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U.S. Supreme Court Update

U.S. SUPREME COURT UPDATE

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Court Receives Two New Petitions in State and Local Tax Matters

***37** The U.S. Supreme Court has received two new petitions for certiorari in cases involving state and local taxes. The first, *South Dakota v. Wayfair, Inc., et. al.* (Docket No. 17-494), involves South Dakota's request that the Court overturn the current physical presence 'nexus' requirement for sales and use taxes, as announced in *Quill Corp v. North Dakota*, 504 U.S. 298 (1992). South Dakota asks specifically for the Court to uphold the state's recent law requiring remote sellers with no physical presence in South Dakota to collect and remit sales tax so long as certain sales thresholds are met.

In the second petition, *Estate of Brooks, et. al. v. Connecticut Comm'r of Revenue Services,* (Docket No. 17-608), several trust beneficiaries challenge Connecticut's ability to impose an estate tax on trust assets transferred to the decedent by a predeceased spouse, who died a domiciliary of another state, and that were held in a qualified terminable interest property ('QTIP') marital deduction trust.

In addition to these new petitions for certiorari, four previously reported petitions remained pending at the time of this writing. And the Court still remains set to review a dispute between Delaware and several other states as to which states have priority rights to claim abandoned, uncashed MoneyGram 'official checks.' The MoneyGram cases set for review are *Delaware v. 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 these cases, and tasked him with coordinating the taking of evidence and making reports. (The Court typically assigns original jurisdiction disputes—cases such as disputes between states that are first heard at the U.S. Supreme Court level—to a Special Master to conduct what amounts to a trial court proceeding.) We will continue to updatereaders as more details become available.

Lastly, the Court has denied the petition for certiorari in one previously reported case.

Court Asked to Overturn *Quill Corp. v. North Dakota*'s Physical Presence Test

****2** On 10/2/17, the Court received a new petition for certiorari in *South Dakota v. Wayfair, Inc., et. al.*, Docket No. 17-494, ruling below at 901 N.W.2d 754 (S.D. 2017), in which the Supreme Court of South Dakota held that a South Dakota law requiring

Internet sellers with no physical presence in South Dakota to collect and remit sales tax violated the dormant Commerce Clause of the U.S. Constitution.

Specifically, the state court noted that since the 1992 decision in *Quill Corp. v. North Dakota*, the U.S. Supreme Court has mandated a 'bright-line rule' for sales and use tax nexus, whereby out-of-state vendors must have a 'physical presence' in a state before that state can require the vendor to collect or remit its sales tax. According to the Supreme Court of South Dakota, despite rumblings to the contrary, '*Quill* has not been overruled [and] remains the controlling precedent on the issue of Commerce Clause limitations on interstate collection of sales and use taxes.'

The recent history of *Quill:* Justice Kennedy asks; South Dakota responds.

In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the U.S. Supreme Court held that, 'at least for now,' states could not impose sales tax requirements on vendors with no 'physical presence' in the state. In the years since 1992, however, an increasing number of voices have questioned *Quill*'s holding in the context of the modern, online economy. Perhaps no criticism of *Quill* generated more buzz than when, in 2015, Justice Kennedy, who originally voted with the majority in *Quill*, urged '[t]he legal system' to 'find an appropriate case for this Court to reexamine [*Quill*].' *See Direct Mktg. Ass'n v. Brohl (DMA),* 135 S. Ct. 1124, 1135 (2015) (Kennedy, J., concurring).

South Dakota, concerned about the increasing loss of sales tax revenue from out-of-state Internet sales, clearly heard the Justice's remarks and, in 2016, passed 'Senate Bill 106,' which answered Justice Kennedy's invitation by requiring out-of-state sellers to collect and remit sales tax based, not on their physical presence in South Dakota, but on their economic connection to the state. Specifically, South Dakota's law requires any business with $100,000 in sales or 200 separate transactions in the state to collect and remit tax on sales made and delivered to South Dakota customers.

***38** In connection with its new law, South Dakota sent direct notices to a large set of out-of-state retailers that it believed met the statutory thresholds. It then sued those retailers that failed to comply, seeking a declaratory judgment affirming the law's validity. Three of those retailers were parties in the case below who challenged South Dakota's laws on constitutional grounds, claiming that the law violated the requirements of the dormant Commerce Clause as announced in *Quill.*

Rulings below.

