28-JAN J. MULTISTATE TAX'N 42

Journal of Multistate Taxation and Incentives
****1**
January, 2019

U.S. Supreme Court Update

Copyright (c) 2019 RIA

U.S. SUPREME COURT UPDATE

DEBRA S. HERMAN is a partner in the New York City office and K. CRAIG REILLY is an associate in the Buffalo and New York City offices of the law firm Hodgson Russ LLP. The authors thank KELLY DONIGAN for his contributions to this issue's column.

Two New Petitions Ask for Certiorari in State and Local Tax Matters

***42** After being nominated by President Donald J. Trump on July 9, 2018, Brett Kavanaugh was confirmed to the Supreme Court following months of speculation and hearings on October 6, 2018. Justice Kavanaugh, who previously sat as a U.S. Circuit Court Judge on the U.S. Court of Appeals for the District of Columbia Circuit, takes the vacant spot created by the retirement of Justice Anthony Kennedy, for whom he clerked. With the Court set to decide three cases in which certiorari was granted in June—*Washington State Dep't of Licensing v. Cougar Den, Inc.* (Docket No. 16-1498); *Dawson v. Steager* (Docket No. 17-419); and *FTB v. Hyatt* (Docket No. 17-1299)—we may not have to wait long to see what Justice Kavanaugh's impact will be on the Court's state and local tax jurisprudence. In the meantime, we have new updates to report.

Specifically, the U.S. Supreme Court has received two new petitions for certiorari in cases involving state and local taxes. First, in W*hite, et al. v. Underwood, et al.* (Docket No. 18-297), a petition for certiorari has been filed with the Court challenging the New York Court of Appeals' decision holding that New York's prepayment obligations on Indian retailers located on reservation land on sales of cigarettes to individuals who are not members of the Seneca Nation of Indians does not constitute a direct tax on the Indian retailers and, therefore, does not conflict with federal law, treaties or Indian law. Second, in *Coleman, et al. v. Campbell County Board of Trustees* (Docket No. 18-283), the Court has been asked to review a decision by the Kentucky Court of Appeals, in which the state court refused to retroactively apply an earlier decision that harmonized Kentucky's statutes relating to the setting of public library district property tax rates.

In addition, one previously reported petition remains pending—*Parmar v. Madigan* (Docket No. 18-241)—and the Court 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 *Delaware v. Pennsylvania et. al.*, Case No. 220145, and *Arkansas et. al. v. Delaware*, Case No. 220146. We will continue to update readers as more details become available.

Seneca Nation Member's Challenge to N.Y.'s Cigarette Excise Tax Prepayment Requirements

****2** On September 4, 2018, the U.S. Supreme Court received a new petition for certiorari in *White, et al. v. Underwood, et al.*, Docket No. 18-297, ruling below at 31 N.Y.3d 543 (2018). In this case, the New York Court of Appeals (New York's highest court) held that the state's 'prepayment obligation does not constitute a direct tax on tribal retailers and is therefore not prohibited by federal law,' nor does it conflict with federal treaties or Indian law.

New York's prepayment obligation.

Section 471 of New York State's Tax Law requires that Indian retailers located on reservation lands prepay the excise tax due on sales of cigarettes to individuals who are not members of an Indian Nation or Tribe. As explained by the New York Court of Appeals, 'the law provides that the tax shall be imposed 'on all cigarettes possessed in the state by any person for sale,' including 'all cigarettes sold on an Indian reservation to non-members of the Indian Nation or Tribe,' but contains an exception for cigarette 'sales ***43** to qualified Indians for their own use and consumption on their nation's qualified reservation.''

As described in the petition for certiorari, '[t]he state enforces Tax Law §471 through a pre-collection scheme by which cigarettes that enter the State are sold exclusively to licensed stamping agents, who purchase tax stamps from the State and affix a stamp to each package of cigarettes as evidence of payment of the State's cigarette excise tax. The stamped cigarettes are then sold to retailers at a price that includes the cost of the cigarette excise tax that was paid to obtain the stamp.' As explained by the Court of Appeals, 'as a result, although tribal retailers must prepay the tax to wholesalers when purchasing inventory, they ultimately recoup the tax by adding it to the retail price for cigarettes sold to non-tribal members of the Nation.' Moreover, New York's law also permits tribes or reservation retailers to purchase 'a limited quantity of cigarettes' based on their 'probable demand' without prepaying the tax to wholesalers.

