THOMSON REUTERS
CHECKPOINT

29-JAN J. MULTISTATE TAX'N 37

Journal of Multistate Taxation and Incentives
****1**
January,2020

U.S. Supreme Court Update

Copyright (c) 2020 RIA

U.S. SUPREME COURT UPDATE

DEBRA S. HERMAN is a partner and KELLY DONIGAN is an associate in the New York City office of the law firm Hodgson Russ LLP.

Arguments Scheduled in Montana Aid to Religion Dispute

***37** At the time of this writing,there have been no new petitions to the U.S. Supreme Court involving pure state and local tax matters filed since our last report. State and local taxes may be in the headlines with President Donald J. Trump filing a petitionfor writ of certiorari in *Trump v. Vance*,but the true underlying issue in that matter is one of presidential immunity. At issue is whether presidential immunity prevents the Manhattan District Attorney from subpoenaing President Trump's tax returns.Indeed,the question presented by President Trump is: ‘Whether [New York's] subpoena violates Article II and the Supremacy Clause of the United States Constitution.‘

As previously reported,the Court remains set to review *Espinoza v. Montana Dep't of Rev.* (Docket No. 18-1195) after granting certiorari on June 28,2019. We are also keeping our eye on *State of Arizona v. State of California*,whichhas been assigned Original Action Number 220150. Arizona filed a Bill of Complaint against California back on February 28,2019,regarding California's enforcement of its ‘doing business‘ standard.

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. 220145,and *Arkansas et. al. v. Delaware*,Case No. 220146. 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.

Finally,we await further action in a previously reported petition,*UMB Bank, N.A. v. Landmark Towers Association,Inc.*, Docket No. 19-241,and the Court has denied the petition in *Staples,Inc. v. Comptroller of Treas.*,DocketNo. 19-119.

Petition Granted

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 Court will review a decision of the Montana Supreme Court,which held that the Montana tax credit program for qualified education contributions violates Article X,§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.‘

****2** In response to legislation allowing 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 to sectarianschools 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 it struck down the statute as a whole. Mothers of children who benefitedfrom the scholarship program and attended religious private schools asked 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?‘

The Montana Department of Revenue filed its brief November 8, 2019,in which it argues that the ‘No-Aid Clause‘ of the state constitution does not violate the Free Exercise Clause of the U.S. Constitution. The Free Exercise Clause bars laws ‘prohibitingthe 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 indirect coercion or penalties and,therefore,no prohibition on the freedom 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 government by barring state aid toreligious schools.‘ Such a restraint,Montana continues to argue,is actually a protection of religious liberty and not a prohibition on the freedom of religion.

Amicus briefs have been filed by the Montana Constitutional Convention Delegates,the Tennessee Education Association,the State of Maine,and several religious groups and institutions.

Other Pending Matters

In addition to the previously granted petition,one previously reported petition for writ of certiorari involving state and local taxes remains pending before the Court: *UMB Bank,N.A. v. Landmark Towers Association,Inc.* (Docket No. 19-241).In addition,the Bill of Complaint filed by Arizona ***38** against California in *State of Arizona v. State of California* (Original Action Number 220150) also is pending before the Court.

Colorado developer seeks to uphold inclusion of condominium owners in special district.

On August 21,2019,the U.S. Supreme Court received a petition for certiorari 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 landowners in the district only to use them as a source of payment for improvements to other property,with the landowners at issue receiving no benefit from those improvements.

****3** The case at issue arises out of an election held pursuant to Colorado's Taxpayer Bill of Rights,or ‘TABOR,‘ which generally requires voters to approve taxes and bonds. Beginning in 2005,a Colorado real estate developer (‘Developer ‘) startedto build two high-rise condominium towers (‘Landmark Towers‘). While the Landmark Towers were being developed from 2005 through 2007,about 130 buyers (‘Landmark Buyers‘) entered into contracts to buy condominiums in the towers. The LandmarkBuyers were required to close when the condominiums were completed. The purchase contracts did not name any special districts encompassing the Landmark Towers but did contain a notice that special districts might be created and impose ad valorem property taxes.

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

Before the Landmark Towers were complete,Developer also decided to develop a separate residential community (the ‘European Village‘) on nearby land. After discovering the revenue base for European Village would not be sufficient to pay the generalobligation bonds Developer intended to issue to fund construction of its necessary infrastructure—streets,sidewalks,curbs and gutters,water lines, sanitation lines,and landscaping—Developer created a special district,the Marin MetropolitanDistrict (the ‘District‘) under Title 32,Article 1 of the Colorado Revised Statutes,as a vehicle for financing the infrastructure of European Village.

To create the District,Developer and five other organizers submitted a service plan for the District to Greenwood Village which said that the District would provide public infrastructure improvements to all property within the District. The service planalso provided that the District could issue up to $35,500,000 in general obligation bonds bearing an interest rate of as much as 12%, which would be paid over a 30-year period. The District's organizers filed a petition for organization with the district court,and the court set a hearing on the petition. At the hearing,the court entered an order directing that an organizational election be held for the District.

