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U.S. Supreme Court Update

U.S. SUPREME COURT UPDATE

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Justices Question Need for Overturning Current Sales Tax Nexus Precedents

***42** On 4/17/2018, the U.S. Supreme Court heard oral arguments in *South Dakota v. Wayfair, Inc.*, *et. al.* (Docket No. 17-494). In South Dakota's closely watched petition for certiorari, the state asked the Court to review and overturnthe physical presence nexus standard announced in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). According to South Dakota, *Quill*'s physical presence standard—which requires out-of-state businesses to maintain some type of physical connection (*e.g.*, employees, inventory, or other property)within a state before the state may subject the business to its sales and use tax collection and remittance requirements—is harmful to local governments, brick-and-mortar businesses, and to interstate commerce itself. The state also argues that *Quill* isthe kind of judicial mistake that need not be reinforced under stare decisis. Instead, South Dakota argues that courts should apply the four-prong test from *Complete Auto Transit Inc. v. Brady* when determining the constitutionality of a state'ssales and use tax laws under the Commerce Clause.

At oral arguments, several justices seemed to question the prudence of overturning the Court's prior precedents. With her second question to Marty J. Jackley, South Dakota's Attorney General, Justice Sotomayor noted she was ‘concerned about the manyunanswered questions that overturning precedents will create a massive amount of lawsuits about.‘ Justice Sotomayor's concerns included possible retroactive application of new sales and use tax laws and the proper standard for determining sales tax nexusin the absence of *Quill*'s physical presence rule.

Similarly, Justice Alito asked, ‘if *Quill* is overruled, what incentives do the states have to ask for any kind of congressional legislation?‘ Justice Alito later noted that ‘South Dakota['s] law is obviously a test case. . . it was devised to present the most reasonable incarnation of this scheme. ‘ Questioning Malcolm L. Stewart, who argued on behalf of the United States as amicus curiae, Justice Alito asked, ‘[D]o you have any doubt that states that aretottering on the edge of insolvency and municipalities which may be in even worse position have a strong incentive to grab everything they possibly can?‘

****2** Other justices, however, appeared to acknowledge the need for a new sales and use tax nexus landscape. Justice Ginsburg, for example, questioned Wayfair's claim, argued by George S. Isaacson, that asking out-of-state sellers to collect tax on goods shippedin-state discriminates against interstate commerce. According to Justice Ginsburg, ‘as I see it, why isn't it, far from discriminating, equalizing sellers; that is, anyone who wants to sell in-state, whether an in-state shop, an out-of-state shop, everybodyis treated to the same tax collection obligation. All who exploit an in-state market are subject to the in-state tax.

Why isn't that equalizing rather than discriminating? ‘ Appearing to agree with Justice Ginsburg, Justice Gorsuch asked, ‘Why shouldwe favor, this Court favor, a particular business model that relies not on brick and mortar but on mail order?‘

As noted, also arguing before the Court was Deputy U.S. Solicitor General, Malcom L. Stuart. The government previously filed an amicus brief in support of South Dakota, in which it argued the Court should not extend *Quill*'s physical presencerule to e-commerce, but instead apply the rule only to traditional mail-order retailers. Mr. Stuart expanded on this argument before the Court, noting that *Quill* has ‘come to be understood to stand for the proposition that an out-of-stateretailer cannot be made to collect state sales tax unless it has employees or a physical facility within the state.‘ This rule, however, according to Mr. Stuart, was directly tied to the Court's *Bellas Hess* ruling in which itheld that ‘if the out-of-state retailer's only contact with the taxing state was delivery of goods and catalogues by mail or common carrier, that was insufficient [to establish nexus].‘ When the Court thenused the term ‘physical presence requirement,‘ Mr. Stuart argued it was using a ‘shorthand‘ for the full principle related only to mail-order retailers. Conversely, ‘the Court was not saying anything one way or the other about the role ofa pervasive Internet presence in establishing sufficient contacts with the state to allow for the collection duty.‘

In addition to hearing the *Wayfair* oral arguments, the Court has also received one new petition for certiorari in another case involving state and local taxes, while two previously reported petitions ***43** remained pending and one previously reportedpetition had been denied at the time of this writing. The Court's newest state and local tax petition, filed under *Franchise Tax Bd. of Cal. v. Hyatt* (Docket No. 17-1299), may sound familiar to regular readers of this column, as the Court haspreviously issued two rulings in the long-running residency and tort dispute between Gilbert Hyatt and the state of California. In the most recent petition, California asks the Court whether it is entitled to absolute immunity from Hyatt's intentional andbad-faith tort claims brought in the Nevada courts.

