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MEMORANDUM

TO: Revenue and Transportation Interim Committee
FROM: Dan Whyte, Chief Legal Counsel
DATE: March 10, 2016
SUBJECT: Department of Revenue Major Case Update

MONTANA SUPREME COURT

Priceline, et al. (On-Line Travel Companies): The Montana Supreme Court ruled that based upon the plain language of the Lodging Facility Use Tax, the online travel companies are not “owners” or “operators”, as defined in statute, and, therefore, are not required to collect and remit the lodging tax on their fees. The lodging tax is 4%. However, the Court ruled that the online travel companies were, and are, required to collect and remit the 3% Sales Tax on their fees when selling, renting, or leasing accommodations and campgrounds. The Court further ruled that the online travel companies were also required to collect and remit a 4% Sales Tax on their fees related to the rental of vehicles. In ruling on damages owed by the companies, the Court rejected the online travel companies’ argument that damages should be prospective, but limited the online travel companies’ liability for the taxes from the filing of the Complaint, November 8, 2010. On August 28, 2015, the Supreme Court remitted the case back to Judge Seeley in the First Judicial District Court for consideration of the damages claims. The remaining issues to be determined are a calculation of taxes, penalties, and interest, and tort claims such as unjust enrichment, constructive trust, and conversion.

FEDERAL DISTRICT COURT

Armstrong et al.: The Armstrongs and the Association of Christian Schools International filed a declaratory judgment action in Montana Federal District Court challenging the Department’s adoption of ARM 42.4.802 as violating MAPA and provisions of the U.S. Constitution. In response, the Department filed a Motion to Dismiss for lack of standing. The matter is fully briefed and awaiting a decision.

LL, Liquor, Inc. v. State of Montana, et al.: During the 2015 Legislative Session, the Legislature passed Senate Bill No. 193, which changed the complicated three-piece commission rates received by the agency liquor stores to a single percentage rate based

on sales. The commission rate percentages range from 12.15% commission for stores that purchase more than \$7,000,000 worth of liquor to 16% for stores that purchase no more than \$250,000 worth of product. It has been reported that this amendment to the commission rates will result in a revenue increase for 90 of the 96 agency liquor stores. One of the remaining six stores, LL Liquor, located in Lolo, Montana, has sued the State arguing that the State breached the contract with LL Liquor, and deprives LL Liquor of its property and contractual rights without due process of law, a constitutional violation. LL Liquor sought a preliminary injunction to stop implementation of the law, which was denied by the District Court. LL Liquor has appealed this issue to the 9th Circuit Court of Appeals. Oral argument before the 9th Circuit Court is scheduled for April 6, 2016.

STATE DISTRICT COURT

Alpine Aviation: Alpine Aviation has been centrally assessed by the Department since it began operating in Montana in the late 1990s. Alpine filed an appeal with the Office of Dispute Resolution, and then with the Montana Tax Appeal Board (MTAB), arguing that it does not meet the definition of a centrally assessed company because it is not a “regularly scheduled airline” as defined in federal law. The Department asked the District Court to determine the meaning of “scheduled airline” and “scheduled air commerce” for Montana property tax purposes. On May 14, 2015, the First Judicial District Court ruled that “regularly scheduled flights” are those flights which follow a pattern, but are not necessarily uniform intervals according to timetables and locations predefined by the carrier, and which fly regardless of whether there are passengers or freight carried. The matter has been appealed to the Montana Supreme Court. The parties are currently briefing the issues for the Court.

Espinoza, et al.: Espinoza and two others filed a declaratory judgment action in the 11th Judicial District Court challenging the Department’s adoption of ARM 42.4.802 as violating MAPA, as well as provisions of the U.S. and Montana Constitutions. In response, the Department filed a Motion to Dismiss. At the end of January, Plaintiffs also filed a motion for a preliminary injunction prohibiting the Department from implementing ARM 42.4.802. The Department filed a response brief in opposition. A hearing on both pending motions is scheduled for March 7, 2016.

Hiland Crude, LLC: Hiland filed a declaratory judgment action in the 1st Judicial District Court challenging the Department’s classification of Hiland’s property for tax year 2014 as a pipeline carrier and, therefore, subject to central assessment. The matter is currently in discovery.

Kohoutek, et al.: Agency liquor store owners seek class certification and challenge the constitutionality of certain statutes. Specifically, agency liquor store owners allege that § 16-2-101(2)(b)(ii)(B), MCA, is unconstitutional because it fails to fully compensate some

liquor store owners for the mandatory 8% discount for unbroken case lot sales to licensees required by § 16-2-201, MCA. Plaintiffs filed in the 8th Judicial District Court, Cascade County. The Court bifurcated the issues (constitutionality and damages). On May 28, 2015, the Court determined that the statute violated the Plaintiffs' rights to substantive due process and to equal protection of the law because the state has continued to use 1994 sales information to reimburse agency liquor stores for the mandatory case lot discounts.

