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MEMORANDUM

TO: Revenue and Transportation Interim Committee
FROM: Dan Whyte, Chief Legal Counsel
DATE: March 14, 2018
SUBJECT: Department of Revenue Major Case Update

NINTH CIRCUIT COURT OF APPEALS

Armstrong, et al. v. Kadas: Senate Bill 410 passed by the 2015 Legislature 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 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 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 arguments were held March 6, 2018, and the Department is awaiting the decision.

FEDERAL DISTRICT COURT

LL Liquor, Inc., v. State of Montana, et al.: The 2015 Legislature passed Senate Bill 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. Oral argument is expected in April or May 2018.

MONTANA SUPREME COURT

Espinoza, et al.: The 2015 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 11th Judicial District in 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 have completed briefing the matter for the Court. Oral argument is scheduled for April 6, 2018.

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 Department

filed its opening brief in mid-January 2018. Hiland Crude will file a response brief by March 16, 2018, with the Department's reply brief is due shortly thereafter.

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 April 1, 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 \$11,434,114, and entered a judgment against the State on January 6, 2017, in the total amount of \$26,156,411. The Court stayed execution of the judgment pending appeal. The Department appealed to the Montana Supreme Court. The Court held oral argument on February 7, 2018. The Department is awaiting the Court's decision.

STATE DISTRICT COURT

Omimex Canada, Ltd.: At issue is the Department's decision to classify Omimex's 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 Judicial District, Silver Bow County, with the declaratory judgment actions for tax years 2013, 2014, and 2015 filed in the First Judicial District, and to transfer venue for all years to the First Judicial District Court, Lewis and Clark County. 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 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. 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 July, VisionNet appealed the Department's 2015 assessment to the Montana Tax Appeal Board (MTAB). VisionNet alleges the Department's classification of VisionNet's property and contests the Department's determination of market value. VisionNet filed a declaratory judgment action before the First 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 motions are fully briefed and oral argument was held on January 24, 2018. The Department is awaiting the Court's decision on Summary Judgment. A three-day bench trial is set for September 12, 2018.

Exxon Mobil: Exxon filed an interlocutory appeal with the First 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. This matter was submitted to the court in mid-January 2018 for its adjudication.

Mountain Water: Mountain Water Company paid property taxes under protest for the period of April 2, 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 Lewis and Clark County District Court 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. Mountain Water removed Judge Townsend; Judge Halligan assumed the case. Once a scheduling order is issued, the case 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: CHS has appealed the Department's 2014 and 2015 market value determination 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. The Yellowstone County Tax Appeal Board (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 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's petition on May 6, 2016. Respecting the 2015 tax year, the Yellowstone CTAB affirmed the Department's value of \$820 million. CHS appealed that decision to the MTAB on May 12, 2016. Depositions conclude the week of September 11, 2017. The 5-day trial before MTAB concluded on November 10, 2017. The parties filed post-hearing briefs and are awaiting the MTAB's decision.

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 Judicial District Court on the meaning 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 have been consolidated. NaturEner filed a motion for summary judgment on July 25, 2017. The motion is fully briefed, and oral argument was set for October 31, 2017. The parties entered into a Stipulation for Entry of Judgment on October 31, 2017. The District Court issued a judgment consistent with the Stipulation and remanded the matter back to the MTAB. The MTAB has issued a scheduling order for this matter, and the final hearing is set for April 15, 2019.

Phillips 66 Refinery, (Phillips): The Department appealed decisions rendered by the Yellowstone CTAB to the MTAB relating to the 2016 and 2017. The underlying litigation concerns the proper market value for Phillips' Billings refinery as of January 1, 2016 and January 1, 2017, respectively. Mediation took place on November 30, 2017 which was unsuccessful. At the request of the parties, the MTAB consolidated the two years and the consolidated trial is currently scheduled for the week of January 28, 2019.

5th Generation, Inc. (5th Generation): 5th Generation filed an appeal and subsequent amended appeal with the MTAB concerning whether it had nexus with the State of Montana during the 2010-2014 tax years. The parties are engaged in discovery, and the trial is scheduled for November 2018. 5th Generation also filed a Declaratory Judgment action in the District Court. The Department's answer is due next month.

Calumet Refinery (Calumet): The Cascade CTAB Board held a hearing February 15, 2018 regarding the Department's 2017 market value determination. The CTAB found that the Department overvalued Calumet's refinery. The Department is considering whether to appeal CTAB's decision to the MTAB.

Wal-Mart/Sam's Club (Wal-Mart): Wal-Mart has appealed the Department's market value for five of its stores. The appeal is based on the "dark store" theory which contends that these stores must be valued as if they were essentially vacant. These five "dark store" appeals are scheduled for hearing October 2-4, 2018. The appeals are likely to be consolidated. If not, the hearings will run on five consecutive days.