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U.S. Supreme Court Update

U.S. SUPREME COURT UPDATE

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Court Issues Two New Decisions, Hears Oral Arguments in Cases Involving SALT Matters

***40** On March 19, 2019, the U.S. Supreme Court issued its decision in *Washington State Dep't of Licensing v. Cougar Den, Inc.*, (Docket No. 16-1498), ruling in favor of the Yakama Nation and concluded that the Yakama Nation's right to travel on publichighways under the Yakama Nation Treaty of 1855 (the 'Treaty') was burdened by Washington's fuel tax and, therefore, the fuel tax was preempted by the Treaty. Then, on May 13, 2019, the Court in *Franchise Tax Board of Calif. v.Hyatt* (Docket No. 17-1299) held that the California Franchise Tax Board 'did not waive its sovereign immunity' and that 'States retain their sovereign immunity from private suits brought in the courts of other States, overruling *Nevadav. Hall*, 440 U.S. 410 (1979),' and that 'stare decisis did not warrant upholding [the] Supreme Court's decision in *Nevada v. Hall.*'

In addition to issuing these two decisions, the Court heard oral arguments on April 16, 2019, in *North Carolina Dep't of Rev. v. The Kimberly Rice Kaestner 1992 Family Trust* (Docket No. 18-457), and it denied certiorari in *Baskins v.Okla. Tax Comm'n* (Docket No. 18-807) on May 13, 2019, and *Mitchell v. Tulalip Tribes of Washington* (Docket No. 18-970) on June 10, 2019.

As the time of this writing, there remain six writs of certiorari pending before the Court in cases involving state and local taxes: *Alabama Dep't of Rev. v. CSX Transportation Inc.* (Docket Nos. 18-447 and 18-612); *Bauerlyv. Fielding*, (Docket No. 18-664); *Illinois Central Railroad Co. v. Tenn. Dep't of Rev.* (Docket No. 18-866); *Ashland Specialty Co. Inc. v. Steager* (Docket No. 18-1053); and *Espinoza, et al. v. Montana Dep't of Rev.* (DocketNo. 18-1195).

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.

Court Rules in Favor of Yakama Nation's 'Right to Travel' Without Taxation

****2** On March 19, 2019, the U.S. Supreme Court issued its decision in *Washington State Dep't of Licensing v. Cougar Den, Inc.* (Docket No. 16-1498). Justice Breyer delivered the 5-4 opinion of the Court that consisted of a three-Justice pluralityand two-Justice concurrence in the judgement. The plurality opinion, joined by Justices Sotomayor and Kagan, holds that the Yakama Nation Treaty of 1855, which guarantees the Yakama Nation the right to travel upon public highways, preempts a Washington statetax on motor fuel entering the state by ground transportation.

As summarized by the Court, Article II of the Treaty provides in relevant part that 'if 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 thenearest 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)).

Cougar Den, a Confederated Tribes and Bands of the Yakama Nation corporation, traditionally transported fuel by truck over a 27-mile route from Oregon to the Yakama Indian Reservation without paying Washington's fuel tax, which is imposed on the importationand transportation of fuel. The Washington Department of Licensing (the 'Department'), however, issued tax assessments on the imported fuel ($3.6 million of taxes, penalties, and fees for hauling the fuel across state lines) in 2013. Cougar Den refusedto pay the assessment, arguing that the imposition of the tax violated its right to travel under the Yakama Nation Treaty of 1855. The Washington Supreme Court, in *Washington State Dep't of Licensing v. Cougar Den, Inc.,* 188 Wash. 2d 55 (2017), agreed with Cougar Den, holding that the Yakama Nation 'tribe[] w[as] entitled under [the Yakama Nation] [T]reaty to import fuel without holding [an] importer'slicense and without paying state fuel taxes.' The question before the U.S. Supreme Court was, 'Whether the Yakama Treaty of 1855 creates a right for ***41** tribal members to avoid state taxes on off-reservation commercial activities that make use of publichighways.'

