Chapter 7

Miscellaneous Federal Limitations

Table of New and Retitled Sections

§ 7:7.50 When is a penalty not a penalty, but a tax? *[New]*

§ 7:9 The Tax Injunction Act does not preclude third parties from pursuing an Establishment Clause challenge of a State tax credit in Federal Court *[New]*

§ 7:10 *Hibbs* distinguished—The comity doctrine as a limitation on jurisdiction of federal courts over a complaint of allegedly discriminatory state taxation *[New]*

§ 7:11 *Hibbs* revisited—Private taxpayer/citizens held not to have Article III standing to bring suit in federal court alleging an Establishment Clause challenge to a state income tax credit *[New]*

KeyCite®: Cases and other legal materials listed in KeyCite Scope can be researched through the KeyCite service on Westlaw®. Use KeyCite to check citations for form, parallel references, prior and later history, and comprehensive citator information, including citations to other decisions and secondary materials.

§ 7:7.50 When is a penalty not a penalty, but a tax? *[New]*

The outcome of what was perhaps one of the most politically charged cases to reach the Supreme Court in recent memory, took an odd turn. The signature Act of President Obama's administration has been the Affordable Care Act, intended to expand coverage to millions of Americans not within a healthcare insurance program nor a federal or state funded program. It was almost immediately challenged in multiple courts joined by several State Attorneys' General. The case that provided the vehicle for the Supreme Court's review was *National Federation of Independent Business v. Sebelius*, 132 S. Ct. 2566, 183 L. Ed. 2d 450 (2012), (consolidated on certiorari with *Florida v. Dept. of Health & Human Services*. The Act was held to be constitutional by a majority

of the Court, Justices Ginsberg, Breyer, Sotomayor, and Kagan, joined in part by the Chief Justice who authored the majority opinion).

As outlined in the dissent by Justice Scalia (joined by Justices Thomas, Kennedy and Alito), the case presents two questions of first impression: (1) whether failure to engage in economic activity—the purchase of health insurance—is subject to regulation under the Commerce Clause, and (2) whether the power to tax and spend granted to Congress under Article I, § 8, cl. 1 of the Constitution "permits the conditioning of a state's continued receipt of all funds under a massive state-administered federal welfare program upon its acceptance of an expansion to that program." Reviewing the Court's decision in *Wickard v. Filburn*, 317 U.S. 111, 63 S. Ct. 82, 87 L. Ed. 122 (1942) which held that the economic activity of growing wheat for one's own consumption affected commerce sufficiently to allow its regulation, the dissent pointed out that no case has gone so far as to hold that not engaging in commerce (i.e., not growing wheat) was cause for regulation, the dissent believes that likewise, not participating in an health insurance program by not buying insurance and paying premiums did not grant power of regulation to Congress. While four of the Justices (Ginsburg, Breyer, Sotomayor, and Kagan) disagree with the dissent with respect to the issue of whether the Act is beyond the power of Congress to regulate under the Commerce Clause, the Chief Justice does not agree with them, and joins with the dissenters.

However, the Chief Justice then opines that while the financial penalty imposed under the Act on individuals who do not elect to participate in a health insurance program is not valid under the Commerce Clause, it may also be considered to be and treated as a tax imposed by Congress under the power to tax and spend.

The dissent obviously does not agree with this analysis and makes the point that traditionally penalties and taxes were different, the primary difference being that penalties are only imposed on voluntary conduct—doing something forbidden, or failing to do something commanded, while the requirement to pay a tax is something the government imposes on its citizens for the support of government regardless of what they do or don't do. See *U.S. v. Reorganized CF & I Fabricators of Utah, Inc.*, 518 U.S. 213, 224, 116 S. Ct. 2106, 135 L. Ed. 2d 506 (1996) and *U.S. v. La Franca*, 282 U.S. 568, 572, 51 S. Ct. 278, 75 L. Ed. 551 (1931).

