of the two classes receiving inconsistent treatment. See *id.*, at 384.

Second, the State argues that its retirement benefits are significantly less munificent than those offered by the Federal Government, in terms of vesting requirements, rate of accrual, and computation of benefit amounts. The substantial differences in the value of the retirement benefits paid the two classes should, in the State's view, justify the inconsistent tax treatment.

Even assuming the State's estimate of the relative value of state and federal retirement benefits is generally correct, we do not believe this difference suffices to justify the type of blanket exemption at issue in this case. While the average retired federal civil servant receives a larger pension than his state counterpart, there are undoubtedly many individual instances in which the opposite holds true. A tax exemption truly intended to account for differences in retirement benefits would not discriminate on the basis of the source of those benefits, as Michigan's statute does; rather, it would discriminate on the basis of the amount of benefits received by individual retirees. Cf. *Phillips Chemical Co.*, *supra*, at 384-385 (rejecting proffered rationale for State's unfavorable tax treatment of lessees of federal property, because an evenhanded application of the rationale would have resulted in inclusion of some lessees of State property in the disfavored class as well).

V

For these reasons, we conclude that the Michigan Income Tax Act violates principles of intergovernmental tax immunity by favoring retired state and local government employees over retired federal employees. 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. See *Iowa-Des Moines Bank v. Bennett*, 284 U. S. 239, 247 (1931).

Appellant also seeks prospective relief from discriminatory taxation. With respect to this claim, however, we are not in the best position to ascertain the appropriate remedy. While invalidation of Michigan's income tax law in its entirety obviously would eliminate the constitutional violation, the Constitution does not require such a drastic solution. We have recognized, in cases involving invalid classifications in the distribution of government benefits, that the appropriate remedy "is a *mandate* of equal treatment, a result that can be

accomplished by withdrawal of benefits from the favored class as well as by extension of benefits to the excluded class." *Heckler v. Mathews*, 465 U. S. 728, 740 (1984). See *Iowa-Des Moines Bank, supra*, at 247; see also *Welsh v. United States*, 398 U. S. 333, 361 (1970) (Harlan, J., concurring in judgment).

In this case, appellant's claim could be resolved either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees. The latter approach, of course, could be construed as the direct imposition of a state tax, a remedy beyond the power of a federal court. See *Moses Lake Homes, Inc. v. Grant County*, 366 U. S., at 752 ("Federal courts may not assess or levy taxes"). The permissibility of either approach, moreover, depends in part on the severability of a portion of § 206.30(1)(f) from the remainder of the Michigan Income Tax Act, a question of state law within the special expertise of the Michigan courts. See *Louis K. Liggett Co. v. Lee*, 288 U. S. 517, 540-541 (1933). It follows that the Michigan courts are in the best position to determine how to comply with the mandate of equal treatment. The judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

JUSTICE STEVENS, dissenting.

The States can tax federal employees or private parties who do business with the United States so long as the tax does not discriminate against the United States. *South Carolina v. Baker*, 485 U. S. 505, 523 (1988); *United States v. County of Fresno*, 429 U. S. 462, 462 (1977). The Court today strikes down a state tax that applies equally to the vast majority of Michigan residents, including federal employees, because it treats retired state employees differently from retired federal employees. The Court's holding is not supported by the rationale for the intergovernmental immu-

nity doctrine and is not compelled by our previous decisions. I cannot join the unjustified, court-imposed restriction on a State's power to administer its own affairs.

The constitutional doctrine of intergovernmental immunity, Justice Frankfurter explained, "finds its explanation and justification . . . in avoiding the potentialities of friction and furthering the smooth operation of complicated governmental machinery." *City of Detroit v. Murray Corp.*, 355 U. S. 489, 504 (1958). To protect the smooth operation of dual governments in a federal system, it was at one time thought necessary to prohibit state taxation of the salaries of officers and employees of the United States, *Dobbins v. Commissioners of Erie County*, 16 Pet. 435 (1842), as well as federal taxation of the salaries of state officials. *Collector v. Day*, 11 Wall. 113 (1871). The Court has since forsworn such "wooden formalism." *Washington v. United States*, 460 U. S. 536, 544 (1983).

