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U.S. SUPREME COURT UPDATE

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Taxpayer *Wynnes*—Maryland's Income Tax Scheme Found Unconstitutional

***44** On 5/18/15, the U.S. Supreme Court issued its opinion in *Comptroller of the Treasury v. Wynne* (Docket No. 13-485, cert. granted 5/27/14). The Court's decision annuls a Maryland personal income tax scheme that credits residents for out-of-state income at the state level, without offering a like credit at the county level. The Court affirmed a ruling from Maryland's highest court, which determined Maryland's failure to offer a county-level tax credit violates the dormant Commerce Clause of the U.S. Constitution and therefore unconstitutionally exposes individuals to double taxation. This column has followed closely the progress of this petition, and we look forward to providing a full analysis of the Court's decision in the next issue of the JOURNAL.

In this issue, we review one new petition for certiorari that involves state and local taxes. The new petition before the Court, which was brought by several New York domiciled insurance companies, claims that Tennessee is unfairly imposing retaliatory insurance taxes against the New York insurers doing business in Tennessee. As stated in the petition for certiorari (and as previously reported in this column), many of these same insurance carriers petitioned the Court to review Michigan's retaliatory tax scheme in *Commerce & Indus. Ins. Co. v. Dep't of Treasury*, Docket No. 13-1164, petition for cert. denied 5/27/14, ruling below at 301 Mich. App. 256 (2013) (Mich. Ct. App. 2013). (As reported in our July 2014 issue, the Supreme Court declined to review the Michigan court's ruling that the state's retaliatory insurance taxes did not unfairly burden New York insurers.)

According to the current petition, the decisions of the Tennessee and Michigan courts at issue ‘provide a roadmap for impermissible application of retaliatory taxes that threaten the nationwide system of retaliatory taxation and the benefits that system has provided.‘

Three previously reported petitions are still pending at press time. And, we await the Court's decision in *King v. Burwell* (Docket No. 14-114, cert. granted 11/7/14), where the Court must decide whether the Internal Revenue Service may permissibly promulgate regulations to extend tax-credit subsidies to healthcare coverage purchased through exchanges established by the federal government under Section 1321 of the Patient Protection and Affordable Care Act (‘Obamacare‘).

Equal Protection Challenge to Tennessee's ‘Retaliatory‘ Insurance Tax

****2** In *Zurich American Ins. Co., et. al. v. Tennessee*, Docket No. 14-1240, rulings below as *Zurich American Insurance Co., et al. v. Tennessee*, 2014 Tenn. App. LEXIS 466 (July 31, 2014) and *Great American Insurance Co. of New York v. Tennessee*, 2014 Tenn. App. LEXIS 464 (July 31, 2014), the Tennessee Court of Appeals found that four of six insurance charges under New York law were properly included by the Tennessee Department of Commerce and Insurance (the 'Department') in a retaliatory tax imposed on certain New York domiciled insurance companies providing insurance in Tennessee and that the Tennessee tax was constitutional. The insurance companies now petition the Supreme Court to review Tennessee's application of its retaliatory insurance tax.

Although the petitioners acknowledge that retaliatory insurance taxes are shielded from challenge under the Commerce Clause as a result of the McCarran-Ferguson Act (codified at 15 U.S.C. § 1011, et seq.), they ask the Court to consider whether such taxes are permissible under the Equal Protection Clause of the U.S. Constitution if, as petitioners claim, the economic burden and legal incidence of the taxes imposed by the insurers' home state (i.e., New York) are borne by New York policyholders, as opposed to out-of-state (i.e., Tennessee) insurers.

Background.

The Department informed several New York domiciled insurance companies, including Zurich American Insurance Company, American Guarantee & Liability Insurance Company, and Great American Insurance Company of New York, that they were under audit and the issues under audit were 'mainly retaliatory in nature.' The Department asked the insurance companies to recalculate their Tennessee retaliatory taxes to include certain New York workers' compensation surcharges, file amended premium tax returns, and remit payment of the additional retaliatory taxes.

Although the insurance companies disputed the application of Tennessee's retaliatory tax statute to the New York workers' compensation surcharges, they eventually paid the disputed taxes under protest and sought refund claims. The Tennessee Claims Commission denied the refund claims, which resulted in the claims being appealed to the Tennessee Court of Appeals.

Retaliatory insurance taxes.

A retaliatory tax is a tax imposed by a state on foreign corporations, usually insurers, when the foreign state imposes a higher aggregate tax burden on actual or hypothetical out-of-state corporations. According to the Tennessee Court of Appeals, 'the principal ***45** purpose of retaliatory tax laws is to promote the interstate business of domestic insurers by deterring other States from enacting discriminatory or excessive taxes.'

