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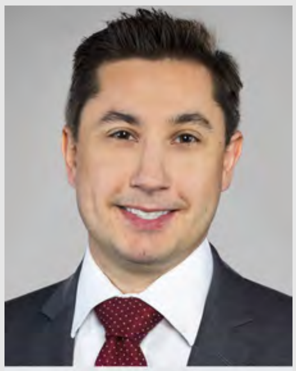

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In this article, the authors discuss the history of the Tax Injunction Act, arguing that recent case developments have created a potential opportunity for more state and local tax cases to be pursued in federal court.

Taxpayers frequently face an uphill battle when attempting to reverse a tax assessment or obtain a tax refund at the state and local tax levels. This is because SALT jurisdictions typically stack the deck against taxpayers in any way they can, including enacting legal authority presuming the correctness of their own tax assessment determinations and imposing substantial evidentiary burdens on taxpayers to overcome these presumptions. And thanks to one 36-word federal statute, SALT authorities enjoy another key advantage: venue.

Federal law generally precludes SALT disputes from being litigated in federal court, often to the disadvantage of the taxpayer (especially the out-of-state taxpayer) who must go through the state or locality's own administrative and judicial dispute resolution systems. The federal Tax Injunction Act (TIA) provides the following:

> The 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.[1]

This article provides a brief history of the TIA, addresses its exceptions with an emphasis on recent case developments, and concludes with observations about why now may be the best time for SALT taxpayers to consider jiggling the door handle to federal court to see if it opens.

## History of the TIA

Federal courts have limited jurisdiction; they can only hear cases listed in the Constitution or specifically permitted by Congress. Accordingly, many laws affirmatively establish the federal courts' authority to decide a dispute. The TIA, by contrast, affirmatively limits federal court jurisdiction. Before the TIA, out-of-state taxpayers could sue a state in federal court based on diversity of citizenship, but state residents did not have the same option. Thus, the TIA was intended to equalize the "highly unfair picture" in which citizens would have to "pay first and then litigate," while diverse plaintiffs from outside the state could litigate the case in federal court without first paying the tax amounts at issue.[2]

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[1] 28 U.S.C. section 1341.

[2] *Hargrave v. McKinney*, 413 F.2d 320, 325 (5th Cir. 1969) (citing S. Rep. No. 1035, 75th Cong., 1st Sess. 1-2 (1937)).

### Exceptions to the TIA

The TIA's limiting language is broad, but some case types have cleared its hurdle and provide a framework for making it into federal court. These include cases involving exactions that are not taxes; cases not seeking to prevent the assessment, levy, or collection of a tax; and cases in which no plain, speedy, and efficient remedy is available.

### Cases Involving Exactions That Are Not Taxes

The TIA only precludes federal courts from hearing cases involving a tax, as opposed to a fee, penalty, or other exaction. Generally, in defining the scope of a tax for TIA purposes, most federal courts follow the First Circuit's decision in *San Juan Cellular*, which instructs the district courts to consider three factors: (i) the revenue's ultimate use, (ii) the nature of the entity imposing the charge, and (iii) the population subject to the charge.[3]

The First Circuit's December 2019 opinion in *Alviti* clarified that the list of three *San Juan Cellular* factors is not exhaustive. Specifically, courts can consider additional factors such as whether "the agency places the money in a special fund," whether collection of the charge is "assigned to the State Tax Assessor," whether the requested injunction "poses [a] threat to the central stream of tax revenues," and whether the enacting entity referred to the charge as a tax.[4] Further, in view of the creative, complex, and aggressive revenue-raising efforts by many states in the 21st century — including expansive definitions, interpretations, and applications of the term "tax" — the court in *Alviti* emphasized that courts applying the TIA should look to the meaning of the word "tax" in 1937, when Congress enacted the TIA. The *Alviti* court determined that absent a compelling reason, there is no need to "complicate the distinction that likely prevailed in 1937."[5]

Also, the U.S. District Court for the Southern District of New York in *Healthcare Distribution Alliance* recently held that the fee created under the Opioid Stewardship Act (OSA) is a surcharge and not a tax under the TIA.[6] Under the OSA, opioid manufacturers and distributors licensed in the state must make a payment based on the volume of opioids they sell or distribute in the state.[7] The payments are used exclusively to pay for opioid abuse prevention, treatment, and recovery services.[8] Even though the surcharge revenue was segregated into a separate fund, the state argued that the surcharge contributed to general revenue since the treatment and programs were available to the general public.

