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U.S. Supreme Court Update

U.S. SUPREME COURT UPDATE

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All Quiet on the State and Local Tax Cert Front

***44** The U.S. Supreme Court has not received or denied certiorari in any cases involving state and local taxes since last month's column. However, the Court is set to review three cases in which certiorari was granted in June: *Washington State Dep't of Licensing v. Cougar Den, Inc.* (Docket No. 16-1498); *Dawson v. Steager* (Docket No. 17-419); and *FTB v. Hyatt* (Docket No. 17-1299). This month, we delve a little deeper into these cases and the issues they present.

The Court still remains set to review 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. 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. (The Court typically assigns original jurisdiction disputes—cases such as disputes between states that are first heard at the Supreme Court level—to a Special Master to conduct what amounts to a trial court proceeding.) We will continue to update readers as more details become available.

At the time of this writing, we're also waiting to see if Brett Kavanaugh is confirmed to the Supreme Court as an Associate Justice after being nominated by President Donald Trump on July 9, 2018. Judge Kavanaugh is currently a U.S. Circuit Court Judge of the U.S. Court of Appeals for the District of Columbia Circuit. Judge Kavanaugh would take the vacant spot created by the retirement of Justice Anthony Kennedy, for whom he clerked.

From a state and local tax perspective, not much is known about Kavanaugh as his portfolio of tax cases is limited. Notably, when the Affordable Care Act was under review, Kavanaugh dissented when a D.C. Circuit Court panel upheld the law, but he did so on procedural grounds, i.e., the Tax Injunction Act. According to Judge Kavanaugh, judges should not decide suits challenging a tax provision until the plaintiff has first paid the tax. Many criticized this dissent, on the basis that if adopted by the majority, this procedural ground would have delayed a ruling on the constitutionality of the law.

****2** Judge Kavanaugh is also widely cited for the principal that 'a judge must be independent and must interpret the law, not make the law.' This type of 'textualism,' would make Kavanaugh skeptical of judge-made doctrines. Accordingly, many believe that he would be a skeptic of the Dormant Commerce Clause doctrine. Under this doctrine, the Commerce Clause of

the U.S. Constitution is construed to prohibit states from enacting laws that improperly burden or discriminate against interstate commerce, and it is at issue in many state and local tax cases, including the Supreme Court's recent *Wayfair* decision.

More Detailed Review of SALT Cases on the Docket for the Current Term

On June 25, 2018, the Supreme Court granted certiorari in *Washington State Dep't of Licensing v. Cougar Den, Inc.* (Docket No. 16-1498) and *Dawson v. Steager* (Docket No. 17-419), and on June 28, 2018, the Court granted certiorari in *FTB v. Hyatt* (Docket No. 17-1299).

Review granted of Yakama Nation 'right to travel' without taxation victory over Washington State.

In *Washington State Dep't of Licensing v. Cougar Den, Inc.* (Docket No. 16-1498), ruling below at 188 Wash. 2d 55 (Wash. 2017), 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, 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 ***45** 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.

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 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.' 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 decisions on the history of the right to travel provision of the treaty, relying on the findings of fact and conclusionsof 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.'

****3** The U.S. Supreme Court has now granted certiorari for the question posed by the Washington State Department of Licensing for review: '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.'

The Court invited the Solicitor General to file a brief expressing the views of the United States. The brief for the United States argues that '[t]he Washington Supreme Court erred in concluding that Article III of the 1885 Treaty exempted [Cougar Den] from paying Washington's motor-fuel tax.' The Solicitor General sets forth two main reasons why the Washington Supreme Court's decision is incorrect.

First, the Solicitor General explains that '[t]he right, in common with citizens of the United States, to travel upon all public highways protected by the 1885 Treaty . . . is not violated by the tax at issue here, which taxes the introduction of a good into the state stream of commerce, no matter where the good originates or how it enters the State.' In this regard, the Solicitor General

further explains that because the 'incidence of the tax is not on the use of public highways, and imposition of the tax does not depend upon a taxpayer's use of the highways . . . the tax is . . . appropriately viewed as an excise tax on 'the first instance of wholesale possession of fuel within Washington,' not as a tax on the use of the public highway within the meaning of Article III of the 1855 Treaty.' Thus, the Solicitor General's argument is focused primarily on the premise that 'Article III does not exempt goods from taxation outside the Treaty's reservationsimply because they are, or could be, transported by the highway.'

The Solicitor General also cites to the history of Washington's motor fuel tax in further support of the proposition that the tax was designed as an excise tax on the fuel itself, rather than a tax on highway travel. The brief explains how the U.S. Supreme Court held in *Oklahoma Tax Commission v. Chickasaw Nation*, 515 U.S. 450 (1995), 'that a State could not apply its motor-fuel tax to fuel sold by a tribe to non-Indians in Indian country, but it noted that 'if a State is unable to enforce a tax because the legal incidence of the impost is on Indians or Indian tribes, the State generally is free to amend its law to shift the tax's legal incidence.'' According, to the Solicitor General, the legislative history of the motor-fuel tax at issue demonstrates that the Washington Legislature responded to the Court's decision and 'moved the incidence of its motor fuel tax up the supply chain to entities that supply fuel to retailers, imposing the tax before the fuel arrives on Indian reservations.' Thus, the law should pass muster.

