



Case Presents Opportunity to Ensure Uniform Application of Tax Code and Prevent Harm to Taxpayers

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Introduction

In May, the U.S. Supreme Court will decide whether to hear the case of *Centerior Energy Corp. v. Mikulski*, an appeal from a lower court decision opening the door to fragmented state-by-state interpretations of the U.S. tax code.[\[1\]](#) [The Tax Foundation filed a friend of the court brief](#) urging the Court to take the case, which raises the question of whether taxes paid to the government can be recovered from a business instead of from the IRS.

I. A Dilemma Faced by Many Taxpayers

Like many taxpayers, Centerior Energy Corp. was confronted with applying complex tax laws to its individual situation. The tax law in question, 26 U.S.C. § 7422, was left ambiguous by Congress, which had expected the IRS to issue further regulations. Since the IRS never did, Centerior and other taxpayers had to choose between two conflicting, but equally plausible, interpretations. The plaintiffs in this case (the Mikulskis) allege that Centerior chose wrongly, and as a result, caused them to overpay their income taxes. The lower court agreed, suggesting that "correct" interpretations of ambiguous tax laws could vary state-by-state.

The dilemma faced by Centerior is one faced routinely by taxpayers. A recent Tax Foundation report examined several examples of items in the tax code that have confused taxpayers, such as the sales tax deduction, the alternative minimum tax, the telephone excise tax refund, Hurricane Katrina exemptions, and education credits.[\[2\]](#)

II. Federal Courts Can Prevent Fragmented Interpretations of Tax Laws

Rather than seeking a tax refund from the IRS, which according to federal law is the only way to recover taxes paid,^[3] the plaintiffs instead sued Centerior in state court. Because this lawsuit would raise the same issues as would be litigated in a federal tax refund claim, a likely outcome could be fifty different official state interpretations of one supposedly uniform federal tax law. Such a fragmented code would undermine economic investments, as the National Taxpayer Advocate's Office recently reported, because uniform application promotes the predictable standard necessary for individual and business tax planning. ^[4] For these reasons, the U.S. Supreme Court recently held that such cases should be heard in federal court.^[5]

Not all tax cases can automatically be heard in federal court. Article III, Section 2 of the U.S. Constitution allows federal courts to exercise jurisdiction over cases alleging a violation of the U.S. Constitution or federal law. This jurisdiction extends to cases initially brought in a state court, if the case involves a federal claim. In *Grable & Sons Metal Products Inc. v. Darue Engineering & Manufacturing*, the Court held that federal courts may hear "a state law claim [that] necessarily raise[s] a stated federal issue, actually disputed and substantial, which a federal forum may entertain without disturbing any congressionally approved balance of federal and state judicial responsibilities."^[6]

This case should be heard in federal court because it turns entirely on the interpretation of one tax code provision. If the plaintiffs are successful at shifting the refund burden from government to business, those businesses may find themselves caught between a state court ordering them to pay and a federal court capable of ordering the federal government to reimburse the company.^[7] Allowing taxpayers to disregard the predetermined procedure for tax refunds would further complicate an already complicated tax code.

III. Past Cases Have Held That Overpaid Taxes Can Only Be Recovered from Government

Other federal courts have held that allegedly overpaid taxes can only be recovered from government, not from businesses, if the business has forwarded the money to the government.^[8] Many of these decisions arose from the temporary lapse of the federal excise tax on airline tickets, because airlines collected the revenue based on their expectation that the tax would eventually be re-enacted. Airline passengers filed breach of contract claims against the airlines in state courts, seeking refund of the money even though the sums had been remitted to the federal government. Each court ruled for the airlines, because the passengers had failed to exhaust their administrative remedies and did not sue the party who actually had the money (the federal government).^[9]

The *Airline Excise Tax Cases* are directly applicable to the *Mikulski* case. Those cases and this case involve a non-governmental actor who, due to an alleged misapplication of federal law, caused the taxpayer to overpay their taxes. In both situations, the money was no longer held by the actor, but by the government without any hope of reimbursement in case of an adverse judgment. Both cases had the taxpayer seeking damages under state law claims matching the amount paid in taxes. The decision in both cases turns entirely on a definitive interpretation of

federal law. While Centerior Energy did not collect the taxes, their action in preparing the 1099 forms was compelled by federal law.^[10] The claimants' claims should therefore be dismissed.

Conclusion

Fragmented interpretations of the federal tax code exacerbate complexity, harm taxpayers, and inhibit commercial activity. If the lower court plaintiffs are successful, states would declare "official" state interpretations of federal tax laws twenty years after the fact, and businesses would be subject to fraud lawsuits for any actions relying on any other interpretation. A federal tax code with supposedly universal application would end up balkanized with fifty different interpretations. Unless the U.S. Supreme Court acts, [as the Tax Foundation urges in its friend of the court brief](#), the plaintiffs' success in the Sixth Circuit will harm taxpayers, weaken the *Grable* test, and undermine the uniform application of the federal tax code.

Notes

[1] See *Mikulski v. Centerior Energy Corp.*, 501 F.3d 555 (6th Cir. 2007).

[2] See Mark A. Robyn & Gerald Prante, *Small Problems in 2007 Tax Filing Could Be Huge in 2008*, Tax Foundation Fiscal Fact No. 107 (Oct. 2007), at <http://www.taxfoundation.org/publications/show/22697.html>.

[3] Taxpayers seeking a refund of money paid to the government must first submit their claim to the administrative process. This process enables the IRS to provide input in the matter, in the context of the tax code and Treasury regulations, and then remedy any overpayment before a court battle. If the administrative appeals process fails, the only remaining option for the taxpayer is to file a civil suit against the United States. See 26 U.S.C. § 7422.

[4] See National Taxpayer Advocate's 2007 Annual Report at v, at <http://www.irs.gov/advocate> ("First and foremost, both taxpayers and tax administrators need certainty. The constant changing of tax laws and procedures confuses taxpayers and leads to their making errors or not claiming deductions or credits to which they are entitled under the law.")

[5] *Grable & Sons Metal Prods. Inc. v. Darue Eng'g & Mfg.*, 545 U.S. 308, 315 (2005) (meaning of the federal tax provision is an important issue of federal law that sensibly belongs in a federal court).

[6] *Id.* at 314.

[7] See *Kaucky v. Sw. Airlines Co.*, 109 F.3d 349, 351 (7th Cir. 1997) (a practical reason for the courts not to create [a taxpayer action]: it would throw a monkey wrench into machinery

designed to confine suits for the refund of federal taxes to suits in the federal courts against the government in order to protect its private as well as public agents from being whipsawed.).

[8] *See Brennan v. Sw. Airlines Co.*, 134 F.3d 1405, 1410 (9th Cir. 1998); *Sigmon v. Sw. Airlines Co.*, 110 F.3d 1200, 1204-05 (5th Cir. 1997); *Kaucky*, 109 F.3d at 351; *Eisenman v. Cont'l Airlines, Inc.*, 974 F.Supp 425, 431-32 (D.N.J. 1997).

[9] *Id.* at 1412.

[10] *See* 26 U.S.C. § 6042.

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