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U.S. SUPREME COURT UPDATE

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Supreme Court Declines Review of Retroactive Tax Law Challenges

***39** While we typically begin each column with a report of the newest state and local tax petitions for certiorari to reach the Supreme Court, the biggest SALT news to come from the Court since our last issue of the JOURNAL is the Justices' decisionto not review several taxpayers' constitutional concerns over retroactive tax changes in Michigan and Washington State.

First, on 5/22/17, the High Court refused to take up six separate petitions that challenged Michigan's retroactive withdrawal from the Multistate Tax Compact and its three-factor apportionment formula for calculating corporate franchise taxes. The six previouslyreported petitions are *Goodyear Tire Rubber Co. v. Michigan Dep't of Treasury* (Docket No. 16-699); *International Business Machines Co. v. Michigan Dep't of Treasury* (Docket No. 16-698); *Gillette Commercial Operations N. Am.v. Michigan Dep't of Treasury* (Docket No. 16-697); *Skadden, Arps, Slate, Meagher & Flom LLP v. Michigan Dep't of Treasury* (Docket No. 16-688); *Sonoco Products Co. et. al. v. Michigan Dep't of Treasury* (DocketNo. 16-687); and *DirectTV Group Holdings LLC v. Michigan Dep't of Treasury* (Docket No. 16-736).

Each of these six petitions stemmed from a September 2015 Michigan Court of Appeals' decision (*Gillette Commercial Operations N. Am. & Subs. v. Michigan Dep't of Treasury*,878 N.W.2d 891 (Mich. Ct. App. 2015), *cert. denied*, Docket No. 16-697), in which the lower court reviewed the Michigan Legislature's response to the Michigan Supreme Court's previous decision in *International BusinessMachines Corp. ('IBM') v. Michigan Dep't. of Treasury*, 496 Mich. 642, 852 N.W.2d 865 (2014).

Specifically, in *IBM*, the Michigan Supreme Court held that for tax years 2008 through 2010, Michigan's Legislature had not implicitly repealed the Multistate Tax Compact's three-factor apportionment formula by enacting its own single-sales factorapportionment scheme in 2011. The court therefore concluded that several taxpayers, including IBM, were entitled to use a three-factor apportionment formula for the years at issue.

In response to the Michigan Supreme Court's ruling, however, the Michigan Legislature expressly repealed the Compact's apportionment provisions and largely negated the court's ruling by expressly giving the new law retroactive effect, beginning January 1,2008.

**2 Various taxpayers with business operations both within and outside of Michigan (including the taxpayers in the petitions referenced above) challenged the Legislature's actions and the case eventually reached the Michigan Court of Appeals, which issued itsopinion as *Gillette Commercial Operations N. Am. & Subs. v. Michigan Dep't of Treasury.* In *Gillette*, the Michigan Court of Appeals held that (1) Michigan was freeto repeal the Compact's apportionment provisions and (2) the state's retroactive repeal of the Compact did not violate the Due Process Clauses of either the state or federal Constitutions or Michigan's rules regarding retrospective legislation.

As is customary, the U.S. Supreme Court Justices did not provide a reason for rejecting the six petitions challenging the Michigan court's ruling, and the denial of certiorari now leaves intact the Michigan court's holding that the state's 2014 departurefrom the Multistate Tax Compact was not unconstitutional. (On 4/19/17, the U.S. Supreme Court received another petition stemming from the Michigan Court of Appeals' 2015 *Gillette* decision. The Court has yet to formally deny this new petition,which was filed as *R.J. Reynolds Co. v. Michigan Dep't of Treasury* (Docket No. 16-1260)).

Also on 5/22/17, the Court denied Dot Foods' separate petition for certiorari, in which the company had asked whether Washington State's retroactive application of amendments to its Business and Occupation ('B&O') Tax comported with due process.In *Dot Foods, Inc. v. Washington Dep't of Revenue*, Docket No. 16-308, ruling below at 372 P.3d 747 (Wash. 2016), the Washington Supreme Court held that the Washington Department of Revenue's retroactive application of an amendment to the state's 'direct seller's representative' exemption under the B&O ***40** Tax comportedwith the Due Process Clause of the U.S. Constitution. Accordingly, the court denied a refund claim by Dot Foods, an Illinois-based food reseller, for B&O taxes paid under protest in the four years prior to the state's amendment.