In other words, retaliatory taxes are a quid pro quo method of taxation meant to level the playing field. In particular, the Tennessee law is meant to protect Tennessee insurance companies by encouraging foreign jurisdictions not to impose heavier burdens on Tennessee companies than Tennessee imposes upon foreign companies who come to Tennessee to do business.

****3** Despite many characteristics that would render other types of state law unconstitutional, retaliatory insurance tax statutes are not *per se* unlawful. And the federal McCarran-Ferguson Act, 15 U.S.C. § 1011 et seq., removes the limitations on the authority of states to regulate and tax the business of insurance and protects retaliatory insurance taxes from challenges brought under the Commerce Clause (*see Western & Southern Life Ins. Co. v. State Bd. Of Equalization of Cal.*, 451 U.S. 648 (1981).) Thus, insurers who wish to raise a constitutional challenge to a state's retaliatory tax, must do so under another provision, such as the Equal Protection Clause.

Tennessee's retaliatory tax (Tenn. Code Ann. § 56-4-218(a)) provides that when another state imposes 'any premium or income or other taxes, or any fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions or restrictions' upon Tennessee insurance companies doing business in the other state that are in excess of the taxes and fees imposed upon the insurance companies of the other state doing business in Tennessee, then Tennessee will retaliate by imposing 'the same premium or income or other taxes, or fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions and restrictions‘ upon the companies of the other state doing business in Tennessee.

Thus, the issue under the retaliatory tax statute was whether any fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions, or restrictions were imposed upon Tennessee insurance companies doing business in New York that were in excess of the taxes, fees, fines, penalties, licenses, deposit requirements or other obligations, prohibitions, or restrictions imposed upon the insurance companies of New York doing business in Tennessee.

New York's insurance charges.

The Tennessee Court of Appeals analyzed several New York charges to determine whether, as imposed upon Tennessee insurance companies, the charges were in excess of the taxes and fees imposed upon New York insurance companies doing business in Tennessee, and, thus, whether the New York charges triggered the Tennessee retaliatory tax. The Tennessee court concluded that retaliation was permissible with respect to four New York charges, each collected by New York to fund its workers' compensation system: (i) the New York Workers' Compensation Board Surcharge under N.Y. Workers' Comp. Law § 151(2)(a); (ii) the Special Disability Fund Surcharge under N.Y. Workers' Comp. Law § 15(8)(h)(4); (iii) the Reopened Case Fund Charge under N.Y. Workers' Comp. Law § 25-a(3); and (iv) the Workers' Compensation Security Fund Charge under N.Y. Workers' Comp. Law §§ 107, 108.

Each of the charges at issue were assessed against and collected from insurance carriers, but, as stated in the case below, insurance carriers were then statutorily instructed to ‘collect such assessments from their policyholders through a surcharge.‘ In other words, the insurance carriers were to pass the charge along to their customers—the policyholders.

****4** The petitioners argued that the New York charges at issue were, therefore, not ‘imposed upon‘ insurance companies doing business in New York as required to trigger the retaliatory tax under Tenn. Code Ann. § 56-4-218(a). Rather, the insurance companies argued that the charges are passed through to the policyholders who ultimately pay the charge. The Tennessee Court of Appeals disagreed, however.

The Court of Appeals relied on a recent Michigan Court of Appeal's decision, *Commerce & Indus. Ins. Co. v. Dep't of Treasury*, Docket No. 13-1164, petition for cert. denied 5/27/14, ruling below at 301 Mich. App. 256 (2013) (Mich. Ct. App. 2013), which found a New York appellate court case instructive, *Selective Insurance Co. v. New York Workers' Compensation Board,* 102 A.D.3d 72, 953 N.Y.S.2d 368 (N.Y. App. Div. 2012) (stating ‘the assessments charged to the carriers are calculated by the [Workers' Compensation] Board based upon the statutory methodology contained in the Workers' Compensation Law and without regard to the amount of the surcharges paid by policyholders‘).

Thus, the Tennessee court concluded that the assessments paid by insurers were separate from the surcharges paid by policyholders, and further that Tennessee insurance companies operating in New York remain subject to such charges. As such, those charges ‘should be included in the computation of the retaliatory tax as to the State of New York.‘

(For background on the Michigan case, and the petition for certiorari brought before the Supreme Court, see U.S. Supreme Court Update, 24 JMT 39 (July 2014).)

Constitutional arguments—rational basis for retaliatory taxes.

The petitioners also argued that Tennessee's application of its retaliatory tax violated the Commerce Clause, the Due Process Clause, the Full Faith and Credit Clause, and the Equal Protection Clause of the U.S. Constitution. On appeal to the U.S. Supreme Court, however, the insurance companies reiterated only their claim under the Equal Protection Clause.

