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IN THE

Supreme Court of Virginia

RECORD NO. 160681

KOHL'S DEPARTMENT STORES, INC.,
Appellant,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Appellee.

BRIEF OF MICHAEL BAKER JR., INC. AS *AMICUS CURIAE* IN SUPPORT OF KOHL'S DEPARTMENT STORES, INC.

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TABLE OF CONTENTS

Table of Authorities iii

Statement of the Case 1

Assignments of Error and Standard of Review 1

Interest of Amicus 2

Summary of Argument 3

Argument 3

1. The plain language of the subject to tax safe harbor provides Kohl's a full exception from addback. 4

   (i) The subject to tax safe harbor provides a full exemption from addback because it does not contain limiting language. 6

   (ii) In direct contravention of the statute, the Department's interpretation provides no addback relief when the related member is subject to a tax on capital. 7

2. Even if the subject to tax safe harbor is ambiguous, extrinsic evidence shows that the General Assembly intended the subject to tax safe harbor to provide an all or nothing exemption from addback. 9

   (a) A comparison with Alabama's addback statute supports Kohl's interpretation. 9

   (b) The subsequent history of the subject to tax safe harbor supports Kohl's interpretation. 12

      (i) A failed rulemaking attempt by the Department reinforces that the Department's proportional interpretation of the subject to tax safe harbor is inconsistent with the statute. 13

(ii) The Department's failed attempts to have the General Assembly amend the subject to tax safe harbor show that the subject to tax safe harbor was intended as an all or nothing exception. 15

(iii) A 2014 statutory change shows that the subject to tax safe harbor, as originally enacted, was intended to be an all or nothing safe harbor. 17

3. The 2014 statutory change cannot be applied to Kohl's. 19

(a) The Department agreed not to apply the 2014 statutory change against Kohl's. 19

(b) Applying the 2014 statutory change to Kohl's would violate due process. 21

Conclusion 23

CERTIFICATE OF SERVICE 24

TABLE OF AUTHORITIES

CASES

Alderson v. County of Alleghany, 585 S.E.2d 795 (Va. 2003) 22

American College of Chest Physicians v. Department of Revenue, 559 N.E.2d 774 (Ill. Ct. App. 1990) 15

Burnette v. Commonwealth, 75 S.E.2d 482 (Va. 1953) 8

Cage v. Cage, 73 Va. Cir. 190 (Portsmouth County Cir. Apr. 3, 2007) 19

Cape Henry Towers, Inc. v. National Gypsum Co., 331 S.E.2d 476 (Va. 1985) 17, 18

City of Richmond v. Virginia Electric & Power Co., 787 S.E.2d 161 (Va. 2016) 8

Colonial Pipeline Co. v. Commonwealth, 145 S.E.2d 227 (Va. 1965) 22

David v. David, 754 S.E.2d 285 (Va. 2014) 5, 6

Deutsche Bank National Trust Co. v. Arrington, 772 S.E.2d 571 (Va. 2015) 1

F.M.C. Stores Co. v. Borough of Morris Plains, 495 A.2d 1313 (N.J. 1985) 21

Giesecke v. Department of Taxation, 34 Va. Cir. 455 (Fairfax County Cir. Sept. 22, 1994) 22, 23

Hodges v. Commonwealth, Dep't of Social Services, 598 S.E.2d 778 (Va. Ct. App. 2004) 8

Kohn v. Marquis, 762 S.E.2d 755 (Va. 2014) 20

Laurels of Bon Air, LLC v. Medical Facilities of America LIV Ltd. Partnership, 659 S.E.2d 561 (Va. Ct. App. 2008) 19

Lewellyn v. Frick, 268 U.S. 238 (1925) 18

Provost v. United States, 269 U.S. 443 (1926) 18

Smietanka v. First Trust & Savings Bank, 257 U.S. 602 (1922) 18

Surtees v. VFJ Ventures, *Inc.*, 8 So.3d 950 (Ala. Civ. App. 2008) 9

Tabler v. Board of Supervisors of Fairfax County, 269 S.E.2d 358 (1980) 15, 16

United Sates v. Carlton, 512 U.S. 26 (1994) 21

Virginia Department of Labor & Industry v. Westmoreland Coal Co., 353 S.E.2d 758 (Va. 1987) 9

