MICHAEL J. HOLZHEID, *et al.*,	*	IN THE
Plaintiffs,	*	CIRCUIT COURT
v.	*	FOR
COMPTROLLER OF MARYLAND,	*	BALTIMORE CITY
et al.,	*	
Defendants.	*	Case No. 24-C-15-005700
	*	

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PLAINTIFFS' REPLY IN SUPPORT OF THEIR MOTION FOR SUMMARY JUDGMENT AND OPPOSITION TO DEFENDANTS' CROSS-MOTION FOR SUMMARY JUDGMENT

INTRODUCTION

This case deals with the property rights of Plaintiffs to interest owed them by the State of Maryland after they were required to overpay taxes to the State in violation of their federal constitutional rights. In *Comptroller of the Treasury of Maryland v. Wynne*, 575 U.S. __, 135 S. Ct. 1787 (2015) ("*Wynne*"), the Supreme Court affirmed the decision of the Maryland Court of Appeals that Maryland's failure to give full credit to Maryland taxpayers for income tax paid to other states on out-of-state income violated the dormant Commerce Clause, U.S. Const. art. I, § 8, cl. 3.

In 2014, after both the Circuit Court for Howard County and the Maryland Court of Appeals had ruled in favor of the Wynne's claim that the Comptroller was violating the dormant Commerce Clause, *Wynne*, 431 Md. at 160, the

Maryland General Assembly passed the Budget Reconciliation and Financing Act of 2014 ("BRFA"), which purported to reduce all interest on *Wynne* refund claims to the average prime rate of interest during 2015, rather than the 13% rate normally applied to tax refunds pursuant to Md. Code Ann., Tax-Gen. § 13-604(b). *See* 2014 Md. Laws Ch. 464 § 16. In doing so, Defendants repeated their error of singling out those who engage in interstate commerce for less favorable treatment, thus compounding the damage to precisely those taxpayers that the State had already subjected to discrimination. Having already violated the dormant Commerce Clause of the Constitution, Defendants went further and, in violation of the Takings Clause, sought through BRFA to take away interest that had already accrued at the rate of 13% prior to the legislative enactment. After the Supreme Court's decision in *Wynne*, Defendants began to process refunds, but paid interest on those refunds at only 3%.

The defect in the tax code that led the Maryland courts and the Supreme Court to conclude in *Wynne* that the State of Maryland was violating the dormant Commerce Clause is the same defect that renders BRFA unconstitutional: the law discriminates on its face against persons who engage in interstate commerce. Thus, BRFA's application of a discriminatory interest rate to Plaintiffs' and the putative class's tax refunds violates the dormant Commerce Clause.

BRFA's application to refund claims pre-dating its effective date also violates the Takings Clause, which prohibits Maryland from taking property

without just compensation. U.S. Const. amend. V. There is no question, first, that the taxes paid by Plaintiffs and the putative class are property. In *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 39 (1990), the Supreme Court held that the exaction of a tax is a taking of property. Defendants nonetheless suggest that interest on a tax overpayment is not property protected by the Constitution. Defendants are simply wrong. *See Phillips v. Wash. Legal Found.*, 524 U.S. 156, 168, 172 (1998) ("[A]ny interest that *does* accrue attaches as a property right incident to the ownership of the underlying principal."); *see also Rosenberg v. Rosenberg*, 64 Md. App. 487, 503 (1985) (affirming holding that foregone interest on a loan constitutes marital property). The interest granted by state law accrued as a property right incident to the tax payment.

Maryland taxpayers' right to interest on a tax refund matures after a refund goes unpaid for 45 days. Md. Code Ann., Tax-Gen. § 13-603. Thus, those Plaintiffs and members of the putative class who filed claims more than 45 days before BRFA's effective date possessed property rights in the interest on their refunds – rights that could not be retroactively taken.

In defense of their actions, Defendants attempt to mislead the Court with arguments that boil down to "The King can do no wrong," any constitutional commandment to the contrary notwithstanding. For example, Defendants unqualifiedly state, "There is no common law or constitutional right to a refund of taxes." Defs.' Mem. Summ. J. at 3 ("Defs.' Mem."). In fact, when a tax violates

the dormant Commerce Clause and the State coerces taxpayers into paying, then challenging the tax, the Fourteenth Amendment to the Constitution *requires* the payment of a refund. *McKesson*, 496 U.S. at 32–38 & n.21 (tracing the unbroken line of cases to this effect). In *McKesson*, Florida violated the dormant Commerce Clause in the structure of its taxes, acknowledged that it had done so, but asserted that it had no obligation to provide refunds. The Supreme Court, after noting that the "exaction of a tax constitutes a deprivation of property," held that the Due Process Clause requires a meaningful remedy, such as a refund, when the tax is unlawful. *Id.* at 36, 38–39.[1]

Perhaps even more breathtaking, Defendants ignore binding precedent permitting Plaintiffs to bring their damages claims under 42 U.S.C. § 1983 against the Comptroller in his individual capacity, *Hafer v. Melo*, 502 U.S. 21, 23, 30–31 (1991), instead relying on arguments that would eliminate damages claims altogether against state officials under § 1983. Defs.' Mem. at 9–12. Moreover, they insist that the State is unconstrained by constitutional limitations preventing it from taking private property without just compensation, asserting that the State has not waived sovereign immunity for such claims and therefore is not answerable for any such actions in either state or federal court. Defs.' Mem. at 12. As set forth *infra*, Maryland courts have no patience for such claims that the

[1] This statement by Defendants is even stranger in light of their citation to *McKesson* elsewhere in their Brief. *See* Defs.' Mem. at 12.

State has a right to unconstrained lawlessness and have long held that takings claims are not barred by sovereign immunity. *E.g.*, *Hammond v. State Roads Comm'n*, 241 Md. 514, 518 (1966).