N.Y. court rules prepayment does not qualify as impermissible direct tax.

The Petitioners in the case are Mr. Eric White and his convenience store Native Outlet. Mr. White is a member of the Seneca Nation and operator of Native Outlet, which sells cigarettes on the Seneca Nation's Alleghany Territory. Mr. White and Native Outlet originally brought an action in New York Supreme Court seeking to enjoin assessment and collection of the cigarette excise tax codified in New York Tax Law §471 on transactions between Indian-owned retailers and non-Indian consumers occurring on lands governed by the Seneca Nation. The basis of their argument was that such assessments ran afoul of the U.S. Supreme Court's holding in *The New York Indians*, 72 U.S. 761 (1866), as well as violating the terms of federal treaties (e.g., Buffalo Creek Treaty) and statutes (e.g., Indian Law §6).

****3** The trial court denied the motion for a preliminary injunction, and New York's appellate division affirmed. The New York Court of Appeals then upheld the appellate division's decision, finding that 'the law's prepayment obligation does not constitute a direct tax on tribal retailers and is therefore not prohibited by federal law.' According to the Court of Appeals, because the retailers have the opportunity to pass the tax along to cigarette consumers in setting their price, New York's pre-collection mechanism did not violate federal law. Specifically, the Court of Appeals noted that '[t]he express language of New York's tax law provides that 'the ultimate incidence of and liability for the tax shall be upon the consumer,' and mandates that the tax money advanced by any 'agent or dealer' be paid back by the consumer (Tax Law §471 [2], [3]; *see Cayuga Indian Nation,* 14 N.Y.3d at 647).'

In addition, with respect to the assertion that the tax violated federal treaties and statutes, including the Buffalo Creek Treaty of 1842, the Court of Appeals ruled that the treaty's ban on any 'taxes' imposed on the lands of the Seneca Indians, protected against 'taxes' only, and because the 'precollection mechanism at issue here is not a tax on the retailer and is borne instead by the consumer,' the court held that '[n]either the Treaty nor the statute supports an argument that any indirect impact on Indian retailers resulting from permissible taxation of non-Indian customers is prohibited.'

Last, the court noted that the U.S. Supreme Court has long held that ‘the States have a valid interest in ensuring compliance with lawful taxes that might easily be evaded through purchases of tax exempt cigarettes on reservations,‘ and to curb that practice, ‘States may impose on reservation retailers minimal burdens reasonably tailored to the collection of valid taxes from non-Indians.‘ Accordingly, the Court of Appeals upheld New York's application of its cigarette excise tax prepayment obligations.

Questions presented.

According to the Petitioners, ‘[t]he decision below ruled that New York's promise to the Seneca Nation of Indians to refrain from assessing taxes ‘for any purpose whatever, upon any Indian reservation in this state,’ as memorialized in a treaty and statue should be interpreted to allow New York to assess and collect any taxes it desires within the Seneca Nation of Indians so long as New York claims the taxes will be paid by non-Indians.‘

The Petitioners then presents two questions for review:

‘Does this interpretation directly conflict with this Court's decision in *The New York Indians*, 72 U.S. 761 (1866), in which this Court specifically prohibited New York from assessing taxes within the Seneca Nation of Indians, even those to be paid by non-Indians, because that mere assessment violated the ancient rights of the Seneca Nation of Indians as memorialized in treaties and statute?‘

‘Does this interpretation violate this Court's canons of construction governing the interpretation of treaties executed and statutes enacted for the benefit of Indians?‘

Ky. Court Refuses to Retroactively Apply Changes to Public Library Ad Valorem Tax Rates

****4 *44** On August 31, 2018, the Court received a new petition for certiorari in *Coleman, et al. v. Campbell County Library Board of Trustees,* Docket No. 18-283, ruling below at 547 S.W.3d 526 (Ky. Ct. App. 2018), in which the Kentucky Court of Appeals held that the court's earlier decision harmonizing statutes relating to setting public library ad valorem property tax rates should not apply retroactively. The Kentucky Court of Appeals found that the taxes at issue were collected in good faith by library districts in reliance on advice of the state's executive branch and that prospective application of the Court of Appeals' decision was justified as it did not violate the Due Process Clause or Separation of Powers Doctrine. In addition, the Court of Appeals noted that its earlier decision established a new principle of law, which merited prospective application only, as any retroactive application would cause substantial inequitable results by depleting the resources of numerous public libraries. The current petition for certiorari concerns the Due Process Clause issue only.

