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U.S. Supreme Court Update

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.

One New Petition Asks the Court to Grant Cert in SALT Matters

***31** On August 21, 2019, the U.S. Supreme Court received a new petition for certiorari in a case involving state and local taxes —*UMB Bank, N.A. v. Landmark Towers Ass'n, Inc.* (Docket No. 19-241). The Court has been asked to review a Colorado Court of Appeals decision that an infrastructure taxing district's levy of an ad valorem property tax to fund improvements violates the Due Process Clause when imposed on property that does not specifically benefit from the funded improvements.

Additionally, Arizona filed a Bill of Complaint against California earlier this year (on February 28, 2019), regarding California's enforcement of its ‘doing business‘ standard. The matter has been generally quiet since that time (and subsequently not covered here); however, because the Solicitor General was invited to file a brief expressing the views of the United States, we will provide a brief overview of the allegation included in the Bill of Complaint and begin tracking the matter for our readers. *State of Arizona v. State of California* has been assigned Original Action Number 220150.

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. In addition, a writ of certiorari remains pending in *Staples, Inc. v. Comptroller of the Treas.* (Docket No. 19-119). Finally, as the Court began its new term on Oct. 7, 2019, it denied petitions for writ of certiorari in the following cases involving state and local taxes: (1) *Kansler v. Miss. Dep't of Rev.* (Docket No. 18-1485); (2) *McClain v. Sav-On Drugs* (Docket No. 18-1512); (3) *Chamberlain v. N.Y.S. Dep't of Tax. and Fin.* (Docket No. 18-1569); (4) *Edelman v. N.Y.S. Dep't of Tax. and Fin.* (Docket No. 18-1570); and (5) *Saban v. Ariz. Dep't of Rev.* (Docket No. 19-136).

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 *Delaware v. 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, as Special 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.

Colorado Developer Seeks to Uphold Ad Valorem Property Tax In Special District

****2** On August 21, 2019, the U.S. Supreme Court received a new petition for certiorari in *UMB Bank, N.A. v. Landmark Towers Ass'n, 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 creation of a special taxing district and the levying of taxes against the property within such district violated the property owners' due process rights. Specifically, the court found that the special taxing district's organizers included certain property in the district only to use it as a source of payment for improvements to other property and the landowners at issue in the district received no benefit from those improvements.

Creation of the special district.

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') started to 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 Landmark Buyers 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.

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 general obligation bonds that he 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 Metropolitan District (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 that said that the District would ***32** provide public infrastructure improvements to all property within the District. The service plan also 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 Colo. Rev. Stat. §32-1-103(5)(a), 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 10-foot by 10-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 district court subsequently entered an order declaring the special district organized.

****3** The District issued bonds to finance the development that were to be paid for by property taxes imposed on landowners within the District. Even though none of the improvements would be on Landmark Towers' property and the Landmark Towers' own infrastructure was being built pursuant to a separate financing arrangement.

Condominium owners bring an action against Developer.

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'), a homewners' association, brought an action to recover taxes Landmark Buyers had paid to the District and to 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 because the improvements funded by the bonds provided no benefit to Landmark Towers' property.

After a bench trial, the trial court sided with Landmark. Relying on a U.S. Supreme Court decision, *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.' After reaching 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 Buyers' due process rights.

On remand, 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. The Colorado Court of Appeals determined that the Supreme Court's *Myles Salt* decision was controlling. As explained by the Court of Appeals, in *Myles Salt*, two adjoining parishes created a drainage district comprising land in both. To pay for construction costs, 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 solely to help fund construction benefiting land in the other parish.

As noted by the Court of Appeals: '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 to due 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 constitutionally impermissible.'

