No. 150, Orig.

In the Supreme Court of the United States

STATE OF ARIZONA,

Plaintiff,

v.

STATE OF CALIFORNIA,

Defendant.

ON MOTION FOR LEAVE TO FILE A BILL OF COMPLAINT

ARIZONA'S SUPPLEMENTAL BRIEF IN RESPONSE TO CVSG BRIEF

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The Solicitor General's opposition brief ("SG Brief") founders for substantially the same reasons as California's: extensive reliance on supposed factual complexity that does not actually exist. The SG Brief contends that it needs to be "fleshed out" whether California actually imposes Extraterritorial Assessments based purely on passive investments. SG Br.19. But California has repeatedly *admitted* that it does just that, in its *official* legal rulings no less. *See* Reply Br.1. And Arizona's complaint provides extensive documentary evidence that California's repeated admissions are true. Complaint Exs. D-R. This case therefore does not require a "more developed factual record." SG Br.18, 6. It simply requires *taking California at its word* as to what it is doing (and with confirmatory evidence). By refusing to do so, the SG Brief fails to provide a persuasive basis for denying leave.

More generally, the SG Brief evades critical questions, simply ducking what it cannot defend. While California at least attempted to argue that its actions were colorably constitutional, the SG Brief offers no such reassurance for the vast majority of Arizona's claims. Nonetheless, in the brief's view, Arizona must simply acquiesce in the violations of its sovereignty and borders until such time as some third-party benefactor steps forward to vindicate Arizona's sovereign, quasi-sovereign, and proprietary interests. The United States would never tolerate such powerlessness for its own interests, and this Court should not impose it on Arizona. Indeed, both *Wyoming v. Oklahoma*, 502 U.S. 437 (1992) and *Maryland v. Louisiana*, 451 U.S. 725 (1981) are directly to the contrary. Both cases

accepted jurisdiction over—and vindicated—strikingly similar original actions by states challenging unconstitutional policies of other states. And neither is persuasively distinguished here. A similar grant of leave is therefore warranted here.

I. ***Purported Need for Factual Development.*** The SG Brief's principal objection appears to be postulated factual complexity/ambiguity as to what California is actually doing, and thus purported need for additional factual development. *See* SG Br.6, 18-19. It argues that "the[] circumstances have not been fleshed out" as to if/how often California imposes Extraterritorial Assessments "based [purely] on some share of passive ownership" and that "resolution of any … claims … would benefit from a more developed factual record." *Id.* at 18-19. But that premise is belied by the pervasive conduct that California *admits* it has engaged in for more than a *decade*, which Arizona cited prominently. *See* Reply Br.1, 3-4; Br.7, 37.

California's official legal interpretations should have dispelled any doubt as to whether California is engaged in taxation based on purely passive investment. As early as 2008, California made clear that investment in a California-Operating LLC was alone sufficient to subject an out-of-state company to an Extraterritorial Assessment. *See* Complaint ¶43. The Board subsequently published Legal Ruling 2014-01, which remarkably admits *four times* that it imposes the very passive-investment-only taxation that Arizona challenges. Specifically, it states that:

- The "doing business" tax may be imposed on businesses that "*ha[ve] no activities or factor presence in California other than through its*

membership in [an] LLC[.]" Complaint Ex. A at 14 (Situation 3; Member F).

- To remove any conceivable doubt as to its pure investment-only taxing policy, the Board restated that dogma for *three additional examples* in virtually identical language. *Id.* at 16-18, 19-20 (Situations 4-6, Members H, J, & L). That expressly included a purely passive member of a manager-managed LLC. *Id.* at 17-18 (Member J).

One might have thought that after *Swart Enterprises, Inc. v. Franchise Tax Bd.*, 7 Cal. App. 5th 497, 510 (Ct. App. 2017) the Board would have backed away from passive-investment-only taxation. Instead, it doubled down. While begrudgingly recognizing an exception compelled by *Swart*, it limited the exception to *Swart*'s narrow facts (both material and immaterial). Complaint ¶47; Br.8-9, 23.

The Board subsequently released Legal Ruling 2018-01, which again tersely acknowledged the "narrow exception" of *Swart*, but nonetheless reiterated its position that "members of the LLC"—*i.e.*, all its investors, whether passive and active—"are themselves generally considered to be 'doing business' in California." Complaint Ex. C at 2. While amending some language of the prior legal ruling, it left unchanged its conclusion that *all four* examples in Legal Ruling 2014-01 cited above were properly subject to Extraterritorial Assessments, including one (Member J) where taxation was based solely on membership in a manager-managed LLC—*i.e.*, a paradigmatic example of purely passive

investment. *Id.* This remains the Board's official interpretation to this day.

