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By DEBRA S. HERMAN, a partner in the New York City office of the law firm of Hodgson Russ, LLP. *She thanks Lance E. Rothenberg and K. Craig Reilly for their contributions to this column.*

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Court Decides Due Process Case, Among Other Actions

The U.S. Supreme Court has issued its decision in *DaimlerChrysler AG v. Bauman,* which involved a due process challenge to a federal district court's exercise of personal jurisdiction over a German corporation based solely upon services performed in California not by Daimler but, rather, by its U.S. subsidiary. State and local tax practitioners had been closely watching this case because state taxes must comport with the Due Process Clause of the Fourteen Amendment in order to withstand a constitutional challenge. As discussed below, the Supreme Court determined that California lacked personal jurisdiction over Daimler. The decision, however, leaves significant questions unanswered.

In addition, as also discussed below, the Court heard oral argument in *U.S. v. Quality Stores, Inc.,* a case concerning whether certain severance payments made to employees whose employment had been involuntarily terminated constituted wages subject to the Federal Insurance Contributions Act (FICA). As previously noted in this column, given the importance of the definition of "wages" for various purposes, including state unemployment insurance taxes and federal and state income taxes for withholding purposes, this case has notable state and local tax implications.

Also, the Court has received five new petitions for certiorari of interest here, two of which have already been denied. The third petition seeks clarification as to whether federal law, via preemption, prohibits Mississippi from imposing a sales tax on durable medical equipment sold at retail to individuals enrolled in the Federal Employees Health Benefits

Program. The fourth petition, raising an issue that should be of interest to many state tax practitioners, urges the Court to review the application of the "all-events" test governing the timing of deductions for accrual-basis taxpayers. The fifth petition for certiorari was filed as we go to press, in *Equifax, Inc. v. Mississippi Department of Revenue,* Docket No, 13-1006, petition filed 2/19/14, ruling below at 125 So 3d 36 (Miss., 2013), *reh'g den.* 11/21/13, *rev'g* Miss. Ct. App., No. 2010-CA-01857-COA, 5/1/12, 2012 WL 1506006, *reh'g den.* 9/4/12, in which the Mississippi Supreme Court held that the Department of Revenue's use of an alternative apportionment method (authorized in regulatory, as opposed to statutory, language) to determine a consumer-credit-reporting company's business in Mississippi was not a promulgation of a new rule in violation of the Mississippi Administrative Procedures Act, and the imposition of penalties was not arbitrary and capricious. We'll have more on this case in the next issue of The Journal. For more on the case now, see Wilson, "Mississippi: State High Court Reverses Lower Court's Shift of Burden of Proof to Revenue Department," 23 JMT 28 (January 2014).

Finally, as noted briefly below, we still await the Court's decisions on whether to grant three previously filed requests for certiorari.

Court Finds No Jurisdiction Based on Subsidiary's In-State Activities

On 1/14/14, the Supreme Court issued its decision in *Daimler AG v. Bauman,* 134 S Ct 746, 82 USLW 4043, 14 CDOS 340, 2014 Daily Journal DAR 444, 24 FLW Fed S 503, 2014 WL 113486 , *rev'g Bauman v. DaimlerChrysler Corp.,* 644 F3d 909 (CA-9, 2011), *reh'g and reh'g en banc den.* CA-9, 11/9/11. Justice Ginsburg, who delivered the Court's opinion, succinctly characterized this case as concerning "the authority of a court in the United States to entertain a claim brought by foreign plaintiffs against a foreign defendant based on events occurring entirely outside the United States." Justice Sotomayor issued a separate opinion, concurring in the judgment only.

The Ninth Circuit's now-reversed opinion. The Ninth Circuit had held that DaimlerChrysler AG ("Daimler"), a German corporation headquartered in Stuttgart and with no facilities or employees in the U.S., was subject to general (all-purpose) personal jurisdiction of a federal district court in California, in a case involving claims of human rights

violations that occurred, not in California, but in Argentina at Daimler's subsidiary plant, Mercedes Benz-Argentina, against Argentine residents more than 30 years ago. The exercise of jurisdiction was predicated solely on the California contacts of Daimler's wholly owned U.S. subsidiary, Mercedes-Benz USA, ("MBUSA"), a Delaware corporation that distributes Mercedes-Benz cars throughout the U.S., including California.

Court applied "at home" test. In reaching its conclusion, the Ninth Circuit relied on an agency theory, determining that MBUSA acted as Daimler's agent for jurisdictional purposes, and then attributed MBUSA's California contacts to Daimler. The Ninth Circuit's agency finding rested primarily on its observation that MBUSA's services were "important" to Daimler, as gauged by Daimler's hypothetical readiness to perform those services itself if MBUSA did not exist.

(For a bit more on the Ninth Circuit's decision, as well as a review of the 10/15/13, oral argument, see U.S. Supreme Court Update, 23 JMT 38 (January 2014).)