Based on this decision, the Court of Appeals observed that '[l]ikewise in this case the District's organizers included the Landmark Project in the District only to use it as a source of payment for improvements to other property—specifically, the European Village Project.' And, given that 'the facts of this case can't be ***33** distinguished from those in *Myles Salt* in any principled way' the Court of Appeals concluded that 'the formation of the District to include the Landmark Project, and the resulting levying of the Landmark owners' properties, violated the Landmark owners' rights to due process.'

****4** (The Court of Appeals also found that 'even aside from *Myles Salt*, Colorado law makes clear that imposing a special assessment on property that doesn't specially benefit from the funded improvements violates those property owners' rights to due process,' and here, the levy at issue in this case is 'a special assessment, not a tax. And so the district court didn't err in ruling on this basis, too, that the levy violates the Landmark owners' rights to due process.')

Question presented.

'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 does not require general *ad valorem* property taxes imposed by an infrastructure taxing district to provide a special benefit to taxpayers within the district?'

Arizona v. California—Bill of Complaint Alleging Extraterritorial Assessment and Collection of Taxes

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. 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 $800 minimum (for corporations). See Cal. Rev. & Tax. Code §§17941(a) and 23153(d)(1). 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 investments in California companies.

Member-managed LLCs and manager-managed LLCs.

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 of the business and affairs of the company. In such an LLC, the members do not play any role in management and operation. Instead, they are simply passive investors. As explained in the Complaint, 'LLCs and corporations are deemed to be 'doing business' in California if they are 'actively engaging in any transaction for the purpose of financial or pecuniary gain or profit.' Cal. Rev. & Tax Code §23101(a).' Furthermore, the Complaint provides that under California law 'a taxpayer is doing business in this state if the taxpayer satisfies 'any' of the four conditions, including (1) being domiciled in California, or exceeding any specified amounts in California, for any of (2) gross 'sales,' (3) ownership of 'real property andtangible presonal property,' or (4) paying 'compensation.''

The Complaint sets forth the California Tax Board's interpretation of 'doing business.' Specifically, according to the Complaint, the California Tax Board addressed the application of the 'doing business' tax to LLCs that elect to be classified as a partnership for tax purposes and their members in Legal Ruling 2014-01. Under this ruling, the Tax Board deems each member of a California-Operating LLC to be doing business in California itself, regardless of whether the California-Operating LLC 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 management of [the] LLC or appoint a manager[.]'

****5** 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 entities have no other connection to California.

Enforcement of assessments.

According to the Complaint, if the tax assessments are not paid voluntarily by out-of-state businesses then the Tax Board assesses a penalty and then seeks collection through special seizure authority. Specifically, the Complaint points out that 'California law permits the Tax Board to issue 'notice[s] served personally or by first-class mail' that 'require any employer [or] person to withhold . . . the amount of any tax, interest or penalties due from the taxpayer . . . [and] transmit the amount withheld to the Franchise Tax Board' (i.e., 'Seizure Orders'). Cal. Rev. & Tax. Code §18670(a).' The Complaint also asserts that 'California expressly precludes recipients of Seizure Orders from challenging the orders in court' and that 'California can and does issue Seizure Orders to multi-state banks requiring that they transfer moneys from out-of-state accounts (i.e., Extraterritorial Seizures).'

Arizona's prayer for relief.

Arizona argues that the California Tax Board has 'effectuated both Extraterritorial Assessments and Seiures in Arizona' that 'directly injure Arizona's interests and provide Article III standing for the instant action ' (i.e., the Bill of Complaint). Specifically, Arizona ***34** requests the Supreme Court to issue the following relief:

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

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

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.

Petition Granted

On June 28, 2019, the U.S. Supreme Court granted certiorari in *Espinoza v. Montana Dep't of Rev.*, Docket No. 10-1195, ruling below at 393 Mont. 446 (2018). The high court will review a decision of the Montana Supreme Court that 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.‘

In response to legislation that allows 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 sectarian schools in direct violation of the Montana Constitution. Mothers of children who benefited from the scholarship program and attended religious private schools have 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 neutral student-aid program simply because the program affords students the choice of attending religious schools?‘

Pending Petition

****6** In addition to the previously granted petition, the following writ of certiorari involving state and local taxes remains pending before the Court.

