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U.S. SUPREME COURT UPDATE

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Court Hears Oral Arguments over Yakama Nation 'Right to Travel' Without Taxation

***39** As previously reported, the U.S. Supreme Court remains set to decide three cases involving state and local taxes in which certiorari was granted in June—*Washington State Dep't of Licensing v. Cougar Den, Inc.* (Docket No. 16-1498); *Dawsonv. Steager* (Docket No. 17-419); and *FTB v. Hyatt* (Docket No. 17-1299). On October 30, 2018, the Court heard oral arguments in the first of these cases—*Washington State Dep't of Licensing v. Cougar Den, Inc.*

The question before the Court is, 'Whether the Yakama Treaty of 1855 creates a right for tribal members to avoid state taxes on off-reservation commercial activities that make use of public highways.'

As summarized in the decisions below, Article II of the Yakama Nation Treaty of 1855 provides in relevant part that 'if 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)).

Cougar Den, a Confederated Tribes and Bands of the Yakama Nation corporation, traditionally transported fuel over a 27-mile route from Oregon to the Yakama Indian Reservation without paying Washington's fuel tax, which is imposed on the importation and transportationof fuel. The Washington Department of Licensing (the 'Department'), however, issued tax assessments on the imported fuel ($3.6 million of taxes, penalties, and fees for hauling the fuel across state lines) in 2013. Cougar Den refused to pay the assessment,arguing that the imposition of the tax violated its right to travel under the Yakama Nation Treaty of 1855. The Washington Supreme Court, in *Washington State Dep't of Licensing v. Cougar Den, Inc.,* 188 Wash. 2d 55 (2017), agreed with Cougar Den, holding that the Yakama Nation 'tribe[] w[as] entitled under [the Yakama Nation] [T]reaty to import fuel without holding [an] importer'slicense and without paying state fuel taxes.'

****2** At oral argument before the U.S. Supreme Court, the Department, joined by the Assistant U.S. Solicitor General, argued that the tax at issue was off-reservation and, therefore, a non-discriminatory tax on fuel itself that applied to everyone, not on highwaytravel. Accordingly, the Department claimed that the Yakama Nation was being appropriately treated 'in common with citizens of the United States,' as required by the Treaty.

Justice Kagan questioned the importance of characterizing the tax as a broad tax on the possession of fuel. In her opinion, from the Yakama Nation's point of view, the tax burdens exactly what they bargained for when signing the treaty—that is, theability to transport their goods without any burdens or tax. Justice Kavanaugh appeared to agree with Justice Kagan, stating that, in exchange for an area of land about the size of Maryland, the Yakama Nation was promised an ability to take their goods tomarket without a burden. Here, the Yakama Nation was facing a burden—the tax—when trying to transport their goods from market.

The Department pushed back, arguing that the tax did not impinge upon the Yakama Nation's treaty-protected right to travel; instead, the tax was on the right to possess fuel. And, engaging in a treaty-protected act, like travel, does not exempt the YakamaNation from other, general state laws. If it did, the Department argued, members of the Yakama Nation would be able to possess illegal firearms or other contraband when travelling in their vehicles. Justice Gorsuch appeared to push back against this argument,stating that the phrase ‘in common with‘ allowed the state to impose certain regulations that facilitate both native and non-native travel along highways for the public good—such as safety regulations, speed limits, and other broad rules.

In its response, the Yakama Nation argued that the treaty preempts the application of the tax for two reasons: (1) by transporting fuel, the Yakama Nation is exercising the treaty-protected right to travel unburdened; and (2) as interpreted by state law,the tax is a tax on transportation and not the possession of fuel.

Chief Justice Roberts appeared to question both of the assertions made by the Yakama Nation. First, because the tax is imposed on the owner of the fuel, and not the owner of the truck who is merely transporting the fuel from one point to another, the ChiefJustice questioned whether the right to travel was infringed upon. Then, because the tax is imposed on a per-gallon basis, and not on a per-mile basis, ***40** Chief Justice Roberts suggested that the tax was on possession and not the transportation of fuel. JusticeBreyer appeared to agree with the Chief Justice, arguing that if the Yakama Nation could avoid this particular tax, it would allow the Yakama Nation to refuse to pay a multitude of taxes that have nothing to do with transportation, but are instead meant toregulate the importation of certain goods. We will continue to update readers on any developments regarding this case.

