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U.S. SUPREME COURT UPDATE

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Court Hears Oral Arguments in Two Cases

The Supreme Court heard oral arguments in two cases involving state taxation on consecutive days in December. On 12/8/14, the Supreme Court heard oral arguments in *Direct Marketing Ass'n v. Brohl*, where the Court has been asked to decide whether the Direct Marketing Association's challenge to a Colorado law imposing information notice and use-tax reporting requirements on nonresident remote retailers could be heard in federal court or whether the Tax Injunction Act bars jurisdiction.

Although the case before the Court is limited to the jurisdictional issue, rather than the legal merits of Colorado's law, the questions and comments at oral argument focused on issues relating to the merits of the case. Justice Scalia acknowledged that this is a "very important case because I have no doubt that if we come out agreeing with [Colorado], every one of the states is going to pass a law like this."

On the following day, on 12/9/14, the Supreme Court heard oral arguments in *Alabama Department of Revenue v. CSX Transportation, Inc.* In *CSX*, the Court will decide whether Alabama's imposition of sales and use taxes on rail carriers' diesel purchases, while exempting other interstate carriers, is discriminatory in violation of the federal Railroad Revitalization and Regulatory Reform Act of 1976 (the "4R Act," codified at 49 USC § 11501). This case is a continuation of litigation that was before the Court three years ago ("*CSX I*") because the Court failed to address the discrimination issue at that time. Decisions for both cases are expected in the spring.

A new petition for certiorari has been filed by nonresidents of Pennsylvania challenging the imposition of Pennsylvania personal income tax on their distributive share of partnership gain resulting from the foreclosure of Pennsylvania commercial property in an amount proportionate with their shares in the property owning partnership. Finally, one petition remains pending before the Court and another reported petition has been denied.

Nonresident Limited Partners' Challenges to Pennsylvania Income Taxation

In *Houssels v. Pennsylvania*, Docket No. 14-638, petition for cert. filed 11/26/14, ruling below as *Wirth v. Commonwealth*, 95 A3d 822, 2014 WL 2743554 (Pa. 2014), the Pennsylvania Supreme Court, with one dissent, affirmed a Commonwealth Court decision that nonresident limited partners, who invested in a Connecticut limited partnership that owned and operated a Pennsylvania skyscraper, realized gains from the foreclosure of the skyscraper that were properly subject to Pennsylvania income tax.

The petitioners now ask the Court to review the Pennsylvania court's ruling and to decide whether a limited partnership interest is a constitutionally sufficient nexus for state taxation and whether Pennsylvania's taxing laws subject nonresident investors to unlawful and discriminatory taxes.

Background. The petitioners, John Houssels and Robert Marshall (the "Petitioners"), are two out of 735 individual investors (e.g., limited partners) in 600 Grant Street Associates Limited Partnership (the "Partnership"), a Connecticut limited partnership organized for the purpose of owning and operating the U.S. Steel Tower in Pittsburgh, Pennsylvania (the "Tower"). The Partnership owned the Tower and leased space to commercial tenants. The Partnership, however, was not financially successful.

As explained by the Pennsylvania Supreme Court, the Partnership secured a nonrecourse Purchase Money Mortgage Note (PMM Note) as part of its transaction to acquire the Tower. Interest on the PMM Note was payable on a monthly basis, but the PMM Note provided that if the monthly interest amount exceeded the Partnership's net operating income from the Tower, the Partnership did not have to pay the excess interest. Instead, the interest could be deferred and compounded on an annual basis.

Since the Partnership incurred net operating losses in every year of its existence (1984-2004), it did not pay the interest per the terms of the PMM Note. And, the nonresident limited partners of the Partnership (710 out of 735 limited partners), including the Petitioners, did not have to file Pennsylvania Personal Income Tax ("PIT") returns related to their investment in the partnership because they had no Pennsylvania source income (only Pennsylvania source losses).

By 2005, the compounded accrued interest on the PMM Note totaled more than $2.3 billion. Given this amount of debt, the Partnership was unable to sell the Tower, and the lender foreclosed on the property. As noted by the Pennsylvania court, the sole reason for the Partnership's existence was to own and operate the Tower. Thus, shortly after the foreclosure, the Partnership liquidated, and each of the partners, including the Petitioners, lost their entire investments in the Partnership.