Staples challenges Maryland apportionment.

In *Staples, Inc.. v. Comptroller of Treas.*, Docket No. 19-119, ruling below at 2018 Md. App. LEXIS 785, the Maryland Court of Special Appeals held that an out-of-state parent company and 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 permeated the activities of each other, the Maryland Court of Special Appeals determined, 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.

Staples, which was founded in 1985, is headquartered in Massachusetts. As part of a corporate reorganization in 1998, four separate corporate entities, each with its own distinct role, were created: Staples, Inc. (‘Staples‘), Staples the Office Superstore, Inc. (‘Superstore‘), Staples the Office Superstore East, Inc. (‘East‘), and Staples Contract & Commercial, Inc. (‘C&C‘). Staples was the parent company; Superstore and C&C were wholly owned subsidiaries of Staples; and East was a wholly owned subsidiary of Superstore.

As explained by the Court of Special Appeals, Staples provided managerial and administrative services to the subsidiaries, including legal, financial, payroll, and accounting services. Superstore, East, and C&C paid Staples fees for its services. Staples also provided the subsidiaries with a cash pooling service. This service provided the subsidiaries with bona fide loans upon which they paid interest. However, none of Staples activity during the years in question occurred physically in Maryland. Superstore operated Staples' franchise system and owned and managed Staples' trademarks and other intellectual property. Superstore owned its own retail stores, but none were located in Maryland. It did, however, provide its franchise system to East and C&C, which paid it royalties. East operated distribution centers and retail stores and conducted business in Maryland. C&C operated a catalog business as well as a contract stationer business and, like East, conducted businessin Maryland.

Because both East and C&C conducted business operations in Maryland, each filed Maryland corporate income tax returns for years 1998 through 2003. At that time, Maryland used a three-factor apportionment formula (property, payroll, and sales) to determine that between 6.5% and 9% of East's income was apportioned to Maryland and slightly under 2% of C&C's income was apportioned to Maryland. East and C&C each properly paid taxes due on their apportioned income.

Staples and Superstore, by contrast, did not file tax returns in Maryland because neither Staples nor Superstore had property, personnel, or product sales in Maryland. However, Maryland took note of the interest and franchise-fee payments East and C&C paid to Staples and Superstore in Maryland. Relying on *Comptroller of the Treas. v. SYL, Inc.*, 825 A.2d 399 (Md. 2003), in which the Maryland Court of Appeals held that simply licensing intellectual property for use in Maryland was sufficient for an out-of-state business to establish Maryland nexus, the Comptroller determined that the interest and franchise-fee payments received by ***35** Staples and Superstore were income earned in Maryland.

****7** Because under Maryland's three-factor formula none of Staples' or Superstores' income was apportioned to Maryland, the Comptroller adopted an alternative formula based entirely on East's and C&C's activities in Maryland. Specifically, the Comptroller combined East's and C&C's individual Maryland apportionment percentages and applied the ‘blended apportionment factor‘ to the total amount of interest and franchise-fee payments each paid to Staples and Superstore to determine what percentage of such fees could be taxable in Maryland. Ultimately, based on such apportionment, Maryland determined Superstore owed more than $12 million in taxes and interest and Staples' liability was nearly $450,000, plus more than $1.6 million in combined penalties.

Staples and Superstore filed petitions with the Maryland Tax Court, arguing they did ‘not have sufficient nexus with the State to be subject to Maryland tax.‘ The Comptroller argued that because ‘no one entity under the Staples umbrella could operate independently from any of the others,‘ they were not separate business entities. Staples and Superstore, by contrast, argued that ‘given [their] numerous employees, substantial operations and interactions with third parties around the country,‘ each entity should be treated separately. The Maryland Tax Court ultimately held in favor of the Comptroller, stating that the ‘facts support the Comptroller's position that enterprise dependency existed between [Staples and Superstore] and [East and C&C]‘ and, therefore, the entities lacked economic substance as separate business entities.