Commentary

The Court's decision in this case with respect to the reach of the Commerce Clause in this context is beyond the purview of this work. However, the Court's decision, which essentially says that a penalty for failure to perform a mandated act can be imposed under the sovereign taxing power, has implications for state and local governments in how they may structure their penalty and taxing schemes within the bounds of due process and double jeopardy. Indeed in *Department of Revenue of Montana v. Kurth Ranch*, 511 U.S. 767, 114 S. Ct. 1937, 128 L. Ed. 2d 767 (1994), discussed *supra* in § 7:7, the Court had interpreted and limited its holding in *U.S. v. Halper*, 490 U.S. 435, 109 S. Ct. 1892, 104 L. Ed. 2d 487 (1989) (abrogated by, Hudson v. U.S., 522 U.S. 93, 118 S. Ct. 488, 139 L. Ed. 2d 450, 162 A.L.R. Fed. 737 (1997)) which held that imposition of a civil penalty could constitute "punishment" for the purposes of double jeopardy analysis, and determined that imposition of a tax on the possession of illegal drugs (marijuana) could also constitute "punishment" which amounted to successive punishment for the same offense prohibited by the Fifth Amendment.

The issue on which the Court disagreed in that case was whether Montana had the nonpenal purpose of raising revenue and the legitimate purpose of deterring tax.

What is left unclear after this decision is where are the boundaries between a penalty being a tax and one being punitive and coercive. We can expect to see further elucidation on this point in later cases arising in state courts wrestling with its implications for state taxing and regulatory schemes.

§ 7:9 The Tax Injunction Act does not preclude third parties from pursuing an Establishment Clause challenge of a State tax credit in Federal Court *[New]*

In *Hibbs, Director, Arizona Dept. of Revenue v. Winn, et al.*[1] the Supreme Court reviewed and affirmed the Ninth Circuit Court's ruling that the Tax Injunction Act[2] (TIA) does not bar an action filed in federal district court by third party taxpayers challenging the allowance under Arizona's income tax laws of tax credits[3] for contributions to nonprofit "state tuition organizations" (STOs) which award scholarships and tuition grants to children attending private schools that provide religious instruction or give religion-based admissions preferences.[4]

Justice Ginsburg, writing for the majority, points out that after nearly fifty years of unchallenged decisions by courts in the federal system, including in the Supreme Court,[5] this case presents the first occasion in which the Court is asked to examine whether the TIA precludes suits challenging the constitutionality of state tax credits from being brought in Federal Court.[6]

The plaintiffs' action seeks injunctive and declaratory relief and an order requiring STOs to pay funds in their possession into the state general fund. The defendant Director did not assert that an injunction would interfere with the State's tax levy or collection efforts, but instead only urged that a federal injunction would restrain the "assessment" of taxes "under State law." The District Court agreed with the Director, but the Ninth Circuit disagreed that the requested relief would adversely affect the State's ability to raise revenue, observing that the requested relief, if granted, would result in the State receiving more, not less, funds. Before the Supreme Court the Director asserted that the literal language of the TIA precludes this action and that prior decisions allowing such actions to proceed in federal courts are merely sub silentio holdings without precedential value.

In affirming the Ninth Circuit the Court examined both the scope of the term "assessment" as used in the TIA and the "the question whether the TIA was intended to insulate state tax laws from constitutional challenge in lower federal courts even when the suit would have no negative impact on tax collection."[7]

Rejecting the Director's assertion that the term "assessment" by itself signified "[t]he entire plan or scheme fixed upon for charging or taxing," the majority looked to the terms "levy" and "collection" (activities which are conceded by the Director as not being affected by the instant suit) and concluded that assessment is but the precursor step which allows levy and collection actions to be set in motion. Since levy and collection are not affected it follows that an action for declaration that a statutory credit is unconstitutional and prospectively enjoining the Director from allowing taxpayer's use of the tax credit, is not an action contemplated by the TIA, nor does such action interfere with or restrain the Director from levy or collection of taxes. Indeed, as the Court points out, the relief sought by plaintiffs, if granted, will enhance rather than reduce the amount of state tax collected.[8]

In dissent, Justice Kennedy joined by the Chief Justice and Justices Scalia and Thomas criticizes the majority opinion for treating States as "diminished and disfavored powers" and asserts that the Court's reading of the TIA contrasts with a literal meaning of its terms and is not borne out by its legislative history. The dissent acknowledges that "unexamined custom" favors the view of the majority, but contends that the statutory text favors the opposite conclusions. The dissent challenges the definition the majority uses for "assessment" and disputes that it was the intent of Congress or the effect of other judicial authorities to so narrowly confine the reach of the TIA. The dissent points out that the plaintiffs do not contend they have no remedy in state court, or that if barred from a plain, speedy, and effective remedy in state court, they would not then have a right to proceed in federal court. In the view of the dissenters, the majority holding upsets the carefully crafted balance between the federal system and the states. Finally the dissenters do not agree that the majority may fairly rest its decision on "years of unexamined habit by litigants and the courts alike which have resulted in federal courts entertaining challenges to state tax credits." From the perspective of the dissent, "while we should not reverse the course of our unexamined practice lightly, our obligation is to give a correct interpretation to the statute."

