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U.S. Supreme Court Update

U.S. SUPREME COURT UPDATE

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Court to Review Physical Presence Nexus Standard

***43** On 1/12/18, the U.S. Supreme Court granted the petition for certiorari in *South Dakota v. Wayfair, Inc., et. al.* (Docket No. 17-494). In South Dakota's closely watched petition, the state asks the Court to review and overturn the physical presencenexus 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) withina 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* is the kind of judicial mistake that need not be reinforced under *stare decisis.* According to South Dakota, the benefits of a physical presence rule are not only illusory, but the rule itself isnot supported by the text of the U.S. Constitution. Instead, the state argues that courts should apply the four-prong *Complete Auto* test when determining the constitutionality of a state's sales and use tax laws under the Commerce Clause.

The Court's *Wayfair* decision has the potential to shake the state and local tax landscape. First, states that have spent years searching for ways to collect what they view as billions of dollars in lost sales tax revenue may be eager to imposetheir tax laws on a greater number of remote retailers. With states expanding the application of their tax laws, retailers may have new compliance concerns and may have to deal with issues such as a lack of uniformity among the new rules and potential effortsby states to retroactively apply their updated nexus laws.

On the federal side, if the Court strikes down *Quill*'s physical presence nexus standard, the resulting chaos and uncertainty among the various state and local jurisdictions could finally push Congress to create a national remote sales tax collectionstandard. In any case, the state and local tax community (including your authors) will closely watch the Court's proceedings, with oral arguments scheduled for April 17.

****2** In addition to granting the *Wayfair* petition, 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 at the time of this writing,and three previously reported petitions were denied by the Court. The Court's new state and local tax petition was filed as *Dulles Duty Free, LLC v. County of Loudoun, Va.* (Docket No. 17-904), in which the U.S. Supreme Court has been asked toreview a Virginia

Supreme Court's decision holding that a local Virginia county's Business, Professional, and Occupational License (‘BPOL‘) tax violates the Import-Export Clause of the U.S. Constitution as applied to duty-free international exportsales.

Last, 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 regarding the pending petitions.

Va. County Challenges Application of Import-Export Clause

On 12/19/17, the U.S. Supreme Court received a petition for certiorari in *Dulles Duty Free, LLC v. County of Loudoun, Va.*, Docket No. 17-904, ruling below at 803 S.E.2d 54 (Va. 2017). In the decision below, the Virginia Supreme Court 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‘).

Traditional application of the Import-Export Clause.

The Import-Export Clause of the U.S. Constitution provides that ***44** ‘[n]o State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws. . . . ‘ U.S. Const. art. 1, §10, cl. 2. Historically, as explained by the state high court, courts applied this language to develop a set of formalistic rules. Specifically with regard to imports, so long as goods remained in their ‘originalpackages,‘ they enjoyed immunity from state taxation. With respect to exports, Import-Export Clause immunity generally attached when a good entered the ‘export stream‘ or final journey out of the country.

In *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69 (1946), for example, the U.S. Supreme Court confronted a California tax on oil intended for export by ship, but assessed when the oil was pumped into the cargo ship's tank before the ship had left California waters for its finalforeign destination. Interpreting the Import-Export Clause, the 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 is plain.‘

****3** In *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), however—a case relied on by Loudon County in its petition for certiorari—the U.S. Supreme Court considered a Georgia ad valorem property tax on inventory that was imported and still in its original packaging.While exiting from the formalistic approach of the original package doctrine—and an exclusive focus on whether a good retained its status as an ‘import‘ within the meaning of the Clause—the Court explained that the Import-Export Clauseshould be interpreted in light of its original understanding and objectives, with attention to ‘the specific abuses which led the Framers to include the Import-Export Clause in the Constitution.‘

The Court further explained that in adopting the Import-Export Clause, the Framers sought to alleviate three main concerns: (1) state taxation should not interfere with the federal government's foreign economic policy; (2) import revenues should be reservedfor the federal government; and (3) seaboard states must be prevented from levying taxes on citizens of other states because goods flowed through their ports. Because the Georgia tax did not interfere with any of these three policies, even though it taxedsome imports that were still in their original packaging, the Court held that the tax was not prohibited by the Import-Export Clause.

Va. Supreme Court's application of SCOTUS precedent.

