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U.S. Supreme Court Update

U.S. SUPREME COURT UPDATE

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U.S. Supreme Court Nominee Neil Gorsuch No Stranger to State and Local Tax Issues

***40** In this issue of the JOURNAL, we note that seven previously reported petitions remain pending before the Court, including the six related petitions challenging Michigan's retroactive repeal of the Multistate Tax Compact. We also note thatthe Court has denied two previously reported petitions for certiorari and one recently filed petition in which the Court had been asked to review the legitimacy of a Maryland court's ‘unreported‘ opinion in a case involving the deductibility of foreignpension income under Maryland's personal income tax laws.

But before summarizing the Court's current docket, we pause to note that on 2/1/17, President Donald Trump formally nominated Tenth Circuit Judge Neil Gorsuch to the U.S. Supreme Court, to fill the seat left vacant after the death of the late Justice AntoninScalia. If confirmed by the Senate, Judge Gorsuch would bring with him a recent sampling of state and local tax opinions. Most notably, Judge Gorsuch authored a separate concurrence in the Tenth Circuit's 2016 ruling in *Direct Marketing Ass'n v. Brohl*,in which the circuit court held that Colorado's notice and reporting requirements imposed on out-of-state retailers do not violate the dormant Commerce Clause because the laws do not discriminate against or unduly burden interstate commerce.

In his concurrence, in which he agreed that Colorado's laws did not violate the U.S. Constitution, Judge Gorsuch wrote separately in order to note the ‘exceptional narrowness‘ of the Supreme Court's holding in *Quill v. North Dakota.* Asregular readers of this column are well aware, in *Quill*, the Court held that under the U.S. Constitution's Commerce Clause, an out-of-state business must have a physical presence in a state before that state can require the business to collectand remit sales and use taxes. But according to Judge Gorsuch's concurrence, *Quill* should not and does not stand for the proposition that states are barred from ever imposing any tax-related burdens on out-of-state businesses.

Instead, Judge Gorsuch noted in his opinion that the Court's *Quill* decision was merely a byproduct of judicial deference, respecting the precedents set in the Supreme Court's earlier decision in *National Bellas Hess, Inc. v. Departmentof Revenue of Illinois*—a case that Judge Gorsuch labels an ‘analytical oddity.‘ In *National Bellas Hess*, the Supreme Court held that states could not impose use tax collection duties on out-of-state firms.

****2** Although Judge Gorsuch acknowledged the importance of judicial precedent, he also noted some precedents may be more valuable than others. In his opinion, Judge Gorsuch opined that ‘while some precedential islands manage to survive indefinitely even whensurrounded by a sea of contrary law . . ., a good many others disappear when reliance interests never form around

them or erode over time.‘ And, according to Judge Gorsuch, ‘*Quill's* very reasoning—its *ratio decidendi*—seemsdeliberately designed to ensure that *Bellas Hess*'s precedential island would never expand but would, if anything, wash away with the tides of time.‘

How Judge Gorsuch's writings and experience could impact the continued viability of the *Quill* doctrine in future Supreme Court cases remains to be seen. But when you combine his writings with the fact that Judge Gorsuch also formally clerkedfor Justice Anthony Kennedy—who, in 2015, issued a separate concurrence asking whether it may be time for the High Court to revisit the *Quill* precedent—it seems likely that Judge Gorsuch could play a significant role in any futuredecisions involving states' abilities and rights to collect tax from out-of-state retailers.

(For more background on the Tenth Circuit's *Direct Marketing Ass'n* ruling, in which Judge Gorsuch concurred, see U.S. Supreme Court Update, 26 JMT 42 (November/December2016).)

Court Invites Parties to File Stipulation of Facts in Pending Unclaimed Property Case

As reported in last month's column, on 12/6/16, the Supreme Court invited the interested parties to file a stipulation of facts in *Arkansas v. Delaware*, a case in which the Court has agreed to review a dispute between Delaware and several otherstates as to which states have priority rights for claiming MoneyGram's uncashed ‘official checks.‘

The Court originally received two separate filings in this case—*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, has now consolidated the two filings as *Arkansas v. Delaware* and has agreed to let multiple states file a complaint asking the Court to address the proper priority rules applicable to MoneyGram'schecks. We look forward to covering this dispute in more detail in a future issue of the Journal.

(For more background on this case, including a detailed discussion of ***41** MoneyGram's ‘official checks‘ and the general priority rules for unclaimed intangible personal property, see U.S. Supreme Court Update, 26JMT 42 (September 2016).)