The court noted that none of the limited partners, including the Petitioners, received any proceeds from the property's foreclosure or the Partnership's liquidation. Each of the investors, including the Petitioners, paid a combination of cash and executed promissory notes, which were satisfied prior to the Partnership's liquidation, for their interests in the Partnership.

In the time between the foreclosure and the liquidation, however, the Partnership reported a gain on its federal and state tax filings that consisted of the unpaid balance of the PMM Note's principal and accrued interest (approximately $2.6 billion). The Partnership allocated the gain to each individual partner in an amount proportionate with the partner's ownership interest in the partnership.

As summarized by the lower court, the Pennsylvania Department of Revenue (the "Department") "[t]herefore, and despite their individual investment losses . . . assessed PIT against the [Petitioners and other limited partners], plus interest and penalties, related to the foreclosure on the [Tower] for tax year 2005. The PIT equaled each limited partner's distributive share of the gain associated with the foreclosure, multiplied by the Pennsylvania PIT rate of 3.07%." The Petitioners now challenge Pennsylvania's right to tax this income.

Pennsylvania's personal income tax. The Pennsylvania Tax Code divides income into eight specific categories. (72 P.S. § 7302). Relevant to the Petitioners claim, subsections (a)(2) and (a)(3) of the Pennsylvania statute permit the collection of Pennsylvania Personal Income Tax ("PIT") upon "the net income from the operation of a business, profession, or other activity," and upon the "net gains or net income, less net losses, derived from the sale, exchange or other disposition of property, including real property [and] intangible personal property."

Furthermore, a Department regulation provides that "gain on the disposition of property is recognized in the taxable year in which the amount realized from the conversion of the property into cash or other property exceeds the adjusted basis of the property." (61 Pa. Code. § 103.13). In the case below, the Petitioners argued that the plain language of this regulation precluded the Department from taxing the discharge of the obligation to pay the debt associated with the Tower because the foreclosure never resulted in the "conversion of the property into cash or other property."

The Department, however, relying on the so-called "*Tufts* Rule," announced in the U.S. Supreme Court's decision in *Commissioner v. Tufts*, 51 AFTR 2d 83-1132, 461 US 300, 75 L Ed 2d 863, 83-1 USTC ¶9328, 1983-1 CB 120 (1983), assessed PIT on the Petitioners following the foreclosure of the Tower, even though the Petitioners did not receive any cash or other property upon foreclosure. Under the *Tufts* Rule, foreclosures on nonrecourse mortgage notes constitute the disposition of property and therefore result in the realization of income or gain for federal tax purposes equal to the amount of the discharged debt.

The Department argued in the case below that the *Tufts* Rule was consistent with section 7303(a)(3) of the Pennsylvania statutes (discussed above), which provides that the Department may tax the net gain associated with the disposition of real property. The Pennsylvania Supreme Court agreed. According to the court, the "*Tufts* [R]ule is encompassed within the plain meaning of 'disposition of real property,' as contemplated by Section 7303(a)(3) and Regulation 103.13, and the [Department's] assessment of PIT was proper."

In their petition for certiorari, the Petitioners argue that they do not have constitutional nexus with Pennsylvania and that, under Pennsylvania's taxing laws, the state has impermissibly discriminated against the Petitioners based on their status as nonresidents.

Nexus. Before the Pennsylvania courts, the Petitioners argued that both the Commerce and Due Process Clauses of the federal Constitution prohibited the Department from assessing PIT. According to the Pennsylvania Supreme Court, however, the Petitioners waived their Commerce Clause arguments as a result of their "underdevelopment" of the argument before the lower court and, therefore, the court did not address the merits of the Petitioners' Commerce Clause claim.

According to the court, "the entirety of the [Petitioners'] Commerce Clause argument . . . was as follows: 'A state's ability to tax is limited by the Commerce and Due Process Clauses of the United States Constitution.' The remainder of the constitutional argument focuses exclusively upon the notion of minimum contacts, which . . . relates solely to an alleged violation of the Due Process Clause." The Pennsylvania Supreme Court therefore focused its analysis on the Petitioners' Due Process claims.

