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Court Begins 2013-2014 Term

Upon starting its 2013-2014 term during the government's recent partial shut-down, the U.S. Supreme Court opened with a grant of certiorari in a case with state and local tax implications, the first such case of the new term. This dispute involves the exclusion of certain severance payments from taxation as "wages" under the Federal Insurance Contributions Act (FICA).

Also, the Court heard oral argument in *Daimler AG v. Bauman,* involving a Due Process Clause personal jurisdiction challenge. Although this case does not involve a tax matter, the Court's ruling could have a profound effect on state tax matters because a state tax must comport with the Due Process Clause to withstand a constitutional challenge.

Two new petitions have been filed challenging the New York Court of Appeals' decision in *Overstock.com, Inc. v. New York State Department of Taxation and Finance,* holding that New York's "Amazon tax" is facially constitutional. That decision is significant given that many states have enacted their own "Amazon taxes." And as discussed below, the New York high court, in its decision in March 2013, appears to have provided an open invitation to the U.S. Supreme Court to determine whether the country's sales and use tax physical presence nexus test is outdated.

One request for review in a state and local tax case remains pending from the prior term. And the Court has denied certiorari in ten petitions requesting review (two that were just recently filed, two others that were among the four pending requests for review held over from the 2012-2013 term, and all six petitions for certiorari first discussed in the October 2013 column).

Certiorari Granted in FICA ‘Wages’ Controversy

The Supreme Court has agreed to hear arguments in *U.S. v. Quality Stores, Inc.,* Docket No. 12-1408, *cert. granted* 10/1/13, ruling below as *In re Quality Stores, Inc.,* 110 AFTR 2d 2012-5827, 693 F3d 605, 2012-2 USTC ¶50551 (CA-6, 2012), *reh'g and reh'g en banc den.* 1/4/13, *aff'g* 105 AFTR 2d 2010-1110, 424 BR 237, 2010-1 USTC ¶50250 (DC Mich., 2010). The federal Court of Appeals for the Sixth Circuit held that payments made by a corporation to its employees upon terminating their employment involuntarily due to business cessation were supplemental unemployment compensation benefit payments, and not taxable "wages" under the Federal Insurance Contributions Act (FICA). The government argues in its petition for review that the payments at issue do not qualify for an exemption under FICA because they were not linked to the receipt of state unemployment compensation, and thus should be wages subject to FICA withholding.

The Supreme Court's decision to grant certiorari is not surprising given the split in the Circuits between the Sixth Circuit in this case and the Federal Circuit in *CSX Corp. v. U.S.,* 101 AFTR 2d 2008-1120, 518 F3d 1328, 2008-1 USTC ¶50218 (CA-F.C., 2008), *reh'g and reh'g en banc den.* CA-F.C., 5/13/08, and other appellate courts, as well as the amount of money at issue (i.e., for this and other claims, the amount currently exceeds $1 billion, as noted in the government's petition for certiorari). Taxpayers who have paid FICA taxes should consider filing protective refund claims in the event that the Supreme Court affirms the Sixth Circuit's decision.

Ultimately, employers and employees should monitor this case given the importance of the definition of the term "wages" for purposes of various federal and state payroll taxes, including, e.g., federal and state unemployment insurance taxes, and federal and state income taxes for withholding purposes. And the federal determination of "wages" may affect the states' determination as to the nature of such payments.

(For more on this case, see U.S. Supreme Court Update, 23 J. Multistate Tax’n 43 (August 2013).)

Oral Argument in Due Process Personal Jurisdiction Challenge

Toward the end of its prior term, the U.S. Supreme Court granted certiorari in *DaimlerChrysler AG v. Bauman,* Docket No. 11-965, *cert. granted* 4/22/13, ruling below as *Bauman v. DaimlerChrysler Corp.,* 644 F3d 909 (CA-9, 2011), *reh'g and reh'g en banc den.* CA-9, 11/9/11. In this case, the federal Court of Appeals for the Ninth Circuit found that it was reasonable to subject a foreign (German) corporation, DaimlerChrysler Aktiengesellschaft (DCAG), to the jurisdiction of a federal district court in California, in a case involving claims of human rights violations that occurred in Argentina (allegedly at a subsidiary plant, Mercedes-Benz Argentina) more than 30 years ago, with jurisdiction based on the activities of DCAG's wholly owned U.S. subsidiary, Mercedes-Benz USA (a Delaware corporation), which distributes its cars in California.