After failing in their bid to remove their case to federal court, the retailers filed a motion for summary judgment in South Dakota state circuit court, raising the alleged unconstitutionality of the state's law under the Commerce Clause. The state then filed a response to the retailers' motion for summary judgment, agreeing with the retailers' statements of fact and also agreeing that the court would have to grant their motion for summary judgment based upon the current precedent of *Quill.* Instead of arguing against the retailers' motion for summary judgment, South Dakota indicated its intention to pursue review of the issue by the U.S. Supreme Court.

****3** The lower court therefore held it was 'duty bound to follow applicable precedent of the United States Supreme Court' and invalidated South Dakota's rule 'as a matter of law.' The South Dakota Supreme Court then affirmed the lower court's ruling, stating that '[h]owever persuasive the State's arguments on the merits of revisiting the issue, *Quill* has not been overruled.'

South Dakota's broad arguments to abrogate *Quill.*

In its petition for certiorari, South Dakota provides the following broad reasons as to why the U.S. Supreme Court should reconsider and overrule *Quill.* First, South Dakota argues that, under contemporary conditions, *Quill's* rule is harmful to local governments, brick-and-mortar businesses, and to interstate commerce itself. Local governments are harmed, the state argues, by losing substantial amounts of revenue. In 2009, for example, South Dakota estimates that states were unable to collect $23

billion in sales tax revenues due to *Quill.* That number, South Dakota alleges, will rise significantly as more sales are made online.

***39** South Dakota also warns that *Quill* harms brick-and-mortar businesses by providing online sellers a functioning tax subsidy that creates an unfair economic playing field. And, according to South Dakota, interstate commerce itself is burdened because *Quill* effectively discourages businesses from investing in jobs or infrastructure in states beyond their principal place of business, for fear of developing a physical presence nexus.

The state also argues that *Quill* is not only incorrect, but that the ruling is the kind of mistake that should not be reinforced due to *stare decisis.* South Dakota argues that the benefits of a physical presence rule are not only illusory, but the rule itself is not supported by the text of the U.S. Constitution. Instead, the state argues that courts should apply the *Complete Auto* test to determine whether sales tax laws are constitutional. As regular readers of this column are aware, for a tax to satisfy the test announced in *Complete Auto*, the tax must: (1) apply to an activity with a substantial nexus with the taxing state; (2) be fairly apportioned; (3) not discriminate against interstate commerce; and (4) be fairly related to the services provided by the state.

Question presented.

In asking the Court to revisit its prior rulings, and potentially alter the sales and use tax nexus landscape, South Dakota now presents the following question for review: ‘Should this Court abrogate *Quill*'s sales-tax-only, physical presence requirement?‘

Trust Beneficiaries Allege Conn.'s Imposition of Estate Tax Violates Due Process

On 10/24/17, the Court received a new petition for certiorari in *Estate of Brooks, et. al. v. Connecticut Comm'r of Revenue Services,* Docket No. 17-608, ruling below at *Estate of Brooks, et al. v. Connecticut Comm'r of Revenue Services,* 159 A.3d 1149 (Conn. 2017), in which the Connecticut Supreme Court held that the Due Process Clause was not violated when Connecticut imposed an estate tax on trust assets that had been transferred to a Connecticut decedent by her predeceased spouse, who died a domiciliary of another state. The assets at issue were held in a qualified terminable interest property (‘QTIP‘) marital deduction trust.

Factual background.

****4** According to the court below, prior to his death in the year 2000, the trust property at issue belonged to Everett M. Brooks (‘Everett‘), who was a Florida domiciliary at the time of his death. Everett's will created a QTIP trust, consisting of intangible property, for the benefit of his surviving spouse, Helen B. Brooks (‘Helen‘). Helen received a beneficial life interest in the assets of the trust and she had a testamentary limited power of appointment to direct the remainder of the trust among Everett's children.

At the time of Everett's death, an election was also made on Everett's federal estate tax return to treat the QTIP property as qualifying for the marital deduction under Internal Revenue Code Section 2056(b)(7), meaning that the federal estate tax due on the QTIP property would be delayed until Helen's death. In 2009, Helen passed away as a domiciliary of Connecticut and, per the terms of the QTIP trust, the assets in the trust were transferred to Everett's children.

After Helen's death, the executors of her estate filed a Connecticut Estate Tax Return, intentionally omitting the QTIP property from Helen's Connecticut taxable estate. At the time, Connecticut's laws required that intangible personal property be ‘owned by‘ a resident decedent for the state to assess estate tax. However, the day after filing the return, the Connecticut Legislature changed the language of Conn. Gen. Stat. §12-391(d)(2) and (d)(3) to allow the taxation of intangible property that was ‘included in the gross estate of‘ a resident decedent, which would include the QTIP property. Accordingly, Connecticut imposed its estate tax on all of Helen's assets including those held in the QTIP trust.