In a separate opinion concurring with the majority, Justice Stevens responds to the dissent by pointing out "that prolonged congressional silence in response to a settled interpretation of a federal statute provides powerful support for maintaining the status quo. In statutory matters, judicial restraint strongly counsels waiting for Congress to take the initiative in modifying rules on which judges and litigants have relied."

Commentary

That the plaintiffs unsuccessfully sought certiorari and review by the Supreme Court of the decision of the Arizona Supreme Court upholding the constitutionality of the tax credit[9] illustrates again that a denial of certiorari should not be heard to speak to the merits of a case. It also illustrates that a case is not over until it is over-and it is not over yet, since it remains to be seen whether the federal courts will read the Establishment Clause in the context of this tax credit as narrowly as did the majority in the Arizona Supreme Court.

[1] *Hibbs v. Winn*, 124 S. Ct. 2276 (U.S. 2004).

[2] "The district courts shall not enjoin, suspend or restrain the assessment, levy, or collection of any tax under State law where a plain, speedy, and efficient remedy may be had in the Courts of such State." 28 U.S.C.A. § 1341.

[3] Up to $500 ($625 for joint filers) per year.

[4] The Arizona statute challenged by plaintiffs, Ariz. Rev. State. Ann. § 43-1089, in effect gives Arizona taxpayers an election. As long as donors do not give STOs more than their total state tax liability, their $500 or $625 contributions are costless. This statute was upheld before it went into effect by the Arizona Supreme Court by a 3-to-2 vote in a special discretionary action invoking the court's original jurisdiction. *Kotterman v. Killian*, 193 Ariz. 273, 972 P.2d 606, 132 Ed. Law Rep. 938 (1999). The parties do not dispute that Kotterman has no preclusive effect on the instant case.

[5] Citing for example *Griffin v. County School Bd. of Prince Edward County*, 377 U.S. 218, 84 S. Ct. 1226, 12 L. Ed. 2d 256 (1964); *Allen v. County School Bd. of Prince Edward County*, 198 F. Supp. 497 (E.D. Va. 1961) and *Moton v. Lambert*, 508 F. Supp. 367 (N.D. Miss. 1981).

[6] Certiorari was granted to resolve the split between the Ninth Circuit and the Fifth Circuit, where the latter Court had held in *American Civil Liberties Union Foundation of Louisiana v. Bridges*, 334 F.3d 416 (5th Cir. 2003) (abrogated by, Hibbs v. Winn, 124 S. Ct. 2276 (U.S. 2004)), that the TIA bars federal action seeking to have any part of a State's tax system declared unconstitutional (emphasis supplied).

[7] The Court also ruled that the recall on its own initiative by the Circuit Court of its mandate reset the 90-day count for seeking certiorari under 28 U.S.C.A. 2101(c) and U.S. S.Ct. Rule 13(3) and therefore the Petition was timely filed.

[8] As was observed by the Seventh Circuit in *Dunn v. Carey*, 808 F.2d 555 (7th Cir. 1986), while the legislative history of the TIA is filled with concern that federal judgments were emptying state coffers, "[t]here was no articulated concern about federal courts' flogging state and local governments to collect additional taxes." See also *In re Jackson County, Mo.*, 834 F.2d 150 (8th Cir. 1987) where the Court observed that the TIA "has been held to be inapplicable to efforts to require collection of additional taxes as opposed to efforts to inhibit the collection of taxes."

[9] *Kotterman v. Killian*, 193 Ariz. 273, 972 P.2d 606, 132 Ed. Law Rep. 938 (1999).

§ 7:10 *Hibbs* distinguished—The comity doctrine as a limitation on jurisdiction of federal courts over a complaint of allegedly discriminatory state taxation *[New]*

Consumers of natural gas in Ohio have two sources from which to purchase gas—local distribution companies (LDCs) and independent marketers (IMs). Ohio grants three tax exemptions which exclusively apply to LDCs. First, LDCs

enjoy an exemption from sales and use taxes which are partially but not completely offset by an excise tax on gross receipts. Second, LDCs are exempt from the commercial activities tax imposed on IMs gross receipts. And third, inter-LDC natural gas sales are exempt from gross receipts tax which IMs must pay when they purchase gas from LDCs.

