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U.S. Supreme Court Update

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U.S. SUPREME COURT UPDATE

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U.S. Supreme Court Receives Four New Petitions for Certiorari

***36** With the U.S. Supreme Court Justices out for summer recess, the Court has received four new petitions for certiorari in cases involving state and local taxes. On 6/28/17, the Court was asked in *Okrie v. Michigan*, Docket No. 17-34, to review a Michigan Court of Appeals decision that held that pensions paid by the Michigan Public School Employees Retirement System were not exempt from Michigan state and local income tax, as the state was free to enact new laws that taxed the previously exempt income. On 7/13/17, the Court received two separate petitions, the first, in *Wayside Church et al. v. Van Buren County et al.*, Docket No. 17-88, in which a group of Michigan property owners challenged a U.S. Court of Appeals decision that held that the U.S. District Court lacked jurisdiction over the property owners' claims regarding Michigan's property tax foreclosure procedures, and the second, in *T. Ryan Legg Irrevocable Trust v. Testa*, Docket No. 17-84,in which a trustee alleged that Ohio's taxation of the trust's capital gain on the sale of shares in a pass-through entity violated the Due Process Clause of the U.S. Constitution. Last, on 7/14/17, the Court was asked in *Irwin Naturals v. Washington Dep't of Revenue*, Docket No. 17-91, to review a Washington Court of Appeals decision, which held that the petitioner, a California company, had substantial nexus in Washington by way of its wholesaler contacts with the state. The taxpayer alleges that Washington's tax violates the Commerce Clause of the U.S. Constitution because its retail sales, upon which the state seeks to impose tax, are dissociated from its in-state wholesale activities.

We also note that on 8/8/17, a New York gentlemen's club petitioned the U.S. Supreme Court to review the club's claim that New York State unconstitutionally denied the club's attempt to qualify for an exemption from the state's ‘place of amusement‘ admission tax. The case, *CMSG Restaurant Group LLC v. New York*, Docket No. 17-147, was filed by the owner of Larry Flynt's New York City Hustler Club, and we plan to cover this petition in more detail in our next issue of the JOURNAL.

In addition to these new petitions for certiorari, five previously reported petitions remained pending as this issue of the JOURNAL went to press. Also, the Court remains set to review a dispute between Delaware and several other states as to which states have priority rights to claiming abandoned, uncashed MoneyGram ‘official checks.‘ The cases set for review are *Delaware v. Pennsylvania et. al.*, Case No. 220145, and *Arkansas et. al. v. Delaware*, Case No. 220146. During the summer recess, the Honorable Pierre N. Leval, of the U.S. Court of Appeals for the Second Circuit, continues his role as Special Master, coordinating the taking of evidence and making reports. (The Court typically assigns original jurisdiction disputes—cases such as disputes between states that are first heard at the U.S. Supreme Court level—to a Special Master to conduct what amounts to a trial court proceeding.)

Retired Michigan School Teachers Challenge Repeal of Tax Exemption

****2** On 6/28/17, the Court received a new petition for certiorari in *Okrie v. Michigan*, Docket No. 17-34, ruling below at 2016 WL 3365308 (Mich. Ct. App. June 16, 2016), in which the Michigan Court of Appeals affirmed a lower court's ruling that rejected all claims brought by a retired Michigan school teacher, on behalf of himself and all similarly situated school teachers, challenging Michigan's repeal of its tax exempt treatment of their pension income.

Michigan's historic state and local tax exemption for retired state employees.

As explained in the case below, the state of Michigan previously provided a state and local tax exemption for certain defined-benefit pension payments received by retired state employees. The exemption, however, was repealed effective January 1, 2012, which was the catalyst for the teachers' claims below.

Specifically, the teachers' claims stemmed from the fact that booklets published by the Michigan Public School Employees Retirement System's (‘MPSERS ‘) Office of Retirement Services, contained a statement indicating that ‘pensions paid by MPSERS are exempt from Michigan state income tax and Michigan City tax.‘ The booklets, however, ‘also contained the following disclaimer: ‘Remember, this book is a summary of the main features of the plan and not a complete description. The operation of the plan is controlled by the Michigan Public School Employees Retirement Act (Public Act 300 of 1980, as amended). If the provisions of this Act conflict with this summary, the Act controls.’‘ ***37** Mr. Okrie, the plaintiff below, filed his original complaint on behalf of himself and all other Michigan public school teacher retirees and state employee retirees who were born after 1945 and who had begun receiving pension benefits from their retirement plan prior to the effective date of the legislation that repealed the tax exemption. Mr. Okrie argued that he relied on the statements in the booklets when deciding whether and when to retire. He, according to the court below, ‘believed that the statements constituted a promise that his pension income would remain tax exempt throughout his retirement.‘ Mr. Okrie also alleged that he purchased additional service credit to increase the value of his pension. For 11 years, Mr. Okrie received his pension benefits without any state or local tax being withheld, until January 2012, when the law changed.

Mr. Okrie then filed several complaints with various claims, all of which were dismissed by the Court of Claims before Mr. Okrie appealed his case to the Michigan Court of Appeals.