The Supreme Court's views. In its petition for certiorari, Daimler explicitly asked the Court to consider "whether it violates due process for a court to exercise general personal jurisdiction over a foreign corporation based solely on the fact that an indirect corporate subsidiary performs services on behalf of the defendant in the forum State." As the Court noted, "Daimler argue[d], and several Courts of Appeals have held, that a subsidiary's jurisdictional contacts can be imputed to its parent only when the former is so dominated by the latter as to be its alter ego." In contrast, the Ninth Circuit adopted a less rigorous test based on what it described as an "agency" relationship.

Although the Court questioned the soundness of the Ninth Circuit's agency test, suggesting that it "stacks the deck" in favor of finding jurisdiction, it declined to squarely address the issue stating: "But we need not pass judgment on invocation of an agency theory in the context of general jurisdiction, for in no event can the appeals court's analysis be sustained." Accordingly, the issue of greatest interest to state and local tax practitioners, i.e., whether the exercise of agency-based general jurisdiction is proper under the Due Process Clause, remains unsettled.

Instead, the Court concluded: "Even if we were to assume that MBUSA is at home in California, and further to assume MBUSA's contacts are imputable to Daimler, there would still be no basis to subject Daimler to general jurisdiction in California." On these facts, the Court said, the Ninth Circuit's exercise of general jurisdiction over Daimler was "so exorbitant" that it was simply "barred by due process constraints." The Court reasoned that, under existing personal jurisdiction precedent, Daimler simply could not be considered sufficiently "at home" in California so as to subject it to the general personal jurisdiction of the district court such that it could be sued in California for activities that had no connection to that state.

Due Process Clause: general vs. specific "personal jurisdiction." In support of its conclusion, the Court walked through a lengthy discussion of general and specific jurisdiction. Starting with a discussion of the seminal Supreme Court case, *International Shoe Co. v. State of Washington,* 326 US 310, 90 L Ed 95 (1945), the Court explained that "a State may authorize its courts to exercise personal jurisdiction over an out-of-state defendant if the defendant has certain minimum contacts with [the State] such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice." (Quoting *Goodyear Dunlop Tires Operations, S. A. v. Brown,* 131 S.Ct. 2846, 180 L Ed 2d 796 (2011), quoting *International Shoe.* Internal quotation marks omitted.) The Court continued, stating: "*International Shoe*'s conception of ‘fair play and substantial justice’ presaged the development of two categories of personal jurisdiction," i.e., (1) general or all-purpose jurisdiction, and (2) specific or conduct-linked jurisdiction.

The Court went on to explain that in *Goodyear,* "we addressed the distinction between general or all-purpose jurisdiction, and specific or conduct-linked jurisdiction. As to the former, we held that a court may assert jurisdiction over a foreign corporation ‘to hear any and all claims against [it]’ only when the corporation's affiliations with the State in which suit is brought are so constant and pervasive ‘as to render [it] essentially at home in the forum State.’"

Accordingly, the exercise of general jurisdiction over a party requires affiliations "so continuous and systematic as to render [the foreign corporation] essentially at home in the forum State." (Internal citations and quotation marks omitted.) That is, the Court explained,

"comparable to a domestic enterprise in that State." The Court continued, stating that "*Goodyear* made clear that only a limited set of affiliations with a forum will render a defendant amenable to all-purpose jurisdiction there." Two classic examples justifying the exercise of general jurisdiction over a corporation would be its place of incorporation and the location of its principal place of business.

Instructed by *Goodyear,* the Court concluded that Daimler was not "at home" in California. Neither Daimler nor MBUSA is incorporated in California, nor does either entity have its principal place of business there. The Court reasoned that to extend the exercise of general jurisdiction to every state in which a corporation "engages in a substantial, continuous, and systematic course of business," as the plaintiffs sought, would constitute an "unacceptably grasping" formulation. Justice Ginsburg worried that finding general jurisdiction under these circumstances would constitute an "exorbitant exercise[] of all-purpose jurisdiction" that "would scarcely permit out-of-state defendants ‛to structure their primary conduct with some minimum assurance as to where that conduct will and will not render them liable to suit.’" (Internal citation omitted; internal quotation marks omitted by the Court.) Accordingly, the exercise of general jurisdiction in California over Daimler so as to authorize a lawsuit for injuries attributable to the conduct, in Argentina, of Daimler's Argentine subsidiary was in error.

Concurring opinion. In a separate opinion concurring in the judgment, Justice Sotomayor questioned the Court's decisional process in not addressing the invocation of an agency theory in the context of general jurisdiction. According to Justice Sotomayor, "[i]n bypassing the question on which we granted certiorari to decide an issue not litigated below, the Court leaves respondents [i.e., the Argentinian plaintiffs in the case below] ‛without an unclouded opportunity to air the issue the Court today decides against them.’" (Internal citation omitted.)