Williams v. Commonwealth, 56 S.E.2d 537 (Va. 1949) 18

STATUTES and RULES

Ala. Code § 40-18-35 10

Ala. Act No. 2001-702 12

Va. Code § 58.1-205(2) 14, 15

Va. Code § 58.1-402(B)(8) ..... *passim*

Va. Sup. Ct. R. 2:02 20

Va. Sup. Ct. R. 5:30 3

OTHER AUTHORITIES

Black's Law Dictionary (10th ed. 2014) 19

HB 791 of 2004 8

HB 5001 Special Session I 2014, § 3-5.11 ..... 17, 18

HB 5002 Special Session I 2014, § 3-5.10 17–19

HB/SB 29 of 2010 15

HB/SB 30 of 2010 15

Hellerstein & Hellerstein, State Taxation ¶ 11.03 7

http://www.merriam-webster.com/dictionary/notwithstanding 19

Letter from Fred Nicely to Janie Bowen (Aug. 29, 2008) 14

Letter from H. Lane Kneedler to Janie E. Bowen (Aug. 29, 2008) 14

Letter from Virginia Society of Certified Public Accountants to Commissioner Janie Bowen (Aug. 29, 2008) 14

Norman Singer & Shambie Singer, 2B Sutherland Statutes and Statutory Construction § 51:6 (7th ed. 2016) 12

Notice of Intended Regulatory Action (NOIRA) Agency Background Document (Mar. 19, 2007) 13, 22

P.D. 07-153 (Oct. 2, 2007) 5

P.D. 07-211 (Dec. 5, 2007) 6

P.D. 14-97 (July 1, 2014) 17

SB 407 of 2010 15

SB 1036 of 2013 15

Scheduling Order, *Kohl's Department Stores Inc. v. Virginia Department of Taxation*, Case No. CL12001774-00-4 (Aug. 27, 2015) 20

Virginia Chamber of Commerce Tax Policy Committee, Comments on Draft Intangible Holding Company Regulation (Aug. 27, 2008) 13, 14

Statement of the Case

Michael Baker adopts the Statement of the Case, including the Material Proceedings and Statement of Facts, as set forth in Kohl's Opening Brief.

Assignments of Error and Standard of Review

Michael Baker adopts the Assignments of Error set forth in Kohl's Opening Brief.

Michael Baker also contends that if the court views the plain language of Va. Code § 58.1-402(B)(8)(a)(1) (the "subject to tax safe harbor") as ambiguous, extrinsic sources confirm that the subject to tax safe harbor must be interpreted as providing a full exception from addback for an intangible expense where any portion of the corresponding item of income received by the related member was subject to a tax based on or measured by net income.

This appeal comes before the court on summary judgment and involves questions of statutory interpretation, so the standard of review is *de novo*. *Deutsche Bank National Trust Co. v. Arrington*, 772 S.E.2d 571, 573 (Va. 2015).

Interest of Amicus

Your amicus, Michael Baker Jr., Inc. ("Michael Baker") is a corporation in the business of providing professional engineering and consulting services. Michael Baker's markets include Aviation, Defense, Environmental, Facilities, Geospatial Information Technologies, Homeland Security, Municipal & Civil, Pipelines & Utilities, Rail & Transit, Transportation, and Water. The services Michael Baker provides span the complete life cycle of infrastructure and managed asset projects, including planning, design, construction services, asset management, and asset renewal.

The outcome in this case has a direct effect on Michael Baker's Virginia income tax liability. Michael Baker has an Application for Refund of Corporation Income Tax pending in the Richmond City Circuit.[1] The sole issue in Michael Baker's Application for Refund is whether intangible expenses paid by Michael Baker to a related member are subject to the intangible expense addback set forth at VA Code § 58.1-402(B)(8).

Michael Baker, like Kohl's Department Stores, Inc. ("Appellant" or "Kohl's"), takes the position that its intangible expenses are not subject to

[1] Civil Action No. 14-4516-4.

addback because its related member paid tax to another state on the intangible payments.[2]

Summary of Argument

On the surface, this appeal centers on statutory interpretation. At its core, though, this appeal tells a story of executive overreach. The General Assembly enacted a statute that was clear on its face. Notwithstanding the statute's clarity, the Department chose to enforce the statute based on an interpretation at odds with the plain language. The Department continued to enforce its interpretation of the statute, despite the fact that the General Assembly subsequently rejected legislation that would have expressly adopted the Department's interpretation.

Michael Baker respectfully urges the Court to protect the taxpaying public and the legislature against this executive overreach. When a statute is clear, the executive branch must apply the statutory language as enacted by the General Assembly.

Argument

Kohl's is not required to add back intangible expenses it paid to Kohl's Illinois because those expenses satisfy the subject to tax safe harbor

[2] Pursuant to Rule 5:30, counsel for all parties have provided written consent to the filing of this amicus brief. Copies of the written consent have been submitted to the Court.

as enacted by the General Assembly in 2004. The plain language of the subject to tax safe harbor unambiguously provides a full exception from addback for any intangible expense when the related member is subject to a tax based on or measured net income or capital in any state and the item of income corresponding to the intangible expense is included in the tax base. However, even if the court finds the plain language ambiguous, extrinsic sources confirm that Kohl's interpretation of the subject to tax safe harbor is correct.