To become eligible electors under the statute,each of the six organizers executed option contracts with Developer's limited partnership that held title to the land to purchase undivided 1/20th interests in a ten-foot by ten-foot parcel in the District.The organizers then held the organizational election in November 2007 and approved the creation of the District. At the same time,the organizers voted to approve the issuance of bonds and to impose ad valorem property taxes to pay the bonds. The districtcourt subsequently entered an order declaring the special district organized. The District issued bonds to finance the development which were to be paid for by property taxes imposed on landowners within the District. Even though none of the improvements wouldbe on Landmark Towers' property,and the Landmark Tower's own infrastructure was being built pursuant to a separate financing arrangement,Developer include the Landmark Towers in the District to provide a sufficient taxbase.

****4** In 2011,after learning of the formation of the District and after the Landmark Buyers were assessed ad valorem taxes,Landmark Towers Association, Inc. (‘Landmark‘) brought an action to recover taxes Landmark Buyers had paid to the District andto enjoin the future levying of taxes pursuant to TABOR. Landmark asserted that TABOR and related statutes had been violated because,in addition to multiple other grievances,taxing the Landmark Buyers violated their constitutional right to due process becausethe improvements funded by the bonds provided no benefit to Landmark Towers' property.

After a bench trial,the trial court sided with Landmark. Relying on *Myles Salt v. Board of Commissioners*,239 U.S. 478 (1916),the trial court held that ad valorem property taxes must confer a special benefit on taxpayers and,in the absence of any special benefit,‘the levy would amount to a confiscation without due process of law.‘ Afterreaching the Colorado Supreme Court on appeal,the case was remanded to the Colorado Court of Appeals to address Landmark's argument that the District violated the Landmark Buyer's due process rights.

On remand,the Colorado Court of Appeals,invoking *Myles Salt*,held that the District violated the Due Process Clause by including Landmark Towers in the District and levying ad valorem property taxes without a special benefit to the LandmarkTowers' property owners. The Colorado Court of Appeals determined that the issue was controlled by this U.S. Supreme Court decision. In *Myles Salt*,two adjoining parishes created a drainage district comprising land in both. To pay for constructioncosts,the district levied an ad valorem tax on all property in the district. Myles Salt sued,claiming that the land in one of the parishes, including its land,wouldn't benefit from the district and that this land had been included in the district solelyto help fund construction benefiting land in the ***39** other parish. The Supreme Court held that the formation of the district to include Myles Salt's land was ‘an act of confiscation‘ violating Myles Salt's right todue process. It reasoned that,although creation of the particular type of district at issue was otherwise authorized by law,the reason for including certain property—to derive revenues for a project solely benefiting other property—was constitutionallyimpermissible.

The U.S. Supreme Court has now been asked to consider: ‘Should the Court remove the cloud over local governments and the national public finance industry by overruling or clarifying *Myles Salt* to confirm that the Due Process Clause doesnot require

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

general ad valorem property taxes imposed by an infrastructure taxing district to provide a special benefit to taxpayers within the district?‘

On October 22,2019,Landmark Towers Association,Inc. filed its briefs in opposition,arguing the following: (1) *Myles Salt* comfortably fits within the Court's longstanding state-tax due process jurisprudence; (2) the Colorado Supreme Courtand Colorado Court of Appeals correctly applied *Myles Salt*; (3) Colorado courts had determined the District to be invalid on non-Supreme Court precedential grounds; and (4) the petition at issue overstated the reach of the lower court decision.

****5** On November 4,2019,UMB Bank filed its reply brief. First,UMB Bank argued it has standing because it is a defendant and defending a claim made against it. With respect to the merits of the claim, UMB Bank argues that the Colorado courts improperly labeledthe imposition a ‘special assessment‘ instead of a ‘tax‘ and,therefore, a ‘clear error review‘ does not apply in determining whether and to what extent property is specially benefitted by an assessment. Instead,UMB Bank argues theCourt may review such a finding de novo and ‘address the legal standard for determining whether an imposition is a ‘tax’ or a ‘special assessment’ under federal law.‘ With respect to *Myles Salt*,UMB Bank argues that extendingthat holding will unravel public finance in Colorado and in many other states that allow special district infrastructure financing. UMB Bank states that an errant extension of *Myles Salt* will allow taxpayersthe right to challenge taxes in cases in which taxes are pledged for repayment of public infrastructure bonds in a planned multi-phased development.

Arizona v. California—Bill of Complaint.

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. 22-0150). 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.

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 manages all 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-operatingLLC 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 in the managementof [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.

****6** Arizona asks the U.S. Supreme Court to:

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

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

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

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 U.S. Solicitor General had not yet filed a brief in the case,as requested by the Court on June 24, 2019.

Petition Denied

On November 4,2019,the Court denied cert in *Staples,Inc. v. Comptroller of Treas.*,Docket No. 19-119,ruling below at 2018 Md. App. LEXIS 785. In the case below,the Maryland Court of Special Appeals held that an out-of-state parent companyand subsidiary company were subject to Maryland corporate income tax because they had sufficient contacts with Maryland and their income was fairly apportioned by the Maryland Comptroller. Because the activities of the parent and subsidiary companies permeatedthe activities of each other,the Maryland Court of Special Appeals determined that the Comptroller properly used the apportionment factors of the affiliates to apportion the subsidiary's franchise fee receipts and the parent's interest income to Maryland.

The Court will review a decision of the Montana Supreme Court, which held that the Montana tax credit program for qualified education contributions violates the Montana Constitution.

The Colorado Court of Appeals held that the District violated the Due Process Clause by including Landmark Towers in the District and levying ad valorem property taxes without a special benefit to the Landmark Towers' property owners.

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.

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

THOMSON REUTERS CHECKPOINT