Under its Due Process inquiry, the Pennsylvania Supreme Court stated that "the pertinent analysis concerning whether a person or entity may be liable for legal damages or, in this case, taxes, under notions of due process, revolves around the well-established notion that the potentially liable party must have 'minimum contacts' with the forum jurisdiction." (S*ee Burger King Corp. v. Rudzewicz*, 471 US 462, 85 L Ed 2d 528 (1985)). And, according to the court, "purposeful availment" is the "touchstone of a minimum contacts analysis."

In examining these principles, the court noted that the "primary purpose of the Partnership was to own, operate, and gain income from a Pennsylvania office tower . . . . [W]ere we to accept [Petitioners'] arguments, the ability to tax non-Pennsylvanians engaged in commercial real estate transactions within our state could be arguably foreclosed." The court therefore found that the Petitioners "purposefully availed themselves to Pennsylvania law through the Partnership's ownership and operation of the [Tower], thus establishing minimum contacts within Pennsylvania, and accordingly were properly subjected to an assessment of PIT."

In their petition for certiorari, the Petitioners ask the Court to review whether a limited partner in a partnership has constitutionally sufficient nexus with a state for purposes of the Due Process Clause. The Petitioners cite to *Goodyear Dunlop Tires-Operations, S.A. v. Brown*, 180 L Ed 2d 796 (2011) in their petition and argue that the Pennsylvania Supreme Court was wrong to focus on whether the Partnership purposefully availed itself of the privilege of doing business in Pennsylvania. According to the Petitioners, under *Goodyear*, the Pennsylvania court was required to examine whether the Petitioners, as opposed to the Partnership, had the requisite connection with Pennsylvania.

Disparate treatment of nonresidents. The Department determined that the Petitioners could not use their investment losses in the Partnership to offset the gain realized at the time of foreclosure. The Pennsylvania Supreme Court agreed.

As summarized by the court, "unlike the federal IRC, which defines income in an all-encompassing manner, the [Pennsylvania] Code enumerates eight specific categories of income . . . of which net profits from business operations . . . and net profits from the disposition of property . . . are two distinct classifications." And under Pennsylvania law, "a person shall not be allowed to offset a gain in one class of income with a loss in another class of income." (61 Pa. Code § 121.13(a)).

Although the Department conceded that both the disposition of the Tower and the Petitioners' investment losses constituted "the disposition of property"-and that therefore both transactions related to the same category of income-the Department nevertheless denied the Petitioners any offsetting reduction to their PIT liabilities. According to the Department, the Petitioners' investment loss was the disposition of an intangible asset, which is "localized at the owner's domicile for purposes of taxation." Accordingly, the Department argued that gains and losses from the disposition of intangible personal property couldn't be taxed *or deducted* within Pennsylvania by a nonresident.

As stated above, the Pennsylvania Supreme Court agreed with the position of the Department. The court agreed that the Petitioners' interests in the Partnership constituted "intangible personal property, separate and apart from the real property interest associated with the [Tower]." And the court agreed that the Petitioners' "shares in the Partnership, and therefore their responsibility to the assets and debts of it, are at the situs of the partnership interest (i.e., the source), which is intangible personal property, and therefore at the domicile of each individual [Petitioner]."

The court noted that "this reasoning is supported by the obvious jurisdictional concerns implicated by one state taxing income sourced from within another." Accordingly, the Petitioners could not use their investment loss to reduce their Pennsylvania PIT liability in contrast to resident Pennsylvania investors.

In the case below, the Petitioners argued that the Department's failure to allow for an offsetting reduction for nonresident partners, versus resident partners, was unconstitutional under the Privileges and Immunities, Commerce, and Equal Protection Clauses of the U.S. Constitution. In making their arguments, the Petitioners relied heavily upon the U.S. Supreme Court's decision in *Lunding v. New York Tax Appeals Tribunal*, 522 US 287, 139 L Ed 2d 717 (1998), in which the Court found a New York statute, which effectively denied nonresidents a state income tax reduction for alimony paid, was unconstitutional under the Privileges and Immunities Clause, when resident taxpayers were permitted to take the deduction.

As summarized by the Pennsylvania Supreme Court, *Lunding* provides that the Privileges and Immunities Clause "affords no assurance of precise equality in taxation between residents and nonresidents of a particular State," but "when a substantial inequality in treatment does occur, there must be a reasonable ground for that diversity." In other words, "for a challenged statute to be found unconstitutional pursuant to a [P]rivileges and [I]mmunities claim, it must lack a substantial reason for the discrimination, and the discrimination must lack a substantial nexus to a legitimate state purpose."