1. The plain language of the subject to tax safe harbor provides Kohl's a full exception from addback.

Kohl's is not required to add back its payments to Kohl's Illinois because those payments fall within the plain language of the subject to tax safe harbor.

The addback statute generally requires a corporation to add back intangible expenses paid to a related member in computing Virginia taxable income. Va. Code § 58.1-402(B)(8)(a). However, the subject to tax safe harbor provides that addback "shall not be required for any portion of the intangible expenses and costs if . . . [t]he corresponding item of income received by the related member is subject to a tax based on or measured by net income or capital imposed by Virginia, another state, or a foreign

government that has entered into a comprehensive tax treaty with the United States government." Va. Code § 58.1-402(B)(8)(a)(1).

The Department interprets the subject to tax safe harbor to apply only **to the extent that** the payee's "income [was] subjected to tax in other states." P.D. 07-153 (Oct. 2, 2007). The Department argues that the subject to tax safe harbor is limited to the amount of the "corresponding item of income" that was taxed by Virginia or another state. Department's Brief in Opposition to Kohl's Motion for Summary Judgment at 13 ("The Subject to Tax Safe Harbor is expressly limited to '**the corresponding item of income** received by a related member.' . . . Thus, when read as a whole, it is clear that the [subject to tax safe harbor] applies only to 'any portion' of Kohl's intangible expenses for which the 'corresponding item of income' received by Kohl's Illinois was 'subject to a tax . . . imposed by . . . another state.'") (emphasis in original).[3]

Case law establishes that "[c]ourts must not construe the plain language of a statute in a way that adds a requirement that the General Assembly did not expressly include in the statute." *David v. David*, 754

[3] Michael Baker refers to the Department's interpretation of the subject to tax safe harbor herein as allowing for a "proportional" exception from addback. In contrast, Michael Baker refers to the interpretation of the subject to tax safe harbor advocated by Kohl's and Michael Baker as allowing for a "full" or "all or nothing" exception from addback

S.E.2d 285, 290 (Va. 2014). In this case, the Department asks the Court to read the words "to the extent that" into the statute even though they are not there. Thus, the Court should reject the Department's interpretation imposing a "proportional" limitation on the subject to tax safe harbor and hold that the subject to tax safe harbor applies on an all or nothing basis.

(i) The subject to tax safe harbor provides a full exemption from addback because it does not contain limiting language.

As Kohl's ably explained in its Petition, the Department's statutory construction attempts to interpret the subject to tax safe harbor outside the context of the addback statute viewed as a whole. *See* Petition at 20–22. Rather than rehashing that explanation, Michael Baker simply adds that, in the context of another deduction, the Department has ruled that language such as "to the extent that" is an "indication of proportionality," and that the absence of such limiting language "create[s] an all or nothing condition for the allowance" of that deduction. P.D. 07-211 (Dec. 5, 2007). The subject to tax safe harbor does not contain limiting language such as "to the extent that," so it must also be construed as an "all or nothing" exception.

(ii) In direct contravention of the statute, the Department's interpretation provides no addback relief when the related member is subject to a tax on capital.

The Department's interpretation is that a taxpayer is only entitled to benefit from the subject to tax safe harbor to the extent that a related member is subject to income tax by Virginia or another state on the "corresponding item of income". This directly contravenes the statute, which also provides an exception if the related member is subject to a tax on capital.

By definition, a tax on capital does not directly take income into account.[4] As a consequence, there is no way to identify a "corresponding item of income" that is taxed by a state that imposes a tax on capital. Therefore, under the Department's interpretation, a taxpayer does not qualify for the subject to tax safe harbor if the related member is only subject to a tax on capital.

This interpretation renders the portion of the statute defining the scope of the subject to tax safe harbor to include when the related member is subject to a tax on capital as surplusage. Under Virginia law, "[a] word or clause contained in a statute may only be rejected as surplusage if it

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[4] *See* Hellerstein & Hellerstein, State Taxation ¶ 11.03 ("Capital stock taxes are typically measured by the value of the corporation's capital, which is usually determined by reference to the corporation's net worth, including capital, surplus, and undivided profits.").

‘appears to have been inserted through inadvertence or mistake, and which is incapable of any sensible meaning.’” *Hodges v. Commonwealth, Dep’t of Social Services*, 598 S.E.2d 778, 781 (Va. Ct. App. 2004) (quoting *Burnette v. Commonwealth*, 75 S.E.2d 482, 484–85 (Va. 1953)); *see, e.g.*, *City of Richmond v. Virginia Electric & Power Co.*, 787 S.E.2d 161, 163–64 (Va. 2016) (“Therefore, the phrase ‘heat, light and power’ in the definition of ‘commission’ must enumerate three separate items and the word ‘power’ must have some meaning independent of what is conveyed by the words ‘heat’ and ‘light.’ Otherwise, ‘power’ would be meaningless, and we are not permitted to adopt such a construction.”).

