No. 150, Original

IN THE

Supreme Court of the United States

STATE OF ARIZONA,

Plaintiff,

v.

STATE OF CALIFORNIA

Defendant.

ON MOTION FOR LEAVE TO FILE BILL OF COMPLAINT

BRIEF *AMICI CURIAE* OF SOUTHEASTERN LEGAL FOUNDATION AND THE CATO INSTITUTE IN SUPPORT OF MOVANT

KIMBERLY S. HERMANN
SOUTHEASTERN LEGAL FOUNDATION
560 West Crossville Road, Suite 104
Roswell, GA 30075
(770) 977-2131

THOMAS R. MCCARTHY
Counsel of Record
CONSOVOY MCCARTHY PARK PLLC
ANTONIN SCALIA LAW SCHOOL SUPREME COURT CLINIC
3033 Wilson Boulevard, Suite 700
Arlington, VA 22201
(703) 243-9423
tom@consovoymccarthy.com

Attorneys for Amici Curiae

May 3, 2019

288460

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

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INTEREST OF *AMICI CURIAE*[1]

Founded in 1976, Southeastern Legal Foundation (SLF) is a national constitutional public interest law firm and policy center on the front lines advocating limited government, individual liberties, and the free enterprise system in the courts of law and public opinion. Its mission is to engage in litigation and public policy advocacy in support of these principles. To that end, SLF regularly appears in this Court as a party and an *amicus* to protect the rights and liberties safeguarded by the Constitution and to enforce the Constitution's limits on governmental authority. *See, e.g.*, *Southeastern Legal Foundation v. Environmental Protection Agency*, No. 12-1268; *Kisor v. Wilkie*, No. 18-15; *Knick v. Township of Scott*, No. 17-647; *Weyerhaeuser Co. v. U.S. Fish & Wildlife Serv.*, No. 17-71.

The Cato Institute is a nonpartisan public-policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Robert A. Levy Center for Constitutional Studies was established to restore the principles of constitutional government that are the foundation of liberty. To those ends, Cato conducts conferences, files *amicus* briefs, and publishes books, studies, and the annual *Cato Supreme Court Review.*

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1. Pursuant to this Court's Rule 37.6, counsel for *amici curiae* certifies that this brief was not authored in whole or in part by counsel for any party and that no person or entity other than *amici curiae*, its members, or its counsel has made a monetary contribution intended to fund the preparation or submission of this brief. All parties have received timely notice of *amici curiae*'s intent to file and consented to the filing of this brief.

The State of California has run roughshod over the Due Process Clause by imposing a "doing business" tax on business entities that have no connection to California whatsoever, except for purely passive investment in California companies. These extraterritorial assessments fail to satisfy the "minimum contacts" standard that limits State authority to tax out-of-state persons. *See Shaffer v. Heitner*, 433 U.S. 186 (1977); *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2093 (2018).

As Arizona explains, California has unconstitutionally assessed this "doing business" tax on hundreds of thousands of out-of-state taxpayers over the last several years. Bill of Complaint ("Arizona Compl.") at ¶ 16. In doing so, California has "cause[d] grave harm" to Arizona and every other State and has imposed serious economic injuries on thousands and thousands of individual taxpayer businesses across the country. *Id.* at ¶¶ 12, 15-16.

Amici SLF and Cato have a strong interest in enforcing the Due Process Clause's limitations on state tax authority and protecting individual taxpaying entities from California's unconstitutional extraterritorial assessment of its "doing business" tax.

INTRODUCTION AND SUMMARY OF ARGUMENT

Like many States, California assesses an annual "doing business" tax on all business entities "for the privilege of doing business" in the state. Cal. Rev. & Tax. Code §17941(a). A business entity is deemed to be "doing business" in California if it is "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." *Id.* §23101(a). And a taxpayer is deemed to be

"doing business in [California]" if it is: (1) domiciled in California; or if it exceeds specific thresholds in California of (2) gross "sales"; (3) ownership of "real property and tangible personal property," or (4) amounts paid for "compensation." *Id.* §23101(b); *see also* California Franchise Tax Board, Legal Ruling 2014-01, at 3 (July 22, 2014) (Legal Ruling 2014-01). For limited liability companies (LLCs), the "doing business" tax is $800. *See id.* §17941(a); *id.* §23153(d)(1).

