Journal of Multistate Taxation and Incentives
Volume 24, Number 2, May 2014
Department: *U.S. SUPREME COURT UPDATE*

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More Petitions Filed; Tribal Property Tax Case Settled

As the U.S. Supreme Court heads toward the end of its current session, two new petitions for certiorari were filed in state and local tax matters. These are reviewed below, together with Equifax Inc.'s due process challenge that was filed as we went to press in our last issue.

In addition, as we go to press with this issue, the Court has just issued its opinion in *U.S. v. Quality Stores, Inc.* We'll discuss the decision briefly below, with a more detailed analysis to follow in our next issue.

And we still await the Court's decisions on whether to grant three previously filed requests for certiorari. Finally, the Court denied certiorari in another previously filed petition, while the petition for review in *Madison County v. Oneida Indian Nation* was withdrawn.

Court Decides Severance Pay FICA Case

The Supreme Court has issued its decision in *U.S. v. Quality Stores, Inc.,* Docket No, 12-1408, 3/25/14, 2014 WL 1168968 *rev'g and rem'g In re Quality Stores, Inc.,* 110 AFTR 2d 2012-5827, 693 F3d 605, 2012-2 USTC ¶50551 (CA-6, 2012), *reh'g and reh'g en banc den.* 1/4/13. The case considered whether certain severance payments made to employees, whose employment had been involuntarily terminated, constitute "wages" subject to the Federal Insurance Contributions Act (FICA). The federal Court of Appeals for the Sixth Circuit found that these severance payments constituted "supplemental unemployment compensation benefits" under IRC Section 3402(o), which governs the withholding of federal income tax and which states that any such benefit "shall be treated as if it were a payment of wages" for purposes of income-tax withholding. Thus, the Sixth Circuit held that

such benefits were not "wages" for income tax purposes but merely were to be "treated" as such for purposes of withholding, and further, such payments were, similarly, not "wages" for purposes of FICA. As previously mentioned in this column, given the importance of the definition of "wages" for various purposes, including state unemployment insurance taxes and federal and state income taxes for withholding purposes, this case has notable state and local tax implications.

As noted above, this column will examine the Supreme Court's reversal of the Sixth Circuit in greater detail in our next edition. (For more on this litigation now, see U.S. Supreme Court Update, 23 J. Multistate Tax’n 43 (August 2013), and for a summary of the oral argument, see U.S. Supreme Court Update 24 J. Multistate Tax’n 39 (Mar/Apr 2014).)

Settlement of Long-Running Tribal Property Tax Case

An agreement between the Oneida Indian Nation and the State of New York settles years of litigation involving land and tax claims. See *New York v. Jewell and Oneida Nation of New York, IntervenorDefendant,* DC N.Y., No. 6:08-CV-0644, 3/4/14, 2014 WL 841764 , the memorandum decision and order approving the settlement agreement.

In the underlying proceedings, *Madison County, N.Y. v. Oneida Indian Nation of New York,* Docket No. 12-604, petition for cert. filed 11/12/12, ruling below as *Oneida Indian Nation of New York v. Madison County, N.Y.,* 665 F3d 408 (CA-2, 2011), Madison and Oneida counties each sought to foreclose on land owned by Oneida Indian Nation for nonpayment of real property taxes. The Oneida Indian Nation sued in federal court to enjoin the New York counties from foreclosing on their properties, and litigation developed in the federal district court in New York, the Court of Appeals for the Second Circuit, and the U.S. Supreme Court. As a part of the settlement agreement, the counties agreed to withdraw their petition for a writ of certiorari filed in the Supreme Court, and New York State agreed to withdraw the amicus brief it filed in the case. In February 2013, the Court had asked the U.S. Solicitor General to file a brief expressing the views of the federal government in this case but such brief was never filed. (For a full discussion of this litigation, see U.S. Supreme Court Update, 22 J. Multistate Tax’n 41 (February 2013).)

The Supreme Court received the motion to dismiss the petition for certiorari on 3/11/14, and on that same date, the Oneida Indian Nation made an $11 million dollar payment to Madison County for real property back taxes. The settlement agreement also provided for certain payments to New York in gaming revenue (estimated to be close to $50 million per year) from the Oneida Indian Nation, which operates the Turning Stone Casino in Oneida County. And the Settlement Agreement guarantees the Oneida Indian Nation, an exclusive ten-county gaming zone in New York, ensuring that it remains the only entity operating a casino in that region. The funds are expected to be used for economic development in central New York State.

