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MEMORANDUM

TO: Revenue and Transportation Interim Committee
 FROM: David R. Stewart, Deputy Chief Legal Counsel *DRS*
 DATE: June 12, 2017
 SUBJECT: Department of Revenue Major Case Update

MONTANA SUPREME COURT

Alpine Aviation: Alpine Aviation has been centrally assessed by the Department as a “regularly scheduled airline” as defined in federal law. The Department asked the District Court to determine the meaning of “scheduled airline” and “scheduled air commerce” for Montana property tax purposes. The Court ruled that “regularly scheduled flights” are those flights which follow a pattern, but are not necessarily uniform intervals according to timetables and locations predefined by the carrier, and which fly regardless of whether there are passengers or freight carried. The Montana Supreme Court agreed. The Court also indicated that *who* sets the schedule is a key element. Alpine scheduled the flights; the customer did not.

Richland Aviation: Richland filed a declaratory judgment action in the 7th Judicial District Court, Richland County, challenging the Department’s classification of Richland’s property for tax year 2015 as subject to central assessment. Richland argued that it is not a “scheduled airline” as that term is used and understood in Montana law. The District Court agreed with Richland, ruling that a “scheduled’ airline must hold itself out to the public (typically by publishing flight schedules) that it operates between designated points regularly.” The Montana Supreme Court upheld the District Court’s decision, stating that Richland does not engage in “regularly scheduled flights” because – taking language from *Alpine* – in this case the customer sets the schedule, not Richland.

Legislative Action Affecting *Alpine* and *Richland*

The 65th Legislature passed SB 180 clarifying the term “regularly scheduled flight” to mean “a flight or aircraft taking off or landing in the state of Montana with a maximum takeoff weight of more than 19,000 pounds.” SB 180 (§ 15-23-401(8), MCA). Aircraft with

a takeoff weight of 19,000 pounds or less are not subject to central assessment. SB 180 (§ 15-23-403(3), MCA). Therefore, this legislative change further narrowly defined which airlines and aircraft are subject to central assessment and which are subject to local assessment.

FEDERAL DISTRICT COURT

LL, Liquor, Inc., v. State of Montana, et al.: During the 2015 Legislative Session, the Legislature passed Senate Bill No. 193, which changed the complicated three-piece commission rates received by the agency liquor stores to a single percentage rate based on sales. The commission rate percentages range from 12.15% commission for stores that purchase more than \$7,000,000 worth of liquor, to 16% commission for stores that purchase no more than \$250,000 worth of product. It has been reported that this amendment to the commission rates will result in a revenue increase for 90 of the 96 agency liquor stores. One of the remaining six stores, LL Liquor, located in Lolo, Montana, has sued the State arguing that the State breached the contract with LL Liquor, and deprives LL Liquor of its property and contractual rights without due process of law, a constitutional violation. LL Liquor sought a preliminary injunction to stop implementation of the law, which was denied by the District Court. The 9th Circuit Court of Appeals agreed with the federal District Court that preliminary injunction is unwarranted, because no substantial impairment existed. The Court held that the alteration to the contract was not beyond reasonable expectation because LL Liquor was aware of the contractual terms that the legislature could change the terms of the contract with respect to price. On remand, both parties filed motions for summary judgment and oral argument was heard on April 21, 2017. Judge Haddon granted the State's motion for summary judgment on all counts on April 25, 2017. LL Liquor has appealed the April 25, 2017 decision to the 9th Circuit. The parties will begin briefing soon.

STATE DISTRICT COURT

Hiland Crude, LLC: Hiland filed a declaratory judgment action in the 1st Judicial District Court challenging the Department's classification of Hiland's property for tax year 2014 as a pipeline carrier and, therefore, subject to central assessment. Both parties filed motions for summary judgment and the Court heard oral argument on February 23, 2017. The Department is awaiting a decision on the motion for summary judgment.

Kohoutek, et al.: Agency liquor store owners sought class certification and challenged the constitutionality of certain statutes. Specifically, agency liquor store owners alleged that § 16-2-101(2)(b)(ii)(B), MCA, is unconstitutional because it fails to fully compensate some liquor store owners for the mandatory 8% discount for unbroken case lot sales to licensees required by § 16-2-201, MCA. Plaintiffs filed in the 8th Judicial District Court, Cascade County. The Court bifurcated the issues (constitutionality and damages). On

May 28, 2015, the Court determined that the statute violated the Plaintiffs' rights to substantive due process and to equal protection of the law because the State has continued to use 1994 sales information to reimburse agency liquor stores for the mandatory case lot discounts.