The nondiscrimination rule recognizes the fact that the Federal Government has no voice in the policy decisions made by the several States. The Federal Government's protection against state taxation that singles out federal agencies for special burdens is therefore provided by the Supremacy Clause of the Federal Constitution, the doctrine of intergovernmental tax immunity, and statutes such as 4 U. S. C. § 111.¹ When the tax burden is shared equally by federal agents and the vast majority of a State's citizens, however, the nondiscrimination principle is not applicable and constitutional protection is not necessary. As the Court explained in *United States v. County of Fresno*:

¹The legislative history of 4 U. S. C. § 111 correctly describes the purpose of the nondiscrimination principle as "[t]o protect the Federal Government against the unlikely possibility of State and local taxation of compensation of Federal officers and employees which is aimed at, or threatens the efficient operation of, the Federal Government." H. R. Rep. No. 26, 76th Cong., 1st Sess., 6 (1939); S. Rep. No. 112, 76th Cong., 1st Sess., 12 (1939).

"The rule to be derived from the Court's more recent decisions, then, is that the economic burden on a federal function of a state tax imposed on those who deal with the Federal Government does not render the tax unconstitutional so long as the tax is imposed equally on the other similarly situated constituents of the State. This rule returns to the original intent of *M'Culloch v. Maryland*. The political check against abuse of the taxing power found lacking in *M'Culloch*, where the tax was imposed solely on the Bank of the United States, is present where the State imposes a nondiscriminatory tax only on its constituents or their artificially owned entities; and *M'Culloch* foresaw the unfairness in forcing a State to exempt private individuals with beneficial interests in federal property from taxes imposed on similar interests held by others in private property. Accordingly, *M'Culloch* expressly excluded from its rule a tax on 'the interest which the citizens of Maryland may hold [in a federal instrumentality] in common with other property of the same description throughout the State.' 4 Wheat., at 436." 429 U. S., at 462-464.⁴

⁴The quotation in the text omits one footnote, but this footnote is relevant:

"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." 429 U. S., at 463.

The Court has repeatedly emphasized that the rationale of the nondiscrimination rule is met when there is a political check against excessive taxation. See *South Carolina v. Baker*, 486 U. S. 506, 526, n. 16 (1988) ("[T]he best safeguard against excessive taxation (and the most judicially manageable) is the requirement that the government tax in a nondiscriminatory fashion. For where a government imposes a nondiscriminatory tax, judges can term the tax 'excessive' only by second-guessing the extent to which the taxing

If Michigan were to tax the income of federal employees without imposing a like tax on others, the tax would be plainly unconstitutional. Cf. *McCulloch v. Maryland*, 4 Wheat. 316, 425-437 (1819). On the other hand, if the State taxes the income of all its residents equally, federal employees must pay the tax. *Graves v. New York ex rel. O'Keefe*, 306 U. S. 466 (1939). See *United States v. County of Fresno*, 429 U. S., at 468 (STEVENS, J., dissenting). The Michigan tax here applies to approximately 4½ million individual taxpayers in the State, including the 24,000 retired federal employees. It exempts only the 130,000 retired state employees. Tr. of Oral Arg. 35-36. Once one understands the underlying reason for the *McCulloch* holding, it is plain that this tax does not unconstitutionally discriminate against federal employees.

The Court reaches the opposite result only by examining whether the tax treatment of federal employees is equal to that of one discrete group of Michigan residents—retired state employees. It states: "It is undisputed that Michigan's tax system discriminates in favor of retired state employees and against retired federal employees." *Ante*, at 814. But it does not necessarily follow that such a tax "discriminate[s] against the [federal] officer or employee because of the source of the pay or compensation." 4 U. S. C. §111. The fact that a State may elect to grant a preference, or an exemption, to a small percentage of its residents does not make the tax discriminatory in any sense that is relevant to the doctrine of intergovernmental tax immunity. The obligation of a federal judge to pay the same tax that is imposed on the

government and its people have taxed themselves, and the threat of destroying another government can be realized only if the taxing government is willing to impose taxes that will also destroy itself or its constituents"); *Washington v. United States*, 460 U. S. 636, 646 (1983) ("A 'political check' is provided when a state tax 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. It has been thought necessary because the United States does not have a direct voice in the state legislatures").