Due Process Challenge to Mississippi's Tax Appeal Procedure

In *Equifax, Inc. v. Mississippi Department of Revenue,* Docket No. 13-1006, petition for cert. filed 2/19/14, ruling below at 125 So 3d 36 (Miss., 2013), *reh'g den.* 11/21/13, *rev'g* Miss. Ct. App., No. 2010-CA-01857-COA, 5/1/12, 2012 WL 1506006 , *reh'g den.* 9/4/12, the Mississippi Supreme Court reversed the Mississippi Court of Appeals decision and reinstated the judgment of the chancery court, which had upheld the Mississippi Department of Revenue's (MDOR's) assessment of corporate income and franchise taxes against Equifax, Inc. and its subsidiary, Equifax Credit Information Services, Inc. (collectively "Equifax"). In what is viewed by many as a surprising decision, the state high court upheld the MDOR's use of an alternative apportionment method—market-based sourcing—in determining Equifax's Mississippi income and, in particular, upheld the chancery court's ruling *placing the burden of proof on the taxpayer* to show that the MDOR's use of an alternative apportionment method was "arbitrary and capricious."

The court found that the use of the market-based sourcing method was not a promulgation of a new rule in violation of the Mississippi Administrative Procedures Act and applied a more-limited trial court "arbitrary and capricious" standard of review, rather than a *de novo* standard of review of the substantive issues underlying the tax assessment. Applying this standard, the court also determined that the chancery court could not reverse the MDOR's decision to impose penalties against Equifax, notwithstanding that the chancellor would have ruled differently on the merits.

Equifax's petition for certiorari raises due process challenges to Mississippi's tax appeals process: whether the Fourteenth Amendment's guarantees of a fair opportunity to challenge tax assessments are violated based on the Mississippi Supreme Court's decision that the chancery court is now limited to reviewing and weighing the record created at the administrative level on an "arbitrary and capricious" basis, rather than having a full evidentiary hearing on the issues presented at the chancery court.

Equifax's apportionment formula. The taxpayers sold credit reports, credit scores, fraud alerts, and other credit reporting and information services to consumers and businesses across the country. For the audit period covering the years 2000 through 2003, Equifax had approximately 800 customers located in Mississippi, generating over $22 million in revenue. Equifax did not have a corporate office in Mississippi but did employ three Mississippi residents. Equifax's Mississippi customers primarily received Equifax's services electronically at their own Mississippi locations. Equifax filed Mississippi state income tax returns for each year in the audit period but reported no taxable income in the state.

In computing its taxable income, Equifax relied on the MDOR's regulations that expressly prescribe "place of performance" or "cost of performance" sourcing of revenue for service providers, which requires service providers to apportion their income based on the place where they perform their income-producing activities. On audit, however, the MDOR determined that the place-of-performance sourcing method did not fairly reflect the extent of Equifax's business activity in Mississippi and that Equifax should have used an alternative, market-based-sourcing apportionment method. Although Mississippi has not adopted the Uniform Division of Income for Tax Purposes Act (UDITPA), the state's apportionment regulations are modeled after UDITPA, including a UDITPA §18 provision, which provides for alternative apportionment if the standard allocation and apportionment provisions do not fairly represent the extent of the taxpayer's business activity in the state (see Miss. Admin. Code 35.III.8.06, R. 402.10). The application of the alternative apportionment method resulted in an assessment of taxes against Equifax.

Procedural history. Equifax first appealed its assessments to the Mississippi State Tax Commission's Board of Review. The Board upheld the assessments (albeit in a reduced amount). Equifax then appealed to the three-member Mississippi State Tax Commission—an

administrative review board comprised of the MDOR's Commissioner and two associate commissioners. The Tax Commission also upheld the MDOR's use of the alternative sourcing method and the resulting assessments. Equifax paid the amounts at issue under protest and filed an appeal with the Hinds County Chancery Court.

In a two-day trial before the chancery court, both Equifax and the MDOR presented testimony from witnesses. The trial court deemed Equifax as the party burdened to prove its entitlement to relief—i.e., Equifax had to show that the MDOR's use of an alternative apportionment formula was improper. The chancellor concluded that Equifax failed to meet its burden. Although the chancellor found the assessment "concerning," it concluded that it could not substitute its judgment for the agency's unless Equifax proved that the latter's interpretation was "arbitrary or unreasonable."

Equifax then appealed to the Mississippi Court of Appeals to review the chancery court's decision. The court of appeals ruled in favor of the taxpayers, finding a *de novo* standard applies to judicial review of MDOR decisions and that the burden of proof was properly on the MDOR, as the party invoking an alternative apportionment method, to demonstrate that the standard apportionment method was not a fair reflection of the taxpayers' in-state activity. The MDOR then sought review by the state's high court.

Standard of review—"deference" or "de novo." The Mississippi Supreme Court examined what a trial *de novo* means in an appeal from a MDOR decision. This required a review of Miss. Code §27-77-7(4), which, as enacted in 2005, stated, in part: "the chancery court shall give deference to the decision and interpretation of law and regulations by the commission as it does with the decisions and interpretation of any administrative agency, but it shall try the case de novo and conduct a full evidentiary judicial hearing on the issues raised. Based on the evidence presented at the hearing, the chancery court shall determine whether the taxpayer has proven, by a preponderance of the evidence or a higher standard if required by the issues raised, that he is entitled to any or all of the relief he has requested." (As amended in 2009, the same general language is found in Miss. Code §27-77-7(5), with the substitution of "Department of Revenue" for "commission" and "party bringing the appeal" for "taxpayer.")