Arizona's Complaint notably provides five specific examples where California imposed Extraterritorial Assessments based solely on purely passive investments in manager-managed LLCs. Complaint ¶¶67-118; Exs. D-R. California unpersuasively—and without citation—quibbled with *one* of them. BIO.24. But even if California were correct, Arizona's Complaint provides specific documentary evidence of at least four such passive-investment-only Extraterritorial Assessments by California, as well as reasonably extrapolating that there are likely *thousands* of others. Complaint ¶¶63-118; Exs. D-R. The SG Brief, however, is premised on looking past the existence of even one such passive-investment-only Extraterritorial Assessment. SG Br.19.

The SG Brief's factual-complexity assertions similarly ignore California's principal defense of its Extraterritorial Seizures: *i.e.*, its four-times-repeated contention that its Seizure Orders constitute only "voluntary" compliance. *See* Reply Br.4-5. But California's claim is as absurd as it is factually simple: moneys extracted by governments under explicit threats of penalties for non-compliance are manifestly not "voluntary." Reply Br.4-5. But while the "voluntary compliance" argument was central to California's opposition (BIO 29-30, 32), the SG Brief remarkably refuses to address it—despite its obvious factual simplicity and lack of merit.

The voluntariness of California's extraction of moneys under its offers-they-can't-refuse Seizure Orders is simply not a question that requires factual

development. This Court thus can and should resolve the pure questions of law raised by California's Extraterritorial Seizures, which squarely infringe on Arizona's sovereignty.

II. *Similarity to* Wyoming *and* Maryland. As explained previously, this case is strikingly similar to both *Wyoming* and *Maryland*. Br.16-17, Reply Br.8-11. The SG Brief's attempt to distinguish these two controlling precedents fails.

In particular, the SG Brief argues that Oklahoma's tax in *Wyoming* "directly affected Wyoming's ability to collect severance tax revenues" whereas "here, Arizona's allege injury is indirect." SG Br.12 (cleaned up). Not so. In *Wyoming*, Oklahoma imposed a mandate that Oklahoma power plants burn "at least 10% Oklahoma-mined coal." 502 U.S. at 440. That, in turn, affected Wyoming coal sales somewhat, which in turn diminished Wyoming's severance tax revenue very modestly. *Id.* at 447-51. Here, California directly taxes Arizona companies, which directly reduces their Arizona taxable income and thereby diminishes the income taxes that Arizona collects. There is no principled manner in which the revenue impact in *Wyoming* was somehow "direct" and but here is "indirect."

Indeed, if anything, the harm is more direct here. In *Wyoming*, Oklahoma mandated only that 10% of coal burned be Oklahoma-mined. Only market conditions determined whether that mandate actually led to less Wyoming coal being purchased/burned/mined. (For example, Oklahoma power plants could have burned 50% Wyoming coal both before and after the statute.) In stark contrast, once California extracts tax revenue from Arizona

companies, it leads inexorably—and without any intervening step or attenuation by markets—to a diminution of tax revenue collected by Arizona. Thus, to the extent that Arizona's injury is distinguishable from *Wyoming*, it is *more* direct.[1]

The SG Brief's attempt to distinguish *Maryland* also fails. While the brief focuses on the states' proprietary interests as purchasers of gas, this Court found that the states' *parens patriae* interests alone justified accepting jurisdiction. 451 U.S. at 737-39; Reply Br.9. The SG Brief further dismisses the estimated 13,333 Arizona business that have been illegally taxed as insufficient, and instead suggests that only the "millions of consumers in over 30 States" in *Maryland* could suffice. SG Br.14. Such thresholds, however, could only realistically be reached if there were multiple states on the left side of the "v." But this Court has exclusive jurisdiction over "all controversies between *two* or more States." 28 U.S.C. §1251(a) (emphasis added). And this Court regularly grants review of disputes with only one state on either side. *See*, *e.g.*, *Florida v. Georgia*, 574 U.S. 972 (2014); *Wyoming*, 502 U.S. at 441.

Contrary to the SG Brief's view, this Court in *Maryland* deemed sufficient that "a great many [of a state's] citizens … are faced with increased costs aggregating millions of dollars per year." 451 U.S. at

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[1] The SG Brief repeatedly (at 15, 16) argues that denial is appropriate because Arizona is not the "most natural plaintiff." But the same was true in *Wyoming* with the mining companies, and this Court accepted jurisdiction even though the companies' absence was for "reasons unknown." 502 U.S. at 451-52. In contrast, Arizona has explained—with a decade of supporting evidence—why taxpayer suits are unlikely to resolve these issues. Reply Br.10-12.