Connecticut courts find application of estate tax does not violate due process.

A Connecticut trial court agreed with the Commissioner's argument that the QTIP property was includable in Helen's Connecticut taxable estate. Specifically, the court held that Helen was the owner of the property at issue because she had the right to its possession and control.

The Connecticut Supreme Court then reached the same conclusion, while also holding that the beneficiaries' argument that the state's tax violated the Due Process Clause, as a tax on out-of-state property, ***40** was unavailing. In doing so, the Connecticut Supreme Court stated that '[u]nlike real and personal property,' intangible personal property is characterized by the 'legal relationships between persons' and therefore 'in fact [has] no geographical location.' For this reason, the court continued, 'intangibles themselves have no real situs.'

Instead, according to the court, Connecticut was free to tax the intangibles at issue if 'by the practical operation of [its] tax, [Connecticut] has exerted its power in relation to opportunities which it has given, to protection which it has afforded, [or] to benefits which it has conferred by the fact of being an orderly, civilized society.' Because Helen was domiciled in Connecticut at the time of her death—thereby benefiting from the services provided by the state—the court concluded that Connecticut maintained jurisdiction to 'tax the transfer of the assets contained within the QTIP marital deduction trust as part of the decedent's estate.' Accordingly, the court held that the imposition of Connecticut's estate tax on the transfer of Helen's assets did not violate due process.

Beneficiaries argue Conn. has violated precedent on constitutional limitations of states' taxing power.

****5** According to the beneficiaries' petition for certiorari, Connecticut has violated the U.S. Supreme Court's precedents on the constitutional limitations of states' taxing power under the Due Process Clause. In framing their arguments, the beneficiaries present the following two questions for review:

1. Can a state impose an estate tax on the termination of an income interest in a trust solely on the basis that a federal election to qualify such trust for the federal marital deduction was made in the estate of the decedent's predeceased spouse, when such predeceased spouse died a domiciliary of another state?

2. Is retroactive tax legislation permissible under the Due Process Clause when (i) the retroactive legislation causes a statute to become unconstitutional in some circumstances; (ii) there is no ambiguity that needs to be corrected; (ii) no proof has been offered to established that the legislative intent is furthered by rational means; (iv) the retroactive period exceeds the year prior to the legislative sessions in which the law was enacted; or (v) the evidence indicated that the legislation has targeted the taxpayer specifically.

Petitions Pending

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

Wash. State 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, with free access from the same to the nearest public highway, is secured them; as also the right, in common with citizens of the United States, to travel upon all public highways.' (Treaty with the Yakamas, 12 Stat. 951, 952-953 (1855)).

In 2013, Cougar Den, a Confederated Tribes and Bands of the Yakama Nation corporation, began transporting fuel from Oregon to the Yakama Indian Reservation. The company sold the fuel to businesses located on Tribal land and owned by Tribal members. The Washington Department 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 its right to travel under the Yakama Nation Treaty of 1855.

***42** 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 not apply 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.' And, the court concluded that '[t]he Department'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]n ruling in Cougar Den's favor, both the ALJ and the Yakima County Superior Court based their decisions on the history of the right to travel provision of the treaty, relying on the findings of fact and conclusionsof law from *Yakama Indian Nation v. Flores*, 955 F. Supp. 1229 (E.D. Wash. 1997),' in particular the depiction in the record of a 'tribal culture whose manner of existence was dependent on the Yakamas' ability to travel.'

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

Natural gas marketer alleges Tex. county's ad valorem property tax violates the Commerce Clause.

On 9/9/17, the Court received a petition for certiorari in *ETC Marketing, Ltd. v. Harris County Appraisal Dist.*, Docket No. 17-422, ruling below at 518 S.W.3d 371 (Tex. 2017), in which the Supreme Court of Texas held that ETC Marketing Ltd. ('ETC'), a natural gas marketer, must pay the ad valorem property tax imposed on its surplus gas held (in-state) for future resale as the tax does not violate the Commerce Clause to the U.S. Constitution.

In the case below, ETC claimed the tax at issue, which was an ad valorem property tax imposed by the Harris County Appraisal District, violated the Commerce Clause of the U.S. Constitution by taxing natural gas, which ETC claimed was stored in Texas for future resale and shipment to out-of-state consumers. The tax, ETC alleged, was therefore an impermissible tax on interstate commerce.