Staples and Superstar appealed to the Maryland Circuit Court, which affirmed the Maryland Tax Court's conclusion that the Comptroller's assessment did not violate the U.S. Constitution. It reasoned that a ‘Maryland retailer's use of its out-of-state affiliate's intangible assets generally produces income for the out-of-state affiliate, which income is taxable in Maryland.‘ The Circuit Court also agreed with the Tax Court's reliance on *Gore Enterprise Holdings Inc. v. Comptroller of Treas.*, 87 A.2d 1263 (Md. 2014), in determining that ‘the [apportionment] formula reflects a reasonable sense of how [Staples' and Superstore's] income is generated.‘ In *Gore Enterprise Holding*, the Maryland Court of Appeals had sanctioned a similar application of apportionment. The Maryland Court of Special Appeals affirmed on the same grounds, concluding that East's and C&C's allocation ‘among the states [in which] they conducted business‘ was sufficient to ‘make clear to the Comptroller‘ how much Staples' and Superstore's income could be ‘properly attributed to Maryland.

Staples now asks the Court: ‘When an out-of-State business receives royalty fees, franchise fees or similar payments from in-State businesses, may a State imposing income taxes constitutionally apportion such income to itself based on the activities of the in-State businesses?‘

Petitions Denied

At the beginning of its new term on Oct. 7, 2019, the Court denied petitions for writ of certiorari involving state and local taxes in the following matters: (1) *Kansler v. Miss. Dep't of Rev.* (Docket No. 18-1485); (2) *McClain v. Sav-On Drugs* (Docket No. 18-1512); (3) *Chamberlain v. N.Y.S. Dep't of Tax. and Fin.* (Docket No. 1569); (4) *Edelman v. N.Y.S. Dep't of Tax. and Fin.* (Docket No. 18-1570); and (5) *Saban v. Ariz. Dep't of Rev.* (Docket No. 19-136).

Mississippi upholds refund claim denial on statute of limitations grounds.

****8** In *Kansler v. Miss. Dep't of Rev.*, Docket No. 18-1485, ruling below at 263 So. 3d 641 (Miss. 2018), the U.S. Supreme Court was asked to review a Mississippi Supreme Court decision that the lower court properly granted summary judgment to the Department of Revenue based on the taxpayers' failed challenge to the state's statute of limitations for claiming a refund. The state court held that the ‘statute of limitations is facially nondiscriminatory and has only an incidental effect on interstate commerce, one that is justified by the practical difficulties of tax administration and the State's interest in finality.‘

***36** Mississippi offers a credit to residents for income taxes paid to other states. To claim the credit, a resident must have actually paid the tax to the other state and provide a copy of the income tax return filed with the other state. Mississippi law, however, generally prohibits the resident from recovering overpaid taxes resulting from a credit more than three years after the original tax return was filed. With respect to the credit for taxes paid to another state, Mississippi offers no mechanism or procedure to claim a credit prior to actually paying another state, or to file a protective claim when an audit by another state is imminent and additional tax is likely to be owed.

While living in New York, Michael Kansler received stock options as part of his compensation from Entergy Corporation. In 2007, Kansler moved to Mississippi and continued to work for Entergy. Kansler and his wife filed Mississippi personal income tax returns for 2008 and 2009, paying taxes on the income from the exercise of stock options and taking the position that the income was only taxable in Mississippi. New York audited the Kanslers in 2012 regarding the exercise of the stock options and, on December 29, 2014, determined the Kanslers owed additional tax to New York. In January 2015, the Kanslers amended their Mississippi personal income tax returns and claimed a refund of more than $250,000 based on credits for taxes paid to other states.