****3** In addition to the previously granted petitions, the Court has also received two new petitions for certiorari in cases involving state and local taxes. First, in *Alabama Dep't of Rev. v. CSX Transportation* (Docket No. 18-447), a petition forcertiorari has been filed asking the Court to review an Eleventh Circuit decision ruling that Alabama's sales tax on diesel fuel discriminates against rail carriers under section 11501(b)(4) of the Railroad Revitalization and Regulatory Act of 1976. Second,in *North Carolina Dep't of Rev. v. The Kimberly Rice Kaestner 1992 Family Trust* (Docket No. 18-457), the Court has been asked to review a North Carolina Supreme Court case, which held that the North Carolina Department of Revenue did not demonstratethe minimum contacts necessary to satisfy the principles of due process required to tax an out-of-state trust.

The Court also continues its review of 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. As previously reported, the Court has assigned the Honorable Pierre N. Leval, of the U.S. Court of Appeals for the Second Circuit, as Special Masterin these cases, 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 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.

Lastly, the Court has denied four petitions involving state and local tax matters since our last update—*Coleman, et al. v. Campbell County Board of Trustees* (Docket No. 18-283); *Parmar v. Madigan* (Docket No. 18-241); *White,et. al. v. Underwood* (Docket No. 18-297); and *Arizona Dep't of Rev. v. Bosch* (Docket No. 18-413).

Alabama Seeks to End Decades Old Dispute over Railroad Fuel Taxes

On October 5, 2018, the U.S. Supreme Court received a new petition for certiorari in *Alabama Dep't of Rev. v. CSX Transportation, Inc.,* Docket No. 18-447, ruling below at *CSX Transportation, Inc. v. Alabama Dep't of Rev.,* 888 F.3d 1163 (11th

Cir. 2018). In the case below, the Eleventh Circuit held that the Alabama sales tax, which applies to diesel fuel purchases by rail carriers but not diesel fuel purchases by motor or water carriers, constituted a tax thatimpermissibly discriminates against rail carriers in violation of section 11501(b)(4) of the Railroad Revitalization and Regulatory Reform Act of 1976 (the '4-R Act').

Alabama's application of its sales and use tax.

The 4-R Act prohibits states from imposing a tax 'that discriminates against a rail carrier.' CSX Transportation, Inc. ('CSX') is an interstate rail carrier that, according to the Eleventh Circuit, competes against trucking transport companies(motor carriers) and commercial ships, vessels, and barges (water carriers).

****4** In Alabama, the state's 4% sales and use tax applies to the purchase of diesel fuel, unless otherwise exempt. No exemption applies for rail carriers; however, motor carriers and water carriers are both exempt from the state sales and use tax. Motor carriers,however, are required to pay a Motor Fuels Excise Tax of $0.19 per gallon of diesel to Alabama, and water carriers are subject to a federal (but not state) excise tax of $0.291 per gallon of fuel.

Round 1: CSX sues Alabama in 2008.

In 2008, CSX first sued the Alabama Department of Revenue (the 'Department '), seeking a declaratory judgment that the imposition of the state's sales and use tax violated the 4-R Act. CSX argued that the imposition of the tax against rail carriers,and not motor or water carriers, violated the language of the 4-R Act, which provides that a state may not 'impose another tax that discriminates against a rail carrier.' The district court dismissed CSX's complaint, and the Eleventh Circuit affirmed.The U.S. Supreme Court, however, reversed and held that denying rail carriers exemptions provided to other carriers can be a form of discrimination under the 4-R Act. ***41** *CSX Transp., Inc. v. Alabama Dep't of Rev.* ('CSX I'), 562 U.S. 277 (2011).