Defendants also invite the Court to revisit its conclusion that Plaintiffs are not required to exhaust their claims in Tax Court, but supply no new reasons for the Court to reverse its prior, correct ruling.

In arguing that the discriminatory interest rate applied to *Wynne* claimants does not violate the dormant Commerce Clause, Defendants eschew the analysis required by the Supreme Court, which must begin with an inquiry as to whether the law facially discriminates against interstate commerce. A statute, like BRFA, that does so discriminate may be saved by only limited exceptions, none of which apply here. But Defendants, to the contrary, make assertions, unfounded in law, that any violation of the Clause is excused by fiscal necessity, Defs.' Mem. at 20–23, despite *McKesson*'s warning that the State's interest in financial stability does not justify a refusal to provide relief from an unconstitutional tax, 496 U.S. at 50. Even assuming, *arguendo*, that Maryland's fiscal concerns are a legitimate state purpose, Defendants offer no evidence, as they must, that there is no alternative nondiscriminatory means available to achieve that purpose. *Maine v. Taylor*, 477 U.S. 131, 138 (1986).

Plaintiffs paid the unconstitutional taxes levied by Defendants. Plaintiffs are entitled to refunds for those unconstitutional taxes. Plaintiffs are entitled to

the same accrual of interest, at the same interest rate, as all taxpayers who did not engage in interstate commerce. Plaintiffs are also entitled to just compensation for Defendants' taking of any accrued interest on their refunds. Finally, Plaintiffs are entitled to whatever injunctive relief is necessary to ensure that they are made whole. Thus, as set forth below, Plaintiffs are entitled to entry of summary judgment.

STATEMENT OF FACTS

Under Maryland's tax system, a taxpayer who believes a tax to be unlawful faces serious economic consequences if she fails to pay the tax before she challenges it. First, the taxpayer will incur interest at the rate of 13% per annum on the underpayment of estimated tax. Md. Code Ann., Tax-Gen. §§ 13-601(a), 13-604.[2] Then, if the taxpayer fails to pay taxes due in full by the due date of the tax return, the taxpayer is subject to a 10% penalty on the underpayment, plus possible interest on the underpayment at the rate of 13% per annum from the April 15 due date. *Id.* §§ 13-601(a), 13-604, 13-701, 13-702. On the other hand, when, as a result of an error by the State, a taxpayer has been wrongly made to pay taxes, interest accrues on the monies refunded at the same 13% interest rate, starting 45 days after the taxpayer files a refund claim. *Id.* § 13-603.

[2] Md. Code Ann., Tax-Gen. §§ 13-602 and 13-702 provide limited safe harbors before interest and penalties are imposed on an underpayment of estimated taxes.

The dilemma Plaintiffs and similarly situated members of the putative class faced when they filed their original returns is obvious: if they paid the tax computed by applying a full credit for their out-of-state income, but the Comptroller prevailed in *Wynne*, they would have to pay a 10% penalty, plus interest of 13% per annum for several years on the underpayment (including on any underpaid estimated tax payments). If, however, they timely paid the tax as Maryland law then required (including making estimated tax payments) and the taxpayers prevailed in *Wynne*, at least they would receive 13% interest on their refund beginning 45 days after filing protective claims. While the interest provisions of the Maryland Code would not make the taxpayers whole, by paying the tax without taking into account any credit potentially to be required by *Wynne*, taxpayers could at least reduce the downside risk to which they were exposed. By passing BRFA, the State attempted to upset that calculus retroactively.

ARGUMENT

I. Defendants Are Not Immune from Suit.

Plaintiffs appropriately have brought all of their claims for damages against the Comptroller in his individual capacity under 42 U.S.C. § 1983, Am. Compl. ¶¶ 71, 78, claims against which he enjoys no sovereign immunity, *Hafer*, 502 U.S. at 23, 30–31. And even apart from § 1983, the State enjoys no immunity from a suit in Maryland state court seeking just compensation for an

unlawful taking. Defendants ignore these long-settled principles and rely instead on precedent that is inapposite to the claims at issue in this case.[3]

Defendants' insistence that this Court look behind the pleadings to determine "the real, substantial party in interest" is misguided. Defs.' Mem. at 9 (quoting *Ford Motor Co. v. Dep't of Treasury of State of Ind.*, 323 U.S. 459, 464 (1945), *overruled on other grounds by Lapides v. Bd. of Regents of Univ. Sys. of Ga.*, 535 U.S. 613 (2002)). The Supreme Court has expressly rejected the argument asserted by Defendants that plaintiffs cannot sue state officials under § 1983 in their personal capacity for their official acts, as Plaintiffs have done here. *Hafer*, 502 U.S. at 23, 30–31. Indeed, the fact that the Comptroller acted in his official capacity is what renders him liable under § 1983, not what insulates him from such liability. *Id.* at 27–28. And "the Eleventh Amendment does not erect a

[3] Inasmuch as Defendants assert sovereign immunity to Plaintiffs' claims for interest on refunds that the State has not yet paid, that argument is foreclosed by *Ex Parte Young*, 209 U.S. 123, 155–56, 159–60 (1908) (holding that plaintiffs may bring suit in federal court to enjoin state officers from enforcing unconstitutional laws), and *General Oil Co. v. Crain*, 209 U.S. 211, 226–27 (1908) (applying the principle of *Ex Parte Young* to suits in state court). "[O]fficial-capacity actions for prospective relief are not treated as actions against the State," *Kentucky v. Graham*, 473 U.S. 159, 167 n.14 (1985); *see also id.* at 169 n.18; *accord Will v. Mich. Dep't of State Police*, 491 U.S. 58, 71 n.10 (1989), and "[m]onetary relief that is 'ancillary' to injunctive relief also is not barred by the Eleventh Amendment," *Graham*, 473 U.S. at 169 n.18 (quoting *Edelman v. Jordan*, 415 U.S. 651, 667–668 (1974)); *see also, e.g.*, *Green v. Mansour*, 474 U.S. 64, 68 (1985) ("Remedies designed to end a continuing violation of federal law are necessary to vindicate the federal interest in assuring the supremacy of that law.").

barrier against suits to impose 'individual and personal liability' on state officials under § 1983." *Id.* at 30–31 (quoting *Scheuer v. Rhodes*, 416 U.S. 232, 237 (1974)).