Although the Pennsylvania Supreme Court found "the question presented close," it ultimately agreed with the Department that "the inability of [Petitioners] to deduct the investment loss does not violate the Privileges and Immunities Clause (or, for that matter, the Equal Protection or Commerce Clauses)." The court distinguished *Lunding* by noting that *Lunding* involved "a specific type of New York taxable income-alimony-and therefore all of the related taxation of income and deduction of payments stemmed from the same economic event: a judicial decree regarding the payment of alimony. In the instant appeal, while under Pennsylvania law the disposition of the [Tower] via foreclosure and the loss related to the investment in the Partnership both fall under the Section 7303(a)(3) class of income, the inability of Appellants to deduct the investment loss from the foreclosure gain because of the situs of the investment loss does not foreclose their ability to deduct from the foreclosure gain by some other Pennsylvania-sourced loss that falls under Section 7303(a)(3)."

Additionally, the court noted that Pennsylvania, as a purely jurisdictional matter, could not have received tax on income from any gain on the Petitioners investment in the Partnership. Therefore, the court ruled, "there is no obligation to accord them a deduction by reason of losses elsewhere incurred." In other words, the court found that because the Petitioners income from the Partnership investment could not be taxed across state borders, their losses likewise could not be deducted. Accordingly, the court affirmed the Department's assessment of PIT.

The Petitioners ask the U.S. Supreme Court to review this ruling, renewing their arguments that Pennsylvania's tax policy violates the Privileges and Immunities, Equal Protection, and Commerce Clauses of the United States Constitution.

Questions presented. In their petition for certiorari, the Petitioners present the following three questions for review:

> (1) "Whether a limited partner in a partnership has constitutionally-sufficient nexus with a state for purposes of the Due Process Clause?"
> (2) "Whether Pennsylvania's income taxation of net gains and losses incurred by nonresident investors discriminates unconstitutionally solely on the basis of residence, contrary to the principles of the Privileges and Immunities Clauses set forth in this Court's decision in *Lunding?*"
> (3) "Whether Pennsylvania treats nonresident investors in a partnership worse than resident partners in violation of the Equal Protection and Commerce Clauses?"

Update on Docketed State and Local Tax Cases

The following discussion updates developments in two (*Direct Marketing Ass'n* and *CSX*) of the three docketed state and local tax cases as this issue of the Journal went to press. (We await the Court's decision in the third case, *Comptroller of the Treasury v. Wynne*, heard by the court in November 2014).

***Direct Marketing Ass'n* oral argument.** On 12/8/14, the Court heard oral arguments in *Direct Marketing Ass'n v. Brohl*, Docket No. 13-1032, cert. granted 7/1/14, ruling below at 735 F3d 904 (10th Cir. 2013), *rem'g Direct Marketing Ass'n v. Huber*, DC Colo., No. 10-CV-01546-REB-CBS, 3/30/12, 2012 WL 1079175. In this case, the U.S. Court of Appeals for the Tenth Circuit overturned a district court's ruling that a Colorado law imposing information notice and reporting requirements on remote retailers violated the Commerce Clause of the U.S. Constitution.

The circuit court remanded the case to the district court for dismissal on procedural grounds, finding that the Tax Injunction Act ("TIA," codified at 28 USC § 1341) precluded federal court jurisdiction over the claims. The language of the TIA provides that "district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

Court questions the DMA. George Isaacson of Brann & Isaacson appeared on behalf of the Direct Marketing Association ("DMA"). Mr. Isaacson began oral arguments explaining the history and purpose of the TIA: "a law passed by Congress in 1937 for the purpose of preventing State taxpayers from circumventing State-established and available procedures for challenging State tax assessments and instead, going directly to Federal court seeking to invoke the equity powers of Federal courts to enjoin the assessment and enforcement of State tax laws." He also told the Justices that "the matter before the Court is one of statutory construction," simply, by its terms, the TIA is not a jurisdictional bar. And, he further explained that the case had an "interesting procedural history."

With respect to the procedural history of the case, Mr. Isaacson informed the Court that the Executive Director of the Colorado Department of Revenue, in her briefing to the Tenth Circuit, "expressly informed the court that the Tax Injunction Act and comity did not apply and were not a bar to the Federal appellate court proceeding to hear the case."