Although DCAG conducted no manufacturing activities in California, had no property or employees in the state, and asserts that the California company is an indirect subsidiary acting independently of DCAG, the Ninth Circuit nevertheless found a sufficient connection (requisite contacts) between the parent company and the subsidiary—the sale of Mercedes-Benz vehicles in California (2% of DCAG's overall vehicle revenue). Applying an "agency" test, the Ninth Circuit found that the services provided by the California subsidiary were sufficiently important to DCAG that, if the California subsidiary were to go out of business, DCAG would continue selling vehicles in California either by selling them itself, or alternatively, by selling them through a new representative. The court further said that actual control of the subsidiary was not necessary, but that the "right to control" the subsidiary through a distributorship agreement was sufficient.

Amici support DaimlerChrysler's request for review. Several amicus briefs were filed in this case in support of the petition for certiorari, including briefs by the U.S. Chamber of Commerce and by the U.S. government. The Justice Department argued that the Ninth Circuit's decision was "seriously flawed" in that it holds a foreign corporation with few contacts in California "to answer in that State for any claim against it, arising anytime, anywhere in the world." The government also emphasized that "expansive assertions of general jurisdiction over foreign corporations may operate to the detriment of

the United States' diplomatic relations and its foreign trade and economic interests." (The government's brief is at 2013 WL 3377321.)

The arguments. On 10/15/13, the Court heard oral arguments in this case from attorneys for DCAG and for the respondents, and from the Deputy Solicitor General of the U.S. as amicus curiae supporting the petitioner (2013 WL 5629592). At the beginning of oral arguments, counsel for DCAG stated that he was "not quite sure what in the Constitution would empower, say, California to essentially override, say Delaware's corporate law and say for our State purposes, we're essentially going to rewrite the corporate DNA of a corporation that's chartered in Delaware in order to" disregard the corporate forum. Justice Sotomayor responded that the Court permitted this to occur in its state and local tax decision, *Container Corp. of America v. Franchise Tax Board,* 463 US 159, 77 L Ed 2d 545 (1983), noting that in *Container Corp.:* "We permitted California law to tax the parent California corporation for the earnings of all its foreign subsidiaries. And we said the Due Process Clause wasn't offended by that." Counsel for DCAG responded, stating that "typically this Court has applied a less rigorous due process standard in the tax cases than it has in the personal jurisdiction cases."

Justice Sotomayor further questioned the Deputy Solicitor General as to whether he "[c]ould tell [her] why we just don't rely on the tests we apply in the tax cases? It's a federal test and it says if you're functionally and economically tied together and you control the other entity, the parent controls the subsidiary, your earnings are subject to the Due Process Clause and can be taxed by an individual state." Justice Alito further framed the question as follows: "[D]oes the due process rule regarding taxation of individuals by a state align with the ability of somebody to sue that person in the state?" The Deputy Solicitor General answered that "there has to be some nexus between the individual and the state," and "in taxation among the states, there is an apportionment formula," which requires a state to tax only "that portion [of overall income] that is fairly attributable" to the state—and, thus, "it's analogous to a specific jurisdiction," versus general jurisdiction, which is at issue before the court.

The Supreme Court's ultimate decision in this case may make a major new pronouncement regarding the scope of U.S. courts' reach over claims of foreign transgression, and impact state and local tax matters.

New Petitions for Certiorari Challenge New York's 'Amazon Tax'

In *Overstock.com, Inc. v. New York State Department of Taxation and Finance,* Docket No. 13-252, petition for cert. filed 8/22/13, and *Amazon.com, LLC v. New York State Department of Taxation and Finance,* Docket No. 13-259, petition for cert. filed 8/23/13, ruling below as *Overstock.com, Inc. v. New York State Department of Taxation and Finance,* 20 N.Y.3d 586, 965 N.Y.S.2d 61, 987 NE2d 621 (2013), Amazon.com and Overstock.com are seeking review of the decision by the New York Court of Appeals (the state's highest court) holding constitutional New York's "Amazon" tax (also known as the Internet tax).

