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MEMORANDUM

TO: Revenue and Transportation Interim Committee

FROM: Dan Whyte, Chief Legal Counsel

DATE: July 9, 2015

SUBJECT: Department of Revenue Major Case Update

MONTANA SUPREME COURT

Lucas, et al.: For the 2009-2014 reappraisal cycle, the Department of Revenue reappraised all of Montana's agricultural properties using updated geographical information system (GIS), soil surveys from the U.S. Department of Agricultural Natural Resource Conservation Service (USDA NRCS), global positioning system (GPS) software, and in-depth review of soil types. This resulted in significant revaluation of numerous agricultural properties. If the changes were driven by market forces outside of the control of the owner (e.g., commodity price changes), the Department used an unadjusted 2002 market value as the value. If the changes occurred as a result of actions of the owner (e.g., change in acreage or use), the Department determined a new value as of January 1, 2008. On April 28, 2015, the Montana Supreme Court upheld a district court decision that the Department had correctly interpreted § 15-7-111, MCA, to classify and appraise agricultural properties for the 2009-2014 reappraisal cycle.

Omimex Canada, Ltd.: At issue in these actions is the Department's decision to classify Omimex's Montana property as a pipeline carrier and therefore subject to central assessment. On April 14, 2015, the Montana Supreme Court reversed the Silver Bow County District Court's decision on issue preclusion and remanded the 2011 declaratory judgment action back to the District Court for further proceedings. The parties have agreed to consolidate the declaratory judgment actions for tax years 2011 and 2012 filed in Silver Bow County with declaratory judgment actions for tax years 2013 and 2014 filed in Lewis & Clark County. The parties are currently awaiting execution of a transfer order from Lewis & Clark County District Court accepting jurisdiction of tax years 2011 and 2012. Omimex has also appealed its central assessed valuations for tax years 2011-2015; which are currently stayed at the Office of Dispute Resolution (ODR) pending the outcome of the classification dispute.

Priceline, et al. (On-Line Travel Companies): The First Judicial District Court recently determined on summary judgment that it is the responsibility of the traveler to pay the lodging taxes and the hotel to collect the taxes. The District Court determined that the online travel companies do not have an obligation to collect the taxes. The state appealed that decision to the Montana Supreme Court. The matter is fully briefed with the Court and oral argument is complete. The state awaits the Court's decision.

STATE DISTRICT COURT

Alpine Aviation: Alpine Air has been centrally assessed by the Department since it began operating in Montana in the late 1990s. Alpine filed an appeal with ODR 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 on interlocutory adjudication from MTAB 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 is subject to appeal before the Montana Supreme Court, and if not appealed, will return to MTAB.

Barnard: Tim and Mary Barnard have filed a declaratory judgment action seeking an order from the Gallatin County District Court that the Department's purported authority to determine residency for state income tax purposes is unconstitutional. Additionally, they are petitioning the court to declare that they are not residents of Montana and thus do not owe the resident income taxes the Department has assessed against them. The case has been fully briefed with the District Court and awaits decision.

Cloud Peak: On January 13, 2015, the Montana Supreme Court issued its decision in *Cloud Peak Energy Resources, LLC v. Department of Revenue*. Before the Court were two questions: whether the District Court erred when it held that the Department incorrectly imputed revenue from non-arm's length coal sales under § 15-35-107, MCA; and, on cross-appeal, whether the District Court erred holding the coal additives are subject to Montana Coal Taxes under § 15-35-102(7), MCA. In response to the first question, the Supreme Court held that the proper time period to use the contract price of arm's length contracts is when those arm's-length contracts were negotiated during a similar time period as the non-arm's length contracts. On the second question, the Court rejected Cloud Peak's argument and upheld the district court's holding that the Department's levying of taxes for additives was proper. The parties are currently in negotiations to settle this matter.

Hiland Crude, LLC: Hiland filed a declaratory judgment action in district court challenging the Department's classification of Hiland's property for tax year 2014 as a pipeline carrier. The matter is currently in discovery.

Kohoutek, et al.: Agency liquor store owners have sought 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 has bifurcated the issues (constitutionality and damages). On May 28, 2015, the Court determined that § 16-2-101(2)(b)(ii)(B), MCA, 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. Trial on the issue of damages is set for February 4, 2016. Potential damages have been estimated at as much as \$37 million.

LL, Liquor, Inc. v. State of Montana, et al.: During the 2015 Legislative Session, the Legislature passed Senate Bill No. 193, which changed the commission rates received by the agency liquor stores to percentages 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 an 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 the LL Liquor and deprives LL Liquor of its property and contractual rights without due process of law, a constitutional violation. The State's answer to the complaint is due in the near future.

Richland Aviation: Richland filed a declaratory judgment action in district court 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.

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 MTAB on Mr. Blixseth's appeal of the Department's audit and assessment. Mr. Blixseth did not appeal any of the orders issued by the Board in the Department's favor. 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 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 company'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 MTAB ruled in favor of the Department, ultimately finding that the Department's assessment of Abbey'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.

SETTLEMENTS

AT&T Mobility: In May, the Department and AT&T Mobility reached a settlement over the market value of the company's centrally assessed property for tax years 2011 through 2014. Of the estimated \$8.9 million AT&T Mobility paid under protest, the state and counties retain an estimated \$5.9 million, and AT&T Mobility received an estimated refund of \$3 million.