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U.S. SUPREME COURT UPDATE

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Court Strikes Down Maryland's Resident Tax Credit Structure and Upholds Obamacare

***38** As reported in our last column, on 5/18/15, the U.S. Supreme Court issued its opinion in *Comptroller of the Treasury v. Wynne* (Docket No. 13-485, cert. granted 5/27/14). The Court's decision annuls a Maryland personal income tax scheme thatcredits residents for out-of-state income tax at the state level, without offering a similar credit at the county level. The Court affirmed a ruling from Maryland's highest court, which determined Maryland's failure to offer a county-level credit violatesthe dormant Commerce Clause of the U.S. Constitution and therefore unconstitutionally exposes individuals to double taxation.

This decision has received significant attention because it calls into question any state or local income taxes that either do not provide a credit for taxes paid to other jurisdictions or limit the scope of such a credit in some way. We're excited to offerour full analysis in this issue of the JOURNAL.

In addition to our *Wynne* commentary, we also review two new petitions for certiorari that involve state and local taxes. The new petitions ask the Supreme Court to consider Washington's retroactive application of an amendment to its estate taxlaws and to review Massachusetts's apportionment scheme as applied to financial institutions involved in issuing and securitizing student loans to borrowers across the country.

We also note that one previously reported petition remains pending while the Court denied certiorari in another.

Finally, as we go to press, the Court, in a 6 to 3 decision, ruled that the Affordable Care Act (‘Obamacare‘) authorized federal tax credits for eligible Americans living not only in states with their own exchanges but also in the 34 states with federalmarketplaces in *King v. Burwell* (Docket No. 14-114, cert. granted 11/7/14). Also, as we go to press, the Court granted certiorari in two previously reported matters.

In *Franchise Tax Board of the State of California v. Hyatt*, Docket No. 14-1175, petition for cert. granted 6/30/15, ruling below at 335 P.3d 125 (Nev. 2014), the Supreme Court of Nevada largely reversed a jury award of $139 million in tort damages and $250 million in punitive damages in favor of inventor Gilbert P. Hyatt in his lawsuit against the California FranchiseTax Board (FTB). However, despite FTB's claims that all of Hyatt's causes of action were barred under principles of discretionary-function immunity and comity, the Nevada high court affirmed the district court's findings that FTB committed fraud and intentionalinfliction of emotional distress in its audit of Hyatt. Accordingly—although the damages imposed against FTB were significantly reduced by the Nevada court—FTB was unable to escape all liability and petitioned the U.S. Supreme Court for review.In its petition for certiorari, FTB asked the High Court to review the sovereign immunity principles allegedly disregarded by the Nevada Supreme Court in its ruling below.

****2** The Court also granted certiorari in *Hickenlooper v. Kerr*, Docket No. 14-460, petition for cert. granted and judgment vacated 6/30/15, ruling below as *Kerr v. Hickenlooper*, 744 F.3d 1156 (10th Cir. 2014), in which the Court of Appeals for the Tenth Circuit had affirmed a district court's ruling that a group of Colorado citizens, including current and former legislators, had standing to challenge Colorado's Taxpayer'sBill of Rights (‘TABOR‘) and that the legislators' challenge was not barred by the political question doctrine. The U.S. Supreme Court vacated this judgment and remanded the case for further consideration in light of its recent decision in *ArizonaState Legislature v. Arizona Independent Redistricting Comm'n,* decided 6/29/15.

We will cover the Court's opinion in *King v. Burwell*, and its action in *Franchise Tax Board of the State of California v. Hyatt* and *Hickenlooper v. Kerr* in the next issue of the JOURNAL.

Taxpayers Wynne—Maryland's Partial Resident Credit Found Unconstitutional

On 5/18/15, the U.S. Supreme Court issued its opinion in *Comptroller of the Treasury v. Wynne* (Docket No. 13-485, cert. granted 5/27/14). The Court, which was asked to review Maryland's personal income tax regime, concluded in a 5 to 4 decisionthat Maryland's income tax credit structure violates the dormant Commerce Clause of the U.S. Constitution as it both has the potential to result in discriminatory double taxation of income earned outside the state and creates an unconstitutional incentivefor taxpayers to engage in intrastate rather than interstate commerce.