The General Assembly’s inclusion of payments to related members that were subject to a tax on capital within the scope of the subject to tax safe harbor was intentional. Prior to enacting the addback statute, the General Assembly considered another bill that included an addback with a subject to tax safe harbor, with the sole difference between the safe harbor enacted and that originally proposed being that the safe harbor originally proposed would have applied only when the related member is subject to income tax. HB 791 of 2004. The General Assembly did not enact that bill, so including taxes on capital in the subject to tax safe harbor was

intentional. The Department's interpretation ignores this intentional change, so should be rejected.

2. Even if the subject to tax safe harbor is ambiguous, extrinsic evidence shows that the General Assembly intended the subject to tax safe harbor to provide an all or nothing exemption from addback.

If the court finds that the subject to tax safe harbor is ambiguous, the Court should turn to extrinsic aids to construe the statute. *See Virginia Department of Labor & Industry v. Westmoreland Coal Co.*, 353 S.E.2d 758, 762 (Va. 1987). In this case, a comparison of Virginia's subject to tax safe harbor with Alabama's subject to tax exception and the subsequent history of the subject to tax safe harbor demonstrate that the General Assembly intended the subject to tax safe harbor to apply on an all or nothing basis.

(a) A comparison with Alabama's addback statute supports Kohl's interpretation.

Below, the Department cited an Alabama case that upheld the subject to tax exception in Alabama's intangible expense addback statute. Department's Brief in Opposition to Kohl's Motion for Summary Judgment at 8 n.1 (citing *Surtees v. VFJ Ventures*, *Inc.*, 8 So.3d 950, 972–76 (Ala. Civ. App. 2008). However, Alabama's statutory language corresponds to

the Department's proportional interpretation of Virginia's subject to tax safe harbor. Ala. Code § 40-18-35.

Michael Baker agrees that if Virginia had enacted an addback statute identical to Alabama's, the Department's proportional interpretation of the subject to tax safe harbor would be correct. But as demonstrated in the table below, the General Assembly chose to enact an addback statute markedly different from Alabama's:

Ala. Code § 40-18-35	Va. Code 58.1-402(B)(8)(a)(1)
Addback is required "except to the extent the corporation shows . . . that the corresponding item of income was in the same taxable year: a. Subject to a tax based on or measured by the related member's net income in Alabama or any other state of the United States, or b. subject to a tax based on or measured by the related member's net income by a foreign nation which has in force an income tax treaty with the United States, if the recipient was a "resident" (as defined in the income tax treaty) of the foreign nation. For purposes of this section, subject to a tax based on or measured by the related member's net income means that the receipt of the payment by the recipient related member is reported and included in income for purposes of a tax on net income, and not offset or eliminated in a combined or	Addback "shall not be required for any portion of the intangible expenses and costs if . . . [t]he corresponding item of income received by the related member is subject to a tax based on or measured by net income or capital imposed by Virginia, another state, or a foreign government that has entered into a comprehensive tax treaty with the United States government."

consolidated return which includes the payor. Any portion of an item of income that is not attributed to the taxing jurisdiction, as determined by that jurisdiction's allocation and apportionment methodology or other sourcing methodology, is not included in income for purposes of a tax on net income and, therefore, shall not be considered subject to a tax. That portion of an item of income which is attributed to a taxing jurisdiction having a tax on net income shall be considered subject to a tax even if no actual taxes are paid on such item of income in the taxing jurisdiction by reason of deductions or otherwise."	

There are several important distinctions between the two statutes:

- The Alabama statute allows an exception from addback "to the extent" that the related member was subject to tax, whereas the Virginia statute contains no such limitation on the subject to tax safe harbor.
- The Alabama statute defines what it means to be "subject to tax," but the Virginia statute does not.
- The Alabama statute allows an exception from addback only in situations in which the related member is subject to a net income tax, whereas the Virginia statute allows an exception for situations in which the related member is subject to either a net income tax or a tax on capital.
- The Alabama statute specifies the treatment of intangible expenses that are eliminated in combined or consolidated returns, whereas the Virginia statute does not.
- The Alabama statute discusses the related member's apportionment, whereas the Virginia statute does not.

Furthermore, Alabama's intangible expense addback statute was enacted in 2001, several years before the General Assembly adopted Virginia's intangible expense addback statute, so the Alabama statutory language was available to the General Assembly as a road map if it had intended to enact a proportional subject to tax safe harbor. *See* Alabama Act No. 2001-702.