In denying the petitioners' original equal protection cause of action, the Tennessee Court of Appeals looked to the Supreme Court's decision in *Western and Southern Life Insurance Co. v. State Bd. of Equalization of Cal.,* 451 U.S. 648 (1981), and applied a rational basis test to petitioners' equal protection argument—i.e., the court sought to determine (1) whether the retaliatory tax had a legitimate purpose and (2) whether it was reasonable for Tennessee lawmakers to believe that use of the retaliatory tax would promote that purpose.

Relying on the Supreme Court's holding in *Western and Southern*, the Tennessee court found that 'promotion of domestic industry by deterring barriers to interstate business is a legitimate state purpose and the mere fact that [a state tries] to promote its insurance industry by influencing the policies of other states through retaliatory taxation [does] not render the purpose illegitimate.' And because the court found that it was reasonable for Tennessee to believe that its retaliatory taxes would induce New York to lower the burdens imposed on Tennessee insurers (in order to spare its own domestic insurers the cost of the retaliatory tax in Tennessee), the court held that Tennessee had a rational basis upon which to justify its retaliatory tax and, therefore, it denied the petitioners' equal protection claim.

Question presented.

****5 *46** The petitioners now argue that because New York's surcharges do not burden insurers—only policyholders—retaliation against those surcharges cannot serve the permissible purpose of protecting Tennessee insurers from excessive taxation. Accordingly, in their petition for certiorari, the New York insurance companies ask the Court to consider '[w]hether Tennessee violates the Equal Protection Clause by retaliating against New York surcharges where the economic burden and legal incidence of those surcharges is borne by New York policyholders, not by insurers.'

Petitions Still Pending

The following three petitions remained pending as the JOURNAL went to press.

Colorado legislators challenge state's Taxpayer Bill of Rights.

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

The plaintiffs seek injunctive and declaratory relief, claiming that TABOR's requirement that new taxes be subject to voter approval 'undermines the fundamental nature of the state's Republican Form of Government' in violation of the Guarantee Clause of the U.S. Constitution. Under TABOR, Colorado, with certain limited exceptions, 'must have voter approval in advance for . . . any new tax, tax rate increase . . . , or a tax policy change directly causing a net tax revenue gain to any district.' (Colo. Const. art. X, § 20, cl. 4(a).)

The legislators named Colorado Governor John Hickenlooper as defendant in their suit, and Governor Hickenlooper moved to dismiss the complaint, arguing that the plaintiffs lacked standing and that the political question doctrine required dismissal of all of the legislators' claims. But, according to the circuit court, the plaintiffs provided adequate proof that TABOR, by requiring a voter referendum on most tax issues, caused them injury. Thus, the plaintiffs had standing to challenge TABOR.

Moreover, under the *Baker v. Carr* test (see 369 U.S. 186, 7 L. Ed. 2d 663 (1962)), the legislators' suit was not barred by the political question doctrine, as there were judicially discoverable and manageable standards for the litigation, and resolving the case would not require the court to improperly make a policy determination. The circuit court's decision was strictly jurisdictional, however. The court stated that the 'merits of the case are not before us' and 'stress[ed] that [its] decision on plaintiffs' Guarantee Clause claim is quite limited, leaving all issues other than standing, prudential standing, and the political question doctrine to the district court.'

****6** In his petition for certiorari, the governor challenges the circuit court's rulings on both the political question doctrine and standing. (For more background on this case, including the circuit court's decision, see U.S. Supreme Court Update, 24 JMT 39 (February 2015).)

ERISA preemption provision challenge to Michigan health insurance tax.

In *Self-Insurance Institute of America, Inc. v. Snyder*, Docket No. 14-741, petition for cert. filed 12/18/14, ruling below at 761 F.3d 631, 59 EBC 1406 (6th Cir. 2014), the U.S. Court of Appeals for the Sixth Circuit affirmed a district court's ruling that the Michigan Health Insurance Claims Assessment Act (Mich. Comp. Laws §§ 550.1731-1734; the 'Michigan Act')—which imposes a 1 percent tax, along with various reporting and record-keeping requirements, on all paid claims by carriers and third party administrators to healthcare providers for services rendered in Michigan for Michigan residents—is not prohibited by ERISA's preemption provision (29 U.S.C. § 1144(a)).