****3** Lastly, the Court still remains set to review a dispute between Delaware and several other states concerning which states have priority rights to claim abandoned, uncashed MoneyGram ‘official checks.‘ The MoneyGram cases set for review are *Delawarev. Pennsylvania et. al.*, Case No. 220145, and *Arkansas et. al. v. Delaware*, Case No. 220146. The Court has assigned the Honorable Pierre N. Leval, of the U.S. Court of Appeals for the Second Circuit, as Special Master in thesecases, tasked with coordinating the taking of evidence and making reports. (The Court typically assigns original jurisdiction disputes—cases such as disputes between states that are first heard at the U.S. Supreme Court level—to a Special Masterto conduct what amounts to a trial court proceeding.) We will continue to update readers as more details become available.

Nev. Supreme Court Determines Calif. FTB Not Immune from Taxpayer Tort Claims

On 3/12/2018, the U.S. Supreme Court received a new petition for certiorari in *Franchise Tax Bd. of Cal. v. Hyatt*, Docket No. 17-1299, ruling below at 407 P.3d 717 (Nev. 2017). In the case below, the Nevada Supreme Court held that the California Franchise Tax Board (the ‘FTB‘) was not entitled to immunity from intentional and bad-faith tort claims brought by former California resident,Gilbert Hyatt.

California's most recent petition for certiorari marks the latest in a long-running saga between Hyatt and the FTB. Hyatt's dispute with the FTB stems from the agency's attempt to collect approximately $10 million in taxes on patent licensing fees earnedby Hyatt in the 1990s. Following its audit, in which the FTB determined Hyatt to be a California resident, Hyatt sued the FTB in Nevada state court, claiming that the FTB's abusive investigation techniques cost him business opportunities and inflicted emotionaldistress. The Supreme Court of Nevada eventually largely reversed a jury award for tort damages and punitive damages awarded to Hyatt, but the Nevada high court held that the FTB was not immune from suit in Nevada and therefore could not escape all liability.

***Hyatt I* —the origins.**

As explained by the Nevada Supreme Court, in 1992, Gilbert Hyatt filed a California tax return stating that he had ceased to be a California resident and had become a Nevada resident. The FTB then commenced an audit of Hyatt's 1991 and 1992 income tax returnsand determined that he moved from California to Nevada in April 2012, not October 1991, as originally claimed. The audit resulted in the FTB assessing Hyatt approximately $7.8 million in additional personal income tax and interest liability.

Alleging the FTB committed several torts in the course of auditing his tax returns—including negligent misrepresentation, intentional infliction of emotional distress, fraud, invasion of privacy, abuse of process, and breach of a confidential relationship—Hyattsued the FTB in Nevada state court. The FTB argued that the Full Faith and Credit Clause to the U.S. Constitution, together with principles of sovereign immunity and comity, required the Nevada courts to grant the FTB the same immunity it would be affordedunder California law. Specifically, California law provides that no public entity may be held liable for any 'act or omission in the interpretation or application of any law relating to a tax.'

**4 Citing to *Nevada v. Hall*, 440 U.S. 410 (1979), however, which held that the U.S. Constitution does not grant states sovereign immunity from suit in the courts of other states, the Nevada Supreme Court eventually rejected the FTB's claim of complete immunity. Ultimately,the U.S. Supreme Court affirmed Nevada's decision in *Franchise Tax Bd. of Cal. v. Hyatt (Hyatt I)*, 538 U.S. 488 (2003).

***Hyatt II*—back again.**

After the Court's decision in *Hyatt I*, and more than ten years after Hyatt's original suit was filed, the case proceeded to a jury trial. The Nevada jury ruled in favor of Hyatt on all claims and awarded him a total judgment of $490 million.

On appeal, the Nevada Supreme Court held that the FTB was liable for fraud and intentional infliction of emotional distress only, which accounted for $86 million of the judgment. The court therefore affirmed in part and reversed in part the trial court'sdecision. In doing so, the Nevada Supreme Court rejected the FTB's argument that it was entitled to the same $50,000 statutory *44 damages cap that Nevada courts apply to Nevada governmental entities. The court did, however, conclude that as a matter of comitythe FTB was immune from punitive damages (as Nevada agencies would be), and due to several errors committed by the trial court, the Nevada court remanded the case for a new trial to set the proper amount of damages.

California again appealed the Nevada court's decision, and the U.S. Supreme Court granted certiorari for a second time, agreeing to consider two questions: (1) whether the Nevada Supreme Court erred by failing to apply to the FTB the statutory immunitiesavailable to Nevada agencies, and (2) whether the U.S. Supreme Court's prior decision in *Nevada v. Hall*, 440 U.S. 410 (1979), should be overruled. In *Hall*, the Court held that one state can hear a private citizen's lawsuit againstanother state without the other state's consent.