Facts and background.

During the year at issue (2006), Brian and Karen Wynne were Maryland residents. Maryland, like most states, taxed its residents on all income, wherever earned. But Maryland, unlike many (although not all) states, did not offer its residents a full creditagainst the income taxes they might pay to other states. Specifically, Maryland imposed both a ‘state‘ and a ‘county‘ income tax on its residents but offered a credit against only the ‘state‘ tax.

***39** During 2006, the Wynnes owned stock in a Subchapter S corporation that operated and earned income in at least 39 states outside of Maryland. They reported the income that flowed through to them from the S corporation on their Maryland resident income taxreturn but also claimed an income tax credit for taxes paid to other states. Maryland, however, denied the Wynnes' credit against the county tax, and assessed a tax deficiency.

The Wynnes challenged Maryland's resident credit structure. The decision of the Maryland State Comptroller of the Treasury was affirmed by the Hearings and Appeals Section of the Comptroller's Office (with slight modifications). The Maryland Tax Court alsoaffirmed, but the Circuit Court for Howard County reversed on the ground that Maryland's tax system violated the Commerce Clause of the U.S. Constitution.

The Court of Appeals of Maryland affirmed the Tax Court. In particular, the Court of Appeals of Maryland evaluated the tax under the four-part test announced in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), which asks whether (1) a tax is applied to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to theservices provided by the state. The court held the tax unconstitutional on the basis that the tax failed both the fair apportionment and nondiscrimination prongs of the *Complete Auto* test. The Maryland Comptroller petitioned the U.S. Supreme Courtfor review and it granted certiorari.

Court rules Maryland's income tax scheme fails the internal consistency test.

****3** Justice Alito, who delivered the majority opinion of the Court, in which Chief Justice Roberts and Justices Kennedy, Breyer, and Sotomayor joined, determined that Maryland's tax scheme violates the dormant Commerce Clause of the U.S. Constitution. Accordingto the majority opinion, the Commerce Clause (Art I, § 8, cl. 3), which grants Congress power to ‘regulate Commerce . . . among the several States,‘ also has ‘a further, negative command, known as the dormant Commerce Clause.‘ (As discussedbelow, Justices Scalia and Thomas openly question the existence of a ‘dormant Commerce Clause.‘)

This negative command precludes states from imposing taxes that discriminate against interstate commerce, the importance of which was underscored by Justice Alito in his opinion: ‘By prohibiting States from discriminating against or imposing excessiveburdens on interstate commerce without congressional approval, [the dormant Commerce Clause] strikes at one of the chief evils that led to the adoption of the Constitution, namely, state tariffs and other laws that burdened interstate commerce.‘

In order to determine if Maryland's tax scheme discriminates against interstate commerce, the Court relied on what is known as the ‘internal consistency test.‘ As restated by Justice Alito, ‘[t]his test, which helps courts identifytax schemes that discriminate against interstate commerce, ‘looks to the structure of the tax at issue to see whether its identical application in every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate.’‘

The majority determined that ‘Maryland's income tax scheme fails the internal consistency test‘ because ‘the tax scheme operates as a tariff and discriminates against interstate commerce.‘ Specifically, if Maryland's tax (and lack of credit)applied in every state, interstate commerce would unconstitutionally suffer because the total tax burden on interstate commerce is higher. Justice Alito illustrated his point with the following example:

‘Assume that every State imposed the following taxes, which are similar to Maryland's ‘county’ and ‘special nonresident’ taxes: (1) a 1.25% tax on income that residents earn in State, (2) a 1.25% tax on income that residents earn in otherjurisdictions, and (3) a 1.25% tax on income that nonresidents earn in State. Assume further that two taxpayers, April and Bob, both live in State A, but that April earns her income in State A whereas Bob earns his income in State B. In this circumstance,Bob will pay more income tax than April solely because he earns income interstate. Specifically, April will have to pay a 1.25% tax only once, to State A. But Bob will have to pay a 1.25% tax twice: once to State A, where he resides, and once to State B,where he earns the income.‘

Although the Court noted that Maryland could ‘remedy the infirmity in its tax scheme‘ by offering a full credit for taxes paid (Bob and April would then pay the same amount of tax—1.25%), Maryland, as discussed above, offers no such creditfor county-level taxes. Accordingly, the majority ruled that Maryland's tax scheme has the potential to result in the double taxation of income earned outside of the state and to discriminate in favor of intrastate over interstate economic activity. Thus,the Court held that Maryland's income tax scheme unconstitutionally violates the dormant Commerce Clause.