If one were to accept MBUSA's actions as those of Daimler, however, Justice Sotomayor concluded that Daimler's contacts with California would be sufficient for that forum to exercise personal jurisdiction. But given the foreign nature of the parties and of the alleged violations, Justice Sotomayor "would reverse the Ninth Circuit's decision on the narrower ground that the exercise of jurisdiction over Daimler would be unreasonable in any event."

Oral Argument in Severance Pay FICA Case

On 1/14/14, the Supreme Court heard oral argument in *U.S. v. Quality Stores, Inc.,* Docket No. 12-1408, *cert. granted* 10/1/13, ruling below as *In re Quality Stores, Inc.,* 110 AFTR 2d 2012-5827, 693 F3d 605, 2012-2 USTC ¶50551 (CA-6, 2012), *reh'g and reh'g en banc den.* 1/4/13, *aff'g* 105 AFTR 2d 2010-1110, 424 BR 237, 2010-1 USTC ¶50250 (DC Mich., 2010). (A transcript of the argument may be accessed at 2014 WL 262860.)

Background. In 2001, respondent Quality Stores, Inc. entered into bankruptcy proceedings. Consequently, it terminated thousands of employees and, as a result, those employees received certain severance payments from respondent. The question presented in this case is whether those severance payments are taxable as "wages" under the Federal Insurance Contributions Act (FICA, codified at IRC Section 3101 *et seq.*).

In addressing this issue, the federal Court of Appeals for the Sixth Circuit held that these severance payments constituted "supplemental unemployment compensation benefits" under IRC Section 3402(o), which governs the withholding of federal income tax and states that any such benefit "shall be treated as if it were a payment of wages" for purposes of income-tax withholding. Accordingly, such benefits were not "wages" for income tax purposes but merely were to be "treated" as such for purposes of withholding, and further, such payments were, similarly, not "wages" for purposes of FICA.

In its petition for review, the government argued that the severance payments do not qualify for an exemption under FICA because only payments linked to the receipt of state unemployment compensation are exempt, and thus payments from an employer should be wages subject to FICA withholding.

The argument: "treated as if wages"? Much of the Court's questioning during oral argument turned on the application of IRC Section 3402(o), entitled "Extension of withholding to certain payments other than wages," and whether that provision is relevant to the FICA definition of "wages." Congress defined "wages" for FICA purposes (with certain exceptions) as "all remuneration for employment, including the cash value of

all remuneration (including benefits) paid in any medium other than cash...." (IRC Section 3121(a)). FICA does not expressly include or exclude supplemental unemployment compensation benefit payments as "wages." IRC Section 3402, however, which deals with federal income tax withholding, and which adopted a definition of "wages" that is nearly identical to the definition of "wages" under FICA (see IRC Section 3401(a)), states that "any supplemental unemployment compensation benefit paid to an individual ... shall be *treated as if it were* a payment of wages" (IRC Section 3402(o)(1)(A), emphasis added). According to attorney Robert Hertzberg, arguing on behalf of the respondent, Quality Stores, "[i]f [supplemental unemployment compensation] were already wages, there would have been no necessity of treating them as if they were wages." To find otherwise, he acknowledged, would be to render Section 3402(o) superfluous.

According to Eric Feigin, Assistant to the U.S. Solicitor General, arguing on behalf of the petitioner government, however, IRC Section 3402(o) was enacted to address a specific problem with regard to withholding taxes, and the statute was not meant to affect the definition of wages for FICA purposes. Moreover, he maintained that "[s]aying that particular types of payments shall be treated as if they were wages made during a payroll period doesn't mean that it's categorically impossible for such payments to have qualified as wages to begin with." Feigin then called the Court's attention to the decision of the Court of Appeals for the Federal Circuit, which held that such payments were taxable wages (*CSX Corp. v. U.S.,* 101 AFTR 2d 2008-1120, 518 F3d 1328, 2008-1 USTC ¶50218 (CA-F.C., 2008), *reh'g and reh'g en banc den,* CA-F.C., 5/13/08), and noted that, as the Federal Circuit's opinion pointed out, "if you were ... to treat all men as if they were six feet tall, that wouldn't mean that no man could possibly be six feet tall." Justice Scalia responded to this analogy by stating: "Yes, unless it was in a section that said how to treat men who are not six feet tall," thereby making reference to the title of Section 3402(o): "Extension of withholding to certain payments other than wages."

Whether the Supreme Court looks to IRC Section 3402(o) to define "wages" for FICA purposes remains to be seen. Given the significance of the definition of the term "wages" for purposes of various federal and state payroll taxes, including, e.g., federal and state unemployment insurance taxes, and federal and state income taxes for withholding

purposes, employers and employees should carefully review the Court's ruling when it is issued. We will, of course, report on it in this column.

(For more on this case thus far, see U.S. Supreme Court Update, 23 JMT 43 (August 2013).)