IMs filed suit against the Tax Commissioner of Ohio in federal district court alleging discriminatory taxation of IMs and their customers in violation of the Commerce and Equal Protection Clauses and seeking declaratory and injunctive relief invalidating the three tax exemptions enjoyed exclusively by LDCs.

The District Court held that while the suit was not barred by the Tax Injunction Act, it nevertheless was barred by the comity doctrine which restrains federal courts from hearing claims that risk disrupting state tax administration.

On appeal the Sixth Circuit Court of Appeals agreed with the ruling of the District Court with respect to the Tax Injunction Act, but reversed the Court's comity ruling and remanded for hearing on the merits.

The Supreme Court granted certiorari and reversed the decision of the Sixth Circuit, holding that the comity doctrine requires that a taxpayer's complaint of discriminatory state taxation must proceed originally in state court even when a successful challenge would have the effect of increasing a competitor's tax burden, thus increasing rather than diminishing state tax revenues.[1]

In reversing the Sixth Circuit, Justice Ginsburg, speaking for an unanimous Court (Justice Kennedy concurring and Justices Thomas, Scalia, and Alito concurring in judgment), distinguished *Hibbs v. Winn*, 542 U.S. 88 (2004) in which the Court had held that neither the TIA nor the comity doctrine were a bar to adjudication in federal court of an Establishment Clause challenge to a state tax credit claimed to have funneled public funds to parochial schools.

In reaching its decision the Sixth Circuit relied upon a footnote in *Hibbs* in which the Court stated that it had "relied upon 'principles of comity' to preclude original federal court jurisdiction only when plaintiff's have sought district court aid in order to arrest or countermand state tax collection." The Sixth Circuit concluded that the footnote foreclosed the District Court's "expansive reading" of the Supreme Court's comity precedents.

In accepting this case for review, the Court undertook to

resolve the conflict among federal circuits in which the holding of the Sixth Circuit was consistent with holdings of the First, Seventh, and Ninth Circuits,[2] but contrary to the opposite conclusion reached by the Fourth Circuit.[3]

In the Court's view the footnote in *Hibbs* should not have been read so expansively. "[T]he two cases differ markedly in ways bearing on the comity calculus. We have had no prior occasion to consider, under the comity doctrine, a taxpayer's complaint about allegedly discriminatory state taxation framed as a request to increase a competitor's tax burden. Now squarely presented with the question, we hold that comity precludes the exercise of original federal court jurisdictions in cases of the kind presented here."[4]

In an effort to give its *Hibbs* footnote its appropriate meaning; the opinion makes clear that the Court did not intend the footnote to mean that it had diminished the force of the comity doctrine. "In context, we clarify the *Hibbs* footnote comment on comity is most sensibly read to affirm that, just as the case was a poor fit under the TIA, so it was a poor fit for comity. The Court, in other words, did not deploy the footnote to recast the comity doctrine; it intended the note to convey only that the Establishment Clause-grounded case cleared both the TIA and comity hurdles."[5]

In that the Court concluded that dismissal of the federal court action was justified by application of the comity doctrine, the Court observed that there was no need for it to decide whether application of the TIA would block the suit.

The Concurring Opinions

Justice Kennedy concurred while observing that the Court's rationale in *Hibbs* remained doubtful to him. Justice Thomas, joined by Justice Scalia, believes that the proper course would have been to dismiss this suit under the TIA without reaching the comity principles which independently support the same result. In his concurrence in judgment, Justice Alito expresses his doubt about the Court's efforts to distinguish *Hibbs*.

---

[1] *Levin v. Commerce Energy, Inc.*, 130 S. Ct. 2323, 176 L. Ed. 2d 1131 (2010).

[2] *Coors Brewing Co. v. Mendez-Torres*, 562 F.3d 3 (1st Cir. 2009) (abrogated by, Levin v. Commerce Energy, Inc., 130 S. Ct. 2323, 176 L. Ed. 2d 1131 (2010)); *Levy v. Pappas*, 510 F.3d 755 (7th Cir. 2007); and *Wilbur v. Locke*, 423 F.3d 1101 (9th Cir. 2005).