Dissent writes in support of states' sovereign power to tax residents' income.

****4** In response to the majority opinion, the principal dissent, filed by Justice Ginsburg, and joined by Justices Scalia and Kagan, argued that the Court now ‘veers from a principle of interstate and international taxation repeatedly acknowledged by thisCourt: A nation or State ‘may tax *all* the income of its residents, even income earned outside the taxing jurisdiction.’‘ And according to the dissent, the Constitution does not ‘require one State, in this case Maryland, to limitits residence-based taxation, should the State also choose to exercise . . . its source-based authority.‘

Instead, the dissent characterizes states' decisions to offer their residents credits for taxes paid to other jurisdictions as an ‘independent *policy* decision,‘ not mandated under the Constitution. Thus, the dissent disagreed that Maryland'stax laws run afoul of the dormant Commerce Clause and questioned the majority's reasons for ‘abandoning principles and precedent sustaining simultaneous residence- and source-based income taxation.‘

Specifically, the dissent challenged the Court's claims that Maryland's tax law (1) creates a risk of double taxation and (2) fails the internal consistency test. First, the dissent argued that the Court has historically upheld other income taxes with asimilar risk of double taxation. And second, according to Justice Ginsburg, the Court has 'not rigidly required States to maintain internally consistent tax regimes.' According to the dissent, the Court has not struck down a state tax for failing theinternal consistency test in nearly 30 years, and the Court has even rejected challenges that fail the test (citing *Shaffer v. Carter*, 252 U.S. 37 (1920)).

Ginsburg dissent—gross receipts taxes vs. net income taxes.

Justice Ginsburg's dissent also criticized the majority for 'relying on a 'trilogy' of decisions it finds 'particularly instructive''—*J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307 (1938); *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939); and ***40** *Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653 (1948)—to support the Court's claim that Maryland's tax scheme violates the dormant Commerce Clause. According to the majorityopinion, these dormant Commerce Clause cases 'all but dictated' the result in the present case.

But as underscored by the dissent, each of these cases involved a tax on gross receipts (of corporations), as opposed to net income. And the dissent found this distinction relevant, noting that 'the Court has routinely maintained that 'the differencebetween taxes on net income and taxes on gross receipts from interstate commerce warrants different results' under the Commerce Clause. ' Justice Alito, however, expressly rejected any meaningful distinction between a tax on gross receipts and a tax onnet income. According to the majority, the Court has 'squarely rejected the argument that the Commerce Clause distinguishes between taxes on net and gross income.'

****5** Similarly, the majority rejected any argument that the dormant Commerce Clause should treat individuals any differently (or less favorably) than corporations. Again responding to the dissent, Justice Alito noted that corporations, just like individuals,'reap the benefits of local roads, local police and fire protection, local public schools, [and] local health and welfare benefits.' Thus, despite the dissent's challenges, the *Wynne* decision now stands for the proposition thatthe dormant Commerce Clause is as equally relevant to taxes imposed on gross receipts as it is to taxes imposed on net income.

Scalia and Thomas dissents—dormant Commerce Clause as a 'judicial fraud'?

Finally, in addition to Justice Ginsburg's dissent, we note that both Justices Scalia and Thomas issued separate dissents in order to underscore apparent (and in their minds fatal) flaws within the Court's negative Commerce Clause jurisprudence. JusticeScalia, for example, claimed that '[t]he fundamental problem with our negative Commerce Clause cases is that the Constitution does not contain a negative Commerce Clause. It contains only a Commerce Clause. ' Therefore, the dormant CommerceClause is a 'judicial fraud' that allows judges to 'set aside laws *they believe* burden commerce.' And Justice Thomas reiterated his view, expressed in prior decisions, that 'the negative Commerce Clause has no basis in thetext of the Constitution, makes little sense, and has proved virtually unworkable in application, and, consequently, cannot serve as a basis for striking down a state statute.'