New York's tax scheme. In 2008, New York became the first state to enact so-called "Amazon" tax legislation, named after the world's largest Internet retailer and targeting online retailers for sales tax collection responsibility. The legislation, codified in N.Y. Tax Law §1101(b)(8)(vi), expanded the definition of the term "vendor" for New York's sales and use tax purposes, by creating a presumption of vendor status for certain out-of-state sellers. That section provides that a seller of taxable tangible personal property or services is presumed to be soliciting business through an independent contractor or other representative in New York if (1) "the seller enters into an agreement with a resident of [New York] under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an internet website or otherwise, to the seller," and (2) "the cumulative gross receipts from sales by the seller to customers in [New York] who are referred to the seller by all residents with this type of an agreement with the seller is in excess of ten thousand dollars during the preceding four quarterly periods...."

The statutory presumption, however, "may be rebutted by proof that the resident with whom the seller has an agreement did not engage in any solicitation in the state on behalf of the seller that would satisfy the nexus requirement of the United States Constitution during the four quarterly periods in question."

In 2008, the New York State Department of Taxation and Finance issued two Technical Services Bureau memoranda (TSB-M-08(3)S, 5/8/08, and TSB-M-08(3.1)S, 6/30/08) providing guidance to taxpayers on the application of the Amazon law, including clarification that advertising alone is beyond the scope of the law, and instructions on how out-of-state sellers could rebut the presumption. For example, TSB-M-08(3.1)S states that two conditions must be met for an out-of-state seller to rebut the presumption—a contractual prohibition forbidding the New York representatives from engaging in solicitation activities in New York and an annual statement of compliance from those representatives declaring that, in fact, they had not engaged in any prohibited solicitation during the year.

(These TSB-Ms were discussed in more detail in Vetter, "Conjuring Jurisdiction Through Presumption—Affiliate Nexus Legislation," 21 J. Multistate Tax'n 6 (February 2012).)

Procedural history of the Amazon and Overstock litigation. Shortly after the enactment of New York's "Amazon" tax, Amazon.com and Overstock.com brought suit claiming that the provision was unconstitutional on its face under the Commerce Clause of the U.S. Constitution, and unconstitutional "as applied" to Amazon.com and Overstock.com. The online retailers also argued that the provisions were violative of the Due Process Clause on the basis that the presumption of solicitation was irrational and unrebuttable. The New York Supreme Court (a trial court) granted the Tax Department's motions to dismiss. (See *Amazon.com, LLC v. New York State Department of Taxation and Finance,* 23 Misc 3d 418, 877 NYS2d 842, 2009 NY Slip Op 29007, 2009 WL 69336 (Sup. Ct. N.Y. County, 2009).)

On appeal, the Appellate Division, First Department, affirmed the trial court's facial constitutional rulings, but reinstated the as-applied challenges for further development. (See *Amazon.com, LLC v. New York State Department of Taxation and Finance,* 81 App Div 3d 183, 913 NYS2d 129, 2010 NY Slip Op 7823, 2010 WL 4345742 (1st Dept., 2010).)

New York high court's analysis. Electing to forgo their as-applied constitutional challenges, both Amazon.com and Overstock.com sought a declaration from the New York Court of Appeals that the "Amazon" tax was unconstitutional on its face on the basis that the law "violates the Commerce Clause by subjecting online retailers, without a physical presence in the State, to New York sales and compensating use taxes." (The online

retailers entered into stipulations of discontinuance withdrawing their as-applied constitutional challenges with prejudice, which were deemed final judgments.) The retailers also maintained that "the Internet tax violates the Due Process Clause by creating an irrational, irrebuttable presumption of solicitation of business within the State."

Both Amazon.com and Overstock.com sold merchandise strictly through the Internet, and each had a program in place through which third parties (e.g., New York residents) would place links for the Internet companies on the third-parties' own websites. When a customer clicked on the link, he or she would be directed to the online retailer, and the third party would receive a commission if the customer ultimately purchased a product. (Some observers posit that these retailers may have abandoned their as-applied challenges because their as-applied facts really were not all that good.)

Commerce Clause analysis. As has often been discussed in this column, the U.S. Supreme Court established a physical presence nexus standard for sales and use taxes in *Quill Corp. v. North Dakota,* 504 US 298, 119 L Ed 2d 91 (1992), that would satisfy the "substantial nexus requirement" under the Commerce Clause of the U.S. Constitution. In *Overstock.com,* as explained by the court of appeals, "although an in-state physical presence is necessary, it 'need not be substantial. Rather, it must be demonstrably more than a "slightest presence."'" (Quoting *Orvis Co., Inc. v. New York State Tax Appeals Tribunal,* 86 N.Y.2d 165, 630 N.Y.S.2d 680, 654 NE2d 954 (1995), which cited *National Geographic Society v. California Board of Equalization,* 430 US 551, 51 L Ed 2d 631 (1977).) The court further stated: "The presence requirement will be satisfied if economic activities are performed in New York by the seller's employees or on its behalf."