Federal Preemption Challenge to Mississippi Sales Tax

In *Mobility Medical, Inc. v. Mississippi Department of Revenue,* Docket No. 13-651, petition for cert. filed 11/26/13, ruling below at 119 So 3d 1002 (Miss., 2013), the Mississippi Supreme Court, in a 5-4 en banc decision, affirmed a chancery court's grant of summary judgment in favor of the Mississippi Department of Revenue. The court found that the state's tax on a medical equipment seller's gross sales is not a tax on the Federal Employees Health Benefits Plan (the Plan). Accordingly, the Federal Employees Health Benefits Act's prohibition against states' taxing the Plan does not preempt Mississippi from requiring sellers to pay the tax on their gross sales, including those sales to individuals covered by the Plan.

Mississippi's sales tax. Mississippi subjects, with certain exceptions, "every person engaging or continuing within this state in the business of selling any tangible personal property whatsoever" to a 7% state sales tax on the gross proceeds of the retail sales of the business (Miss. Code Ann. §27-65-17(1)(a)). As explained by the court, in 2008 the Mississippi Department of Revenue reclassified, as taxable transactions, certain sales of medical equipment paid for by third-party payors on behalf of government agencies. This subjected medical equipment retailers, such as Mobility Medical, Inc., and Mobility Medical of North Mississippi, LLC (together, Mobility or the petitioners), to the 7% state sales tax on the gross proceeds of these sales. Mobility now challenges the tax as applied to its sales to customers who are covered by the Plan, claiming the state's taxing statute is preempted by federal law.

The Plan. The Federal Employees Health Benefits Plan, which provides federal employees, retirees, and their families with subsidized healthcare benefits, was created under the Act (5 USC §§8901 to 8913). The Act requires enrollees and the federal

government to make matching contributions, which are deposited into the Employees Health Benefits Fund (the Fund). The Fund is then used to reimburse insurance carriers that initially pay enrollees' claims.

At issue in the case below was the Act's prohibition against states' assessing taxes on Fund payments and whether that prohibition preempted Mississippi sales tax laws as applied to Mobility. The Act states in relevant part: "No tax, fee, or other monetary payment may be imposed, directly or indirectly, on a carrier or an underwriting or plan administration subcontractor of an approved health benefits plan by any State ... or by any political subdivision or other governmental authority thereof, with respect to any payment made from the Fund" (5 USC §8909(f)(1)).

State court finds no preemption. According to the Mississippi Supreme Court, federal preemption of state law can occur in three instances: (1) where Congress explicitly preempts state law; (2) where Congress has occupied the entire field; or (3) where an actual conflict exists between federal and state law. In this case, the court found that Congress has neither explicitly preempted a tax on retailers nor has it occupied the entire field of taxation. Thus, the only way federal law would preempt Mississippi's sales tax law would be if that state law actually conflicted with the Act. The majority found no such conflict.

As quoted above, the Act prevents taxes from being imposed "directly or indirectly, on a carrier or an underwriting or plan administration subcontractor of an approved health benefits plan ... with respect to any payment made from the Fund." Noting that Mobility is a retailer of medical equipment, not "a carrier or an underwriting or plan administration subcontractor," the court found that Mississippi was not *directly* imposing a tax on one of the specified entities. And, the court said, "because the state does not require that the tax be charged to its customers or their insurance carriers, or that it be reimbursed by the fund, the state does not *indirectly* tax a prohibited entity with respect to a payment from the fund" (emphasis added).

Addressing whether the tax burden reaches the Fund, Mobility argued below that it must pass along to its customers the cost of the taxes, which it believes qualifies as an indirect tax on the prohibited entities. The court, however, saw the connection as much more

tenuous: i.e., Mobility *might* pass the tax along to its customer; the customer *might* seek reimbursement for the tax from an insurance company; the insurance company's policy *might* cover the tax; and the insurance company *might* pass the sales tax cost on to the Fund. The court, therefore, "decline[d] to hold that federal law prevents the State of Mississippi from requiring Mobility to pay a tax on the gross amount of its sales, simply because part of that tax *might* be passed along to its customers who are covered by the [Act]." (Emphasis in original.)

The dissent. In contrast to the majority, which saw a tenuous connection between the Mississippi sales tax and the federal Act, the dissent believed that "it is clear that some of the cost created by Mississippi's sales tax on medical equipment sold by Mobility inevitably will reach the fund." According to the dissent, "[s]ales taxes, by definition, are always indirect taxes on the consumer," which means those purchasing equipment from Mobility pay the tax. And because the chancery court below—which granted summary judgment in favor of the Department of Revenue without examining the Act preemption issue—failed to trace the tax burden to see if it eventually reached the Fund, the dissent would "remand to the chancery court for a determination of whether any of the challenged assessments have been reimbursed from the fund." If the additional sales tax payment ultimately is borne by the Fund, then the dissent believes "it is obvious that the sales tax in that transaction is preempted by federal law."