Justices Scalia and Sotomayor questioned whether it was Mr. Isaacson's position that the "TIA is a waivable protection?" Mr. Isaacson replied that the issue was more one of consent, rather than waiver. Mr. Isaacson told the Justices that states can give federal courts the power to hear cases that fall under the TIA, as the law is based on comity.

Justice Ginsburg focused on the TIA's application to regulations that require an employer to report their employees' taxable income, and she questioned why Colorado's law should be exempt from the TIA while the employment regulation should be covered. Mr. Isaacson argued that the cases that involve that employment reporting provision involve situations where "it was the taxpayer that was seeking to prevent that information-reporting from taking place . . . for the purposes of anticipating a tax assessment, and attempting to prevent the issuance of that . . . assessment by depriving the director . . . of necessary information." Here, in contrast, the out-of-state sellers that are being forced to turn over information under Colorado law are not the taxpayers seeking to prevent the issuance of a tax assessment.

And, according to Mr. Isaacson, under Supreme Court precedence in the *Hibbs* case, "in the Tax Injunction Act, the word 'collection' is referring to actions of government officials following the assessment of the tax." Mr. Isaacson further stressed that the term "collection" is a term of art under common tax parlance, "it's the action that is taken by tax authorities, by government officials, after a determination of a tax liability has been made, after notice has been given to the taxpayer of their obligation, and it's the efforts of the government to then recover the amount of money which is owed." Thus, he added that "[t]he fact that there may be information which is of use, or of relevance that may precede the collection activity of the government doesn't convert those preliminary activities into collection itself."

Colorado's position. In defending Colorado's reporting requirements, the state's Solicitor General, Daniel Domenico, was forced to address the unique nature of Colorado's reporting requirements. Justice Scalia, for example, found it "amazing" that "Colorado is the only State that seeks to do this with respect to out-of-State sellers." Justice Scalia could "not imagine that the other States have not piled on with this thing if it is-if it is so essential to the tax system and if there are no problems with-with doing it." Scalia noted that, in his experience, "if it moves, you tax it."

Mr. Domenico tried to deflect this slippery-slope line of questioning by noting that such a result will turn on the merits of the case, whereas the question before the Court is merely whether the challenge goes through federal or state courts. In response, the Justices noted the important constitutional issues that might be barred from federal courts if the TIA were to apply in this case.

Justice Scalia, for example, raised First Amendment issues by asking about a hypothetical "unpopular not-for-profit corporation that has members who don't-who don't want their identity known." In Scalia's example, the nonprofit "make[s] a sale which would be exempt from Colorado's laws if indeed it was made by a not-for-profit organization to one of its members. And Colorado demands from this organization the names of its members." If the nonprofit responds by claiming a First Amendment objection to turning over the names of its members, Scalia asked Mr. Domenico whether it was Colorado's position that the nonprofit would be barred from arguing its claim in federal court because of the TIA.

The Justices also questioned Mr. Domenico as to the meaning of the term "collection" under the TIA. Mr. Domenico argued that "collection" includes an action that is "intended to culminate in assessment or collection of taxes." Justice Breyer, however, cautioned Mr. Domenico that if the Court were to "start down your road, there is no stopping place."

Justice Kennedy inquired about the potential for a limitless application of the TIA and asked Mr. Domenico what test the court could create to determine when claims were barred by the TIA. In response to Justice Kennedy's question, Mr. Domenico asked the Court to look to the D.C. Circuit as providing one possible test. According to Mr. Domenico, the D.C. Circuit has asked, "particularly under the AIA [the Anti Injunction Act, which bars any suit brought for the purpose of restraining the assessment or collection of any tax for federal purposes under 26 U.S.C. § 7421(a)]" whether an activity is "inextricably linked" to the assessment and collection process.

Moreover, Mr. Domenico argued that state courts have proven themselves capable of addressing these claims and that "the worst case scenario under any of the parade of horribles that the Plaintiffs have-have brought forward is that the cases go to State court." But Justice Kennedy questioned state courts' ability to address these claims. And as suggested by Justice Scalia, the Court "accept[s] [a] minuscule, minuscule percentage of appeals from State supreme courts."