Michigan court rejects retired school teachers' claims.

The Michigan Court of Appeals considered and rejected all claims brought by Mr. Okrie. First, the Court of Appeals determined that Mr. Okrie ‘has pointed to no language in the Income Tax Act, MCL 206.1 *et. seq.*, the State Employees Retirement Act, MCL 38.1 *et. seq.*, or the Public School Employees Retirement Act, MCL 38.1301 *et. seq.* that shows an adequate expression that the Legislature actually intended for the State to be bound contractually [to the obligation of the MPSERS].‘ Rather, the court, citing to an Advisory Opinion issued by the Michigan Supreme Court, stated as follows: ‘By failing to identify language indicating that the Legislature intended to bind successive Legislatures by precluding amendment of the tax-exempt status of plaintiff's pension, plaintiff has failed to rebut the presumption that the Legislature did ‘not intend[ ] to create private contractual or vested rights but merely [to]

****3** declare[] a policy to be pursued until the [L]egislature [] ordain[ed] otherwise.'‘ The Court also found that ‘at most the statements in the booklets informed plaintiff of extant tax policy; they provided no promise regarding future tax policy.‘ The Court also noted that ‘the Michigan Constitution provides the legislative branch with the power to tax . . . and it explicitly states that ‘[t]he power of taxation shall never be surrendered, suspended or contracted away.’‘ As a result, ‘none of the named defendants in this case had authority to contract away the Legislature's taxation power.‘

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Next, the Court of Appeals considered Mr. Okrie's promissory estoppel claim. As explained by the Court of Appeals, ‘promissory estoppel is a judicially created doctrine that was developed as an equitable remedy applicable in common-law contract actions. A party seeking to invoke the doctrine must show [1] the existence of a promise, [2] that the promisor should have reasonably expected the promisee to act, [3] that the promisee relied on the promise, and [4] that the promise must be enforced to avoid injustice.‘ The Court of Appeals concluded that the booklets contained no promise to Mr. Okrie that his pension benefits would be tax-exempt in perpetuity and, thus, held that the trial court did not err by granting the defendants a summary disposition regarding the plaintiff's promissory estoppel claim.

The Court of Appeals also considered and rejected Mr. Okrie's unjust enrichment claim. As explained by the Court of Appeals, ‘the elements of a claim for unjust enrichment are (1) receipt of a benefit by the defendant from the plaintiff, and (2) an inequity resulting to plaintiff from defendant's retention of the benefit.‘ Mr. Okrie argued that the benefit received by the state was his 33 years of service as a public school teacher. The Court of Appeals, however, highlighted that the actual defendants in the litigation below were the various state government officials and departments who administer public school teachers' and state employees' retirement programs, along with the Department of Treasury, which collects taxes. As a result, the Court of Appeals held that Mr. Okrie had ‘not alleged that he provided any benefit to those named defendants,‘ and the unjust enrichment claim therefore has no basis.

With respect to Mr. Okrie's constitutional contractual impairment claim, the Court of Appeals stated that ‘because we concluded that no contractual relationship existed, we need not proceed to the question of impairment. ‘ Similarly, the Court of Appeals rejected Mr. Okrie's constitutional government taking claim on the basis that the plaintiffs did not have a ‘contractual right to a tax-exempt pension in perpetuity‘ and did not have a ‘vested right in a tax statute or in the continuance of any tax law.‘

Question presented.

Mr. Okrie, on behalf of all retired Michigan state and public school employees who were born after 1945 and who made irrevocable decisions to retire prior to January 1, 2012, now asks the U.S. Supreme Court to consider the following question: ‘Does Michigan's ***38** retraction of the retirement tax benefits for these retirees violate the retroactivity principles stated in *Landgraf v. USI Film Prods.,* 511 U.S. 244 (1994) and the principles underlying the rule of law?‘

Church Alleges Michigan's Property Tax Law Violates Takings Clause

****4** On 7/13/2017, the Court received a new petition for certiorari in *Wayside Church et al. v. Van Buren County et al.*, Docket No. 17-88, ruling below at 847 F.3d 812 (6th Cir. 2017), in which the U.S. Court of Appeals for the Sixth Circuit held, in a 2-1 opinion, that a federal district court lacked subject matter jurisdiction to hear a group of taxpayers' claims that Michigan violated their Fifth Amendment rights by selling their tax delinquent property and keeping the surplus profits from the sales as an alleged ‘windfall.‘

The taxpayers' constitutional claims.

In the proceedings below, a group of Michigan taxpayers, including the Wayside Church, claimed that a Michigan county violated their Fifth Amendment rights by taking their property without just compensation. According to the court below, each of the taxpayers owned property in Van Buren County, Michigan, and when the taxpayers failed to pay their property taxes for 2011, the properties were foreclosed and sold at auction.

