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U.S. Supreme Court

For nearly 70 years, the Tax Injunction Act (TIA) barred federal district courts from hearing most state tax cases. In 2004, the U.S. Supreme Court ruled, in *Hibbs v. Winn*, that the act applied only to those cases that would disrupt the flow of state tax revenues. Following *Hibbs*, the states began to argue for another barrier to the federal forum—the doctrine of ''comity.'' A form of legal reciprocity, comity is the central issue in *Levin v. Commerce Energy*, in which several out-of-state natural gas suppliers charge that Ohio's taxing scheme discriminates in favor of in-state suppliers. In this article, authors Charolette Noel and Bryan D. Lammon, of Jones Day, trace the evolution of the comity doctrine and discuss the U.S. Supreme Court's likely options for refining its scope.

Will U.S. Supreme Court, in *Levin v. Commerce Energy*, Expand or Restrict State Taxpayers' Access to Federal Forum?

BY CHAROLETTE NOEL AND BRYAN D. LAMMON

INTRODUCTION

Plaintiffs have long faced an uphill battle when trying to challenge a state tax in a federal forum. For more than 70 years, the jurisdictional bar imposed by the Tax Injunction Act (TIA) has prohibited federal district court suits that would ''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.''[1] While the TIA bars federal courts from hearing most state tax cases, its plain language bars only certain prohibited actions where the claimant otherwise has an adequate state remedy.

In *Hibbs v. Winn*,[2] the U.S. Supreme Court ruled that the federal courthouse doors are open to certain suits involving state taxes. According to the *Hibbs* court, the TIA bars only those ''cases in which state taxpayers

[1] 28 U.S.C. §1341.
[2] 542 U.S. 88 (2004).

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seek federal-court orders enabling them to avoid paying state taxes.''[3] Post-*Hibbs*, state taxpayers had a renewed hope for broader access to a federal forum. But state taxpayers were soon faced with another hurdle: even if a case was not barred by the TIA, a federal court might refuse to hear it under the ''doctrine of comity.''

''Comity,'' as further described below, is a type of legal reciprocity whereby one jurisdiction (*e.g.*, the federal government) extends certain courtesies to other jurisdictions (*e.g.*, the states) by recognizing the validity and effect of their executive, legislative, and judicial acts. In order to avoid requested litigation and the need to answer unnecessary constitutional questions, federal courts may exercise discretion to abstain from state tax cases requiring interpretation of state law if state courts have jurisdiction to decide the matter.

After *Hibbs* narrowed the reach of the TIA, a circuit split soon developed over the extent of comity's reach. This term, the U.S. Supreme Court is expected to resolve this circuit split in *Levin v. Commerce Energy*.[4]

This article discusses the federal court jurisdiction to hear state tax cases, historical application of notions of comity in cases seeking equitable remedies to enjoin collection of state taxes, and the evolution of cases invoking comity after enactment of the TIA. In light of this evolution, this article suggests options that the Supreme Court may consider for refining comity's scope, particularly when addressing matters of federal constitutional concern.

FEDERAL DISTRICT COURT JURISDICTION

Federal courts are courts of limited jurisdiction that are able to decide only cases involving certain subject matter, such as ''federal questions,'' claims against the federal government, and ''diversity claims'' involving parties from different states with amounts in controversy exceeding $75,000. Article III of the U.S. Constitution allows Congress to create federal courts to hear ''cases, *in law and equity*, arising under th[e] Constitution, the laws of the United States, and Treaties made, or which shall be made, under their Authority.''[5] Congress passed legislation granting federal district courts original jurisdiction in all civil actions arising under the Constitution or federal statutes.[6] Generally, federal courts are obliged to exercise their statutory jurisdiction.

Where equitable remedies, as opposed to legal remedies, are sought to enjoin collection of state taxes on the basis of constitutional challenges, the doctrine of equitable restraint has been of ''notable application.''[7] Because a federal court's decision to grant an injunction or other equitable relief is discretionary, the court may decline to grant equitable relief when the circumstances warrant. If a taxpayer seeks only legal remedies or common law damages, as opposed to equitable remedies under federal law, less justification for abstention exists.[8]

Pre-Tax Injunction Act

Prior to enactment of the TIA, courts often declined to grant equitable relief in state tax cases under the general principle of equitable restraint. Equitable restraint requires federal courts to refrain from granting equitable relief when the plaintiff has a plain and adequate remedy at law, such that the plaintiff must show exceptional circumstances before invoking a court's equity jurisdiction.[9] Plaintiffs would need to show, for example, that equitable relief was necessary to avoid a multiplicity of suits or irreparable harm. In the state tax context, a taxpayer's ability to request refunds from the taxing authority is considered an adequate remedy generally precluding equitable relief in federal court.