The court held that under the language of this provision, "the chancery court must hold a judicial hearing to determine whether the taxpayer challenging the Commission decision can prove entitlement to any or all of the relief requested by a preponderance of the evidence." The court held further that the evidence to be considered by the chancellor was the record from the MDOR administrative agency appeal and that, to be entitled to reversal of the agency decision, a taxpayer "must raise and prove one or more of the following: the agency's decision was unsupported by substantial evidence, the agency's decision was arbitrary and capricious, the agency's decision was beyond the power of the administrative agency to make, and/or the agency's decision violated the complaining party's statutory or constitutional right" (citing *Buffington v. Mississippi State Tax Commission,* 43 So 3d 450 (Miss., 2010)). The court explained that the chancery court "does not adjudicate the merits (or lack thereof) of the agency's decision, but rather is limited to examining the legality of the decision," i.e., whether the taxpayer can demonstrate one of the four bases for reversal. The court further explained that "[t]he chancery-court proceedings mark the first time a taxpayer may judicially challenge the legality of the Commission's final decision. In the absence of a prior proceeding, no trial anew can occur." Thus, in the supreme court's view, the statute's "instruction to ‘try the case de novo’ is misdirected," and the chancery court's "limited purpose is only to examine whether the Commission's decision was supported by substantial evidence, was not arbitrary and capricious, was within the Commission's power to make, and did not violate the taxpayer's statutory or constitutional rights." The supreme court ultimately determined that Equifax failed to prove that the agency's decision satisfied one of the four bases for reversal.

The court also rejected on this basis the taxpayers arguments that the chancery court erred by finding that the use of the alternative apportionment method to determine Equifax's business in Mississippi was not a promulgation of a new rule in violation of the Mississippi Administrative Procedures Act. Quoting *W.C. Fore v. Mississippi Department of Revenue,* 90 So 3d 572 (Miss., 2012),the supreme court said: "These are factual determinations, and ‘[w]e review the chancellor's factual determinations applying a manifest-error standard.’" The court "likewise" held that it could not abate penalties based solely upon the chancery court's disagreement with the MDOR's findings as to whether Equifax acted reasonably and without willful neglect. "The chancellor was correct that he could not reverse the Commission's decision to impose penalties solely because he would have found differently

than the Commission; rather, he could reverse only if Equifax proved that the imposition of penalties was supported by substantial evidence presented to the Commission, arbitrary and capricious, beyond the power of the Commission, or in violation of Equifax's statutory or constitutional rights—which the chancellor found Equifax had failed to do." Thus, the taxpayers were found subject to penalties even though they followed the precise rule set forth under the MDOR's regulations, an action that typically supports an abatement of penalty (i.e., the deficiency resulted from the taxpayer's acting reasonably by following the tax department's own regulations).

Burden of proof. The Mississippi Supreme Court further interpreted Miss. Code §27-77-7(4) to find that rather than the MDOR, it was the taxpayers that had the burden of proof to show entitlement to relief. Thus, Mississippi's highest court concluded that the court of appeals erred by reversing the chancellor's judgment, and that multistate taxpayers, like Equifax, bear the burden of proving that the MDOR's use of an alternative method of apportionment is "unsupported by substantial evidence, arbitrary and capricious, beyond the power of the Commission, or in violation of a statutory or constitutional right."

The court rejected the authority cited by the taxpayers involving other jurisdictions' adoption of UDITPA; such authority provides, as a general rule, that the party invoking an alternative apportionment method must generally establish the existence of distortion and the reasonableness of the proposed alternative apportionment method to divert from the standard formula. The court noted in a footnote that those decisions "do not inform our decision, for the Mississippi Legislature has not adopted the UDITPA as law; in Mississippi, this UDITPA language appears in an administrative regulation," and more significantly, the "Mississippi Legislature has specifically provided that the taxpayer bears the burden of proof in appeals of Commission decisions" citing Miss. Code §27-77-7(4).

Legislative response. On 2/10/14, the Mississippi State Senate approved a bill to mitigate the effects of the Mississippi Supreme Court's decision in *Equifax.* S.B. 2487 would require that the party requesting or requiring an alternative apportionment method, in this case the MDOR, bear the burden of proof by clear and convincing evidence in any administrative or judicial proceeding that the standard methods of apportionment do not fairly represent the taxpayer's activity in the state. The Mississippi House passed a similar

bill, H.B. 799, on 2/7/14. Then, on 3/6/14, each chamber passed amended versions of the other chamber's bill and returned the legislation to the originating chamber, each of which declined to concur and invited a conference. Whether this legislative response will impact the U.S. Supreme Court's decision on whether to grant certiorari remains to be seen.