Petitions Still Pending

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

Court extends time to respond to petitions challenging MI's retroactive repeal of Multistate Tax Compact. On 2/1/17, the Supreme Court issued an order extending the time for Michigan to respond to the six related petitions for certiorari thatthe Court has received challenging Michigan's retroactive repeal of its statute enacting the Multistate Tax Compact and its three-factor apportionment formula. Michigan now has until 3/13/17 to file a response to the previously reported petitions, which 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 Commercial Operations N. Am. v. Michigan Dep't ofTreasury* (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't of Treasury* (DocketNo. 16-687); and *DirectTV Group Holdings LLC v. Michigan Dep't of Treasury* (Docket No. 16-736), all of which raise nearly identical issues.

****3** The six Michigan petitions currently pending before the Court stem from a September 2015 Michigan Court of Appeal's decision (*Gillette Commercial Operations N. Am. & Subs. v. Michigan Dep'tof Treasury*, 878 N.W.2d 891 (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 MachinesCorp. (‘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. 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 repealedthe Compact's apportionment provisions and largely negated the court's ruling by 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.

Specifically, the taxpayers ask the Court to consider (1) whether the Compact has the status of a contract that binds its signatory states and (2) whether a state law that imposes a retroactive tax liability for a period of almost seven years violates theDue Process Clause of the U.S. Constitution.

Court asked whether WA's retroactive application of amendments to the 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.3d747 (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 with the 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.

****4** 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, leading some practitioners (including the authors of this column) to speculate that the Justiceshave linked the *Dot Foods* petition with the Michigan Multistate Tax Compact retroactivity cases (discussed above) in order to potentially consider the retroactive tax issue jointly.

Petitions Denied

The Court denied the following three petitions on 2/21/17.

The Court denied the petition for certiorari in *American Business USA Corp. v. Florida Dep't of Revenue*, Docket No. 16-567, ruling below as *Florida Dep't of Revenue v. American Business USA Corp*, 191 So. 3d 906 (Fla. 2016). Inthe case below, the Florida Supreme Court reversed a Florida Court of Appeals decision, in which the lower court held that Florida's tax on flower sales by in-state florists that are delivered to out-of-state customers violated the dormant Commerce Clauseof the U.S. Constitution. American Business USA had challenged the Florida Supreme Court's reversal and asked the U.S. Supreme Court to consider whether ‘a State [can] collect sales tax on out-of-state property ordered over the internet for out-of-statedelivery, by relying on this Court's decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) and the State's connection to the corporation that accepts the order and arranges the sale, or doessuch a tax violate both the Due Process Clause and dormant Commerce Clause of the United States Constitution by imposing a sales tax on the out-of-state transfer of tangible personal property?‘ (For

more background on this case, including a detailed discussionof the lower court's ruling, see U.S. Supreme Court Update, 26 JMT 38 (February 2017).)

The Court also denied the petition in *First Marblehead Corp. v. Massachusetts (First Marblehead Corp. II)*, Docket No. 16-777, ruling below at ***42** 475 Mass. 159 (2016), in which the Supreme Judicial Court of Massachusettsheld that Massachusetts's apportionment rules, which allow the Commonwealth, in cases involving taxpayers possessing interests in loans, to assign the taxpayer's property (i.e. loans) to the location of its commercial domicile did not violate the dormantCommerce Clause's internal consistency test. This challenge represented First Marblehead's second petition to the U.S. Supreme Court. On 10/13/15, the Court had granted the company's original petition and vacated and remanded the lower court's ruling for furtherconsideration in light of the U.S. Supreme Court's decision in *Comptroller of Treasury of Maryland v. Wynne*, 135 S. Ct. 1787, 191 L. Ed. 2d 813 (2015). In *Wynne*, the Court invalidated portionsof Maryland's personal income tax scheme as violating the dormant Commerce Clause under the ‘internal consistency test.‘

****5** On remand, the Massachusetts Supreme Judicial Court considered further whether the Commonwealth's apportionment formula, as applied to First Marblehead, failed the internal consistency test. But, even after specifically considering the Supreme Court's *Wynne* decision,the lower court still found that the Massachusetts tax scheme satisfied the requirements of the dormant Commerce Clause. First Marblehead had asked the Supreme Court to review Massachusetts's dormant Commerce Clause analysis and asked in its unsuccessful petitionfor certiorari (1) ‘Whether an apportionment factor reflects a reasonable sense of how income is generated when it disregards the activities and entities that actually generate the income and instead arbitrarily assigns the income to the commercial domicileof an owner of the income-producing entities,‘ and (2) ‘Whether the court below properly followed this Court's precedents when it based its conclusion that an apportionmentformula was internally consistent on an assumption that other states would apply an apportionment formula different from the formula in the statute it upheld. ‘ (For more background on this case, see U.S. Supreme Court Update, 27JMT 45 (March/April 2017). For a detailed discussion of the Massachusetts court's previous ruling, see U.S. Supreme Court Update, 25 JMT 38 (September 2015).)

