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U.S. Supreme Court Update

U.S. SUPREME COURT UPDATE

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Court Overturns *Quill* 'Physical-Presence' Standard; Grants Cert in Three SALT Matters

***42** The U.S. Supreme Court issued its decision in *South Dakota v. Wayfair, Inc. et al.*, 585 U.S. ____ (2018) and overturned the 'physical-presence' nexus standard that had been the law of the land for sales tax purposes for the past fewdecades. The Court overturned not one but two of its previous decisions: *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) and *National Bellas Hess, Inc. v. Dep't of Revenue of Illinois*, 386 U.S. 753 (1967). What the Court did not do, however, is rule that South Dakota's new economic nexus standard is valid under the U.S. Constitution. Rather, the Court remanded the case to the lower courts to examine the law's constitutionalityin the absence of a *Quill* physical presence standard. A few days after the issuance of the *Wayfair* decision, in which he authored the majority opinion, Justice Anthony Kennedy announced that he would retire from the Court on July31, 2018.

In addition to the *Wayfair* opinion, the Court denied the recently reported petition in *Nextel Communications of the Mid-Atlantic, Inc. v. Pennsylvania* (Docket No. 17-1506) and granted certiorari in three separate cases: *WashingtonState 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). Also, the Court remains set to review a dispute between Delaware and several otherstates 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 *Arkansaset. al. v. Delaware*, Case No. 220146.

South Dakota v. Wayfair

In *South Dakota v. Wayfair, Inc. et al.*, 585 U.S. ____ (2018), the Supreme Court, in a 5-4 decision, overruled the physical presence nexus standard set forth in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). In *Quill*,the Court held that for an out-of-state business to be subject to sales and use tax collection and remittance requirements, the out-of-state business must maintain some type of physical connection in the state, such as having employees, inventory, or otherproperty, to satisfy the Commerce Clause of the U.S. Constitution. Justice Kennedy wrote the opinion of the Court in *Wayfair,* with Justices Thomas, Ginsburg, Alito and Gorsuch concurring. Chief Justice Roberts wrote the dissenting opinion withJustices Breyer, Sotomayor and Kagan joining.

Pre-*Quill*, *Bellas Hess.*

****2** As regular readers may recall, before the U.S. Supreme Court decided *Quill*, it decided *National Bellas Hess, Inc. v. Dep't of Revenue of Illinois*, 386 U.S.753 (1967). In *Bellas Hess,* the Court held that a 'seller whoseonly connection with customers in the State is by common carrier or United States mail' does not have the requisite minimum contacts with the state required by the Due Process Clause and Commerce Clause. In *Quill*, while the Court overturned theDue Process Clause holding of *Bellas Hess*, it found the 'continuing value of a bright line [physical presence] rule . . . and the doctrine and principles of *stare decisis* indicate that the *Bellas Hess* [physicalpresence] rule remains good law' for Commerce Clause purposes. Thus, it overturned the physical presence nexus rule for due process purposes, but retained the physical presence nexus rule for Commerce Clausepurposes for sales tax.

Justice Kennedy's invitation to reexamine *Quill* and South Dakota's response.

In his concurrence in *Direct Marketing Ass'n v. Brohl,* 135 S. Ct. 1124 (2015), Justice Kennedy signaled that the Court might be open to overturning *Quill*, writing: 'Given these changes in technology and consumer sophistication, it is unwise to delay any longer a reconsiderationof the Court's holding in *Quill.* A case questionable even when decided, *Quill* now harms States to a degree far greater than could have been anticipated earlier.'

South Dakota reacted to this invitation and its Legislature enacted 2016 Senate Bill 106, which provides that an out-of-state seller has nexus for sales and use tax purposes as long as the out-of-state seller either has gross revenues from delivery of productsor services into South Dakota that exceed $100,000, or it sold goods for delivery into South Dakota in 200 or more separate transactions (during ***43** the previous calendar or current calendar year). The law was effective May 1, 2016, and applied only prospectively.

After enacting the law, South Dakota filed suit in state court seeking a declaration that the law's requirements were valid and applicable to certain online retailers. (The South Dakota Legislature included the declaratory judgment mechanism within its law,together with an injunction that stayed the law's enforcement pending a decision on the constitutionality of the law). Online retailers Wayfair, Inc., Systemax, Inc., and Overstock, Inc. sought summary judgment that the law was unconstitutional under *Quill.* Thetrial court granted their request for summary judgment and the South Dakota Supreme Court affirmed on the grounds that the physical presence standard of *Quill* was controlling precedent. South Dakota's petition of certiorari, which asked 'shouldthis Court abrogate *Quill's* sales-tax-only physical presence requirement,' was ultimately granted.

South Dakota had argued that the *Quill* standard was harmful to local governments, brick-and-mortar businesses, and to interstate commerce itself, and that *Quill* was the type of judicial mistake that did not need to be reinforcedunder *stare decisis.* Instead of the physical presence standard required by *Quill*, South Dakota argued that the four-prong test from *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977), should be applied when determining the constitutionality of a state's sales and use tax laws under a Commerce Clause analysis.

The Court's 5-4 decision.

****3** In its decision, the Court agreed with South Dakota and held that the 'physical presence rule becomes further removed from economic reality' with each passing year. In the view of the majority of the Court, the growth of e-commerce and Internet saleshas made *Quill* unworkable and unreliable as precedent.

