No. 02-42

IN THE
Supreme Court of the United States

FRANCHISE TAX BOARD
OF THE STATE OF CALIFORNIA,
Petitioner,

v.

THE NEVADA SUPREME COURT,
Respondent,
and

GILBERT P. HYATT,
Real Party in Interest.

On Petition for Writ of Certiorari to the Supreme Court of the State of Nevada

Brief *Amicus Curiae* of Multistate Tax Commission in Support of Petitioner

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In Memoriam

Paull Mines[1]

August 27, 1942 – August 29, 2002

[1] This brief is the last that will bear the imprint of Paull's name, but not, we trust, the impact of his mind. Our brilliant, warm counselor guided us all at the Multistate Tax Commission as he guided the Court, *see, e.g., Wisconsin Dept. of Revenue v. Wrigley Co*, 505 U.S. 214, 228-229 (1992). He will be remembered for many reasons, including his advocacy of Bookman Old Style.

Question Presented (Additional)

Does the exception to Eleventh Amendment sovereign immunity recognized in *Nevada v. Hall*, 440 U.S. 410 (1979) extend to the core state sovereignty power to impose tax?

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BRIEF *AMICUS CURIAE* OF MULTISTATE TAX COMMISSION IN SUPPORT OF PETITIONER[2]

INTEREST OF *AMICUS CURIAE*

The Multistate Tax Commission is the administrative agency of the MULTISTATE TAX COMPACT. *See* RIA ALL STATES TAX GUIDE ¶ 701 *et seq.*, p. 657 (2001). Twenty-one States have legislatively established full membership in the COMPACT. In addition, five States are sovereignty members and sixteen States are associate members.[3] The Court upheld the validity of the COMPACT in *United States Steel Corp.* v. *Multistate Tax Comm'n*, 434 U.S. 452 (1978), including its authority to conduct joint audits on behalf of its member States. [4]

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[2]No counsel for any party authored this brief in whole or in part. Only *Amicus* Multistate Tax Commission and its members States through the payment of their membership fees made any monetary contribution to the preparation or submission of this brief. Finally, this brief is filed pursuant to the consent of the parties.

[3] The COMPACT parties are Alabama, Alaska, Arkansas, California, Colorado, District of Columbia, Hawaii, Idaho, Kansas, Maine, Michigan, Minnesota, Missouri, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah and Washington. The Sovereignty members are Florida, Kentucky, Louisiana, New Jersey and Wyoming. The Associate members are Arizona, Connecticut, Georgia, Illinois, Maryland, Massachusetts, Mississippi, New Hampshire, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina, Tennessee, West Virginia and Wisconsin.

[4] Congress has recognized the Commission's role in simplifying state taxation of interstate commerce. Mobile Telecommunications Sourcing Act, Pub. Law 106-252, 114 STAT. 626, 628 and 629 (2000), codified at 4 U.S.C. §§ 119(a)(2)(C) and 120(b)(1).

Historically, the COMPACT evolved out of concern of the States and multistate taxpayers about proposed federal legislation to regulate state tax systems that followed the findings and recommendations of the Willis Committee.[5] *See* D. Brunori, *Interview: Gene Corrigan, a 'Proud Parent' of the MTC*, 17 STATE TAX NOTES 1295 (November 15, 1999). The States' initial interest in forming the COMPACT was to safeguard state taxing power in the context of multistate commerce, an essential governmental power for States to fulfill their constitutional role. To this end, the Commission reviews state decisions that preempt or restrict state tax sovereignty to determine whether a given decision can have a perverse influence over the development of the law in the remaining States.

A second and equally important function served by the Commission is its efforts to lead its member and other participating States in adopting methods to "promote uniformity or compatibility in significant components of tax systems." (COMPACT, Art. I, § 2.) To serve this important function without any coercive influences being asserted by the federal government, the Commission States must operate on a cooperative basis.

This cooperation is evidenced through several examples. For one, the Commission holds quarterly meetings of the respective Directors of Revenue and their top staff to discuss methods of cooperation

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[5]The Willis Committee, a congressional study of State taxation of interstate commerce sanctioned by TITLE II of PUB. L. 86-272, 73 STAT. 555, 556 (1959), made extensive recommendations as to how Congress could regulate State taxation of interstate and foreign commerce.

and joint action for achieving increased uniformity and decreased complexity in the states' tax laws and their administration.

The Commission studies and adopts uniform regulations as recommendations to all States in various areas of transactional and operational taxation of multistate enterprises and transactions.