Dot Foods argued in its petition that the U.S. Supreme Court has 'never endorsed a retroactive period of more than a year or two—that is, a period covering the year preceding the legislative session in which the law was enacted'—and askedthe Justices 'whether, or under what circumstances, imposing additional tax beyond the year preceding the legislative session in which the law was enacted violates due process.'

Similar to the Michigan petitions discussed above, the Justices gave no reason for denying the Dot Foods petition and thereby left in place the Washington court's ruling that the state's retroactive application of a tax amendment failed to violate due process.The Supreme Court last issued an opinion addressing the application of retroactive tax laws in *United States v. Carlton*, 512 U.S. 26 (1994), in which the Court held that a 1987 amendment to the federal tax rules involving employee stock ownership plans did not violate due process when it was retroactively applied to an estate's 1986 transactions. Many practitioners(and taxpayers) were hopeful that the Court would update its guidance by reviewing one of the petitions discussed above. Instead, however, it appears that the issues surrounding retroactive tax amendments will continue to be addressed on a state-by-state basis.

**3 In addition to its 5/22/17 denials of certiorari, the Supreme Court also received two new petitions in cases involving state and local taxes. The first, *Diversified Ingredients, Inc. v. Testa* (Docket No. 16-1266), asks whether the Tax InjunctionAct should bar a federal district court from reviewing an out-of-state taxpayer's challenge to Ohio's Commercial Activity Tax. The second, *Homewood Village LLC v. Unified Government of Athens-Clarke County Georgia* (Docket No. 16-1361), also addresseshow and when federal courts should review the assessment of state and local taxes and fees. However, instead of focusing on an application of the Tax Injunction Act, the petitioners in *Homewood Village* ask the Supreme Court to consider whetherthe federal courts below were right to dismiss their challenge to a local stormwater management program fee out of a concern for comity between the federal courts and state governments.

Additionally, two other previously reported petitions remained pending as this issue of the JOURNAL went to press and one other previously reported petition has been denied. And, lastly, as reported in last month's column, on 3/29/17, the SupremeCourt appointed the Honorable Pierre N. Leval, of the U.S. Court of Appeals for the Second Circuit as Special Master in *Arkansas v. Delaware*, a case in which the Court has agreed to review a dispute between Delaware and several other statesas to which states have priority rights for claiming MoneyGram's uncashed 'official checks.' The appointment provides Judge Leval with the authority to fix the time and conditions for the filing of additional pleadings, to direct subsequent proceedings,to summon

witnesses, to issue subpoenas, and to take such evidence as may be introduced in the case. (For more background on this case, including a detailed discussion of MoneyGram's ‘official checks‘and the general priority rules for unclaimed intangible personal property, see U.S. Supreme Court Update, 26 JMT 42 (September 2016).)

Out-of-State Taxpayer Seeks Federal Review of Ohio CAT

On 4/21/17, the Supreme Court received a new petition for certiorari in *Diversified Ingredients, Inc. v. Ohio State Tax Commissioner*, Docket No. 16-1266, ruling below at 846 F.3d 994 (8th Cir. 2017), in which the U.S. Court of Appeals for the Eighth Circuit affirmed a lower court's ruling that the Tax Injunction Act (‘TIA‘) deprived the lower federal district court of subject matter jurisdiction tohear a Missouri corporation's challenges to the Ohio Commercial Activity Tax (‘CAT‘).

Taxpayer alleges CAT violates Public Law 86-272.