In two separate opinions, a five-Justice majority agreed that the Yakama Nation would have understood the Treaty to provide a right to travel freely on public highways and bring their goods to market. Both the Justice Breyer opinion and the Justice Gorsuch-authoredconcurring opinion, which was joined by Justice Ginsburg, hold that the Washington State fuel tax is pre-empted by the Treaty because the tax is imposed on goods being transported to the Yakama Reservation from an out-of-state market. The Justice Breyer opinionreaches this conclusion by finding the tax is an impermissible burden on the Yakama Nation's Treaty right to travel. The Justice Gorsuch opinion, however, reaches the same conclusion by relying on the uncontested fact that the Yakama Nation would have understoodthe Treaty to allow them a right to travel with their goods to market. In Justice Gorsuch's words, the Treaty was a 'bargain-basement deal' for the Yakamas who gave up a large tract of land 'worthfar more than an abject promise that they would not be made prisoners on their reservation.'

****3** Chief Justice Roberts wrote the principal dissenting opinion, joined by Justices Thomas, Alito, and Kavanaugh, which finds that the Treaty provided the right to 'continue to travel to the places where they traded' and because the tax was on fueland not a highway tax, it was not preempted by the Treaty. Justice Kavanaugh, in a separate dissent joined by Justice Thomas, wrote the tax was not preempted because it was not a highway tax and the Treaty language 'in common with' provides the YakamaNation with only the right to travel on public highways.

Court Finds in Favor of California in Sovereign Immunity Case

On May 13, 2019, the Court issued its decision in *Franchise Tax Board of Calif. V. Hyatt* (Docket No. 17-1299). Justice Thomas delivered the 5-4 opinion of the Court, holding the Constitution does not permit a state to be sued without its consentin the courts of a different state by a private party. The Court's decision overturns a 40-year old precedent established by the Court in *Nevada v. Hall*, 440 U.S. 410 (1979).

The Court's decision finally (we think) brings the end to a long-running saga between Hyatt and the California Franchise Board (the 'FTB'). Mr. Hyatt's dispute with the FTB stems from the agency's attempt to collect approximately $10 million in taxeson patent licensing fees earned by Hyatt in the 1990s. Following its 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 businessopportunities and inflicted emotional distress.

After suing the FTB in Nevada court, the Nevada Supreme Court eventually largely reversed a jury award of tort damages and punitive damages to Hyatt. Citing to *Nevada v. Hall*, 440 U.S. 410 (1979), however, which held that the U.S. Constitutiondoes not grant states sovereign immunity from suit in the courts of other states, the Nevada Supreme Court eventually rejected the FTB's claim of complete immunity. Ultimately, the Court affirmed Nevada's decision in *Franchise Tax Board ofCalif. 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 only, the FTB appealed once again to 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*, 440U.S. 410 (1979), should be overruled. In its second decision, *Franchise Tax Board of Calif. 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 thanit 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 *Nevada v. Hall* should be overruled.

****4** 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 withinthe cap of $50,000. The FTB again ***42** asked 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 theCourt to answer the question it agreed to decide in *Hyatt II:* ‘whether *Nevada v. Hall* should be overruled.‘

Justice Thomas, joined by Chief Justice Roberts and Justices Alito, Gorsuch, and Kavanaugh, authored the majority opinion overturning *Nevada v. Hall* and ruling in favor of the FTB. The opinion, which calls state sovereign immunity ‘a historicallyrooted principle embedded in the text and structure of the Constitution,‘ holds that states do have sovereign immunity in one another's courts and cannot be sued in another state's courts without agreeing to such jurisdiction. Stating that stare decisis‘does not compel continued adherence to [] erroneous precedent,‘ Justice Thomas's opinion stated the Court was overruling *Nevada v. Hall* because it ‘is contrary to our constitutional design and the understandingof sovereign immunity shared by the States that ratified the Constitution.‘

More specifically, the Court explains that ‘[t]he problem with Hyatt's argument is that the Constitution affirmatively altered the relationships between the States, so that they no longer relate to each other solely as foreign sovereigns. Eachstate's equal dignity and sovereignty under the Constitution implies certain constitutional limitation[s] on the sovereignty of all of its sister States. *World-Wide Volkswagen Corp. v. Woodson,* 444 U.S. 286, 293 (1980). One such limitation is the inability of one state to hale another into its courts without the latter's consent. The Constitution does not merely allow states to afford each other immunity as a matter of comity; itembeds interstate sovereign immunity within the constitutional design. Numerous provisions reflect this reality.‘

The Justices then highlighted as examples Article I of the Constitution (divesting the states of the traditional diplomatic and military tools that foreign sovereigns possess) and Article IV of the Constitution (imposing duties on the states not requiredby international law, such as the Full Faith and Credit Clause precedents that demand that state-court judgments be accorded full effect in other states and preclude states from ‘adopting any policy of hostility to the public Acts‘ of other states).