739. Arizona's Complaint squarely alleges as much. Complaint ¶65. The SG Brief's position ignores—and ultimately flouts—this standard that *Maryland* actually set forth.

The SG Brief further protests (at 16) that this Court's "'docket would be inundated'" if leave were granted here. *Wyoming* and *Maryland* demonstrate otherwise. In the 38 years since *Maryland* was decided, this appears to be the first original action in which a state has challenged a tax of another state as unconstitutional. One case every generation is not even a trickle, let alone a flood.

III. ***Seriousness and Dignity of Arizona's Claims.*** The SG brief correctly observes that "'the model case for invocation of this Court's original jurisdiction is a dispute between States of such seriousness that it would amount to *casus belli* if the States were fully sovereign." SG Br.8-9 (cleaned up) (citation omitted). But despite the acknowledged centrality of this standard, the SG Brief notably refuses to offer any analysis under it. And that standard makes this action a "model case" for accepting jurisdiction.

Arizona specifically argued that "[t]he federal government would *never* tolerate equivalent conduct by other nations—something California does not meaningfully dispute." Reply Br.7-8. The SG Brief notably does not dispute this point either. And for good reason: If China or Venezuela imposed an illegal head tax on all U.S. citizens of Chinese/Venezuelan descent and then enforced the tax by coercing U.S. banks into transferring U.S.-based deposits to them, the United States would hardly stand idly by. Instead it quite properly would

regard such conduct as a *casus belli* precipitating an international incident.

More generally, *Wyoming* and *Maryland* establish that Arizona's proprietary and quasi-sovereign injuries, respectively, justify acceptance of jurisdiction. Br.14-18; Reply Br.8-9; *supra* at 5-7.

The SG Brief also belittles Arizona sovereign interests while never actually disputing that California is "effectively treating Arizona's territory as its own in exercising its taxing and police powers." Br.17. That alone is sovereign injury *by definition*. The SG Brief instead contends (at 9-10) that "Arizona has not identified any case suggesting that one State's taxation of another State's residents violates that [sovereign] interest." But the fact that no state has ever previously violated the sovereignty of other states with its taxing powers so egregiously (*e.g.*, violating *all four Complete Auto* requirements) is hardly a reason to deny jurisdiction. Moreover, even if the SG Brief were correct, California's non-judicial, jurisdiction-less, and warrantless seizures *in Arizona* go far beyond mere out-of-state taxation into wholly distinct violations of Arizona's sovereignty and borders (which go unaddressed).

The brief further (at 10) disparages Arizona's interest in regulating in-state banks and protecting the deposits of its citizens by contending that "Arizona points to no regulation that it cannot enforce due to California's collection of its doing-business tax." But Arizona—like most or all states—unsurprisingly has laws *inter alia* prohibiting violations of its banking code and theft (bank or otherwise), A.R.S. §§6-132-33, 13-1802. And Arizona specifically prohibits theft by extortion, *id.* §13-

1804—which California's Seizure Orders effectively constitute if they are illegal (and they are, *see* Br.32-36, Reply Br.4-7). California's seizures thus directly interfere with Arizona enforcing these laws within its own sovereign territory. And protecting citizens' property is one of the core sovereign functions of any legitimate republican government. *See*, *e.g.*, U.S. Const. Amends. V, XIV.

The SG Brief also fails to address California's persistent pattern of encroachments upon the sovereignty of other states. Br.18-20. But where California has intruded upon the constitutional prerogatives of the federal government—such as by entering into its own agreements with foreign governments—the United States has been far less sanguine about the infringement of *its* sovereignty. *See*, *e.g.*, *United States v. California*, No. 19-2142 (filed E.D. Cal. Oct. 23, 2019).

IV. ***Availability of Alternative Fora.*** The SG Brief notably does not contend there is any other forum in which Arizona could file suit. SG Br.15-17. Nor does it dispute that there are no "assurances … that [Arizona's] interests under the Constitution will find a forum for appropriate hearing and *full relief*"—the absence of which caused this Court to hold jurisdiction "proper" in *Wyoming*. 502 U.S. at 452 (emphasis added). But the SG Brief nonetheless argues denial is appropriate here while pointing to *no relief whatsoever* that Arizona could obtain itself elsewhere.

