California: Franchise Tax Board seeks Supreme Court review of state sovereignty in tax cases

David M. Kall | Thursday, May 10, 2018

In 2016, the United States Supreme Court decided the case *Cal. Franchise Tax Bd. v. Hyatt*, in which the Franchise Tax Board of California (FTB) asked the court to put an end to the precedent that allows a "sovereign State [to] be haled into the courts of another State against its will," as the FTB put it in its cert petition at the time. Had the court done what the FTB asked, the court would have overruled its 1979 decision in *Nevada v. Hall*. Instead, the court deadlocked and affirmed *Hall's* holding, that one state is not constitutionally immune from being sued in the courts of another. The *Hall* court reasoned that no such protection was "discussed by the framers," or articulated anywhere else in the Constitution.

Now, the FTB is again seeking redress from the court in the latest step of the *Hyatt* case, and in mid-March, filed a new cert petition. In mid-April, Indiana and 44 other states filed a friend-of-the-court brief, as did the Multistate Tax Commission.

Background

The 2016 *Hyatt* case featured a lawsuit that a Nevada resident, Gilbert Hyatt, filed against the FTB, in the state of Nevada, after the FTB assessed more than $10 million in taxes, penalties and interest against him in a dispute over his state of residence. The court's opinion provides that the FTB became suspicious that Hyatt had unlawfully declared Nevada, a no-income tax state, as his state of residence. During its audit, FTB employees "allegedly peered through Hyatt's windows, rummaged around in his garbage, contacted

his estranged family members, and shared his personal information not only with newspapers but also with his business contacts and even his place of worship."

Hyatt sought damages against the FTB for those "abusive" practices in a Nevada court, alleging various torts, fraud, intentional infliction of emotional distress, and invasion of privacy.

California defended itself on the ground that it should be immune from lawsuits involving claims for actions taken "during the course of collecting taxes," and that the Full Faith and Credit Clause of the U.S. Constitution required Nevada to apply California's immunity laws to Hyatt's claims.

The court's deadlock meant that *Hall* would not be overturned, but there was a second question regarding the size of damages that could be awarded. It enforced the Full Faith and Credit principle precluding "acts of hostility" toward another state's laws, and concluded that Nevada could not award damages as to agencies in other states, under its own laws, when those damages would exceed what it could award a Nevada based agency: "Nevada's rule lacks the 'healthy regard for California's sovereign status'…and it reflects a constitutionally impermissible 'policy of hostility to the public Acts' of a sister State.'"

The court thus remanded Hyatt's case to the Nevada Supreme Court, where that court capped the original damage award of $139 million, plus another $250 million in punitive damages, to $50,000. Under principles of comity, the FTB was held to be immune from punitive damages at all. That result has now been stayed pending the FTB's new petition to the Supreme Court.

The FTB's cert petition

Many stakeholders are still smart from the court's failure to overturn *Hall*, leaving intact the legal permissibility of lawsuits attempting to enforce one state's laws in another state. In its brief, the FTB does not mince words: "*Hall* was wrong when it was decided and has become only more clearly wrong in the intervening years…[it] cannot be squared with the Nation's constitutional structure…[and] [t]here are no compelling reasons to preserve *Hall* in the name of stare decisis."

Hall is a different than *Hyatt* because it addresses the power of one state's courts over another state, rather than the administration and adjudication of taxes. In *Hall*, a University of Nevada employee hurt California residents in car accident that occurred in California. The Californians sued the state of Nevada, in California state court, and won over $1 million in damages there. On review, the Supreme Court held that sovereign immunity did not prevent one state from being haled into another state's courts against the will of the first state.

The FTB's cert petition in *Hyatt* declares that "at the Framing, one State would have possessed sovereign immunity in the courts of another," and that later decisions also recognized the "widespread acceptance of the view that a sovereign state is never amenable to suit without its consent." "[N]onetheless[, the Court has] dismissed this 'widespread' Framing-era view as irrelevant to the constitutional question whether States are immune from suit in the courts of their fellow sovereigns." For this reason, according to the FTB, *Hall* "stands in sharp conflict with the Founding-era understanding of state sovereign immunity."