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 duties,as the stores' goods were all sold in their original packaging and destined for locations outside the United States. Loudoun County, however, imposes a separate 0.17% BPOL tax, measured by the gross receipts of retail stores located in the county. After thecounty applied its BPOL tax to Dulles's duty-free operations, Dulles filed suit, arguing the county's collection of such taxes applied to international sales and violated the Import-Export Clause under the U.S. Supreme Court's ruling in *RichfieldOil.*

Applying the less formalistic *Michelin* analysis, a Loudoun County Circuit Court first rejected Dulles' argument, ***45** concluding the BPOL tax ‘is not an impost or duty, and does not transgress any of the policy dictates behind theImport-Export Clause.‘ On appeal, however, the Virginia Supreme Court reversed the lower court. While acknowledging the contrary holdings, the Virginia high court held that the U.S. Supreme Court ‘has not overruled *Richfield Oil* and, whileit has significantly revised its Import-Export Clause jurisprudence, the Court has carefully carved out for 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 tax is, in operation, a direct tax on export goods in the export stream that are immune from taxation.According to the Virginia Supreme Court, ‘[t]he BPOL tax as applied to [Dulles's] export goods in transit constitutes an impermissible impost upon an export in violation of the Import-Export Clause of the Constitution of the UnitedStates.‘

Questions presented.

****4** In response to the Virginia court's holding, Loudoun County presents the following questions in its petition for certiorari:

1. Should the validity under the Import-Export Clause of a non-discriminatory local business license tax calculated on the basis of gross receipts be evaluated using this 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)?

2. Does a local business license 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?

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)).

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.

***46** 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.'

****5** 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.'

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 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.'

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 intragovernmental 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 ***48** invited the Solicitor General to file a brief in this case expressing the views of the United States.

Petitions Denied

The Court has denied three previously reported petitions: *Southern California Edison v. Nevada Dep't of Taxation* (Docket No. 17-755); *Wayne Cnty. Sch. Dist. V. Frierson* (Docket No. 17-827) and *Estate of Brooks, et. al.v. Connecticut Comm'r of Rev. Services* (Docket No. 17-608).

In *Southern California Edison v. State of Nevada Dep't of Taxation,* Docket No. 17-755, ruling below at 398 P.3d 896 (Nev. 2017), the Supreme Court of Nevada held that although Nevada's use tax on minerals mined outside of the state violated the dormant Commerce Clause, the taxpayer, a coal energy company, was properly denied a $23.8 millionrefund of taxes paid because it failed to demonstrate the existence of substantially similar in-state entities that had gained a competitive advantage because of the unconstitutional tax. The taxpayer argued it did not need to demonstrate the existence ofsubstantially similar in-state entities before it could properly claim a refund of use taxes.

****6** In *Wayne Cnty. Sch. Dist. v. Morgan,* Docket No. 17-827, ruling below at *Wayne Cnty. Sch. Dist. v. Morgan*, 224 So. 3d 539 (Miss. 2017), the Mississippi Supreme Court held that a chancery court correctly applied Miss. Code Ann. §27-65-53 when it determined interest owed to a school district on its overpayment of severance taxes at the rateof 1% per month, beginning 90 days after the Mississippi Supreme Court found the taxes were overpaid. The taxpayer had argued that the language of Miss. Code Ann. §27-7-315(2) did not allow for deferring the start date for interest on a tax overpaymentto the date that a court determined there was an overpayment to be refunded. Instead, the taxpayer sought interest from 90 days after it filed its original application for refund.

In *Estate of Brooks, et. al. v. Connecticut Comm'r of Rev. Services,* Docket No. 17-608, ruling below at 159 A.3d 1149 (Conn. 2017), the Connecticut Supreme Court held that the Due Process Clause was not violated when Connecticut imposed an estate tax on trust assets that were 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.

In framing their arguments to the Court, the beneficiaries had presented 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, whensuch 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 in the needs to be corrected; (ii) no proofhas been offered to establish 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 targetedthe taxpayer specifically.

The resulting chaos and uncertainty among the various state and local jurisdictions could finally push Congress to create a national remote sales tax collection standard.

The Virginia Supreme Court held that the Import-Export Clause . . . bars Loudoun Country from imposing its [BPOL] tax on receipts from international export sales made by Dulles Duty Free LLC.

The [unsuccessful petitioner] argued it did not need to demonstrate the existence of substantially similar in-state entities before it could properly claim a refund of use taxes.

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