Question before the U.S. Supreme Court. Countering the Mississippi court's view that Mobility can simply pay the sales tax out of its own pocket, the petitioners ask the U.S. Supreme Court to consider "whether [5 USC] §8909(f) preempts the Mississippi Department of Revenue from taxing sales of durable medical equipment to enrollees under Miss. Code Ann. §27-65-17(a)(1), particularly where another Mississippi statute, Miss. Code Ann. §27-65-31, requires the Petitioners to charge and collect sales tax from these enrollees, tax that, per the FEHBA, should be paid by a carrier and reimbursed from the Fund." (The petition for certiorari is available at 2013 WL 6228557.)

Court Asked to Review "All-Events" Test

In *New York Life Insurance Company v. U.S.,* Docket No. 13-849, petition for cert. filed 1/14/14, ruling below at 112 AFTR 2d 2013-5555, 724 F3d 256, 2013-2 USTC ¶50458 (CA-

2, 2013), the U.S. Supreme Court is asked to consider the application of the "all events" test—a foundational test within the tax law that governs the timing of deductions for accrual-basis taxpayers. The effect of this test at the federal level, of course, passes through to the deductions claimed at the state level.

Interestingly though, this case comes to the Supreme Court, if certiorari is granted, on a motion to dismiss. New York Life Insurance Company (N.Y. Life), an accrual-basis taxpayer, claimed deductions on its federal income tax returns related to certain accrued policyholder dividends. Concluding that the deductions did not satisfy the "all-events" test, the IRS disallowed them and determined that N.Y. Life could not deduct the dividends until the year of payment. When N.Y. Life challenged the Service's actions in court, the IRS filed a motion to dismiss under Fed. Rul. Civ. Proc. 12(b)(6) for failure to state a claim. The district court granted the Service's motion to dismiss (107 AFTR 2d 2011-2107, 2011-1 USTC ¶50373, 780 F Supp 2d 324 (DC N.Y., 2011). The federal Court of Appeals for the Second Circuit affirmed, finding that "New York Life's complaint fails to state a plausible claim that the deductions at issue satisfied the first prong of the all-events test."

Background and procedural history. N.Y. Life, a mutual life insurance company, is a calendar-year, accrual-basis taxpayer. The company issues certain policies that entitle the policyholders to receive dividends, including an "Annual Dividend," comprising the policyholders' shares of the company's surplus earnings. For various reasons (discussed below), N.Y. Life's practice was to credit a policyholder's account with the amount of the "Annual Dividend" prior to actual payment. In its returns for each of the tax years 1990 through 1995, N.Y. Life deducted the dividends as accrued expenses; the dividends were not actually paid until the following year. On audit, the IRS rejected the claimed deductions, ruling that N.Y. Life was entitled to deduct these policyholder dividends only in the years of actual payment.

N.Y. Life paid the resulting deficiency and filed a claim for a refund, which the IRS denied. In its subsequent complaint to the district court, N.Y. Life sought a refund of just under $100 million plus interest, claiming that it was entitled to accrue and deduct the dividend-related amounts in each of the years at issue. The district court, as noted above, granted the motion to dismiss under Fed. Rul. Civ. Proc. 12(b)(6). The court concluded that N.Y. Life

failed to allege sufficient facts from which to infer that the deductions satisfied the "all-events" test, a requirement under Treas. Reg. §1.461-1(a)(*2*)(i) for deduction of an accrued expense.

Reg. §1.461-1(a)(*2*)(i) and the "all-events" test. As noted by the Second Circuit, under IRC Section 808(c) a life insurance company may deduct from gross income "an amount equal to the policyholder dividends paid *or accrued* during the taxable year." (Emphasis added by the court.) In turn, Treas. Reg. §1.461-1(a)(*2*)(i) provides that under the accrual method of accounting, "a liability ... is incurred, and generally is taken into account for Federal income tax purposes, in the taxable year in which [1] all the events have occurred that establish the fact of the liability, [2]) the amount of the liability can be determined with reasonable accuracy, and [3] economic performance has occurred with respect to the liability." Combined, these three factors are known as the "all-events" test. At issue in the case below was the application of the first prong of the "all-events" inquiry: whether "all the events have occurred that establish the fact of the liability."

Citing two Supreme Court cases (*U.S. v. Hughes Properties, Inc.,* 58 AFTR 2d 86-5062, 476 US 593, 90 L Ed 2d 569, 86-1 USTC ¶9440, 1986-2 CB 63 (1986), and *U.S. v. General Dynamics Corp.,* 59 AFTR 2d 87-899, 481 US 239, 95 L Ed 2d 226, 8 EBC 1489, 87-1 USTC ¶9280, 1987-2 CB 134 (1987)), the Second Circuit noted that "the all-events test is not satisfied, and a liability not established, by a statistical probability—however high—that the taxpayer will ultimately pay the expense. Instead, the test requires that nothing further be needed to create a ‘fixed liability ... which [the taxpayer cannot] escape.’ [Quoting *Hughes Properties.*] If the taxpayer's obligation remains in some way contingent—dependent on some discrete event that has not yet occurred—the deduction will not satisfy the all-events test and may be disallowed."