Defendants do not address *Hafer* and its controlling holding. Instead, they rely on cases in which the plaintiffs did *not* assert claims against the defendants expressly in their individual capacities, *see Ford Motor*, 323 U.S. at 464; *Great N. Life Ins. Co. v. Read*, 322 U.S. 47, 52–53 (1944), and suits brought under laws other than § 1983, *see Martin v. Wood*, 772 F.3d 192 (4th Cir. 2014) (Fair Labor Standards Act); *Lizzi v. Alexander*, 255 F.3d 128 (4th Cir. 2001) (Family and Medical Leave Act). As *Lizzi* acknowledges, the Supreme Court has established a different rule for analyzing personal-capacity claims against state officials under § 1983 than that which the Fourth Circuit applies to other statutes. 255 F.3d at 137 (citing *Hafer*, 502 U.S. at 23, 28), *overruled in part on other grounds by Nev. Dep't of Human Res. v. Hibbs*, 538 U.S. 721 (2003); *see also Martin*, 772 F.3d at 195–96 (relying on *Lizzi*). Indeed, to accept Defendants' argument would render § 1983 a dead letter with regard to damages claims against state officials: plaintiffs would have no cause of action under § 1983 unless the state official acted in his official capacity, but would be barred by sovereign immunity in any case in which a cause of action arose. The law does not accept such an absurdity.

Defendants' contention that the Comptroller cannot be sued in his individual capacity because he was not "in any way involved in processing

[Plaintiffs'] tax returns or determining the amount of interest that they received" is frivolous as a matter of fact and law. Defs.' Mem. at 12 n.3 (citing *Slakan v. Porter*, 737 F.2d 368, 372–73 (4th Cir. 1984)). Far from being removed from processing Plaintiffs' tax returns, the Comptroller signed the checks refunding Plaintiffs their taxes and interest. Pls.' Mot. Summ. J., Exs. 5, 8.[4] Nor is such direct involvement necessary. As the Fourth Circuit recognized in *Slakan*, supervisory officials may be liable under § 1983 when their "indifference or tacit authorization of subordinates' misconduct" is a "causative factor in the constitutional injuries." 737 F.2d at 372. Here, the Comptroller more than tacitly authorized the unconstitutional policy—he instructed his subordinates to carry it out. Pls.' Mot. Summ. J., Ex. 5 (informing Plaintiff Jeffrey Grill, in a May 12, 2016, letter, that "[t]he Comptroller's Office does not have the statutory authority to pay the additional amount you have requested" due to BRFA). "Supervisory liability in the civil rights context may extend to the highest levels of state government," 737 F.2d at 373, and Defendant has supplied no reason it should not do so here.

Moreover, Plaintiffs may bring their takings claims directly against the State. For decades the Maryland Court of Appeals has held that plaintiffs may bring suit against the State in its own courts to seek compensation, including

[4] For the convenience of the Court, Plaintiffs have attached the relevant portions of Exhibits 5 and 8 from their Motion for Summary Judgment, maintaining the same numbering of exhibits.

interest, for unlawful takings. In *Hammond*, the Court of Appeals held that plaintiffs may sue the State in state court for interest on a condemnation award, "irrespective of sovereign immunity" or any "procedural requirements." 241 Md. at 518. Although the plaintiffs in *Hammond* brought suit under the Maryland State Constitution, the analysis in that case was not confined to state law claims. Rather, the Court of Appeals relied on Supreme Court precedent holding that "the traditional rule, based on sovereign immunity, that interest on a claim cannot be recovered against the government" is "inapplicable in the area of acquisition by eminent domain because the constitutional requirement of 'just compensation' entitled the property owner to receive interest from the date of the taking to the date of payment." *Id.* at 519 (citing, *inter alia*, *United States v. Thayer-West Point Hotel Co.*, 329 U.S. 585 (1947)). Twenty years later, the Court of Appeals reaffirmed that "agents of the State do not enjoy immunity with respect to a wrongful taking of property without just compensation." *Dep't of Nat. Res. v. Welsh*, 30 Md. 54, 60 (1986).

Defendants give no reason to now deviate from this binding authority; rather, they ignore it entirely and instead invoke sovereign immunity to revive their argument, already dispatched by this Court, that this is a tax case that must be administratively exhausted through the Tax Court. Defs.' Mem. at 12. As established by this Court's previous ruling in this case on Defendants' Motion to Reconsider the Denial of the Motion to Dismiss, the fact that Plaintiffs have not

followed the process for tax cases is irrelevant. *Cf. Ford Motor*, 323 U.S. at 465–66 (holding that the Eleventh Amendment barred the plaintiff's suit in federal court for a *tax refund* when the state had waived sovereign immunity to such claims in state court only). Moreover, to accept Defendants' position that the State must waive sovereign immunity before plaintiffs may sue to recover just compensation for a taking would allow states to nullify the Takings Clause at will. Fortunately, as *Hammond* and *Welsh* establish, in Maryland that is not the law.