Moreover, Justice Thomas claimed that those who ratified the Constitution would be surprised to learn that credits for taxes paid to other states are a constitutional requirement. Justice Thomas claimed to have found no indication that states offered creditsfor taxes paid to other jurisdictions at the time of the adoption of the Constitution. But the majority dismissed this concern by noting that the number of individuals who earned out-of-state income in 1787 was undoubtedly very small: 'We are unaware ofrecords showing, for example, that it was common in 1787 for workers to commute to Manhattan from New Jersey by rowboat or from Connecticut by stagecoach.'

Despite the claims of Justices Scalia and Thomas, a majority of Justices clearly view the dormant Commerce Clause as significantly more than a 'judicial fraud.' Quite the opposite. In fact, and as discussed above, a majority of Justices view thedormant Commerce Clause as the fundamental constitutional provision under which Maryland's income tax scheme must fail.

Due Process Clause Challenge to WA's Retroactive Application of Estate Tax Law

In *Hambleton v. Washington*, Docket No. 14-1436, petition for cert. filed 06/05/15, ruling below at 335 P.3d 398 (Wash. 2014), the Supreme Court of Washington denied two estates' challenges to Washington's retroactive application of a 2013 amendment to the state's estate tax laws. The amendment granted Washington greater authority to taxqualified terminable interest property (QTIP) trust assets, but the estates claimed that the state's eight-year retroactive application of the amendment violated their due process rights.

****6** The Washington Supreme Court rejected this argument, finding that the amendment (and the period of retroactivity) satisfied a rational basis review. The estates now petition the U.S. Supreme Court to revisit that holding and to define the due process rightsassociated with retroactive tax laws.

Washington's estate tax laws.

As stated by the Washington Supreme Court, Washington was without an independent estate tax until 2005. Instead, the state participated in a federal tax sharing system—known as the 'pickup' tax—whereby the federal government shared estatetax revenues with the states. This system was gradually eliminated beginning in 2001, and in 2005, the Washington Legislature enacted a stand-alone estate tax, the Washington Estate and Transfer Tax Act (the 'Act '), modeled after the federal estatetax regime.

The 2005 Act imposed a tax on 'every transfer of property located in Washington ' and the Act applied prospectively to estates of decedents dying on or after May 17,

2005 (the Act's effective date). In 2012, however, the Washington Supreme Court,in *In re Estate of Bracken*, 290 P.3d 99 (Wash. 2012), limited Washington's ability to tax what are known as qualified terminable interest property (QTIP) trust assets held by certain decedents dying after May 17, 2005. Specifically, the court held that the WashingtonDepartment of Revenue (DOR) had overstepped its authority by adopting regulations that taxed QTIP assets transferred to surviving spouses prior to May 17, 2005, even in cases where the surviving spouse died after the effective date of the Act.

QTIP trusts are testamentary trusts created by a deceased spouse for the benefit of the surviving spouse. When the first spouse dies, the survivor receives a 'life estate' in the assets that are left to the QTIP trust. And when the second spousedies, the QTIP trust assets go to the 'final beneficiary' named in the trust—often children. As stated by the court below, '[t]he advantage of QTIP trusts is that no [federal] estate tax is paid on the death of the firstspouse; the property is taxed only upon the death of the surviving spouse.'

In *Bracken*, the Washington Supreme Court held that for QTIP trusts, the relevant 'transfer of property' occurs at the death of the first spouse. Therefore, the state could not tax QTIP trusts created before May 17, 2005, regardless ofthe date of death of the surviving spouse.

In 2013, in response to the *Bracken* decision, the Washington Legislature amended the Act in order to allow Washington to tax QTIP trust assets upon the death of surviving spouses, so long as the surviving spouse died after the effective dateof the Act. According to the Washington Supreme Court, the legislature intended for the amendments to 'apply both prospectively and retroactively to all estates of decedents dying on or after May 17, ***41** 2005.' And '[t]he legislature's amendmentsclarified the intent of the legislature to include QTIP trusts created before 2005 in the surviving spouse's Washington taxable estate (if the surviving spouse died after the Act's effective date).'

Estates at issue.