Nor are individual taxpayer suits an acceptable alternative. Among other problems, they merely perpetuate the constitutional violations. Br.20-23;

Reply Br.10-13.[2] Simply put, if California cannot exercise personal/taxing jurisdiction over companies, it should not be able to seize their money and hold it as ransom to compel them to "voluntarily" appear in California courts. But the SG Brief remarkably blesses these compounded constitutional violations by contending that "regulated entities often challenge regulations in the courts of the State that has imposed them." SG Br.16. There is, however, no "regulated entity" exception to this Court's personal jurisdiction and taxation precedents (including *Shaffer v. Heitner*, 433 U.S. 186 (1977)). Nor should California courts be deemed "adequate alterative" fora if they cannot constitutionally exercise jurisdiction.

More generally, the SG Brief's reliance on California state courts as alternative fora defies compelling historical evidence cited by Arizona. The brief simply ignores Arizona's demonstration that a decade of—and likely over a million—Extraterritorial Assessments have failed to produce even a single precedential court decision addressing Arizona's claims. Reply Br.11-12. And there is no reason given (or extant) to be more optimistic about the next decade.

Again, the United States would *never* countenance a situation where its thousands-of-times-over injuries might perhaps be addressed indirectly by a third-party action sometime within the next decade (but probably not given the last

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[2] In addition, Arizona's "interests would not be directly represented" in such suits, which also supported accepting jurisdiction in *Wyoming*. 502 U.S. at 452.

decade). This Court should not inflict that intolerable position on Arizona.[3]

California courts have had over a decade to stop the flagrantly unconstitutional abuses identified by Arizona's Complaint. Arizona should not have to wait another decade or more to obtain resolution of its constitutional claims.

V. ***Constitutional Merits.*** Rather than defending the constitutionally indefensible, the SG Brief largely adopts a see-no-evil approach that refuses to engage with most of Arizona's merits arguments. The SG Brief, for example, will not even quarrel with California's astonishing and repeated contention that its Seizures Orders effectuate only "voluntary" compliance. Reply Br.4-5. And the few stray arguments the SG Brief actually advances are readily dispatched.

The SG Brief, for example, points (at 20-21) to IRS's similar (but actually less problematic) ability to levy assessments against domestic bank deposits. But the United States has *in rem* jurisdiction over all U.S.-based deposits and *in personam* jurisdiction over all U.S. residents. The same is manifestly not true for California, which unlike the United States has no sovereign authority within *Arizona*'s borders. *See* Br.33-36; Reply Br.6-7. The SG Brief's curious

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[3] The SG Brief also points (at 15) to "pending class actions." But it pointedly ignores Arizona's demonstration that taxpayer refund class-actions in California move *glacially*—failing to produce refunds even *a decade* after the constitutional violation has been definitively determined. Reply Br.12. And, notably, the first class-action cited has been pending for 3½ years and has not even advanced to a motion for class certification. *See Rasmussen Co. v. FTB*, No. 16-554150 (filed Cal. Super. Ct. Sep. 8 2016).

unwillingness to acknowledge this crucial distinction—which is *the crux* of Arizona's claims—renders its analogy unsound. Similarly, the SG Brief's suggestion that a "regulated entity" exception exists to the demands of due process/this Court's personal-jurisdiction precedents is patently flawed. *Supra* at 10. California cannot violate *Shaffer* and *Complete Auto* with impunity as long as the target happens to be a "regulated entity."

It is also worth noting that the SG Brief does not dispute that passive-investment Extraterritorial Assessments would violate the Due Process Clause under *Shaffer*. Reply Br.1-3. And they would similarly violate the *Complete Auto* nexus requirement. Reply Br.5. Nor does the SG Brief dispute "Arizona's demonstration that California does not provide *any* benefits to the targets of Extraterritorial Assessments." Reply Br.6.

Thus, if California engages in passive-investment-only taxation—and it *admits* that it does, *supra* at 1-4—this Court is presented with pervasive and patent constitutional violations for which there is no material factual complexity whatsoever. Indeed, the violations of due process under *Shaffer* and two of the *Complete Auto* Commerce-Clause requirements are both factually quite simple and effectively undefended.

VI. ***More Limited Grant.*** Even if the SG Brief were correct that this case presents factual complexity that militates against plenary review, the appropriate remedy would not be denial of leave entirely. Instead, this Court should simply grant leave and direct Arizona to file an amended complaint challenging California's Extraterritorial

Assessments and Seizures only insofar as California is taxing/seizing based solely on purely passive investment. California admits that it is doing as much, and Arizona's Complaint adds documentary proof. Such a narrowed complaint presents no factual complexity, and requires no meaningful factual development. And such taxation/seizures are flagrantly unconstitutional and flout Arizona's sovereignty.

Thus, at a bare minimum, this Court should permit Arizona to challenge California's admitted and official policy of imposing Extraterritorial Assessments and Seizures based purely on passive investment in California companies.

Respectfully submitted,

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