Putting policy aside, the problem with California's "doing business" tax is not its existence, but rather California's unconstitutional extraterritorial assessment of the tax. Specifically, California interprets Section 23101(a)'s "active[] engag[ement]" requirement in a counterintuitive manner to include "purely passive investments in California companies" by out-of-state entities. Br. in Supp. of Mot. for Leave to File Bill of Compl. ("Arizona Br.") at 2.

In Legal Ruling 2014-01, the Franchise Tax Board concluded that a company's mere ownership interest in an LLC doing business in California—and nothing more—amounts to the company doing business in California *itself* and subjects the company to the $800 annual tax. The Franchise Tax Board could not have been more clear that passive investment alone is enough (in its view) for California to assess its "doing business" tax. It expressly stated in Legal Ruling 2014-01 that "a corporation that is a member of [an] LLC" has "a California return filing requirement and obligation to pay all applicable taxes and fees as a result of its membership interest" even if it is "not incorporated, organized, or registered to do business in California and has no activities or factor presence in California other than through its membership in [the] LLC." Legal Ruling 2014-01, at 11.

On top of that, California takes extraordinary steps to enforce these extraterritorial assessments including taking the money without warning and without process. For example, if a company does not voluntarily pay the assessment, California locates any funds the company holds in out-of-state bank accounts and demands that the relevant banks transfer the funds to the State. And if the bank refuses to comply with the demand, California takes the money from the bank's accounts instead. California effectuates these extraterritorial seizures ex parte, without notice, without warrant, and with no any opportunity for judicial review. *See generally* Cal. Rev. & Tax. Code §§18670, 18670.5, 18674; *see also* Arizona Compl. ¶¶ 54-61.

This is not the first time the Franchise Tax Board has asserted authority to tax out-of-state entities with passive investments in California businesses. In 1996, the California Board of Equalization struck down the Franchise Tax Board's assertion of authority to tax "out-of-state corporations whose only California contacts were as limited partners in [California] limited partnerships" without "the power to manage and conduct partnership business." Legal Ruling 2014-01, at 5.

California's extraterritorial assessment of its "doing business" tax upon nonresident entities that have passive investments in California LLCs likewise should be struck down. As explained more fully in the Arizona Brief, these extraterritorial assessments "violate (1) the Due Process Clause, (2) the Commerce Clause, and (3) the Fourth Amendment." Arizona Br. at 2; *id.* at 23-36. *Amici* SLF and Cato agree with the State of Arizona that the Court should take up this case to review "California's aggressive policy of extraterritorial taxation, which transgresses

both state borders and multiple provisions of the Constitution." *Id.* at 1. *Amici* write separately to further explain why California's extraterritorial assessment of its "doing business" tax violates the Due Process Clause.

ARGUMENT

I. The "minimum contacts" standard for evaluating personal jurisdiction is an appropriate test for determining whether an extraterritorially assessed state tax violates the Due Process Clause.

"The Due Process Clause of the Fourteenth Amendment limits the power of a state court to render a … judgment against a nonresident defendant." *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 291 (1980). The Clause requires that the out-of-state defendant "be subject to the personal jurisdiction of the court." *Id.* (citing *Int'l Shoe Co. v. Washington*, 326 U.S. 310 (1945)). It "has long been settled" that "a state court may exercise personal jurisdiction over a nonresident defendant only so long as there exist 'minimum contacts' between the defendant and the forum State." *Id.* (quoting *Int'l Shoe*, 326 U.S. at 316). Minimum contacts exist only where the defendant has "purposefully avail[ed] itself of the privilege[s] of conducting activities within the forum," *see Hanson v. Denkla*, 357 U.S. 235, 253 (1958), and thus "should reasonably anticipate being haled into court there," *see World-Wide Volkswagen*, 444 U.S. at 297. This "minimum contacts" standard performs two "related" functions: "It protects the defendant against the burdens of litigating in a distant or inconvenient forum. And it acts to ensure that the States through their courts, do not reach out beyond the limits imposed on them by their status as coequal sovereigns in a federal system." *Id.* at 291-92.

