No. 02-1809

# In The Supreme Court of the United States

J. ELLIOTT HIBBS, in his official capacity as Director of the Arizona Department of Revenue,

*Petitioner,*

v.

KATHLEEN M. WINN, Arizona taxpayer; DIANE WOLFTHAL, Arizona taxpayer; MAURICE WOLFTHAL, Arizona taxpayer; LYNN HOFFMAN, Arizona taxpayer,

*Respondents.*

**On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit**

## PETITIONER'S BRIEF ON THE MERITS


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## QUESTION PRESENTED

Did the Ninth Circuit err in holding, in conflict with the First, Fifth, Sixth, and Eleventh Circuits, that the Tax Injunction Act, 28 U.S.C. § 1341, and principles of comity that traditionally restrain federal judicial interference with state tax systems do not require district courts to dismiss constitutional challenges to state tax credits that directly impact the administration of a State's tax system?

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## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit is reported at 307 F.3d 1011 (9th Cir. 2002), and is reprinted at Petitioner's Appendix (Pet. App.) 11. The denial of rehearing en banc and Judge Kleinfeld's dissent from that denial, which was joined by Judge O'Scannlain, is reported at 321 F.3d 911 (9th Cir. 2003), and is reprinted at Pet. App. 1. The district court's unreported decision is reprinted at Pet. App. 27.

## JURISDICTION

Respondents invoked the district court's jurisdiction under 28 U.S.C. §§ 1331 and 1343(a). The United States Court of Appeals for the Ninth Circuit issued its judgment and opinion on October 3, 2002. The Ninth Circuit denied the request for rehearing en banc on March 5, 2003. Petitioner filed the Petition for Writ of Certiorari on June 3, 2003. The Court granted certiorari on September 30, 2003, and has jurisdiction under 28 U.S.C. § 1254(1).

## STATUTES INVOLVED

The Tax Injunction Act, 28 U.S.C. § 1341, provides that "[t]he 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." Section 43-1089, Arizona Revised Statutes (A.R.S.), allows Arizona taxpayers to reduce their state tax liability by claiming a credit for amounts they have already paid to a "school tuition

organization." The complete text of A.R.S. § 43-1089 is set forth at Pet. App. 37.

## STATEMENT OF THE CASE

This case concerns whether the Tax Injunction Act and the principles of comity prohibit a federal district court from interfering with state income tax assessments by enjoining the Director of the Arizona Department of Revenue from allowing taxpayers to use a state tax credit. As this Court has recognized, the Tax Injunction Act "and the decisions of this Court which preceded it, reflect the fundamental principle of comity between federal courts and state governments that is essential to 'Our Federalism,' particularly in the area of state taxation." *Fair Assessment in Real Estate Ass'n v. McNary*, 454 U.S. 100, 103 (1981). That essential principle as codified in the Tax Injunction Act applies as surely to an injunction against the granting of a tax credit as it does to an injunction against the collection of state revenue.

The Ninth Circuit's contrary conclusion ignores the statutory language of the Tax Injunction Act, which bars restraints on the *assessment* of taxes in addition to the *collection* of taxes, and the Act's overriding federalism purpose. *See California v. Grace Brethren Church*, 457 U.S. 393, 409 n.22 (1982) ("the legislative history of the Tax Injunction Act demonstrates that Congress worried . . . about divesting the federal courts of jurisdiction to interfere with State tax administration"); *Fair Assessment*, 454 U.S. at 103. The Ninth Circuit's holding also conflicts with a long line of this Court's decisions that recognize the "dangers inherent in disrupting the administration of

state tax systems." *Grace Brethren*, 457 U.S. at 410 n.23 (citing *Dows v. City of Chicago*, 78 S. Ct. (11 Wall.) 108 (1871)).

The Ninth Circuit's unjustifiedly restricted construction of the Act and principles of comity will result in increased and duplicative federal court litigation involving all aspects of state tax administration despite plain, speedy, and adequate state court remedies. The history of the present dispute shows the extent of this unnecessary duplication. In 1999, two years after the enactment of A.R.S. § 43-1089, the Arizona Supreme Court decided the same issues raised by the Respondents in this case and this Court denied certiorari. *Kotterman v. Killian*, 972 P.2d 606 (Ariz. 1999), *cert. denied*, 528 U.S. 921, *cert. also denied in Rhodes v. Killian*, 528 U.S. 810 (1999). According to the Ninth Circuit, however, those same issues must now be relitigated in the federal courts. This Court should reverse the Ninth Circuit and clarify that the Tax Injunction Act and principles of comity preclude federal court interference with the administration of all phases of a State's tax system.