II. Plaintiffs Were Not Required to Exhaust Administrative Remedies.

Defendants make no additional arguments and offer no new citations for their relentless contention, in the face of facts, precedent, and this Court's rulings, that Plaintiffs' claims are subject to administrative exhaustion in the Tax Court. As this Court has already stated in this case, "It is clear that Plaintiffs' claims in the Amended Complaint are constitutional in nature and not subject to administrative exhaustion. Further, Plaintiffs' claims are not challenges to a tax assessment and, as such, Tax Court is not an appropriate venue." Order on Mot. Recons., Dkt. 9/1 (Mar. 24, 2016).

The Court got it right the first time. There is no dispute that Plaintiffs are owed refunds under *Wynne*. The Court need only determine whether Defendants have committed unconstitutional torts and violated federal law relative to the interest owed on those undisputed refunds. That is beyond the exclusive ambit of the Tax Court. There is nothing about these claims that involves tax law, its

interpretation or its application. That the interest is on a tax refund as opposed to on some other property of Plaintiffs is incidental at best. Further, as Plaintiffs have previously explained, "federal constitutional claims brought pursuant to 42 U.S.C. § 1983 need not be exhausted through state administrative processes." Pls.' Opp. Mot. Dismiss at 9, Dkt. 6/1 (Feb. 1, 2016) (citing *Felder v. Casey*, 487 U.S. 131, 147–48 (1988), and *Maryland Reclamation Assoc., Inc. v. Harford Cty.*, 342 Md. 476, 492–93 (1996)). To the extent the Court wishes to review the arguments it has twice found persuasive, Plaintiffs incorporate their prior pleadings and arguments herein. *See id*. at 4–14.

III. Plaintiffs Have Established That the Lower Interest Rate Applicable to *Wynne* Refund Claims Violates the Interstate Commerce Clause.

The Constitution gives Congress the express power to "regulate Commerce . . . among the several States." U.S. Const. art. I, § 8, cl. 3. The Supreme Court has consistently held that the Commerce Clause "contains 'a further, negative command, known as the dormant Commerce Clause.'" *Am. Trucking Assoc., Inc. v. Mich. Pub. Serv. Comm'n*, 545 U.S. 429, 433 (2005) (quoting *Okla. Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179 (1995)). The dormant Commerce Clause prevents a state from "plac[ing] burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear." *Id*. (quoting *Jefferson Lines*, 514 U.S. at 180); *see also Hughes v. Okla.*, 441 U.S. 322, 326 (1979) ("The Commerce Clause has accordingly been

interpreted by this Court not only as an authorization for congressional action, but also, even in the absence of a conflicting federal statute, as a restriction on permissible state regulation.").

To determine whether a law violates the dormant Commerce Clause, a court must first ask whether the law "discriminates on its face against interstate commerce." *United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 338 (2007) (citations omitted); *see also Or. Waste Sys., Inc. v. Dep't of Envtl. Quality of State of Or.*, 511 U.S. 93, 99 (1994) ("[W]e have held that the first step in analyzing any law subject to judicial scrutiny under the negative Commerce Clause is to determine whether it 'regulates evenhandedly with only "incidental" effects on interstate commerce, or discriminates against interstate commerce.'" (quoting *Hughes*, 441 U.S. at 336)). Defendants do not acknowledge that answering this question is this Court's first task or suggest how the Court should answer it, perhaps because it is clear that BRFA discriminates on its face.

"Discrimination" in this context "simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *United Haulers*, 550 U.S. at 338 (quoting *Or. Waste Sys.*, 511 U.S. at 99). By this definition, BRFA "discriminates on its face against interstate commerce." It does not lower interest rates on tax refunds for all Maryland taxpayers but only for taxpayers whom the Supreme Court held in *Wynne* had

engaged in interstate commerce by earning income out of state. The Supreme Court agreed with the Maryland Court of Appeals that "the tax discriminated against interstate commerce because it denied residents a credit on income taxes paid to other States and so taxed income earned interstate at a rate higher than income earned intrastate." *Wynne*, 135 S. Ct. at 1793; *see also id.* at 1805 ("[T]he tax scheme operates as a tariff and discriminates against interstate commerce, and so the scheme is invalid."). BRFA perpetuates that discrimination by establishing a lower interest rate on refunds only for taxpayers who had already been discriminated against for engaging in interstate commerce. Because the scope of those affected by the *Wynne* decision and those affected adversely by BRFA are the same, the Supreme Court has foreclosed any argument that BRFA is not facially discriminatory.

If the law is discriminatory, "it is virtually *per se* invalid." *Or. Waste Sys.*, 511 U.S. at 99. A state may not "discriminat[e] against articles of commerce coming from outside the State unless there is some reason, apart from their origin, to treat them differently." *City of Philadelphia v. New Jersey*, 437 U.S. 617, 626–27 (1978). Here, nothing separates Plaintiffs' refunds from those of other taxpayers except the origin of the income generating the refunds. Thus, Defendants' creation and application of a separate, lower interest rate applicable only to Plaintiffs and the putative class violates the dormant Commerce Clause.

Such a facially discriminatory law "invokes the strictest scrutiny of any purported legitimate local purpose and of the absence of nondiscriminatory alternatives." *Hughes*, 441 U.S. at 337. Defendants assert a local purpose – using the saved interest to address a purported fiscal crisis, Defs.' Mem. at 21–22 – but make no attempt to show "the absence of nondiscriminatory alternatives." Instead, Defendants mislead this Court by suggesting that *Maine v. Taylor* allows statutes that facially discriminate against interstate commerce to stand so long as the action is within a State's "general police powers to regulate matters of legitimate local concern." 477 U.S. at 138 (citation omitted). In fact, the Supreme Court in that case required not only a legitimate local purpose, but that "the purpose . . . cannot be served as well by available nondiscriminatory means." *Id.* at 140; *accord United Haulers*, 550 U.S. at 338–39. Of course, the tax scheme invalidated in *Wynne* also contributed to deficit reduction, but that did not render it constitutional. Here, Defendants have not even suggested that the only way out of the fiscal crisis was on the backs of Maryland taxpayers who had engaged in interstate commerce.