The opinion also makes clear that ‘Interstate Sovereign Immunity is similarly integral to the structure of the Constitution.‘ In this regard, the opinion provides that ‘[l]ike a dispute over borders or water rights, a State's assertionof compulsory judicial process over another State involves a direct conflict between the sovereigns. The Constitution explicitly strips States of any

power they once had to refuse each other sovereign immunity, just as it denies them the power to resolve borderdisputes by political means. Interstate immunity, in other words, is ‘implied as an essential component of federalism.’‘

****5** Warning against potential legal uncertainty going forward and too strong a willingness to overturn precedent, Justice Breyer authored a dissent that was joined by Justices Ginsburg, Kagan, and Sotomayor. Arguing that *Nevada v. Hall* wasnot obviously wrong and that the majority should not have overruled it, Justice Breyer's dissent stated: ‘To overrule a sound decision like *Hall* is to encourage litigants to seek to overrule other cases; it is to make it more difficult forlawyers to refrain from challenging settled law; and it is to cause the public to become increasingly uncertain about which cases the Court will overrule and which cases are here to stay.‘

Arguments Heard in N.C.'s Challenge to Application of the Due Process Clause to Trust Taxation

On April 16, 2019, the Court heard oral arguments in *North Carolina Dep't of Rev. v. The Kimberly Rice Kaestner 1992 Family Trust* (Docket No. 18-457). The question before the Court is whether ‘the Due Process Clause prohibit[s]

states from taxing trusts based on trust beneficiaries' in-state residency.‘

The North Carolina Supreme Court held that the North Carolina Department of Revenue (the ‘Department‘) did not establish the minimum contacts necessary to satisfy the principles of due process required to tax an out-of-state trust.

According to the court below, ruling at 814 S.E.2d 43 (N.C. 2018), The Joseph ***43** Lee Rice, III Family 1992 Trust (the ‘Joseph‘ Trust) was created in New York in 1992 and, pursuant to the trust agreement, was governed by the laws of New York, where Mr. Rice was a resident. Noparty to the Joseph Trust resided in North Carolina until Rice's daughter and primary beneficiary, Kimberly Rice Kaestner, moved to North Carolina in 1997. On December 30, 2002, the Joseph Trust was divided into three share sub-trusts for the benefit of Rice'sthree children, including Kaestner. The Kimberly Rice Kaestner 1992 Trust (the ‘Trust‘) was the separate share trust formed for the benefit of Kaestner and her three children, all of whom reside in North Carolina.

Throughout oral arguments, several Justices expressed concerns regarding North Carolina's position. The representative for North Carolina, the state's Solicitor General Matthew W. Sawchak, put forth an argument that trust beneficiaries are the ‘trueowners of trust income.‘ Led by Justices Sonia Sotomayer and Stephen Breyer, the Court questioned Sawchak's true-ownership argument. After Sawchak conceded the trustee had complete discretion over both the timing of distributions and allocation of distributionsto beneficiaries, Justice Sotomayer asked: ‘What makes it your right under any circumstances to tax all of the trust income where there's no guarantee that she [the primary trust beneficiary] is going to receive all of it at any point?‘

Justice Breyer expressed concern with the fairness of North Carolina's attempt to tax the Trust income as it accumulated, given the beneficiary may never receive a distribution or a distribution may not be made for many years. He asked Sawchak: ‘Do youdiscount the increased value of the trust by the time she has to wait? Because she has nothing that increased in value more than [the income of the Trust] discounted by the probability that she will ever get it and when.‘ The Justices also questionedhow North Carolina's tax based on the location of trust beneficiaries would impact other states' efforts to tax trust income based on in-state administration or residency of a trustee. Sawchak argued that North Carolina's system of credits for taxes paid toanother jurisdiction solved any problems of multi-state taxation.

****6** Justice Elena Kagan appeared to be the most skeptical of the Trust's position. The attorney for the Trust, David O'Neill, argued that the income did not belong to the primary beneficiary because the beneficiary ‘didn't possess it or control it. She didn'taccess it. She couldn't use it.‘ Justice Kagan countered this argument, stating that ‘all the benefit of this trust is going to this person who lives down in North Carolina‘ and ‘[f]or these tax years, North Carolina is providingservices to a person who is the only person who is going to benefit from the income growth of this Trust.‘ We will update readers once there is a decision.