Moreover, Scalia noted that "as a practical matter, these challenges in State supreme courts, if they're-if they're ruled in a manner that-that violates Federal law, they're not going to come up here-90 percent of them aren't going to come up-more than 90 percent. So it is important that it begin in Federal court when-especially when what is at issue is the selfish State's assessment and collection of taxes."

(For more on this case, including a detailed discussion of Colorado's notice and reporting requirements, see U.S. Supreme Court Update, 24 JMT 40 (May 2014). For more background, see also Hecht, "Information Reporting for Out-of-State Vendors Just as Unconstitutional as Tax Collection Responsibility," 22 JMT 6 (August 2012).)

***CSX* oral argument.** On 12/9/14, the Court heard oral arguments in *Alabama Department of Revenue v. CSX Transportation, Inc.*, Docket No. 13-553, cert. granted 7/1/14, ruling below as *CSX Transportation, Inc. v. Alabama Department of Revenue*, 720 F3d 863 (11th Cir. 2013). In this case, Alabama has asked the Court to review the decision by the U.S. Court of Appeals for the Eleventh Circuit, which held that Alabama's failure to provide rail carriers with a tax exemption from the state's sales and use taxes for their purchases of diesel fuel, while exempting both interstate motor carriers and water carriers, was discriminatory in violation of the federal Railroad Revitalization and Regulatory Reform Act of 1976 (the "4R Act," codified at 49 USC § 11501).

The arguments before the Court revolved around the two principal issues in the case: (1) the proper class of taxpayers to which rail carriers must be compared when reviewing claims of discrimination under section (b)(4) of the 4R Act and (2) whether Alabama may rely on "alternative and comparable taxes"-in this case, the state's fuel excise tax that motor carriers pay-as justification for exempting motor carriers and water carriers' purchases of diesel fuel from sales tax.

Alabama argues for a broad comparison class. Andrew Brasher, the Alabama Solicitor General told the Court "that the 4-R Act does not make the railroads the most favored taxpayers. It instead balances the needs of carriers, shippers and the general public." He argued that in reviewing the state's tax treatment of rail carriers, the proper comparison class should not be CSX's "handpicked class of competitors" i.e. motor carriers and water carriers, but "the mass of other businesses in the State with a focus on whether a State is targeting or singling out railroads for a tax that the other general mass of other businesses do not have to pay."

Mr. Brasher argued that "if you link the railroad's taxation to the general mass of other businesses in the State [who do pay sales and use tax on their purchases of diesel fuel], then [the rail carriers] are not paying an unfair tax rate." But Justice Alito challenged Mr. Brasher as to whether he believed such a conclusion was "consistent with the purposes" of the 4R Act, to which Mr. Brasher responded, yes. According to Mr. Brasher, the purpose of the 4R Act was to "prevent states from singling out or targeting railroads."

As highlighted by Justice Scalia, however, section (b)(4) of the 4R Act, the provision at issue in this case, prohibits states from "[i]mpos[ing] another tax that discriminates against a rail carrier." Unlike other sections of the 4R Act that expressly require a comparison against "other commercial and industrial" taxpayers, section (b)(4) does not specify the class of taxpayers to which rail carriers are to be compared. And Justice Scalia imagined that there are likely "good reason[s] that [Congress] didn't spell out a specific comparison class" in section (b)(4). Referring to the Court's decision in *CSX I,* Justice Kagan agreed with Scalia, noting that the Court's decision in that case highlighted that section (b)(4) is "very different" from the other sections of the 4R Act.

Similarly, Chief Justice Roberts noted that it seems odd to only compare the tax treatment of rail carriers to business in general when "their economic viability depends upon how they're faring with respect to their competitors, not how . . . they're fairing with respect to . . . an agricultural conglomerate in the State." Although Mr. Brasher attempted to question whether rail carriers and other forms of transportation are truly competitors, the Court appeared unimpressed with this argument. Justice Kennedy asked, "You really . . .

want us to write an opinion to say railroads generally do not compete with trucking companies? [Y]ou want that to be the opening line of our opinion?"

Finally, the Court also questioned Mr. Brasher as to whether it was appropriate or feasible for courts to look at a state's entire taxing scheme when evaluating discrimination under the 4R Act. And more specifically, even if the Court were to engage in such an analysis, the Court inquired whether Alabama could put forth any justification for exempting water carriers' purchases of diesel fuel from sales tax.