As explained by the courts below, Ohio's CAT is a ‘gross receipts‘ tax imposed on the ‘privilege of doing business‘ in the state. The CAT is imposed on all ‘gross receipts sitused to [Ohio].‘ Gross receipts are sitused toOhio ‘if the property is received in [Ohio] by the purchaser.‘ Subject to exclusions, gross receipts are defined as ‘the total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, thatcontributes to the production of gross income.‘ Diversified Ingredients, an out-of-state seller of commodities such as pet food ingredients, challenged the application of the CAT to its gross receipts by claiming that the Interstate Income Act (15U.S.C. § 381) ‘divests Ohio of jurisdiction to assess the CAT against Diversified's out-of-state sales that are delivered to its customers inOhio.‘

****4** The Interstate Income Act, or, as it is more commonly referred, ‘Public Law 86-272,‘ is a U.S. statute that allows ***41** businesses to go, or to send representatives, into a state to solicit orders for goods without being subject to that state's net incometaxes. Specifically, the statute provides in relevant part:

‘No State, or political subdivision thereof, shall have power to impose . . . a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such personduring such taxable year are either, or both, of the following:‘

‘(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery froma point outside the State; and‘

‘(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resultingfrom such solicitation are orders described in paragraph (1).‘

As explained by the Eighth Circuit Court of Appeals in reviewing the history of the case, ‘[a]lthough the Interstate Income Act (‘IIA’) limits state taxation of ‘net income,’ . . . and the CAT is imposed on a corporation's grossreceipts, Diversified claims that the IIA divests Ohio of jurisdiction to assess the CAT against Diversified's out-of-state sale that are delivered to its customers in Ohio.‘ Before reaching the merits of Diversified's claims, however, the federal districtcourt determined that Diversified's action was barred by the TIA (28 U.S.C. § 1341), which provides that ‘[t]he district courts shall not enjoin, suspend orrestrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.‘

On appeal to the Eighth Circuit, Diversified's ‘primary contention [wa]s that the district court erred in failing to determine whether [Public Law 86-272] bars Ohio from imposing the CAT on Diversified's out-of-state sales becausefederal courts have exclusive jurisdiction to interpret and enforce the [law's] ‘federally conferred tax immunity.’‘ While the circuit court agreed that

the TIA has been held not to preclude federal equitable relief in cases involving federalstatutes that confer ‘original or exclusive jurisdiction‘ on the federal courts, the court below noted that Public Law 86-272 does ‘not explicitly provide for exclusive federal jurisdiction, and numerous appellate state court decisions have applied[Public Law 86-272] to specific state tax cases.‘ Accordingly, the court found that Public Law 86-272 does ‘not divest state courts of jurisdiction to decide whether the [the law] barsa particular state tax assessment, levy, or collection.‘

**5 Next, Diversified argued that the Ohio CAT fails to provide a ‘plain‘ state court remedy as required under the TIA. Specifically, Diversified alleged that because Ohio's laws expressly provide that the CAT is ‘not subject to‘ Public Law 86-272,out-of-state taxpayers lack a plain remedy for review. But, according to the circuit court, Diversified's contention was ‘without merit.‘ Specifically, the court noted that the ‘plain remedy‘ exception to the TIA is procedural, addressing onlywhether ‘state law provides a remedy that permits a taxpayer to challenge the state tax at issue in state court.‘ Also, the Eighth Circuit found that ‘the Ohio Revenue Code provides taxpayers an appeal of right to an Ohio appellate court whichwill ‘hear and decide’ a claim that a state tax has been invalidly assessed or collected.‘ This, according to the court, ‘obviously includes authority to decide that imposing the CAT on Diversified'sout-of-state transactions violates [Public Law 86-272].‘ The Court of Appeals therefore affirmed the district court's ruling that the TIA deprived the lower court of subject matter jurisdiction over Diversified's claims.

Question presented.

In its petition for certiorari, Diversified now asks the Supreme Court, ‘[w]hether remote sellers, whose only connection to a taxing State is interstate delivery of wholesale goods at the instruction of remote customers, may maintain Federaljurisdiction for adjudication of immunity under 15 U.S.C. §§ 381-384 (the ‘Interstate Income Act‘) from foreign State income tax assessments, rather than besubject to foreign State reassessment proceedings from which Congress intended to shield such businesses by the Act's minimum State nexus requirements.‘

GA Property Owners Barred by Comity from Challenging Local Program Fee in Federal Court

On 5/8/17, the Supreme Court also received a new petition for certiorari in *Homewood Village LLC v. Unified Government of Athens-Clarke County Georgia*, Docket No. 16-1361, ruling below at 2017 WL 491151 (11th Cir. 2017) in which a group of Georgiaproperty owners sought ***42** to challenge an Athens-Clarke County ordinance, which imposed a fee on certain property owners to fund the county's stormwater management program. The property owners claim that the fee violates their rights under the Takings Clauseof the Fifth Amendment and the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the U.S. Constitution.