We also note that the Court is being asked to combine this case with another case currently atthe Court on a writ of certiorari, *Bauerly v. Fielding,* (discussed below), which raises similar due process claims.

Pending Petitions

In addition to the previously granted petitions, six petitions remain pending before the Court: *Alabama Dep't of Rev. v. CSX Transportation Inc.* (Docket Nos. 18-447 and 18-612); *Bauerly v. Fielding,* (Docket No. 18-664); *Illinois Central Railroad Co. v. Tenn. Dep't of Rev.* (Docket No. 18-866); *Ashland Specialty Co. Inc. v. Steager* (Docket No. 18-1053); and *Espinoza, et al. v. Montana Dep't of Rev.* (Docket No. 18-1195).

Alabama seeks to end decades old dispute over railroad fuel taxes.

In *Alabama Dep't of Rev. v. CSX Transportation, Inc.,* Docket No. 18-447, ruling below at *CSX Transportation, Inc. v. Alabama Dep't of Rev.,* 888 F.3d 1163 (11th Cir. 2018), ***44** the U.S. Supreme Court is asked to review the Eleventh Circuit's holding that the Alabama sales tax, which applies to diesel fuel purchases by rail carriers but not diesel fuel purchases by motor or water carriers,constitutes a tax that impermissibly discriminates against rail carriers under §11501(b)(4) of the Railroad Revitalization and Regulatory Reform Act of 1976 (the '4-R Act').

Alabama is asking the U.S. Supreme Court to consider the following question in what could be the third round of the state's dispute with CSX: 'Under 49 U.S.C. §11501(b)(4),when can a State justifiably maintain a sales-and-use tax exemption for fuel used by vessels to transport goods interstate without extending the same exemption to rail carriers?'

On May 21, 2019, the Court received an amicus curiae brief from the United States arguing that the Court should deny Alabama's writ of certiorari. The Solicitor General of the United States argues that the Eleventh Circuit U.S. Court of Appeals correctlydetermined that the Alabama tax impermissibly discriminates against rail carriers.

CSX files a conditional cross-petition.

On November 9, 2018, CSX filed a conditional cross-petition for certiorari with the Court (Docket No. 18-612) should the Court grant Alabama's petition, discussed above. CSX asks the Court to review the motor carrier portion of the Eleventh Circuit's holding.The question presented is as follows: 'Whether, as the Eleventh Circuit held, Alabama's imposition of a motor fuels tax used by the interstate motor carriers sufficiently justifies Alabama's imposition of a facially discriminatory sales and use tax onrailroad diesel fuel, notwithstanding decisions of the Court and at least one state supreme court.'

Challenge to Minnesota's resident trust provision.

****7** In *Bauerly v. Fielding*, Docket No. 18-664, ruling below at 916 N.W.2d 323 (Minn. 2018), the U.S. Supreme Court has been asked to review a Minnesota Supreme Court decision that held Minnesota's resident trust classification violated both the federal and Minnesota Due Process Clauses, as applied tofour Minnesota trusts, because (1) the state lacks sufficient contacts with the trusts, and (2) there is no rational relationship between the income the state seeks to tax and the protections and benefits conferred by the state.

Minnesota is asking the U.S. Supreme Court to consider the following question: 'Does the Due Process Clause prohibit states from imposing incomes taxes on statutory 'resident trusts' that have significant additional contacts with the state, butare administered by an out-of-state trustee?' Minnesota has asked the Court to combine the case with the previously granted and now argued *Kimberly Rice Kaestner 1992 Family Trust* case.

Railroad carriers challenge to Tennessee sales and use tax on diesel purchases

On January 2, 2019, the U.S. Supreme Court received a petition in *Illinois Central Railroad Co. v. Tenn. Dep't of Rev.,* Docket No. 18-866, ruling below at 748 Fed. Appx. 26 (6th Cir. 2018). The Court has been asked to review a decision by the Sixth Circuit holding that Tennessee did not violate the U.S. Constitution by imposing a sales tax on the fuel purchases of railroad carriers while exemptingthe fuel purchases of motor carriers.

Illinois Central asks the Supreme Court to consider 'whether Tennessee's tax on railroad fuel discriminates against railroads under 49 U.S.C. §11501(b)(4)?'The cited statute prohibits states from imposing a tax 'that discriminates against a rail carrier.'

Wholesaler challenges penalty imposed for selling delisted cigarettes in W.V.