****7** Two separate estates (the 'Estates') now petition the U.S. Supreme Court to review the retroactive application of Washington's 2013 amendment. Both Estates utilized QTIP trusts, whereby one spouse created a QTIP trust for the benefit of the survivingspouse. The QTIP elections were made prior to May 17, 2005, but the surviving spouse (i.e., the spouse who received a life estate in the QTIP trust assets) died after May 17, 2005.

Based on their readings of the Act, one estate did not include the value of the QTIP property in its Washington taxable estate, whereas the second estate paid taxes on its QTIP assets, but did so under protest, later seeking a refund for the taxes paid.The DOR disallowed the QTIP deduction for the first estate and denied the second estate's refund claim. The parties then moved to state trial court, where two separate proceedings resulted in contrary decisions: one in favor of the estate and one in favorof the DOR. The two matters were joined, and the Washington Supreme Court accepted review of the cases.

Due process challenges to retroactivity.

Before the Washington Supreme Court, the Estates challenged Washington's 2013 estate tax amendments on a variety of grounds, including estoppel, a violation of the separation of powers doctrine, an impairment of the Contracts Clause to the U.S. Constitution,and a violation of the Estates' due process rights under the 14th Amendment to the U.S. Constitution. Only the Estates' due process claims remain before the U.S. Supreme Court.

Applying a rational basis standard, the Washington Supreme Court held that the 2013 amendment's retroactive application did not violate the Estates' due process rights. Citing *U.S. v. Carlton*, 512 U.S. 26 (1994), the court applied a rational basis standard of review because, according to the court, '[t]he due process standard to be applied to tax statutes with retroactive effect . . . is the same as that generallyapplicable to retroactive economic legislation: [i.e.,] . . . a rational legislative purpose.'

Rational basis is satisfied provided there is a legitimate legislative purpose furthered by means that are rationally related to that purpose. And under this standard of review, the Washington court concluded that the legislature had satisfied its burden.First, the amendment's purpose was to 'restore parity between married couples and unmarried individuals [by not allowing married individuals to avoid or greatly reduce their potential Washington estate tax liability], restore parity between QTIPproperty and other property eligible for the marital deduction, and prevent the adverse fiscal impacts of the *Bracken* decision,' which limited the state's ability to tax QTIP property. These 'largely economic' goals were, accordingto the court, a legitimate legislative purpose.

And second, the court found that the period of retroactivity was rationally related to the state's legitimate purposes. Specifically, the court noted that the period of retroactivity was meant to apply to all estates since the original enactment of the Act(i.e., May 17, 2005), which was a legitimate date to which the retroactively could apply. Moreover, the court stated that Washington courts have consistently 'found that a retroactive period spanning more than seven years [does] not violate thedue process clause.'

Question presented.

****8** The Estates now ask the U.S. Supreme Court to review these findings. According to the Estates, courts across the country are 'sharply split over the Due Process limits on retroactive tax laws.' And the Estates argue that the Washington Supreme Courthas drained the rational means test of 'any vitality,' claiming that the U.S. Supreme Court has never endorsed a retroactive period of 'more than a year or two . . . as a rational means of furthering revenue goals or correcting asserted legislativemistakes in drafting tax laws.'

Accordingly, the Estates ask the Court to consider 'whether, or under what circumstances, imposing additional tax beyond the year preceding the legislative session in which the law was enacted violate[s] due process.'

Student Loan Lenders Challenge MA's Apportionment of Income Under the State's Financial Institution Excise Tax

In *First Marblehead Corp. v. Massachusetts Commissioner of Revenue*, Docket No. 14-1422, petition for cert. filed 05/29/15, ruling below at 23 N.E.3d 892 (Mass. 2015), the Supreme Judicial Court of Massachusetts upheld a decision of the Appellate Tax Board (the ‘Board‘), which determined that all of a financial institution's property—consisting exclusively of securitizedstudent loans—was properly assigned to Massachusetts for purposes of the state's financial institution excise tax (FIET). The financial institutions now challenge the Massachusetts's ruling and, by invoking arguments from the Court's decision in *Comptrollerof the Treasury v. Wynne* (discussed above), claim that Massachusetts's apportionment scheme violates the Commerce Clause of the U.S. Constitution by failing both the internal and external consistency tests.