As noted above, Alabama has attempted to justify the sales tax exemption it provides to motor carriers and water carries by noting that motor carriers pay a similar fuel excise tax. But as highlighted by the Court, water carriers pay neither tax. Mr. Brasher argued that there is "no evidence at all about water carriers to show that railroads actually suffer some practical disadvantage," but Justice Kagan quickly pointed out one such disadvantage: "[rail carriers] pay a tax that the water carriers haven't . . . and it makes the water carriers more competitive against them." Mr. Brasher also argued that the treatment of water carriers is based on the "historical preferences for water shipments in this country."

U.S. Solicitor General's split argument. Arguing in support of neither party, Assistant U.S. Solicitor General Elaine J. Goldenberg explained to the Court why the federal government disagrees with Alabama as to the comparison class issue but agrees with Alabama that the state should be permitted to look to its "alternative and comparable taxes" to justify any sales tax exemption not granted to rail carriers.

Ms. Goldenberg argued that "the omission of a specific comparison class in (b)(4) is extremely telling here when there is such a specific comparison class set forth in (b)(1) through (3)." And, she thought that there was a "very good rational reason why Congress would have wanted to leave the comparison class issue open with respect to (b)(4) and not limit the comparison class in that arena to other commercial and industrial entities."

Ms. Goldenberg explained that when it comes to non-property taxes, "if it's really railroads and their competitors who are using the diesel fuel, then the competitors are the comparison class that you ought to be looking to." Or, stated differently, the comparison class should effectively be the class of taxpayers using the item at issue.

The Justices also questioned Ms. Goldenberg as to why she believed it was appropriate for courts to compare alternative and comparable taxes when deciding discrimination claims under the 4R Act. In particular, Justice Alito asked, "What is your response to CSX's argument that this is really a very, very difficult comparison to make?"

In response, Ms. Goldenberg accused the lower courts of essentially "throw[ing] up their hands" at this issue and argued, "that can't possibly be right." Ms. Goldenberg then noted that "there is a long history, particularly in the dormant commerce clause area, of the Court looking to alternative and comparable taxes."

As explained above, even if the Court declines CSX's position that the Court should not look to other aspects of Alabama's tax scheme when assessing the discriminatory tax challenge, and looks to Alabama's alternative and comparable taxes, CSX may have a valid claim that it is being discriminated against vis-à-vis water carriers. Justice Scalia pressed Ms. Goldenberg as to whether she was "going to say anything about that."

Ms. Goldenberg responded that it was the federal government's position that the water carriers issue should be remanded to the court of appeals to fully address the district court's finding that exempting water carriers from the diesel fuel sales tax did not discriminate against rail carriers. She noted that the government is "dubious that the district court's reasons are correct" and urged the Court "not to simply decide the water carriers issue without deciding the alternative and comparable tax issue because, in that case, we think the state could just change the statute with respect to water carriers and all the motor-carrier related issued would remain."

CSX's arguments. Arguing on behalf of CSX, Carter Phillips of Sidley Austin, argued that CSX merely wants to be taxed in the same manner as its competitors and that Alabama cannot justify its failure to provide rail carriers with a sales tax exemption by pointing to other taxes levied on CSX's competitors. Mr. Phillips made clear that the railroads are not "seeking a most-favored nation opportunity." And, further, that water carriers are a major competitor of CSX and should be included in the comparison class.

Relying on the U.S. Solicitor General's arguments in favor of using the narrow, competitor comparison class to analyze CSX's claims, Mr. Phillips spent much of his time arguing against Alabama's dependence on alternative and comparable taxes (i.e., the motor fuels excise tax) to justify its disparate treatment of rail carriers. Moreover, while Mr. Philips argued that it is wrong for courts to engage in such an analysis when evaluating claims of discrimination under the 4R Act, Mr. Philips also noted that the analysis Alabama seeks to use is overly simplified.

According to Mr. Philips, Alabama wants to justify its exemption of motor carriers from diesel fuel sales tax by asking "how much are [the railroads] paying today [in sales tax] and how much are [the motor carries] paying today [in fuel excise taxes], and if it's close enough, that's good enough for government work." Instead, Mr. Philips argues that a complete analysis would have to take into account the fact that the sales tax and the fuel excise tax are "not mutually exclusive proxies for each other. They're imposed on different activities at different rates and for different purposes." And if a court were to engage in a comparison of the two taxes, it would have to look at each of those factors, which is an overly burdensome, if not "limitless," task.