On February 6, 2019, the U.S. Supreme Court received a petition for certiorari in *Ashland Specialty Co., Inc. v. Steager*, Docket No. 18-1053, ruling below at 818 S.E.2d 827 (W.V. 2018). The Court has been asked to review a West Virginia Supreme Court of Appeals decision concluding that a penalty imposed on a taxpayer for selling brands of cigarettes that were not on the West Virginia Tax Commissioner'slist of cigarettes that could be lawfully sold in West Virginia was not an abuse of discretion, should not be canceled or reduced, and does not violate the Excessive Fines Clause of the West Virginia Constitution or the Eighth Amendment of the U.S. Constitution.

The taxpayer, Ashland Specialty Co., has asked the Court to consider the ***45** following questions: (1) 'Was the penalty grossly disproportionate to the offense and unconstitutional under the Eighth Amendment's Excessive Fines Clause and *United Statesv. Bajakajian*?'; and (2) 'In the light of the myriad criteria currently employed by state and federal courts to evaluate gross disproportionality, should the Court resolve the multiple splits and affirmatively adopt factors, like those in *CooperIndustries v. Leatherman*, to decide whether a civil monetary penalty is grossly disproportionate to the underlying offense?'

****8** Over two decades ago, in *U.S. v. Bajakajian*, 524 U.S. 321 (1998), the Court articulated a standard for evaluating whether a fine was excessive and in violation of the Eighth Amendment, holding a punishment unconstitutional if it is 'grossly disproportionate' to the underlyingoffense. The state court in this matter applied factors found in a previous West Virginia Supreme Court of Appeals decision—*Dean v. State*—to determine whether a punishment is 'grossly disproportionate.' Ashland Specialty Co.is asking the U.S. Supreme Court, however, to apply factors set forth in *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.*, 52 U.S. 424 (2001).

Challenge to Mont. tax credit program's limit on aid to religious schools.

On March 12, 2019, the U.S. Supreme Court received a petition for certiorari in *Espinoza, et al. v. Montana Dep't of Rev.*, Docket No. 10-1195, ruling below at 393 Mont. 446 (2018). The Court has been asked to 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.This section, entitled 'Aid prohibited to sectarian schools,' 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 dollar-for-dollar credits against taxes owed to the state, the Legislature is the entity providing aid tosectarian schools in direct violation of the Montana Constitution. Mothers of children who benefited from the scholarship program and attended religious private schools ask the Court: 'Does it violate the Religion Clauses or Equal Protection Clause ofthe United States Constitution to invalidate a generally available and religiously neutral student-aid program simply because the program affords students the choice of attending religious schools?'

Petitions Denied

Two previously reported petitions have been denied by the Court.

In *Baskins v. Okla. Tax Comm'n* (Docket No. 18-807), ruling below at OK Ct. App., Case No. 115,947 (May 9, 2018), the Court declined to review an Oklahoma Court of Appeals decision affirming an Oklahoma Tax Commission decision that held the‘Oklahoma Headquarters‘ requirement of Okla. Stat. tit. 68, §2358(F) does not violate the dormant Commerce Clause of the U.S. Constitution.

In *Mitchell v. Tulalip Tribes of Wash.*, Docket No. 18-970, memorandum below at 740 Fed. Appx. 600 (9th Cir. 2018), the Court was asked to review a Ninth Circuit decision that affirmed the dismissal of Petitioners' complaint under the doctrine of tribal sovereign immunity. The Petitioners, who reside within the boundariesof the Tulalip Indian Reservation in Snohomish County, Washington, challenged a 1% tax imposed on the transfer of real property within the boundaries of the Indian Reservation, asserting that the tax created a cloud upon their title which rendered the titleunmarketable. The question the Court declined to consider was: ‘Does sovereign immunity bar the federal courts' consideration of a declaratory judgment action to determine whether Respondent Tribes can exercise regulatory/taxing authority over real propertyowned in fee by Petitioners non-Indians, pursuant to allotments that were authorized by the Tribes' treaty with the United States?‘

****9** The plurality opinion holds that the Yakama Nation Treaty of 1855 . . . preempts a Washington state tax on motor fuel entering the state by ground transportation.

Justice Thomas delivered the 5-4 opinion of the Court [in *Hyatt*], holding the Constitution does not permit a state to be sued without its consent in the courts of a different state by a private party.

Throughout oral arguments, several Justices expressed concerns regarding North Carolina's position [in the *Kimberly Rice Kaestner 1992 Family Trust* case].

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