The court's view of the dividends. Under New York insurance law, N.Y. Life is required to annually distribute a portion of its surplus earnings to policy owners. The two dividends at issue in the case below were N.Y. Life's "Annual Dividend for January Policies" and its "Minimum Liability Dividend." N.Y. Life's petition for certiorari raises issues concerning only the "Annual Dividend for January Policies."

The annual dividends are payable on the anniversary of a policy if the policy remains in force on that date and all premiums due have been paid. For the tax years at issue, N.Y. Life credited a policyholder's account with the annual dividend on the later of: (1) 30 days before the policy's anniversary, or (2) the date on which all premiums due have been received. N.Y. Life typically credited a policyholder's account up to 30 days before the policy anniversary, but did not pay the annual dividend until the policy's anniversary. As a result, the "Annual Dividends for January Policies" were credited in one tax year and paid in the next tax year.

According to the terms of its policies, however, N.Y. Life, as indicated above, is obligated to make the dividend payment only if the policy remains in force on the actual anniversary date. Thus, according to the Second Circuit, N.Y. Life overlooked the fact that "‵the last link in the chain of events creating liability′—the policyholder's decision to keep his or her policy in force through the policy's anniversary date—did not occur until January of the following year." (Quoting *General Dynamics.*) Under N.Y. Life's policies, a policyholder has the right to surrender his or her policy at any time for its cash value. Consequently, the court said, N.Y. Life "could not know in December which course of action the policyholder would choose the following month" (i.e., continue the policy or surrender it for its cash value)—a fact that N.Y. Life could not "disavow ... simply to accelerate its use of the related income tax deduction." Therefore, the court concluded that N.Y. Life "failed to allege facts sufficient to support an inference that its deductions for the Annual Dividend for January Policyholders satisfied the all-events test."

Relevant to its petition for certiorari, N.Y. Life argued in the case below that "a policyholder's decision to keep her policy in force does not constitute an ‵event′ for purposes of the all-events test." The circuit court, however, saw N.Y. Life's liability for its "Annual Dividend for January Policies" as "depending upon an actual *choice* by the third-party policyholder: her decision not to redeem her policy for cash, for example, and invest her money elsewhere." (Emphasis in original.) This, according to the court, distinguished the case at hand from other decisions which found that an "event" for purposes of the "all-events" test "is ‵ordinarily something which marks a change in the status quo′" (quoting *Burnham Corp. v. C.I.R.,* 65 AFTR 2d 90-684, 878 F2d 86, 89-2 USTC ¶9419 (CA-2, 1989)).

Supreme Court asked to review the definition of an "event."

In its petition for certiorari (2014 WL 173176), N.Y. Life highlights the U.S. Supreme Court's distinction between conditions subsequent, which do not prevent accrual, and conditions precedent, which do prevent accrual, and argues that the Second Circuit failed to properly apply this distinction. According to N.Y. Life, "[t]he principles articulated in that precedent establish that the continuation of the status quo is not an event for purposes of the all events test." Rather, N.Y. Life argued, "[t]he continuation of the status quo is a non-event. The existence of a condition subsequent that could change the status quo does not prevent accrual."

Focusing on the Second Circuit's ruling that a mere continuation of the status quo is necessary to satisfy the "all-events" test, N.Y. Life asks the Court to consider "[w]hether the Second Circuit erred in holding, in conflict with this Court's decision in *United States v. Hughes Properties, Inc.,* 476 U.S. 593 (1986), that the continuation of the status quo is a required event, and thus a 'condition precedent,' needed to establish the fact of liability under the all-events test governing the accrual method of tax accounting."

N.Y. Life asserts that the Second Circuit misapplied existing precedent, thereby "resurrect[ing] a conflict among several circuits that should be resolved in light of this Court's decision in *Hughes Properties.*"

Petitions Still Pending

As we go to press, as noted above we still await the Court's decisions on whether to grant three previously filed requests for certiorari.

Court invites Solicitor General to file brief in resident income tax credit Commerce Clause challenge. In *Comptroller of the Treasury of Maryland v. Wynne,* Docket No. 13-485, petition for cert. filed 10/13/13, ruling below at 431 Md. 147, 64 A3d 453 (2013), the Maryland Court of Appeals (the state's highest court) held that Maryland's law that provides a credit against Maryland state income tax for incomes taxes paid to other states violated the Commerce Clause of the U.S. Constitution because the credit was not available to offset county-level income taxes.

In the case below, the Maryland court analyzed the taxpayers' challenge to the statute under the dormant Commerce Clause test announced in *Complete Auto Transit, Inc. v. Brady* 430 US 274, 51 L Ed 2d 326 (1977), whereby a state tax will pass constitutional muster if the tax: (1) applies to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate or foreign commerce; and (4) is fairly related to the services provided by the state. Focusing on the requirements of fair apportionment and no discrimination against interstate commerce, the Maryland court found that the lack of a credit against the county tax resulted in the tax's failing under both prongs.