The Kentucky statutes and underlying issue.

As explained by the state court, Kentucky has two statutes, both applicable to the ad valorem taxing rates of public library taxing districts. Kentucky Revised Statutes (KRS) §173.790(1) allows for an increase in the tax rate only via a petition signed by 51 percent of duly qualified voters in the respective district. On the other hand, KRS §132.023 allows a taxing district to increase revenue from ad valorem taxes up to four percent without triggering a reconsideration by the district or voter recall referendum.

The Petitioners, who were property owners and taxpayers residing within the Campbell County Library District, filed a declaratory judgment, asserting causes of action for refunds and seeking injunctive relief, against the Campbell County Library Board of Trustees (the ‘Library District‘). The Petitioners argued that the Library District had erroneously calculated its ad valorem rates under KRS §132.023, when in fact it should have applied KRS §173.790, which requires all rate increases to be approved by a majority of taxpayers. The Library District then moved for summary judgment solely on Petitioners' declaratory judgment count, claiming that KRS §132.023 properly governed the mechanism by which the district could set tax rates.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Harmonization of the statutes.

The Kentucky courts initially held in favor of the Petitioners, stating that the more specific statute, KRS §173.790, applied over the more general statute, KRS §132.023, which the Library District had previously used to set its rates. The Kentucky Court of Appeals interpreted and harmonized KRS §§173.790 and 132.023, holding that a library taxing district formed by petition may set the ad valorem tax rate each year at the compensating tax rate or at a rate that would allow up to a four percent increase in revenue above the compensating tax rate as permitted under KRS §132.023.

****5** On remand, the Library District moved for summary judgment arguing that the decision of the Kentucky Court of Appeals should be given a prospective-only application, thus denying any decision as to prior tax rates and backward-looking relief to Petitioners. Petitioners also moved for summary judgment, arguing that the Library District had increased taxes in violation of the statutes as harmonized by the Court of Appeals, and the Petitioners sought refunds of all taxes overpaid since January 2007. The Petitioners submitted evidence that the Library District had improperly amassed cash reserves of approximately $3,100,000. Nonetheless, the trial court determined that the Court of Appeals' opinion should be given a prospective-only application and granted the Library District's motion for summary judgment on the remaining counts.

Petitioners' Due Process Clause claims.

On appeal to the Kentucky Court of Appeals, the Petitioners moved to alter, amend, or vacate the trial court's summary judgment order, raising several arguments, including that Petitioners were denied meaningful backward-looking relief as required by the Due Process Clause of the Fourteenth Amendment of the U.S. Constitution. The Petitioners specifically argued that the U.S. Supreme Court's decision in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco,* 496 U.S. 18 (1990) required the court to grant their refunds, as the Supreme Court's decision held that minimum due process safeguards require 'meaningful backward-looking relief' when taxpayers are coerced into paying taxes first and litigating the validity of the tax through a refund action.

Nonetheless, the Kentucky trial court held that the due process safeguards of the U.S. Constitution are limited by Kentucky law because '[Kentucky] case law provides that due process protections may be balanced against consideration of good-faith reliance and equity.' The Kentucky Court of Appeals affirmed this decision, noting that—based on the 'unique fact' that the taxes in this case were collected in good faith by the Library District in reliance on the advice of the state's executive branch—this case presents one of the rare occasions when a court is justified in exercising its discretion to 'make application of a holding prospective only.'

Questions presented.

The Petitioners' appeal to the Kentucky Supreme Court was ***45** denied, and the Petitioners now ask the U.S. Supreme Court to consider two questions for review in their petition for certiorari: '(1) Whether a state can circumvent the requirements of the Due Process Clause to provide taxpayers retroactive relief from unlawful taxes by making its decision prospective only,' and '(2) Whether a state violates the Due Process Clause by refusing to rule on claims asserted in an action to recover unlawful taxes.'