### A. Statement of Facts.

In 1997, the Arizona Legislature enacted A.R.S. § 43-1089. Pet. App. 37. That statute allows taxpayers to reduce their state income tax liability by claiming a credit for amounts they have paid to a school tuition organization ("STO"). Specifically, the statute permits any person owing $500 or more in Arizona income taxes in any tax year to reduce state tax liability by up to $500 if a contribution is made to an STO. Pet. App. 28. The Arizona Legislature raised the maximum credit allowed for a married couple to $625 per year, effective January 1, 2001.

Pet. App. 12. STOs must use the donated funds to provide scholarships to students attending private elementary and secondary schools in Arizona and may provide scholarships to students attending religious schools. Pet. App. 12-13, 28.

Shortly after the Arizona Legislature enacted A.R.S. § 43-1089, several Arizona taxpayers brought an action directly in the Arizona Supreme Court challenging its constitutionality. *Kotterman v. Killian*, 972 P.2d 606 (Ariz. 1999), *cert. denied*, 528 U.S. 921, *cert. also denied in Rhodes v. Killian*, 528 U.S. 810 (1999). Like Respondents here, the *Kotterman* plaintiffs alleged that A.R.S. § 43-1089 violated the Establishment Clause; they also alleged that the statute violated the Arizona Constitution. *Id.* at 610. The Arizona Supreme Court held that A.R.S. § 43-1089 did not violate the Establishment Clause. *Id.* at 616.

### B. Proceedings Below.

Respondents are Arizona taxpayers who allege that A.R.S. § 43-1089 violates the First and the Fourteenth Amendments of the United States Constitution because it authorizes the use of funds raised through state taxation to provide direct support for religious education. Pet. App. 13, 29. Respondents brought suit in the United States District Court for the District of Arizona against J. Elliott Hibbs, in his official capacity as Director of the Arizona Department of Revenue ("State").[1]

[1] J. Elliott Hibbs became the Director of the Arizona Department of Revenue on January 6, 2003, replacing Mark W. Killian, the original Defendant in this action. Accordingly, Hibbs has been substituted as a party pursuant to Supreme Court Rule 35.3.

Respondents request a declaration that A.R.S. § 43-1089, on its face and as applied, violates the Establishment Clause and an injunction that

> prohibit[s] defendant from allowing taxpayers to utilize the tax credit authorized by A.R.S. § 43-1089 for payments made to STOs that make tuition grants to children attending religious schools, to children attending schools of only one religious denomination, or to children selected on the basis of their religion.
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> . . . .
>
> . . . order[s] that Defendant [Hibbs] inform all STOs that make tuition grants to children attending religious schools, to children attending schools of only one religious denomination, or to children selected on the basis of their religion, that all funds in their possession as of the date of this Court's order must be paid into the state general fund.

Joint App. at 15.

The district court granted the State's Motion to Dismiss on the grounds that it had no subject-matter jurisdiction to hear the matter under the Tax Injunction Act. Pet. App. 12, 36. The court found persuasive the Sixth Circuit's interpretation of the Act in *In re Gillis*, 836 F.2d 1001, 1005 (6th Cir. 1988), and held that the jurisdictional bar imposed by the Act was not limited to lawsuits that challenge the collection of taxes. Pet. App. 31. The court also held that even "[a]ssuming the tax credits are not covered by the specific language of the Act, the underlying principles of comity and equitable restraint that are

embodied in the [Act] prevent this Court from exercising jurisdiction over the action." Pet. App. 34 (citing *Fair Assessment*, 454 U.S. at 108, and *Gillis*, 836 F.2d at 1005).

