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Director

Montana Department of Revenue



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MEMORANDUM

TO: Revenue and Transportation Interim Committee
FROM: Dan Whyte, Chief Legal Counsel
DATE: May 2, 2018
SUBJECT: Department of Revenue Major Case Update

NINTH CIRCUIT COURT OF APPEALS

Armstrong, et al. v. Kadas: SB 410 allows for an individual to receive a \$150 tax credit for donations of at least that amount to a scholarship organization, who can use the donation to provide scholarships to students who wish to attend a private school. After review of the Montana Constitutional provisions that prohibit appropriation or payment of public funds to religious schools, the Department implemented rules limiting those scholarships to schools that do not have religious ties.

Kathy and Jerry Armstrong and the Association of Christian International Schools filed an action in federal District Court alleging that the Department's rule violates their constitutional rights to free exercise of religion, establishment of religion, and equal protection. The Department moved for the stay of the proceedings during the pendency of the *Espinoza v. Department of Revenue* in state district court. The federal District Court recognized that the Flathead District Court in *Espinoza* had issued a preliminary injunction (now permanent) enjoining the State from enforcing the rule and that this is the same relief being sought by the Armstrongs. The federal court determined that it should abstain from the lawsuit on the grounds that the constitutional question may be mooted by the Montana state courts. That decision was appealed to the 9th Circuit Court. Oral argument was held on March 6, 2018, and the Department is awaiting the decision.

FEDERAL DISTRICT COURT

LL Liquor, Inc., v. State of Montana, et al.: The 2015 Legislature passed Senate Bill No. 193, changing the complicated three-piece commission rates received by 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% commission for stores that purchase no more than \$250,000 worth of product. It has been reported that this commission rate change 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, sued the State arguing that the State breached its contract with LL Liquor, depriving 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. The 9th Circuit Court of Appeals agreed with the federal District Court that preliminary injunction is unwarranted, because no substantial impairment existed. The Court held that the alteration to the contract was not beyond reasonable expectation because LL Liquor was aware of the contractual term that the Legislature could change the terms of the contract with respect to price. LL Liquor has appealed the District Court's decision to the 9th Circuit Court of Appeals. Oral argument is scheduled for May 15, 2018.

MONTANA SUPREME COURT

Espinoza, et al.: The 2015 Montana Legislature passed Senate Bill No. 410, allowing for an individual to receive a \$150 tax credit for donations of at least that amount to a scholarship organization, to provide scholarships to students who wish to attend a private school. After review of the Montana constitutional provisions that prohibit appropriation or payment of public funds to religious schools, the Department implemented rules limiting those scholarships to schools without religious ties.

In December 2016, several parents of religious school students sued the state in the 11th Judicial District (Flathead County) on the basis that the Department's administrative rules violated the Legislature's intent that scholarships be allowed for students attending religious schools. Additionally, the plaintiffs argue that the Department has interfered with the families' constitutional rights to free exercise of religion and equal protection.

On May 23, 2017, the District Court granted Espinoza's motion for summary judgment, finding that the tax credit is not an appropriation under the Montana Constitution, permanently enjoining the Department from applying its administrative rules prohibiting scholarships to religious schools. The case has been appealed to the Montana Supreme Court and the parties have completed briefing the matter for the Court. Oral argument was held on April 6, 2018, and the Department is awaiting the decision.

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. On July 14, 2017, the First Judicial District Court granted summary judgment against the Department ordering the Department to tax Hiland's gathering systems as class eight property. The Department appealed the decision to the Montana Supreme Court. This matter is fully briefed and has been submitted to the Court for decision.

Kohoutek, et al.: Agency liquor store owners alleged 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. The 8th Judicial District Court, Cascade County, bifurcated the issues into constitutionality and damages. On April 1, 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. The District Court awarded \$14,722,297 in damages after concluding that the weighted average discount ratio statute became unconstitutional on July 1, 1998. The Court held that the State owed interest in the amount of \$11,320,233.43, and entered a judgment against the State on January 6, 2017, in the total amount of \$26,156,411.65. The Court stayed execution of the judgment pending appeal. The Department appealed to the Montana Supreme Court is complete and the Court held oral argument on February 7, 2018. The Department is awaiting the Court's decision.

STATE 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 District Court recently granted class certification. The class certified is “all lakefront property owners in Neighborhood 800 who have timely paid under protest any portion of their property taxes since the last assessment cycle beginning in 2009.” Neighborhood 800 is the Somers/Lakeside area in which the Solem’s property is located. Between 2009 and 2015, approximately 200 taxpayers in Neighborhood 800 paid property taxes under protest. The matter is moving forward in the District Court and the parties are engaged in discovery.

