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U.S. Supreme Court Update

U.S. SUPREME COURT UPDATE

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Eight-Member U.S. Supreme Court Continues to Review State and Local Tax Issues

***43** At the time of writing, the biggest news out of the U.S. Supreme Court remained the fate of Tenth Circuit Judge Neil Gorsuch's nomination to the High Court, as the White House and Senate Republicans continued their ‘charm offensive‘ in an attemptto avoid a potential filibuster over President Trump's nominee. But just as the eight-member Court has done since the passing of Justice Antonin Scalia in February 2016, the Court continues to work through its docket, including those cases involving stateand local taxes.

In this issue of the JOURNAL, we outline Michigan's Brief in Opposition to the six related petitions for certiorari that the Court has received challenging Michigan's retroactive repeal of its statute enacting the Multistate Tax Compact andits three-factor apportionment formula. We note that the Court has scheduled a 4/13/17 conference date to review these six petitions and the petition in *Dot Foods, Inc. v. Washington Dep't of Revenue* (Docket No. 16-308)—another case involvingthe retroactive application of state tax laws.

We also detail a new petition in *616 Croft Avenue LLC v. City of West Hollywood* (Docket No. 16-1137), which was filed by a group of property developers challenging the constitutionality of West Hollywood's building permit fees. And on 2/1/17,the parties involved in *Arkansas v. Delaware*, a case in which the Court has agreed to review a dispute between Delaware and several other states as to which states have priority rights for claiming MoneyGram's uncashed ‘official checks,‘filed an initial letter in response to the Court's request for the parties to file a stipulation of facts.

Michigan Claims Court Lacks Jurisdiction to Consider Compact Retroactivity Case

On 3/13/17, the state of Michigan filed its Brief in Opposition to the six related petitions for certiorari that the Court has received challenging Michigan's retroactive repeal of its statute enacting the Multistate Tax Compact and its three-factor apportionmentformula. The previously reported 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 CommercialOperations 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'tof Treasury* (Docket No. 16-687); and *DirectTV Group Holdings LLC v. Michigan Dep't of Treasury* (Docket No. 16-736).

****2** Each of the six petitions stem from a September 2015 Michigan Court of Appeal's decision (*Gillette Commercial Operations N. Am. & Subs. v. Michigan Dep't of Treasury*, 878 N.W.2d891 (Mich. Ct. App. 2015), *cert. pending*, No. 16-697), in which the lower court reviewed the Michigan Legislature's response to the Michigan Supreme Court's previous decision in *International Business Machines 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 Compact's three-factor apportionment formula by enacting its own single-sales factor apportionmentscheme 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 law retroactive effect, beginning January 1, 2008.

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. Many of thosesame taxpayers now challenge the lower court's ruling and ask the U.S. Supreme Court to review the Michigan courts' acceptance of the state's retroactive law change.

In Michigan's Brief in Opposition, the state argues that its original 2011 law change, which enacted the state's single-sales factor apportionment scheme, did not constitute retroactive legislation. Instead, Michigan alleges that the law change was merelya 'legislative correction' that must be viewed jointly with the state's 2008 departure from the Multistate Tax Compact. Together, Michigan's brief argues, these changes 'eliminated the Compact's three-factor apportionment option ***44** *in* 2008(and also clarified in 2011 that it had already been eliminated).'

'Under Michigan law,' the state's brief then argues, 'a legislative clarification is considered to express the original legislative intent and therefore is controlling.' Accordingly, Michigan claims that 'no retroactivity occurred becausein 2008 [the state] eliminated the Compact's apportionment method, and that change occurred before all of the tax years in question here. ' This, Michigan concludes, provides 'an independent and adequate state law ground for the decision below.'And under the 'independent and adequate state ground doctrine,' the U.S. Supreme Court therefore 'lacks jurisdiction over questions premised on the theory that [Michigan's Legislature] made a retroactive change to Michigan law (as opposedto clarifying what it originally meant).' (In a 3/24/17 reply brief, IBM alleges that Michigan's brief attempts to create a new doctrine of 'legislative clarification,' and that this 'so-calleddoctrine . . . does not exist.')

****3** If, however, it is determined that the Court has jurisdiction to consider the retroactivity issue, Michigan also claims in its brief that the state's lower court 'correctly applied [the] Court's precedent in determining that [Michigan's2014 amendment] furthered legitimate legislative purposes by a rational means,' and that the 2014 law change was therefore 'valid under the Due Process Clause.' The Court has now set a 4/13/17 conference date to review the six related petitionsfor certiorari, along with Michigan's Brief in Opposition.

Court Receives New Petition Challenging West Hollywood Building Permit Fees

On 3/15/17, the Court received a new petition for certiorari in *616 Croft Avenue LLC v. City of West Hollywood*, Docket No. 16-1137, ruling below at 3 Cal. App. 5th 621 (Cal. Ct. App. 2016). In the petition, a group of California property developersask the U.S. Supreme Court to consider whether a West Hollywood ordinance that requires builders to either sell/rent a portion

of their newly developed housing units at below-market rates or, alternatively, to pay an ‘in lieu‘ fee that is used tofund the construction of other low-income housing violates the Takings Clause of the Fifth Amendment of the U.S. Constitution.

