THOMSON REUTERS
CHECKPOINT

28-JUN J. MULTISTATE TAX'N 43

Journal of Multistate Taxation and Incentives
****1**
June, 2018

U.S. Supreme Court Update

U.S. SUPREME COURT UPDATE

DEBRA S. HERMAN is a partner in the New York City office and K. CRAIG REILLY is an associate in the Buffalo and New York City offices of the law firm Hodgson Russ LLP. The authors thank KELLY DONIGAN for his contributions to this month's column.

Court Prepares for Oral Arguments in Online Sales Tax Dispute

***43** On 4/17/18, the U.S. Supreme Court hears oral arguments in *South Dakota v. Wayfair, Inc.*, *et. al.* (Docket No. 17-494). In South Dakota's closely watched petition for certiorari, the state asked the Court to review and overturn thephysical presence nexus standard announced in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). According to South Dakota, *Quill*'s physical presence standard—which requires out-of-state businesses to maintain some type of physical connection (*e.g.*, employees, inventory, or other property)within a state before the state may subject the business to its sales and use tax collection and remittance requirements—is harmful to local governments, brick-and-mortar businesses, and to interstate commerce itself. The state also argues that *Quill* isthe kind of judicial mistake that need not be reinforced under stare decisis. Instead, South Dakota argues that courts should apply the four-prong test from *Complete Auto Transit Inc. v. Brady* when determining the constitutionalityof a state's sales and use tax laws under the Commerce Clause.

In its petitioner's brief with the Court, filed 2/26/18, South Dakota argued *Quill*'s physical presence rule is ‘squarely inconsistent‘ with the ‘substantial nexus‘ test laid out in *Complete Auto*, and, according tothe state, the Court's prior ruling created an ‘artificial rule,‘ which has led to ‘arbitrary distinctions that are increasingly unclear‘ and harmful to the national economy. South Dakota pointed to several specific problems created by thephysical presence rule, including forum shopping by multistate companies, which creates complex shipping mechanisms meant to avoid certain states. While South Dakota conceded that ‘using physical presence as a proxy for ‘substantial nexus' made sense‘when ‘the first rule of retail was ‘location, location, location,’‘ in today's digital economy, South Dakota argues the rule makes little sense when applied to online retail giants deriving substantialincome from sales into a state.

Representatives for South Dakota and Wayfair may not be the only parties arguing before the Court on 4/17/18. In a 3/19/17 filing, the U.S. Solicitor General asked the Court for 10 minutes of time during the case's oral arguments, arguing that ‘the rulesthat govern in this area will significantly affect the functioning of the national economy and the States' financial stability.‘ The government previously filed an amicus brief in support of South Dakota, in which it argued the Court should not extend*Quill*'s physical presence rule to e-commerce, but instead apply the rule only to traditional mail-order retailers.

****2** The Court's *Wayfair* decision has the potential to shake the state and local tax landscape, and, as to be expected, there have been no shortage of opinions both in favor of and opposed to eliminating *Quill*'s physical presence standard.

Pick your side.

Influential parties on both sides of the issue have lined up, making public statements and filing amicus briefs in support of their arguments. Of the nearly 40 briefs already filed with the Supreme Court—including at least 18 filed since the Courtgranted South Dakota's petition—some of the most notable voices include the brief for Colorado and 34 other states in support of South Dakota, filed on 3/5/18. The states argue that *Quill* infringes on states' rights to respond to the economicrealities of today and that direct collection by retailers is the only adequate way for states to collect the sales taxes desperately needed to fund their public services.

Similarly, the National Association of Certified Service Providers and the Software and Information Industry Association filed an amicus brief on 3/1/18, arguing that the same technological advances that have allowed for the growth of widespread e-commercehave also lessened the administrative burdens of collecting state and local taxes in multiple jurisdictions. Pointing to service providers such as TaxCloud and Taxometry, the brief argues these providers offer full filing services in all 50 states. These technologicaladvances, the brief continues, should ease the Court's concerns regarding the complexities of collecting and remitting taxes in different jurisdictions.

On the other side of the aisle, various tax and e-retail trade and policy organizations, including NetChoice and the National Taxpayers Union Foundation, argue that the Court should maintain *Quill*'s physical presence rule, as Congress, not theCourt, is ‘the proper venue for the regulation of interstate commerce.‘ The supporters of Wayfair also argue that ‘[s]ales tax complexity has, in many ways, grown worse in the ***44** intervening years between the *Quill* ruling andthis case,‘ pointing specifically to a lack of uniformity in the taxability of certain online sales and conflicting rules regarding the sourcing of income received from those sales.