income of similarly situated citizens in the State should not be affected by the fact that the State might choose to grant an exemption to a few of its taxpayers—whether they be state judges, other state employees, or perhaps a select group of private citizens. Such an exemption might be granted “in spite of” and not necessarily “because of” its adverse effect on federal employees. Cf. *Personnel Administrator of Massachusetts v. Feeney*, 442 U. S. 256, 279 (1979). Indeed, at least 14 other States grant special tax exemptions for retirement income to state and local government employees that they do not grant to federal employees.⁸ As long as a state

⁸See Ariz. Rev. Stat. Ann. §§ 43-1022(3) and (4) (Supp. 1988) (benefits, annuities, and pensions received from the state retirement system, the state retirement plan, the judges' retirement fund, the public safety personnel retirement system, or a county or city retirement plan exempt in their entirety; income received from the United States civil service retirement system exempt only up to \$2500); Colo. Rev. Stat. §§ 39-22-104(4)(f) and (g) (Supp. 1988) (amounts received as pensions or annuities from any source exempt up to \$20,000, but amounts received from Federal Government as retirement pay by retired member of Armed Forces less than 65 years of age exempt only up to \$2000); Ga. Code Ann. § 48-7-27(a)(4)(A) (Supp. 1988) (income from employees' retirement system exempt); La. Rev. Stat. Ann. §§ 42:646, 47:44.1 (West Supp. 1989) (annuities, retirement allowances and benefits paid under the state employee retirement system exempt from state or municipal taxation in their entirety, but other annuities exempt only up to \$6000); Md. Tax-Gen. Code Ann. § 10-207(o) (1988) (fire, rescue, or ambulance personnel length of service award funded by any county or municipal corporation of State exempt); Mo. Rev. Stat. § 169.687 (Supp. 1989) (retirement allowance, benefit, funds, property, or rights under public school retirement system exempt); Mont. Code Ann. §§ 16-30-111(2)(c)-(f) (1987) (benefits under teachers retirement law, public employees retirement system, and highway patrol law exempt in their entirety; benefits under Federal Employees Retirement Act exempt only up to \$3000); N. Y. Tax Law § 612(c)(3) (McKinney 1987) (pensions to officers and employees of State, its subdivisions and agencies exempt); N. C. Gen. Stat. §§ 106-141(b)(13) and (14) (Supp. 1988) (amounts received from retirement and pension funds established for firemen and law enforcement officers exempt in their entirety, but amounts received from federal-employee-retirement program exempt only up to \$4000); Ore. Rev. Stat. §§ 316.680(1)(c) and (d) (1987) (payments from Public Employees Retire-

income tax draws no distinction between the federal employees or retirees and the vast majority of voters in the State, I see no reason for concern about the kind of “discrimination” that these provisions make. The intergovernmental immunity doctrine simply does not constitute a most favored nation provision requiring the States to accord federal employees and federal contractors the greatest tax benefits that they give any other group subject to their jurisdiction.

To be sure, there is discrimination against federal employees—and all other Michigan taxpayers—if a small group of residents is granted an exemption. If the size of the exempt group remains the same—say, no more than 10% of the populace—the burden on federal interests also remains the same, regardless of how the exempt class is defined. Whether it includes schoolteachers, church employees, state judges, or perhaps handicapped persons, is a matter of indifference to the Federal Government as long as it can fairly be said that

ment Fund exempt in their entirety, but payments under public retirement system established by United States exempt only up to \$6000); S. C. Code §§ 12-7-436(a), (d), (e) (Supp. 1988) (amounts received from state retirement systems and retirement pay received by police officers and firemen from municipal or county retirement plans exempt in their entirety; federal civil service retirement annuity exempt only up to \$3000); Va. Code § 68.1-322(C)(3) (Supp. 1988) (pensions or retirement income to officers or employees of Commonwealth, its subdivisions and agencies, or surviving spouses of such officers or employees paid by the Commonwealth or an agency or subdivision thereof exempt); W. Va. Code §§ 11-21-12(c)(6) and (6) (Supp. 1988) (annuities, retirement allowances, returns of contributions or any other benefit received under the public employees retirement system, the department of public safety death, disability, and retirement fund, the state teachers' retirement system, pensions and annuities under any police or firemen's retirement system exempt); Wis. Stat. § 71.06(1)(a) (Supp. 1988-1989) (payments received from the employees' retirement system of city of Milwaukee, Milwaukee city employees' retirement system, sheriff's retirement and benefit fund of Milwaukee, firefighters' annuity and benefit fund of Milwaukee, the public employee trust fund, and the state teachers' retirement system exempt).

federal employees are treated like other ordinary residents of the State.