At the auction, the minimum bid was calculated by totaling ‘[a]ll delinquent taxes, interest, penalties, and fees due on the propert[ies]‘ plus the ‘expenses for administering the sale.‘ Each property was then sold for significantly more than the minimum bid and, pursuant to the Michigan General Property Tax Act (Mich. Comp. Laws § 211.1, *et. seq.*), the county retained the surplus proceeds.

In their suit, the taxpayers sought the return of the surplus funds, alleging that they ‘possessed a cognizable property interest in each of their foreclosed properties and in the surplus proceeds generated by the sales, in connection with which [the county] was required to pay just compensation pursuant to the Fifth Amendment.‘

Lower court lacks subject matter jurisdiction to hear taxpayers' claims.

Although a lower federal district court originally exercised jurisdiction over the case—eventually ruling that the taxpayers failed to state a claim upon which relief could be granted—the federal circuit court held that the district court lacked subject matter jurisdiction to review the taxpayers' claims. The Sixth Circuit based its holding on two findings: (1) the taxpayers' claims were not ripe for review and (2) the Tax Injunction Act and principles of comity prevented any federal court from exercising jurisdiction over the taxpayers' claims. Accordingly, the circuit court ruled that the district court erred in determining that it could exercise jurisdiction over the taxpayers' claims.

With regard to the issue of ripeness, the Sixth Circuit held that under the holding of *Williamson Cnty. Regional Planning Comm'n v. Hamilton Bank of Johnson City,* 473 U.S. 172 (1985), a ‘takings claim is not ripe ‘unless or until the State fails to provide an adequate postdeprivation remedy for the property loss.'‘ Although the taxpayers alleged in the case below that ‘no adequate state procedures existed‘ in which they could challenge the alleged taking, the circuit court held that the taxpayers were free to bring their actions, including their constitutional claims, in state court and thus ‘were not deprived of a state forum for vindicating their federal constitutional rights.‘ In their petition for review, the taxpayers now ask the U.S. Supreme Court whether it is time to ‘overrule or limit the portion of *Williamson County* that requires a property owner to sue in state court to ‘ripen' a federal takings claim.‘

****5** In addition to the Sixth Circuit's ripeness ruling, the court also held that (1) the Tax Injunction Act—which states that ‘district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State‘—and (2) the principle of comity, barred the taxpayers' claims. According to the court, both doctrines ‘only allow federal courts to exercise jurisdiction when state courts cannot provide ‘plain, adequate, and complete' remedies.‘ Since the court already ruled in its ripeness analysis that the taxpayers were free to challenge Michigan's General Property Tax Act on constitutional grounds in state court, the court held that the taxpayers' action in federal court was barred by the Tax Injunction Act and the doctrine of comity and that, consequently, ‘the district court lacked jurisdiction to entertain this action.‘

Questions presented.

In their petition for certiorari, the taxpayers present three questions for review:

***39** 1. Does a local government violate the Takings Clause when it takes and sells tax delinquent property and keeps the surplus profit as a windfall?

2. Should the Court overrule or limit the portion of *Williamson County* that requires a property owner to sue in state court to ‘ripen‘ a federal takings claim, as suggested by many Justices of this Court? See *Arrigoni Enterprises, LLC v. Town of Durham*, 136 S. Ct. 1409 (2016) (Thomas, J., joined by Kennedy, J., dissenting from denial of certiorari); *San Remo Hotel, L.P. v. San Francisco*, 545 U.S. 323, 349 (2005) (Rehnquist, C.J., concurring in judgment).

3. Do the Tax Injunction Act and comity bar a federal court from hearing a claim that challenges the uncompensated retention of funds that exceed a tax debt but does not challenge the taxes or debt itself?

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Nonresident Trust Challenges Ohio Taxation of Stock Sale Gain

In *T. Ryan Legg Irrevocable Trust v. Testa*, Docket No. 17-84, ruling below at 149 Ohio St. 3d 376 (2016), the Ohio Supreme Court held that (1) a nonresident trust's capital gains from the sale of stock in an Ohio company constituted a ‘qualifying trust amount‘ subject to Ohio income tax and that (2) the taxation of this gain did not violate the trust's due process rights. On petition to the U.S. Supreme Court, the trust now argues that in order for a state to properly tax a nonresident, the state must have *specific* jurisdiction over the nonresident, which, under due process rules, requires ‘some definite link, some minimum connection, between the state and both the person . . . and transaction it seeks to tax.‘ The trust argues that, contrary to these principles, in the case below, ‘the Ohio Supreme Court held that Ohio could assert jurisdiction to tax [1] over a nonresident and [2] on a transaction with no identified or asserted connection to Ohio.‘

Nonresident trust recognizes gain on sale of stock in Ohio-based company.

****6** In the case below, T. Ryan Legg, an Ohio resident and co-founder of an Ohio trucking and logistics business, transferred his half of the S corporation's shares into two trusts, one of which was the T. Ryan Legg Irrevocable Trust (the ‘Trust‘). The Trust then sold the shares back to Mr. Legg's former business partner, generating capital gain of $18,614,242. According to the Ohio Supreme Court, the Trust properly qualified as a nonresident trust pursuant to R.C. 5747.01(I)(3). Thus, the issue in the case below was what, if any, portion of the Trust's capital gain was taxable in Ohio.