On appeal, the Ninth Circuit reversed, holding that neither the Tax Injunction Act nor the principles of comity bar Respondents' challenge to Arizona's tax credit. Pet. App. 26. With respect to the Act, which bars district court interference with the "assessment, levy or collection" of any state tax, the Ninth Circuit concluded that a determination of tax liability made after taking account of a tax credit does not constitute an "assessment" within the meaning of the Act. In reaching that decision, the court rejected both relevant dictionary definitions and ordinary understandings of the word "assessment." Instead, the Ninth Circuit narrowly defined "assessment" to cover only those tax calculations made in the course of determining "gross" income, and not those made "after a taxpayer's gross income has been determined" but before the taxpayer's ultimate liability is established. Pet. App. 16. The court also held that the Respondents' suit was not barred by the principles of comity. According to the Ninth Circuit, those principles apply only to federal court relief that would interfere with the State's ability to *collect* a tax, and not to injunctions that affect state tax administration more generally. Pet. App. 23-26.

In accordance with the Ninth Circuit's sua sponte order dated November 12, 2002, the parties filed supplemental briefs addressing whether the Ninth Circuit should rehear the case en banc. *Id.* In a published order dated March 5, 2003, the court declined to rehear the case en banc. Pet. App. 1. Judge Kleinfeld dissented from the denial and Judge O'Scannlain joined. Pet. App. 2.

In his dissent, Judge Kleinfeld disagreed with the panel's narrow definition of the term "assessment" in the Tax Injunction Act and instead defined it as the process of calculating a person's final tax bill after all deductions and credits are accounted for. In support, Judge Kleinfeld pointed to definitions of "assessment" in the Internal Revenue Code, lay dictionaries, tax treatises, and law dictionaries. Pet. App. 3-4. Under the proper definition of assessment, Judge Kleinfeld reasoned, "the Tax Injunction Act deprives the federal courts of jurisdiction to enjoin states from granting tax credits as part of the calculation due." Pet. App. 5. Judge Kleinfeld also determined that the principles of comity necessitated overturning the panel's decision. Pet. App. 6. He found that, under this doctrine, "federal district courts are required to dismiss claims asserting challenges to state tax systems, whether they are constitutional or not, and whether they are technically within the Tax Injunction Act's ban or not, so long as there is an adequate state remedy available." Pet. App. 7.

## SUMMARY OF ARGUMENT

This case involves an issue of federalism that is critical to the cooperative relationship between the federal courts and state governments. The question presented here, which involves the extent of the federal courts' jurisdiction over litigation that interferes with state tax systems, goes to the core principles of state sovereignty. Respondents' federal court lawsuit, an Establishment Clause challenge to an Arizona tax credit, is barred by the plain language of the Tax Injunction Act, which is consistent with the broad federalism purpose of the Act. Respondents' lawsuit is also barred by the principles of comity

because Respondents request injunctive and declaratory relief that would interfere with Arizona's administration of its taxes.

A. The Tax Injunction Act prohibits federal district courts from "enjoin[ing], suspend[ing], or restrain[ing] the assessment, levy or collection of any tax under state law" where there is a "plain, speedy and efficient remedy" in the state courts. 28 U.S.C. § 1341. Respondents' lawsuit, which seeks an injunction against implementation of certain state tax credits, is barred because it would interfere with the "assessment" of taxes. The ordinary meaning of "assessment" is the process of calculating a person's final tax bill after all deductions and credits are accounted for." Pet. App. 3 (Kleinfeld, J., dissenting). This meaning fits in the context of the Act's broad language, which follows "assessment" with "levy" and "collection" to encompass every stage of the state tax system. This meaning is also consistent with Congress's use of the term in the Internal Revenue Code and the Court's understanding of that term. The plain language of the statute is clear, and enough to dispose of this case: Respondents may not proceed in federal court because their challenge interferes with the "assessment" of state taxes.

B. The Tax Injunction Act's broad federalism purpose is entirely consistent with the straightforward text of the statute. This Court has consistently recognized that, when it enacted the Tax Injunction Act, Congress was concerned generally about federal-court intervention in the States' core sovereign function of taxation. Thus, the prohibition is worded broadly to encompass all phases of the state tax system, and to prevent not only federal-court interference with state revenue collection but also interference with

state officials' ability to do their duties and state courts' responsibility to interpret state tax laws.

