



Mike Kadas
Director


Montana Department of Revenue



Steve Bullock
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MEMORANDUM

TO: Revenue and Transportation Interim Committee

FROM: Dan Whyte, Chief Legal Counsel 

DATE: December 5, 2017

SUBJECT: Department of Revenue Major Case Update

NINTH CIRCUIT COURT OF APPEALS

Armstrong, et al. v. Kadas: The 2015 Legislature passed Senate Bill 410 which allows 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 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 could be mooted by the Montana state courts. That decision was appealed by the Armstrong's and the Association of Christian International Schools to the 9th Circuit Court. Oral argument is being scheduled.

FEDERAL DISTRICT COURT

LL Liquor, Inc., v. State of Montana, et al.: The 2015 Legislature passed Senate Bill 193, which changed the complicated three-piece commission rates received by the 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 amendment to the commission rates 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 the contract with LL Liquor, and deprives 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 Ninth 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 terms that the legislature could change the terms of the contract with respect to price. It has yet to be determined whether the matter will return to the federal District Court. The matter was remanded to the federal District Court for further proceedings on the merits. Trial is scheduled for June 2, 2018.

MONTANA SUPREME COURT

Espinoza, et al.: The 2015 Montana Legislature passed Senate Bill 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 Eleventh District Court, 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 are in the process of briefing the matter for the Court.

Hiland Crude, LLC: Hiland filed a declaratory judgment action in the First 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 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. The Department will be filing its opening brief in January of 2018.

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 Eighth District Court, Cascade County, bifurcated the issues into constitutionality and damages. On May 28, 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 briefing is complete and the parties await a decision from the Montana Supreme Court.

STATE DISTRICT COURT

Omimex Canada, Ltd.: At issue is the Department's decision to classify Omimex's Montana property as a pipeline carrier and, therefore, subject to central assessment. The parties agreed to consolidate the declaratory judgment actions for tax years 2011 and 2012, filed in the Second District Court, Silver Bow County, with the declaratory judgment actions for tax years 2013, 2014, and 2015 filed in the First District Court, Lewis and Clark County, and to transfer venue for all years to the First District Court. Judge Reynolds assumed jurisdiction over all five pending tax years. Omimex filed for partial summary judgment on November 5, 2015, in the consolidated 2011-2015 matters. Omimex asked the Court to determine the meaning of "pipeline carrier" and whether Omimex met that definition. On March 16, 2017, the First District Court upheld the Department's interpretation of a "pipeline carrier" for taxation purposes. Both parties submitted additional briefing on remaining issues and await further order from the District Court. The appeal for 2016 is stayed pending the Court's decision.

Solem: The Solems filed a motion for class certification in the Eleventh District Court, Flathead County, challenging their land value for the 2009-2015 reappraisal cycle, 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 of 2015, VisionNet appealed the Department's 2015 assessment to the Montana Tax Appeal Board (MTAB). Generally, VisionNet alleges the Department's classification of VisionNet is improper. VisionNet also contests its market value assessment as improperly including intangible personal property and use of improper capitalization rates. VisionNet filed a declaratory judgment action before the First District Court. Both parties filed motions for summary judgment on July 7, 2017. The motions are fully briefed and the District Court set oral argument for January 24, 2018. If the Court denies the summary judgment motions, a three-day bench trial has been set for September 12, 2018.

Exxon Mobil: Exxon filed an interlocutory appeal with the First District Court, Lewis and Clark County, 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. The parties are currently briefing this legal question, and oral argument is scheduled for January 18, 2018.

Mountain Water: Mountain Water Company filed property taxes under protest for the period of April 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 the First District Court, 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 motion to dismiss and motions to change venue are fully briefed. Once the First District Court reaches a decision on whether to keep the case, dismiss the case, or change venue, the parties 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 (MTAB)

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. CHS and the Department each appealed that decision to the MTAB. Shortly after the parties initiated appeals before the MTAB and had agreed upon a January 2017 trial date, CHS filed a petition for interlocutory adjudication with the Thirteen 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 MTAB on May 12, 2016. A 5-day trial before MTAB concluded on November 10, 2017. The parties are working on post-hearing briefing due in late January.

NaturEner: NaturEner has filed with the MTAB six separate appeals of the Department's 2015 and 2016 assessments. At issue is the Department's valuation of NaturEner's three windfarms: Glacier Wind Energy 1, LLC, Glacier Wind Energy 2, LLC, and Rim Rock Wind

Energy, LLC. NaturEner has filed petitions for interlocutory adjudication and declaratory judgment with the First District Court, Lewis and Clark, on the meaning of the term “economic obsolescence” and “intangible personal property.” The Department filed answers to the petitions on March 7, 2017. NaturEner filed a motion for summary judgment on July 25, 2017. The parties entered into a Stipulation for Entry of Judgment regarding the summary judgment on October 31, 2017. The District Court issued a judgment consistent with the Stipulation and remanded the matter back to MTAB.

Phillips 66 Refinery, (Phillips): The Department appealed a decision relating to the 2016 tax year from the Yellowstone County Tax Appeal Board to the MTAB. The underlying litigation concerns the proper market value for Phillips’ Billings refinery as of January 1, 2016. The parties are currently engaged in discovery. Mediation took place on November 30, 2017. Trial is currently scheduled for the week of April 24, 2018.