Even if it were appropriate to determine the discriminatory nature of a tax system by comparing the treatment of federal employees with the treatment of another discrete group of persons, it is peculiarly inappropriate to focus solely on the treatment of state governmental employees. The State may always compensate in pay or salary for what it assesses in taxes. Thus a special tax imposed only on federal and state employees nonetheless may reflect the type of disparate treatment that the intergovernmental tax immunity forbids because of the ability of the State to adjust the compensation of its employees to avoid any special tax burden on them. *United States v. County of Fresno*, 429 U. S., at 468-469 (STEVENS, J., dissenting). It trivializes the Supremacy Clause to interpret it as prohibiting the States from providing through this limited tax exemption what the State has an unquestionable right to provide through increased retirement benefits.⁴

Arguably, the Court's holding today is merely a logical extension of our decisions in *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U. S. 376 (1960), and *Memphis Bank & Trust Co. v. Garner*, 469 U. S. 392 (1983). Even if it were, I would disagree with it. Those cases are, however, significantly different.

⁴The Court also suggests that compensating state employees through tax exemptions rather than through increased pension benefits discriminates against federal taxpayers by reducing the pension income subject to federal taxation. See *ante*, at 816, n. 4. But retired state employees are not alone in receiving a subsidy through a tax exemption. Michigan, like most States, provides tax exemptions to select industries and groups. See, e.g., Mich. Comp. Laws Ann. §206.64(g) (West 1986 and Supp. 1988) (industrial processing), and §206.64(wp) (1986) (pollution control). That the State chooses to proceed by indirect subsidy rather than direct subsidy, however, should not render the tax invalid under the Supremacy Clause.

Phillips involved a tax that applied only to lessees of federal property. Article 6248 of the Texas Code imposed a tax on lessees of federal lands measured by the value of the fee held by the United States. Article 7173 of the Code, the only other provision that authorized a tax on lessees, either granted an exemption to lessees of other public lands or taxed them at a lower rate. Lessees of privately owned property paid no tax at all.⁵ The company argued that "because Article 5248 applies only to private users of federal property, it is invalid for that reason, without more." 361 U. S., at 382. The Court rejected that argument, reasoning that it was "necessary to determine how other taxpayers similarly situated are treated." *Id.*, at 383. It then defined the relevant classes of "similarly situated" taxpayers as the federal lessees who were taxed under Article 6248 and the lessees of other public property taxed under Article 7173. Within that narrow focus, the Court rejected the school district's argument that the discrimination between the two classes could be justified. Because the Court confined its analysis to the two state taxes that applied to lessees of public property, its reasoning would be controlling in the case before us today if Michigan's income tax applied only to public employees; on that hypothesis, if state employees were exempted, the tax would obviously discriminate against federal employees.

The troublesome aspect of the Court's opinion in *Phillips* is its failure to attach any significance to the fact that the tax on private landlords presumably imposed an indirect burden on

⁵"Although Article 7173 is, in terms, applicable to all lessees who hold tax-exempt property under a lease for a term of three years or more, it appears that only lessees of public property fall within this class in Texas. Tax exemptions for real property owned by private organizations—charities, churches, and similar entities—do not survive a lease to a business lessee. The full value of the leased property becomes taxable to the owner, and the lessee's indirect burden consequently is as heavy as the burden imposed directly on federal lessees by Article 6248." 361 U. S., at 380-381 (emphasis in original; footnote omitted).

their lessees that was as heavy as the direct burden on federal lessees imposed by Article 5248. The Court did note that "[u]nder these circumstances, there appears to be no discrimination between the Government's lessees and lessees of private property." *Id.*, at 381. But—possibly because of the School District's rather unwise reliance on an equal protection analysis of the case⁶—the Court never even considered the question whether the political check provided by private property owners was sufficient to save that tax from the claim that it singled out federal lessees for an unconstitutional tax burden.⁷

In *Memphis Bank & Trust Co.*, the question presented was the lawfulness of a Tennessee tax on the net earnings of

⁶"The School District addresses this problem, essentially, as one of equal protection, and argues that we must uphold the classification, though apparently discriminatory, 'if any state of facts reasonably can be conceived that would sustain it.' *Allied Stores v. Bowers*, 368 U. S. 622, 628." *Id.*, at 383.