However, the court noted that the OSA "charges a regulated industry to create a segregated fund that is directed toward specific purposes closely intertwined with the industry in question," finding that these "straightforward facts undercut any argument that the OSA is a tax." The case is on appeal at the Second Circuit, which may further clarify the scope of a tax and public benefit for TIA purposes.[9]

### Cases Not Seeking to Prevent the Assessment, Levy, or Collection of the Tax

By the express words of the statute, the TIA only applies to the "assessment, levy, or collection" of a tax. The U.S. Supreme Court in *Direct Marketing Association v. Brohl*[10] recently clarified the scope of these terms and held that the TIA did not bar a challenge to Colorado's notice and reporting statute because the provision did not pertain to the assessment, levy, or collection of state taxes.[11] The Court found that assessment "refers to the official recording of a taxpayer's liability, which occurs after information relevant

[3] *San Juan Cellular Telephone Co. v. Public Service Commission of Puerto Rico*, 967 F.2d 683, 685 (1st Cir. 1992); *see also GenOn Mid-Atlantic LLC v. Montgomery County, Maryland*, 650 F.3d 1021, 1023 (4th Cir. 2011); *Entergy Nuclear Vermont Yankee LLC v. Shumlin*, 737 F.3d 228, 232 (2d Cir. 2013); and *Bidart Brothers v. California Apple Commission*, 73 F.3d 925, 930 (9th Cir. 1996). *But see Snodgrass v. City of Wichita, Kansas*, No. 18-1231-JWB, 2018 WL 6019344, at *2 (D. Kan. Nov. 15, 2018) ("The Tenth Circuit has held that the critical inquiry on whether an assessment is a tax under the TIA 'focuses on the purpose of the assessment and the ultimate use of funds.'" (quoting *Hill v. Kemp*, 478 F.3d 1236, 1245 (10th Cir. 2007)).

[4] *American Trucking Associations Inc. v. Alviti*, 944 F.3d 45, 55 (1st Cir. 2019).

[5] *Id.* at 49.

[6] *Healthcare Distribution Alliance v. Zucker*, No. 18 Civ. 6168 (KPF), 2018 WL 6651682 (S.D.N.Y. Dec. 19, 2018).

[7] N.Y. Pub. Health Law section 3323(5).

[8] *Id.* section 3323(2).

[9] *Healthcare Distribution Alliance v. Zucker*, No. 19-199 (appeal filed Jan. 17, 2019).

[10] 575 U.S. ___, 135 S. Ct. 1124 (2015).

[11] *Id.* at 1130-31.

to the calculation of that liability is reported to the taxing authority."[12] Levy is "limited to an official governmental action imposing, determining the amount of, or securing payment on a tax," and collection is the "act of obtaining payment of taxes due."[13]

Following the Supreme Court's direction in *Brohl*, the District Court for the Western District of Louisiana in *Rock Creek Oil* held that the TIA did not bar a suit by an oil company contesting penalties for failure to furnish certain reports on its oil and gas severance activities.[14] Although the TIA generally applies to penalties that are "inexorably tied" to tax collection, and the required reports were used to determine tax liability, the court found the reporting requirements "were merely part of the Department of Revenue's information-gathering stage."[15] The court reasoned that the reports involved "'reporting information pertaining to tax liability' rather than the official recording of taxpayer liability, the specific mode of collection, or the act of obtaining taxes due."[16]