Wayfair's respondent's brief states that South Dakota's proposed rule ‘runs roughshod over principles of *stare decisis*, disregards significant concerns of retroactive liability, and fails to establish facts sufficient for this Court to evaluatethe complex and delicate balance between the burdens of imposing nationwide sales and use tax obligations on interstate businesses, on the one hand, and the States' interest in requiring companies located beyond their borders to serve as the States' use taxcollectors, on the other.‘

In addition to the pending *Wayfair* arguments, the Court has also received one new petition for certiorari in another case involving state and local taxes, while two previously reported petitions remained pending and one previously reported petitionhas been denied at the time of this writing. The Court's newest state and local tax petition was filed as *Cosgriff v. County of Winnebago, et al* (Docket No. 17-1232), in which the U.S. Supreme Court has been asked to review a decision of theU.S. Court of Appeals for the Seventh Circuit, which ruled the taxpayers' tax-related claims could not be brought in federal court under principles of comity between state and federal courts.

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

Court Asked to Review Dismissal of Claims against Ill. County for Retaliatory Increase to Property Taxes

On 3/1/2018, the U.S. Supreme Court received a new petition for certiorari in *Cosgriff v. County of Winnebago*, Docket No. 17-1232, ruling below at 876 F.3d 912 (7th Cir. 2017), in which the Seventh Circuit held that, under the comity doctrine, the taxpayers' tax-related claims could not be brought in federal court. The circuit court therefore affirmed the dismissal of the taxpayers'complaint.

A pool and a dog bite leads to an increase in property taxes and a local feud.

As explained by the Seventh Circuit, when employees of Roscoe Township (the 'Township'), located in Winnebago County, Illinois, came onto the property of Kelly and Anita Cosgriff (the 'Cosgriffs') to reassess the property's value after theCosgriffs installed a $50,000 pool at their home, one of the employees was allegedly bitten by the Cosgriffs' dog. The employee and Township then sued the Cosgriffs.

In response, the Cosgriffs posted a 'No Trespass' sign on their property and started an online petition encouraging other taxpayers to not allow the Township to trespass on private property. After quarrelling over the dog bite and the trespassingnotices, the Township issued a property value assessment of the Cosgriffs' property 47.14% higher than the previous year (from $357,000 to $525,000). It was the highest increase in the Township in 2014, a year in which over 99% of properties saw their assessedvalues reduced from the previous year.

Following the assessment, the Cosgriffs allege they emailed the Winnebago County Supervisor of Assessments to complain. He forwarded their message to the Assistant State's Attorney and the Assistant State's Attorney forwarded the message to his son, theTownship Attorney, with a one-word message: 'Boom.'

The Cosgriffs then filed a property tax assessment complaint with the Winnebago County Board of Review, and at the county hearing, the Township Assessor could not explain how she reached the value given to the Cosgriffs' property. (The Cosgriffs had invitedthe Roscoe Township to inspect the property, but the Township did not do so.) Accordingly, the Winnebago County Board of Review lowered the property's assessed value (from $525,000 to $409,000—an amount that essentially reflected the $50,000 pool installation).The Cosgriffs did not appeal this ruling in the state court system. Rather, the Cosgriffs brought suit in the federal district court against Winnebago County and various county and Township officials.

Taxpayers' constitutional challenges dismissed under doctrine of comity.

****4** The Cosgriffs brought suit in federal district court claiming the defendants violated ***46** 42 U.S.C. § 1983, which prohibits unconstitutional actions by persons acting under thecolor of state law, by: '(1) retaliating against the Cosgriffs for exercising their First Amendment rights to free speech; (2) conspiring to violate the Cosgriffs' Fourteenth Amendment rights to due process; and (3) violating the Cosgriffs' FourteenthAmendment rights to equal protection of the law.'

Without discussing the merits of the Cosgriffs' allegations, the district court dismissed the suit and the Seventh Circuit affirmed. Both courts made their respective rulings under the doctrine of comity, which, according to the circuit court, 'counselslower federal courts to resist engagement in certain cases falling within their jurisdiction.' In cases dealing with state tax systems, for example, the Seventh Circuit noted that the U.S. Supreme Court has 'recognized the important and sensitive natureof state tax systems and the need for federal-court restraint when deciding cases that affect such systems. ' (*Fair Assessment in Real Estate Ass'n, Inc. v. McNary,* 454 U.S. 100 (1981).) Citing also to the federal Tax Anti-Injunction Act (28 U.S.C. § 1341), the Seventh Circuit therefore dismissed the Cosgriffs' §1983 claims.

Question presented.