Taxpayers' business.

During the tax years at issue, First Marblehead Corporation (‘FMC‘) was a publicly traded Delaware corporation with its principal offices in Boston. FMC was also the principal tax-reporting corporation for itself and a number of subsidiaries, includingGATE Holdings, Inc. (GATE).

FMC, and its subsidiaries, were involved in the issuance of private loans to higher education students. Neither FMC nor GATE lent funds directly to student borrowers, but instead, they ‘facilitated and coordinated the issuance and securitization of studentloans through a complex process in which loans were purchased from originating banks with financing obtained via the issuance of asset-backed securities.‘ And neither FMC nor GATE were directly involved in servicing the loans. Rather, FMC outsourced theservicing activities to independent entities (the ‘Servicers‘) who were located outside of Massachusetts.

According to the court below, GATE was ‘essentially a holding company with no employees, payroll, tangible assets, or office space.‘ GATE held a beneficial interest in various trusts that in turn held all of the student loans that had been securitizedby FMC and its affiliates. These beneficial interests constituted substantially all of GATE's assets, and the interest income from the loans comprised substantially all of GATE's gross income. GATE's tax return indicated that its principal office was locatedat the same Boston address as FMC, and according to the court, there was ‘no dispute that [GATE's] commercial domicile was in Massachusetts during the tax years at issue.‘

Procedural history.

****9 *42** In 2006, FMC and GATE filed a voluntary disclosure request with the Massachusetts Commissioner of Revenue (Commissioner), seeking to change GATE's filing status from a foreign corporation to a ‘financial institution‘ as defined in Mass. Gen. Lawsch. 63, § 1. GATE then filed Massachusetts financial institution excise tax returns, seeking an abatement of corporate taxes previously paid. The Commissioner denied the application for an abatement and, following an audit, the Commissioner assessed FMCand GATE for additional taxes based on the Commissioner's determination that GATE was taxable as a foreign corporation or, alternatively, that GATE owed additional taxes as a financial institution.

Following an appeal to the Appellate Tax Board, the Board concluded that GATE was a financial institution entitled to apportion its income using Massachusetts's three-factor apportionment (receipts, payroll, and property). The Board determined, however,that GATE did not have a payroll factor and therefore its apportionment percentage was to be based on the receipts and property factors only. The Board ruled that GATE had properly reported its receipts factor but sided with the Commissioner in determiningthat GATE miscalculated its property factor, which should have been, according to the Board, entirely allocated to Massachusetts for the tax years at issue.

Appeal to the Supreme Judicial Court.

Neither the taxpayers nor the Commissioner challenged the Board's rulings that GATE qualified as a financial institution or that GATE properly calculated its receipts factor. Instead, the only issue presented to the Supreme Judicial Court was how GATE'sproperty factor was to be calculated.

Specifically, the court was asked to determine ‘whether the loan portfolios that represented substantially all of [GATE's] property for the tax years at issue should be treated as having been located in whole or in part within the Commonwealth,and thus included in the numerator of [GATE's] property factor fraction, or outside the Commonwealth, and therefore excluded from the numerator and included only in the denominator of the fraction.‘ The answer to this question was significantin that if GATE's loans were located in Massachusetts, its property factor would be 100 percent, whereas if GATE's loans were located outside of Massachusetts, its property factor would be 0 percent.

Massachusetts's property factor rules for loans held by financial institutions.

According to Mass. Gen. Laws ch. 63, § 2A(e)(vi), which provides the rules for determining a Massachusetts's taxpayer's property factor, a loan held by a financial institution is generally considered to be assigned to the taxpayer's regular place ofbusiness. If, however, a taxpayer with a commercial domicile in Massachusetts wishes to assign its loans to a location other than its principal place of business, it must overcome the rebuttable presumption that the loans are assigned to Massachusetts. Inorder to rebut this presumption, the taxpayer must show, by the preponderance of evidence, that ‘the preponderance of substantive contacts regarding the loan‘ occurred outside of the state.