Question presented to the U.S. Supreme Court. In its petition for certiorari (see 2014 WL 690176), Equifax asks the U.S. Supreme Court to decide "whether a state violates the Due Process Clause's guarantee of an opportunity to receive a ‘fair opportunity to challenge the accuracy and legal validity’ of an assessment for taxes and penalties, when the taxpayer must present its administrative appeals to employees of the state's revenue department without learning the complete basis for the assessment or having the opportunity to present witnesses or to cross-examine the state's representatives, and the subsequent judicial appeal is not *de novo* but one in which the judge can only reverse the assessment or abate the penalties under a highly deferential standard of review."

(*Equifax* was also discussed in Wilson, "Mississippi: State High Court Reverses Lower Court's Shift of Burden of Proof to Revenue Department," 23 J. Multistate Tax’n 28 (January 2014).)

Unitary Business and Apportionment Challenge

In *Tesoro Corp. v. Alaska Department of Revenue,* Docket No. 13-1023, petition for cert. filed 2/24/14, ruling below at 312 P3d 830 (Alaska, 2013), the Alaska Supreme Court held that Tesoro Corporation, a petroleum company headquartered in Texas, and its subsidiaries constituted a unitary business subject to formula apportionment in Alaska. According to the court, the facts as found by the administrative law judge (ALJ) demonstrate functional integration, centralization of management, and economies of scale—relationships that the state's highest court and the U.S. Supreme Court have held to be unitary. The court also found that Tesoro lacked standing to challenge the constitutionality (i.e., internal consistency) of Alaska's apportionment scheme because the company failed to demonstrate an actual injury that it suffered as a result of the alleged constitutional violation. The court also held that the Alaska Department of Revenue's use of an alternative apportionment formula was reasonable as applied to the taxpayer.

Tesoro's filing history. During the years under audit, Tesoro, had 33 subsidiary corporations that were organized into five business segments: (1) the Exploration and Production ("E&P") segment based in Texas and Bolivia; (2) the Retail and Marketing ("R&M") segment based in Alaska; (3) the Marine Services segment based in Louisiana and Texas; (4) the Corporate segment based in Texas; and (5) the Finance segment based in Texas. The court noted that from the time Tesoro began doing business in Alaska in 1969 until 1994, Tesoro filed its income tax returns as a unitary business, making all of Tesoro's business income subject to apportionment in Alaska. Also, the court found that during the period at issue (1994-1998), two developments (the sale of an interest in a valuable gas field and success in a breach-of-contract claim) caused the companies within E&P to realize profits (nearly $200 million) that were greater than those realized by the subsidiaries in R&M, and that the taxpayer's appeal "effectively tries to shield the profits related to those events from taxation in Alaska."

Tesoro filed its 1998 return taking the position that the subsidiaries within Alaska-based R&M were not unitary with the remainder of Tesoro's subsidiaries. Also for that year, as well as for earlier years at issue, Tesoro took the position that the Alaskan Kenai Pipeline (KPL), a pipeline it purchased in 1995, also was not unitary with the remainder of Tesoro's business segments, and was subject to taxation under a two-factor (property and sales) apportionment formula, while the R&M business segment was subject to tax under a three-factor (property, payroll, and sales) apportionment formula. Tesoro also took the position during these years that, while its Finance segment provided a number of administrative and financial services that were shared across all subsidiaries, the Finance Segment was not unitary with any of the Alaska filers, and therefore, not subject to taxation in Alaska.

Unitary business. The Alaska Supreme Court decision indicates that the court "review[s] questions of law de novo, using our independent judgment." The court explained that "[w]hether Tesoro's business is unitary is a question of law that requires no agency expertise. We will consider the issue de novo, giving only ‘some weight’ to the agency's decision on the matter." (Internal footnotes omitted.) (Compare this de novo standard of review to the standard discussed in the *Equifax* decision, above.)

The court further explained that "[i]n order for a business to be unitary ... there must be flows of value between the parent and subsidiary." The court distinguished between flows of value from the mere passive flow of funds that arises from any parent-subsidiary relationship. Citing *Container Corp. of America v. Franchise Tax Board,* 463 U.S. 159 (1983), the court specifically noted that "[t]hree 'factors of profitability' indicate a unitary business: functional integration, centralization of management, and economies of scale," and determined that the facts found by the ALJ demonstrated such factors. The ALJ heard ten days of testimony and reviewed more than 30,000 pages of documents. The Alaska Supreme Court found it significant that the ALJ found Tesoro's witnesses to be unconvincing, often ignoring the relevant facts in the record; whereas, the ALJ found the Tax Department's expert witness, a professor, to be persuasive, and the facts identified by such expert as relevant.

According to the court, Tesoro's subsidiaries were functionally integrated inasmuch as Tesoro (1) provided its subsidiaries with both loans and loan guarantees; (2) pooled customer remittances from all of its subsidiaries into a shared bank account and then distributed these funds back to the subsidiaries; (3) set overall limits on capital expenditures, thus capital investments made by one subsidiary had to be offset by investments in other subsidiaries; (4) provided its subsidiaries with general oversight and guidance (i.e., Tesoro's board reviewed and approved annual operating budgets, major expenses, and specific projects for the subsidiaries); and finally, (5) experienced significant cost savings by providing its subsidiaries with uniform centralized services (i.e., environmental compliance and safety, information services and technology, internal auditing, legal affairs, insurance, risk management, purchasing, and accounting). According to the court, "[t]hese shared services refute Tesoro's assertion that its subsidiaries were not functionally integrated."