Instead, the General Assembly chose statutory language markedly different from Alabama's when it enacted Virginia's addback statute. This shows an intent to enact an addback statute that would be applied differently from Alabama's. *See* Norman Singer & Shambie Singer, 2B Sutherland Statutes and Statutory Construction § 51:6 (7th ed. 2016) ("Legislation that is different from that common in other states, but on the same subject, typically manifests a legislative purpose to accomplish legal results different from those in other states.").

(b) The subsequent history of the subject to tax safe harbor supports Kohl's interpretation.

Before litigating the scope of the subject to tax safe harbor, the Department made several attempts to revise the subject to tax safe harbor administratively and legislatively. These attempts were not successful until 2014, after Kohl's appeal was already pending. As explained below, the Department's failure to promulgate regulations or to convince the General

Assembly to change the subject to tax safe harbor confirms that the safe harbor was intended to apply on an all or nothing basis.

(i) A failed rulemaking attempt by the Department reinforces that the Department's proportional interpretation of the subject to tax safe harbor is inconsistent with the statute.

The Department's first attempt to limit the subject to tax safe harbor was to initiate a rulemaking. On March 19, 2007, the Department issued a notice that explained the purpose of the intended regulation. Notice of Intended Regulatory Action (NOIRA) Agency Background Document (Mar. 19, 2007). According to the notice, the intended regulation would "clarify the safe harbors granted by the General Assembly" in passing the addback statute.

The Department issued a draft regulation on May 29, 2008. This draft regulation limited the subject to tax safe harbor in the exact manner that the Department has endorsed in this appeal. In response to the draft, the Department received the following comments:

- "The [Department's interpretation of the subject to tax safe harbor] may follow recent rulings of the Commissioner, but that position is inconsistent with the plain wording of the statutes. There is no authority in the statute for the Department to convert a bright line 'safe harbor' into a prorated add back. . . .Had the General Assembly intended the exception to be

proportional, instead of outright, it easily could have added words to that effect, but it did not do so."[5]

- "[C]larification is needed regarding how corporations would demonstrate that there is an actual tax liability and whether it includes franchise taxes or just taxes based on income."[6]
- "Eliminate the 'subject to tax' portions of the regulation—they are contrary to the statutory exception to the addback provision for income subject to tax by another state (or foreign entity), see Virginia Code § 58.1-402(B)(8)(a)(1)."[7]
- "Contrary to the statute, which provides complete immunity from add-back when the requirements of these statutory exceptions are satisfied, the draft regulation erroneously purports to narrow the scope of this immunity only to a portion of the add-back. This exceeds the statutory authority. The only add-back exception to receive different treatment by the General Assembly is the conduit exception to the intangible expense add-back, which expressly provides that the exception applies to 'such portion' of the expense that satisfies the exception criteria."[8]

Understandably, the Department halted the rulemaking after receiving these comments.

The fact that the Department abandoned the rulemaking reinforces that the Department's proportional interpretation of the subject to tax safe harbor was either "unreasonable or plainly inconsistent with applicable provisions of law." *See* Va. Code Ann. § 58.1-205(2). Otherwise, the Department would have proceeded with the rulemaking as its position

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[5] Virginia Chamber of Commerce Tax Policy Committee, Comments on Draft Intangible Holding Company Regulation (Aug. 27, 2008).
[6] Letter from Virginia Society of Certified Public Accountants to Commissioner Janie Bowen (Aug. 29, 2008).
[7] Letter from Fred Nicely to Janie Bowen (Aug. 29, 2008).
[8] Letter from H. Lane Kneedler to Janie E. Bowen (Aug. 29, 2008).

would have become the law. *Id.; cf. American College of Chest Physicians v. Department of Revenue*, 559 N.E.2d 774, 777 (Ill. Ct. App. 1990) (agency's failure to finalize proposed regulation shows that interpretation in proposed regulation was not the law).

(ii) The Department's failed attempts to have the General Assembly amend the subject to tax safe harbor show that the subject to tax safe harbor was intended as an all or nothing exception.

Rather than proceeding with the rulemaking, the Department instead attempted to convince the General Assembly to pass a bill that would limit the subject to tax safe harbor. From 2010 to 2013, the General Assembly considered and rejected bills on three separate occasions that would have amended the subject to tax safe harbor to conform with the Department's "proportional" interpretation. *See* SB 407 of 2010; HB/SB 29 of 2010; HB/SB 30 of 2010; SB 1036 of 2013. The General Assembly rejected each of these proposals. For the Court's reference, Michael Baker has prepared a table attached to this brief showing the proposed changes to the language of the subject to tax safe harbor that were drafted by the Department and the legislative outcome for each of the legislative proposals.