Defendants claim only that BRFA was appropriately targeted at the *Wynne* Plaintiffs because they were the "source of the problem." Defs.' Mem. at 23. But the *Wynne* Plaintiffs did not cause the fiscal shortfalls identified by Defendants. Defendants alone bear the responsibility for imposing, and budgeting based on, an unconstitutional tax. They cannot escape the consequences of their actions by

blaming their victims for seeking recompense – by Defendants' logic, they could re-instate the very tax held unconstitutional in *Wynne*, to make up for the shortfall caused by *Wynne* Plaintiffs seeking refunds. Once the full burden of what Defendants must show and their transparent attempt to shift the blame are acknowledged, Defendants' argument fails.[5]

Ignoring that the Court's first task is to ask if the statute is facially discriminatory, Defendants instead suggest that BRFA must not discriminate against interstate commerce because of what it allegedly does not do: (1) overtly block the flow of interstate goods at Maryland's borders; (2) confer on Maryland residents rights not conferred on out-of-state residents; (3) isolate Maryland residents from the national economy; (4) afford a Maryland entity an advantage over competitors from out of state; or (5) give economic preference to Maryland's own commercial interests. Defs.' Mem. at 19. While these actions violate the dormant Commerce Clause, the absence of a forward-looking effect on commerce

[5] Defendants cite a number of cases that note that on such local matters as traffic safety, some greater deference is accorded to the State. Defs.' Mem. at 23. This case, involving the payment of interest on refunds, does not involve such matters. In any event, as demonstrated by the decision in *Kassel v. Consolidated Freightways Corp.*, 450 U.S. 662, 675 (1981), that "special deference" does not necessarily translate to upholding a challenged regulation. Nor does the fact that BRFA burdens only Maryland residents render it constitutional. As the Court explained in *Wynne*, "if a State's tax unconstitutionally discriminates against interstate commerce, it is invalid regardless of whether the plaintiff is a resident voter or nonresident of the State." 135 S. Ct. at 1797.

does not mean that State action passes constitutional muster.[6] More pertinent than these case law sound bites is the Court's clear statement in *Wynne*: "Under our precedents, the dormant Commerce Clause precludes States from 'discriminat[ing] between transactions on the basis of some interstate element.'" *Wynne*, 135 S. Ct. at 1794 (quoting *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 332, n.12 (1977)).

Indeed, all of Defendants' arguments that BRFA is not facially discriminatory run contrary to the binding holding in *Wynne* that the tax scheme upon which BRFA is based, the effects of which BRFA perpetuates, discriminated against interstate commerce.

Defendants argue that because some Maryland taxpayers receive no interest at all on refunds – those who, for example, obtain their refunds fewer than 45 days after filing their claims or who choose to overpay withholding tax – the Constitution sanctions all distinctions between interest rates on refunds. Defs.' Mem. at 16, 17. Such an argument could have been made in *Wynne*, of course: that because the State can lawfully deny tax credits in some circumstances, it can deny credit for payment of out-of-state taxes. But the *Wynne* Court looked instead at whether the particular policy was one that was constitutionally infirm. So, too, here, Plaintiffs concede that Defendants may impose many limitations on

[6] In fact, the Supreme Court has used the dormant Commerce Clause to invalidate laws the legislature has already repealed. *Fulton Corp. v. Faulkner*, 516 U.S. 325, 327 n.1 (1996).

the payment of interest – so long as doing so runs afoul of no constitutional command.

The comparison by which one determines the constitutionality of BRFA must be made between Plaintiffs and the putative class, on the one hand, and those Maryland taxpayers who are similarly situated, on the other, not with just any Maryland taxpayer. In *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Maine*, 520 U.S. 564 (1997), for example, the Supreme Court invalidated a property tax scheme that taxed charities primarily serving out-of-state residents more heavily than charities mostly serving in-state residents; the Court did not consider whether other, dissimilar institutions paid even higher property taxes. In this case, the appropriate comparison is between *Wynne* claimants and Maryland taxpayers who, although similar in all other respects relevant to interest payments, earned no out-of-state income. That comparison reveals that only Plaintiffs will not receive interest at the 13% rate and that is *only because* their entitlement to a refund stems from being a taxpayer covered by the *Wynne* decision, that is, a taxpayer engaged in interstate commerce. That is facially discriminatory.

Defendants also say that giving less than full credit for taxes paid to another state on out-of-state income from real property does not violate the dormant Commerce Clause. Defs.' Mem. at 18. This is an attempt by the State to re-argue part of *Wynne*, suggesting that only partial credit should still be allowed

when the out-of-state income derives from real estate. This argument, if it had any validity, should have been raised by the Comptroller in *Wynne* before both the Court of Appeals and the Supreme Court, to ask those Courts not to strike down Tax-Gen. § 10-703(a) insofar as it applied to income earned from real estate. That neither Court remarked on a distinction between income earned from out-of-state property investments, on the one hand, and that earned via other out-of-state transactions, on the other, speaks volumes to the weight Defendants' argument deserves here.