Instead of heeding this broad federalism purpose, the Ninth Circuit jealously guarded its jurisdiction by finding that Respondents' lawsuit was not barred by the Tax Injunction Act because Congress intended only to prohibit federal-court litigation that would have an adverse effect on state tax collection. This holding cannot be squared with the statutory language or the legislative history, and it directly disregards this Court's admonition in *Arkansas v. Farm Credit Service*: "Given the systemic importance of the federal balance, and given the basic principle that statutory language is to be enforced according to its terms, federal courts must guard against interpretations of the Tax Injunction Act which might defeat its purpose and text." 520 U.S. 821, 827 (1997).

C. Respondents' lawsuit is also barred by the principles of comity that have traditionally restrained the federal courts from exercising their equitable powers in state tax cases where the state law affords adequate relief. Both before and after the enactment of the Tax Injunction Act, the Court has applied the principles of comity expansively to avoid disruption of state tax administration, which is an area of particular state concern. Respondents' lawsuit requests both declaratory and injunctive relief that would significantly disrupt Arizona's tax administration if granted. If the district court were to enjoin the State from allowing taxpayers to use the tax credit, the State would be unable to determine the liability of thousands of Arizona taxpayers with certainty until this case is finally resolved. Moreover, invalidating the Arizona tax credit and enjoining its use would result in inconsistent judgments between the federal court and the Arizona

Supreme Court – precisely the type of harm that the principles of comity are designed to prevent. In finding that comity did not bar the district court's jurisdiction, the Ninth Circuit ignored "the fundamental principle of comity between federal court and state governments that is essential to 'Our Federalism.'" *Fair Assessment*, 454 U.S. at 103. By itself, that is a sufficient and alternative ground for reversing the Ninth Circuit's decision.

## ARGUMENT

### RESPONDENTS' FEDERAL-COURT LAWSUIT CHALLENGING ARIZONA'S TAX CREDIT IS BARRED BY THE TAX INJUNCTION ACT AND PRINCIPLES OF COMITY.

#### A. Respondents' Lawsuit Challenging Arizona's Tax Credit Is Barred by the Plain Language of the Tax Injunction Act.

The Tax Injunction Act prohibits federal district courts from "enjoin[ing], suspend[ing] or restrain[ing] the assessment, levy or collection" of any state tax as long as there is a "plain, speedy and efficient remedy in state court." 28 U.S.C. § 1341. The question in this case is whether an injunction against implementation of a tax credit interferes with an "assessment" under the Act.[2] The

[2] Respondents in this case have never argued that the state law remedy available to them was inadequate. Indeed, the Arizona Supreme Court decided the exact issues raised here shortly after the Arizona Legislature enacted the tax credit in A.R.S. § 43-1089. *Kotterman*, 972 P.2d at 610.

Ninth Circuit concluded that the term "assessment" reaches only the calculation of *gross* income on a tax form, but not the application of a tax *credit* to determine bottom-line tax liability. But that strained definition ignores the ordinary meaning of "assessment" that fits within the context of the Act's language and the common understanding of "assessment" in federal and state precedent. Respondents' lawsuit requests relief that interferes with the assessment of state income taxes and is therefore prohibited by the Tax Injunction Act.

1. In statutory construction cases, this Court first determines "whether the language at issue has a plain and unambiguous meaning with regard to the particular dispute in the case." *Barnhart v. Sigmon Coal Co.*, 534 U.S. 438, 450 (2002) (internal quotations omitted); *see also Rosewell v. LaSalle Nat'l Bank*, 450 U.S. 503, 512 (1981). ("The starting point of our inquiry is the plain language of the statute itself.") "The inquiry ceases if the statutory language is unambiguous and the statutory scheme is coherent and consistent." *Barnhart*, 534 U.S. at 450 (internal quotations omitted). Here, the ordinary and plain meaning of the word "assessment" is reinforced by its statutory context. There is no reason for the Court to go beyond the plain language of the statute.