Under Virginia law, when the General Assembly repeatedly considers and rejects bills on a topic, it demonstrates that the General Assembly

disapproved of the content of the bills. *Tabler v. Board of Supervisors of Fairfax County*, 269 S.E.2d 358, 360 (1980). In *Tabler*, the question was whether a statute allowed counties to require deposits on disposable containers. *Id.* at 359. The statue allowed counties to regulate garbage and litter, but was ambiguous as to whether a county could impose deposits on disposable containers. *Id.*

To resolve this ambiguity, the court turned to the subsequent history of the statute. *Id.* at 360. After the statute in question had been enacted, the General Assembly considered and rejected bills that would have banned disposable containers, bills that would have placed a tax on disposable containers, and bills that would have permitted a city to ban disposable containers. *Id.* at 360–61. The court concluded that "[t]hese actions by the General Assembly indicate clearly and unambiguously that the General Assembly did not intend to grant local governing bodies the power to regulate or prohibit the sale or use of disposable containers." *Id.* at 361.

Likewise in this case, on three separate occasions from 2010 through 2013 the General Assembly considered and rejected bills that would have limited the subject to tax safe harbor to a proportional exception from addback, in accordance with the Department's interpretation. These

actions indicate clearly and unambiguously that the General Assembly did not intend a proportional exception from addback.[9]

(iii) A 2014 statutory change shows that the subject to tax safe harbor, as originally enacted, was intended to be an all or nothing safe harbor.

On April 1, 2014 Governor McAuliffe signed bills that provided that

> Notwithstanding the provisions of § 58.1-402(B)(8), Code of Virginia, . . . [t]he exception in § 58.1-402(B)(8)(a)(1) for income that is subject to a tax based on or measured by net income or capital imposed by Virginia, another state, or a foreign government shall be limited and apply only to the portion of such income received by the related member, which portion is attributed to a state or foreign government in which the related member has sufficient nexus to be subject to such taxes . . . .[10]

According to the Department, "[b]ecause the language in th[ese] Act[s] is intended to merely clarify existing law, these provisions are effective for taxable years beginning on and after January 1, 2004, when the addback requirement was initially effective." Virginia Department of Taxation, 2014 Legislative Summary, P.D. 14-97 (July 1, 2014). But this is inconsistent with the principle that "amendments to the law are purposeful and not unnecessary or vain." *See Cape Henry Towers, Inc. v. National*

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[9] As explained *infra*, the General Assembly eventually enacted a statute in 2014 that accords with the Department's proportional interpretation of the subject to tax safe harbor. However, that statutory change should not be applied to Kohl's.

[10] HB 5001 Special Session I 2014, § 3-5.11; HB 5002 Special Session I 2014, § 3-5.10.

Gypsum Co., 331 S.E.2d 476, 479 (Va. 1985) (citing *Williams v. Commonwealth*, 56 S.E.2d 537, 543 (Va. 1949)).

The United States Supreme Court's decision in *Smietanka v. First Trust & Savings Bank* is instructive. 257 U.S. 602 (1922). In that case, a 1913 statute was ambiguous as to whether "income held and accumulated by a trustee for the benefit of unborn and unascertained persons was taxable." *Id.* at 603. The Commissioner of Internal Revenue ruled that the income was taxable and assessed taxpayers for the 1913 through 1915 tax years. *Id.* at 603, 606. In 1916, Congress enacted a statute that expressly stated that such income was taxable. *Id.* at 607. Rather than interpreting the 1916 statute as clarifying the 1913 statute, the Court held that the 1916 statute meant that the 1913 statute did not intend to tax the income in question. *Id.* at 606; *see also Provost v. United States*, 269 U.S. 443, 458 (1926); *Lewellyn v. Frick*, 268 U.S. 238, 252 (1925).

Additionally, the language of the 2014 statutory change implies that the original Subject to Tax exception was intended to provide an exception from addback that applied on an all or nothing basis. According to its own terms, the 2014 statutory change applies "**[n]otwithstanding** the provisions of § 58.1-402(B)(8)[the original addback statute]." HB 5001 Special Session I 2014, § 3-5.11; HB 5002 Special Session I 2014, § 3-

5.10 (emphasis added). "Notwithstanding" is defined as "despite,"[11] so the use of the word "notwithstanding" suggests that the originally enacted subject to tax safe harbor differed from the statutory change; otherwise, there would be no need to preface the 2014 statutory change with "notwithstanding." *See Laurels of Bon Air, LLC v. Medical Facilities of America LIV Ltd. Partnership*, 659 S.E.2d 561, 566–67 (Va. Ct. App. 2008); *see also Cage v. Cage*, 73 Va. Cir. 190 (Portsmouth County Cir. Apr. 3, 2007) (use of notwithstanding "clearly reflects the legislature's determination for [new statute] to govern despite any other conflicting, contrary or seemingly incongruous statutory provision"). And the only distinction between the original addback statute and the 2014 amendment is that the originally enacted statute provided a subject to tax safe harbor that applied on an all or nothing basis.