The Mississippi Department of Revenue (‘DOR‘) denied the refund because the general three-year statute of limitations period for a refund had expired. The DOR Board of Review and the Mississippi Board of Tax Appeals agreed with the denial of the refund claim. On appeal, both the Chancery Court and the Mississippi Supreme Court agreed with the DOR and upheld the denial and determined the statute of limitations statute did not violate the Commerce, Due Process, or Equal Protection Clauses of the U.S. Constitution.

According to the Mississippi Supreme Court, the statute of limitations provision should not be judged by the *Complete Auto Transit Inc. v. Brady* test to determine whether the statute violates the dormant Commerce Clause because the test ‘is specifically intended for evaluating the constitutionality of taxes, not state regulations in general.‘ Rather, the test should be the ‘traditional discrimination/*Pike* balancing test, and we find that the discrimination alleged by the Kanslers is ‘incidental’ to Mississippi's otherwise nondiscriminatory statute of limitations. It therefore must be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.‘

****9** The Kanslers argued that the denial of the refund is a violation of the dormant Commerce Clause. In addition, they argued the four component tests of *Complete Auto* should be applied more broadly and are applicable in instances involving more than ‘taxes.‘ *Complete Auto* provides that to avoid violating the dormant Commerce Clause, ‘a tax must: (1) be imposed on an activity with a substantial nexus with the taxing state; (2) be fairly apportioned, based on the activity within the taxing state; (3) not discriminate against interstate commerce; and (4) be fairly related to services provided by the taxing state. ‘ With respect to the apportionment prong (and also discrimination prong), the Kanslers contended that the statute must satisfy the ‘internal consistency test,‘ which ‘looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantageas compared with intrastate commerce,‘ and that here the statute ‘fails the internal consistency test because taxpayers with income from other states will suffer more from [Mississippi's] statute of limitations than taxpayers whose income is derived solely from Mississippi.‘

In the petition that has now been denied, the Kanslers asked the U.S. Supreme Court to consider the following questions:

***37** 1. 'Is Mississippi's income tax refund statute of limitation immune *per se* from Commerce Clause scrutiny under *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) and the internal consistency test when it produces actual, undisputed double taxation of its residents' income earned in interstate commerce?'

2. 'Does Mississippi discriminate against interstate commerce by permitting certain residents to recover overpaid income taxes well beyond the normal three-year statute of limitations while denying other residents the same benefit, based exclusively on an interstate element or criteria, when that denial produces actual, undisputed double taxation of residents' income earned in interstate commerce?'

3. 'Does Mississippi violate the Commerce Clause and Due Process Clause of the United States Constitution by failing to afford its resident taxpayers, when audited by a sister state, any pre- or post-deprivation mechanism to preserve their right to claim a credit for taxes paid to other states in order to avoid double taxation of income they earned in interstate commerce?'

Challenge to California sales tax reimbursements.

In *McClain v. Sav-On Drugs,* Docket No. 18-1512, ruling below at 435 P.3d 424 (Cal. 2019), the U.S. Supreme Court was asked to review a case in which customers who paid sales tax reimbursement on purchases they believed to be exempt from sales tax were unable to file suit to compel the retailers to seek a refund of those reimbursements from the California Department of Tax and Fee Administration. The California Supreme Court rejected the customers' argument that the unavailability of a judicially created remedy violates the Due Process Clause of the U.S. Constitution and that California's tax refund system, by unjustly enriching the state at the expense of consumers, works an unconstitutional taking under the Takings Clause of the U.S. Constitution.