Even assuming the issue of whether income derived from real property affects interstate commerce is properly before this Court, the flow of investment income across state lines clearly is an element of interstate commerce. *See Chem. Waste Mgmt., Inc. v. Hunt*, 504 U.S. 334, 342 (1992) ("[A] State may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." (alteration in original) (quoting *Armco Inc. v. Hardesty*, 467 U.S. 638, 642 (1984)). In *Fulton*, 516 U.S. 325, for example, the Supreme Court invalidated a North Carolina law that taxed residents' stock in corporations doing business out of state at higher rates than stock in corporations doing business in state. The Court had "no doubt" that such a tax "facially discriminates against interstate commerce." *Id.* at 333. Defendants suggest no reason, and there is none, for why income from out-of-state real property investments should be treated differently than income from out-of-state corporate

investments. "Even when business activities are purely local, if 'it is interstate commerce that feels the pinch, it does not matter how local the operation which applies the squeeze.'" *Camps Newfound/Owatonna*, 520 U.S. at 573–74 (quoting *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241, 258 (1964) (citation omitted)); *see also Boston Stock Exch.*, 429 U.S. at 337 ("[N]o State may discriminatorily tax . . . the business operations performed in any other State.").

The cases cited by Defendants in support of their argument that income from real estate should not be affected by *Wynne* do not materially support their position.

Department of Treasury v. Wood Preserving Corp., 313 U.S. 62 (1941), involved neither real property nor income taxes, but whether railroad ties sold in Indiana to an out-of-state purchaser could be subject to a sales tax in Indiana. Plainly, the answer was yes, but the facts, the question presented, and the result, singly and in combination, had nothing to do with the case before this Court.

Munday v. Wisconsin Trust Co., 252 U.S. 499 (1920), also cited by the State, did not involve tax, but whether a Maine corporation could buy real property in Wisconsin without registering as a foreign corporation with the Secretary of State. Far from declaring that the acquisition or disposition of real property never affects interstate commerce, the Court more measuredly stated, "[W]here interstate commerce is not directly affected, a state may forbid foreign

corporations from . . . acquiring property within her borders except upon such terms as those prescribed by the Wisconsin statute." *Id.* at 503.

The final case cited by Defendants, *S.M.Z. Corp. v. Director, Division of Taxation*, 5 N.J. Tax 232 (1982), is a New Jersey Tax Court decision that was reversed in the Superior Court on the very ground for which the Comptroller cites it. The Superior Court adopted the Director's language verbatim that, to avoid having the tax run afoul of the dormant Commerce Clause, the Director was authorized by the New Jersey Legislature to allocate some of the net worth being taxed,

> even in cases in which, under the statute and regulations, a taxpayer lacks a regular place of business outside of New Jersey. Even in such cases there could be situations in which refusing a corporation the right to allocate a portion of its income and net worth to another state in which it does business would violate either the Commerce Clause or the Due Process Clause. In such cases, the Legislature has made . . . available to the Director [the authority] to make appropriate adjustments.

S.M.Z. Corp. v. Dir., Div. of Taxation, 193 N.J. Super. 305, 317 (1984).

In short, the Comptroller makes his novel argument that income derived from real estate has no impact on interstate commerce in the wrong court at the wrong time, contrary to authority, and without any support of his own.

Even had the issue not been decided by *Wynne*, Defendants' apparent contention that BRFA is not facially discriminatory because it does not penalize *all* interstate commerce is unsupportable. Defs.' Mem. at 17. Indeed, Defendants

make no attempt to support it. The Supreme Court consistently has struck down state laws that target particular interstate transactions without requiring that they target all interstate transactions. *E.g.*, *Camps Newfound/Owatonna*, 520 U.S. at 570 (invalidating a property tax on charities that "engag[ed] in a certain level of interstate commerce" (citation omitted)). With their position, Defendants would invalidate almost the entire corpus of dormant Commerce Clause jurisprudence.

Finally, Defendants argue that it is permissible to discriminate in the payment of interest on tax refunds based on whether the recipient engaged in interstate commerce, because BRFA penalizes taxpayers only retroactively for engaging in interstate commerce, and thus there will be no prospective deterrent after this last swipe at the taxpayers on the way out the door. The question, however, must be cast a little less narrowly: may a state pay two different interest rates based on whether the recipient has engaged in interstate commerce. The answer to that is "no."

BRFA is facially discriminatory. To the extent that it serves deficit reduction, the State has failed to show, as it must, the absence of nondiscriminatory ways to address that problem.

IV. Defendants' Retroactive Withdrawal of Accrued Interest Is a Taking Barred by the Fifth and Fourteenth Amendments to the Constitution.

Until BRFA's enactment, Plaintiffs Holzheid and Grill had a statutory right to interest on their refund claims at a rate of 13% per annum. The interest

that accrued pursuant to that right prior to BRFA was property that could not be constitutionally taken by the State.

The State correctly points out that the right to interest is a creature of State law, *Comptroller of Treasury v. Fairchild Indus., Inc.*, 303 Md. 280, 284 (1985), but this does not aid the analysis. Property rights are generally rooted in state law. As the Supreme Court explained in *Board of Regents of State Colleges v. Roth*, 408 U.S. 564, 577 (1972):

> Property interests . . . are not created by the Constitution. Rather they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law—rules or understandings that secure certain benefits and that support claims of entitlement to those benefits.

Because interest and the rate of interest on tax refunds are entirely the product of legislation, they may lawfully be changed prospectively; that is, they may be changed as to those who have no existing right to the property as then defined by State law. Many of the cases cited by Defendants are to that effect, Defs.' Mem. at 24, and this proposition is neither remarkable nor in dispute.[7]

But where a right to interest exists and there is a current holder of that right, the right is private property that the State may not take without just compensation. *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 164–65 (1980); *see also Phillips*, 524 U.S. at 172. "The State's having mandated

[7] Thus, for example, Plaintiffs do not argue that there is a protected property right to a continuation of government benefits at a previous level. *See Bowen v. Gillard*, 483 U.S. 587, 605 (1987).

the accrual of interest does not mean the State or its designate is entitled to assume ownership of the interest." *Webb's*, 449 U.S. at 162. As the Court in *Phillips* explained, the property right to interest is based on the rule, "established under English common law since at least the mid-1700's," that "interest follows principal." 524 U.S. at 165 (citation omitted); *see also id.* at 165 n.5 (citing cases from 18 states finding, based on common law, that interest is private property). Where the state has no right to the principal, "any interest that *does* accrue attaches as a property right incident to the ownership of the underlying principal." *Id.* at 168 (emphasis in original); *see Webb's*, 449 U.S. at 164–65 (holding that a county's taking of the interest that accrued on an interpleader fund deposited in the registry of the county court violated the Fifth and Fourteenth Amendments).