⁷An interesting feature of the Phillips opinion is its reference to the fact that the tax upheld in *United States v. City of Detroit*, 366 U. S. 466 (1968), had actually included an exemption for school-owned property—and therefore discriminated "against" federal property in the same way the tax involved in this case discriminates "against" federal employees.

"This argument misconceives the scope of the Michigan decisions. In those cases we did not decide—in fact, we were not asked to decide—whether the exemption of school-owned property rendered the statute discriminatory. Neither the Government nor its lessees, to whom the statute was applicable, claimed discrimination of this character." *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U. S., at 386.

The Court's description of the relevant class of property subject to tax in the *Detroit* case obviously would have provided the same political check against discrimination regardless of how the school property might have been classified. In *Detroit*, Justice Black described that class as follows: "But here the tax applies to every private party who uses exempt property in Michigan in connection with a business conducted for private gain. Under Michigan law this means persons who use property owned by the Federal Government, the State, its political subdivisions, churches, charitable organizations and a great host of other entities. The class defined is not an arbitrary or invidiously discriminatory one." 366 U. S., at 473.

banks doing business in the State that defined net earnings to "include interest received by the bank on the obligations of the United States and its instrumentalities, as well as interest on bonds and other obligations of States other than Tennessee, but [to] exclude interest on obligations of Tennessee and its political subdivisions." 459 U. S., at 394. Although the federal obligations were part of a large class and the tax therefore did not discriminate only against the income derived from a federal source, all other members of the disfavored class were also unrepresented in the Tennessee Legislature. There was, therefore, no political check to protect the out-of-state issuers, including the federal instrumentalities, from precisely the same kind of discrimination involved in *McCulloch v. Maryland*. Indeed, in the *McCulloch* case itself, the taxing statute did not, in terms, single out the National Bank for disfavored treatment; the tax was imposed on "all Banks, or branches thereof, in the State of Maryland, not chartered by the legislature." 4 Wheat., at 317-318. A tax that discriminates against a class of nonresidents, including federal instrumentalities, clearly is not protected by the political check that saved the state taxes in cases like *United States v. County of Fresno*, 429 U. S. 462 (1977), and *City of Detroit v. Murray Corp.*, 355 U. S. 489 (1968).

When the Court rejected the claim that a federal employee's income is immune from state taxation in *Graves v. New York ex rel. O'Keefe*, 306 U. S. 466 (1939), Justice Frankfurter wrote separately to explain how a "seductive cliché" had infected the doctrine of intergovernmental immunity, which had been "moving in the realm of what Lincoln called 'pernicious abstractions.'" He correctly noted that only a "web of unreality" could explain how the "[f]ailure to exempt public functionaries from the universal duties of citizenship to pay for the costs of government was hypothetically transmuted into hostile action of one government against the other." *Id.*, at 489-490.

Today, it is not the great Chief Justice's dictum about how the power to tax includes the power to destroy that obscures the issue in a web of unreality; it is the virtually automatic rejection of anything that can be labeled "discriminatory." The question in this case deserves more careful consideration than is provided by the mere use of that label. It should be answered by considering whether the *ratio decidendi* of our holding in *McCulloch v. Maryland* is applicable to this quite different case. It is not. I, therefore, respectfully dissent.

FRAZEE v. ILLINOIS DEPARTMENT OF EMPLOYMENT SECURITY ET AL.

APPEAL FROM THE APPELLATE COURT OF ILLINOIS, THIRD DISTRICT

No. 87-1946. Argued March 1, 1989—Decided March 29, 1989

Appellant, who refused a temporary retail position because the job would have required him to work on Sunday in violation of his personal religious beliefs, applied for, and was denied, unemployment compensation benefits. The denial was affirmed by an administrative review board, an Illinois Circuit Court, and the State Appellate Court, which found that since appellant was not a member of an established religious sect or church and did not claim that his refusal to work resulted from a tenet, belief, or teaching of an established religious body, his personal professed religious belief, although unquestionably sincere, was not good cause for his refusal to work on Sunday.