Tesoro urged the Alaska Supreme Court to rule that vertical or horizontal integration is a necessary condition for finding a unitary business. But, according to the court, "Tesoro cites no case that affirmatively establishes this principle, but asserts that it must be true because no United States Supreme Court case denies it." The court refused to adopt such a bright line rule, explaining, first, that the U.S. Supreme Court "has been reluctant to issue bright-line rules such as the one Tesoro proposes, saying instead that the mutual interdependence

necessary for a unitary business can arise in 'any number of ways,'" and also based on its own precedent. Tesoro now asks the U.S. Supreme Court for such a ruling.

With respect to centralization of management, the Alaska high court found that all of Tesoro's subsidiaries were governed by Tesoro's very active board of directors. In particular, the Tesoro board discussed and approved many Alaska-based projects. The court found that this type of "hands-on Tesoro involvement in Alaskan business refutes any claim that Tesoro's Alaska-based subsidiaries should have been treated as somehow insulated from the rest of Tesoro's business enterprise." Finally, the court cited the ALJ's report, which provides numerous observations of economies of scale by the expert professor, including but not limited to the following: elimination of administrative redundancies and consolidated services that saved Tesoro $2.24 million a year; provision of centralized services that created unquantifiable flows of value by allowing local management to focus on day-to-day business operations without worrying about administrative and financial matters; and the savings of $30 million of interest through the use of shared credit facilities.

No standing to challenge apportionment scheme. Under the state's general apportionment statute (Art. IV, §9, of Alaska Stat. 43.19.010, the state's version of the Multistate Tax Compact), the portion of a unitary business's total income apportioned to Alaska is determined based on the typical three-factor formula, i.e., by "multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three."

Alaska Stat. §43.20.144, however, modifies the general apportionment scheme for all taxpayers "engaged in the production of oil or gas from a lease or property in this state or engaged in the transportation of oil or gas by pipeline in this state." Specifically, §43.20.144(c) provides three different apportionment formulas for taxpayers, depending on the nature of the taxpayer's oil or natural gas business in Alaska. Under §43.20.144(c)(1), a taxpayer that only transports oil or gas in Alaska is subject to a two-factor formula based on property and sales. Under §43.20.144(c)(2), a taxpayer that only produces oil or gas in Alaska is subject to a two-factor formula based on property and extraction. And, under §43.20.144(c)(3), a taxpayer that both produces and transports oil or gas in Alaska is subject to a three-factor formula based on property, sales, and *extraction.* A taxpayer that

both produces and transports oil or gas but does neither activity in Alaska, however, is instead subject to the general three-factor apportionment formula prescribed in Alaska Stat. §43.19.010 based on property, sales, and *payroll.*

During 1999, in the interval between Tesoro's first audit (of tax year 1995) and second audit (of tax years 1996-1998), Alaska's attorney general issued an opinion questioning the constitutionality of Alaska Stat. §43.20.144 as applied to businesses that produce oil or gas in-state but transport it out of state. To address the constitutional infirmity identified by the attorney general, the Department of Revenue issued an advisory letter in response that stated that the Department would exercise its authority to apply an alternative apportionment formula under Alaska Stat. §43.19.010, Art. IV, §18(c) (Alaska's UDITPA §18 remedial provision providing for "the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state"). Specifically, the Department's letter stated that it would allow taxpayers engaged in both the production of oil or gas in any jurisdiction and the transportation of oil or gas in any jurisdiction (and also engages in at least one of these activities in Alaska) to use the three-factor property, sales, and *extraction* apportionment formula of Alaska Stat. §43.20.144(c)(3) (the "remedial formula"). In its assessment of tax years 1996-1998, the Department applied the remedial formula to Tesoro.

Tesoro challenged the constitutionality of the state's special apportionment rules for oil and gas businesses. The Department of Revenue urged the court to consider only the specific three-factor, property, payroll, and extraction formula that it applied to Tesoro, rather than the state's entire apportionment regime. The court sided with the taxpayer but ultimately concluded that the taxpayer lacked standing to challenge the internal consistency because it could not demonstrate that it was injured by any inconsistency in the scheme.