If Defendants' assertion that there is no property right in interest were correct, the State could then, without violating the Takings Clause, seize all interest already paid to *Wynne* claimants (and other taxpayers), since, according to Defendants, that interest never acquired the indicia of property. Of course, that is an absurd proposition, but it leads to the critical inquiry: when did Plaintiffs' property rights in the interest on their tax refunds accrue? The answer, according to Maryland law, is 45 days after Plaintiffs filed their protective claims. Md. Code Ann., Tax-Gen. § 13-603. Thus, Plaintiffs who filed claims for refunds under *Wynne* before the enactment of BRFA have vested rights to the interest that had accrued at the rate of 13% from 45 days after their claims were filed to the

date BRFA went into effect. After BRFA's effective date, any further interest would have been calculated at 3%, but for the fact that doing so violates the dormant Commerce Clause, as discussed *supra*.

Defendants' arguments to the contrary quote cases out of context. Defendants rely primarily on *U.S. Shoe Corp. v. United States*, 296 F.3d 1378 (Fed. Cir. 2002), but that case is inapposite, because the United States had not enacted legislation entitling the claimant to pre-judgment interest at all. *Id.* at 1381–82. And, if "not granted by statute, the Supreme Court has held only the Fifth Amendment of the Constitution to mandate the payment of interest." *Id.* at 1383. This provides full support for the uncontested proposition that the State of Maryland did not need to create a property right to interest on a refund in the first place. It provides no support for Defendants' contention that they may snatch back property rights the State created and that have already accrued to a citizen.

Defendants' mistaken reliance on the *constitutional* holding of *U.S. Shoe* leads them to conclude, incorrectly, that interest does not accrue until a refund request is granted. Defs.' Mem. at 27. But in Maryland, *statutory* law establishes when a right to interest on a tax refund accrues – 45 days after an unpaid request for a refund. Md. Code Ann., Tax-Gen. § 13-603.

Defendants' suggestion that Plaintiffs possess a property right to interest only where the government has deposited funds with third parties misunderstands that property right. Defs.' Mem. at 28. Plaintiffs have a property right to their

unconstitutionally collected taxes. *McKesson*, 496 U.S. at 36. Under *Phillips*, the property right to interest flows logically from that principal right. 524 U.S. at 165. Where the tax collected by the government was unconstitutional *ab initio*, a person's obligation to pay taxes does not render her payment the property of the government until a refund is granted. *See Martin-Marietta Corp. v. United States*, 418 F.2d 502, 509 (Cl. Ct. 1969) ("[P]laintiff, not the government, was properly entitled . . . to the use of the taxes which were later refunded. . . . The government merely had the use of certain funds, the use of which properly belonged to plaintiff. Thus, the interest recovered in this suit must be viewed as compensation for plaintiff's lost use of its funds, or the transferral of the benefit incident to the use of such funds from the government to the proper recipient.").

Defendants also assert that Plaintiffs are not entitled to a "higher rate than would have been possible in the private sector," Defs.' Mem. at 29 n.11, and cite *Brown v. Legal Foundation of Washington*, 538 U.S. 216, 237–40 (2003), for the related proposition that Plaintiffs did not suffer a "net loss" because their right to any interest derived from the State, Defs.' Mem. at 31. Defendants misread *Brown*. *Brown* did not hold that a taking of accrued interest is noncompensable when the right to interest is established only by statute – a holding that would have conflicted with *Webb's*, 449 U.S. at 162. Rather, *Brown* reaffirmed that "the private party 'is entitled to be put in as good a position pecuniarily as if his property had not been taken. He must be made whole but is not entitled to

more.'" 538 U.S. at 237 (quoting *Olson v. United States*, 292 U.S. 246, 255 (1934)). In *Brown*, no interest on the plaintiffs' funds legally could have accrued prior to the challenged law, and the plaintiffs therefore had no prior entitlement to any interest on the funds at issue. *Id.* at 239–40. Here, Plaintiffs simply seek to be put back in their position pre-taking by recovering the interest that accrued at the same rate that applied to all other tax refunds, and to which they were entitled prior to BRFA. Defendants were free to reduce the rate for all refunds prospectively at any time. Instead, Defendants chose to reduce the rate of interest only on refunds resulting from having to undo the effects of their unconstitutional tax scheme, and chose to do so retroactively. Neither of those acts were themselves constitutional. Their combination is doubly offensive.

The State argues, nonetheless, that some "future act, contingency or decision" was necessary for the right to interest to become secure. Defs.' Mem. at 29 (citing *McComas v. Criminal Injuries Comp. Bd.*, 88 Md. App. 143, 150 (1991) (construing a statute governing caps on awards as applicable prospectively to all claims for which awards had not been granted)). The fact that Plaintiffs could not receive their refunds until the Comptroller granted their claims does not establish that Plaintiffs had no property right to the interest mandated by statute at the time they filed their claims. *See* Defs.' Mem. at 27. A "lack of immediate right . . . does not automatically bar a claimant ultimately determined to be entitled to all or a share of [a] fund from claiming a proper share of the interest . .

