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U.S. Supreme Court Update

U.S. SUPREME COURT UPDATE

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Seattle's 'Democracy Voucher Program' Challenged; Court Receives Reply Brief in Montana School Tax Credit Case

***36** A new petition for writ of certiorari was filed with the U.S. Supreme Court seeking review of an opinion by the Washington Supreme Court in *Elster v. City of Seattle, Wash.,* Docket No. 19-608, ruling below at 444 P.3d 590 (Wash. 2019), which upheld the constitutionality of Seattle's 'Democracy Voucher Program.' This program, funded by property taxes, provides vouchers to registered municipal voters and qualifying residents, who can, inturn, give the vouchers to qualified municipal candidates, who can then redeem them for campaign purposes.

As previously reported, the Court has granted certiorari in *Espinoza v. Montana Dep't of Rev.* (Docket No. 18-1195) and has scheduled oral argument for January 22, 2020. The issue in this case is whether it violates the religion clauses or theEqual Protection Clause of the U.S. Constitution to invalidate a generally available and religiously neutral student-aid program because the program affords the students the choice of attending religious schools. On December 6, 2019, the Court received thereply brief for the Petitioners. Furthermore, on December 9, 2019, the Court granted the Solicitor General's motion for leave to participate in oral argument as amicus curiae and for divided argument.

The Court also continues its review of 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. 22O145, and *Arkansas et. al. v. Delaware*, Case No. 22O146. As previously reported, the Court has assigned the Honorable Pierre N. Leval, of the U.S. Court of Appeals for the Second Circuit, asSpecial Master in these cases, tasked with coordinating the taking of evidence and making reports. We will continue to update readers as more details become available. We will also continue to track *Arizona v. California*, which has been assignedOriginal Action Number 22O150, in which Arizona filed a Bill of Complaint against California regarding California's selective enforcement of its 'doing business' tax standard.

Finally, the Court denied the previously reported petition in *UMB Bank, N.A. v. Landmark Towers Association, Inc.,* Docket No. 19-241.

First Amendment Challenge to Seattle's Democracy Voucher Public Finance Program

****2** The U.S. Supreme Court received a petition for writ of certiorari in *Elster v. City of Seattle, Wash.,* Docket No. 19-608, ruling below at 444 P.3d 590 (Wash. 2019), seeking review of the determination by the Washington Supreme Court that Seattle's Democracy Voucher Program does not violate First Amendment rights, inasmuch as the program 'does not alter, abridge, restrict, censor, or burden speech. Nor does it force association between taxpayers and any message conveyed by the program.'

The 'Democracy Voucher Program.'

In 2015, Seattle voters approved Initiative 122, establishing the Democracy Voucher Program. As explained by the Washington Supreme Court, the purposes of the program are: '(1) to 'expand the pool of candidates for city offices and to safeguardthe people's control of the elections process,' (2) to 'ensure the people of Seattle have equal opportunity to participate in political campaigns and be heard by candidates,' and (3) to 'prevent corruption.' Clerk's Papers at 14, 16.'

This program provides vouchers to eligible municipal residents for use in Seattle elections, who then give the vouchers to qualified local candidates that chose to participate in the program. A 10-year property tax levy funds the program. Two Seattle propertyowners brought a 42 U.S.C. §1983 action (civil action for deprivation of rights) challenging the constitutionality of the program. (Section1983 provides an individual the right to sue state government employees and others 'acting under color of state law' for civil rights violations.) The Petitioners argued that 'it is unconstitutional to use tax dollars to underwrite campaigncontributions.' Seattle moved to dismiss the action. The Superior Court granted the city's motion, upholding the constitutionality of the Democracy Voucher Program. The Petitionersappealed, and the Court of Appeals certified the case to the Washington Supreme Court.

Standard of scrutiny.

***37** As the Washington Supreme Court explained, 'if the Democracy Voucher Program does not burden fundamental rights, the program enjoys the presumption of constitutionality and the challengers bear the heavy burden of showing the city lacked the power toimpose the tax under rational basis scrutiny (citations omitted).' Furthermore, it made clear that '[i]f rational basis scrutiny applies, the program's tax need only rationally relate to a legitimate government interest.' If, however,the program 'burdens fundamental rights, strict scrutiny applies; to survive strict scrutiny, the city needs to show the program furthers a compelling interest and is narrowly tailored to achieve that interest.'