In their earliest practices, federal courts declined to enjoin the collection of state taxes as a matter of judicial discretion. And to explain or reinforce this discretionary decision, federal courts often invoked notions of comity. Generally speaking, comity embodies federal courts' ''proper respect for state functions,'' instructing them to refrain from ''unduly interfer[ing] with the legitimate activities of the States.''[10] Under the doctrine of comity, where an independent tribunal has concurrent jurisdiction, federal courts are permitted to exercise judicial restraint to avoid collision of the concurrent authorities. Concerns over comity arise in many areas of the law.

The real basis for a federal court to decline to hear a state tax dispute was the traditional principle of equitable restraint, which comity merely buttressed.

State tax disputes in federal court generally raised two comity-related issues. First, in any case where a federal court enjoins the operation of a state government, friction might arise. Second, and unique to the state tax context, a federal injunction against the collection of taxes could place a state in a precarious fiscal position. States rely on taxes to provide public services, and any disruption in these services due to interruptions in the tax stream would ultimately harm the public.[11] Interests of comity thus amplify the importance of equitable restraint in state tax disputes.

Comity is not, however, a free-standing doctrine that allows courts to decline to hear a state tax dispute. While not a rule of law, comity has long been a principle of ''practice, convenience, and expediency'' that has ''substantial value in securing uniformity of decision, and discouraging repeated litigation of the same ques-

[3] *Id.* at 107.
[4] 554 F.3d 1094 (6th Cir. 2009), *oral argument* (U.S. March. 22, 2010) (No. 09-223).
[5] U.S. Const. art. III, §2 (emphasis added).
[6] 28 U.S.C. §1331 (amended in 1980 to eliminate the amount-in-controversy requirement).
[7] *See Fair Assessment in Real Estate Ass'n v. McNary*, 454 U.S. 100, 107–08 (1981).
[8] *See Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706 (1996); *but see Fair Assessment*, 454 U.S. 100.
[9] *Dows v. Chicago*, 78 U.S. 108, 112 (1870).
[10] *Younger v. Harris*, 401 U.S. 37, 44 (1971).
[11] *See Dows*, 78 U.S. 108, 110.

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tion.''[12] The real basis for a federal court to decline to hear a state tax dispute was the traditional principle of equitable restraint, which comity merely buttressed. Prior to the TIA, then, state tax disputes were kept out of federal court only by the traditional rules of equity.

Notwithstanding the principle of equitable restraint, federal courts still heard state tax disputes, and they sometimes enjoined state tax collection.[13] This situation stemmed primarily from the particularities of federal equity practice, which allowed several exceptions to the general rule of restraint. For example, the ''adequate legal remedy'' that would preclude equitable relief had to be available in federal (as opposed to state) court. The Eleventh Amendment sometimes barred refund suits against states from proceeding in federal court, so with no other adequate legal remedy available in federal court, state taxpayers could avoid the principle of equitable restraint.[14] Federal courts also strictly construed the requirement that a legal remedy be ''plain, adequate, and complete,'' frequently concluding that state remedies did not suffice.[15] Even if an individual taxpayer had an adequate remedy at law, equitable restraint could be avoided if the relief would prevent a multiplicity of suits.[16] For these reasons and others, federal courts heard state tax cases and sometimes enjoined state tax collection, despite the principle of equitable restraint and notions of comity.

Frequent decisions limiting equitable restraint created two major problems. First, it created a disparity in the relief available to in-state and out-of-state taxpayers, because states often forbade their own courts to enjoin the collection of taxes from domestic taxpayers. In-state taxpayers who had no basis for invoking federal jurisdiction were thus required to pay taxes under protest and then seek a refund. But out-of-state taxpayers, often corporations, could invoke federal court diversity jurisdiction. If they could get past the principle of equitable restraint, out-of-state taxpayers could potentially obtain an injunction, relief unavailable to their in-state counterparts.

Second, federal injunctions against the collection of state taxation threatened states' revenue streams. Because in-state taxpayers had to pay first and then sue for a refund, states received a relatively stable stream of revenue from them. In contrast, out-of-state taxpayers were able to tie up substantial amounts of tax revenue in federal proceedings, thus disrupting state and local finances. Desperate states were often forced to settle tax bills for fractions of what they thought was owed to them.

