




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: September 14, 2017
SUBJECT: Department of Revenue Major Litigation Update

NINTH CIRCUIT COURT OF APPEALS

Armstrong, et al. v. Kadas: SB 410 allows for 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, among other things, the Department's rule violates their constitutional rights to free exercise 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 Court also 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 to the 9th Circuit Court of Appeals. The matter has been fully briefed and oral argument is being scheduled.

FEDERAL DISTRICT COURT

LL, Liquor, Inc., v. State of Montana, et al.: During the 2015 Legislative Session, the Legislature passed Senate Bill No. 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 was 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 9th 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.

MONTANA SUPREME COURT

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 8th Judicial 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 damages. The District Court awarded \$14,722,297 in damages after concluding that the weighted average discount ratio statute became unconstitutional on July 1, 1998. A hearing on attorneys' fees and interest was held December 2, 2016, and Plaintiffs' counsel was awarded \$8,718,803.88. The Court entered a judgment against the State on January 6, 2017, wherein the Plaintiffs were awarded a total of \$26,156,411.65. The Court stayed execution of the judgment pending appeal. The Department appealed to the Montana Supreme Court and briefing in front of the Supreme Court is currently in progress.

STATE DISTRICT COURT

Hiland Crude, LLC: Hiland filed a declaratory judgment action in the 1st Judicial District Court challenging the Department's classification of Hiland's property for tax year 2014 as a pipeline carrier making the property subject to central assessment. On July 14, 2017, the 1st Judicial District Court granted summary judgment in favor of Hiland ordering the Department to tax Hiland's gathering systems as locally assessed class eight property,

instead of as centrally assessed property. The Department's deadline to appeal to the Montana Supreme Court is September 26, 2017.

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 2nd Judicial District, Silver Bow County, with the declaratory judgment actions for tax years 2013 through 2016 filed in the First Judicial District, and to transfer venue for all years to the 1st Judicial District Court, Lewis and Clark County. Judge Reynolds assumed jurisdiction over all six 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 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.

Solem: The Solems filed a motion for class certification in the 11th 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 for "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 Solems' 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, VisionNet appealed the Department's 2015 assessment to the Montana Tax Appeal Board. Generally, VisionNet alleges the Department's classification of VisionNet is improper and its market value assessment as improperly including intangible personal property and use of improper capitalization rates. VisionNet filed a declaratory judgment action before the 1st Judicial 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 September 26, 2017. A four-day bench trial is set for October 10, 2017.

Exxon Mobil: Exxon filed an interlocutory appeal with the 1st Judicial District Court 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 October 17, 2017.

MONTANA TAX APPEAL BOARD

CHS: The 2014 and 2015 disputes center on the market value of the Laurel Refinery. For the 2014 tax year, the Department valued the refinery at \$848 million, but the company requested a market value of \$200 million. Yellowstone CTAB determined a market value of \$510 million. CHS and the Department each appealed that decision to the Montana Tax Appeal Board. Shortly after the parties initiated appeals before the Board and had agreed upon a January 2017 trial date, CHS filed a petition for interlocutory adjudication with the 13th Judicial District Court. The District Court dismissed CHS' 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 Montana Tax Appeal Board on May 12, 2016. Depositions conclude the week of September 11, 2017. Trial is scheduled for the week of November 6, 2017.

NaturEner: NaturEner has filed with the Montana Tax Appeal Board 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 1st Judicial District Court on the definition of the term "economic obsolescence" as it is used in § 15-8-111, MCA. The Department filed answers to the petitions on March 7, 2017. The District Court matters are consolidated under one cause number, BDV-2017-68. The 1st Judicial District Court issued its scheduling order on April 21, 2017. The parties are currently engaged in discovery. NaturEner filed a motion for summary judgment on July 25, 2017. The Department filed its response on August 15, 2017. NaturEner has yet to file its reply. Oral argument is currently scheduled for October 31, 2017.

Phillips 66 Refinery: The Department appealed a decision relating to the 2016 tax year from the Yellowstone CTAB to the Montana Tax Appeal Board. The underlying litigation concerns the proper market value for Phillips' Billings refinery as of January 1, 2016. The parties are currently engaged in the early stages of discovery. Trial is currently scheduled for the week of April 24, 2018.

Plains Pipeline: Plains Pipeline has appealed the Department's centrally assessed valuation of their Montana property to the Montana Tax Appeal Board. Plains Pipeline has also made allegations challenging classification. A hearing date is scheduled for December 11, 2017.

Rocky Mountain Pipeline: Rocky Mountain Pipeline has appealed the Department's centrally assessed valuation of their property located in Montana to the Montana Tax Appeal Board. The matter is being held in abeyance pending the Plains Pipeline decision.

SETTLEMENTS

NorthWestern Energy: NorthWestern appealed its 2017 market value, appraised by the Department at \$2,646,821,680. The company appealed the capitalization rate the Department used as part of the valuation. Settlement was successful between the parties and NWE's market value of the taxable centrally property was set at \$2,575,000,000.