Tesoro was able to show through a hypothetical example that if multiple states used Alaska's approach to apportionment, a company could be subject to tax on more than 100% of its income. (The hypothetical demonstrated how the state's tax structure could result in double taxation if it were applied to a business with production activities outside but not inside Alaska.) The court, however, determined that "Tesoro was not such a business during the contested years because it owned KPL, an Alaska-based pipeline," and thus was not

subject to double taxation. The court also found that Tesoro "has not shown that it has been adversely affected by this choice [to apply the remedial formula]." Rather, "Tesoro's example demonstrates that [the Department] applied the formula that was *more favorable* to Tesoro" (emphasis in original). (Application of the remedial formula resulted in only 46.7% of Tesoro's income being subject to tax versus 65% of Tesoro's income being subject to tax upon application of the standard three-factor apportionment formula.) The court explained that "[t]o show injury here, Tesoro is not required to demonstrate that multiple taxation has resulted because *other* states have treated it unfairly. It must only show that there is a risk of multiple taxation because *this* state, Alaska, has treated it unfairly" (emphasis in original). Since the court found that application of the remedial formula did not increase its tax burden, it determined that Tesoro had suffered no injury. As such, the court did not "see why a taxpayer should be excused from application of a tax scheme whose alleged internal inconsistency results in no-less-favorable tax treatment than would have resulted from a consistent scheme."

The court also found that the Department of Revenue's application of the remedial formula in this case was reasonable. (Interestingly, the Department took the position that the taxpayer had the burden to prove the unreasonableness of the Department's use of an alternative apportionment method, similar to the MDOR's position (and the Mississippi high court's ruling) in *Equifax.* But in *Tesoro,* the court noted that it need not decide the burden of proof issue because even if the Department of Revenue had the burden, it met that burden.)

Questions presented. Tesoro's petition for certiorari (see 2014 WL 768704) presents the following questions to the Court:

> (1) "Does the Due Process Clause permit a finding that an in-state taxpayer and an out-of-state business under common ownership are unitary when the two are neither vertically nor horizontally integrated?"
>
> (2) "Even if businesses could be unitary in the absence of vertical or horizontal integration, is exposure to the risk of double taxation a sufficient injury to trigger relief for a violation of the Commerce Clause's internal-consistency requirement?"

Tax Injunction Act Challenge

In *Direct Marketing Ass'n v. Brohl,* Docket No. 13-1032, petition for cert. filed 2/25/14, ruling below at 735 F3d 904 (CA-10, 2013), *rem'g Direct Marketing Ass'n v. Huber,* DC Colo., No. 10-CV-01546-REB-CBS, 3/30/12, 2012 WL 1079175 , the federal Court of Appeals for the Tenth Circuit overturned a district court's ruling that a Colorado law imposing information notice and reporting requirements on remote retailers, violated the Commerce Clause. The circuit court remanded the case to the district court for dismissal on procedural grounds, finding that the Tax Injunction Act (TIA, codified at 28 USC §1341) precluded federal court jurisdiction over the claims. The plaintiff, the Direct Marketing Association (DMA), asks the Supreme Court to clarify the scope of the TIA's jurisdiction.

Colorado's notice and reporting requirements. The petition for certiorari stems from a 2010 Colorado law requiring remote retailers selling to in-state customers to comply with a number of notice and reporting obligations intended to improve the state's use tax collections. As with generally all states that impose a sales tax, Colorado complements its sales tax with a use tax that is designed to prevent in-state consumers from purchasing products out-of-state in order to avoid paying Colorado sales tax. A 2010 report submitted as part of the litigation estimated that Colorado and its local governments would lose $172.2 million in 2012 because of residents' failures to pay use tax on e-commerce purchases from out-of-state, non-tax-collecting retailers.

In response to the elusive nature of use tax collection (where the onus is on the purchaser to report and pay the tax), the Colorado legislature enacted statutory requirements for out-of-state retailers who are not legally required to—and choose not to—collect and remit sales or use tax on sales to Colorado purchasers. The statute, which applies to out-of-state non-collecting retailers with gross Colorado sales in excess of $100,000, requires the retailers: (1) to provide transaction notices to Colorado purchasers, reminding them of their obligation to file a sales or use tax return and to pay the tax owed; (2) to send annual purchase summaries to Colorado customers who purchased from the retailer more than $500 worth of goods in the preceding year, again reminding the customers of their sales and use tax obligations; and (3) to annually report Colorado purchaser information to the Colorado Department of Revenue (CDOR), including purchasers' names, addresses, and

amounts purchased. (See Colo. Rev. Stat. §39-21-112(3.5), added by H.B. 1193, 2/24/10, §2.) Non-collecting retailers that do not comply with the notice and reporting obligations are subject to penalties.

Procedural history. In June 2010, DMA—a group of businesses and organizations that market products via catalogs, advertisements, broadcast media, and the Internet—sued the Executive Director of the CDOR, challenging the constitutionality of the notice and reporting requirements. According to DMA, the obligations were both facially discriminatory against and unduly burdensome on interstate commerce.

A federal district court in Colorado granted DMA's motion for summary judgment, concluding that the notice and reporting requirements were unconstitutional under the dormant Commerce Clause. Then, in 2012 the district court entered a permanent injunction prohibiting enforcement of the Colorado statute, from which the CDOR appealed to the federal Court of Appeals for the Tenth Circuit.