. that is realized in the interim." *Webb's*, 449 U.S. at 162. The Supreme Court in *Webb's* recognized the property interest of creditors in the interest accrued on an interpleader fund even though "none of the creditor claimants had any right to the deposited fund until their claims were recognized and distribution was ordered." *Id.* at 161. The same principle applies here.

Moreover, it should be noted that on June 29, 2011, the Circuit Court for Howard County held that the failure to give the Wynnes full credit for out-of-state taxes violated the dormant Commerce Clause, a decision affirmed by the Maryland Court of Appeals before BRFA was enacted. *Md. State Comptroller of Treasury v. Wynne*, 431 Md. 147, 160 (2013). Thus, the only potential future contingency was not one that would have granted the right to the property, but only one that might have nullified the right to a refund and to interest. And, of course, that contingency never occurred.

The prerequisites to ownership of property are creatures, largely, of state law. Prospectively, a state is free to change those prerequisites, so long as those changes satisfy other constitutional requirements. What a state is not free to do is to change those rules after the fact. Here, Maryland state law said that a Maryland taxpayer who filed a request for refund, believing that the State had erroneously required an overpayment of taxes, was entitled to interest at the rate of 13% per annum starting 45 days after that request. Plaintiffs Holzheid and the Grills filed such requests prior to BRFA's passage. Having met the requirements

for a property right to accrued interest on their refunds prior to BRFA, they were entitled to receive that interest on the terms previously set by the State.

V. The Plaintiffs' Right to Interest on Their Refunds Is Based on Their Constitutional Claims, not How They Paid Their Taxes.

Defendants claim that certain of the Plaintiffs' interest claims should be dismissed because they are "based on" an overpayment of estimated tax or of withholding. Defs.' Mem. at 31–35. The provisions on which Defendants rely, Md. Code. Ann., Tax-Gen. § 13-603(b)(2)(ii), (iii), are designed to prevent taxpayers from "arbitraging" their tax payments: intentionally overpaying taxes with the expectation that they will get a tax refund with interest calculated at 13% per annum from the date of payment. While Plaintiffs may have made estimated tax payments or had income withheld, the claims for refunds in this case are not based on those facts. The only basis for Plaintiffs' refund claims, and the claims for interest that follow, is their payment of taxes that violated the dormant Commerce Clause. In short, Defendants confuse *how* Plaintiffs paid their taxes with *why* they are entitled to a refund (*i.e.*, the basis for their entitlement). That conflation is belied by administrative practice and logic.

Defendants' argument is at odds with the Comptroller's long-standing interpretation of the law. In 2014, the Department of Legislative Services submitted a Fiscal and Policy Note to the General Assembly on Senate Bill 423

(2014 Session, Maryland General Assembly). *See* Ex. 9.[8] That Note was prepared based on information supplied by the Comptroller to the Department of Legislative Services. It makes clear the Comptroller's position that "[u]nder current law, the Comptroller owes interest on . . . refunds [due on properly filed *Wynne* claims] going back to the date of filing." *Id.* at 4. The Comptroller did not purport to exclude interest on *Wynne* claims for taxpayers who had withholding or paid estimated taxes.

Not only did the Comptroller take the position that interest will be paid on refunds for all *Wynne* claimants who seek them, he relied on that interpretation to persuade the General Assembly to lower the interest rate on those refunds. The calculations in the Fiscal and Policy Note to the General Assembly on Senate Bill 172 (2014 Session, Maryland General Assembly) – *i.e.*, the Fiscal Note accompanying BRFA – assumed that interest would be due on the entire amount of such refunds, even if some taxpayers had made estimated tax payments prior to filing their tax returns. Ex. 10.

As the Court of Appeals said in *Comptroller v. Citicorp International Communications, Inc.*, "[a court's] role is to accord deference to an agency's interpretation of a statute which it administers," 389 Md. 156, 163 (2005) (citing *Charles Cty. Dep't of Social Servs. v. Vann*, 382 Md. 286, 295–96 (2004)), and

[8] For the convenience of the Court, Plaintiffs have continued the numbering of exhibits from their Motion for Summary Judgment.

"an administrative agency's interpretation and application of the statute which the agency administers should ordinarily be given considerable weight by reviewing courts," *id.* (citing *Board of Physician Quality Assurance v. Banks*, 354 Md. 59, 69 (1999)). But little deference is due when an administrative agency changes its interpretation to support litigation positions as those positions change from time to time. *See Marriott Emps. Fed. Credit Union v. Motor Vehicle Admin.*, 346 Md. 437, 445–46 (1997).

Having consistently adopted one interpretation of the tax code, and even relied on that interpretation to induce the General Assembly's actions at issue here, the Comptroller cannot now offer an inconsistent interpretation merely because that interpretation suits his current position in this litigation.

Finally, Defendants' interpretation of "based on" leads to insupportably arbitrary results: two people might pay an unconstitutional tax, but only the one who did not make estimated payments receives interest. That is not the purpose of § 13-603(b)(2)(ii), (iii). That statute is designed to deter taxpayers from intentionally overpaying as an investment strategy. It is not designed to deter taxpayers from paying taxes they believe are unconstitutional; indeed, Maryland law intends the opposite, by coercing taxpayers into paying a tax first and challenging it later. Md. Code Ann., Tax-Gen. §§ 13-601(a), 13-604, 13-701, 13-702.

CONCLUSION

For the reasons set forth above, Plaintiffs respectfully request that their Motion for Summary Judgment be granted and that Defendants' Motion be denied.

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CERTIFICATE OF SERVICE

I **HEREBY** certify that, on this 1st day of November, 2016, a true and accurate copy of the Plaintiffs' Reply in Support of Their Motion for Summary Judgment and Opposition to Defendants' Cross-Motion for Summary Judgment was hand delivered and electronically mailed to:

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