EVERSHEDS SUTHERLAND

CAPITOL TAX PARTNERS

Fair Access to Interstate Remedies Coalition (FAIR Coalition)

The Tax Injunction Act – a bar to fair litigation in state tax controversies

The Federal Tax Injunction Act (TIA), Section 1341 of Title 28, enacted nearly a century ago in 1937, prohibits most state tax cases from being heard in federal court. Taxpayers must file state tax claims in state courts "as long as a plain, speedy and efficient remedy may be had in state court." Unless the United States Supreme Court ("Supreme Court") agrees to hear a constitutional challenge to a state tax, which is relatively rare, taxpayers have no recourse from a state court decision in tax cases.

Litigating in state court – taxpayer concerns

Taxpayers engaged in interstate commerce face a growing history and pattern of discriminatory state taxation, resulting in due process and equal protection concerns under the Fourteenth Amendment and concerns regarding discrimination against interstate commerce under the Commerce Clause. Technological, legal and economic changes in recent years have enabled taxpayers to expand their businesses across state and national boundaries. With the Supreme Court's recent decision in *South Dakota v. Wayfair*, 138 S. Ct. 2080 (2018), states are increasingly emboldened to tax businesses that establish an "economic presence" in their state. As a result, taxpayers of all sizes engaged in interstate commerce now face the daunting burden of potentially having to litigate state tax issues in all 50 states and thousands of local jurisdictions, including jurisdictions where they have no physical presence.

"Don't tax you, don't tax me, tax that fellow behind the tree." This expression, attributed to Russell B. Long, reflects taxpayers' heightened concerns following the Supreme Court's decision in *Wayfair*, regarding the decision's potential impact on existing precedent and the constitutionality of future state efforts to require multistate businesses to collect and pay a multitude of state and local taxes. Out-of-state taxpayers are increasingly concerned they will be targeted by states seeking new revenue, and that existing legal remedies will not be adequate to defend against unfair and discriminatory state taxation. A significant risk exists that a single state court decision regarding the home state's authority to impose tax on a global business could have national, and even international, implications and dictate US tax policies far into the future. Providing taxpayers with greater access to federal courts will provide greater certainty and consistency and help to ensure that the states' expanded authority to tax interstate commerce does not unduly burden interstate and foreign commerce or violate taxpayers' Fourteenth Amendment rights.

Similar to the pattern of discriminatory taxation of railroads in the last century, which prompted Congress to provide federal court jurisdiction to prevent discriminatory treatment of national railroad property in the Railroad Revitalization and Regulatory Reform (4R) Act, recent state court decisions involving state taxation of interstate commerce also demonstrate a

pattern of discriminatory taxation. These decisions include state tax cases involving retroactive changes to state tax laws decades later, failure to provide backward-looking relief to taxpayers in refund cases, inconsistent application of sourcing rules for income apportionment to maximize state revenue, upholding assessments of tax on remote sellers for periods prior to the *Wayfair* decision, inconsistent and unfair decisions regarding taxation of remote workers, and other concerns. The lack of state tax tribunals that are independent from the state executive branch, where state tax tribunals often establish the record, intensifies these concerns. Recent state legislative action further compounds these concerns, with states devising tax laws that target out-of-state corporations—including digital advertising services taxes.

Our response – Federal legislation creating another exception to the TIA

In recognition of these issues, we have formed a coalition of taxpayers to support federal legislation that would expand the exceptions to the TIA and provide federal court jurisdiction in certain state tax cases. Our current proposal would provide taxpayers with access to judicial remedies in federal courts, notwithstanding the TIA, to (i) contest liability for a state or local tax that violates federal laws regarding taxation of interstate commerce, (ii) allow a small business claiming a violation of federal law to bring suit in the district court in which it resides, (iii) provide relief regarding local taxes imposed on interstate commerce, in which the controversy exceeds a certain amount and the parties have diverse citizenship, or (iv) seek injunctive or equitable relief, or a declaratory judgment, in order to prevent an imposition of a state or local tax that violates federal laws.

Why now?

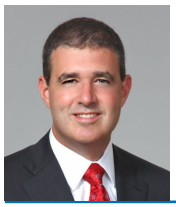
Historically, taxpayers engaged in interstate commerce were protected from extensive state taxation by P.L. 86-272 (federal statute enacted in 1959), with respect to state income taxes, or the physical presence standard set forth in *Quill v. North Dakota*, 504 U.S. 298 (1992), with respect to state sales taxes. However, in *South Dakota v. Wayfair* the United States Supreme Court overturned its precedent in *Quill*, abandoning the physical presence requirement that previously protected taxpayers engaged in interstate commerce. Further, the Multistate Tax Commission (MTC) formed a workgroup in late 2018 to update its Statement of Information regarding P.L. 86-272, with a focus on the application of P.L. 86-272 to modern business activities. Based on proposed revisions drafted by this workgroup, the likely outcome of this group's work will be to erode the protections afforded by P.L. 86-272 for out-of-state taxpayers, including those conducting business via the internet or through independent contractors. In addition, since 1988 the Supreme Court's discretionary review of state tax cases no longer ensures a taxpayer a hearing before an impartial federal court. Currently, less than 2% of petitions for writ of certiorari are granted by the Supreme Court. States also have a home-court advantage with the Supreme Court's recent ruling in *FTB v. Hyatt*, 139 S. Ct. 1485 (2019), which held that taxpayers may not bring suit in their own state's courts when engaged in a dispute with another state, overturning its prior holding in *Nevada v. Hall*, 440 U.S. 410 (1979).

Congress has provided other exceptions to the TIA to address taxes that unreasonably burden and discriminate against interstate commerce, including laws applicable to the railroad industry, the motor carrier industry, and a recent exception related to the mobile telecom industry. Further, although Congress recognized the importance of federal jurisdiction in class action lawsuits when passing the Class Action Fairness Act, courts have subsequently frustrated the purpose of this federal legislation by holding that the TIA nevertheless prevents federal jurisdiction in class actions involving state taxes.

Learn more and get involved

The Fair Access to Interstate Remedies (FAIR) Coalition is expanding its membership, and we are inviting interested organizations to join our efforts. There are ongoing opportunities to provide input into this effort, with different levels of participation available depending on the organization's needs and capabilities.

For more information about our efforts, and to get involved, please contact one of the following individuals:



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