Held: The denial of unemployment compensation benefits to appellant on the ground that his refusal to work was not based on tenets or dogma of an established religious sect violated the Free Exercise Clause of the First Amendment as applied to the States through the Fourteenth Amendment. *Sherbert v. Verner*, 374 U. S. 398, *Thomas v. Review Bd. of Indiana Employment Security Div.*, 450 U. S. 707, and *Hobbie v. Unemployment Appeals Comm'n of Florida*, 480 U. S. 136, rested on the fact that each of the claimants had a sincere belief that religion required him or her to refrain from the work in question, not on the consideration that each of them was a member of a particular religious sect or on any tenet of the sect forbidding such work. While membership in a sect would simplify the problem of identifying sincerely held beliefs, the notion that one must be responding to the commands of a particular religious organization to claim the protection of the Free Exercise Clause is rejected. The sincerity or religious nature of appellant's belief was not questioned by the courts below and was conceded by the State, which offered no justification for the burden that the denial of benefits placed on appellant's right to exercise his religion. The fact that Sunday work has become a way of life does not constitute a state interest sufficiently compelling to override a legitimate free-exercise claim, since there is no evidence that there will be a mass movement away from Sunday employment if appellant succeeds on his claim. Pp. 832-836.

169 Ill. App. 3d 474, 612 N. E. 2d 789, reversed and remanded.

APPENDIX 7

DETERMINATIVE LAW

Utah Code Ann. § 59-1-301 (Supp. 1989):

In all cases of levy of taxes, licenses, or other demands for public revenue which is deemed unlawful by the party whose property is taxed, or from whom the tax or license is demanded or enforced, that party may pay under protest the tax or license, or any part deemed unlawful, to the officers designated and authorized by law to collect the tax or license; and then the party so paying or a legal representative may bring an action in the tax division of the appropriate district court against the officer to whom the tax or license was paid, or against the state, county, municipality, or other taxing entity on whose behalf it was collected, to recover the tax or license or any portion of the tax or license paid under protest.

Utah Code Ann. § 78-12-31 (1987):

Within six months:

an action against an officer, or an officer de facto:

- (1) to recover any goods, wares, merchandise or other property seized by any such officer in his official capacity as tax collector, or to recover the price or value of any goods, wares, merchandise or other personal property so seized, or for damages for the seizure, detention, sale of, or injury to, any goods, wares, merchandise or any other personal property seized, or for damages done to any person or property in making any such seizure.
- (2) for money paid to any such officer under protest, or seized by such officer in his official capacity, as a collector of taxes, and which, it is claimed, ought to be refunded.

Utah Code Jud. Admin. R4-504(2):

Copies of the proposed findings, judgments, and orders shall be served upon opposing counsel before being presented to the court for signature unless the court otherwise orders. Notice of objections shall be submitted to the court and counsel within five days after service.

Utah R. Civ. P. 54(d)(1):

To whom awarded. Except when expressed provision therefor is made either in a statute of this state or in these rules, costs shall be allowed as of course to the prevailing party unless the court otherwise directs; provided, however, where an appeal or other proceeding is taken, costs of the action, other than costs in connection with such appeal or other proceeding for review, shall abide the final determination of the cause. Costs against the state of Utah, its officers and agencies shall be imposed only to the extent permitted by law.

Utah R. Civ. P. 52:

(a) Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58A; in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. . . .

Utah Code Ann. § 59-1-704 (1987):

(1) Except as otherwise provided in Parts 5, 6, and 7 of Chapter 1 and Chapter 2, 6, 7, 10, and 12 and the rules promulgated thereunder, no suit for the purpose of restraining the assessment or collection of any tax, penalty, or interest imposed under Chapter 1, 2, 6, 7, 10, or 12 may be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.

(2) No suit may be maintained in any court for the purpose of restraining the assessment or collection of the amount of the state tax liability, of a transferee or of a fiduciary of property of a taxpayer.

Utah Code Ann. § 78-27-56(1) (Supp. 1991 and 1987):

In civil actions, the court shall award reasonable attorney's fees to a prevailing party if the court determines that the action or defense to the action was without merit and not brought or asserted in good faith.

4 U.S.C. § 111:

The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.