As explained by the California appellate court in the case below, the ‘in lieu‘ fee is part of a West Hollywood city ordinance (the ‘Ordinance‘) (West Hollywood Municipal Code section 19.22.010 *et seq.*), which was enacted to‘increase the availability of affordable housing in West Hollywood.‘ The Ordinance provides developers with a choice to either (i) build a specified number of low-income housing units or (ii) pay a fee ‘designed to fund construction of the equivalentnumber of units the developer would have otherwise been required to set aside.‘

In the case below, the Croft 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 paymenthad nearly doubled from what the city had proposed at the time of their original application. The Croft developers eventually paid the fees ‘under protest,‘ and later sued the city, alleging, in part, that the fees were both facially unconstitutionaland also unconstitutional as 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*, 512U.S. 374 (1994) and *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987).

In the case below, the lower court held that because the Croft developers brought their facial constitutional challenges ‘more than 90 days after the City enacted the Ordinance,‘ the developers' facial challenge was untimely under California GovernmentCode § 65009(c)(1)(B)-(C), which requires that facial challenges to a zoning ordinance be brought within 90 days of the enactment of the law in question.

****4** With regard to the Croft developers' as-applied challenge, the lower court held that ‘the validity of the in-lieu fee—which is an alternative to the on-site affordable housing requirement‘ was not subject to the heightened scrutiny requiredunder the U.S. Supreme Court's *Nollan* and *Dolan* line of cases. Instead, the court found that the fee was a ‘permissible regulation of the use of land,‘ which was meant to ‘enhance the public welfare by promoting the useof available land for the development of housing that would be available to low- and moderate-income households.‘ ***46** Accordingly, because the fee was akin to a broad, nondiscriminatory land use regulation, the court noted that, ‘[a]s a general matter, so long as a land use regulation does not constitute a physical taking or deprive a property owner of allviable economic use of the property, such a restriction does not violate the takings clause insofar as it governs a property owner's future use of his property.‘ Based on this analysis, the court held that the in-lieu fee did not constitute an unconstitutionaltaking and therefore denied the Croft developers' request to compel the city to refund the fees.

In their petition for certiorari, the developers argue that the Ordinance ‘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*].‘

Petitions Still Pending

The following petitions remained pending as the JOURNAL went to press.

Court asked whether WA's retroactive application of amendments to the state's B&O Tax comports 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 Business and Occupation (‘B&O‘) Tax comported withthe 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 now petitions the U.S. Supreme Court for review, arguing that the 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‘—andasking the 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.‘

The Court was originally scheduled to consider Dot Foods' petition during its 1/19/17 conference, but on 1/10/17, the Court rescheduled its conference date to coincide with the Court's review of the Michigan petitions discussed above. This scheduling changehas led some practitioners (including the authors of this column) to speculate that the Justices have linked the *Dot Foods* petition with the Michigan Multistate Tax Compact retroactivity cases in order to potentially consider the retroactive taxissue jointly. The *Dot Foods* petition is now also scheduled for conference on 4/13/17.

****5 Parties file letter in response to Court's request for stipulation of facts in pending ‘MoneyGram‘ unclaimed property case.** As reported in last month's column, on 12/6/2016, the Supreme Court invited the interested parties to file astipulation of facts in *Arkansas v. Delaware*, a case in which the Court has agreed to review a dispute between Delaware and several other states as to which states have priority rights for claiming MoneyGram's uncashed ‘official checks.‘On 2/1/17, the parties filed a letter in response to the Court's request, which we plan to cover as soon as additional details become available.

In this case, the Court originally received two separate filings—*Delaware v. Pennsylvania and Wisconsin* (motion for leave to file a bill of complaint filed 5/26/16) and *Arkansas et. al. v. Delaware* (motion for leave to filea bill of complaint filed 6/9/16). The Court, however, consolidated the two filings as *Arkansas v. Delaware* and agreed to let multiple states file a complaint asking the Court to address the proper priority rules applicable to MoneyGram's checks.

On 3/29/17, the Court also appointed the Honorable Pierre N. Leval, of the U.S. Court of Appeals for the Second Circuit, as Special Master in this case with authority to fix the time and conditions for the filing of additional pleadings, to direct subsequentproceedings, to summon witnesses, to issue subpoenas, and to take such evidence as may be introduced and such as he may deem it necessary to call for. (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).)

Michigan argues that its original 2011 law change, which enacted the state's single-sales factor apportionment scheme, did not constitute retroactive legislation.

A group of California property developers ask the Court whether a West Hollywood ordinance [requiring them to pay a fee] that is used to fund the construction of low-income housing violates the Takings Clause of the Fifth Amendment of the U.S.Constitution.

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