Because "assessment" is not defined in the Act, it should be construed in accordance with its ordinary meaning and in light of the terms that surround it. *Smith v. United States*, 508 U.S. 223, 226 (1993). In ordinary usage, an "assessment" is "the process of calculating a person's final tax bill after all deductions and credits are

accounted for." Pet. App. 4 (Kleinfeld, J., dissenting); *see also ACLU Found. v. Bridges*, 334 F.3d 416, 422 (5th Cir. 2003) (defining "assessment" as "the entire plan or scheme fixed upon for charging or taxing"). Put even more simply, a "tax assessment" is a tax *bill*: the final amount owed to the government. Under that ordinary and sensible understanding of the word "assessment," a federal court challenge to a state tax credit – a component of a taxpayer's ultimate liability – is barred by the plain terms of the Tax Injunction Act.

Dictionary definitions of "assessment" support this common-sense interpretation. Current dictionary definitions of "assessment" include "the entire plan or scheme fixed upon for charging or taxing" and "the act of assessing: the act of apportioning or determining an amount to be paid," *Webster's Third New International Dictionary* 131 (1981) – both of which correspond to the ordinary understanding that "assessment" refers to a taxpayer's bottom-line liability to the state. Dictionaries available in 1937, when Congress enacted the Tax Injunction Act, are to the same effect. For example, *Webster's New International Dictionary of the English Language* defines "assessment" as the "act of apportioning or determining an amount or amount to be paid"; "[t]he entire plan or scheme fixed upon for charging or taxing." 166 (2d ed. 1934).[3]

[3] In *Rosewell*, 450 U.S. at 516, the Court relied on the same dictionary to determine the meaning of the words "plain," "speedy," "efficient," and "remedy," as used in the Act.

When the word "assessment" is read together with the terms that surround it, it becomes even more clear that "assessment" refers to the final determination of tax liability. First, the context eliminates one dictionary definition upon which the Ninth Circuit relied: "to estimate officially the value of (property, income, etc.) as a basis for taxation." Pet. App. 16 (quoting *Random House Dictionary of the English Language* 90 (1979)). That definition does not fit with the surrounding words of the Act. The Act does not contain the word "property"; property is not the subject of the term "assessment" in the provision. Second, defining "assessment" as the determination of the amount to be paid also fits with the words "levy" and "collection" in the Act. When viewed together, it is clear that the three terms are intended to encompass all three of the major parts of the state taxation system: the "assessment" (the determination of the tax) is first, followed by the "levy" (the imposition of the tax), followed by the "collection" (obtaining payment of the tax). In short, the statutory context only confirms that "assessment" should be construed according to its ordinary meaning as a final determination of tax liability.

This common-sense construction of "assessment" is also supported by Congress's use of the term in the Internal Revenue Code. In the Code, Congress uses the word "assessment" to refer to the ultimate tax liability of a taxpayer – that is, "how much money the taxpayer owes to the government in taxes, after consideration of any credits as well as deductions." Pet. App. 5 (Kleinfeld, J., dissenting); *see*, *e.g.*, 26 U.S.C. § 6201(a)(1) ("[t]he Secretary shall 'assess' all taxes" shown on tax returns); 26 U.S.C. § 6203 ("assessment shall be made by recording the liability of the taxpayer"). As Judge Kleinfeld correctly concluded,

"[t]here is no reason to think that Congress meant something narrower in the Tax Injunction Act than it did in the Internal Revenue Code." Pet. App. 5.

Finally, this Court itself has used and understood the term "assessment" to mean the determination of tax liability. For example, in *United States v. Fior D'Italia, Inc.*, the Court stated that "[a]n assessment amounts to an IRS *determination* that a taxpayer owes the Federal Government a certain amount of unpaid taxes." 536 U.S. 238, 242 (2002) (emphasis added). The Court then held that the provision of the Internal Revenue Code that grants the IRS assessment authority "must simultaneously grant the IRS power to decide *how* to make that assessment." *Id.* at 243; *cf*. *New Energy Co. v. Limbach*, 486 U.S. 269, 274 (1988) (state action in allowing tax credit directly concerns State's "assessment and computation of taxes").

2. The Ninth Circuit simply ignored most of this evidence in the course of concluding that the term "assessment" in the Tax Injunction Act refers to the calculation of *gross* taxable income but not to "below-the-line" calculations of total tax liability. That narrow and strained definition of "assessment" is contrary to common usage, inconsistent with the Ninth Circuit's own understanding of the purpose of the Act, and irreconcilable with Arizona's own system for calculating state taxes.