In overturning *Quill*, the Court affirmed that the *Complete Auto* test should be applied to determine the validity of state taxes under the Commerce Clause. Thus, a court will sustain a tax so long as it: (1) applies to an activitywith a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services the state provides. Accordingly, the Court remanded the case to the lower courts fora determination of whether

South Dakota's new nexus standard did not discriminate against or unduly burden interstate commerce in violation of the dormant Commerce Clause. However, the Court signaled that the safeguards put in place by South Dakota seemedlikely to result in minimal burdens to interstate commerce. Such safeguards include the $100,000 in-state receipts/200 in-state transaction threshold, participation in the Streamlined Sales and Use Tax Agreement, and theprospective-only applicability.

The Court also explained why *Quill* was 'unsound and incorrect.' First, the Court noted that 'the physical presence rule is not a necessary interpretation of the requirement that a state tax must be 'applied to an activity witha substantial nexus with the taxing state'' (the first prong of *Complete Auto*). Second, the Court explained that '*Quill* creates rather than resolves market distortions.' Third, the Court found that '*Quill* imposesthe sort of arbitrary, formalistic distinction that the Court's modern Commerce Clause ***44** precedents disavow.' Per the majority, '[t]his Court should not maintain a rule that ignores . . . substantial virtual connections to the State.'

With respect to *stare decisis,* the Court stated '*[s]tare decisis* is not an inexorable command. Here *stare decisis* can no longer support the Court's prohibition of a valid exercise of the State's sovereignpower.' The Court noted the 'Internet's prevalence and power have changed the dynamics of the national economy' since *Quill* was decided. It also cited other aspects of the Court's Commerce Clause doctrine protecting against undue burdenson interstate commerce.

The dissent.

Chief Justice Roberts authored the dissenting opinion. First, Chief Justice Roberts explained that '[t]he Court argues in favor of overturning [the *Bellas Hess*] decision because the 'Internet's prevalence and powerhave changed the dynamics of the national economy' . . . . But that is the very reason why I oppose discarding the physical presence rule.' Further, Chief Justice Roberts argues that '[a]ny alteration to those [*Bellas Hess* and*Quill* physical presence] rules with the potential to disrupt the development of such a critical segment of the economy should be undertaken by Congress.'

****4** Second, the dissent maintained that *stare decisis* 'should be an even greater impediment to overruling precedent now' and 'the Court may have waylaid Congress's consideration of the issue.'

Third, Chief Justice Roberts examined the factual predicates of the majority's assertion that the states are experiencing significant revenue losses and found an indication that with remote collection growing 'the pendulum is swinging in the opposite direction.'

Finally, the dissenting opinion argued that the Court disregarded the costs that its decision will impose on retailers: 'The Court's decision today will surely have the effect of dampening opportunities for commerce in a broad range of new markets.'

Petitions Granted

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 certiorariin *FTB v. Hyatt* (Docket No. 17-1299).

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

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 'w[as] entitled under [the Yakama Nation] [T]reaty to import fuel without holding [an] importer's license andwithout 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, withfree 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 WashingtonDepartment 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 itsright to travel under the Yakama Nation Treaty of 1855.

***45** 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 notapply 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]heDepartment'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]nruling 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.‘

****5** The 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 activitiesthat make use of public highways.‘

Court to consider W.V.'s differential treatment of retirement benefits and intergovernmental immunity.

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 Mr. Dawson, a retired U.S. Marshal, was not entitled to exempt his FederalEmployee Retirement System (‘FERS‘) income from state income tax.

According to the West Virginia court, James Dawson (‘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 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 West Virginia Supreme Court ofAppeals held that this distinction did not violate the doctrine of ‘intergovernmental tax immunity.‘

According to the state 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 4U.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.‘

In his petition, 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 againstsimilarly situated federal retirees based on the source of their retirement income.‘ However, the Court did not grant certiorari with respect to Dawson's question, and instead granted certiorari limited to the issue presented by the U.S. Solicitor Generalin an amicus curiae brief filed on May 15, 2018.

The Solicitor General argued that ‘[t]he West Virginia Supreme Court of Appeals misapplied the doctrine of intergovernmental tax immunity‘ and that, ‘[u]nder the test articulated in *Davis v. Michigan Department ofthe 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 court's application of a ‘totality of the circumstances‘ analysis, the Solicitor General argued, ‘is inconsistent with *Davis* and with this Court's other intergovernmental tax immunity decisions.‘

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

****6** 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 ***46** bad-faith tort claims brought by a former California resident, Gilbert Hyatt.

The granting of certiorari marks the latest in a long-running saga between Hyatt and the FTB. Hyatt's dispute with the FTB stems 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. The NevadaSupreme Court eventually largely reversed a jury award of tort damages 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 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, the FTB sought review once again in 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*, 440U.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 thanit 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, spilt 4-4 on whether *Hall* should be overruled.

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 withinthe cap of $50,000. The FTB again requested the U.S. Supreme Court to 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 askedthe Court to answer the question it agreed to decide in *Hyatt II:* ‘whether *Nevada v. Hall* should be overruled.‘ The Court has now granted the FTB's request.

Petition Denied

****7** On June 11, 2018, the Court denied review in *Nextel Communications of the Mid-Atlantic, Inc. v. Pennsylvania Dep't of Revenue* (Docket No. 17-1506), in which the Court had been asked to review a Pennsylvania Supreme Court decision that held that,although a state cap on net loss carryovers for tax year 2007 violated the Uniformity Clause of the Pennsylvania Constitution, the taxpayer was not entitled to a refund of taxes paid because the proper remedy was to sever the unconstitutional flat-dollar capprovision from the law, as opposed to striking down the statute entirely.

In overturning *Quill*, the Court affirmed that the *Complete Auto* test should be applied to determine the validity of state taxes under the Commerce Clause.

The Solicitor General argued that '[t]he West Virginia Supreme Court of Appeals misapplied the doctrine of intergovernmental tax immunity.'

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