In addition, the Solicitor General argues that the Washington Supreme Court's 'decision is in tension with decisions of the Ninth Circuit interpreting the same treaty provision,' and, thus, must be corrected. The Solicitor General cites in particular to the appeals court decision in *King Mountain Tobacco Co. v. Mckenna,* 768 F.3d 989 (9th 2014), *cert. denied,* 135 U.S. 1542 (2015*),* where the court held that Article III of the 1855 Treaty did not exempt members of the Tribe from complying with a state law that required cigarette companies to place money in an escrow account for every qualifying unit of tobacco sold subject to the state's cigarette tax, in order to reimburse the state for public health expenses related to the use of tobacco products. Per the Solicitor General, this case is significant because '[t]he Court rejected the Tribe's argument that Article III of the 1855 Treaty 'prohibit[s] imposition of economic restrictions or preconditions on the Yakama people's Treaty right to engage in the trade of tobacco products' . . . [t]he Court explained that that while the treaty secures for the Tribe a 'right to *travel* . . . for the purpose of transporting goods to market' without state interference,it does not secure any right to *trade* beyond the right to transport goods on the highways.'

W.V.'s differential treatment of retirement benefits and intergovernmental immunity to be reviewed.

****4 *46** In *Dawson v. Steager,* Docket No. 17-419, ruling below at *Steager v. Dawson*, 2017 WL 2172006 (W. Va. 2017), the West Virginia Supreme Court of Appeals held that James Dawson, a retired U.S. Marshal, was not entitled to exempt his Federal Employee Retirement System ('FERS') income from state income tax.

According to the court, Dawson worked as a deputy U.S. Marshal in West Virginia. Dawson was enrolled in FERS, a federal retirement plan, and sought a West Virginia exemption for all of his FERS income. The state court, however, noted that under West Virginia law, unlike certain state law enforcement retirees who may exempt all of their state retirement benefits from taxable income, Dawson was entitled to exempt only a portion of his FERS income. The Supreme Court of Appeals held that this distinction did not violate the doctrine of 'intergovernmental tax immunity,' as codified in 4 U.S.C. § 111 (which permits state taxation of federal officers' or employees' compensation, including retirement benefits, only if 'the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.')

According to the state high court, 'the total structure of West Virginia's system for taxing personal income does not discriminate against retired members of the United States Marshals Service in violation of 4 U.S.C. § 111. ' Instead, the court held the exemption at issue merely gives a benefit to 'a very narrow class of former state and local employees, and that benefit was not intended to discriminate against former federal marshals.'

Dawson asked the U.S. Supreme Court to consider: 'Whether this Court's precedent and the doctrine of intergovernmental tax immunity bar states from exempting groups of state retirees from state income tax while discriminating against similarly

situated federal retirees based on the source of their retirement income.' However, the Court did not grant certiorari with respect to Dawson's question, but instead granted certiorari limited to the issue presented by the Solicitor General in an amicus curiae brief filed on May 15, 2018.

The Solicitor General argues that '[t]he West Virginia Supreme Court of Appeals misapplied the doctrine of intergovernmental tax immunity, as codified in 4 U.S.C. § 111' and that, '[u]nder the test articulated in *Davis v. Michigan Department of the Treasury*, 489 U.S. 803 (1989), the court should have asked whether the State's inconsistent tax treatment of former federal and state law-enforcement officers 'is directly related to, and justified by, significant differences between the two classes.'' The West Virginia high court's application of a 'totality of the circumstances' analysis, the Solicitor General argues, 'is inconsistent with *Davis* and with this Court's other intergovernmental tax immunity decisions.'

More specifically, the Solicitor General's brief provides as follows: 'West Virginia fully exempts from its income tax the retirement benefits of certain state-law enforcement officers, while providing a lesser exemption for the retirement benefits received by federal law-enforcement officers, like Mr. Dawson. The Circuit Court of Mercer County found it 'undisputed . . . that there are no significant differences between Mr. Dawson's powers and duties as a U.S. Marshal and the powers and duties of the state and local enforcement officers . . . .' The West Virginia Supreme Court of Appeals did not cast doubt on that view of the record . . . . If that understanding of the facts is correct . . . West Virginia's differential taxing scheme impermissibly discriminates between 'similarly situated federal and state employees' based on the source of their pay or compensation.''

****5** Before the U.S. Supreme Court, the state will likely continue to argue that the state court decision was correct, including its application of *Davis*. Furthermore, as set forth in its briefs, the state will also likely argue that 'revisiting this Court's intergovernmental tax immunity precedent would needlessly unsettle decisions ***48** of courts across the country that have already resolved these issues consistent with [4 U.S.C.] Section 111 and the Constitution.' Dawson will likely argue, as the Solicitor General does in its brief, that the West Virginia Supreme Court of Appeals incorrectly articulated the test under *Davis*, and when applying the proper test, the decision must be reversed as there is no justification for the differential treatment.