The majority opinion found that "[a]ctive, in-state solicitation that produces a significant amount of revenue qualifies as 'demonstrably more than a "slightest presence,"'" and thus "the [New York] statute plainly satisfies the substantial nexus requirement" under the Commerce Clause. While acknowledging that "no one disputes that a substantial nexus would be lacking if New York residents were merely engaged to post passive advertisements on their websites," the court concluded this was not the case. Instead, the majority opinion noted that many of the third-party websites (e.g., radio stations, religious institutions, schools) "are geared toward predominantly local audiences," thus creating for the vendor

"an in-state sales force," and concluded that "if a vendor is paying New York residents to actively solicit business in this State, there is no reason why that vendor should not shoulder the appropriate tax burden." In light of this, the majority opinion held that the Amazon tax was not facially unconstitutional under the Commerce Clause.

Due process analysis. At the outset of its Due Process analysis, the court of appeals noted that, unlike for Commerce Clause purposes, physical presence is not required for Due Process Clause purposes. Instead, the focus of inquiry is "on whether a party has purposefully directed its activities toward the forum state and whether it is reasonable, based on the extent of a party's contacts with that state and the benefits derived from such access, to require it to collect taxes for that state." The majority opinion, quoting *Quill,* noted that "an entity 'that is engaged in continuous and widespread solicitation of business within a State ... clearly has fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign,' even in the absence of physical presence." Again quoting *Quill,* the majority further concluded that "we believe that a brigade of affiliated websites compensated by commission are the equivalent of 'a deluge of catalogs' and a 'phalanx of drummers.'"

As the court noted, Overstock.com and Amazon.com argued that "the Internet tax violates due process because the statutory presumption is irrational and essentially irrebuttable." The majority opinion found that "[i]n order for the presumption to be constitutionally valid, there must be a 'rational connection between the facts proven and the fact presumed, and ... a fair opportunity for the opposing party to make [a] defense.'" (Quoting *Casse v. New York State Racing and Wagering Board,* 70 N.Y.2d 589, 523 N.Y.S.2d 423, 517 NE2d 1309 (1987).) The court concluded that "[h]ere, the fact proved is that the resident is compensated for referrals that result in purchases," and "[t]he fact presumed is that at least some of those residents will actively solicit other New Yorkers in order to increase their referrals and, consequently, their compensation." The court pointed out that the record contained examples of this type of solicitation by, e.g., schools and other organizations. The court did note that "[t]he presumption would appear decidedly less rational if it were applied to those who receive some types of 'other compensation'—i.e., those whose compensation is unrelated to actual sales." Such an arrangement, the court said, would be "difficult to distinguish ... from traditional advertising."

Since the court was considering solely the facial constitutionality of the statute, rather than an "as applied" challenge, however, it made clear that "the fact that [the] plaintiffs can posit a potential constitutional infirmity does not require the statute's invalidation on its face." Although the court recognized that obtaining the necessary information to rebut the presumption may impose a burden on the retailers, it determined that this inconvenience does not make the statute unconstitutional—i.e., it does not make the presumption irrebuttable. The court also relied on the Tax Department's memorandum guidance as providing "a method (contractual prohibition and annual certification) through which the retailers will be deemed to have rebutted the presumption." As such, the court held that the statute does not fail under the Due Process Clause.

A dissent. One judge filed a dissenting opinion, declaring that the court's "task here is to decide whether certain New York-based websites—Overstock's 'Affiliates' and Amazon's 'Associates'—are the equivalent of sales agents, soliciting business for Overstock and Amazon, or are only media in which Overstock and Amazon advertise their products." In the dissent's view, "they are the latter."

Noting that the New York Internet tax at issue "tries to turn advertising media into an in-state sales force through a presumption," the dissent warned that "[t]o presume that every website that has an agreement under which it carries an Overstock or Amazon link is a sales agent for Overstock or Amazon would be to nullify the rule that advertising in in-state media is not the equivalent of physical presence." According to the dissent, "[t]o infer, from an agreement to put a link on a website and to compensate the website owner in proportion to the resulting sales, that the website owner is actively soliciting business for the seller 'is so strained as not to have a reasonable relation to the circumstances of life as we know them.'" (Quoting *Tot v. U.S.,* 319 US 463, 87 L Ed 1519 (1943).) The dissent would, therefore, find New York's Internet tax invalid under the Commerce Clause.