The Ninth Circuit rests its entire statutory analysis on one selective quotation from a dictionary, defining "assess" as "(1) 'to estimate officially the value of (property, income, etc.) as a basis for taxation,' and (2) 'to impose a tax or other charge on.'" Pet. App. 16 (quoting *Random House Dictionary of the English Language* 90 (1979)). As

discussed above, the first of those definitions is a poor fit with the statutory context, which does not use "property" or "income" as the subject of "assessment"; the second refers as easily to the State's understanding of "assessment" as ultimate taxpayer liability as it does to the Ninth Circuit's proposed interpretation of the word. More important, the Ninth Circuit simply omitted an alternative definition from the same dictionary: "2. to fix or determine the amount of (damages, a tax, a fine, etc.)." *Random House Dictionary of the English Language* 90 (1979). That definition – which fits neatly with the surrounding text – corresponds perfectly to the common-sense understanding that "assessment" means ultimate tax liability once all deductions and credits are calculated.

The Ninth Circuit's strained interpretation of "assessment" is inconsistent not only with the term's plain meaning but also with the court's own understanding of the purpose of the Tax Injunction Act. According to the Ninth Circuit, the Tax Injunction Act is implicated only when federal court relief would interfere with a State's ability to collect tax revenue. Pet. App. 21. But even the Ninth Circuit's selected dictionary definitions of "assessment" do not impose that limit. And the Ninth Circuit's own definition – under which a tax *deduction* made in the course of calculating gross revenue is part of an "assessment," though a tax *credit* applied below-the-line is not, Pet. App. 16-17 & n.5 – fails to track the court's notion of statutory purpose. Under the Ninth Circuit's theory, a challenge to a tax deduction would be precluded despite the fact that the relief requested would not hinder the State's ability to collect tax revenue. The Court should therefore reject the Ninth Circuit's construction of "assessment."

3. In Arizona, taxpayers determine their income tax liability by subtracting both allowable deductions and credits. This is readily apparent from the 2000 Arizona Personal Income Tax Return (Form 140), which sets forth the Arizona taxpayer's liability on line 40, after all deductions *and credits* have been taken into account. Joint App. 56. Thus, a district court injunction that disallows tax credits would not allow the State of Arizona to "assess" the tax due under state law.[4] It is therefore prohibited by the Tax Injunction Act.

In sum, the ordinary meaning of "assessment" comprehends any calculation or adjustment that affects the taxpayer's bottom-line liability. That common-sense understanding is confirmed when the term "assessment" is read in context, and in light of Congress's consistent usage of the term in the Internal Revenue Code. This federal-court lawsuit challenging Arizona's tax credit is foreclosed by the plain language of the Act, and that is enough to dispose of this case.

[4] Other state courts also treat tax credits as an integral part of the assessment of taxes. *See* 85 C.J.S. *Taxation* § 1758 (2003) ("in making an assessment [of taxes], the assessing officer should take into account all deductions and credits to which the taxpayer is lawfully entitled, and compute them in the manner required by statute") (citing *Wiegand v. Hefferman*, 368 A.2d 103 (Conn. 1978); *State Tax Comm'r v. Carpenter*, 200 A.2d 437 (Del. Super. 1964); and *Grunewald v. Mich. Dep't of Treasury*, 305 N.W.2d 269 (Mich. App. 1981).

### B. Applying the Tax Injunction Act to Preclude Respondents' Lawsuit Challenging Arizona's Tax Credit Is Consistent with the Act's Broad Federalism Purpose.

Because Respondents' lawsuit is barred under the plain language of the Tax Injunction Act, the Court need not resort to legislative history to resolve this case. *See Davis v. Mich. Dep't of Treasury*, 489 U.S. 803, 808-09 n.3 (1989) (resort to legislative history unnecessary where statutory text is clear). However, giving "assessment" its ordinary meaning of "determining the amount of tax owed" is entirely consistent with the congressional purpose behind the Tax Injunction Act. As this Court has long recognized, Congress enacted the Tax Injunction Act to further the broad federalism purpose of limiting federal interference with a core aspect of state sovereignty. Construing the Act to preclude federal-court challenges to state tax credits directly advances this core purpose.