On February 4 and 5, 2016, a bench trial was held addressing the damages phase. The District Court awarded \$14,722,297 in damages after concluding that the weighted average discount ratio statute became unconstitutional on July 1, 1998. A hearing on attorneys' fees and interest was held December 2, 2016, and awarded Plaintiffs' counsel \$8,718,803.88. The Court entered a judgment against the State on January 6, 2017, wherein the plaintiffs were awarded a total of \$26,156,411.65. The Court stayed execution of the Judgment pending appeal. The Department appealed to the Montana Supreme Court and briefing in front of the Supreme Court is currently in progress.

Lake County: On July 17, 1985, the Federal Energy Regulatory Commission (FERC) issued an *Order Approving Settlement and Issuing License* regarding the Kerr Project. The Order approved a settlement between the Confederated Salish Kootenai Tribes (CSKT) and the Montana Power Company (MPC) that included resolution of disputes over payments MPC made to CSKT for the use and occupancy of its lands and competing FERC license applications made by MPC and the CSKT. Under the Settlement, a 50-year license would jointly issue to MPC and the CSKT. The License provided that MPC would operate the project for 30 years, and then the CSKT could purchase the Project between the 30th and 40th years of the License under certain conditions outlined in the Settlement. Successors to MPC for the Kerr Project were PPL and NWE. The CSKT purchased the Kerr Dam from NWE on September 5, 2015. The FERC approved changing the name of the Kerr Project to Séliš Ksanka Qlispé (SKQ). The taxable value the Department apportioned to NWE for Kerr Dam for tax year 2015 was \$3.5 million.

The SKQ Property is located within the exterior boundaries of the Flathead Indian Reservation. The Department determined that because the property is tribal trust land and tribal improvements on tribal trust land owned by the CSKT, the property is no longer subject to taxation. Lake County filed a Writ of Mandamus on August 29, 2016, in the 20th Judicial District Court, challenging the Department's determination that (SKQ) Property is exempt from taxation under federal Indian law. Lake County claims the SKQ Property is taxable under state law and the NWE/Confederated Salish & Kootenai Tribes (CSKT) Deed. Lake County also claims it was not allowed to participate in the Department's decision-making process regarding the taxability of the SKQ Property.

On January 23, 2017, the District Court concluded that the BIA's August 16, 2016, determination that the underlying land is in trust status is "dispositive", and as a result, the Court does not have jurisdiction to review the Department's tax decision regarding the

SKQ Property located on tribal trust land. The Court also concluded that: 1) a writ is not available to undo a Department action that has already been done; and 2) although the Department does not have a clear legal duty to conduct the fact specific evaluation of the SKQ Property advocated by Lake County or to solicit additional input from Lake County, according to Lake County's admission, it was clear that the Department allowed Lake County to participate in the decision-making process regarding the taxability of the SKQ Property. Lake County did not appeal the decision.

Omimex Canada, Ltd.: At issue is the Department's decision to classify Omimex's Montana property as a pipeline carrier and, therefore, subject to central assessment. The parties have agreed to consolidate the declaratory judgment actions for tax years 2011 and 2012, filed in the 2nd Judicial District, Silver Bow County, with the declaratory judgment actions for tax years 2013, 2014, and 2015 filed in the First Judicial District, and to transfer venue for all years to the First Judicial District Court, Lewis and Clark County. Judge Reynolds has assumed jurisdiction over all five pending tax years. Trial is scheduled for May 2017. Omimex filed for partial summary judgment on November 5, 2015, in the consolidated 2011-2015 matters. Omimex asks the Court to determine the meaning of "pipeline carrier" and whether Omimex meets that definition. On March 16, 2017, the District Court held that the Omimex is subject to central assessment as a "pipeline carrier" for taxation purposes, but has asked the parties for further briefing as to additional remaining issues.