The future of *Quill*'s physical presence nexus test. The majority opinion beckons the U.S. Supreme Court, as "the ultimate arbiter of the meaning of the Commerce Clause," to determine whether the physical presence test is outdated, stating: "The world has changed dramatically in the last two decades, and it may be that the physical presence test is outdated. An entity may now have a profound impact upon a

foreign jurisdiction solely through its virtual projection via the Internet. That question, however, would be for the United States Supreme Court to consider. We are bound, and adjudicate this controversy, under the binding precedents of that Court, the ultimate arbiter of the Commerce Clause."

Questions for the U.S. Supreme Court. Overstock.com's petition for certiorari asks the Court to consider: "Whether a business that has no employees or operations in a State is deemed to be physically present, and therefore subject to the State's taxing power, merely by entering into contractual relationships with residents of the State who are not its legal agents."

Similarly, in its petition, Amazon.com presents the Court with two questions:

> (1) "Whether [N.Y. Tax Law] Section 1101(b)(8)(vi) violates the Commerce Clause by imposing tax-collection obligations on out-of-state retailers that have no physical presence in New York."
>
> (2) "Whether Section 1101(b)(8)(vi) violates the Due Process Clause by adopting an effectively irrebuttable evidentiary presumption that the prerequisites for taxation under the Commerce Clause have been satisfied."

(For more on *Overstock.com, Inc.,* see Bingel and Genz, "New York: High Court Upholds 'Amazon Tax' Provision for Internet Retailers," 23 J. Multistate Tax'n 33 (July 2013). For more background on New York's "Amazon law," see Cristman, "New York: Novel Sales Tax Law Seeks to Reach Internet and Other Out-of-State Vendors," 18 J. Multistate Tax'n 35 (August 2008); and Hecht, Burkard, Melone, Sutton, Yesnowitz, and Jones, "New York: State Clarifies New Affiliate Nexus Standard for Sales Tax Vendors," 19 J. Multistate Tax'n 32 (February 2010). For an analysis of the New York high court's opinion in *Orvis,* see Bartlett, "New York: High Court Finds Nexus on More Than a Slightest Presence," 5 J. Multistate Tax'n 219 (Nov/Dec 1995). For more on *Quill* and physical presence generally, see Eule and Richman, "Out-of-State Mail-Order Vendors Need Not Collect Use Taxes—Yet!," 2 J. Multistate Tax'n 163 (Sep/Oct 1992); and Nolan, "Crossing the Bright Line: Evaluating Physical Presence in *Quill*'s Shadow," 7 J. Multistate Tax'n 244 (Jan/Feb 1998).)

Pending Request for Review

As we go to press, we still await the Court's decision on whether to grant certiorari in one case held over from last term.

Madison County, N.Y. v. Oneida Indian Nation of New York, Docket No. 12-604, petition for cert. filed 11/12/12, ruling below as *Oneida Indian Nation of New York v. Madison County, N.Y.,* 665 F3d 408 (CA-2, 2011), follows a remand from the U.S. Supreme Court in an earlier action in this ongoing litigation, in which the federal Court of Appeals for the Second Circuit affirmed in part, vacated in part, and remanded with instructions, the district court's judgments. Specifically, the circuit court held that the Oneida Nation waived its claim to tribal sovereign immunity from enforcement of real property taxation through foreclosure by state, county, and local governments, when the tribe issued a formal declaration to that effect. Accordingly, the appellate court vacated the district court's judgments to the extent that they granted summary judgment to the Oneida Nation based on claims relating to the doctrine of sovereign tribal immunity to suit.

The Second Circuit also reversed the district court's judgment in favor of the Oneida Nation on its claims of violations under the Due Process Clause of the Fourteenth Amendment, finding that the Oneida Nation had sufficient notice of the counties' tax enforcement proceedings to enable it to take steps to protect its property interests. And the circuit court also declined to exercise supplemental jurisdiction over the tribe's state law claims, thereby vacating the district court's grant of injunctive relief barring the counties from foreclosing on the Oneida Nation's properties. Citing its prior holding on this question, the Second Circuit also affirmed the dismissal of the counties' counterclaims regarding the issue of whether the Oneida reservation had been disestablished.

