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# Montana Department of Revenue



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## MEMORANDUM

TO: Revenue Interim Committee

FROM: Dan Whyte, Chief Legal Counsel 

DATE: June 27, 2019

SUBJECT: Department of Revenue Major Case Update

### UNITED STATES SUPREME COURT

Espinoza, et al.: In December 2016, several parents of religious school students sued the state in the 11<sup>th</sup> Judicial District (Flathead County) on the basis that the Department's administrative rules limiting SB 410 scholarships to nonreligious private schools violated the Legislature's intent that scholarships be allowed for students attending religious schools. Additionally, the Plaintiffs argued that the Department 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. On December 12, 2018, the Montana Supreme Court, issued its opinion concluding that § 15-30-3111, MCA (the Tax Credit Program) violates Article X, Section 6 of the Montana Constitution. The Montana Supreme Court severed § 15-30-3111, MCA, from the remainder of Part 31 of Title 15, Chapter 30. The Court held that the Montana Constitution prohibited the SB 410 scholarship program.

The case was appealed to the United States Supreme Court and the parties completed briefing the matter of whether the Court should grant Espinoza's Petition for Writ of Certiorari. The Department is awaiting the Court's decision on whether to grant Espinoza's Petition for Writ of Certiorari.

### NINTH CIRCUIT COURT OF APPEALS

Armstrong, et al. v. Kadas: 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.

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 District 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 9<sup>th</sup> Circuit Court. Oral argument was conducted on March 6, 2018. The Ninth Circuit Court of Appeals concluded that the federal Tax Injunction Act (28 U.S.C. § 1341) deprives federal courts of subject matter jurisdiction over the Armstrongs' claims.

However, since the application of the Tax Injunction Act to the claims asserted by the Association of Christian Schools International had not been briefed by the parties, the Ninth Circuit ordered the parties to file letter briefs addressing this issue. The parties have agreed to have the matter put in abeyance during the pendency of the *Espinoza* before the U.S. Supreme Court.

### **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 9<sup>th</sup> 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 9<sup>th</sup> Circuit Court of Appeals.

The 9<sup>th</sup> Circuit Court of Appeals reversed, subsequently holding that SB 193 breached the Agency Franchise Agreement between LL Liquor and the Department of Revenue. The case was remanded to the District Court, for a determination of damages (if any) the State owes to LL Liquor.

## **MONTANA SUPREME COURT**

Exxon Mobil: Exxon filed an interlocutory appeal with the 1<sup>st</sup> Judicial District Court concerning the Department's assessment of additional corporate income tax for tax years 2006 through 2010. Exxon 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. The District Court agreed with the Department and Exxon appealed to the Montana Supreme Court. Briefing is now complete, and the parties are awaiting the Court's decision.

VisionNet: In February 2016, 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 1<sup>st</sup> 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 District Court granted the Department's motion for summary judgment finding that VisionNet is properly centrally assessed because it is a telecommunications company that operates a single, continuous property crossing county and state lines.

The case was appealed to the Montana Supreme Court and the parties completed briefing the matter for the Court. The Department is awaiting the Court's decision.

## **STATE DISTRICT COURT**

Solem: The Solems filed a motion for class certification in the 11<sup>th</sup> 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. Trial was conducted on March 11 through March 14, 2019. The Department is awaiting the District Court's determination.

Mountain Water: Mountain Water Company (MWC) paid property taxes under protest for the period from April 2, 2014, to June 2017, during which time frame the City of Missoula successfully condemned the water system. MWC 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.

Judge Halligan granted summary judgment to the Department, Missoula County, and City of Missoula, finding that Mountain Water was correctly assessed the taxes for the years in question and remained responsible for the taxes until the completion of the condemnation proceedings. Mountain Water appealed to the Montana Supreme Court. Mandatory mediation is scheduled for July 8, 2019. Briefing and hearing schedule will follow.