After the Tax Injunction Act

In response to these inequities, Congress passed the Act of Aug. 21, 1937,[17] more commonly known as ''the Tax Injunction Act.'' As amended, the TIA declares that ''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.''[18] On its face, the TIA is somewhat limited, barring only certain types of relief, and then only when a ''plain, speedy and efficient remedy'' is available in state court. But over the years, the TIA has blossomed into a more general bar on federal court interference with most aspects of state tax administration. For example, the U.S. Supreme Court has interpreted the TIA as barring declaratory judgments, even though such judgments are not mentioned in the TIA.[19] The court has also interpreted the ''plain, speedy and efficient remedy'' exception to the TIA's prohibition as ordering the states to satisfy only procedural (as opposed to substantive) requirements.[20] The *Rosewell* court noted, ''Nowhere in the TIA did Congress suggest that the remedy must be the speediest.'' Nevertheless, some courts occasionally find that there *is* no ''plain, speedy and efficient'' remedy in the state court.

The TIA quickly became the focus of any effort to bring a suit in—or get a suit out of—federal court. But comity still cropped up from time to time. For instance, shortly after the TIA's passage, the U.S. Supreme Court declined to decide whether the TIA barred a federal court from issuing a declaratory judgment in a state tax dispute.[21] The court found resolution of that issue unnecessary and instead looked to the pre-TIA practice of equitable restraint. As discussed above, federal courts had the discretion to refrain from granting equitable relief such as a declaratory judgment. Accordingly, the principle of equitable restraint, reinforced with notions of comity, was enough to keep suits for a declaratory judgment out of federal court. It was not until almost 40 years later that the court finally held that the TIA itself barred granting declaratory judgments.[22]

Over the years, the TIA has blossomed into a more general bar on federal court interference with most aspects of state tax administration.

Comity similarly expanded beyond its initial formulation as a reason for exercising equitable restraint into what appeared to be a free-standing doctrine barring federal jurisdiction in virtually all state tax disputes. This progression is exemplified in the Supreme Court's 1981 decision in *Fair Assessment*. The taxpayers in *Fair Assessment* sought damages under §1983 for allegedly unconstitutional property taxes. Such a suit was not mentioned in the TIA, and equitable restraint had no applicability to a legal remedy such as damages.

Nevertheless, a sharply divided Court held that principles of comity barred §1983 actions seeking damages

[12] *See Mast, Foos & Co. v. Stover Manufacturing Co.*, 177 U.S. 485, 488 (1900).

[13] *See Fair Assessment*, 454 U.S. at 129 (Brennan, J., concurring in the judgment).

[14] *See, e.g., City Bank Farmers' Trust Co. v. Schnader*, 291 U.S. 24, 29 (1934).

[15] *Hopkins v. S. Cal. Tel. Co.*, 275 U.S. 393, 399–400 (1928).

[16] *Gramling v. Maxwell*, 52 F.2d 256, 260–01 (W.D.N.C. 1931).

[17] Pub. L. No. 75-332, 50 Stat. 738 (codified as amended at 28 U.S.C. §1341).

[18] 28 U.S.C. §1341.

[19] *See California v. Grace Brethren Church,* 457 U.S. 393, 407-11 (1982).

[20] *Rosewell v. LaSalle Natl. Bank,* 450 U.S. 503, 512 (1981).

[21] *See Great Lakes Dredge & Dock Co. v. Huffman,* 319 U.S. 293 (1943).

[22] *California v. Grace Brethren Church,* 457 U.S. 393.]

for unconstitutional state taxes. The majority invoked several broad statements on comity from its pre-TIA opinions, noting ''the important and sensitive nature of state tax systems and the need for federal-court restraint when deciding cases that affect such systems.''[23] The court also suggested that the TIA reflected Congress's belief ''that the autonomy and fiscal stability of the states survive best when state tax systems are not subject to scrutiny in federal courts.''[24] The majority thus envisioned comity as ''the scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts.''[25]

Having found damages suits to be antithetical to this principle, as they would halt the operation of a state tax and generally disrupt state tax administration, the majority therefore held that such suits were barred by the doctrine of comity. In dissent, Justice Brennan sharply criticized the majority for expanding comity—a notion that had previously only informed a federal court's discretion over the granting of equitable relief—into a jurisdictional bar. According to Justice Brennan, Congress had given federal courts jurisdiction over damages suits under §1983, and courts had no authority to reject this properly conferred jurisdiction due to concerns over comity.[26]

