

Sovereignty Ruling Emboldens States To Push Taxing Bounds

By Maria Koklanaris

Law360 (May 14, 2019, 7:57 PM EDT) -- The U.S. Supreme Court ruling that California wasn't obliged to answer a suit in Nevada state court could embolden states to push the boundaries of taxing nonresidents with limited contacts while enjoying a "home court" advantage in litigation.

In a 5-4 decision Monday, the court's conservative majority ruled in favor of California's Franchise Tax Board in its long-running dispute with inventor Gilbert B. Hyatt, a former California resident who sued the agency in Nevada state court, claiming it committed numerous torts in pursuit of taxes on royalties he earned. The majority found weight in California's argument it shouldn't have to litigate in another state's court, overruling the court's own 40-year-old precedent in *Nevada v. Hall*, and with it an external check on state powers and taxing authority.

The Hyatt case dovetails with the court's landmark 2018 *Wayfair* decision in giving states broader taxing authority over out-of-state residents but then denying those residents the ability to seek recourse in their own courts if they believe the outside state has treated them badly.

"Together, *Wayfair* and *Hyatt* mean that remote vendors are subject to new tax collection obligations and have to go to the imposing state to challenge misapplications of those obligations, even egregiously tortious administration of those obligations where the harm is really felt at home," Hayes Holderness, professor of taxation at the University of Richmond School of Law, told Law360. "Cases like *Hyatt* are rare, so I don't meant to oversell it, but that result could be fairly burdensome for smaller taxpayers."

Holderness said the decision places enough limitations on nonresidents that they might give up before getting their concerns resolved.

"If a state court demonstrates a home-court bias, then an aggrieved taxpayer will have to look to the federal courts for a more neutral arbiter," Holderness said. "The federal Tax Injunction Act makes the path to federal court long and expensive, if not elusive."



The U.S. Supreme Court's 5-4 decision Monday in favor of California's Franchise Tax Board overturned court precedent, and with it a check on state powers and taxing authority. (AP)

If the Hyatt decision throws up a roadblock for nonresidents, it removes one for states, which are now more free to create laws and regulations that apply to nonresidents, without the concern that they will have to defend those laws and regulations in nonresident state courts.

“The Hall decision operated as a check on states,” said Jennifer Weidler Karpchuk of Chamberlain Hrdlicka. “With that off the table, does that change anything?”

Hyatt is also another in a string of state victories, along with Wayfair and the 2018 decision in *Murphy v. NCAA* — which struck down a federal prohibition on states' legalizing sports betting — that facilitate in some way the ability of states to impose taxation as they wish.

One possible imminent and concrete effect of the Hyatt ruling may be seen in a case involving Virginia-based Crutchfield Corp., which is suing the Massachusetts Department of Revenue in a Virginia court. Experts say they doubt Crutchfield can now stay in a Virginia court while suing the Massachusetts tax agency, given that the justices found that states need not answer suits brought against them in the courts of other states.

The Crutchfield case is a notable intersection between Hyatt and Wayfair, as the company is suing Massachusetts over whether enforcement of a nexus regulation constitutes retroactivity. It has strong parallels to Hyatt in that a taxpayer, Crutchfield, is suing a state taxing agency in Massachusetts in the taxpayer's own state rather than the agency's, according to Darien Shanske, tax professor at the University of California, Davis School of Law.

Crutchfield has relied on a Virginia law that says it has the right to bring the suit in its home courts while Massachusetts has maintained, as it did in a brief last month, that “Crutchfield has not carried its burden of establishing that the exercise of jurisdiction in these circumstances comports with due process.”

Unless Crutchfield can prove that its case represents an exception to the sovereign immunity doctrine, it will almost certainly have to take the case out of its home courts, Shanske said.

Hyatt “could be very relevant,” Shanske said. On the matter of Virginia jurisdiction, he said, “This decision clearly means they are going to lose.”

Counsel for Crutchfield did not respond to Law360's requests for comment. The Massachusetts Department of Revenue could not be reached.

The Hyatt ruling also puts a damper on efforts like those of New Hampshire, which unsuccessfully attempted last summer to craft a law in response to the Wayfair decision that prevents the sales and use tax statutes of other states from being imposed on New Hampshire businesses.

New Hampshire's governor has vowed to try again, but the Hyatt decision may make such a law moot, since it strengthens other states' ability to tax nonresidents. Now, if a New Hampshire taxpayer felt wronged by another state's collection activities, it would have to sue in that state's courts, not New Hampshire's, which would be far less convenient for the taxpayer.

And that is how things should be, according to Helen Hecht, general counsel to the Multistate Tax Commission, which was on California's side in the Hyatt case. In an amicus brief in the case, the MTC said that being sued in another state interferes with the state's ability to administer and enforce its own tax laws.

Taxpayers should not have the ability to “shop around” for the state court they like best, as that gives them an unfair advantage, Hecht said. The Hyatt ruling rightly gets rid of this forum shopping, she said, “where, ‘If we don't like your tax laws, we can give our taxpayers a forum to challenge.’ It puts an end to all that.”

With these changes and the Supreme Court's message that states have less to fear when reaching across their borders, states may no longer have to answer challenges to their actions in other states' courts, according to Charles Rothfeld of Mayer Brown LLP.

“It gives the states another way of resisting attempts to hold them responsible,” Rothfeld said.

--Editing by Robert Rudinger and John Oudens.