3. The 2014 statutory change cannot be applied to Kohl's.

Despite the 2014 statutory change, Kohl's qualifies for a full subject to tax safe harbor for two reasons. First, the Department agreed not to apply the 2014 statutory change to Kohl's for the tax years at issue in this case. Second, due process prohibits retroactive tax increases except under limited circumstances which are not present in this case.

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[11] *See* http://www.merriam-webster.com/dictionary/notwithstanding; Black's Law Dictionary (10th ed. 2014) ("notwithstanding").

(a) The Department agreed not to apply the 2014 statutory change against Kohl's.

At the request of the parties, the Richmond City Circuit entered a scheduling order that provided that "[t]o promote judicial economy, the preservation of resource[s] and the efficient resolution of the principal issues that are before the Court in this case, the parties have agreed (without waiving any rights or arguments that may be applicable in future cases related to other taxpayers) that the" 2014 statutory change is not at issue in Kohl's appeal. Scheduling Order, *Kohl's Department Stores Inc. v. Virginia Department of Taxation*, Case No. CL12001774-00-4 (Aug. 27, 2015).

If the court chooses to follow the scheduling order, there is no need to address the application of the 2014 statutory change to Kohl's. However, deciding whether the statutory change could be applied retroactively to Kohl's may promote judicial economy, preserve resources, and efficiently resolve Kohl's appeal as well as other appeals pending below.[12] If the Court decides that Kohl's is entitled to a full exception from addback

[12] Remand is not necessary because this case is before the court on summary judgment and the 2014 statutory change is capable of judicial notice, Rule 2:02. *See Kohn v. Marquis*, 762 S.E.2d 755, 757 (Va. 2014) ("In an appeal arising from the grant of a motion for summary judgment, appellate courts will review the application of law to undisputed facts de novo.").

without addressing the 2014 statutory change, another taxpayer would need to litigate the constitutionality of the retroactive application of the 2014 statutory change.[13]

(b) Applying the 2014 statutory change to Kohl's would violate due process.

If the Court chooses to address the application of the 2014 statutory change to Kohl's, case law establishes that retroactively applying the 2014 statutory change to Kohl's would violate due process. A retroactive tax increase can only be applied when the legislature's "purpose in enacting the amendment was neither illegitimate nor arbitrary" and the legislature established "only a modest period of retroactivity." *United Sates v. Carlton*, 512 U.S. 26, 32 (1994). Neither of these conditions is satisfied here, so the 2014 statutory change cannot be applied to Kohl's.

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[13] Furthermore, allowing the Department to ignore the retroactive statute in Kohl's appeal but not in other taxpayers' appeals would allow the Department to take "two bites at the apple." If the Department wins in this case on the statutory interpretation question, the Department will also prevail in all of the other pending appeals regarding the issue of whether the subject to tax safe harbor provides a full or proportional exception from addback. However, if Kohl's wins on the statutory interpretation question in this case, only Kohl's wins—the Department will still be able to argue that the 2014 statutory change should be applied retroactively against all other taxpayers with pending appeals. This type of gamesmanship by the government should not be tolerated. *Cf. F.M.C. Stores Co. v. Borough of Morris Plains*, 495 A.2d 1313, 1318 (N.J. 1985) (state government "may not conduct itself so as to achieve or preserve any kind of bargaining or litigational advantage over" taxpayers because the government's "primary obligation is to comport itself with compunction and integrity").

Virginia decisions have only permitted retroactive changes to tax statutes after an unforeseeable occurrence. *See Alderson v. County of Alleghany*, 585 S.E.2d 795 (Va. 2003) (retroactive tax allowed after city converted into a town); *Colonial Pipeline Co. v. Commonwealth*, 145 S.E.2d 227, 231 (Va. 1965) (retroactive tax allowed after agency decision found that entity was not subject to existing tax); *Giesecke v. Department of Taxation*, 34 Va. Cir. 455 (Fairfax County Cir. Sept. 22, 1994) (retroactive tax allowed after court interpreted statute in manner contrary to Department's position that had been consistent and unchallenged for thirty years). There was no unforeseeable occurrence here. Taxpayers have taken the position that the subject to tax safe harbor applied on an all nothing basis since the addback statute was passed in 2004. The Department has been aware that taxpayers interpreted the subject to tax safe harbor as all or nothing since at least March 2007.[14] Yet the statute remained the same until 2014.