As previously reported, in February 2013 the Court asked the U.S. Solicitor General to file a brief expressing the views of the federal government in this case but, at this writing, such brief has yet to be filed. (For more background on this litigation, and more on the current request for certiorari, see U.S. Supreme Court Update, 22 J. Multistate Tax’n 41 (February 2013).)

Certiorari Has Been Denied in:

677 New Loudon Corp. v. New York Tax Appeals Tribunal, Docket No. 13-38, *cert. den.* 10/15/13, ruling below at 19 N.Y.3d 1058, 955 N.Y.S.2d 795, 979 NE2d 1121 (2012), *reargument den.* 2/7/13, where the New York Court of Appeals (the state's highest court), with one dissent in which two other judges concurred, held that admission fees and private dance performance fees charged by a facility (an adult "juice bar") with "pole dancing" were not exempt from sales tax as charges for a "dramatic or musical arts performance[]" (which is exempt under N.Y. Tax Law §1105(f)(1)). In its opinion affirming the lower tribunals, the New York high court stated: "Clearly, it is not irrational for the Tax Tribunal to decline to extend a tax exemption to every act that declares itself a 'dance performance.' If ice shows presenting pairs ice dancing performances, with intricately choreographed dance moves precisely arranged to musical compositions, were not viewed by the Legislature as 'dance' entitled to a tax exemption, surely it was not irrational for the Tax Tribunal to conclude that a club presenting performances by women gyrating on a pole to music, however artistic or athletic their practiced moves are, was also not a qualifying performance entitled to exempt status." The court of appeals also found the taxpayer's remaining constitutional arguments "unavailing." The taxpayer had argued that nude dancing is protected expression under the First Amendment.

(For more on this case, including a discussion of the dissent, see U.S. Supreme Court Update, 23 J. Multistate Tax'n 40 (October 2013).)

Cornelius v. Nelson, Docket No. 12-1282, *cert. den.* 10/7/13, ruling below as *Cornelius v. Rosario,* 51 A3d 1144 (Conn. Ct. App., 2012), *rev. den.* Conn. S.Ct., 11/27/12, where the Connecticut Court of Appeals held that the City of Hartford satisfied due process considerations when, prior to selling property in a tax sale, it took certain additional steps to notify the record property owner after the initial notice mailed to the record title owner was returned to the city marked "undeliverable," including locating and sending notices of tax sale to the record property owner's listed agents, posting notice of the tax sale at City Hall, and publishing notice in the local newspaper. The court also held that a city is not required

to search its records for unrecorded interests (in this case, the petitioner had failed to record his warranty deed on the city's land records).

(For more on this case, see U.S. Supreme Court Update, 23 J. Multistate Tax'n 40 (October 2013).)

County of Oakland v. Federal Housing Finance Agency, Docket No. 13-233, *cert. den.* 10/7/13, and ***Michigan Department of Attorney General v. Federal Housing Finance Agency,*** Docket No. 13-237, *cert. den.* 10/7/13, ruling below as *County of Oakland v. Federal Housing Finance Agency,* 716 F3d 935 (CA-6 2013), in which the federal Court of Appeals for the Sixth Circuit reversed the district court's grant of summary judgment in favor of the State of Michigan and County of Oakland, Michigan, and remanded with instructions to enter summary judgment for the three defendants, the Federal National Mortgage Association (Fannie Mae, a corporation chartered by the U.S. Congress), the Federal Home Loan Mortgage Corporation (Freddie Mac, also a corporation chartered by the U.S. Congress), and the Federal Housing and Finance Agency (an independent federal agency), on the basis that such defendants are exempt from Michigan's State Real Estate Transfer Tax and the Michigan County Real Estate Transfer Tax, pursuant to their federal enabling legislation (i.e., Fannie Mae's and Freddie Mac's charter, and the Housing and Economic Recovery Act, respectively). The Sixth Circuit had determined that when Congress established the two corporations and the Housing and Finance Agency, it intended that they be exempt from all state and local taxes. Thus, the appeals court ruling reversed a district court finding that, because the local real estate transfer taxes were not direct taxes, the exemption did not apply.