Tax Injunction Act. Before addressing the merits of the issue on appeal—whether Colorado's notice and reporting requirements violate the dormant Commerce Clause—the Tenth Circuit addressed first whether the TIA precluded federal jurisdiction over DMA's claims. The circuit court concluded that it did and thus did not reach the merits of the appeal.

The TIA provides 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." Thus, federal jurisdiction is precluded in the case if (1) DMA seeks to "enjoin, suspend or restrain the assessment, levy or collection" of state taxes, and (2) DMA has "a plain, speedy and efficient remedy" in Colorado courts.

Enjoin, suspend, or restrain the assessment, levy, or collection of taxes. Focusing on the first prong of the statute, the circuit court addressed DMA's argument that the TIA does not preclude federal jurisdiction because DMA is not a taxpayer seeking to avoid a tax. According to the court, any plaintiff that seeks to reduce the flow of state tax revenue, regardless of whether it is a taxpayer challenging a tax payment, may be subject to the TIA. As the court explained, "the key question is whether the plaintiff's lawsuit seeks to prevent

‘the State from exercising its sovereign power to collect ... revenues’" (quoting *Hill v. Kemp,* 478 F.3rd 1236 (CA-10, 2007)). Because DMA sought to restrict the feasibility of collecting use taxes in Colorado, it could not escape the TIA even though it was not a taxpayer seeking to avoid payment of a tax.

Next, the Tenth Circuit refuted DMA's argument that the TIA did not apply because DMA was challenging notice and reporting requirements, not a tax assessment. The court explained that "the TIA bars more than suits that would enjoin tax collection." In fact, the court noted that, by its very terms, the statute prohibits federal involvement in suits that seek to "*restrain*" state tax collection. Citing precedent for applying a broad, ordinary meaning of the word "restrain," the court concluded that "[a] lawsuit seeking to enjoin state laws enacted to ensure compliance with and increase use tax collection, like DMA's challenge here, would ‘restrain’ state tax collection." Thus, the court found that DMA's action fell within the TIA's prohibition on federal lawsuits that would "enjoin, suspend or restrain the assessment, levy or collection of any tax under State law." The court then proceeded to the TIA's second prong.

A plain, speedy, and efficient remedy in state court. For the TIA to apply, DMA must also have a "plain, speedy and efficient remedy ... in the courts of [Colorado]." According to the circuit court, this part of the TIA requires that Colorado law offer a "full hearing and judicial determination" on DMA's claims. After analyzing the available remedies for DMA—or the remote retailers it represents—to challenge Colorado's statutory scheme, the court concluded that there was a more specific remedy for DMA. For example, a remote retailer could chose to collect and remit sales tax and seek a refund of the tax. The court found that "[i]n pursuing the refund, the retailer could argue that Colorado laws unconstitutionally coerce it to choose between collecting a sales tax and complying with the notice and reporting requirements." Or, a remote retailer could challenge any penalty assessments for failing to comply with the notice and reporting requirements. Since "Colorado's administrative remedies provide for hearings and appeals to state court, as well as ultimate review in the United States Supreme Court" for refund and penalty assessment matters, a plain, speedy, and efficient remedy is available, thereby satisfying the TIA's second prong. As such, the circuit court remanded the case for the district court to dismiss DMA's

Commerce Clause claims for lack of jurisdiction and to dissolve the permanent injunction entered against the CDOR.

Question presented. DMA's petition for certiorari (see 2014 WL 825171) asks the Court "[w]hether the TIA bars federal court jurisdiction over a suit brought by non-taxpayers to enjoin the informational notice and reporting requirements of a state law that neither imposes a tax, nor requires the collection of a tax, but serves only as a secondary aspect of state tax administration?"

Petitions Still Pending

As we go to press, as noted above we still await the Court's decisions on whether to grant three previously filed requests for certiorari.

Accrual rule, "all-events" test challenge. In *New York Life Insurance Company v. U.S.,* Docket No. 13-849, petition for cert. filed 1/14/14, ruling below at 112 AFTR 2d 2013-5555, 724 F3d 256, 2013-2 USTC ¶50458 (CA-2, 2013), the Supreme Court is asked to consider the application of the "all events" test—a foundational test within the tax law that governs the timing of deductions for accrual-basis taxpayers. The effects of this test at the federal level, of course, pass through to the deductions claimed at the state level.

New York Life Insurance Company (N.Y. Life), an accrual-basis taxpayer, claimed deductions on its federal income tax returns related to certain accrued policyholder dividends. Concluding that the deductions did not satisfy the "all-events" test, the IRS disallowed them and determined that N.Y. Life could not deduct the dividends until the year of payment. When N.Y. Life challenged the Service's actions in court, the IRS filed a motion to dismiss under Fed. Rul. Civ. Proc. 12(b)(6) for failure to state a claim. The district court granted the Service's motion to dismiss (107 AFTR 2d 2011-2107, 2011-1 USTC ¶50373, 780 F Supp 2d 324 (DC N.Y., 2011)). The federal Court of Appeals for the Second Circuit affirmed, finding that "New York Life's complaint fails to state a plausible claim that the deductions at issue satisfied the first prong of the all-events test."