In terms of timing, there is no bright line test for what constitutes "a modest period of retroactivity," but the longest period of retroactivity for a taxing statute that has been upheld in Virginia is three years. *Giesecke*, 34 Va. Cir. 455 at * 4. In *Giesecke*, the Circuit Court expressly noted that the

[14] This is when the Department initiated the rulemaking process to to limit Subject to Tax Exception. Notice of Intended Regulatory Action (NOIRA) Agency Background Document (Mar. 19, 2007).

three year retroactive period "is longer than generally found acceptable" but was consistent with due process because the "legislature acted promptly" in revising the statute after an unexpected judicial interpretation of the statute. *Id.* at *5. In contrast, in this case, if the 2014 statutory change were to be applied retroactively to Kohl's, the period of retroactivity would be five years as applied to the first year at issue. Given the fact that the Department was aware of the conflicting statutory interpretations for at least seven years when the 2014 statutory change was enacted, five years can hardly be considered a modest period of retroactivity.

Conclusion

Michael Baker requests that the court rule that Kohl's is entitled to a full exception from addback under the subject to tax safe harbor, issue an order striking the Department's assessment, and grant all other just and proper relief.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that this brief complies with Rule 5:26 and that on this 9th day of December, 2016, that ten copies of this Amicus Brief have been filed with the Clerk's Office of the Supreme Court of Virginia, an electronic copy filed through VACES, and an electronic copy sent via email to all counsel of record.

By: /s/ Michael A. Jacobs
Michael A. Jacobs (VSB No. 34790)

Attachment

Bill	Proposed Revision (additions in italics, deletions in strikethrough)	Legislative Outcome	Department's Explanation of Bill
SB 407 of 2010	Addback "shall not be required for any portion of the intangible expenses and costs ~~if~~ ***to the extent that*** one of the following applies . . . [t]he corresponding item of income received by the related member is subject to a tax based on or measured by net income or capital imposed by Virginia, another state, or a foreign government that has entered into a comprehensive tax treaty with the United States government. . . ."	Referred to Committee on Finance. Stricken at request of Patron in Finance.	Clarifies the addition required for royalty and similar payments made to an affiliated intangible holding company ("IHC") by codifying The Department of Taxation's ("TAX") interpretation of the exception for payments on which the IHC is subject to tax in another state. TAX has interpreted this exception as being limited to the portion of the payments that are subject to tax in the other state(s). Thus, if five percent of the IHC's income was apportioned to another state, then only five percent of the payments to the IHC are exempt from the addition.[15]
HB/SB 29 of 2010; HB/SB 30 of 2010 Item 4-14	Addback "shall not be required for any portion of the intangible expenses and costs ~~if~~ ***to the extent that*** one of the following applies . . . [t]he corresponding	Removed in HB 29 Conference Report Item 5.0.00 #1c and	HB/SB 29 includes an enactment that amends and reenacts Section 58.1-615.1 of the Code, clarifying the wording of a 2004 Session change

[15] Virginia's Legislative Information System, *https://lis.virginia.gov/cgi-bin/legp604.exe?101+cab+SC10115SB0407+SBREF*

	item of income received by the related member is subject to a tax based on or measured by net income or capital imposed by Virginia, another state, or a foreign government that has entered into a comprehensive tax treaty with the United States government. . . .”	HB 30 and HB 29 Item 5-0.00 #1c.	related to royalty payments made to affiliated intangible holding companies. Interpretation of the Code of Virginia language continues to be questioned, and the proposed amendment clarifies initial intent.[16]
SB 1036 of 2013	Addback “shall not be required for any portion of the intangible expenses and costs if one of the following applies ***to such portion*** . . .[t]he ~~**corresponding**~~ item of income ***corresponding to such portion*** received by the related member is subject to a tax based on or measured by net income or capital imposed by Virginia, another state, or a foreign government that has entered into a comprehensive tax treaty with the United States	Referred to Committee on Finance. Stricken at request of Patron in Finance.	Clarifies the applicability of the exceptions to the add back of intangible expenses to a corporation's taxable income. The bill states that it is declarative of existing law[17]

[16] Summary of the Governor’s Proposed Amendments to the 2008–2010 Budget Introduced as HB/SB 29 and the Governor's Proposed 2010-2012 Budget Introduced as HB/SB 30, Page 35 (January 11, 2010).

[17] Virginia’s Legislative Information System, https://lis.virginia.gov/cgi-bin/legp604.exe?131+cab+SC10110SB1036+SBREF

	government. . . . ***[T]the provisions of this act are declarative of existing law.***”		