Solem: The Solems filed a motion for class certification in the 11th Judicial District Court, Flathead County, challenging their land value, primarily arguing that the water influence used by the Department leads to improperly inflated values. The District Court recently granted class certification. The class certified is "all lakefront property owners in Neighborhood 800 who have timely paid under protest any portion of their property taxes since the last assessment cycle beginning in 2009." Neighborhood 800 is the Somers/Lakeside area in which the Solem's property is located. Between 2009 and 2015, approximately 200 taxpayers in Neighborhood 800 paid property taxes under protest. The matter is moving forward in the District Court and the parties are engaged in discovery.

VisionNet: In July, VisionNet appealed the Department's 2015 assessment to the Montana Tax Appeal Board. Generally, VisionNet alleges the Department's classification of VisionNet is improper. VisionNet also contests its market value assessment as improperly including intangible personal property and use of improper capitalization rates. VisionNet has filed a declaratory judgment action before the First Judicial District Court. The Department filed an answer to the complaint on May 18, 2016, and discovery is proceeding. A four-day bench trial is set for October 10, 2017.

MONTANA TAX APPEAL BOARD

Blixseth: The Department is pursuing Tim Blixseth's tax debt. On March 20, 2015, the Department received final judgment against Mr. Blixseth before the Montana Tax Appeal Board on Mr. Blixseth's appeal of the Department's audit and assessment. Mr. Blixseth did not appeal any of the orders issued by the Montana Tax Appeal Board. Consequently, the Department has billed Mr. Blixseth in the approximate amount of \$74.4 million, and will begin pursuing Mr. Blixseth for collection. Dismissal of the involuntary bankruptcy petition remains on appeal before the United States District Court for the District of Nevada, where the matter is fully briefed. The Department has advised the United States District Court of the MTAB rulings, and the Department awaits a decision.

CHS: The 2014 and 2015 disputes center on the market value of the Laurel Refinery. For the 2014 tax year, the company requested a market value of \$200 million, and the Department valued the refinery at \$848 million. Yellowstone CTAB determined a market value of \$510 million, and CHS and the Department each appealed that decision to the Montana Tax Appeal Board. Shortly after the parties initiated appeals before the Board and had agreed upon a January 2017 trial date, CHS filed a petition for interlocutory adjudication with the 13th Judicial District Court. The District Court dismissed CHS's petition on May 6, 2016. Respecting the 2015 tax year, the Yellowstone CTAB affirmed the Department's value (\$820 million), and CHS appealed that decision to the Montana Tax Appeal Board on May 12, 2016. That case is currently in discovery and trial is scheduled for the week of November 6, 2017.

NaturEner: NaturEner has filed with the Montana Tax Appeal Board six separate appeals of the Department's 2015 and 2016 assessments. At issue is the Department's valuation of NaturEner's three windfarms: Glacier Wind Energy 1, LLC, Glacier Wind Energy 2, LLC, and Rim Rock Wind Energy, LLC. NaturEner has filed petitions for interlocutory adjudication and declaratory judgment with the First Judicial District Court on the meaning of the term "economic obsolescence" as it is used in § 15-8-111, MCA. The Department filed answers to the petitions on March 7, 2017. The district court matters are consolidated under cause number BDV-2017-68. The First Judicial District Court issued its scheduling order on April 21, 2017. The parties are currently engaged in discovery.

Phillips 66, LLC (Phillips): Phillips appealed its 2016 valuation to the Montana Tax Appeal Board. Phillips mainly takes issue with the Department's capitalization rate and deduction for intangible personal property. The parties are currently engaged in discovery. Trial is currently scheduled for the week of February 5, 2018.

Plains Pipeline: Plains Pipeline has appealed the Department's centrally assessed valuation of their Montana property to the Montana Tax Appeal Board. Plains Pipeline has also made allegations challenging classification. A weeklong trial before the Board is set for December 11, 2017.

Rocky Mountain Pipeline: Rocky Mountain Pipeline has appealed the Department's centrally assessed valuation of their property located in Montana to the Montana Tax Appeal Board. This matter is currently stayed pending a final decision in the Plains Pipeline matter.

SETTLEMENTS

AT&T: AT&T appealed its 2016 valuation. AT&T mainly takes issue with the Department's deduction for intangible personal property and its weighting under the cost approach. An initial scheduling conference was held August 24, 2016, and both parties expressed interest in mediation. Mediation was successful between the parties and AT&T's taxable value for 2016 was set at \$107,000,000.