The property owners first brought their challenge against the fee in a federal district court in Georgia. The county initially sought to have the case removed from federal court under the Tax Injunction Act (‘TIA‘) but the lower court held that theTIA (discussed above) did not deprive the court of subject matter jurisdiction. According to the district court, the county ordinance imposing the stormwater charge constitutes a user ‘fee,‘ not a ‘tax,‘ and, thus, the TIA did not deprive federalcourts of jurisdiction over claims that the fee was unconstitutional. Nevertheless, the lower court noted that ‘[i]t is sometimes appropriate to dismiss an action in federal court due to comity concerns even when the Tax Injunction Act does notdeprive the court of subject matter jurisdiction.‘ According to the lower court, this was one such case.

**6 Specifically, the district court noted that, under the principle of comity, federal courts should be ‘reluctant to interfere in the fiscal operations of state and local governments and must be particularly sensitive to avoid such interference when thedispute involves a constitutional challenge to a state or municipal tax or fee and an adequate remedy exists in state court. ‘ In the present case, the court held that the relief sought by the Georgia property owners—*i.e.*, a declaratoryjudgment preventing Athens-Clarke from collecting the stormwater management fee from the petitioners—would require, ‘through a federal judicial mandate, that

Athens-Clarke abandon the fee system and fund the [stormwater] program in anotherway.‘ This, according to the court, is ‘precisely the type of federal judicial interference that raises comity concerns that counsel in favor of federal court abstention.‘

On appeal, the U.S. Court of Appeals for the Eleventh Circuit reviewed the district court's abstention decision for ‘an abuse of discretion‘ and held that it could not conclude that the district court abused its discretion in abstaining from decidingthe merits of the claims asserted. Accordingly, the circuit court upheld the lower court's dismissal of the petitioners' claims due to concerns over comity between federal courts and state governments.

Questions presented.

In their appeal to the Supreme Court, the petitioners raise two questions for review. First, they ask, ‘[w]hen a district court dismisses a complaint for comity is the standard of appellate review de novo or abuse of discretion or somethingin between, as some Circuits have held, in conflict with the Eleventh Circuit?‘ Second, the petitioners ask, ‘[d]oes a municipality's potential loss of user-fee revenue constitute an exceptional circumstance that requires a district courtto abstain based on comity from exercising its virtually unflagging obligation to hear and decide a case over which it has undoubted jurisdiction?‘

Petitions Still Pending

The following two petitions for certiorari remained pending before the Court as this issue of the JOURNAL went to press.

Court requests response to petition challenging West Hollywood building permit fees. On 3/15/17, the Court received a petition for certiorari in *616 Croft Avenue LLC v. City of West Hollywood*, Docket No. 16-1137, ruling below at3 Cal. App. 5th 621 (Cal. Ct. App. 2016). In the petition, a group of California property developers ask the U.S. Supreme Court to consider whether a West Hollywood ordinance that requires builders to either sell/rent a portion of newly developedhousing units at below-market rates, or, alternatively, to pay an ‘in lieu‘ fee that is used to fund the construction of other low-income housing, violates the Takings Clause of the Fifth Amendment of the U.S. Constitution.

In the case below, the developers chose to pay the in-lieu fee, but the developers faced significant delays in their construction schedule such that when they requested their final building permits in 2011, the city's proposed in-lieu fee payment had nearlydoubled from what the city had proposed at the time of their original application. The developers eventually paid the fees ‘under protest,‘ and later sued the city, alleging, in part, that the fees were both facially unconstitutional and also unconstitutionalas applied to their permit application under the Fifth Amendment's ‘unconstitutional conditions doctrine,‘ which, the developers argue, is set out in two U.S. Supreme Court cases: *Dolan v. City of Tigard*, 512 U.S. 374 (1994) and *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987).