Addressing, first, fair apportionment, the Maryland court noted that in order to assess that factor, it was necessary to decide whether the tax was both "internally consistent" as well as "externally consistent." The court concluded that Maryland's tax was neither. Applying the internal consistency test of *Oklahoma Tax Commission v. Jefferson Lines, Inc.,* 514 US 175, 131 L Ed 2d 261 (1995), the court ruled that the tax was not internally consistent because if each state imposed a county tax without a credit, intrastate commerce would be favored over interstate commerce. This conclusion was based on the finding that "a taxpayer with income sourced in more than one state will consistently owe more in combined state income taxes than a taxpayer with the same income sourced in just the taxpayer's home state," which may discourage interstate investment and business activity. The court also concluded that the tax provision was not "externally consistent" because the tax liability under the Maryland income tax law failed to reasonably reflect how the income was generated, and thus, there was the possibility for multiple taxation of the same income.

The court also examined the third prong of the *Complete Auto* test, the prohibition against discrimination toward interstate commerce, focusing on the U.S. Supreme Court's analysis of a North Carolina tax in *Fulton Corp. v. Faulker,* 516 US 325, 133 L Ed 2d 796 (1996). In that case, the tax at issue resulted in North Carolina stockholders being taxed at higher rates for holdings in companies that did not do business in North Carolina than for holdings in companies that did do business in North Carolina. In *Wynne,* the Maryland court found that, at least in the context of ownership of an S corporation, the application of the credit in Maryland's income tax law has a similar discriminatory effect: "The more a Maryland business can locate its value-creating activities within Maryland the less it will be taxed."

Accordingly, the Maryland Court of Appeals held that "the application of the county tax to pass-through S corporation income sourced in other states that tax that income, without application of an appropriate credit, discriminates against interstate commerce."

Maryland's petition for certiorari asks the Supreme Court to consider the following question: "Does the United States Constitution prohibit a state from taxing all the income of its residents—wherever earned—by mandating a credit for taxes paid on income earned in other states?" On 1/13/14, the Court asked the U.S. Solicitor General to file a brief expressing the views of the federal government (2014 WL 102377).

(For more on this case, including a discussion of Maryland's income tax scheme and a dissenting opinion in *Wynne,* see U.S. Supreme Court Update, 23 JMT 40 (February 2014).)

Court asks for Solicitor General's views in 4R Act tax discrimination challenge. On 1/27/14, the Supreme Court invited the Solicitor General to file a brief expressing the views of the federal government in *Alabama Department of Revenue v. CSX Transportation, Inc.,* Docket No. 13-553, petition for cert. filed 10/30/13, ruling below as *CSX Transportation, Inc. v. Alabama Department of Revenue,* 720 F3d 863 (CA-11 2013). In the state's petition for review, the Alabama Attorney General asks the Court to review the decision by the federal Court of Appeals for the Eleventh Circuit holding that Alabama's failure to provide a tax exemption from the state's sales and use taxes for railroads' purchases of diesel fuel, while exempting both interstate motor carriers and water carriers, was discriminatory in violation of the federal Railroad Revitalization and Regulation Reform Act of 1976 (the "4R Act," codified at 49 USC §11501). This is the latest decision in the long-running dispute between the railroads and the state of Alabama. Congress enacted the 4R Act in 1976 to restore the financial stability of the railroad industry. One provision of the Act, 49 USC §11501(b), expressly prohibits four forms of discriminatory state and local taxation. Subsections (b)(1) through (b)(3) involve discriminatory property tax rates and unfair assessments on "rail transportation property" vs. other "commercial and industrial property." Subsection (b)(4), and the specific provision at issue in this case, provides a catch-all prohibition against a state's imposition of "another tax that discriminates against a rail carrier."

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

Tribal property tax case. *Madison County, N.Y. v. Oneida Indian Nation of New York,* Docket No. 12-604, petition for cert. filed 11/12/12, ruling below as *Oneida Indian Nation of New York v. Madison County, N.Y.,* 665 F3d 408 (CA-2, 2011), follows a remand from the U.S. Supreme Court in an earlier action in this ongoing litigation, in which the federal Court of Appeals for the Second Circuit affirmed in part, vacated in part, and remanded with instructions, the district court's judgments. Specifically, the circuit court held that the Oneida Nation waived its claim to tribal sovereign immunity from enforcement of real property taxation through foreclosure by state, county, and local governments, when the tribe issued a formal declaration to that effect. Accordingly, the appellate court vacated the district court's judgments to the extent that they granted summary judgment to the Oneida Nation based on claims relating to the doctrine of sovereign tribal immunity to suit.

The Second Circuit also reversed the district court's judgment in favor of the Oneida Nation on its claims of violations under the Due Process Clause of the Fourteenth Amendment, finding that the Oneida Nation had sufficient notice of the counties' tax enforcement proceedings to enable it to take steps to protect its property interests. And the circuit court also declined to exercise supplemental jurisdiction over the tribe's state law claims, thereby vacating the district court's grant of injunctive relief barring the counties from foreclosing on the Oneida Nation's properties. Citing its prior holding on this question, the Second Circuit also affirmed the dismissal of the counties' counterclaims regarding the issue of whether the Oneida reservation had been disestablished.