In doing so, the Court explained that a tax discriminates when it treats 'groups [that] are similarly situated' differently without 'justification for the difference in treatment.' The Court did not ultimately decide whether thedifferent tax treatment violated the 4-R Act and instead remanded the case to allow Alabama to offer sufficient justification for declining to provide the exemption to rail carriers.

Round 2: a comparison of similar taxes.

On remand, the district court ruled that Alabama's sales and use tax scheme does not discriminate against CSX. The Eleventh Circuit reversed, however, after deciding to apply a 'competitive approach,' which compares rail carriers only to their directcompetitors when addressing claims of discrimination under the 4-R Act. Under the competitive approach, the Eleventh Circuit held that motor carriers and water carriers are direct competitors of rail carriers and because motor carriers and water carriers areexempt from the sales and use tax, CSX had established a prima facie case of discrimination.

Alabama was then required to justify its facially discriminatory tax. It argued the motor carrier exemption was justified because motor carriers pay a substantially similar amount of tax due to the state's excise taxes, but the Eleventh Circuit was not persuadedby Alabama's argument.

On appeal, the U.S. Supreme Court agreed with the Eleventh Circuit's use of a 'competitive approach' comparison, but disagreed with the circuit court's refusal to examine Alabama's alternate-tax based justifications for its disparate treatment ofrail carriers. Instead, the Court held that 'an alternative, roughly equivalent tax is one possible justification that renders a tax disparity nondiscriminatory.' *Alabama Dep't of Rev. v. CSX Transp., Inc.* ('CSX II'), 135 S. Ct. 1136 (2015). Therefore, the Court determined that the lower courts should have allowed Alabama to 'justify its decision to exempt motor carriers from its sales and use tax,' and the Court remanded the case back to the districtcourt, setting the stage for CSX round three.

****5** (For more background on *Alabama Dep't of Rev. v. CSX Transp., Inc.* ('CSX II'), 135 S. Ct. 1136 (2015), including a detailed discussion of the U.S. Supreme Court's ruling, see U.S. Supreme Court Update, 25 JMT 40 (July 2015).)

Round 3: a split decision.

On remand, and after a four-day trial, the district court agreed with Alabama that neither the motor carrier nor the water carrier exemption gives rise to a violation of the 4-R Act. On appeal, the Eleventh Circuit partially agreed, at least regarding themotor carrier exemption. According to the Eleventh Circuit, the motor carrier exemption was justified because the state's sales and use tax is 'roughly equivalent' to the excise tax imposed on motor carriers.

The Eleventh Circuit disagreed, however, with the district court's ruling as to the exemption for water carriers. The district court had determined the water carrier exemption did not violate the 4-R Act for two reasons: (1) CSX suffered no competitive injuryfrom the exemption; and (2) because the imposition of state sales and use tax on an interstate water carrier would expose Alabama to liability under the negative Commerce Clause, the exemption was compelled by federal law.

The Eleventh Circuit disagreed, stating that exposure to a lawsuit and the fact that water carriers impose virtually no financial burden to Alabama were not sufficient justifications. Instead, the Eleventh Circuit held that, in order to remedy the discrimination,Alabama must either (1) stop collecting sales and use taxes from CSX, or (2) revoke the water carriers' exemption.

Question presented.

Alabama has now asked the U.S. Supreme Court to consider the following question: 'Under 49 U.S.C. § 11501(b)(4), when can a State justifiably maintain a sales-and-usetax exemption for fuel used by vessels to transport goods interstate without extending the same exemption to rail carriers?'

North Carolina Challenges Application of Due Process Clause to Trust Taxation

On October 9, 2018, the Court received a new petition for certiorari in *North Carolina Dep't of Rev. v. The Kimberly Rice Kaestner 1992 Family Trust*, Docket No. 18-457, ruling below at 814 S.E.2d 43 (N.C. 2018). In the decision below, the North Carolina Supreme Court held that the North Carolina Department of Revenue (the 'Department') did not establish the minimum contacts necessary to satisfy the principles ofdue process required to tax an out-of-state trust.

North Carolina's tax of a New York-based trust.