HIBBS' NARROWING OF THE TIA AND THE RESURGENCE OF COMITY

With the expansion of the TIA's reach and courts' evoking broad notions of comity like those in *Fair Assessment*, it seemed that there was virtually no way for state taxpayers to challenge the constitutionality of a tax in federal court. In 2004, however, the U.S. Supreme Court narrowed the scope of the TIA to permit a limited class of state tax cases in federal court. In *Hibbs v. Winn*, several Arizona taxpayers challenged the constitutionality of tax credits for payments to organizations that provide scholarship grants to children attending private schools. The taxpayers asserted that this credit violated the Establishment Clause because the organizations could direct funds to children of a particular religious denomination. The court held that the TIA did not bar the taxpayers' suit, as the TIA barred only suits in which taxpayers sought to avoid paying their own taxes. If the tax credits at issue in *Hibbs* were enjoined, state tax revenues would actually increase.

This slight narrowing of the TIA renewed interest in the independent power of comity to bar state tax disputes.

Hibbs thus seemed to offer new hope to state taxpayers trying to get into federal court: so long as a suit would not interfere with the collection of taxes, the TIA was not a bar. But this slight narrowing of the TIA renewed interest in the independent power of comity to bar state tax disputes. *Hibbs* left comity relatively untouched, as the opinions were nearly silent on the topic. Justice Ginsburg's opinion for the court addressed comity only in a footnote, noting ''that [the] Court has relied upon 'principles of comity' to preclude original federal-court jurisdiction only when plaintiffs have sought district-court aid in order to arrest or countermand state tax collection.''[27] Justice Stevens' concurrence did not mention comity, and Justice Kennedy's dissent made only one brief mention of it.

Post-*Hibbs*, states soon argued that comity, as broadly defined in *Fair Assessment*, stood as an independent bar to suits that survived the TIA. Taxpayers retorted that comity, like the TIA, barred only suits that would interfere with the collection of state taxes. Courts quickly split over the issue. On one side, the Seventh and Ninth Circuits sided with the taxpayers, holding that comity applied only when a case would tie up state tax revenue.[28] According to these courts, *Hibbs* did not overrule *Fair Assessment* and its broader notions of comity. However, *Hibbs* did limit comity's reach. In contrast, the Fourth Circuit held that *Hibbs* left comity untouched so that comity could bar a suit that seeks to force increased tax collection.[29]

The Sixth Circuit took a more nuanced approach to the issue in *Commerce Energy Inc. v. Levin*.[30] In *Commerce Energy*, several out-of-state natural gas suppliers challenged Ohio's taxing scheme, alleging that it discriminated against them in favor of in-state natural gas suppliers. The Sixth Circuit held that comity did not bar the suit. But in defining comity's scope, the court noted that the decision to hear a state tax dispute could not be resolved ''with abstract generalizations about nontextual constitutional principles of comity and federalism.''[31] Thus, while the court rejected a broad reading of comity that would ''bar from federal court nearly every state-tax challenge,'' it was unwilling to adopt any bright-line rules about comity's applicability. The Sixth Circuit instead focused on ''the degree to which the claims and relief requested would intrude upon a state's

[23] 454 U.S. at 102.
[24] *Id.* at 102–03.
[25] 454 U.S. at 116 (quotation marks and alteration omitted).
[26] The court later backed away from *Fair Assessment*'s broad application of comity in *National Private Truck Council Inc. v. Oklahoma Tax Comn. (NPTC)*. According to the *NPTC* court, *Fair Assessment* did not hold that comity deprived federal courts of jurisdiction over §1983 cases challenging the constitutionality of state taxes. Comity instead indicated that Congress would not have authorized a suit that would disrupt the collection of state taxes. According to the *NPTC* court, *Fair Assessment* was actually an interpretation of §1983. That is, the court had found nothing in §1983 to suggest that Congress intended to deviate from principles of comity, and thus it interpreted §1983 as not authorizing a suit for damages for unconstitutional taxes.