[3] *DIRECTV, Inc. v. Tolson*, 513 F.3d 119, 4th Cir. (2008).

[4] *Levin v. Commerce Energy, Inc.*, 130 S. Ct. 2323, 176 L. Ed. 2d 1131 (2010).

[5] *Levin v. Commerce Energy, Inc.*, 130 S. Ct. 2323, 176 L. Ed. 2d 1131 (2010).

§ 7:11 *Hibbs* revisited—Private taxpayer/citizens held not to have Article III standing to bring suit in federal court alleging an Establishment Clause challenge to a state income tax credit *[New]*

In the Commentary at the end of § 7:9 discussing a previous iteration of this case in *Hibbs*,[1] this author observed that "a case is not over until it is over, since it remains to be seen whether the federal courts will read the Establishment Clause in the context of this tax credit[2] as narrowly as did the majority in the Arizona Supreme Court." Now that the Court has decided *Arizona Christian*, we may not ever know the answer to that question.[3]

History

Arizona taxpayers first brought suit in State court challenging the tax credit statute under the U.S. and Arizona Constitutions. The Arizona Supreme Court rejected taxpayers' claims on the merits.[4] This suit was then filed in U.S. District Court in Arizona under a claim of a violation of the Establishment Clause alleging that the challenged statute allowed STOs to use State income tax revenues to pay tuition for students at religious schools, some of which were alleged to discriminate on the basis of religion in selecting students. The suit was dismissed as barred by the Tax Injunction Act (TIA) (28 U.S.C.A. § 1341). On appeal, the Supreme Court affirmed the Court of Appeals which had reversed the District Court and held that suit was not barred by the TIA. The District Court, on remand, dismissed the suit for failure to state a cause of action. Again the Court of Appeals reversed and held that the plaintiffs had standing under *Flast v. Cohen*, and that the plaintiffs had stated a claim that the tax credit statute violated the Establishment Clause.[5] The Court of Appeals denied *en banc* review and the Supreme Court granted certiorari, and after hearing reversed, declaring that the plaintiffs lacked standing to bring this suit.[6]

Holding

Until this case was decided, it seemed to be settled law that private citizens had standing to challenge tax legisla-

tion alleged to violate the Establishment Clause. While, as the majority pointed out, paying taxes does not generally give an individual Article III standing to challenge government action, this case was about the exception to the rule which, as said by Justice Kagan in her dissent,[7] was established decades ago in *Flast v. Cohen*,[8] and followed consistently case after case thereafter. As Justice Kagan observed, "Not every suit has succeeded on the merits, or should have. But every taxpayer-plaintiff has had her day in court to contest the government's financing of religious activity." That is, of course, until the decision in this case was announced.

Justice Kagan went on to observe that "[t]oday, the Court breaks from this precedent by refusing to hear taxpayers' claims that the [Arizona] government has unconstitutionally subsidized religion through its taxing system."[9]

Under *Flast* the plaintiff can establish a two-part nexus between the status of being a taxpayer and the tax claim sought to be adjudicated. As set out by Justice Kagan, the Court in *Flast* held:

> First, by challenging legislative action taken under the taxing and spending clause, the taxpayer shows "a logical link between [her] status and the type of . . . enactment attacked." Second, by invoking the Establishment Clause—a specific limitation on the legislature's taxing and spending power—the taxpayer demonstrates "a nexus between [her] status and the precise nature of the constitutional infringement alleged." Because of these connections, Flast held, taxpayers alleging that the government is using tax proceeds to aid religion have "the necessary stake . . . in the outcome of the litigation to satisfy Article III." They are "proper and appropriate part[ies]"—indeed, often the only possible parties—to seek judicial enforcement of the Constitution's guarantee of religious neutrality.[10]

How, one might ask, does the majority reach the conclusion that the taxpayer/plaintiff here lacked standing under the *Flast* rule? Justice Kagan answers the question thusly,

> The majority reaches a contrary decision by distinguishing between two methods of financing religion: A taxpayer has standing to challenge state subsidies to religion, the Court announces, when the mechanism used is an appropriation, but not when the mechanism is a targeted tax break, otherwise called a "tax expenditure." In the former case, but not in the latter, the Court declares, the taxpayer suffers cognizable injury.[11]