1. In construing the Tax Injunction Act, this Court consistently has been mindful of the broad federalism purpose that underlies the Act. For example, in *Rosewell*, the Court generously interpreted the Tax Injunction Act's "plain, speedy and efficient" language to encompass even a tax refund procedure that does not pay interest on taxes collected under protest. In addition to the Act's language and history, the Court relied on Congress's intent "to transfer jurisdiction over a class of substantive federal claims from the federal district courts to the state courts." 450 U.S. at 515 n.19.

Similarly, in *Grace Brethren*, the Court interpreted the Act to prohibit suits for declaratory relief as well as injunctive relief – even though the Act does not explicitly mention declaratory actions – because "the legislative

history of the Tax Injunction Act demonstrates that Congress worried not so much about the form of relief available in the federal courts, as about divesting the federal courts of jurisdiction to interfere with state tax administration." 457 U.S. at 409 n.22. Most recently, in narrowly interpreting the judicial exception to the Act for suits by the United States, the Court recognized that "[e]nactment of the Tax Injunction Act of 1937 reflects a congressional concern to confine federal court intervention in state government." *Farm Credit Servs.*, 520 U.S. at 826-27.

Thus, when interpreting the Tax Injunction Act, this Court has begun with the presumption that "federal law generally will not interfere with administration of state taxes." *Nat'l Private Truck Council, Inc. v. Okla. Tax Comm'n*, 515 U.S. 582, 588 (1995). Giving the term "assessment" its ordinary meaning and interpreting the Act to preclude federal court interference with all phases of tax administration is entirely consistent with this well-understood congressional purpose.

2. Contrary to this Court's precedents, the Ninth Circuit takes the position that the purpose of the Tax Injunction Act is limited "to prevent[ing] the disruption on a state's efforts to collect tax." Pet. App. 18.[5] But that theory cannot be reconciled with the Act's language, which makes perfectly clear that the scope of the Act is not so

[5] The Ninth Circuit also noted that Congress was concerned about "the discriminatory effect of diversity jurisdiction in tax cases" and intended to eliminate the advantage of foreign parties to avoid paying a disputed tax. Pet. App. 18 n.6. That purpose, the court concluded, is not relevant to the instant case. Pet. App. 18.

confined. The Tax Injunction Act forbids interference not only with the "collection" of state taxes, but with the "assessment, levy *or* collection" of taxes. The Ninth Circuit's reading of the Act to apply only to tax "collection" renders the words "assessment" and "levy" entirely meaningless. Indeed the Ninth Circuit's own definition of "assessment" is inconsistent with the limited purpose that it ascribes to the Act. Under the Ninth Circuit's theory, the term "assessment" extends to above-the-line tax deductions, *see* Pet. App. 16-17 & n.5, despite the fact that a challenge to tax deductions does not interfere with the "collection" of state taxes. Even the Ninth Circuit cannot construe the Act's text in a way that corresponds to its cramped notion of congressional purpose. In fact, the Act's statutory text demonstrates that Congress intended to prevent federal-court interference with more than the collection of state taxes.

Like the plain language of the statute, the Tax Injunction Act's legislative history demonstrates that Congress sought to eliminate federal-court challenges that interfere with the States' administration of their core sovereign functions, and not merely to prevent interference with the collection of revenue. This Court has held that the legislative history of the Johnson Act of 1934 (currently codified at 28 U.S.C. § 1342), is highly relevant in construing the Tax Injunction Act, because the Congress that enacted the Tax Injunction Act expressly relied on the congressional purpose underlying the Johnson Act. *Grace Brethren*, 457 U.S. at 410 n.22. The Johnson Act prohibits federal-court interference with orders issued by state administrative agencies to public utilities. The Johnson Act's legislative history demonstrates that its purpose was to prevent public utilities from avoiding state administrative and