On February 4 and 5, 2016, a bench trial was held addressing the damages phase. Plaintiffs seek damages from 1997 through January 31, 2016. The amount of damages sought including 10% interest is approximately \$24 million. The Court has ordered post-trial findings of fact and conclusions of law to be filed 30 days after receipt of the trial transcript.

Omimex Canada, Ltd.: At issue is the Department's decision to classify Omimex's Montana property as a pipeline carrier and, therefore, subject to central assessment. The parties have agreed to consolidate the declaratory judgment actions for tax years 2011 and 2012, filed in the 2nd Judicial District, Silver Bow County, with the declaratory judgment actions for tax years 2013 and 2014 filed in the First Judicial District, and to transfer venue to the First Judicial District Court, Lewis and Clark County. Judge Reynolds has assumed jurisdiction over all four pending tax years. Trial is scheduled for May 2017. Omimex filed for partial summary judgment on November 5, 2015, in the consolidated 2011-2014 matters. Omimex asks the Court to determine the meaning of "pipeline carrier" and whether Omimex meets that definition making the company subject to central assessment. Omimex has filed for summary judgment on the issue. The issues have been briefed and oral argument is scheduled for April 2016.

Richland Aviation: Richland filed a declaratory judgment action in the 7th Judicial District Court, Richland County, challenging the Department's classification of Richland's property for tax year 2015 as subject to central assessment. The matter is currently in discovery. Richland has filed a motion for summary judgment arguing that it is not a "scheduled airline" as that term is used and understood in Montana law. Richland's summary judgment motion is fully briefed, argued, and the parties are awaiting a decision from the District Court.

Solem: The Solems filed a motion for class certification in the 11th Judicial District Court, Flathead County, challenging their land value, primarily arguing that the water influence used by the Department leads to improperly inflated values. The class certification request is for "all waterfront landowners affected by DOR's improper and illegal assessment methodology." It is unclear if Solem seeks certification of all waterfront landowners state-wide, or only those on Flathead Lake. The Department has argued that the class does not meet certification requirements, but if the Court certifies a class action,

the class should be limited to those taxpayers residing in the Somers/Lakeside area in which Solems' property is located. The issue was argued in September 2014, and the parties await a ruling from the District Court.

MONTANA TAX APPEAL BOARD

Blixseth: The Department is pursuing Tim Blixseth's tax debt. On March 20, 2015, the Department received final judgment against Mr. Blixseth before the Montana Tax Appeal Board on Mr. Blixseth's appeal of the Department's audit and assessment. Mr. Blixseth did not appeal any of the orders issued by the Montana Tax Appeal Board. Consequently, the Department has billed Mr. Blixseth in the approximate amount of \$74.4 million, and will begin pursuing Mr. Blixseth for collection. Dismissal of the involuntary bankruptcy petition remains on appeal before the United States District Court for the District of Nevada, where the matter is fully briefed. The Department has advised the United States District Court of the MTAB rulings, and the Department awaits a decision.

Abbey/Land Co.: The Department valued a high-end luxury complex on Shelter Island on Flathead Lake at \$41.8 million. Abbey/Land contested the Department's property valuation of the property owner's Shelter Island luxury mansion and other improvements, asserting that the Department overvalued the property for tax year 2012. Abbey/Land's appraiser valued the improvements at \$9.8 million. The Montana Tax Appeal Board ruled in favor of the Department, ultimately finding that the Department's assessment of Abbey/Land's improvements was based on accepted valuation methodologies and reflects fair market value as of the lien date. Abbey/Land did not appeal the decision.

VisionNet: By stipulation of parties, the VisionNet appeal was dismissed before ODR on January 14, 2016, and moved to MTAB. VisionNet filed its Complaint before MTAB on February 16, 2016. The Department's Answer is due on March 17, 2016.

DOR OFFICE OF DISPUTE RESOLUTION

NaturEner: NaturEner has filed with the Office of Dispute Resolution three separate appeals of the Department's 2015 assessments. At issue is the Department's valuation of NaturEner's three windfarms; Glacier Wind Energy 1, LLC, Glacier Wind Energy 2, LLC, and Rim Rock Wind Energy, LLC. The matter awaits a schedule for discovery and trial. At NaturEner's request, mediation is scheduled for July 2016.

SETTLEMENTS

Phillips 66 Pipeline LLC (Phillips): Phillips, a wholly owned subsidiary of Phillips 66, operates more than 12,000 miles of pipelines in the United States. Phillips transports both raw and finished petroleum products, including crude oil, propane, and refined products. The Department assessed Phillips' property at \$120,014,871 for tax year 2015. Phillips appealed to the Department's Office of Dispute Resolution. The parties

have agreed to settle the matter at 90% of the Department's original assessed value, \$108,000,000.

Verizon Wireless: Following informal review, the Department assessed Verizon's property at \$239,000,000. Verizon appealed the Department's determination of value to the Department's Office of Dispute Resolution. Generally, Verizon alleged that the 2015 value was too high because the deduction for intangible personal property was not properly computed. Verizon also challenged the Department's methodologies and capitalization rates. The parties set a date for mediation, but were ultimately successful in settling the matter short of mediation. The parties agreed to a Montana value of \$232,500,000 for 2015.