Fein v. C.I.R., Docket No. 13-64, *cert. den.* 10/7/13, ruling below at 110 AFTR 2d 2012-6946, 2012-2 USTC ¶50707, 504 Fed Appx 41 (CA-2, 2012), *aff'g* TC Memo 2011-142, RIA TC Memo ¶2011-142, 101 CCH TCM 1683 , where the federal Court of Appeals for the Second Circuit upheld the complete disallowance of deductions claimed on the taxpayers' federal income tax returns for business expenses relating to accounting and photography activities, including car and truck expenses, gifts and promotions, meals, entertainment, travel, and rent expenses. The taxpayers had argued in their petition for certiorari that the Second Circuit failed to follow its longstanding rule articulated in *Cohan v. C.I.R.,* 8 AFTR

10552, 39 F2d 540, 2 USTC ¶489 (CA-2, 1930), where, in connection with legendary entertainer and producer George M. Cohan's claiming various entertainment expenses, Judge Learned Hand stated, in part, "[a]bsolute certainty in such matters is usually impossible and is not necessary; the Board [of Tax Appeals, the precursor to the Tax Court] should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent...." In their petition for certiorari, the taxpayers had observed that "[w]hile most federal circuits have recognized the applicability of the *Cohan* rule, its vitality has come into question in recent decades," and thus, "[the Supreme] Court's intervention is necessary to clarify and restore uniformity to this muddled landscape" (which can affect claims for deductions on state tax returns, as well). Still, the Second Circuit (and other lower courts) rejected the taxpayers' claims on the basis that they failed to provide adequate (i.e., legible) substantiation for the claimed deductions, and/or on the basis that the claimed expense deductions fell within the strict substantiation requirements of IRC Section 274(d), which Congress enacted to supersede the *Cohan* rule for certain categories of expense deductions.

(For a bit more on this case, and on IRC Section 274(d) and the related Treasury regulations, see U.S. Supreme Court Update, 23 J. Multistate Tax'n 40 (October 2013).)

Haydel v. Zodiac Corp., Ltd., Docket No. 12-1487, *cert. den.* 10/7/13, ruling below as *Quantum Resources Management, L.L.C. v. Pirate Lake Oil Corp.,* 112 So 3d 209 (La., 2013), where the Louisiana Supreme Court held that an August 1925 tax sale where there was a failure to give the property owner adequate notice of the pending sale could not be nullified based on a pre-sale notice rule articulated by the U.S. Supreme Court in *Mennonite Board of Missions v. Adams,* 462 US 791, 77 L Ed 2d 180 (1983), because the property owners' title case was not on direct review on the date that *Mennonite* was rendered and there was no basis to apply such rule retroactively. As explained by the Louisiana Supreme Court, in *Mennonite* "the [U.S.] Supreme Court recognized a tax sale of property is an action affecting a property right protected by the Due Process Clause of the Fourteenth Amendment. Consequently, a party possessing a substantial property interest 'is entitled to notice reasonably calculated to apprise him of a pending tax sale.'" (Quoting *Mennonite.*) There was no evidence in the present case that the sheriff provided notice of the tax sale to

the record owner of the property in 1925. Nevertheless, because the U.S. Supreme Court "has never stated whether the requirements announced in *Mennonite* are to apply retroactively to tax sales predating the decision," the Louisiana Supreme Court considered the U.S. Supreme Court's jurisprudence regarding retroactive application of its decisions and ultimately concluded that *Mennonite* could not apply retroactively to invalidate the 1925 tax sale.

(For more on this case, see U.S. Supreme Court Update, 23 J. Multistate Tax'n 40 (October 2013).)

In re Grand Jury Proceedings No. 4-10, Docket No. 12-1409, *cert. den.* 10/7/13, ruling below at 111 AFTR 2d 2013-794, 707 F3d 1262, 2013-1 USTC ¶50182 (CA-11, 2013), in which the federal Court of Appeals for the Eleventh Circuit found the "Required Records Doctrine" applicable, and thus held that the taxpayer must produce subpoenaed records, and cannot invoke the Fifth Amendment privilege against self-incrimination. The subpoenaed Records were ones required to be kept under the Bank Secrecy Act of 1970, and the Required Records Doctrine may be regarded as an exception to the Fifth Amendment privilege.

(For more on this case, see U.S. Supreme Court Update, 23 J. Multistate Tax'n 43 (August 2013).)