****7** In their petition for certiorari, the developers argue that the ordinance ***43** ‘imposes the fee automatically as a condition on the approval of a building permit, without any requirement that [West Hollywood] show that the project creates a needfor low-cost housing.‘ The developers therefore ask the Court whether ‘a legislatively mandated permit condition is subject to scrutiny under the unconstitutional conditions doctrine as set out in [*Nollan* and *Dolan*].‘On 4/25/17, the Court requested a response to the developers' petition, which is due on or before 6/26/17. (For more background on this case, including a detailed discussion of the West Hollywood ordinance and the lower court's ruling, see U.S. Supreme CourtUpdate, 27 JMT 43 (June 2017).)

W. Va. seeks ruling on requiring S&U tax credits for taxes paid to neighboring cities and counties. On 4/17/17, the Court received a petition for certiorari in *Steager v. CSX Transportation*, Docket No. 16-1251, ruling belowat 238 W. Va. 238 (2016), in which the Commissioner of the West Virginia State Tax Department (the ‘Commissioner‘) asks whether a state must credit out-of-state sales taxes against its in-state use taxes or, alternatively, whether thestate can satisfy the requirements of the dormant Commerce Clause by other means, such as apportioning a use tax to reach only intrastate activity.

In the ruling below, the Supreme Court of Appeals of West Virginia held that the dormant Commerce Clause required that the Commissioner offer CSX Transportation (‘CSX‘), an operator of an interstate rail transportation system, full credit againstits West Virginia use tax obligations for the sales taxes CSX paid on motor fuel to *both* other states and to the subdivisions of those other states. Specifically, the Supreme Court of Appeals applied the four-pronged *Complete Auto* test(*see Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)) and found that if the Commissioner were to credit only taxes paid to other states (and not taxes paid to subdivisions of those states), West Virginia's use tax would fail both the fair apportionment and discriminationprongs of the *Complete Auto* test.

Arguing that the West Virginia Supreme Court of Appeals' decision ‘exacerbates [an] existing split among state courts of last resort about whether a State must credit out-of-state sales taxes against use taxes or whether it can satisfy thedormant commerce clause by other means,‘ the Commissioner presents two questions for review in the petition for certiorari:

1. Does the dormant commerce clause require a State that imposes a fairly apportioned use tax to also credit sales taxes paid to other States?

2. Does the dormant commerce clause require a State that does not impose county or municipal use taxes to provide a credit for sales taxes paid to other States' counties or municipalities?

(For more background on this case, including the lower court's review of the four-pronged *Complete Auto* test, see U.S. Supreme Court Update, 27 JMT 42 (July 2017).)

Petition Denied

****8** On 6/5/17, the Court denied the petition for certiorari in *Allen v. Connecticut Commissioner of Revenue Services*, Docket No. 16-1192, ruling below at 324 Conn. 292 (2016). In their petition, two former Connecticut residents (the ‘Allens‘) had asked whether Connecticut may impose its personal income tax on income derived from nonqualified stock options simply as a result of the taxpayerperforming services within the state during the year the options were granted and, if so, whether such taxation comports with due process.

In the case below, the Connecticut Supreme Court held that (1) Connecticut's income tax regulations provided the Department of Revenue Services with the authority to tax income derived from stock options so long as a taxpayer performed services within Connecticutduring *either* the year the options were exercised *or* the year the options were granted, and (2) the taxation of the Allens' stock option income ‘comports comfortably with the due process principle that a state may tax the compensationof nonresidents who perform services within the taxing state.‘

The Allens had sought to challenge Connecticut's due process analysis, asking the U.S. Supreme Court to consider whether the lower court ‘violated [the principles of due process] and widen[ed] a conflict among the lower courts whenit held that Connecticut may tax income from a nonresident's exercise of stock options because he supposedly realized that income when he received [stock] options as compensation for work in Connecticut and not when, as a nonresident, he exercisedthe options?‘ (For more background on this case, including a discussion on Connecticut's income tax sourcing rules, see U.S. Supreme Court Update, 27 JMT 42 (July 2017).)

The High Court refused to take up six separate petitions that challenged Michigan's retroactive withdrawal from the Multistate Tax Compact . . . .

An out-of-state seller of commodities . . . challenged the application of the Ohio CAT to its gross receipts [under Public Law 86-272].

The lower court noted that '[i]t is sometimes appropriate to dismiss an action in federal court due to comity concerns even when the Tax Injunction Act does not deprive the court of subject matter jurisdiction.'

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