****10** California imposes its sales tax on the retailer making sales of tangible personal property. Retailers, however, are allowed to collect 'sales tax reimbursement' from the customer, which ultimately places the economic incidence of the tax on the customer. A by-product of such a tax structure is that the retailer is considered to be the 'taxpayer' authorized to file a tax refund claim under California Rev. & Tax. Code §6902(a). If a retailer pays more sales tax than is due, it may file a refund claim for taxes paid with the California Department of Tax and Fee Administration (the 'Department'). If customers pay excess sales tax reimbursements to the retailer, the retailer must either return the excess to the customer or remit it to the state. There is no statutory remedy for a customer to obtain a refund directly from the Department. However, in *Javor v. State Board of Equalization*, 12 Cal. 3d 790 (1974), the California Supreme Court authorized a customer suit compelling retailers to file claims for refund on behalf of taxpayers who had paid excess tax reimbursement.

As described in the case below, Petitioners, insulin-dependent pharmacy customers, paid sales tax reimbursements on the purchase of glucose test strips and skin puncture lancets from pharmacies, which the Petitioners claim were exempt from sales tax. In California, '[g]lucose test strips and skin puncture lancets furnished by a registered pharmacist ... in accordance with a physician's instructions' to be used by a diabetic patient are not taxable. However, the Department's position has been that if customers are able to remove the glucose test strips and skin puncture furnishings from the shelf and pay for them without the intervention of a pharmacist, then the sales are subject to tax. Petitioners paid sales tax reimbursements on such purchases.

Petitioners filed a class action against a group of several pharmacies and the Department seeking a refund of sales tax reimbursement paid, orders compelling the pharmacy defendants to file refund claims against the Department, and an order compelling the Department to award refunds to be passed on to customers. Petitioners ultimately argued that to deny consumers a remedy to recover sales tax reimbursement would (1) constitute a public 'taking' without just compensation under the Takings Clause of the U.S. Constitution and (2) be a deprivation of property without due process of law under the Due Process Clause of the U.S. Constitution. Both the pharmacy defendants and the Department objected and demurred to the complaint. The trial court sustained the demurrers without leave to amend and the Court of Appeal affirmed, noting that 'the result is not an entirely satisfying one,' but the California Legislature was best suited to provide a mechanism for refund.

The California Supreme Court held that for Petitioners to be entitled to a *Javor* remedy, whereby the California courts would compel the pharmacies to seek a refund on behalf of the Petitioners, the Petitioners must, as a threshold requirement, show a prior legal determination that establishes their entitlement to a refund. In this case, Petitioners had not shown such a legal determination. Therefore, the defendant pharmacies would not be forced to file refund claims on behalf of customers.

****11** Petitioners, in their now denied petition, asked the U.S. Supreme Court to consider the following: 'Does a State violate the Due Process Clause and trigger a right to just compensation under the Takings Clause when it permanently escheats private property from an intermediary to itself under a statutory scheme that denies standing to the real parties in interest, including denying them any right to a judicial or administrative procedure by which to reclaim their private property.'

Challenge to the constitutionality of New York's personal income tax scheme.

In both *Chamberlain v. N.Y.S. Dep't of Tax. and Fin.*, (Docket No. 18-1569) and ***38** *Edelman v. N.Y.S. Dep't of Tax. and Fin.* (Docket No. 18-1570), [1] Connecticut domiciliaries were deemed to be New York statutory residents because they spent more than 183 days in New York. The New York lower courts upheld the taxation of their intangible income by New York because they held it did not amount to double taxation, observing that a credit for taxes is available when the income being taxed is 'earned' in the other state.

New York taxes the worldwide income, including intangible income, not just of individuals domiciled in New York, but also individuals domiciled elsewhere who maintain a dwelling place in New York and spend more than 183 full or part days of a tax year in New York (i.e., a 'statutory resident of New York'). New York offers a credit for taxes paid to another state if the credit is on 'income derived from sources within' that state. With respect to income from intangibles, New York does not offer a credit for taxes paid to another state unless the income is from 'property employed in a business, trade or profession, carried on' in the other state.

