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MEMORANDUM

TO: Revenue and Transportation Interim Committee

FROM: Dan Whyte, Chief Legal Counsel 

DATE: July 11, 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 Department is awaiting the Court's decision.

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 1st 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. This matter is fully briefed and awaiting the Court's decision.

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.

In subsequent proceedings the Court awarded damages in the amount of \$26,042,531.31. The Court stayed execution of the judgment pending appeal.

On May 16, 2018, the Supreme Court in a 7-0 decision reversed the decision, holding that the weighted average discount ratio was constitutional and did not violate the Plaintiffs' equal protection rights. First, the Court determined when the WADR is tested against the purpose of offsetting some or all of the cost of providing the case lot discount, it did not violate the liquor store owners' rights to substantive due process because it was neither arbitrary nor unreasonable. Second, the Court concluded that the stores' independent business decisions created fundamental differences and rendered the classes dissimilar. Whether a store's unbroken case sales grew, stayed the same, or diminished after 1994 was attributable to that store's independent business decisions and not the WADR. Without creating similarly situated classes, the WADR could not cause unequal treatment, and did not violate owners' rights to equal protection.

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 motions are fully briefed and oral argument was held on January 24, 2018, and 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 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. This matter was submitted

to the Court in mid-January 2018, after briefing and argument, for its adjudication. The Department is awaiting the Court's decision.

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. Mountain Water 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 has assumed the case. The case is going forward on the merits of Mountain Water'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

CHS: This is a dispute 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 held a 5-day trial in mid-November 2017, after which the parties filed post-hearing briefs. The MTAB recently 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. CHS' deadline for appealing this decision to the District Court is in mid-July.

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. 5th Generation also filed a declaratory judgment action in the 1st Judicial District Court raising the same nexus question as well as the legality of the Montana's bailment system for distributing alcohol in this state. The MTAB hearing was stayed to permit the District Court to adjudicate all issues, and that hearing is scheduled for March 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. This dispute is scheduled for trial in June 2019.

Wal-mart/Sam's Club: Several Walmart stores and one Sam's Club filed appeals first with the local CTABs arguing that valuation of the 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. Several of the stores have appealed to the MTAB which requested a joint status update by August 13, 2018.

SETTLEMENTS

NaturEner: NaturEner filed with the Montana Tax Appeal Board six separate appeals of the Department's 2015, 2016, and 2017 assessments. At issue was 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. Settlement discussions were successful between the parties and the parties agreed on taxable values for tax years 2015, 2016, 2017, and 2018.

NorthWestern Energy: NorthWestern Energy appealed its centrally assessed property values for tax year 2018. The Department's market value for 2018 was \$2,735,240,065. The parties settled all claims for a market value of \$2,620,000,000.

Phillips 66 Refinery (Phillips): The Department appealed decisions rendered by the Yellowstone County Tax Appeal Board to the Montana Tax Appeal Board relating to the 2016 and 2017 tax years. The underlying litigation concerned 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, and in May 2018, the parties reached a mutually agreeable settlement for this litigation. The parties settled for a market value of \$514,000,000 for 2016 and \$561,000,000 for 2017.