The capital gain constitutes a ‘qualifying trust amount‘ that can properly be allocated to Ohio.

The Ohio Supreme Court held that, pursuant to R.C. 5747.01(BB)(2), the Trust's capital gain constituted a ‘qualifying trust amount,‘ which was therefore subject to Ohio tax, even when recognized by a nonresident trust. In the case below, the Trust argued that one of the conditions necessary in order for the capital gains to fall within the definition of a ‘qualifying trust amount‘ was not satisfied. Specifically, the Trust argued that the ‘book value‘ of the Trust's physical assets in Ohio were not ‘available to the trust,‘ as required under Ohio law.

However, the court below concluded that, given the close relationship between the Trust and the underlying business which held the physical assets, the Trust's arguments were ‘unpersuasive‘ that the book value of the company's assets were unavailable. Because the income was a ‘qualifying trust amount,‘ the Ohio Supreme Court instructed the Ohio Tax Commissioner to properly allocate the gain to Ohio based on the Ohio share of the underlying company's physical assets as determined on the last day of the company's tax year immediately prior to the date on which the Trust recognized the qualifying trust amount.

The Trust alleges that the assessment of tax violates due process and equal protection.

In the case below, the Trust argued that ‘to the extent that [Ohio's] statutes permit the assessment . . ., the assessment is unconstitutional‘ as it violated its rights to both due process and equal protection. Regarding due process, the Trust argued that ‘the income and the taxpayer lack[ed] sufficient connection with Ohio to permit the imposition of the tax.‘ Regarding equal protection, the Trust argued that Ohio violated its constitutional rights by according ‘different treatment . . . to a nonresident trust based on whether it owns S-corporation shares or C-corporation shares.‘ The Trust raises only its due process claim in its petition for certiorari.

In analyzing the Trust's due process claims, the Ohio Supreme Court noted that ‘the Due Process Clause of the Fourteenth Amendment guards against a state exceeding its jurisdiction to tax by establishing a twofold test. First, there must be a definite link or a minimum connection between the state and the person, property or transaction that Ohio seeks to tax; second, the income attributed to the state for tax purposes must rationally relate to values connected with the taxing state.‘ In finding that Ohio's tax assessment satisfied these criteria, the court focused on its recent holding in *Corrigan v. Testa*, 149 Ohio St. 3d 18

(2016), in which it held that Ohio's tax on a nonresident's sale of equity interests in pass-through entities doing business in Ohio violated due process as applied to the petitioner in that case, Corrigan.

****7** In *Corrigan*, the Ohio Supreme Court first held that ‘the link between Ohio and the capital gain of a nonresident who did not engage in the underlying business was attenuated.‘ Second, the court held that there was ‘no showing [in *Corrigan*] that attributing the gain to Ohio as if it were business income actually related to the values giving rise to the gain.‘ Although the Ohio Supreme Court acknowledged in its ruling in *T. Ryan Legg Irrevocable Trust* that it decided *Corrigan* after the briefing in the former case, the court also noted that the Trust's counsel relied on it at oral argument. Accordingly, much of the court's due process analysis was spent determining whether *Corrigan* controlled the Trust's claims.

The court acknowledged that there were ‘two strong parallels between this case and *Corrigan.*‘ First, the court noted that ‘[t]he tax commissioner found that the trust was a nonresident here, just as Corrigan was a nonresident individual.‘ Second, ‘the tax commissioner here apportioned to Ohio the capital gain from the sale of the pass-through entity as if it were business income and did so in the very manner prescribed by R.C. 5747.212,‘ which was the statute struck down in *Corrigan.* However, despite these parallels, the court found that a ‘more comprehensive look at the situation . . . persuades us that the differences are more important than the similarities.‘

The Ohio Supreme Court noted that, although the Trust was a nonresident, it was ‘undisputed that the grantor of the trust and contributor of the . . . shares, T. Ryan Legg, was an Ohio resident‘ during ***40** the years in question. Moreover, ‘unlike Corrigan, Legg was a founder and manager of the business of the pass-through entity,‘ which the court held was a ‘material distinction.‘ (In *Corrigan*, the Ohio Supreme Court found the tax at issue unconstitutional as applied to Corrigan ‘in light of the absence of any assertion or finding that Corrigan's own activities amounted to a unitary business with that of‘ the in-state business).

‘Properly analyzed,‘ the Ohio Supreme Court found that the case ‘involves an Ohio resident who conducted business in significant part in Ohio through the corporate form and who disposed of his business and corporate interest not by a personal sale but by means of a trust that he created to accomplish his objectives for himself and his family.‘ Accordingly, the court reasoned that ‘[a]lthough Legg deliberately set up a Delaware trust, his Ohio contacts [were] still material for constitutional purposes.‘ Citing to the U.S. Supreme Court's ruling in *Curry v. McCanless*, 307 U.S. 357 (1939), which upheld the imposition of Alabama inheritance taxes on the transfer of a Tennessee decedent's property, the court held that ‘the tax assessment at issue did not violate the trust's due-process rights.‘

Question presented.