The TIA is also inapplicable to cases in which a third party does not contest its own tax liability, such as "third-party claims that would enlarge state receipts"[17] or claims against a tax benefit enjoyed by other taxpayers.[18] For example, in *Union Pacific*, the court held that the TIA did not bar a cross-complaint by third-party county defendants claiming the state tax commission undervalued the taxpayer's property.[19] The court reasoned that the TIA only applies in "cases in which state taxpayers seek federal-court orders enabling them to avoid paying state taxes," not claims to enforce and increase taxes.[20]

Also, the TIA does not preclude federal courts from hearing cases filed by a taxing authority seeking a declaratory judgment that a taxpayer is engaged in an activity that makes the taxpayer subject to a state or local tax. For instance, before the U.S. Supreme Court heard an appeal from the South Dakota Supreme Court in *South Dakota v. Wayfair*,[21] the taxpayer sought to remove the case to federal court.[22] While the district court remanded the case based on lack of a federal question, the court otherwise determined that the TIA was not a bar to hearing the case because the case was not a claim by a taxpayer seeking to prevent tax collection proceedings.[23]

### Cases in Which No Plain, Speedy, and Efficient Remedy is Available

While taxpayers often have good reason to lament the complexity, delays, and inefficiency of SALT remedies, this exception to the TIA is rarely invoked by federal courts that are hesitant to find SALT procedures inadequate.

Federal courts have further defined the terms "plain," "speedy," and "efficient," but taxpayers have found limited success asserting this as a basis for federal jurisdiction. First, federal courts have defined plain to mean "clear" or "manifest," and determined that a state remedy is not plain just because there is uncertainty regarding its availability or effect.[24] Second, speedy has been interpreted as "a relative concept,"[25] such that a state's remedy is speedy "if it does not entail a significantly greater delay than a corresponding federal procedure."[26] Finally, "to be efficient, the state court remedy must not impose 'unusual hardship' or require 'ineffectual activity or unnecessary expenditure of time and energy.'"[27]

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[12] *Id.*

[13] *Id.*

[14] *Rock Creek Oil Inc. v. Louisiana Department of Revenue*, No. 2:19-cv-00815, 2019 WL 4413260 (W.D. La. Sept. 13, 2019).

[15] *Id.* at 3.

[16] *Id.* (quoting *Brohl*, 135 S. Ct. at 1130-31).

[17] *Hibbs v. Winn*, 542 U.S. 88, 108 (2004).

[18] *JMCB LLC v. Board of Commerce and Industry*, 293 F. Supp. 3d 580 (M.D. La. 2017) (holding that the TIA did not bar a class action suit from proceeding in federal court when the lawsuit challenged a state contract exempting a taxpayer's property from ad valorem taxes).

[19] *Union Pacific Railroad Co. v. Utah State Tax Commission*, No. 2:18-cv-00630, 2019 WL 3225755, at *3 (D. Utah July 17, 2019).

[20] *Id.*

[21] 585 U.S. ___ (2018).

[22] 229 F. Supp. 3d 1026 (D.S.D. 2017).

[23] *Id.* at 1038-39.

[24] *Colonial Pipeline Co. v. Morgan*, 231 F.R.D. 518, 529 (M.D. Tenn. 2005), *aff'd*, 474 F.3d 211 (6th Cir. 2007) (citing *Rosewell v. LaSalle National Bank*, 450 U.S. 503, 516-17 (1981)).

[25] *Id.* (citing *Rosewell*, 450 U.S. at 518).

[26] *Hyatt v. Yee*, 871 F.3d 1067, 1073 (9th Cir. 2017).

[27] *Cabral v. Caesars Entertainment Corp.*, No. 2:17-cv-02841, 2018 WL 2943437, at *6 (D. Nev. June 11, 2018) (quoting *Ashton v. Cory*, 780 F.2d 816, 819 (9th Cir. 1986)).