Justice Breyer acknowledged the difficulty in engaging in a proper comparison, noting that "[w]e're going to have to tell [the Eleventh Circuit] just what to do, which that sounds worse to me, and-and, moreover, [the case] may come back here again." Chief Justice Roberts also expressed concern that the Court might see *CSX III,* stating, "I don't want to have the case up here a third time."

In response to the Court's concern about the potential for a *CSX III,* Mr. Phillips assured the court that if it merely ruled that water carriers were within the class against which the taxation of rail carriers is to be compared, the decision of the Eleventh Circuit would remain undisturbed, because the state has put forth no justification for its sales tax exemption for water carriers.

(For more background on this request for certiorari, including a discussion of Alabama's tax scheme at issue and the procedural history of the litigation see U.S. Supreme Court Update, 23 JMT 40 (February 2014).)

Petition Still Pending

The following petition remained pending as the Journal went to press.

Colorado legislators challenge state's Taxpayer Bill of Rights. In *Hickenlooper v. Kerr*, Docket No. 14-460, petition for cert. filed 10/17/14, ruling below as *Kerr v. Hickenlooper*, 744 F3d 1156 (10th Cir. 2014), *petition for rehearing en banc denied*, 759 F.3d 1186, the U.S. Court of Appeals for the Tenth Circuit affirmed a district court's ruling that legislators had standing to challenge Colorado's Taxpayer's Bill of Rights ("TABOR") and that the legislators' challenge was not barred by the political question doctrine.

The plaintiffs seek injunctive and declaratory relief, claiming that TABOR's requirement that new taxes be subject to voter approval "undermines the fundamental nature of the state's Republican Form of

Government" in violation of the Guarantee Clause of the U.S. Constitution. Under TABOR, Colorado, with certain limited exceptions, "must have voter approval in advance for . . . any new tax, tax rate increase . . . , or a tax policy change directly causing a net tax revenue gain to any district." (Colo. Const. art. X, § 20, cl. 4(a).)

The legislators named Colorado Governor John Hickenlooper as defendant in their suit, and Governor Hickenlooper moved to dismiss the complaint, arguing that the plaintiffs lacked standing and that the political question doctrine required dismissal of all of the legislators' claims. But, according to the circuit court, the plaintiffs provided adequate proof that TABOR, by requiring a voter referendum on most tax issues, caused them injury. Thus, the plaintiffs had standing to challenge TABOR. Moreover, under the *Baker v. Carr* test (*see*369 US 186, 7 L Ed 2d 663 (1962)), the legislators' suit was not barred by the political question doctrine, as there were judicially discoverable and manageable standards for the litigation, and resolving the case would not require the court to improperly make a policy determination.

The circuit court's decision was strictly jurisdictional. The court stated that "merits of the case are not before us" and "stress[ed] that [its] decision on plaintiffs' Guarantee Clause claim is quite limited, leaving all issues other than standing, prudential standing, and the political question doctrine to the district court." In his petition for certiorari, the governor challenges the circuit court's rulings on both the political question doctrine and standing.

Petition Denied

The Court has denied certiorari in the following case.

In *Seminole Tribe of Florida v. Florida Department of Revenue*, Docket No. 14-351, petition for cert. denied 1/12/15, ruling below at 750 F3d 1238 (11th Cir. 2014), the U.S. Court of Appeals for the Eleventh Circuit, with one judge concurring in part and dissenting in part, held that sovereign immunity bars a federal complaint by the Seminole Tribe of Florida ("Tribe"), a federally recognized Indian tribe, against the Florida Department of Revenue and its Executive Director (the "Department") for a declaratory judgment that the tribe is exempt from paying a Florida tax on motor and diesel fuel and for an injunction requiring a refund of taxes paid.

The Tribe argued that the Florida fuel tax on motor and diesel fuel purchased off tribal lands violated the Indian Commerce Clause of the U.S. Constitution (U.S. Const., Art. 1, s. 8, cl 3), the Indian Sovereignty doctrine, and the Equal Protection Clause of the U.S. Constitution.