As noted by the Second Circuit, under IRC Section 808(c) a life insurance company may deduct from gross income "an amount equal to the policyholder dividends paid *or accrued* during the taxable year." (Emphasis added by the court.) In turn, Treas. Reg. §1.461-1(a)(*2*)(i) provides that under the accrual method of accounting, "a liability ... is incurred, and generally is taken into account for Federal income tax purposes, in the taxable year in which [1] all the events have occurred that establish the fact of the liability, [2] the amount of the liability can be determined with reasonable accuracy, and [3] economic performance has occurred with respect to the liability." Combined, these three factors are known as the "all-events" test. At issue in the case below was the application of the first prong of the "all-events" inquiry: whether "all the events have occurred that establish the fact of the liability." (For more background on this case and the current request for certiorari, see U.S. Supreme Court Update, 24 J. Multistate Tax'n 39 (Mar/Apr 2014).)

Resident income tax credit Commerce Clause challenge. In *Comptroller of the Treasury of Maryland v. Wynne,* Docket No. 13-485, petition for cert. filed 10/13/13, ruling below at 431 Md. 147, 64 A3d 453 (2013), the Maryland Court of Appeals (the state's highest court) held that Maryland's law that provides a credit against Maryland state income tax for incomes taxes paid to other states violated the Commerce Clause of the U.S. Constitution because the credit was not available to offset county-level income taxes.

In the case below, the Maryland court analyzed the taxpayers' challenge to the statute under the dormant Commerce Clause test announced in *Complete Auto Transit, Inc. v. Brady,* 430 US 274, 51 L Ed 2d 326 (1977), whereby a state tax will pass constitutional muster if the tax: (1) applies to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate or foreign commerce; and (4) is fairly related to the services provided by the state. Focusing on the requirements of fair apportionment and no discrimination against interstate commerce, the Maryland court found that the lack of a credit against the county tax resulted in the tax's failing under both prongs.

As previously reported in this column, on 1/13/14 the Supreme Court asked the U.S. Solicitor General to file a brief expressing the views of the federal government (2014 WL

102377). (For more on this case, including a discussion of Maryland's income tax scheme and a dissenting opinion in *Wynne,* see U.S. Supreme Court Update, 23 J. Multistate Tax’n 40 (February 2014).)

4R Act tax discrimination challenge. On 1/27/14, the Supreme Court invited the U.S. Solicitor General to file a brief expressing the views of the federal government in *Alabama Department of Revenue v. CSX Transportation, Inc.,* Docket No. 13-553, petition for cert. filed 10/30/13, ruling below as *CSX Transportation, Inc. v. Alabama Department of Revenue,* 720 F3d 863 (CA-11, 2013). In Alabama's petition for review, the state's attorney general asks the Court to review the decision by the federal Court of Appeals for the Eleventh Circuit holding that Alabama's failure to provide a tax exemption from the state's sales and use taxes for railroads' purchases of diesel fuel, while exempting both interstate motor carriers and water carriers, was discriminatory in violation of the federal Railroad Revitalization and Regulatory Reform Act of 1976 (the "4-R Act," codified at 49 USC §11501). This is the latest decision in the long-running dispute between the railroads and the state of Alabama. Congress enacted the 4-R Act in 1976 to restore the financial stability of the railroad industry. One provision of the Act, 49 USC §11501(b), expressly prohibits four forms of discriminatory state and local taxation. Subsections (b)(1) through (b)(3) involve discriminatory property tax rates and unfair assessments on "rail transportation property" versus other "commercial and industrial property." Subsection (b)(4), and the specific provision at issue in this case, provides a catch-all prohibition against a state's imposition of "another tax that discriminates against a rail carrier."

(For more background on this request for certiorari, including a discussion of Alabama's tax scheme at issue, the procedural history, and a dissenting opinion in this latest case, see U.S. Supreme Court Update, 23 J. Multistate Tax’n 40 (February 2014).)

Certiorari Has Been Denied in:

Mobility Medical, Inc. v. Mississippi Department of Revenue, Docket No. 13-651, *cert. den.* 3/24/14, ruling below at 119 So 3d 1002 (Miss., 2013), in which the Mississippi Supreme Court, in a 5-4 en banc decision, affirmed a chancery court's grant of summary judgment in favor of the state's Department of Revenue. The court found that the state's tax on a medical equipment seller's gross sales is not a tax on the Federal Employees Health

Benefits Plan. Accordingly, the Federal Employees Health Benefits Act's prohibition against states' taxing the Plan does not preempt Mississippi from requiring sellers to pay the tax on their gross sales, including those sales to individuals covered by the Plan. (For more on the issues in this case, and the state court's opinion, see U.S. Supreme Court Update, 24 J. Multistate Tax’n 39 (Mar/Apr 2014).) **[]**

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