Just as the Due Process Clause limits the reach of States' authority over nonresident defendants in their courts, the Clause also has long been understood to impose limits on States' authority to impose taxes outside their borders. Indeed, "[n]o principle is better settled than that the power of a [S]tate, even its power of taxation, in respect to property, is limited to such as is within its jurisdiction." *N.Y., L.E. & W. R.R. Co.. v. Pennsylvania*, 153 U.S. 628, 646 (1894) (citations omitted). Accordingly, if one State "should enact that the citizens or property of another State or country should be taxed in the same manner as the persons and property within its own limits and subject to its authority ... , such a law would be as much a nullity as if in conflict with the most explicit constitutional inhibition." *St. Louis v. Wiggins Ferry Co.*, 78 U.S. 423, 430 (1870). Put simply, "the imposition of [such] a tax would be *ultra vires* and void." *Id.* In limiting State extraterritorial tax authority, the Due Process Clause "requires some definite link, some *minimum connection*, between a state and the person, property or transaction it seeks to tax." *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954) (emphasis added); *see also Wayfair*, 138 S. Ct. at 2093 (quoting *Miller*).

As this Court has explained, the "minimum connection" required between a taxing State and the subject of its taxing authority parallels the "minimum contacts" requirement the Due Process Clause places on States under the doctrine of personal jurisdiction. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 308 (1992) (describing these two components of the Due Process Clause as employing "[c]omparable reasoning"), *overruled on other grounds by Wayfair*, 138 S. Ct. 2080. Not surprisingly, then, the Court routinely relies on its Due Process personal jurisdiction precedents in cases concerning exterritorial

state taxation. *See, e.g.*, *Quill Corp.*, 504 U.S. at 307-08 (discussing *International Shoe*, 326 U.S. 310, *Shaffer*, 433 U.S. 186, and *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985)); *Wayfair*, 138 S. Ct. at 2093 (discussing *Burger King*, 471 U.S. 462). Arizona thus quite rightly recognizes that the "minimum connection" standard for extraterritorial taxation "effectively mirrors this Court's 'minimum contacts' standard for personal jurisdiction." Arizona Br. at 24.

II. Under this Court's "minimum contacts" precedent, California's extraterritorial assessments violate the Due Process Clause.

As explained above, the "minimum contacts" standard requires that a nonresident have purposefully availed himself of the benefits and protections of another State, *see Hanson v. Denkla*, 357 U.S. 235, 253 (1958), such that he could anticipate being subject that State's authority, *see World-Wide Volkswagen*, 444 U.S. at 297. In the circumstances presented here—where a nonresident individual taxpayer entity has only a purely passive investment in a California LLC—this Court has concluded that minimum contacts are lacking. *See Shaffer v. Heitner*, 433 U.S. 186 (1977). California's extraterritorial assessments thus violate the Due Process Clause.

In *Shaffer*, this Court addressed whether a Delaware court could exercise jurisdiction over nonresident defendants in a stockholder's derivative action based on their "positions as officers and directors of a [Delaware] corporation." *Id.* at 213. In other words, did the nonresidents establish "minimum contacts" with the State thereby subjecting themselves to the State's jurisdiction simply because of their roles as officers and directors?

The Court answered that question in the negative, with reasoning that applies here.