Petitions Granted

On June 25, 2018, the U.S. Supreme Court granted certiorari in two previously reported petitions: *Washington State Dep't of Licensing v. Cougar Den, Inc.* (Docket No. 16-1498) and *Dawson v. Steager* (Docket No. 17-419), and on June 28, 2018, the Court granted certiorari in *FTB v. Hyatt* (Docket No. 17-1299).

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

Review granted of Yakama Nation 'right to travel' without taxation victory.

****6** In *Washington State Dep't of Licensing v. Cougar Den, Inc.* (Docket No. 16-1498), ruling below at 188 Wash. 2d 55 (Wash. 2017), the Washington Supreme Court held that the Yakama Nation '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.

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 andconclusions of 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.'

The Supreme Court has now granted certiorari for the question posed by Washington State Department of Licensing for review: '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.' Oral arguments in the case are set for October 30, 2018, and on October 9, 2018, the Court granted the Solicitor General's motion for leave to participate in the argument as amicus curiae.

Court to consider W.V.'s differential treatment of retirement benefits and intergovernmental immunity.

****7** In *Dawson v. Steager,* Docket No. 17-419, ruling below at *Steager v. Dawson*, 2017 WL 2172006 (W. Va. 2017), the Supreme Court of Appeals of West Virginia held that James 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 West Virginia court, Dawson worked as a deputy U.S. Marshal in West Virginia. He was enrolled in ***46** FERS, a federal retirement plan, and sought a West Virginia exemption for all of his FERS income. The court, however, noted that, under West Virginia law, 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 court held that this distinction did not violate the doctrine of 'intergovernmental tax immunity.' 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.'

WESTLAW © 2020 Thomson Reuters. No claim to original U.S. Government Works.

In his petition, Dawson asked the U.S. Supreme Court to consider: '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.' However, the Court did not grant certiorari with respect to Dawson's question, and instead granted certiorari limited to the issue presented by the U.S. Solicitor General in an amicus curiae brief filed on May 15, 2018.

The Solicitor General argued that '[t]he West Virginia Supreme Court of Appeals misapplied the doctrine of intergovernmental tax immunity' and that, '[u]nder the test articulated in *Davis v. Michigan Department of the Treasury*, 489 U.S. 803 (1989), the court should have asked whether the State's inconsistent tax treatment of former federal and state law-enforcement officers 'is directly related to, and justified by, significant differences between the two classes.' ' The West Virginia court's application of a 'totality of the circumstances' analysis, the Solicitor General argued, 'is inconsistent with *Davis* and with this Court's other intergovernmental tax immunity decisions.'

On August 28, 2018, Dawson filed his brief with the Court, arguing that West Virginia taxes federal law enforcement retirees more than state law enforcement retirees, despite the absence of significant differences. According to Dawson, '[i]t is undisputed . . . that there are no significant differences between [the] powers and duties [of a] US Marshal and the powers and duties of the state and local law enforcement officers.' Accordingly, Dawson maintains that West Virginia has misapplied the intergovernmental immunity test from *Davis*, and the judgment of the West Virginia Supreme Court of Appeals should be reversed. Oral arguments in the case are set for December 3, 2018, and on October 9, 2018, the Court granted the Solicitor General's motion for leave to participate in the argument as amicus curiae.

Court will review whether California FTB is immune from taxpayer tort claims.

****8** In *Franchise Tax Bd. of Cal. v. Hyatt*, Docket No. 17-1299, ruling below at 407 P.3d 717 (Nev. 2017), the Nevada Supreme Court held that the California Franchise Tax Board (the 'FTB') was not entitled to immunity from intentional and bad-faith tort claims brought by a former California resident, Gilbert Hyatt.

