




Mike Kadas
Director

Montana Department of Revenue



Steve Bullock
Governor

MEMORANDUM

TO: Revenue and Transportation Interim Committee
FROM: Dan Whyte, Chief Legal Counsel 
DATE: September 13, 2018
SUBJECT: Department of Revenue Major Case Update

NINTH CIRCUIT COURT OF APPEALS

Armstrong, et al. v. Kadas: The 2015 Montana Legislature passed Senate Bill No. 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.

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 (now permanent) enjoining the State from enforcing the rule and that this is the same relief being sought by the Armstrongs. The Federal District Court determined that it should abstain from the lawsuit on the grounds that the constitutional question may be mooted by the Montana state courts. That decision was appealed to the 9th Circuit Court. Oral argument was conducted on March 6, 2018. The Ninth Circuit Court of Appeals concluded that the federal Tax Injunction Act (28 U.S.C. § 1341) deprives federal courts of subject matter jurisdiction over the Armstrongs' claims. However, since the application of the Tax Injunction Act to the claims asserted by the Association of Christian Schools International had not been briefed by the parties, the Ninth Circuit ordered the parties to file letter briefs addressing this issue. The Department is awaiting the Court's decision on the Association of Christian Schools' claims.

FEDERAL DISTRICT COURT

LL Liquor, Inc., v. State of Montana, et al.: The 2015 Legislature passed Senate Bill No. 193, changing the complicated three-piece commission rates received by 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 commission rate change 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 its contract with LL Liquor, depriving 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 term that the Legislature could change the terms of the contract with respect to price. LL Liquor has appealed the District Court's decision to the 9th Circuit Court of Appeals. The 9th Circuit Court of Appeals held oral argument on May 15, 2018. The Department is awaiting the Court's decision.

MONTANA SUPREME COURT

Espinoza, et al.: In December 2016, several parents of religious school students sued the state in the 11th Judicial District (Flathead County) on the basis that the Department's administrative rules limiting SB 410 scholarships to nonreligious private schools violated the Legislature's intent that scholarships be allowed for students attending religious schools. Additionally, the Plaintiffs argued that the Department 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 was appealed to the Montana Supreme Court and the parties completed briefing the matter for the Court. Oral argument was held on April 6, 2018, and the Department is awaiting the Court's decision.

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 and, therefore, subject to central assessment. On July 14, 2017, the First Judicial 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 Montana Supreme Court ruled in favor of the taxpayer, concluding that the gathering systems

owned by the taxpayer should be taxed as class 8 property rather than class 9. The Department is currently working with the Taxpayer to determine the amount of protested funds to be returned to Hiland.

STATE 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. 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 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 February 2016, VisionNet appealed the Department’s 2015 assessment to the Montana Tax Appeal Board (MTAB). VisionNet alleges the Department’s classification of VisionNet is improper and contests its market value assessment as improperly including intangible personal property and improper capitalization rates. VisionNet filed a declaratory judgment action before the 1st Judicial District Court. The Department filed an answer to the complaint on May 18, 2016. Both parties filed motions for summary judgment on July 7, 2017. The District Court granted the Department’s motion for summary judgment finding that VisionNet is properly centrally assessed because it is a telecommunications company that operates a single, continuous property crossing county and state lines. VisionNet has until September 25, 2018, to appeal the District Court’s order to the Montana Supreme Court.

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 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. This matter was submitted to the Court in mid-January 2018, after briefing and argument, for its adjudication. The District Court concluded in the Department’s favor.

Mountain Water: Mountain Water Company (MWC) paid property taxes under protest for the period from April 2, 2014, to June 2017, during which time frame the City of Missoula successfully condemned the water system. MWC filed a declaratory judgment action in 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 Lewis and Clark District Court changed venue to Missoula County District Court. MWC removed Judge Townsend; Judge Halligan assumed the case. The case is going forward on the merits of MWC’s claim that it is entitled to a full refund of the taxes paid under protest.

Discovery is in process and closes November 15, 2018. A hearing will be scheduled no earlier than March 2019

MONTANA TAX APPEAL BOARD

Boyne USA, Inc.: Boyne, which owns Big Sky Resort, includes a Resort Services Fee (RSF) on guest bills on all Big Sky Resort bookings. Boyne filed an action before the Montana Tax Appeal Board from The Department's audit of the RSF, arguing that this fee is not subject to Montana's lodging use and sales taxes. Boyne's contention is that the RSF is excluded from taxation by the definition of 'accommodation charge' under § 15-65-101(1), MCA. There is an additional dispute over Boyne's failure to remit taxes collected on Boyne's no-show and/or cancellation revenue. The case is moving forward and the parties are engaged in discovery. The hearing is scheduled for April 23, 2019.

Calumet Refinery (Calumet): The Department and Calumet appealed a decision rendered by the Cascade County Tax Appeal Board to the Montana Tax Appeal Board relating to the 2017 tax year. The underlying litigation concerns the proper market value for Calumet's Great Falls refinery as of January 1, 2017. Discovery is ongoing and the matter is scheduled for trial in June 2019.

Walmart/Sam's Club: Several Walmart stores and one Sam's Club filed appeals first with the local CTABs arguing that valuation of their stores should be appraised as if the store is empty and on the market. This is an appraisal methodology commonly known as the "dark store" theory. Seven stores across Montana appealed their assessments to MTAB. The parties mutually agreed to postpone scheduling hearings while settlement discussions continue.

SETTLEMENTS

CHS: This dispute was over the market value of the Laurel Refinery. For the 2014 tax year, the Department valued the refinery at \$848 million. At the Yellowstone CTAB, CHS requested a market value of \$200 million. The CTAB determined a market value of \$510 million, and CHS and the Department each appealed that decision to the MTAB. Similar appeals for tax years 2015, 2016, and 2017 were stayed during the pendency of the 2014 litigation.

The MTAB ruled on this case, vacating the CTAB determination and affirming the Department's assessed value of \$848 million. MTAB also determined that CHS did not prove that the Department failed to equalize the Laurel Refinery with similarly situated refineries. Based on the MTAB decision, CHS and the Department reached a settlement for the 2014-2018 tax years which includes provisions to help the parties avoid future litigation. The parties settled for the following market values: 2014: \$848,639,534; 2015: \$738,816,274; 2016: \$842,902,659; 2017: \$876,224,576; 2018: \$838,909,998.