In a recent unsuccessful attempt to invoke the "plain, speedy, and efficient remedy" exception to the TIA, the taxpayer in *Hyatt v. Yee* argued that forcing him to switch from a "protest-then-pay" process to a "pay-then-protest" process to have his constitutional claims heard was not a sufficient remedy.[28] Even though the taxpayer had been in litigation over the original assessments for 22 years, the Ninth Circuit rejected the taxpayer's argument, reasoning that the taxpayer had chosen not to pay the tax assessments initially and only recently decided to add constitutional claims. The court added that even if pursuing the "pay-then-protest" process required the taxpayer to abandon some of his claims to attorney fees, this did not mean the state had deprived him of a plain, speedy, and efficient remedy.[29]

## Other Exceptions to the TIA

Several other narrow exceptions may apply to some taxpayers:

- proceedings in federal bankruptcy court;[30]
- suits by Indian tribes challenging state taxes on the tribe's land;[31]
- challenges by railroads to some property taxes;[32]
- some taxpayers enforcing their rights under ERISA;[33] and
- suits involving the United States as a joined plaintiff in which it would ultimately bear the burden of the tax.[34]

## What Now?

As the world gets flatter and businesses engage in more transactions across state lines, the opportunity to present SALT cases in federal court becomes all the more enticing. State court proceedings often have different judges for different phases of the case, with varying levels of clerical support provided to each judge. In states where judges are addressing complex tax disputes without any significant tax background or experience, this further complicates an already sensitive situation. There are always hazards and unsettling levels of uncertainty in litigation, but these factors are exacerbated in cases involving SALT disputes.

In contrast, federal judges have highly qualified clerks who dedicate substantial time and resources uniformly across the country, and they are much more suited to address constitutional questions involving the due process and dormant commerce clauses. Further, although it cannot often be proven, the perception certainly exists that SALT jurisdictions are much less likely to strike down their own laws and determinations or favor tax refunds affecting their own budgets.[35]

With federal courts providing more guidance lately on exceptions to the TIA, now may be the opportune time to see if the door to federal court can be opened a little more for SALT disputes. There is always the risk that pursuing a case in federal court may be remanded to state court, but that risk might be more worth taking now. After all, state and local budgets keep getting tighter, and mechanisms to collect more revenue keep getting more creative and aggressive. As a result, state and local jurisdictions frequently seek to avoid higher vote thresholds, procedural hurdles, and the corresponding stigma that comes with enacting a new tax by structuring revenue-raising mechanisms in other forms. Although this is no doubt a troubling trend for taxpayers, it may come with a silver lining. As recent federal case law illustrates, federal courts are willing to hear cases that fit into exceptions to the TIA, and they are looking closer at what it takes to meet one of these exceptions.

To capitalize on this potential opportunity, taxpayers and practitioners should analyze their SALT issues to see if there is a colorable argument

[28] 871 F.3d at 1067.

[29] *Id.* at 1075.

[30] *In re Hechinger Investment Co. of Delaware Inc.*, 335 F.3d 243, 247 (3d Cir. 2003).

[31] *Agua Caliente Band of Cahuilla Indians v. Hardin*, 223 F.3d 1041, 1049 (9th Cir. 2000).

[32] *BNSF Railway Co. v. Oregon Department of Revenue*, No. 3:17-cv-1716, 2018 WL 6585279, at *2 (D. Or. Dec. 14, 2018).

[33] 27 Fed. Proc., L. Ed. section 61:273 (Dec. 2018 update) ("There is a split of authority over the interaction of state tax laws, the Tax Injunction Act, and ERISA.").

[34] *See Arkansas v. Farm Credit Services of Central Arkansas*, 520 U.S. 821, 823-24 (1997).

[35] Walter Hellerstein and Andrew Appleby, "Substantive and Enforcement Jurisdiction in a Post-*Wayfair* World," *State Tax Notes*, Oct. 22, 2018, p. 283 (acknowledging the "home cooking" doctrine as well known to tax practitioners and why they generally support federal legislation allowing state tax challenges to be brought in federal court).

that they do not strictly involve the assessment, levy, or collection of a tax, and thus qualify as an exception to the TIA and a way into federal court. Some may ask if taxpayers can afford the extra cost of fighting to be heard by federal court, but with the troubling trend of more aggressive taxing jurisdictions coupled with already cozy rules in friendly home venues, the better question might be whether taxpayers can afford not to try. ■