In each of the underlying cases, the taxpayers were domiciled in Connecticut, but owned a residence in New York and spent more than 183 days in New York during the tax years at issue. After selling their shares of respective companies, the taxpayers each paid full taxes to Connecticut on their worldwide income. The taxpayers each also filed New York tax returns for those years and, after audits, were required to pay tax to New York on the intangible income from the sale of the shares of the companies, even though each had already paid tax to Connecticut on that intangible income. The taxpayers each filed suit against New York arguing that New York's tax scheme violates the dormant Commerce Clause under the U.S. Supreme Court's decision in *Comptroller of Treasury of Maryland v. Wynne*, 135 S. Ct. 1787 (2015).

In *Wynne*, the Court struck down a Maryland tax scheme in which residents were allowed a credit against only a portion of their Maryland taxes (the state taxes but not the county taxes) for income taxes paid to other states. In that decision, the Court held the Maryland tax scheme violated the 'internal consistency test,' which, as discussed above, 'looks to the structure of the tax at issue to see whether its identical application by every state in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate.' However, the intermediate New York courts rejected the taxpayers' arguments and upheld New York's tax scheme.

****12** In each of the underlying cases, the New York courts held that the New York tax scheme was constitutional. According to the courts, the *Wynne* decision did not abrogate the New York Court of Appeals prior decision in *Tamagni v. Tax Appeals Tribunal*, 91 N.Y.2d 530 (N.Y. 1998), which upheld the constitutionality of the tax scheme. The New York courts distinguished the present matters from *Wynne*, emphasizing that *Wynne* 'did not involve individuals who faced double taxation on intangible investment income by virtue of being domiciliaries of one state and statutory residents of another' and that 'the income subject to tax in *Wynne* was not intangible investment income, but business income, traceable to an out-of-state source.' The taxpayers appealed to the New York Court of Appeals but the court denied review on the ground that 'no substantial constitutional question [was] directly involved.'

In their petition that has now been denied, the taxpayers asked the Supreme Court ‘Whether a state tax scheme that taxes the intangible income of individuals who are domiciled in the State and certain individuals not domiciled in the State, without off-setting credits for taxes paid to another State of domicile, violates the dormant Commerce Clause under this Court's decision *Comptroller of Treasury of Maryland v. Wynne,* 135 S. Ct. 1787 (2015).‘

The Supreme Court received briefs of amici curiae from the National Federation of Independent Business Small Business Legal Center, The Tax Foundation, and the American Academy of Attorney-Certified Public Accountants, Inc. Each brief supported the taxpayers' argument that New York's tax violates the dormant Commerce Clause.

Rental car companies challenged Arizona surcharge on rental of vehicles.

On July 25, 2019, the U.S. Supreme Court received a petition for certiorari in *Saban v. Ariz. Dep't of Rev.*, Docket No. 19-136, ruling below 434 P.3d 1168 (Ariz. 2018), in which the Arizona Supreme Court concluded that a Maricopa County car rental surcharge was not unconstitutional under the federal or state constitutions. Petitioners argued that the surcharge, which was enacted to help fund the construction of stadiums, was unconstitutional under the Arizona Constitution, art. IX, §14 and the dormant Commerce Clause of the U.S. Constitution. The Arizona Supreme Court disagreed.

As set forth in the petition for certiorari, ‘[g]overnments in 44 states and the District of Columbia have imposed more than 118 different excise taxes on car rentals at the state, county, and municipal level.‘ In Arizona, Ariz. Rev. Stat. Ann. §5-839, which authorizes the tax, was implemented to pay for the public portion of any new sports stadium project following polling that indicated that residents preferred such funds to come from ‘tourism taxes.‘ Promising the tax would be ‘paid primarily by out-of-state visitors,‘ an Advisory Task Force established ***39** by the Governor recommended an extra tax atop an already existing flat $2.50 tax that had been collected on all car-rental transactions.