### **MONTANA TAX APPEAL BOARD**

Boyne USA, Inc.: Boyne, which owns Big Sky Resort, includes a Resort Services Fee (RSF) on guest bills on all Big Sky Resort bookings. Boyne filed an action before the Montana Tax Appeal Board from the Department's audit of the RSF, arguing that this fee is not subject to Montana's lodging use and sales taxes. Boyne contends that the RSF is excluded from taxation by the definition of 'accommodation charge' under § 15-65-101(1), MCA. There is an additional dispute over Boyne's failure to remit taxes collected on Boyne's no-show and/or cancellation revenue. The case is moving forward, and the parties are engaged in discovery. The Board held a hearing on cross motions for summary judgment on April 23, 2019.

On June 12, 2019, the Board held that for the no-show and forfeiture cancellation, Boyne does not owe a tax obligation. The Board, however, found Boyne owes the lodging and facility use and sales taxes on the RSF.

Calumet Refinery (Calumet): The Department and Calumet appealed a decision rendered by the Cascade County Tax Appeal Board to the Montana Tax Appeal Board relating to the 2017 and 2018 tax years. The underlying litigation concerns the proper market value for Calumet's Great Falls refinery. Discovery is ongoing, and the matter is scheduled for trial in February 2020.

Plains Pipeline, LP and Rocky Mountain Pipeline System (PPLP): Plains and Rocky appealed their 2018 centrally assessed property tax values to the Montana Tax Appeal Board. The parties agreed to hold Rocky Mountain in abeyance while taking Plains forward in litigation. Plains is challenging the Department's methodology for establishing the capitalization rate, the unit selected to determine value, and the values themselves. A 5-day hearing is set to begin December 2, 2019. The parties are currently in the process of exchanging discovery and compiling expert witness reports.

Phillips 66 Refinery: Phillips initiated a limited appeal from the Yellowstone County Tax Appeal Board's November 2018 decision. The company's appeal relates to the market value of its Billings refinery. Discovery is ongoing, and the case is scheduled for trial in December 2019.

## SETTLEMENTS

CHS: This dispute was over the market value of the Laurel Refinery. For the 2014 tax year, the Department valued the refinery at \$848 million. At the Yellowstone CTAB, CHS requested a market value of \$200 million. The CTAB determined a market value of \$510 million, and CHS and the Department each appealed that decision to the MTAB. Similar appeals for tax years 2015, 2016, and 2017 were stayed during the pendency of the 2014 litigation.

The MTAB ruled on this case, vacating the CTAB determination and affirming the Department's assessed value of \$848 million. MTAB also determined that CHS did not prove that the Department failed to equalize the Laurel Refinery with similarly situated refineries. Based on the MTAB decision, CHS and the Department reached a settlement for the 2014-2018 tax years which includes provisions to help the parties avoid future litigation. The parties settled for the following market values: 2014: \$848,639,534; 2015: \$738,816,274; 2016: \$842,902,659; 2017: \$876,224,576; 2018: \$838,909,998.

NorthWestern Energy: NorthWestern Energy appealed its centrally assessed property values for tax year 2018. The Department's market value for 2018 was \$2,735,240,065. The parties settled all claims for a market value of \$2,620,000,000.

Walmart/Sam's Club: Several Walmart stores and one Sam's Club filed appeals first with the local CTABs arguing that valuation of their stores should be appraised as if the store is empty and on the market. This is an appraisal methodology commonly known as the "dark store" theory. Seven stores across Montana appealed their assessments to MTAB. The parties settled all seven appeals globally with an 8.5% reduction in the Department's assessed market value.

Yellowstone Club: The Department issued several notices of proposed department action and seizure notices against licensees located at the Yellowstone Club relating to the sale and storage of alcoholic beverages at unlicensed locations. The Department settled with the licensees for a cumulative monetary penalty of \$370,000, suspensions ranging from seven to twenty days for each licensee, and an agreement that the licensee who owned the licenses and managed the licenses will no longer be associated with management or ownership of each license.