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NAVIGATING ROADBLOCKS TO STATE TAX REFUNDS: MANAGING EXPECTATIONS & CUTTING A DEAL

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Agenda



State Tax Refunds



Sources.

A Constitutional Right?

Cases Around Which We Will Structure Today's Conversation.



Navigating Roadblocks



What are the roadblocks?

How to avoid the roadblocks?



Managing Expectations



Managing Your Expectations.

Managing the Expectations of Your Boss.



Cutting A Deal



Who? With whom do I negotiate?

What? Am I really willing to settle?

Why? What are the pros and cons of settlement?

How? Alternative Ways of Achieving a Settlement.



State Tax Refunds



Sources – Refund claims may flow from at least four sources:



Statute Held Unconstitutional.



Regulation Held Invalid.



Differing Interpretation of Statutes or Regulations.



Mistakes.



Federal RAR's.



Payments Made to Avoid Amnesty and Understatement Penalties.



State Tax Refunds (*cont.*)



Does a Taxpayer have a Constitutional Right to a Refund?
McKesson Corp. v. Div. of Alcoholic Bev. & Tob., 496 U.S.
18 (1990).



Due process requires a state to ensure that it collects only the amount of tax to which it is legally entitled.



Clear and certain remedy required.



State may offer pre-deprivation relief (litigate first, pay later) or post-deprivation relief (pay first, litigate later).



State had 3 choices – (1) refunds; (2) collect tax from favored parties; or (3) a combination of refunds and assessments.



State Tax Refunds (*cont.*)



Cases Around Which to Structure Today's Conversation




Miller v. Johnson Controls, 2009 Ky. LEXIS 196, __ S.W.3d __ (Aug. 27, 2009), *pet. for reh'g pending*.




Abbott Laboratories, et al. v. FTB, 175 Cal. App. 4th 1346 (Ct. App. 2nd Dist. July 21, 2009), *pet. for rev. pending*.




State Tax Refunds (*cont.*) – *Johnson Controls*

 Taxpayers filed amended returns (refund claims) based on 12/22/94 KY SCT ruling requiring combined filing.

 2000 HB 541

 No refund claims based on amended returns filed on combined basis after 12/22/94 if no combined filing before 12/22/94.

 Approx. 35 taxpayers with claims totaling \$100M before interest.



State Tax Refunds (*cont.*) - *Johnson Controls* – Federal Court Action



2007 HB 316 – The Silver Bullet?



Federal Court Litigation.



Same causes of action.



Mot. to Dismiss by State – Denied.



No violation of Tax Injunction Act.



State Tax Refunds (*cont.*) - *Abbott Labs*



In *Farmer Bros. v. FTB*, 108 Cal. App. 4th 976 (2003), California's dividends received deduction statute (Revenue and Taxation Code (RTC) Section 24402) was held to be unconstitutional under the Commerce Clause and a full DRD (and Refund) was allowed.



In response, the FTB set forth a policy that for tax years ending prior to 12/1/99 a full DRD (and Refund) would be permitted. For tax years ending on or after 12/1/99, no DRD (or Refund) would be allowed.



State Tax Refunds -

Abbott Labs (cont.)



Abbott Labs challenged the FTB policy for tax years 1999 and 2000.



Court of Appeals held that RTC 24402 was unconstitutional in its entirety and could not be reformed.



Court declined to apply the severability provisions of RTC 23057.








No DRD (or Refund) allowed.






Navigating Roadblocks

What are the roadblocks?

-  Size of refund claim.
-  States without money.
-  Stubborn taxing agencies.
-  Retroactive statutes.
-  Protective courts (or lack of impartial courts).



Navigating Roadblocks (cont.)

-  Size of refund claims - \geq \$100M?
-  States without money – need more be said?
-  Stubborn taxing agencies – has it become personal?



Navigating Roadblocks (cont.)



Retroactive Statutes – *U.S. v. Carlton*, 512 U.S. 26 (1994).



Retroactive statutes are ok provided they are enacted for a legitimate legislative purpose and the enactment is rationally related to that purpose.



To be “rationally related,” the period of retroactivity must be “modest.”



Navigating Roadblocks (cont.)



What constitutes modest?



A period equal to the SOL for tax claims?



One year or less?



A short and limited period required by the practicalities of producing legislation?



It's like pornography, I can't define it, but I will know it when I see it?



Navigating Roadblocks (cont.)



Protective (or lack of impartial) courts.



Are the judges elected or appointed?



Are they influenced by the overall economic conditions of the state?



Do they understand the tax issues presented?



Navigating Roadblocks (cont.)



Ways to avoid roadblocks -



Do Not Pay! Do Not Pay! Do Not Pay!



Declaratory/Injunctive Relief



Force Collection Action by Taxing Authority.



Navigating Roadblocks (cont.)



Ways to avoid roadblocks (*cont.*).



Proceed in federal court.



Really? What about the Tax Injunction Act?



There are exceptions.



Work with legislators.



Managing Expectations



Managing Your Expectations.



Assess the environment.



Amount of claim.



State of the State.



Politics.



Am I in a state that will settle?



Managing Expectations (*cont.*)



Managing Your Expectations (*cont.*).



Assess strength of facts and legal arguments.



Are the equities on your side?



Review both current and future tax years in dispute.



Be realistic.



Don't let it get personal.



Managing Expectations (*cont.*)



Managing the expectations of the boss.



Provide a fair assessment of the environment, strengths, weaknesses, equities and potential costs.



Have an adequate reserve.



Explain the taxing agencies different view of hazards of litigation.



Be realistic.



Cutting a Deal



With whom to negotiate?



Department of Revenue?



Attorney General's Office?



Finance and Administration Cabinet?



Economic Development?



Governor?



Cutting a Deal (cont.)



Am I really willing to settle?



Are you prepared to go to the mat in litigation?



Are you prepared to make it look like you are willing to go to the mat?



What are you willing to give up?



What have you reserved?



Do you have flexibility regarding terms of a settlement?



Cutting a Deal (cont.)



When to settle?



Before litigation costs start mounting rapidly.



After discovery is complete.



After a victory.



Just prior to end of state's fiscal year.



Cutting a Deal (cont.)



Why settle?



Need to end the nightmare and move on, *i.e.*, litigation fatigue.



Case is weak.



Use of resources and expenses related to continuing.



Itemize pros and cons.



Effect on future years.



Are the issues continuing?



Cutting a Deal (cont.)



Alternatives to payment of large refunds.



Refund payment over time.



Combine refund with abatement of taxes for other years.



Consider NOL and credit carryovers.



Consider future years tax exposures.



Cutting a Deal (cont.)

Alternatives to payment of large refunds (*cont.*).



Apply refund to other taxes.



Hold funds as tax deposit.



Apply refund credits to future years.



Closing agreement as to certain issues for future years.



QUESTIONS