In the case below, the Cosgriffs argued that their case was properly before the federal courts as their action involved allegations that their federal rights had been violated, rather than the appeal of their property tax assessment. Specifically, the

Cosgriffsalleged they were ‘concerned about the defendants' unconstitutional actions against them‘—specifically, the alleged infringement of their rights under the First and Fourteenth Amendments to the U.S. Constitution. The Cosgriffs now ask the U.S.Supreme Court to consider ‘[w]hether Comity will protect State Officials who, in emails and their actions, conspired to falsely inflate citizens' property tax in retaliation of the citizens' exercise of free speech.‘

Petitions Pending

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

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

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

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

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

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

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

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

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

On 9/19/17, the Court received a petition for certiorari in *Dawson v. Steager,* Docket No. 17-419, ruling below at *Steager v. Dawson*, 2017 WL 2172006 (W. Va. 2017), in which the Supreme Court of Appeals of West Virginia held thatMr. Dawson, a retired U.S. Marshal, was not entitled to exempt his Federal Employee Retirement System (‘FERS‘) income from state income tax.

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

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

Dawson now asks the U.S. Supreme Court to consider the following question for review: ‘Whether this Court's precedent and the doctrine of *48 intergovernmental tax immunity bar states from exempting groups of state retirees from state income tax while discriminatingagainst similarly situated federal retirees based on the source of their retirement income.‘ On Jan. 8, 2018, the Court invited the Solicitor General to file a brief in this case expressing the views of the United States.

Petition Denied

The Court has denied a petition for certiorari in *Loudon County, Virginia v. Dulles Duty Free, LLC*, Docket No. 17-904, ruling below at 803 S.E.2d 54 (Va. 2017). In the case below, the Supreme Court of Virginia held that the Import-Export Clause of the U.S. Constitution bars Loudoun County from imposing its 0.17% Business, Professional, and Occupational License (‘BPOL‘)tax on receipts from international export sales made by Dulles Duty Free LLC (‘Dulles‘).

Historically, as explained by the Supreme Court of Virginia, courts have applied the language of the Import-Export Clause of the U.S. Constitution to develop a set of formalistic rules. In *Richfield Oil Corp. v. State Board of Equalization*,329 U.S. 69 (1946), interpreting the Import-Export Clause, the U.S. Supreme Court held that a good has immunity under the Import-Export Clause when it begins its physical movement ‘so long as the certainty of the foreign destination isplain.‘ Regarding imports, so long as goods remained in their ‘original packages,‘ they historically enjoyed immunity from state taxation. However, in *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), while exiting from the formalistic approach of the original package doctrine, the Court explained that the Import-Export Clause should be interpreted in light of its original understanding and objectives: (1) state taxationshould not interfere with the federal government's foreign economic policy, (2) import revenues should be reserved for the federal government, and (3) seaboard states must be prevented from levying taxes on citizens of other states because goods flowed throughtheir ports.

In the case below, Dulles, which operates ‘duty free‘ stores at Dulles International Airport located in Loudoun County, Virginia, did not charge any Virginia sales tax on sales to customers flying internationally and did not collect any import duties,as the stores' goods were all sold in their original packaging and destined for locations outside the United States. Loudoun County, however, imposed a separate 0.17% BPOL tax, measured by the gross receipts of retail stores located in the county.

**7 Dulles filed suit over imposition of the tax. Applying the less formalistic *Michelin* analysis, a Loudoun County Circuit Court rejected Dulles' argument. On appeal, however, the Supreme Court of Virginia reversed the lower court.While acknowledging contrary holdings, the Virginia court held that the U.S. Supreme Court ‘has not overruled *Richfield Oil* and, while it has significantly revised its Import-Export Clause jurisprudence, the Court has carefully carved outfor future disposition the issue of whether the *Michelin* test would apply to a non-discriminatory tax that falls on export goods in transit.‘ To that end, the court applied the *Richfield Oil* analysis and determined the BPOL taxis, in operation, a direct tax on export goods in the export stream that are immune from taxation.

In response to the Virginia court's holding, Loudoun County presented the following questions in its unsuccessful petition for certiorari: (1) Should the validity under the Import-Export Clause of a non-discriminatory local business license tax calculatedon the basis of gross receipts be evaluated using the Court's approach in *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), or in *Richfield Oil Corp. v. State Bd. Of Equalization*, 329 U.S. 69 (1946); and (2) does a local businesslicense tax calculated based on gross receipts, which does not specifically target imports or exports, violate the Import-Export Clause if some of the gross receipts include export sales?

The Court's *Wayfair* decision has the potential to shake the state and local tax landscape.

The Cosgriffs argue their action involved allegations that their federal rights had been violated, rather than the appeal of their property tax assessment.

End of Document