Ultimately, the Washington Supreme Court determined that strict scrutiny does not apply, and found under a rational basis review that the program's tax directly supports the government's legitimate interest in its public financing of elections.

First Amendment argument.

Per the court, the Petitioners maintained that the Democracy Voucher Program, 'through its tax, unconstitutionally compels them to support the program's message.' However, per the court, the Petitioners 'c[ould] not show the tax individuallyassociated them with any message conveyed by the Democracy Voucher Program,' and, therefore, the program was not subject to heightened scrutiny.

****3** Instead, the court cited *Buckley v. Valeo*, 424 U.S. 1 (1976) for U.S. Supreme Court precedent for the upholding of public financing of elections, in the context of a system where taxpayers elect to authorize payment from their taxes to the PresidentialElection Campaign Fund. The court also distinguished the Democracy Voucher Program from other financing schemes found unconstitutional by the U.S. Supreme Court that provided matching funds to publicly financed candidates. (The court noted that the U.S. SupremeCourt found that 'matching funds penalized privately financed candidates who 'robustly' exercised their First Amendment rights, by providing funds to their political rivals.')

The court also emphasized that, in this case, ‘the decision of who receives the vouchers is left to the individual municipal resident and is not dictated by the city or subject to referendum‘ and ‘that some candidates will receive more vouchersreflects the inherently majoritarian nature of democracy and elections, not the city's intent to subvert minority views.‘ The Washington Supreme Court also looked to the stated purpose of the program, namely to ‘giv[e] more people an opportunityto have their voices heard in democracy,‘ and concluded that the ‘government has a legitimate interest in its public financing of elections, as *Buckley* held. *See* 424 U.S. at 92-93. The program's tax directly supports thisinterest. The program, therefore, survives rational basis scrutiny.‘

Questions presented.

The Petitioners have asked the Court to decide:

1. ‘Whether a levy that forces property owners to fund other individuals' campaign donations implicates the First Amendment's compelled-subsidy doctrine.‘

2. ‘Whether a compelled subsidy of speech should be examined under rational basis review, as the decision below concluded, or whether a higher standard of review is appropriate.‘

Granted Petition

On June 28, 2019, the U.S. Supreme Court granted certiorari in *Espinoza v. Montana Dep't of Rev.*, Docket No. 18-1195, ruling below at 393 Mont. 446 (2018). Arguments have been set for January 22, 2020. The U.S. Supreme Court will review a decision of the Montana Supreme Court, which held that the Montana tax credit program for qualified education contributions violates ArticleX, §6, of the Montana Constitution, entitled ‘Aid prohibited to sectarian schools,‘ which prohibits aid used ‘for any sectarian purpose or to aid any ... school ... controlled in whole or in part by any church, sect, or denomination.‘

In response to legislation that allows a tax credit to fund scholarships to private schools, the Montana Supreme Court determined that, by providing a dollar-for-dollar credit against taxes owed to the state, the Legislature is the entity providing aid tosectarian schools in direct violation of the Montana Constitution. The Montana Supreme Court held that the program's provision of aid to religious schools violated the No-Aid Clause and struck down the statute as a whole. Mothers of children who benefitedfrom the scholarship program and attended religious private schools ask the U.S. Supreme Court: ‘Does it violate the Religion Clauses or Equal Protection Clause of the United States Constitution to invalidate a generally available and religiously neutralstudent-aid program simply because the program affords students the choice of attending religious schools?‘

****4** As previously reported, the Montana Department of Revenue filed its brief November 8, 2019. In its brief, Montana argues that the ‘No-Aid Clause‘ of its Constitution does not violate the Free Exercise Clause of the U.S. Constitution. The Free ExerciseClause bars laws ‘prohibiting the free exercise‘ of ‘religion.‘ In this case, Montana argues, the Montana Supreme Court invalidated the statute as to both religious schools and non-religious schools, which ensured that there would be no indirectcoercion or penalties and, therefore, no prohibition on the freedom ***38** of religion. In response to the Petitioners' argument that the No-Aid Clause itself violates the Free Exercise Clause, Montana argues it does not, but rather only ‘restrains the governmentby barring state aid to religious schools.‘ Such a restraint, Montana continues to argue, is actually a protection of religious liberty and not a prohibition on the freedom of religion.