The Court explained that "accepting positions as officers and directors of a Delaware corporation" does not establish that the nonresidents "have 'purposefully avail(ed themselves) of the privilege of conducting activities within the forum State.'" *Id.* at 215-16 (quoting *Hanson*, 357 U.S. at 253). Delaware's assertion of authority over the nonresident officers and directors was "inconsistent with [the Due Process] limitation on state power" because those officers "had nothing to do with the State of Delaware" and "had no reason to expect" to be subject to the State's jurisdiction. *Id.* at 216-17.

If anything, the Court's reasoning applies even more forcefully here, as "the *Shaffer* appellants were notably officers and directors of the corporation and thus quite active in its management, not mere passive investors." Arizona Br. at 25. Indeed, the nonresident officers and directors in *Shaffer* had assumed specific "powers" and "responsibilities" within the corporation, *Shaffer*, 433 U.S. at 228 (Brennan, J., concurring in part and dissenting in part), such that at least some of them were considered "key employees" thereof. Appellee's Answering Br., *Shaffer v. Heitner*, No. 75-1812, 1976 WL 181713, at *2, 11, 13, 14, 15 (Dec. 17, 1976). Under *Shaffer* then, the Due Process Clause plainly precludes California's exercise of taxing authority over entities that have no connection to California other than a purely passive investment in a California LLC.

Importantly, *Shaffer* illustrates a larger point of the Court's "minimum contacts" analysis: the Court has eschewed simple, check-the-box tests based upon the

mere establishment of a legal relationship with an in-state entity. As the Court explained in *Burger King*, it "long ago rejected the notion that personal jurisdiction might turn on mechanical tests, or on conceptualistic ... theories of the place of contracting or of performance." 471 U.S. at 478-79 (quotations and citations omitted). Instead, the Court has "emphasized the need for a highly realistic approach" that recognizes that the establishment of a legal relationship is "ordinarily but an intermediate step … with future consequences which themselves are the real object of the business transaction." *Id.* at 479 (quotations and citations omitted). It is those "future consequences"—not the mere relationship itself—"that must be evaluated in determining whether the defendant purposefully established minimum contacts within the forum." *Id.* Accordingly, just as a nonresident's role as an officer or director of an in-state corporation fails to establish "minimum contacts," a nonresident who contracts with an in-state entity lacks minimum contacts with the forum state. *See Burger King*, 471 U.S. at 478 ("If the question is whether an individual's contract with an out-of-state party *alone* can automatically establish sufficient minimum contacts in the other party's home forum, we believe the answer clearly is that it cannot."). So too for an individual taxpayer entity whose only contact with the state asserting tax authority is a purely passive investment in an in-state LLC.

* * *

Arizona puts it well: "purely passive investments in California companies are an insufficient basis to impose taxes because the requisite 'minimum contacts' over those out-of-state businesses are lacking." Arizona Br. at 2. And given that California's extraterritorial assessments

violate the Due Process Clause, their extraterritorial seizures of funds to enforce the tax necessarily do as well: "[S]eizure of property by the State under pretext of taxation when there is no jurisdiction or power to tax is simple confiscation and a denial of due process of law." *Miller*, 347 U.S. at 342.

The Court should grant the motion in order to police the Due Process Clause's limitations on State extraterritorial taxing authority and safeguard the due process rights of non-resident taxpayers.

CONCLUSION

Amici curiae respectfully request that the Court grant the motion for leave to file a bill of complaint.

Respectfully submitted,

KIMBERLY S. HERMANN
SOUTHEASTERN LEGAL FOUNDATION
560 West Crossville Road, Suite 104
Roswell, GA 30075
(770) 977-2131

THOMAS R. MCCARTHY
Counsel of Record
CONSOVOY MCCARTHY PARK PLLC
ANTONIN SCALIA LAW SCHOOL SUPREME COURT CLINIC
3033 Wilson Boulevard, Suite 700
Arlington, VA 22201
(703) 243-9423
tom@consovoymccarthy.com

Attorneys for Amici Curiae

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