Finally, the Court denied a petition that was just filed on 12/28/2016, *Friedman v. Comptroller of the Treasury*, Docket No. 16-844, ruling below at 2016 WL 3002464 (Md. Ct. Spec. App. May 25, 2016). In the petition, two Maryland taxpayers (ahusband and wife) had asked the U.S. Supreme Court to consider whether state court rules that prohibit the citation of ‘unreported‘ or ‘unpublished‘ opinions as either precedent or persuasive authority violate the Equal Protection and DueProcess mandates of the U.S. Constitution.

In the case below, Wilbur and Victoria Friedman (the ‘Friedmans‘) attempted to subtract Mrs. Friedman's foreign pension income (i.e. Chilean pension income) from their 2008 joint Maryland taxable income. They argued that they relied on the instructionscontained in the Comptroller's income tax instruction book. After comparing the Friedmans' state tax return with their federal filings (via an audit matching program), however, the Comptroller of Maryland determined that the Friedmans had improperly deductedthe foreign pension income and assessed additional tax, interest, and penalties against the taxpayers. (As a result of claiming the pension deduction, the taxpayers claimed an overpayment on their Maryland income tax return and requested the Comptroller toapply the overpayment to the subsequent tax year).

The Friedmans challenged the Maryland assessment in the Maryland Tax Court, but the court upheld the imposition of additional tax and interest primarily because the tax statute authorizing the subtraction of pension income expressly excluded foreign pensionsfrom eligibility. The Tax Court also found that the Comptroller's use of an audit ‘matching program‘ to analyze different sources of data to find discrepancies did not ‘violate equal protection in enforcement.‘ The Tax Court received testimony that the programdid not alter how the Comptroller had been interpreting the statute governing the pension subtraction, nor did the program target any type of pension, pensions from a particular source, or pensions received by any particular class of taxpayers.

****6** Ultimately, the Maryland Tax Court concluded that the Comptroller ‘couldn't possibly physically . . . audit [all] 400,000 returns dealing with the pension exclusion. So to suggest that there [was] aberrational enforcement by the Comptroller[was]

just not [borne] out by the facts of this case.‘ The Friedmans appealed the decision to the Maryland Court of Special Appeals, which, in an unreported decision, upheld the assessment.

Specifically, the Maryland Court of Special Appeals held that (1) the Tax Court had correctly ruled that the Comptroller may assess interest on unpaid liabilities, even when taxpayers have applied an overpayment to a subsequent tax year; (2) the Comptrollerhad not denied the taxpayers equal protection by auditing some, but not all, tax returns claiming a foreign pension subtraction (in this regard, the Court of Special Appeals determined that the Comptroller demonstrated ‘that there was a rational basis,based on administrative considerations, for the Comptroller's assessment of [the] tax delinquency against the Friedmans for the 2008 tax year . . .‘ via the matching program), and (3) the Tax Court had properly quashed the Friedmans' discoveryrequest for information related to their ‘aberrational enforcement‘ argument.

The Friedmans did not challenge any of the lower courts' substantive rulings in their petition for certiorari. Instead, the Friedmans questioned whether Maryland Rule 1-104, which prohibits the citation of unreported opinions as either precedent or persuasiveauthority, violates taxpayers' equal protection and due process rights. According to the Friedmans, the rule allows lower courts to ‘use[] the device of an ‘unreported’ opinion to avoid effectively and definitively resolving . . . issue[s]

of first impression and to deviate from precedent.‘ Moreover, the ‘net effect of the ‘unreported opinion,’‘ according to the Friedmans, is ‘to reduce the possibility of review by [higher courts] because the decision cannot affectthe result of any future cases.‘ And, because the Friedmans claimed that ‘uncitable ‘unreported’ or ‘unpublished’ opinions . . . treat litigants unequally without a rationalbasis for the distinction,‘ the taxpayers had asked the U.S. Supreme Court to consider whether ‘a State court rule prohibiting citation of ‘unreported’ or ‘unpublished’ appellate court opinions as either precedent or persuasive authorityviolate[s] the Equal Protection and Due Process mandates of the Constitution of the United States.‘

Judge Gorsuch wrote separately [in *DMA v Brohl*] in order to note the ‘exceptional narrowness‘ of the Supreme Court's holding in *Quill v. North Dakota.*

The Supreme Court invited the interested parties to file a stipulation of facts in *Arkansas v. Delaware.*

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