In its petition for certiorari, the Trust challenges the Ohio Supreme Court's due process analysis and asks whether ‘the Ohio Supreme Court err[ed] by applying the *general* jurisdiction due process rules applied in *Curry v. McCanless*, 307 U.S. 357 (1939) instead of the *specific* jurisdiction due process rules applied in *Quill* [*v. North Dakota,* 504 U.S. 298 (1992)] and *Allied Signal* [*v. Director, Div. of Taxation,* 504 U.S. 768 (1992)], to uphold Ohio's imposition of income tax against a nonresident trust taxpayer on its sale of stock in an Ohio-based company based solely on the contacts between Ohio and the trust's grantor (a different taxpayer), absent any other contacts between the trust and Ohio, and absent any unitary business relationship between the trust and an instate entity?‘

Out-of-State Taxpayer Seeks ‘Dissociation‘ Nexus Ruling for Washington Taxes

****8** On 7/14/17, the Court also received a new petition for certiorari in *Irwin Naturals v. Washington Dep't of Revenue*, Docket No. 16-1708, ruling below at 195 Wash. App. 788 (2016), in which the Washington Court of Appeals affirmed a lower court's ruling that an out-of-state corporation could not dissociate its retail sales from its wholesale sales to avoid creating ‘substantial nexus‘ with the state. Specifically, the Court of Appeals held that the taxpayer, Irwin Naturals, a California company, had not

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proved that it did not have a substantial nexus with Washington under the Commerce Clause, for purposes of both the state's Business and Occupation tax (‘B&O tax‘) and Retail Sales tax (‘sales tax‘).

Background.

Irwin Naturals was in the business of developing, marketing, and selling retail and wholesale nutritional products. From 2002 through 2009, Irwin Naturals made wholesale sales to retailers and distributors in the State of Washington. As explained by the lower court, ‘[d]uring this period, Irwin invested considerable resources into its store presence in Washington.‘ The court noted specifically that ‘[s]enior company employees spent a considerable amount of time in the state,‘ engaging in such activities as ‘participat[ing] in new item presentation, category review, promotional planning, educating sales staff and trade show exhibitions.‘

The court also explained that the company employed four marketing firms to aid in marketing its products in Washington, including engaging in a wide variety of activities with the company's wholesale customers (i.e., soliciting sales, receiving product orders, attending retailer shows on the company's behalf and acting as an intermediary with the company's retailers on promotional programs and other matters). Other activities, however, Irwin Naturals handled in-house with respect to its wholesale sales. This included the shipment of orders, the ***41** collection of payments, and inquiries from its wholesale customers.

In 2004, Irwin Naturals began making retail sales to Washington residents. As explained by the court, however, the company alleged that ‘the retail and wholesale sales operated independently of each other from 2004 through 2009. ‘ The lower court noted that ‘Irwin's strategy for developing retail sales was to offer particular products for sale through infomercials‘ and ‘[o]nce the retail sales of those products peaked, Irwin planned to offer the same products to its established retailers and distributors, with the goal of maximizing revenue from both retail and wholesale sales.‘ In contrast to its wholesale sales, Irwin Naturals used third parties for solicitation and taking of consumer orders, assembly and shipment, collection of consumer payments and customer service inquiries.

The Washington Department of Revenue audited Irwin Naturals and issued assessments for unpaid B&O tax and sales tax, plus penalties and interest. Irwin Naturals paid the assessments under protest and filed a claim for refund. The trial court rejected Irwin Naturals argument that the imposition of the taxes violated the Commerce Clause of the U.S. Constitution, basing its decision on the fact that Irwin Naturals' retail sales had a substantial nexus with the state. Irwin Naturals then appealed the lower court's ruling to the state Court of Appeals.

‘Dissociation.‘

****9** In the case below, Irwin Naturals claimed that ‘its retail sales are separate and distinct from its wholesale activities in Washington,‘ and, therefore, the State of Washington is precluded from imposing either a B&O tax or sales tax. According to the Court of Appeals, Irwin Naturals relied primarily on *Norton Co. v. Dept. of Revenue, State of Ill*, 340 U.S. 354 (1951), where the U.S. Supreme Court held that an ‘interstate seller who engages in activities within a state can still avoid taxation on some in-state sales by showing that particular transactions are disassociated from the local business and solely interstate in nature.‘ Conversely, the Washington Department of Revenue relied primarily on *National Geographic Soc'y v. California Board of Equalization*, 430 U.S. 551 (1977), where the U.S. Supreme Court held that ‘the taxpayer was not permitted to dissociate its mail order sales for sales and use tax purposes,‘ and ‘contend[ed] that disassociation is no longer a viable means for an interstate seller to avoid a tax imposed by a state with which it has a substantial nexus.‘

‘Substantial nexus‘ under the Commerce Clause.