As previously reported, in February 2013 the Court asked the U.S. Solicitor General to file a brief expressing the views of the federal government in this case but, at this writing, such brief has yet to be filed. The court recently received two letters from Petitioner's counsel, but no conference has yet been scheduled in this case.

(For more background on this litigation, and more on the current request for certiorari, see U.S. Supreme Court Update, 22 JMT 41 (February 2013).)

Certiorari Has Been Denied in:

Capra v. Cook County Board of Review, Docket No. 13-627, *cert. den.* 1/27/14, ruling below at 733 F3d 705 (CA-7, 2013), the Supreme Court was asked to address issues concerning local taxpayers' abilities to sue local tax officials for alleged federal constitutional violations. Specifically, the question presented in the petition for certiorari (2013 WL 6140525) was as follows: "Under this Court's decisions in *Hibbs v. Winn,* 542 U.S. 88 (2004) and *Commerce Energy, Inc. v. Levin* 130 S.Ct. 2323 (2010), what is the scope of the principle of comity in relation to the Tax Injunction Act, 28 U.S.C. §1341, when state tax schemes are alleged to violate Equal Protection, the First Amendment, and Due Process?"

The case below involved claims brought by two taxpayers under 42 USC §1983 against a local property tax board of review, its commissioners, and staff. The taxpayer's alleged that certain property tax reductions initially granted were later rescinded following a local political scandal. In addressing whether a federal court was the correct forum for the taxpayers' claims, the federal Court of Appeals for the Seventh Circuit affirmed a dismissal of the claims against the individual defendants on quasi-judicial absolute-immunity grounds and remanded for dismissal of the claims against the board under principles of abstention and comity.

Citing *Fair Assessment in Real Estate Ass'n v. McNary,* 454 US 100, 70 L Ed 2d 271 (1981), the Seventh Circuit noted the "tension between section 1983, which provides broadly for suits under federal law against state and local governments and employees, and the Tax Injunction Act, 28 U.S.C. §1341, which forbids federal courts from enjoining or interfering with the collection of state taxes" and held that it "must abstain from considering the [petitioner's] claims unless the available state remedies are not adequate, plain, and complete." Taking guidance from comity case law and the Tax Injunction Act—which bars federal courts from enjoining state taxes where a "plain, speedy and efficient" state remedy is available—the court found the available state remedies to be adequate and thus dismissed the claims against the board without prejudice, allowing the petitioners to raise federal constitutional issues in any subsequent state proceedings.

(42 USC §1983 provides a civil rights cause of action for violation of federal constitutional rights by state officials. For some background on §1983 (which was enacted as part of the federal Civil Rights Act of 1871), see, e.g., McCray, "U.S. Supreme Court Permits Commerce Clause Suits Under Civil Rights Statute," 1 JMT 258 (Jan/Feb 1992).)

McLane Southern, Inc. v. Bridges, Docket No. 13-657, *cert. den.* 1/27/14, ruling below at 110 So 3d 1262 (La. Ct. App. 1st Cir., 2013), *writ den.* La. S.Ct., 8/30/13, in which the petition for certiorari (2013 WL 6236872) asked the U.S. Supreme Court to consider "[w]hether the Commerce Clause of the United States Constitution allows States to tax goods distributed by out-of-state wholesalers more heavily than goods distributed by in-state wholesalers."

The case involved Louisiana's excise tax on smokeless tobacco. Petitioner McLane Southern, Inc. is a Mississippi-based wholesaler that sells smokeless tobacco to Louisiana retailers from a distribution center out of state. In its petition for review, McLane argued that because Louisiana's excise tax was based on the price invoiced to the first distributor to bring the product into the state and that because a product's price increases at every step of a multi-step distribution chain, it follows that the excise tax falls more heavily on products that enter into Louisiana at a later point in the distribution chain. As such, because McLane sold product from an out-of-state distribution center, it asserted that it confronted a higher tax burden than did in-state distributors, thus resulting in a competitive disadvantage. McLane argued that Louisiana's taxing scheme inherently discriminated against out-of-state wholesalers.

By declining to consider this issue, the U.S. Supreme Court leaves in place the ruling of the Louisiana courts, which held that McLane failed in its burden of proving that the Louisiana Department of Revenue's interpretation of the tobacco tax statute discriminates against interstate commerce. According to the Louisiana Court of Appeal, "[i]t is [the supplier's] business model, and not the statutory structure, that causes McLane's higher tax obligation. The Commerce Clause does not protect particular structure[s] or methods of operation in a retail market" (quoting *McLane Minnesota, Inc. v. Commissioner of Revenue,* 773 NW2d 289 (Minn., 2009), internal quotation marks omitted). **[]**

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