Court to review whether California FTB is immune from taxpayer tort claims.

In *Franchise Tax Bd. of Cal. v. Hyatt*, Docket No. 17-1299, ruling below at 407 P.3d 717 (Nev. 2017) the Nevada Supreme Court held that the California Franchise Tax Board (the 'FTB') was not entitled to immunity from intentional and bad faith tort claims brought by a former California resident, Gilbert Hyatt.

The granting of certiorari marks the latest in a long-running dispute between Hyatt and the FTB, stemming from the agency's attempt to collect approximately $10 million in taxes on patent licensing fees earned by Hyatt in the 1990s. Following an audit in which the FTB determined Hyatt to be a California resident, Hyatt sued the FTB in Nevada state court, claiming that the FTB's abusive investigation techniques cost him business opportunities and inflicted emotional distress. After a verdict in Hyatt's favor, the Nevada Supreme Court eventually largely reversed a jury award for tort and punitive damages awarded to Hyatt. Citing to *Nevada v. Hall*, 440 U.S. 410 (1979), however, which held that the U.S. Constitution does not grant states sovereign immunity from suit in the courts of other states, the Nevada Supreme Court eventually rejected the FTB's claim of complete immunity. Ultimately, the U.S. Supreme Court affirmed Nevada's decision in *Franchise Tax Bd. of Cal. v. Hyatt (Hyatt I)*, 538 U.S. 488 (2003).

After another round at the Nevada Supreme Court, which held that the FTB was liable for fraud and intentional infliction of emotional distress only, the FTB appealed once again to the U.S. Supreme Court. The Court granted certiorari for the second time, agreeing to consider two questions: (1) whether the Nevada Supreme Court erred by failing to apply to the FTB the statutory immunities available to Nevada agencies and (2) whether the U.S. Supreme Court's prior decision in *Nevada v. Hall*, 440 U.S. 410 (1979), should be overruled. In its second decision, *Franchise Tax Bd. of Cal. v. Hyatt (Hyatt II)*, 136 S. Ct. 1277 (2016), the Court held that, with regard to California's first claim, the Full Faith and Credit Clause does not 'permit[] Nevada to award damages against California agencies under Nevada law that are greater than it could award against Nevada agencies in

similar circumstances.‘ As to California's second question, however, the Court, in the wake of Justice Antonin Scalia's death, split 4 to 4 on whether *Hall* should be overruled.

****6** On remand from *Hyatt II*, the Nevada Supreme Court followed the high court's instructions and held that the FTB was entitled to the benefit of Nevada's statutory damages cap and instructed the trial court to enter a damages award for fraud within the cap of $50,000. The FTB again requested the U.S. Supreme Court grant certiorari, arguing that ‘under our federal system, an agency of one State may not (absent its consent) be sued in the courts of another State.‘ Specifically, the FTB asked the Court to answer the question it agreed to decide in *Hyatt II:* ‘whether *Nevada v. Hall*, 440 U.S. 410 (1979), which permits a sovereign State to be haled into another State's courts without its consent, should be overruled.‘ The Court granted the FTB's request.

Two amicus briefs were filed during this round. The Multistate Tax Commission (MTC) filed an amicus brief in support of the California Franchise Tax Board. The petition, as noted, asks the Court to overturn *Nevada v. Hall.* In its brief, the MTC argued that *Nevada v. Hall*, ‘opens a path for putative taxpayers to disrupt state tax enforcement‘ and ‘states cannot solve these problems through reciprocal agreements to exercise comity.‘

In addition, a joint state amicus brief was filed by Indiana and 44 other states. The states set forth three reasons for the Court to grant the petition: (1) that ‘*Hall* enables another state's courts to review a state tax audit demonstrates the severity of the insult to sovereignty,‘ (2) ‘*Hall* continues to enable widespread state judicial interference with the sovereign functions of other states,‘ and (3) ‘*Hall* is fundamentally contrary to the remainder of sovereign immunity doctrine and should be overruled.‘ As explained by the states in their brief, ‘[t]he Constitution never would have been ratified if the States and their courts were to be stripped of their sovereign authority except as expressly provided by the Constitution itself . . . . [b]ut while *Hall* took that underlying sentiment to mean that an expectation of comity was sufficient protection against interstate jurisdiction,the more appropriate inference is that the inquiry for this Court should be whether anything in the Constitution *allows* jurisdiction to State courts over their sister States—not whether anything *forbids* it.‘

The Solicitor General argues that the Washington Supreme Court's ‘decision is in tension with decisions of the Ninth Circuit interpreting the same treaty provision.‘

The Solicitor General argues that ‘[t]he West Virginia Supreme Court of Appeals misapplied the doctrine of intergovernmental tax immunity . . . .‘

The FTB asked the Court to answer the question it agreed to decide in *Hyatt II:* ‘whether *Nevada v. Hall*, 440 U.S. 410 (1979) . . . should be overruled.‘

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