The Washington Court of Appeals concluded that 'an out-of-state corporation is not subject to a state tax if it can prove the sales or activity in question does not have a substantial nexus to the taxing state.' With respect to Washington's sales tax, the Court of Appeals stated that 'a substantial nexus exists if the corporation has a presence in the taxing state.' With respect to B&O tax, the Court of Appeals stated that a 'substantial nexus exists if the corporation's in-state activities aid in establishing or maintaining a market within the taxing state.' The Court of Appeals found that Irwin Naturals had a substantial nexus for both types of taxes.

First, the Court of Appeals examined substantial nexus for sales tax purposes. The court discussed *Norton Co.* and made clear that the U.S. Supreme Court 'expressly limited its holding—that the presence of a local office in a state is not, by itself, sufficient to support the imposition of a B&O Tax on transactions that did not involve the local office in any way, to a tax like the B&O Tax, because it is imposed directly on the vendor.' Accordingly, the holding in *Norton Co.* does not apply to sales and use taxes.

The court then discussed *National Geographic*, as the case where the U.S. Supreme Court addressed dissociation in the context of a sales or use tax. The Court of Appeals summarized the Supreme Court's conclusions in *National Geographic* as follows: 'It concluded that while a transactional nexus may be necessary to sustain a direct tax, like that at issue in *Norton*, 'such dissociation does not bar the imposition of the use-tax collection duty.'' In addition, the Court of Appeals discussed the U.S. Supreme Court's holding in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), and explained that the 'determinative factor in *National Geographic*, that the Society had a substantial presence in California, continued to be a determinative factor under *Quill.*' As a result, 'because it is undisputed that Irwin ha[d] a substantial physical presence in Washington,' the Courtof Appeals 'concluded that the commerce clause [did] not prohibit the state from imposing on Irwin an obligation to collect the sales tax.'

****10** Next, the Court of Appeals examined substantial nexus for B&O tax purposes. The Court of Appeals framed the issue as whether "transactional nexus' is essential to establishing a substantial nexus.' The Court of Appeals agreed with the Washington Department of Revenue that establishing a transactional nexus is not essential to finding a substantial nexus.

Specifically, the Court of Appeals determined that the U.S. Supreme Court's decision in *Tyler Pipe v. Dep't of Revenue*, 483 U.S. 251 (1987) controls the analysis of whether a substantial nexus exists and that *Tyler Pipe* makes two things clear: (1) 'for businesses with a presence in the taxing state, the fact that orders are received and filled out-of-state for delivery within the taxing state does not, by itself, immunize the sales from a B&O Tax;' and (2) 'the activities that form the nexus with the taxing state need not be tied to specific sales, but instead need only generally support the out-of-state vendor's ability to establish and maintain a market for its goods in the taxing state.'

Based on the foregoing concepts, the Court of Appeals found 'the requisite nexus exists to support Washington's imposition of the B&O tax on all of Irwin's retail sales.' In particular, the Court of Appeals emphasized that the company's wholesale and retail products each ***42** involved nutritional products and that the wholesale activities were creating a market for its retail sales (i.e. the packaging of the wholesale products contained the phone number, email address, and website of Irwin Naturals).

Questions presented.

Irwin Naturals now asks the Court to consider the following two questions in its petition for certiorari:

1. 'Does this Court's holding in *Norton Co. v. Dep't of Revenue of Illinois,* 340 U.S. 534 (1951), control when a taxpayer is permitted to dissociate sales unrelated to nexus-creating activities in a state, or did this Court's subsequent decision in *Tyler Pipe Indus. v. Washington State Dep't of Revenue*, 483 U.S. 232 (1987) articulate the Court's current approach to dissociation under the dormant Commerce Clause?'

2. 'Does *National Geographic Soc. v. Cal. Bd. of Equalization*, 430 U.S. 551 (1977), preclude dissociation for sales and use tax purposes, or does this Court's contemporary dormant Commerce Clause jurisprudence control requiring that a state have tax nexus with each activity it seeks to tax as required by the holding in *Quill Corp. v. North Dakota,* 504 U.S. 298 (1992)?'

Petitions Still Pending

The following five petitions for certiorari remained pending before the Court as this issue of the JOURNAL went to press.

Pennsylvania's sheriff sale and due process notice rights.

On 3/13/2017, the Court received a new petition for certiorari in *Reynolds v. Bethel Park School District,* Docket No. 16-1403, ruling below at *Bethel Park School Dist. v. Reynolds*, No. 2618 (Pa. Commonwealth Ct. June 9, 2016), appeal denied, Pa. S. Ct., in which the Commonwealth Court of Pennsylvania held that the taxpayer, Reynolds, was not entitled to set aside the sherriff's sale of his property based on inadequate notice.

****11** As explained by the court below, Reynolds failed to pay real estate taxes on his property located in Bethel Park, Pennsylvania for the periods 1987-1989 and 1991-2005. As a result, the Bethel Park School District eventually seized and sold the property to a third party at a sheriff's sale. Reynolds then filed a petition in trial court to set aside the sheriff's sale, asserting that he failed to receive proper notice of the sale.