****10** During the tax years at issue, GATE had no regular place of business in Massachusetts. And, in the case below, the company argued that its loans were therefore to be assigned outside of the state, to the non-Massachusetts locations of the loan Servicers.According to GATE, the Servicers' locations were where the ‘preponderance of substantive contacts‘ relating to the loans occurred, and therefore GATE could overcome any presumption that the loans should be assigned to the company's commercial domicile—i.e.,Massachusetts. But the Massachusetts court rejected GATE's argument.

The court held that GATE failed to overcome the rebuttable presumption that its loans were assigned to its in-state commercial domicile. As discussed above, GATE argued that because the loans were entirely administered by the Servicers (i.e., GATE had nodirect role in servicing the loans), the Servicers' activities should be attributed to GATE. And because the Servicers were located outside of Massachusetts, GATE maintained that the ‘preponderance of substantive contacts regarding the loan[s]‘took place outside of the state.

According to the court, however, ‘work performed by . . . separate businesses with their own places of business and their own staff, do not fit within the [preponderance of substantive contacts] equation.‘ The court therefore rejected GATE'sclaim that it could, in essence, take credit for the work performed by the Servicers. Thus, GATE was left with no evidence to rebut the commercial domicile presumption, and the court included the loans in GATE's Massachusetts property factor.

Constitutional considerations.

In addition to the statutory analysis discussed above, the Massachusetts Supreme Judicial Court also considered the constitutionality of Massachusetts's apportionment regime. The court noted that ‘both the United States Supreme Court and this court havefound the due process clause and the commerce clause require fairness in apportioning the income of a business that may be taxed in multiple States.‘ And, specifically, the court noted that in order for an apportionment scheme to not run afoul of the DueProcess Clause, it must satisfy both ‘internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business'[s] income being taxed[—and]

. . . external consistency—[that is,] the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.‘

Considering internal consistency, the court looked at the taxes actually paid by GATE in the years at issue and noted that GATE's Massachusetts apportionment percentage was approximately 51 percent, and that GATE filed tax returns only in Massachusetts andFlorida for the relevant years. The court then noted that based on GATE's Florida tax returns, it appeared that GATE's apportionment percentage ***44** in Florida was less than 5 percent for each of the tax years at issue.

****11** The court therefore held that it had no reason to conclude that its interpretation of the apportionment statute produced duplicative taxation of GATE's income. It its petition for certiorari, GATE questions the Massachusetts court's reliance on taxes actuallypaid as a method for determining the internal consistency of Massachusetts's apportionment factors.

With regard to external consistency (i.e., whether Massachusetts's apportionment scheme reasonably reflected how GATE generated income), the court noted that GATE existed to ‘hold interests in trusts containing loans as part of FMC's securitization process.‘Furthermore, because GATE had no offices or employees of its own, and because it was a wholly owned subsidiary of FMC, the court found that it made ‘more sense to view the income-producing activity of [GATE] as connected to FMC, its parent company,rather than as connected to the [Servicers], which were independent and unrelated entities.‘ Based on this rationale, the court concluded that ‘an outcome that locates all of the loans at [GATE's] and FMC's commercial domicile .. . results in the most appropriate approximation of how [GATE] generated income.‘ Thus, the court held, Massachusetts's apportionment scheme satisfied the external consistency test.

Questions presented.

In their petition for certiorari, FMC and GATE claim that Massachusetts's application of the property factor for financial institutions gives rise to serious concerns about double taxation and that Massachusetts has attempted to capture tax revenue thatbelongs to other jurisdictions. Accordingly, the petitioners—citing to both *Comptroller of the Treasury v. Wynne* (discussed above) and *Container Corp. of Am. v. Franchise Tax Board*, 463 U.S. 159 (1983)—argue that Massachusetts's apportionment scheme is both internally and externally inconsistent, and the financial institutions ask the Supreme Court to consider:

1. ‘Whether the court below acted in accordance with this Court's precedents when it looked solely to the taxes actually paid by a taxpayer in determining that an apportionment formula was internally consistent.‘

2. ‘Whether a factor that disregards the activities and entities actually involved in producing and collecting income and instead arbitrarily assigns income to the commercial domicile of an owner of the income-producing entities reflects a reasonablesense of how the income is generated.‘

Petition Still Pending

The following petition remained pending as the JOURNAL went to press.