[27] 542 U.S. at 107, n.9 (citation omitted).
[28] *Levy v. Pappas*, 510 F.3d 755, 761–62 (7th Cir. 2007); *Wilbur v. Locke*, 423 F.3d 1101, 1110 (9th Cir. 2005). The First Circuit later joined the Sixth, Seventh, and Ninth Circuits. *See Coors Brewing Co. v. Méndez-Torres*, 562 F.3d 3 (1st Cir. 2009).
[29] *DirecTV Inc. v. Tolson*, 513 F.3d 119, 127–28 (4th Cir. 2008).
[30] 554 F.3d 1094 (6th Cir. 2009).
[31] 554 F.3d 1094, 1100.

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power to organize, conduct, and administer its tax system.''[32]

OPTIONS BEFORE THE COURT

The U.S. Supreme Court later granted Ohio's petition for *certiorari* and is expected to resolve the issue of comity's scope. The court is faced with several options. One extreme position would be to hold that comity bars most federal court interference with state tax administration. This position finds support in some of the court's broader statements on comity, particularly in *Fair Assessment*. But such a decision raises some very troubling questions of federal courts' authority to define their own jurisdiction. As Justice Brennan pointed out in his concurring opinion in *Fair Assessment*, Congress has sole responsibility for defining federal courts' jurisdiction, and it encroaches on this separation of powers when courts attempt to define their jurisdiction to reflect a court's views on proper federal-state relations. This position also provides a relatively undefined, and thus malleable, standard that courts could manipulate or abuse.

The other extreme would be to hold that, like the TIA, comity bars only suits that would disrupt the inflow of state taxes. This position benefits from the certainty of a bright-line rule and is also deeply rooted in comity's historical practice. As the court pointed out in *Hibbs*, comity has been invoked only when taxpayers seek to interfere with the collection of state taxes. But this rule also has its problems. For one, it would generally render the TIA and comity virtually coterminous, except for issues where the federal courts have first interpreted relevant federal statutory or constitutional law. Further, as noted by Justice Breyer during oral argument in *Levin v. Commerce Energy*, such a rule could be manipulated by taxpayers to gain access to federal court in virtually every case involving an alleged discriminatory state tax, simply by challenging another party's right to certain tax credits, deductions or exemptions, instead of claiming the right to a refund or seeking to enjoin a taxing authority's collection of such tax.

The other extreme would be to hold that, like the TIA, comity bars only suits that would disrupt the inflow of state taxes.

Another option would be some sort of middle ground that could provide a more refined rule. The court has, on several occasions, explained that suits addressing ''exceptional circumstances'' involving federal rights may fall outside the bar of comity, even if those cases restrict a state's collection of revenue. For example, in *Tully v. Griffin*,[33] the court explained that ''[a] federal district court is under an equitable duty to refrain from interfering with a State's collection of its revenue *except in cases where an asserted federal right might otherwise be lost.*''[34] In a similar vein, in *National Private Truck Council*, the court explained that ''extraordinary circumstances'' may exist to allow federal courts to grant injunctive or declaratory relief under §1983 when the ''enforcement of the tax would lead to a multiplicity of suits, or produce irreparable injury, [or] throw a cloud upon the title.''[35] During oral argument in *Levin v. Commerce Energy*, Justices Sotomayor and Ginsburg indicated that exceptional circumstances might include denial of fundamental rights or claims of discrimination based on a suspect classification such as race.

Regardless of its holding, it is hoped that the court will provide the needed guidance on the applicability of comity to state tax cases. The court's cases have created much confusion over comity, such as whether it is a jurisdictional bar or just a factor that influences judicial discretion. History indicates the latter. As Justice Story wrote in his early analysis of comity published in the Commentaries on the Conflict of Law:

> [C]omity is and ever must be, uncertain. That it must necessarily depend on a variety of circumstances, which cannot be reduced to any certain rule. That no nation will suffer the laws of another to interfere with her own to the injury of her citizens. That, whether they do or not, must depend on the condition of the country, in which the foreign law is sought to be enforced . . . . [36]

In light of its history and purpose, the doctrine of comity seems unlikely to be refined into a ''bright-line rule.'' Nevertheless, additional refinement is needed to identify the unusual circumstances, if any, where federal courts lose jurisdiction of federal questions.

[32] *Id.*

[33] 429 U.S. 68, 73 (1976).

[34] *Id.*(emphasis added).

[35] *National Private Truck Council Inc. v. Oklahoma Tax Comn.*, 515 U.S. 582, 591 n. 6 (1995).

[36] Joseph Story, *Commentaries on the Conflict of Laws*, §28 (1834).

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