According to the court below, The Joseph Lee Rice, III Family 1992 Trust (the 'Joseph Trust') was created in New York in 1992 and, pursuant to the trust ***42** agreement, was governed by the laws of New York, where Mr. Rice was a resident. No party to theJoseph Trust resided in North Carolina until Rice's daughter and primary beneficiary, Kimberly Rice Kaestner, moved to North Carolina in 1997. On December 30, 2002, the Joseph Trust was divided into three share sub-trusts for the benefit of Rice's three children,including Kaestner. The Kimberly Rice Kaestner 1992 Trust (the 'Trust') was the separate share trust formed for the benefit of Kaestner and her three children, all of whom reside in North Carolina.

****6** During the tax years at issue (2005 through 2008), the assets held by the Trust consisted of various financial investments, and the custodians of those assets were located in Boston, Massachusetts. Documents related to the Trust were kept in New York. Noneof the beneficiaries of the Trust had an absolute right to any of the Trust's assets or income because distributions could only be made at the sole discretion of the trustee, who was a Connecticut resident. During the tax years at issue, no distributions weremade to the beneficiaries.

For tax years 2005 through 2008, North Carolina taxed the Trust on income accumulated each year, even though no income was distributed to North Carolina beneficiaries. In response, the Trust sought a refund of those taxes, totaling more than $1.3 million.North Carolina denied the refund request on February 11, 2011.

N.C. Supreme Court's application of trust principles to tax matters.

The Trust brought an action in North Carolina state court, asserting that North Carolina violated the U.S. Constitution's Due Process Clause by assessing taxes on undistributed income held by the Trust. The Trust argued that the Trust itself, as opposedto the Trust's beneficiaries, did not have a constitutionally sufficient connection with North Carolina. The state trial court agreed with the Trust's argument, and, in a 6-1 decision, the North Carolina Supreme Court affirmed that decision and held that thein-state residence of the Trust's beneficiaries is not a sufficient connection with North Carolina to allow North Carolina to tax the Trust's income.

Question presented.

The North Carolina Department of Revenue has asked the Court to consider whether ‘the Due Process Clause prohibit[s] states from taxing trusts based on trust beneficiaries' in-state residency.‘

Petitions Previously Granted

In addition to hearing oral arguments in *Washington State Dep't of Licensing v. Cougar Den, Inc.*, the Court also remains set to decide two other previously granted petitions: *Dawson v. Steager* (Docket No. 17-419) and *FTBv. Hyatt* (Docket No. 17-1299).

Court to consider W.V.'s differential treatment of retirement benefits and intergovernmental immunity.

In *Dawson v. Steager,* Docket No. 17-419, ruling below at *Steager v. Dawson*, 2017 WL 2172006 (W. Va. 2017), the Supreme Court of Appeals of West Virginia held that James Dawson, a retired U.S. Marshal, was not entitled to exempthis Federal Employee Retirement System (‘FERS‘) income from state income tax.

According to the West Virginia court, Dawson worked as a deputy U.S. Marshal in West Virginia. He was enrolled in FERS, a federal retirement plan, and sought a West Virginia exemption for all of his FERS income. The court, however, noted that, under WestVirginia law, 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 court held that this distinction did not violate thedoctrine of ‘intergovernmental tax immunity.‘ 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 federalmarshals.‘

****7** In his petition, Dawson asked the U.S. Supreme Court to consider: ‘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 discriminating againstsimilarly situated federal retirees based on the source of their retirement income.‘ However, the Court did not grant certiorari with respect to Dawson's question, and instead granted certiorari limited to the issue presented by the U.S. Solicitor Generalin an amicus curiae brief filed on May 15, 2018.

The Solicitor General argued that ‘[t]he West Virginia Supreme Court of Appeals misapplied the doctrine of intergovernmental tax immunity‘ and that, ‘[u]nder the test articulated in *Davis v. Michigan Department ofthe Treasury*, 489 U.S. 803 (1989), the court should have asked whether the State's inconsistent tax treatment of former federal and state law-enforcement officers ‘is directly related to, and justified by, significant differences between the two classes.’‘ The West Virginia court's application

***43** of a 'totality of the circumstances' analysis, the Solicitor General argued, 'is inconsistent with *Davis* and with this Court's other intergovernmental tax immunity decisions.'