The FTB goes on to argue that the *Hall* court failed to protect sovereign immunity. The heart of the FTB's position is the importance of "sovereign dignity," and the promotion of self-government by citizens. Their position stands at odds with the *Hall* court's unsatisfactory rationale that a state could obtain recourse by way of hoping for a "voluntary decision" on the part of one state to exempt another from suit, as "a matter of comity" and "wise policy."

To bolster its position, the FTB relies upon the 11th Amendment, which protects states from private lawsuits. According Justice Blackmon, who dissented in *Hall*, this "clearly shows that such [sovereign] immunity was assumed."

The FTB also points to two "fundamental principles" that the *Hall* court relied on, noting that the court has repudiated both of them in subsequent cases. The first is that sovereign immunity must be located in explicit textual provisions. The second is that sovereign immunity is solely a question of the above-mentioned comity and wise policy. The long and short of the FTB's position is that immunity should be the rule, not the exception.

The FTB went on to chastise the court for giving undue import to its precedent, because "stare decisis is not an inexorable command; rather, it 'is a principle of policy and not a mechanical formula of adherence to the latest decision.'" Simply put, *Hall* is now "unworkable."

Amicus interest in the FTB's new case

The Multistate Tax Commission (MTC) and Indiana and 44 other states are the only two amici that have appeared so far, and they also want the court to reverse *Hall*. Though the FTB's cert petition does not, both amici mention the Tax Injunction Act (TIA), which serves to keep the federal courts out of state tax disputes. The states' brief contends that "[s]uch a substantive limit on the power of federal courts demonstrates the core status of the taxing power to the States." Otherwise, the amici briefs largely track with the spirit of the FTB's, even as the individual positions reflect the specific concerns of the signators.

The Multistate Tax Commission's amicus brief

The MTC is premised on the idea of fostering cooperation and uniformity of tax laws, so its views stem from that attitude. It opines that *Hall* "undermine[s] any cooperative solution, and may threaten other types of interstate cooperation" because it can be deployed by states to promote their own interests, and by taxpayers to pit one state against another.

The MTC also objects to the *Hall* precedent because it subjects a state to a "sister-state's procedural and policy choices. This is a quantum of power no sovereign would willingly cede to another." The MTC is concerned, for example, that *Hall* makes it easier for "putative taxpayers to disrupt state tax enforcement." Additionally, *Hall* allows for "significant incentives to sue a taxing state in an out-of-state court, even if the suit may not succeed," such as receiving protective orders, as Hyatt did, that prevent the use of tax documents in the tax proceeding itself.

The MTC further worries that sister-courts can be persuaded to disregard tax rules and regulations, "as well as other public acts or documents, such as tax notices, assessments, etc., that would have substantial weight in the taxing state's own forum." Indeed, at least 33 states have independent tax tribunals, whose rulings "might not be entitled to any effect in the out-of-state suit."

Finally, a comity-based solution, which, generally speaking, calls for states to recognize each other's laws, is "not a simple matter," the MTC argues, because it requires consideration of other ideas, some of which could be "novel and complex," like which state's laws should apply, and whether a state has waived immunity, among other things.

The states' amicus brief

Similarly, 45 states signed a second amicus brief support the FTB and want the court to overrule *Hall*. Just

California, New Hampshire, New Mexico, New York, and Pennsylvania out of the fray, at least for now.

Their summary of the argument is this: “States all too frequently find themselves the targets of private-plaintiff lawsuits filed in the courts of other States. Such cases not only insult the sovereign dignity of defendant States, but also pose the real risk of exposing States to judgments unrestrained by any concern for local fiscal impact. And where, as here, the State is haled into another State’s courts based on how it has exercised its authority to conduct tax audits, the interest in preserving immunity as an attribute of State sovereignty is particularly acute.”

Hyatt’s response to the FTB’s cert petition is due on May 31, 2018.

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Team member bio