The trial court denied Reynolds's petition and the Pennsylvania Commonwealth Court affirmed the trial court's order that the sheriff's sale should not be set aside. The court found that multiple notification letters were sent to both the property address and the tax mailing address by U.S. first-class mail and certified mail. On this basis, the court found that there was ‘ample evidence to support the trial court's decision to deny the Petition because Reynolds was provided with adequate notice of the sheriff sale and there was no violation of due process.‘

The Commonwealth Court also rejected the case cited by Reynolds—*Jones v. Flowers,* 547 U.S. 220 (2006)—in support of his argument that there was inadequate notice. Reynolds now asks the U.S. Supreme Court ‘Whether the Sherriff's sale was in violation of the Due Process Clause of the Constitution of the United States due to lack of notification?‘ The Court has distributed this petition for conference for September 25, 2017, when it returns next term. (For more background on this case see U.S. Supreme Court Update, 27 JMT 41 (September 2017).)

Washington asks Court to overturn Yakama Nation ‘right to travel‘ without taxation victory.

On 6/14/17, the Court received a new petition for certiorari in *Washington State Dep't of Licensing v. Cougar Den, Inc.*, Docket No 16-1498, ruling below at 188 Wash. 2d 55 (Wash. 2017), in which the Washington Supreme Court held that the Yakama Nation ‘tribe[] w[as] entitled under [the Yakama Nation] [T]reaty to import fuel without holding [an] importer's license and without paying state fuel taxes.‘

As explained by the court below, Article II of the Yakama Nation Treaty of 1855 states in relevant part: ‘[I]f 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 the nearest 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)).

In 2013, Cougar Den, a Confederated Tribes and Bands of the Yakama Nation corporation, began transporting fuel from Oregon to the Yakama Indian Reservation. The company sold the fuel to businesses located on Tribal land and owned by Tribal members. The Washington Department of Licensing, however, issued tax assessments on the imported fuel ($3.6 million of taxes, penalties, and fees for hauling the fuel across state lines). Cougar Den refused to pay the assessment, arguing that the imposition of the tax violated its right to travel under the Yakama Nation Treaty of 1855.

****12** In reviewing the assessment, and upholding the lower courts' ruling in Cougar Den's favor, the Washington Supreme Court noted that ‘[t]here is no dispute that the taxes and licensing requirements would apply if the treaty provision does not apply

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here.‘ The court further explained, however, that the U.S. Supreme Court's rule of treaty interpretation requires that ‘Indian treaties must be interpreted as the Indians would have understood them.‘ And, the court concluded that ‘[t]he Department's interpretation of the treaty provision ignores the historical significance of travel to the Yakama Indians and the rule of treaty interpretation established by the United States Supreme Court.‘ The court specifically noted that ‘[i]n ruling in Cougar Den's favor, both the ALJ and the Yakima County Superior Court based their ***43** decisions on the history of the right to travel provision of the treaty, relying on the findings of fact and conclusions of law from *Yakama Indian Nation v. Flores*, 955 F. Supp. 1229 (E.D. Wash. 1997),‘ in particular the depiction in the record of a ‘tribal culture whose manner of existence was dependent on the Yakamas' ability to travel.‘

The Washington State Department of Licensing now presents the U.S. Supreme Court with the following question for review in its petition for certiorari: ‘Whether the Yakama Treaty of 1855 creates a right for tribal members to avoid state taxes on off-reservation commercial activities that make use of public highways.‘ (For more background on this case see U.S. Supreme Court Update, 27 JMT 41 (September 2017).)

City of West Hollywood, Calif., files response in building permit fee case.

On 3/15/17, the Court received a 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 developers ask the U.S. Supreme Court to consider whether a West Hollywood ordinance that requires builders to either sell/rent a portion of newly developed housing units at below-market rates or, alternatively, to pay an ‘in lieu‘ fee that is used to fund the construction of other low-income housing violates the Takings Clause of the Fifth Amendment of the U.S. Constitution.

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

****13** 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 need for 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*].‘ On 4/25/17, the Court requested a response to the developers' petition. This response, a brief in opposition was filed on 6/26/17. The Court has distributed this petition for conference for September 25, 2017, when it returns next term. (For more background on this case, including a detailed discussion of the West Hollywood ordinance and the lower court's ruling, see U.S. Supreme Court Update, 27JMT 43 (June 2017).)

W. Va. seeks ruling on requiring S&U tax credits for taxes paid to neighboring cities and counties.

On 4/17/17, the Court received a petition for certiorari in *Steager v. CSX Transportation*, Docket No. 16-1251, ruling below at 238 W. Va. 238 (2016), in which the Commissioner of the West Virginia State Tax Department (the ‘Commissioner‘) asks whether a state must credit out-of-state sales taxes against its in-state use taxes or, alternatively, whether the state can satisfy the requirements of the dormant Commerce Clause by other means, such as apportioning a use tax to reach only intrastate activity.