In its second decision, *Franchise Tax Bd. of Cal. v. Hyatt (Hyatt II)*, 136 S. Ct. 1277 (2016), the Court held that, with regard to California's first claim, the Full Faith and Credit Clause does not 'permit[] Nevada to award damages against California agencies under Nevada law that are greater thanit could award against Nevada agencies in similar circumstances.' As to California's second question, however, the Court, in the wake of Justice Antonin Scalia's death, spilt 4-4 on whether *Hall* should be overruled.

On remand from *Hyatt II*, the Nevada Supreme Court followed the High Court's instructions and held that the FTB was entitled to the benefit of Nevada's statutory damages cap and instructed the trial court to enter a damages award for fraud withinthe cap of $50,000. The Nevada court also held that a new trial was unnecessary on Hyatt's intentional infliction of emotional distress claim as the evidence at trial supported a damages award on that claim at the $50,000 cap.

**5 (For more background on *Hyatt II*, including a detailed discussion of the Court's decision, see U.S. Supreme Court Update, 26 JMT 40 (July 2016).)

Hyatt III—question presented.

In its 3/12/2018 filing, the FTB has now again requested that the U.S. Supreme Court grant certiorari, arguing that ‘under our federal system, an agency of one State may not (absent its consent) be sued in the courts of another State. ‘ Specifically,the FTB now asks the Court to answer the question it agreed to decide in *Hyatt II:* ‘whether *Nevada v. Hall* should be overruled.‘

Petitions Pending

The following two petitions for certiorari remained pending before the Court at the time of this writing.

Washington asks Court to overturn Yakama Nation ‘right to travel‘ without taxation victory.

On 6/14/17, the Court received a petition for certiorari in *Washington State Dep't of Licensing v. Cougar Den, Inc.*, Docket No 16-1498, ruling below at 188 Wash. 2d 55 (Wash. 2017), in which the Supreme Court of Washington held that the Yakama Nation ‘tribe[] w[as] entitled under [the Yakama Nation] [T]reaty to import fuel without holding [an]

importer's license and without paying state fuel taxes.‘

As explained by the court below, Article II of the Yakama Nation Treaty of 1855 states, in relevant part: ‘[I]f necessary for the public convenience, roads may be run through the said reservation; and on the other hand, the right of way, withfree access from the same to the nearest public highway, is secured them; as also the right, in common with citizens of the United States, to travel upon all public highways.‘ (Treaty with the Yakamas, 12 Stat. 951, 952-953 (1855)).

In 2013, Cougar Den, a Confederated Tribes and Bands of the Yakama Nation corporation, began transporting fuel from Oregon to the Yakama Indian Reservation. The company sold the fuel to businesses located on Tribal land and owned by Tribal members. The WashingtonDepartment of Licensing, however, issued tax assessments on the imported fuel ($3.6 million of taxes, penalties, and fees for hauling the fuel across state lines). Cougar Den refused to pay the assessment, arguing that the imposition of the tax violated itsright to travel under the Yakama Nation Treaty of 1855.

In reviewing the assessment, and upholding the lower courts' ruling in Cougar Den's favor, the Washington Supreme Court noted that ‘[t]here is no dispute that the taxes and licensing requirements would apply if the treaty provision does notapply here.‘ The court further explained, however, that the U.S. Supreme Court's rule of treaty interpretation requires that ‘Indian treaties must be interpreted as the Indians would have understood them.‘ The court concluded that ‘[t]heDepartment's interpretation of the treaty provision ignores the historical significance of travel to the Yakama Indians and the rule of treaty interpretation established by the United States Supreme Court. ‘ The court specifically noted that ‘[i]nruling in Cougar Den's favor, both the ALJ and the Yakima County Superior Court based their decisions on the history of the right to travel provision of the treaty, relying on the findings of fact and conclusionsof law from *Yakama Indian Nation v. Flores*, 955 F. Supp. 1229 (E.D. Wash. 1997),‘ in particular the depiction in the record of a ‘tribal culture whose manner of existence was dependent on the Yakamas' ability to travel.‘

****6** The Washington State Department of Licensing now presents the U.S. Supreme Court with the following question for review in its petition for certiorari: ‘Whether ***46** the Yakama Treaty of 1855 creates a right for tribal members to avoid state taxes on off-reservationcommercial activities that make use of public highways.‘

Federal officer alleges W.Va.'s treatment of retirement benefits violates intergovernmental immunity.