The Supreme Court of Texas disagreed, however, after it analyzed ETC's challenge and found that the state tax satisfied all four prongs of the Commerce Clause test announced in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). In its petition for certiorari, ETC now asks '[w]hether, or in what circumstances, the Commerce Clause of the Constitution bars a State or locality from taxing natural gas temporarily stored within the jurisdiction during interstate transit.'

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

On 9/19/17, the Court received a petition for certiorari in *Dawson v. Steager,* Docket No. 17-419, ruling below at *Steager v. Dawson*, 2017 WL 2172006 (W. Va. 2017), in which the Supreme Court of Appeals of West Virginia held that Mr. 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 below, 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 state court noted 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 held that this distinction did not violate the doctrine of ‘intergovernmental tax immunity.‘

According to the state court, ‘the total structure of West Virginia's system for taxing personal income does not discriminate against retired members of the United States ***44** Marshals Service in violation of 4 U.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.‘

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

Satellite providers challenge Fla.'s Communications Services Tax.

On 9/8/17, the Court received a petition for certiorari in *Echostar Satellite LLC v. State of Florida,* Docket No. 17-379, ruling below at *Florida Department of Revenue v. DirectTV, Inc.* 215 So. 3d 46 (Fla. 2017). In the case below, the Supreme Court of Florida held that Florida's Communications Services Tax (‘CST‘) did not violate the U.S. Constitution's Commerce Clause.

In 2001, Florida enacted its CST (Fla. Stat. §202.12), which abandoned a uniform 6% sales tax on all pay-TV services and implemented a two-tiered system in which ‘communications services which [o]riginates and terminates in this state‘—*i.e.*, cable providers—would be subject to a 6.8% rate, while service ‘by satellite‘ would be subject to a 10.8% rate (presently, cable service is taxed at 4.92% and satellite is taxed at 9.07%). According to the satellite companies who brought the challenge below, this difference violates the dormant Commerce Clause of the U.S. Constitution.

The Florida Supreme Court disagreed, however, finding the CST to be constitutional. According to the Florida Supreme Court, ‘[c]able companies are not in-state interests for the purpose of the dormant Commerce Clause. ‘ Instead, the Florida Supreme Court found that both cable providers and satellite providers are ‘interstate in nature.‘ And the court went on to note that a state may ‘treat ‘two categories of companies' differently so long as the discrimination is based on ‘differences between the nature of their businesses' and not ‘the location of their activities.’‘

Challenging both the state court's ‘in-state interests‘ analysis and also raising a discriminatory purpose claim, Echostar Satellite LLC now brings a petition for certiorari, presenting the following two questions for review:

1. Did the court below err in concluding that a law cannot discriminate against interstate commerce unless it benefits purely in-state companies and burdens purely out-of-state companies?

2. Is a court evaluating a law's discriminatory purpose forbidden from considering evidence other than the law's text and formal legislative history?

Petition Denied

The Court also denied the previously reported petition in *2 Crooked Creed, LLC et. al. v. Treasurer of Cass County, Mich.*, Docket No. 17-169, ruling below at *In re Petition of Cass County Treasurer for Foreclosure v. 2 Crooked Creek, LLC.*, 2016 WL 901700 (Mich. Ct. App. 2016). In the case below, the Michigan Court of Appeals held that a county treasurer met the minimum requirements of due process in providing notice to taxpayers regarding their foreclosed property, so the trial court did not abuse its discretion by denying the property owners' motion to set aside a judgment of foreclosure. The property owners had alleged that the Michigan Treasurer knew she was sending notices to an incorrect address and that she did not act reasonably by failing to search online for the correct address. Based on these allegations, the property owners asked the U.S. Supreme Court to consider whether, '[i]n the Internet age, do the 'practicable' 'additionalreasonable steps' that due process mandates include requiring a Michigan taxing authority to conduct a search of Indiana's online business entity database (or simple Google search) to ascertain an Indiana business's correct address before foreclosing on its multi-million dollar property over approximately $15,000 in delinquent property taxes?'

****8** South Dakota argues that, under contemporary conditions, *Quill's* rule is harmful to local governments, brick-and-mortar businesses, and to interstate commerce itself.

The Connecticut Supreme Court stated that . . . intangible personal property is characterized by the 'legal relationships between persons' and therefore 'in fact [has] no geographical location.'

The Florida Supreme Court found that both cable providers and satellite providers are 'interstate in nature.'

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