On December 6, 2019, the Petitioners filed their reply brief. In their brief, they explain how ‘Respondents concede that applying section 6(1) to exclude religious schools from the scholarship program would violate the federal constitution‘ and that‘the court's remedy reconciled the conflict between the Montana and federal constitutions.‘ In response, they argue that the Montana Supreme Court ‘did not invalidate the program to reconcile a conflict between the Montana and federal constitutions,‘rather ‘[t]o the contrary, the court held there was no conflict between them.‘

The Petitioners further argue that ‘even if the Montana Supreme Court viewed itself as reconciling the state and federal constitutions, invalidating the program was still not permissible‘ inasmuch as the ‘Court has already held that eliminatinga public program to prevent including a protected class in that program is just as discriminatory as excluding that class in the first place (citations omitted).‘ Petitioners also argue that invalidating the program penalizes religious families and schoolsfor exercising their beliefs.

In addition, the Petitioners argue that applying the No-Aid Clause to bar religious options from the scholarship program violates the Free Exercise Clause, the Equal Protection Clause, and the Establishment Clause of the U.S. Constitution, in contraventionof prior U.S. Supreme Court precedent. And, lastly, they argue that ruling for the Petitioners ‘would not create a parade of horribles.‘

Pending Matter

On February 28, 2019, the U.S. Supreme Court received a Bill of Complaint filed by the State of Arizona against the State of California (Docket No. 22O150). Arizona is challenging California's taxation under its ‘doing business‘ standard, specifically,against entities that invest in manager-managed limited liability companies.

According to the Complaint, the tax at issue is a ‘doing business‘ tax assessed by California on all business entities that purportedly conduct business in California. The tax is either an $800 flat amount (for limited liability companies) or $800minimum (for corporations). Arizona is alleging that California is assessing the ‘doing business‘ tax on out-of-state companies that do not conduct any actual business in California and have no connection to California except for purely passive investmentsin California companies.

****5** In a member-managed LLC, all of the members actively participate in the management and control of the company. In a manager-managed LLC, however, one or more managers act as an agent of the LLC and manage all of the business and affairs of the company. Insuch an LLC, the members do not play any role in management and operation. Instead, they are simply passive investors. Codified as Legal Ruling 2014-01, the California Franchise Tax Board (‘FTB‘) addresses the application of the ‘doing business‘tax to LLCs that elect to be classified as a partnership for tax purposes and their members. Under that ruling, the FTB deems each member of a California-operating LLC to be doing business in California itself, regardless of whether the California-*operating* LLC is manager-managed or member-managed. Thus, under Legal Ruling 2014-01, members of a California-operating LLC are subject to the ‘doing business‘ tax even if they do not ‘participate inthe management of [the] LLC or appoint a manager[.]‘

The Bill of Complaint alleges that California has assessed the ‘doing business‘ tax against many Arizona entities that are entirely passive investors in manager-managed California-operating LLCs. The Bill of Complaint alleges that these Arizona entitieshave no other connection to California. Moreover, according to the Complaint, if the tax assessments are not paid voluntarily by out-of-state businesses, the FTB assesses a penalty and then seeks collection through special seizure authority.

Arizona asks the U.S. Supreme Court to:

1. declare California's assessments violate the Due Process Clause and the Commerce Clause of the Constitution,

2. declare California's assessments violate the Due Process Clause and the Fourth Amendment of the Constitution,

3. preliminarily and permanently enjoin California's assessments,

4. enter an injunction requiring California to refund to all Arizona businesses all funds collected, and

5. award compensatory damages to Arizona in an amount to be approved before a Special Master.

At the time of this writing, the Solicitor General has not yet filed a brief in this case, as requested by the Court on June 24, 2019.

Petition Denied

On Nov. 25, 2019, the Court denied the petition for review in *UMB Bank, N.A v. Landmark Towers Association, Inc.*, Docket No. 19-241, ruling below at 436 P.3d 1139 (Colo. App. 2018). In the case below, the Colorado Court of Appeals, on remand from the Colorado Supreme Court, held that the inclusion of certain landowners in a special taxing district and the purported taxation of those landownersviolated their due process rights because the district's organizers included the property owners in the district only as a source of payment for improvements to other property, and the landowners at issue received no benefit from those improvements.

Seattle's ‘Democracy Voucher Program‘ provides vouchers to eligible municipal residents for use in Seattle elections, who then give the vouchers to qualified local candidates that chose to participate in the program.

****6** Arizona's Bill of Complaint alleges that California has assessed the ‘doing business‘ tax against many Arizona entities that are entirely passive investors in manager-managed California-operating LLCs.

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