The Commission also issues statements of advice to multistate businesses on various aspects of state taxation. An example of this activity is that, both before and after this Court's decision in *Wisconsin Department of Revenue v. Wrigley Co.*, 505 U.S. 214 (1992), the Commission States executed a Statement providing the taxpaying community with a collective interpretation of Pub.L. 86-272 that they could rely on in making their tax filing decisions.[6]

Another Commission effort to bring added harmony and uniformity to the states' varied efforts to enforce their tax laws is its Alternative Dispute Resolution Program. This Program offers a single forum for two or more States, or for taxpayers with a tax issue that stretches between two or more States, to explore state tax conflicts through the voluntary processes of mediation and arbitration.

A last example of cooperative efficiencies among the States is the Commission's Joint Audit Program. Commission States streamline the audit process

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[6] See, "Statement of Information Concerning Practices of the Multistate Tax Commission and Signatory States Under Public Law 86-272" originally adopted by the Commission on July 11, 1986, revised January 22, 1983, July 29, 1994, July 27, 2001, *at* http://www.mtc.gov/uniform/pl86272-_72701.pdf.

through this Program, so that multistate businesses may be subjected to only one audit on behalf of several States, thus providing increased uniformity and reduced compliance cost.

A vital mission of the Commission, as made clear from the above examples, is its safeguarding of the relationships that propel those activities—the willingness of States to put their oars in the water and to voluntarily pull in concert with one another in the direction of creating more uniform and less burdensome state tax systems. The scuttling of this "cooperative federalism"[7] is raised by the Nevada Supreme Court's decision below.

ARGUMENT

IT IS IMPORTANT AND TIMELY FOR THE COURT TO RE-EXAMINE ITS DECISION IN *NEVADA v. HALL*, 440 U.S. 410 (1979) TO SETTLE WHETHER IT APPLIES TO THE CORE SOVEREIGNTY AREA OF STATE TAXATION.

The Commission views the decision below to be an unwise extension of the Court's ruling in *Nevada v. Hall*. That case involved a traffic accident in California involving a Nevada state employee. The majority held that neither Article III to the U.S. Constitution, nor the principle of sovereign immunity, nor the Eleventh Amendment barred the negligence suit from being pursued in a California state court against the State of Nevada. In a telling footnote to the majority opinion, the Court noted an important limitation to its holding.

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[7] *Nevada v. Hall*, 440 U.S. at 422, fn. 24.

> California's exercise of jurisdiction in this case poses no substantial threat to our constitutional system of cooperative federalism. Suits involving traffic accidents occurring outside of Nevada could hardly interfere with Nevada's capacity to fulfill its own sovereign responsibilities. We have no occasion, in this case, to consider whether different state policies, either of California or of Nevada, might require a different analysis or a different result.

Id. The Nevada Supreme Court decision below raises that "substantial threat" to our system of cooperative federalism. Whatever different state policies this Court may have had in mind requiring a different analysis and different result, one cannot envision any state power more critical to its "capacity to fulfill its own sovereign responsibilities" than the power to impose tax.

The dissenting Justices in *Nevada v. Hall* were Chief Justice Burger, Justice Blackmun and then-Justice Rehnquist. A portion of Justice Rehnquist's dissent was most prophetic and lays the basis for the Court's granting review of this matter. Justice Rehnquist noted that:

> I join my Brother BLACKMUN'S doubts about footnote 24 of the majority opinion. Where will the Court find its principles of "cooperative federalism"? Despite the historical justification of federal courts as neutral forums, despite an understanding shared by the Framers and, for close to 200 years, expounded by some of the most respected Members of this Court, and despite the fact that it is the op-

> erative postulate that makes sense of the Eleventh Amendment, the Court concludes that the rule that an unconsenting State is not subject to the jurisdiction of the courts of a different State finds no support "explicit or implicit" in the Constitution … . If this clear guidance is not enough, I do not see how the Court's suggestion that limits on state-court jurisdiction may be found in principles of "cooperative federalism" can be taken seriously. Yet given the ingenuity of our profession, pressure for such limits will inevitably increase. Having shunned the obvious, the Court is truly adrift on uncharted waters; the ultimate balance struck in the name of "cooperative federalism" can be only a series of unsatisfactory bailing operations in fact.[8]

This case provides an important opportunity for the Court to re-examine and clarify its Eleventh Amendment, sovereign immunity and comity jurisprudence as it may be applied to state tax administration. The Commission suggests that either of two courses is navigable here. The Court can go from buoy to buoy—keeping the ship afloat by, in Chief Justice Rehnquist's words, "bailing" when the circumstances identify that a *core sovereignty* value is at stake. Or, the Court can chart that more direct course that the dissenters in *Nevada v. Hall* suggested was the proper legal result—that the sovereign State be subject to a sister state's judicial process only to the extent of its waiver of immunity. Under either course, it is critical that the administration of state taxes be safeguarded in a watertight

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[8] *Id.* at 442-443.

hold of the ship of state in order that each State retain its "capacity to fulfill its own sovereign responsibilities." States must therefore be afforded immunity from interference to the extent not expressly waived.