****13** Eventually, legislation was passed that resulted in a surcharge tax on all motor-vehicle rentals in Maricopa County, which amounts to the greater of $2.50 per rental or 3.25% of the rental business's ‘gross proceeds or gross income‘ on each rental. Ariz. Rev. Stat. Ann. §5-839(B)(1). Exemptions to the tax include businesses that provide longer-term rentals of more than one year, replacement rentals for vehicles when a primary vehicle is broken or receiving repairs, buses, vehicles used in ‘employee vanpool arrangements,‘ and off-road vehicles. As explained in the petition for certiorari, prior to passing the law, voters were given publicly available materials that stated the ‘best part‘ of the surcharge is that ‘it will cost Arizona residents next to nothing. As much as 95% of the new taxes will be borne by visitors to our state.‘

On August 19, 2009, the Petitioners, rental car companies located in Maricopa County that have paid the surcharge, sued for a refund of taxes paid in Arizona Tax Court. Petitioners argued the surcharge was invalid under the dormant Commerce Clause of the U.S. Constitution and under Arizona Constitution, art. IX, §14, which requires ‘fees, excises, or license taxes relating to registration, operation, or use of vehicles on the public highways or streets ‘ to be used for highway and street purposes. Petitioners contended that because the surcharge was not used for highway and street purposes, but instead sports stadiums, it is invalid because the phrase ‘related to‘ implies that the constitutional restriction applies to any fee connected to driving on Arizona roads.

The Arizona Tax Court held that the surcharge did not violate the dormant Commerce Clause but did violate the Arizona Constitution's anti-diversion provision. The Arizona Court of Appeals affirmed the Tax Court's dormant Commerce Clause ruling, but reversed the Tax Court's anti-diversion provision. Petitioners appealed the ruling to the Arizona Supreme Court.

In a divided opinion, the Arizona Supreme Court upheld the Arizona Court of Appeals decision. In reaching its decision regarding the dormant Commerce Clause, the Arizona Supreme Court determined the rental car surcharge to be similar to the coal tax at issue in *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981). In *Commonwealth Edison*, a law regarding local resources that burdens nonresidents more than residents remains constitutional if, like Montana's coal tax, the law treats residents and nonresidents equally, and the disparate burden results solely because nonresidents consume more of the resources being regulated (i.e., rental cars). The Arizona Supreme Court reasoned that, like Montana's coal tax, the burdens may be unequal on residents and nonresidents, but they are proportionate based on the demand by nonresidents and residents.

By contrast, Petitioners argued the surcharge is more similar to the exemption at issue in *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Me.*, 520 U.S. 564 (1997), in which the Court struck down a Maine law denying a tax exemption to charitable organizations operating 'principally for the benefits of nonresidents.' In doing so, the Court determined that when the burdens of a state or local law 'fall by design in a predictably disproportionate way,' then the tax constitutes discrimination against interstate commerce. Because the Arizona surcharge was advertised to affect primarily nonresidents and exemptions were put in place to shield residents from the surcharge, Petitioners argued that the surcharge was designed to disproportionately affect nonresidents in violation of the Court's holding in *Camps Newfound/Owatonna.*

****14** Petitioners asked the Court, in the petition that has now been denied, to review the following questions:

1. 'Whether a car-rental tax designed to foist a disproportionate share of the tax's burden onto nonresidents is nonetheless immune from dormant Commerce Clause scrutiny simply because the tax is assessed on the companies that rent the cars rather than the nonresidents who are the ultimate target of the tax?'

2. 'Whether evidence that a tax was intended to impose a disproportionate burden on nonresidents is relevant in determining whether a statute imposes an impermissibly discriminatory design?'

The court found that the special taxing district's organizers included certain property in the district only to use it as a source of payment for improvements to other property and the landowners at issue in the district received no benefit from those improvements.

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 management of [the] LLC or appoint a manager[.]'

Footnotes

1 The authors' law firm, Hodgson Russ LLP, has been engaged to represent the taxpayers in these matters and filed the petitions for certiorari at issue before the Court.