VisionNet: In July, VisionNet appealed the Department’s 2015 assessment to the Montana Tax Appeal Board (MTAB). VisionNet alleges the Department’s classification of VisionNet is improper and contests its market value assessment as improperly including intangible personal property and improper capitalization rates. VisionNet filed a declaratory judgment action before the First Judicial District Court. The Department filed an answer to the complaint on May 18, 2016. Both parties filed motions for summary judgment on July 7, 2017. The motions are fully briefed and oral argument was held on January 24, 2018, and the Department is awaiting the Court’s decision on Summary Judgment. A three-day bench trial is set for September 12, 2018.

Exxon Mobil: Exxon filed an interlocutory appeal with the First Judicial District Court concerning the Department’s assessment of additional corporate income tax for tax years 2006 through 2010. Exxon has asked the District Court to determine whether it is entitled to a 100% dividends received deduction or an 80% dividends received deduction for dividends paid to it by what are known as “80/20” companies. This matter was submitted to the court in mid-January 2018, (after briefing and argument) for its adjudication.

Mountain Water: Mountain Water Company filed property taxes under protest for the period of April 2, 2014, to June 2017, during which time frame the City of Missoula successfully condemned the water system. Mountain Water filed a declaratory judgment action in Lewis and Clark County to recover those taxes. In response, the Department filed a motion to dismiss for a variety of reasons. Missoula County and the City of Missoula both filed motions

to intervene and change venue to Missoula County District Court. The Lewis and Clark District Court changed venue to Missoula County District Court. MWC removed Judge Townsend; Judge Halligan assumed the case. Once a scheduling order is issued, the case will go forward on the merits of Mountain Waters' claim to be entitled to a full refund of the taxes paid under protest.

MONTANA TAX APPEAL BOARD

CHS: The 2014 and 2015 disputes center on the market value of the Laurel Refinery. For the 2014 tax year, the company requested a market value of \$200 million, and the Department valued the refinery at \$848 million. Yellowstone CTAB determined a market value of \$510 million, and CHS and the Department each appealed that decision to the Montana Tax Appeal Board. Shortly after the parties initiated appeals before the Board and had agreed upon a January 2017 trial date, CHS filed a petition for interlocutory adjudication with the 13th Judicial District Court. The District Court dismissed CHS's petition on May 6, 2016. Respecting the 2015 tax year, the Yellowstone CTAB affirmed the Department's value (\$820 million), and CHS appealed that decision to the Montana Tax Appeal Board on May 12, 2016. Depositions conclude the week of September 11, 2017. The 5-day trial before MTAB finished on November 10, 2017, and the parties filed post-hearing briefing. CHS has also appealed the value of the Laurel Refinery for tax years 2016 and 2017 to the Montana Tax Appeal Board. Those appeals have been held in abeyance pending the outcome of the 2014 litigation.

Phillips 66 Refinery, (Phillips): The Department appealed decisions rendered by the Yellowstone County Tax Appeal Board to the Montana Tax Appeal Board relating to the 2016 and 2017. The underlying litigation concerns the proper market value for Phillips' Billings refinery as of January 1, 2016 and January 1, 2017, respectively. Mediation took place on November 30, 2017. At the request of the parties, the Board consolidated the two years and the consolidated trial is currently scheduled for the week of January 28, 2019.

5th Generation, Inc. (5th Generation): 5th Generation filed an appeal and subsequent amended appeal with the Montana Tax Appeal Board concerning whether it had nexus with the State of Montana during the 2010-2014 tax years. 5th Generation also filed a Declaratory Judgment action in the District Court where the company is challenging Montana's bailment system for

the importation and distribution of liquor in this state. The parties are engaged in discovery, and the MTAB trial is scheduled for November 2018, and a scheduling conference on the District Court litigation took place on April 27, 2018.

Calumet Refinery (Calumet): The Cascade County Tax Appeal Board held a hearing on February 15, 2018, relating to the valuation of the Calumet Refinery for the 2017 tax year. Both parties appealed that board's decision to the Montana Tax Appeal Board and a hearing is scheduled to commence on June 10, 2019.

Wal-mart/Sam's Club: These seven "dark store" MTAB appeals are scheduled for hearing 10/2 through 10/4/18. The seven cases are likely to be consolidated. If not, the hearings will run on consecutive days. On April 18, 2018, a status conference was held and the cases were "continued" for another 60 days. Wal-mart has retained new counsel, Crowley, Fleck and Crapo, Dietz. Opposing counsel wants to resolve or at least limit the number of cases. The October hearing dates remain in place, but the hearing will probably take place in late February or early March 2019. DOR will need to hire at least one expert.