The fact that a state's ability to raise revenue through taxation embodies a core sovereignty value is beyond any real dispute. This Court has consistently recognized that the states' taxing powers provide a necessary element supporting our federal system. *National Private Truck Council, Inc.* v. *Oklahoma Tax Comm'n*, 515 U.S. 582, 587 (1995), quoting *Dows* v. *City of Chicago*, 11 Wall. 108, 110 (1871) ("It is upon taxation that the several States chiefly rely to obtain the means to carry on their respective governments, and it is of the utmost importance to all of them that the modes adopted to enforce the taxes levied should be interfered with as little as possible."); *Wisconsin* v. *J.C. Penney Co.*, 311 U.S. 435, 444 (1940). Without that power, the States will either have to forgo providing its residents needed services and protections or be relegated to a total dependency upon the federal government. Whether construing the Constitution or a congressional statute, the Court has cautioned against quick and superficial findings that the state taxing power is barred. *Department of Revenue* v. *ACF Industries, Inc.*, 510 U.S. 332, 345 (1994)

The administrative and judicial bodies of the State of California have always been open to Mr. Hyatt for his obtaining review of the actions taken by the Franchise Tax Board personnel. Who can anticipate what the outcome of a properly conducted protest of his tax assessments might be if his Cali-

fornia administrative remedies were pursued and exhausted? The rulings of the Nevada Supreme Court below with regard to the protective order and the privilege rulings are calculated to impede the pending California administrative process.

The exhaustion of administrative remedies requirement is an extremely important policy in all state jurisdictions. Its application to the state tax area is necessary to protect the state's core interest in revenue raising. With rare exception, States require those seeking to challenge their tax obligations to administratively dispute them, after assessment or payment, before resorting to judicial remedies. The satisfaction of this requirement—the exhaustion of the administrative review process—is a reasonable condition before a State waives its sovereign immunity in the tax area. As noted by the Nevada Supreme Court in an unrelated case:

> The 'exhaustion doctrine' is sound judicial policy. If administrative remedies are pursued to their fullest, judicial intervention may become unnecessary. Had appellant sought relief before the respective boards of equalization, he may well have been granted the relief he now seeks in the first instance by judicial intervention.[9]

It is critical for the Court to review this matter and set the appropriate course to be followed in matters vital to state tax administration. If the decision below is allowed to stand, it dredges a channel for those wishing to hijack the administration of

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[9] *First American Title Company v. State of Nevada, et al.*, 91 Nev 804, 543 P.2d 1344 (1975).

state tax systems. They can do so merely by launching a paper boat carrying allegations of an intentional tort, pled "on information and belief," without more, indeed, without mooring.

For example, a state's attempt to obtain records from an out-of-state taxpayer for the most basic income tax audit may, on occasion, meet with resistance. Most, if not all, States provide their revenue departments with specific statutory authority to employ administrative subpoena power with enforcement, if necessary, through the issuing state's trial court. See, for example, Cal. Rev. & Tax. Code § 19504 and Nevada Rev. Stat. §§360.240.3, 375A.815 and 375.820. The taxpayer would normally defend against subpoena enforcement in that state's court on any one of a number of grounds, such as relevancy, undue burden of the request, or privilege. Could the taxyaper, under *Nevada v. Hall,* stop the audit (and any potential assessment) in its tracks by filing an action in a court of the State of its domicile merely alleging, without more, that the auditing State was violating its Fourth Amendment protection against unreasonable search and seizure? If so, the ability of States to administer their tax systems and to conduct audits of out-of-state taxpayers in a timely fashion will have been effectively torpedoed.

CONCLUSION

Recent revelations about shifting income to tax havens by several U.S. corporations highlight substantial tax avoidance and tax evasion that subverts fair, rational and credible federal and state tax systems. A more vigilant and effective enforcement of our tax laws on both state and national levels is

necessary to have all players in our economic system contribute their fair share to our self-governance. Timely and thorough auditing of businesses and individuals that earn income from sources within a State, but locate themselves outside the State, is one very important way to separate the tax smart from the tax cheats. The decision below may make that auditing all but impossible.

Based on the foregoing, the Commission respectfully requests that the Court grant California's petition, so that the Court can examine the full ramifications of *Nevada v. Hall*.

Respectfully submitted,

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