In the ruling below, the West Virginia Supreme Court of Appeals held that the dormant Commerce Clause required that the Commissioner offer CSX Transportation (‘CSX‘), an operator of an interstate rail transportation system, full credit against its West Virginia use tax obligations for the sales taxes CSX paid on motor fuel to *both* other states and to the subdivisions of

those other states. Specifically, the Supreme Court of ***44** Appeals applied the four-pronged *Complete Auto* test (*see Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)) and found that if the Commissioner were to credit only taxes paid to other states (and not taxes paid to subdivisions of those states), West Virginia's use tax would fail both the fair apportionment and discrimination prongs of the *Complete Auto* test.

Arguing that the West Virginia Supreme Court of Appeals' decision ‘exacerbates [an] existing split among state courts of last resort about whether a State must credit out-of-state sales taxes against use taxes or whether it can satisfy the dormant commerce clause by other means,‘ the Commissioner presents two questions for review in its petition for certiorari:

1. Does the dormant Commerce Clause require a state that imposes a fairly apportioned use tax to also credit sales taxes paid to other states?

2. Does the dormant Commerce Clause require a state that does not impose county or municipal use taxes to provide a credit for sales taxes paid to other states' counties or municipalities?

****14** The Court has distributed this petition for conference for September 25, 2017, when it returns next term. (For more background on this case, including the lower court's review of the four-pronged *Complete Auto* test, see U.S. Supreme Court Update, 27 JMT 42 (July 2017).)

Comity barred Ga. property owners from challenging local fee in federal court.

On 5/8/17, the Court received a petition for certiorari in *Homewood Village LLC v. Unified Government of Athens-Clarke Cnty. Georgia*, Docket No. 16-1361, ruling below at 2017 WL 491151 (11th Cir. 2017) in which a group of Georgia property owners sought to challenge an Athens-Clarke County ordinance, which imposed a fee on certain property owners to fund the county's stormwater management program. The property owners claim that the fee violates their rights under the Takings Clause of the Fifth Amendment and the Due Process and Equal Protection Clauses of the Fourteenth Amendment.

The property owners first brought their challenge against the fee in Georgia federal district court. The county initially sought to have the case removed from federal court under the Tax Injunction Act (‘TIA‘), but the lower court held that the TIA did not deprive the court of subject matter jurisdiction. According to the district court, the county ordinance imposing the stormwater charge constitutes a user ‘fee,‘ not a ‘tax,‘ and, thus, the TIA did not deprive federal courts of jurisdiction over claims that the fee was unconstitutional. Nevertheless, the lower court noted that ‘[i]t is sometimes appropriate to dismiss an action in federal court due to comity concerns even when the Tax Injunction Act does not deprive the court of subject matter jurisdiction.‘ According to the lower court, this was one such case.

Specifically, the district court noted that, under the principle of comity, federal courts should be ‘reluctant to interfere in the fiscal operations of state and local governments and must be particularly sensitive to avoid such interference when the dispute involves a constitutional challenge to a state or municipal tax or fee and an adequate remedy exists in state court.‘ In the present case, the court held that the relief sought by the Georgia property owners—i.e., a declaratory judgment preventing Athens-Clarke from collecting the stormwater management fee from the petitioners—would require, ‘through a federal judicial mandate, that Athens-Clarke abandon the fee system and fund the [stormwater] program in another way.‘ This, according to the court, is ‘precisely the type of federal judicial interference that raises comity concerns that counsel in favor of federal court abstention.‘

On appeal, the U.S. Court of Appeals for the Eleventh Circuit reviewed the district court's abstention decision for ‘an abuse of discretion‘ and held that it could not conclude that the district court abused its discretion in abstaining from deciding the merits of the claims asserted. Accordingly, the circuit court upheld the lower court's dismissal of the petitioners' claims due to concerns over comity between federal courts and state governments.

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****15** In their appeal to the Supreme Court, the petitioners raise two questions for review. First, they ask, '[w]hen a district court dismisses a complaint for comity is the standard of appellate review de novo or abuse of discretion or something in between, as some Circuits have held, in conflict with the Eleventh Circuit?' And, second, the petitioners ask, '[d]oes a municipality's potential loss of user-fee revenue constitute an exceptional circumstance that requires a district court to abstain based on comity from exercising its virtually unflagging obligation to hear and decide a case over which it has undoubted jurisdiction?'

The Court has distributed this petition for conference for September 25, 2017, when it returns next term. (For more background on this case, see U.S. Supreme Court Update, 27 JMT 39 (August 2017).)

The Michigan Court of Appeals affirmed a lower court's ruling that rejected all claims brought by a retired Michigan school teacher, . . . challenging Michigan's repeal of its tax exempt treatment of [teachers'] pension income.

[T]axpayers claim that Michigan violated their Fifth Amendment rights by selling their tax delinquent property and keeping the surplus profits from the sales as an alleged 'windfall.'

[A] trust argues that in order for a state to properly tax a nonresident, the state must have *specific* jurisdiction over the nonresident.

The Washington Court of Appeals affirmed a ruling that an out-of-state corporation could not dissociate its retail sales from its wholesale sales to avoid creating 'substantial nexus' with the state.

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