Jessica Mae Matheson, d/b/a Jess's Wholesale v. Washington Department of Revenue, Docket No. 13-135, *cert. den.* 10/7/13, ruling below as *Matheson v. State, Department of Revenue,* Wash. Ct. App., Div. 2, No. 42723-1-II, 9/17/12, *rev. den.* Wash. S.Ct., No. 88244-4, 4/30/13, where the Washington Court of Appeals affirmed the decision of the superior court upholding the assessment of $1.4 million in taxes and more than $7 million in interest and penalties for failing to pay cigarette taxes on more than 700,000 packs of unstamped cigarettes shipped to the taxpayer's wholesale business by two distributors, on the basis that the taxpayer failed to document an exempt disposition of those cigarettes. The taxpayer, a registered member of the Puyallup Indian Tribe and resident on two Indian reservations, held a Washington state tobacco license, which she claimed was for the purpose of allowing her to transport cigarettes between reservations free of state tax stamps. The taxpayer challenged the assessment on the basis that the

activities were exempt from state taxes under the Indian and Interstate Commerce Clauses of the U.S. Constitution.

Jordan River Restoration Network v. Salt Lake City Corp., Docket No. 12-1355, *cert. den.* 10/7/13, ruling below at 299 P3d 990 (Utah, 2012), in which the Utah Supreme Court, with one dissent, held that service of notice of a lawsuit (bond validation litigation) in the form of publication in a trade magazine, rather than service by first-class mail to each of the defendants—all the taxpayers of Salt Lake City Utah—satisfied due process under the U.S. Constitution's Fourteenth Amendment. The petitioners claimed that publication of the bond validation lawsuit in a trade publication with unknown circulation in Salt Lake City failed to satisfy the requirements of due process articulated by the U.S. Supreme Court in *Mullane v. Central Hanover Bank & Trust Co.,* 339 US 306, 94 L Ed 865 (1950), which the dissent in *Jordan River* interpreted as unequivocally requiring first-class mail notice or its equivalent.

(For more on this case, see U.S. Supreme Court Update, 23 J. Multistate Tax'n 43 (August 2013).)

Knappe v. U.S., Docket No. 13-34, *cert. den.* 10/15/13, ruling below at 111 AFTR 2d 2013-1531, 713 F3d 1164, 2013-1 USTC ¶50266, 2013-1 USTC ¶60663 (CA-9, 2013), *aff'g* DC Cal., 10/22/10, 2010 WL 9463256, 2013-1 USTC ¶60662 , where the federal Court of Appeals for the Ninth Circuit held that reliance on an accountant's incorrect advice about the deadline for filing a federal estate tax return did not establish the "reasonable cause" necessary under IRC Section 6651(a) to excuse the executor of the estate from paying a late filing penalty with respect to the late-filed federal estate tax return. In this case, the court distinguished between "substantive advice on tax law, on which executors may reasonably rely" (e.g., whether a liability exists), and "nonsubstantive advice, on which executors may not rely" (e.g., reliance on an attorney to file a tax return). Such differing types of advice, of course, can arise in state tax matters as well.

(For more on this case, see U.S. Supreme Court Update, 23 J. Multistate Tax'n 40 (October 2013).)

Tonasket v. Sargent, Docket No. 12-1410, *cert. den.* 10/7/13, ruling below at 510 Fed Appx 648 (CA-9, 2013), *aff'g* 830 F Supp 2d 1078 (DC Wash., 2011), where the federal

Court of Appeals for the Ninth Circuit held that the Colville Confederated Tribes of the Colville Indian Reservation did not waive tribal sovereign immunity from enforcement of cigarette taxation when the Tribes executed a cigarette tax contract with the State of Washington. Accordingly, the district court lacked subject matter jurisdiction and properly dismissed the claims brought by the plaintiffs, Terry Tonasket (doing business as Stogie Shop) and Daniel Miller, concerning the Colville Confederated Tribes' imposition of cigarette taxes on non-Indians. The court of appeals noted also that tribal sovereign immunity extended to the defendant Tom Sargent (Tobacco Tax Administrator), who is a tribal official. In reaching its decision, the court cited its earlier decision in *Miller v. Wright,* 705 F3d 919 (CA-9, 2013), *cert. den.* U.S. S.Ct., 6/17/13, a case in which Miller brought the same claims against the Puyallup Tribe of Indians.

(For a bit more on this case, see U.S. Supreme Court Update, 23 J. Multistate Tax'n 40 (October 2013).) **[]**