The Court set December 3, 2018, as the date for oral argument.

Court will review whether California FTB is immune from taxpayer tort claims.

In *Franchise Tax Bd. of Cal. v. Hyatt*, Docket No. 17-1299, ruling below at 407 P.3d 717 (Nev. 2017), 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 a former California resident, Gilbert Hyatt.

The granting of certiorari marks the latest in a long-running saga between Hyatt and the FTB. Mr. Hyatt's dispute with the FTB stems from the agency's attempt to collect approximately $10 million in taxes on patent licensing fees earned by Hyatt in the 1990s.Following an 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 emotional distress. The NevadaSupreme Court eventually largely reversed a jury award of tort damages and punitive damages awarded to Hyatt. 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 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).

After another round at the Nevada Supreme Court, which held that the FTB was liable for fraud and intentional infliction of emotional distress, the FTB sought review once again in the U.S. Supreme Court. The Court granted certiorari for the second time,agreeing to consider two questions: (1) whether the Nevada Supreme Court erred by failing to apply to the FTB the statutory immunities available to Nevada agencies and (2) whether the U.S. Supreme Court's prior decision in *Nevada v. Hall*, 440U.S. 410 (1979), should be overruled.

****8** 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 FTB again requested the U.S. Supreme Court to 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 askedthe Court to answer the question it agreed to decide in *Hyatt II:* 'whether *Nevada v. Hall* should be overruled.' The Court granted the FTB's request and set January 9, 2019, as the date for oral argument.

Petitions Denied

Three previously reported petitions for certiorari and one new petition have been denied by the Court since our last update.

First, in *Coleman, et al. v. Campbell County Board of Trustees* (Docket No. 18-283), the Court denied a request to review a decision by the Kentucky Court of Appeals, which held that a court decision harmonizing statutes relating to setting publiclibrary property tax rates should not apply retroactively.

In *Parmar v. Madigan* (Docket No. 18-241), the Court had been asked to review a decision by the Illinois Supreme Court upholding the judgment of a lower circuit court, which dismissed a complaint filed by the executor of an estate for lack ofjurisdiction. The Petitioner had challenged Illinois' retroactive application of the state's estate tax and argued in his petition for certiorari that Illinois failed to provide a clear and certain post-deprivation procedure for reviewing his claims, as requiredunder the Due Process Clause of the U.S. Constitution. On October 29, 2018, the Court denied the petition for certiorari.

Next, in *White et al v. Underwood* (Docket No. 18-297), the Court denied a request to review a New York Court of Appeals decision that requiring Indian retailers to prepay cigarette taxes due on sales of cigarettes to non-members of the SenecaNations Indians is not a tax on the Indian retailers and, therefore, does not conflict with federal treaty or Indian law.

Lastly, in *Arizona Dep't of Rev. v. Bosch* (Docket No. 18-413), ruling below at Ariz. Ct. App., Dkt. No. 1 CA-TX 16-0015, June 13, 2017, the U.S. Supreme Court denied a request to review an Arizona Court of Appeals decision that granted summaryjudgment in favor of the Arizona Department of Revenue after the Department filed a complaint in tax court seeking judgment against a taxpayer for failure to file state income tax returns and the taxpayer failed to provide any evidence indicating that thereturns had been filed.

****9** Justice Kavanaugh appeared to agree with Justice Kagan, stating that . . . the Yakama Nation was promised an ability to take their goods to market without a burden.

Justice Breyer appeared to agree with the Chief Justice, arguing that if the Yakama Nation could avoid this particular tax, it would allow the Yakama Nation to refuse to pay a multitude of taxes.

A petition has been filed asking the Court to review an Eleventh Circuit decision ruling that Alabama's sales tax on diesel fuel discriminates against rail carriers under the 4-R Act.

The Court has been asked to review a N.C. Supreme Court case, which held that the N.C. Department of Revenue did not demonstrate the minimum contacts necessary to satisfy the principles of due process required to tax an out-of-state trust.

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