On 9/19/17, the Court received a petition for certiorari in *Dawson v. Steager,* Docket No. 17-419, ruling below at *Steager v. Dawson*, 2017 WL 2172006 (W. Va. 2017), in which the Supreme Court of Appeals of West Virginia held thatMr. Dawson, a

retired U.S. Marshal, was not entitled to exempt his Federal Employee Retirement System (‘FERS‘) income from state income tax.

According to the court, James Dawson (‘Dawson‘) worked as a deputy U.S. Marshal in West Virginia. Dawson was enrolled in FERS, a federal retirement plan, and sought a West Virginia exemption for all of his FERS income. Under West Virginia law, however,the court held that, unlike certain state law enforcement retirees who may exempt all of their state retirement benefits from taxable income, Dawson was entitled to exempt only a portion of his FERS income. The Supreme Court of Appeals of West Virginia heldthat this distinction did not violate the doctrine of ‘intergovernmental tax immunity.‘

According to the court, ‘the total structure of West Virginia's system for taxing personal income does not discriminate against retired members of the United States Marshals Service in violation of 4U.S.C. §111.‘ Instead, the court held the exemption at issue merely gives a benefit to ‘a very narrow class of former state and local employees, and that benefit was not intended to discriminate against former federal marshals.‘

Dawson now asks the U.S. Supreme Court to consider the following question for review: ‘Whether this Court's precedent and the doctrine of intergovernmental tax immunity bar states from exempting groups of state retirees from state income tax while discriminatingagainst similarly situated federal retirees based on the source of their retirement income.‘

Petition Denied

On 05/14/2018, the U.S. Supreme Court denied a petition for certiorari in *Cosgriff v. County of Winnebago*, Docket No. 17-1232, ruling below at 876 F.3d 912 (7th Cir. 2017), in which the U.S. Court of Appeals held that, under the comity doctrine, the taxpayers' tax-related claims could not be brought in federal court and, therefore, it dismissed the taxpayers' complaint.

As explained by the court below, when employees of Roscoe Township (the ‘Township‘), located in Winnebago County, Illinois, came onto the property of Kelly and Anita Cosgriff (the ‘Cosgriffs‘) to reassess the property's value after the Cosgriffsinstalled a $50,000 pool at their home, one of the employees was allegedly bitten by the Cosgriffs' dog. The employee and Township then sued the Cosgriffs. In response, the Cosgriffs posted a ‘No Trespass‘ sign on their property and started an onlinepetition encouraging other taxpayers to not allow the Township to trespass on private property.

****7** After quarrelling over the dog bite and the trespassing notices, the Township issued a property value assessment of the Cosgriffs' property 47.14% higher than the previous year (from $357,000 to $525,000). It was the highest increase in the Township in 2014,a year in which over 99% of properties saw their assessed values reduced from the previous year. The Cosgriffs then filed a property tax assessment complaint with the Winnebago County Board of Review. At the county hearing, the Township Assessor could notexplain how she reached the value given to the Cosgriffs' property. Accordingly, the Winnebago County Board of Review lowered the property's assessed value. The Cosgriffs did not appeal this ruling in the state court system. Rather, the Cosgriffs brought suitin the federal district court against Winnebago County and various county and Township officials.

Without discussing the merits of the Cosgriffs' allegations, the U.S. District Court dismissed the suit and the Seventh Circuit affirmed. Both courts made their respective rulings under the doctrine of comity, which, according to the circuit court, ‘counselslower federal courts to resist engagement in certain cases falling within their jurisdiction.‘ In cases dealing with state tax systems, for example, the Seventh Circuit noted that the U.S. Supreme Court has ‘recognized the important and sensitive natureof state tax systems and the need for federal-court restraint when deciding cases that affect such systems. ‘ (*Fair Assessment in Real Estate Ass'n, Inc. v. McNary,* 454 U.S. 100 (1981).) Citing also to the federal Tax Anti-Injunction Act (28 U.S.C. § 1341), the Seventh Circuit therefore dismissed the Cosgriffs' section1983 claims.

The Cosgriffs had asked the U.S. Supreme Court in their unsuccessful petition to consider '[w]hether Comity will protect State Officials who, in emails and their actions, conspired to falsely inflate citizens' property tax in retaliation ofthe citizens' exercise of free speech.'

Justice Sotomayor's concerns included possible retroactive application of new sales and use tax laws and the proper standard for determining sales tax nexus.

Justice Ginsburg questioned Wayfair's claim that asking out-of-state sellers to collect tax on goods shipped in-state discriminates against interstate commerce.

The FTB now asks the Court to answer the question it agreed to decide in *Hyatt II:* 'whether *Nevada v. Hall* should be overruled.'

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