The granting of certiorari marks the latest in a long-running saga between Hyatt and the FTB. Mr. Hyatt's dispute with the FTB stems from the agency's attempt to collect approximately $10 million in taxes on patent licensing fees earned by Hyatt in the 1990s. Following an audit, in which the FTB determined Hyatt to be a California resident, Hyatt sued the FTB in Nevada state court claiming that the FTB's abusive investigation techniques cost him business opportunities and inflicted emotional distress. The Nevada Supreme Court eventually largely reversed a jury award of tort damages and punitive damages ***48** awarded to Hyatt. Citing to *Nevada v. Hall*, 440 U.S. 410 (1979), however, which held that the U.S. Constitution does not grant states sovereign immunity from suit in the courts of other states, the Nevada Supreme Court rejected the FTB's claim of complete immunity. Ultimately, the U.S. Supreme Court affirmed Nevada's decision in *Franchise Tax Bd. of Cal. v. Hyatt (Hyatt I)*, 538 U.S. 488 (2003).

After another round at the Nevada Supreme Court, which held that the FTB was liable for fraud and intentional infliction of emotional distress, the FTB sought review once again in the U.S. Supreme Court. The Court granted certiorari for the second time, agreeing to consider two questions: (1) whether the Nevada Supreme Court erred by failing to apply to the FTB the statutory immunities available to Nevada agencies and (2) whether the U.S. Supreme Court's prior decision in *Nevada v. Hall*, 440 U.S. 410 (1979), should be overruled.

In its second decision, *Franchise Tax Bd. of Cal. v. Hyatt (Hyatt II)*, 136 S. Ct. 1277 (2016), the Court held that, with regard to California's first claim, the Full Faith and Credit Clause does not 'permit[] Nevada to award damages against California agencies under Nevada law that are greater than it could award against Nevada agencies in similar circumstances.' As to California's second question, however, the Court, in the wake of Justice Antonin Scalia's death, spilt 4-4 on whether *Hall* should be overruled.

 © 2020 Thomson Reuters. No claim to original U.S. Government Works.

On remand from *Hyatt II*, the Nevada Supreme Court followed the high court's instructions and held that the FTB was entitled to the benefit of Nevada's statutory damages cap and instructed the trial court to enter a damages award for fraud within the cap of $50,000. The FTB again requested the U.S. Supreme Court to grant certiorari, arguing that ‘under our federal system, an agency of one State may not (absent its consent) be sued in the courts of another State. ‘ Specifically, the FTB asked the Court to answer the question it agreed to decide in *Hyatt II:* ‘whether *Nevada v. Hall* should be overruled.‘ The Court granted the FTB's request.

Petition Pending

****9** In addition to the new petitions and granted petitions, one previously reported petition for certiorari remained pending before the Court as this issue of the JOURNAL went to press.

In *Parmar v. Madigan* (Docket No. 18-241), the Court has been asked to review a decision by the Illinois Supreme Court upholding the judgment of a lower court, which dismissed a complaint filed by the executor of an estate under the jurisdictional bar of state sovereign immunity. The Petitioner had challenged Illinois' retroactive application of the state's estate tax and now argues in his petition for certiorari that Illinois failed to provide a clear and certain post-deprivation procedure for reviewing his claims, as required under the Due Process Clause of the U.S. Constitution.

Petitions Denied and Dismissed

On October 15, 2018, the Court denied the petition for certiorari in *Northern Cal. Water Ass'n, et al. v. State Water Resources Control Bd., et al.* (Docket No. 18-205), in which a group of plaintiffs looked to the Supremacy Clause of the U.S. Constitution to challenge the California State Water Resources Control Board's imposition of a new annual fee on water right permit and license holders.

Finally, on October 5, 2018, the parties in *Rollyson, et al. v. O'Neal et al.* (Docket No. 18-114) filed a Rule 46 agreement with the Court, requesting that the petition be dismissed. In the original petition for certiorari, a West Virginia state official had asked the U.S. Supreme Court to review the application of qualified immunity in a case involving the issuance of a tax deed related to real property in West Virginia.

We may not have to wait long to see what Justice Kavanaugh's impact will be on the Court's state and local tax jurisprudence.

The Court of Appeals upheld New York's application of its cigarette excise tax prepayment obligations.

The Kentucky Court of Appeals held that the court's earlier decision harmonizing statutes relating to setting public library ad valorem property tax rates should not apply retroactively.

End of Document

© 2020 Thomson Reuters. No claim to original U.S. Government Works.

THOMSON REUTERS CHECKPOINT