ERISA preemption provision challenge to Michigan health insurance tax. In *Self-Insurance Institute of America, Inc. v. Snyder*, Docket No. 14-741, petition for cert. filed 12/18/14, ruling below at 761 F.3d 631, 59 EBC 1406 (6th Cir. 2014), the U.S. Court of Appeals for the Sixth Circuit affirmed a district court's ruling that the Michigan Health Insurance Claims Assessment Act (Mich. Comp. Laws §§ 550.1731-1734; the ‘MichiganAct‘)—which imposes a 1 percent tax, along with various reporting and record-keeping requirements, on all paid claims by carriers and third party administrators to healthcare providers for services rendered in Michigan for Michigan residents—isnot prohibited by ERISA's preemption provision (29 U.S.C. § 1144(a)).

****12** As explained by the Sixth Circuit in its decision upholding the Michigan Act, one of the purposes of ERISA is ‘to provide a uniform regulatory regime over employee benefit plans.‘ Accordingly, ‘ERISA contains a broad preemption provision that ‘supersede[s] any and all State laws insofar as they . . . *relate* to any employee benefit plan' that falls under the regulation of ERISA. (29 U.S.C. § 1144(a)). ‘ (emphasisadded). The Sixth Circuit interpreted this standard to mean that ‘[a] law ‘relates to’ an employee benefit plan, in the normal sense of the phrase, if it has a connection with or reference to such a plan.‘

In the proceedings below, the Self-Insurance Institute of America, Inc. (‘SIIA ‘) argued that the Michigan Act has an impermissible connection with employee benefit plans inasmuch as the Michigan Act: ‘(1) interferes with the administration of theplans; (2) imposes administrative burdens in addition to those prescribed by ERISA; and (3) interferes with the relationships between ERISA-covered entities.‘ The Sixth Circuit disagreed with all three of SIIA's contentions, however.

In its petition for review, SIIA argues that ‘[t]he circuit court invoked a strong presumption against the preemption of state taxing powers to read [ERISA's preemption provisions] narrowly despite Congress's deliberate choice of preemptivelanguage whose breadth has been repeatedly emphasized by this Court, and Congress's express recognition that ERISA can and does preempt state tax laws.‘ Accordingly, SIIA argues (as it did in the proceedings below) that the Supremacy Clause of the U.S. Constitution(art. VI, § 2) and ERISA's preemption provision, prohibit the application of the Michigan Act to ERISA-covered entities. (For more background on this case, including a detailed discussion of the circuit court's response to SIIA's specific claims, seeU.S. Supreme Court Update, 25 JMT 45 (May 2015).)

Petition Denied

The Court denied certiorari on 6/22/15 in *Zurich American Ins. Co, et. al. v. Tennessee*, Docket No. 14-1240, rulings below as *Zurich American Insurance Co., et al. v. Tennessee*, 2014 Tenn. App. LEXIS 466 (July 31, 2014) and *GreatAmerican Insurance Co. of New York v. Tennessee*, 2014 Tenn. App. LEXIS 464 (July 31, 2014). The Tennessee Court of Appeals ruled in favor of the Tennessee Department of Commerce and Insurance's (the ‘Department‘) imposition of retaliatory taxeson certain New York domiciled insurance companies that provide insurance in Tennessee. The Tennessee Court of Appeals ruled that the Department had a rational basis for imposing the taxes, thus denying the petitioners equal protections claims.

The majority [in *Wynne*] determined that ‘Maryland's income tax scheme fails the internal consistency test‘ because ‘the tax scheme operates as a tariff and discriminates against interstate commerce.‘

The dissent [in *Wynne*] characterizes states' decisions to offer their residents credits for taxes paid to other jurisdictions as an ‘independent *policy* decision,‘ not mandated under the Constitution.

****13** The estates [in *Hambleton*] petition the U.S. Supreme Court to . . . to define the due process rights associated with retroactive tax laws.

The financial institutions [in *First Marblehead Corp.*] . . . claim that Massachusetts's apportionment scheme violates the Commerce Clause of the U.S. Constitution by failing both the internal and external consistency tests.

SIIA argues . . . that the Supremacy Clause of the U.S. Constitution and ERISA's preemption provision, prohibit the application of the Michigan Act to ERISA-covered entities.

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