As explained by the Sixth Circuit in its decision upholding the Michigan Act, one of the purposes of ERISA is 'to provide a uniform regulatory regime over employee benefit plans.' Accordingly, 'ERISA contains a broad preemption provision that 'supersede[s] any and all State laws insofar as they . . . *relate* to any employee benefit plan' that falls under the regulation of ERISA. (29 U.S.C. § 1144(a))' (emphasis added). The Sixth Circuit interpreted this standard to mean that '[a] law 'relates to' an employee benefit plan, in the normal sense of the phrase, if it has a connection with or reference to such a plan.'

In the proceedings below, the Self-Insurance Institute of America, Inc. ('SIIA ') argued that the Michigan Act has an impermissible connection with employee benefit plans inasmuch as the Michigan Act: '(1) interferes with the administration of the plans; (2) imposes administrative burdens in addition to those prescribed by ERISA; and (3) interferes with the relationships between ERISA-covered entities.' The Sixth Circuit disagreed with all three of SIIA's contentions, however.

In its petition for review, SIIA argues that '[t]he circuit court invoked a strong presumption against the preemption of state taxing powers to read [ERISA's preemption provisions] narrowly despite Congress's deliberate choice of preemptive language whose breadth has been repeatedly emphasized by this Court, and Congress's express recognition that ERISA can and does preempt state tax laws.' Accordingly, SIIA argues (as it did in the proceedings below) that the Supremacy Clause of the U.S. Constitution (art. VI, § 2) and ERISA's preemption provision, prohibit the application of the Michigan Act to ERISA-covered entities. (For more background on this case, including a detailed discussion of the circuit court's response to SIIA's specific claims, see U.S. Supreme Court Update, 25 JMT 45 (May 2015).)

Lack of immunity for CA's Franchise Tax Board in Nevada intentional tort and bad-faith conduct suit.

****7** In *Franchise Tax Bd. of the State of Cal. v. Hyatt*, Docket No. 14-1175, petition for cert. filed 3/23/15, ruling below at 335 P.3d 125 (Nev. 2014), the Supreme Court of Nevada largely reversed a jury award of $139 million in tort damages and $250 million in punitive damages in favor of inventor Gilbert P. Hyatt in his lawsuit against the California Franchise Tax Board (FTB). However, despite FTB's claims that all of Hyatt's causes of action were barred under principles of discretionary-function immunity and comity, the Nevada high court affirmed the district court's findings that FTB committed fraud and intentional infliction of emotional distress in its audit of Hyatt.

Accordingly—although the damages imposed against FTB were significantly reduced by the Nevada court—FTB was unable to escape all liability and now petitions the U.S. Supreme Court for review. In its petition for certiorari, FTB asks the high court to review the sovereign ***48** immunity principles allegedly disregarded by the Nevada Supreme Court in its ruling below.

Under Nevada law, discretionary-function immunity provides that no action can be brought against the state or its employee 'based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of the State . . . or of any . . . employee . . . , whether or not the discretion involved is abused.' (Nev. Rev. Stat. § 41.032(2).) But Nevada has historically recognized an exception to discretionary-function immunity for intentional torts and bad-faith conduct. And although, as addressed in the ruling below, Nevada has also adopted the federal *Berkovitz-Gaubert* two-part test for determining the applicability of discretionary-function immunity (*see Berkovitz v. United States*, 486 U.S. 531 (1988) and *United States v. Gaubert*, 499 U.S. 315 (1991)), according to the Nevada Supreme Court, that test has not altered the exception for intentional torts or acts in bad faith.

Under the *Berkovitz-Gaubert* two-part test, discretionary-function immunity will apply if the government actions at issue '(1) involve an element of individual judgment or choice and (2) [are] based on considerations of social, economic, or political policy.' However, according to the Nevada Supreme Court, intentional torts and acts in bad faith cannot satisfy this test, as these acts 'by definition cannot be within the actor's discretion.'

Accordingly, Nevada's exception to discretionary-function immunity for intentional torts and bad-faith conduct applies. FTB now asks the Court to review this matter in order to address what it views as the important sovereign immunity issues at stake.

(For more background on this case, including a detailed discussion of the underlying audit, see U.S. Supreme Court Update, 25 JMT 40 (July 2015).)

The insurance companies petition the Supreme Court to review Tennessee's application of its retaliatory insurance tax.

****8** The insurance companies argued that the charges are passed through to the policyholders who ultimately pay the charge.

The Tennessee court concluded that the assessments paid by insurers were separate from the surcharges paid by policyholders, and further that Tennessee insurance companies operating in New York remain subject to such charges.

In his petition for certiorari, the Colorado governor challenges the circuit court's rulings on both the political question doctrine and standing.

The Self-Insurance Institute of America, Inc. argued that the Michigan Act has an impermissible connection with employee benefit plans.

The Nevada high court affirmed the district court's findings that FTB committed fraud and intentional infliction of emotional distress in its audit of Hyatt.