judicial proceedings by going to federal district court to challenge state administrative orders. *See*, *e.g.*, S.Rep. No. 73-125 at 33 (1933). ("It is the jurisdiction which Congress has given to Federal courts to pass on matters of State regulation which holds up the laws of the States, prevents the officials of the States from doing their duty, and robs the people of the benefit which would accrue to them, if the commissions which they have set up by law in the various States were permitted to perform their duty") (quoted in *Grace Brethren*, 457 U.S. 410 n.22); H.R. Rep. No. 73-1194 at 2 (1934) (in opposition to the Johnson bill, declaring that it "seeks to withdraw completely from the district courts of the United States all jurisdiction in suits relating to orders of State administrative boards or commissions affecting rates chargeable by public utilities") (quoted in *Grace Brethren*, 457 U.S. 410 n.22.); 78 Cong. Rec. 8338 (1934) (remarks of Rep. Tarver) ("The Johnson bill contains but one substantive proposition, and that is to divest the district courts of the United States of jurisdiction in public-utility rate cases") (quoted in *Grace Brethren*, 457 U.S. 410 n.22.); *Id.* at 8419 (remarks of Rep. Hancock) ("the Johnson bill seeks to [save time and money] by divesting the Federal courts of all jurisdiction in public-utility cases except the right of appeal to the Supreme Court of the United States after the final decision of the State court of last resort") (quoted in *Grace Brethren*, 457 U.S. 410 n.22.).

Thus, in relying on the purpose underlying the Johnson Act to support its enactment of the Tax Injunction Act, Congress indicated its concern with federal-court interference with all aspects of state tax administration, and not just interference with the collection of revenue. Like utility

regulation, state tax administration involves a core sovereign function of state government; as with utility regulation, allowing federal courts to pass on state tax issues would inhibit the state officials from doing their duties in implementing the tax system.

Further, the Court has recognized that, just as it was concerned about the federal-court interpretation of state utility law, Congress was also concerned about federal-court interpretation of state tax law. *Fair Assessment*, 454 U.S. at 108-09 n.6 ("'federal constitutional issues are likely to turn on questions of state tax law, which, like issues of state regulatory law, are more properly heard in the state courts'") (quoting *Perez v. Ledesma*, 401 U.S. 82, 128 n.17 (1971) (Brennan, J., concurring in part and dissenting in part)). In addressing the importance of the restrictions imposed by the Tax Injunction Act, the Court recently stated: "The federal balance is well served when the several States define and elaborate their own laws through their own courts and administrative processes and without undue interference from the Federal Judiciary. The States' interest in the integrity of their own processes is of particular moment respecting questions of state taxation." *Farm Credit Servs.*, 520 U.S. at 826.

3. In addition to being contrary to statutory text and legislative history, the Ninth Circuit's position is hopelessly illogical. Congress could not have intended to limit the Tax Injunction Act to cases in which "the adjudication of a constitutional claim in federal court . . . will hamper a state's ability to raise revenue," Pet. App. 21, because that standard would leave the federal courts and litigants with a test that is difficult to manage and leads to absurd results.

Like most other state tax laws,[6] Arizona's tax laws provide numerous credits, deductions, and exemptions from personal income,[7] corporate income,[8] and sales

[6] *See* States' Amici Brief in Support of Petitioner on the Merits at 2-4.

[7] For example, A.R.S. § 43-1022 lists twenty-eight different subtractions for a wide variety of income and expenditures. *See also* A.R.S. §§ 43-1023 (exemptions for blind persons and persons over sixty-five); -1027 (subtraction for wood stoves); -1028 (medical savings accounts); -1030 (subtraction for World War II victims); -1031 (subtraction for constructing an energy efficient residence); -1041 (standard deduction); -1042 (itemized deductions, defined as deductions allowed under the Internal Revenue Code with some adjustments); -1043 (personal exemptions); -1071 (credit for taxes paid to other states); -1072 (earned credit for property taxes); -1072.01 (credit for increased excise taxes paid); -1073 (family income tax credit); -1074 (credit for increased employment in enterprise zones); -1074.01 (credit for increased research activities); -1075 (credit for dependent day care facilities); -1076 (recycling equipment credit); -1077 (credit for employment by qualified defense contractor); -1078 (credit for property tax paid by qualified defense contractor); -1079 (credit for increased employment in military reuse zones); -1080 (credit for construction costs of qualified environmental technology); -1081 (credit for pollution control equipment); -1081.01 (credit for agricultural pollution control equipment); -1081.02 (credit for taxpayers participating in agricultural preservation district); -1082 (credit for construction materials incorporated into qualifying facility); -1083 (credit for solar energy devices); -1084 (credit for agricultural water conservation system); -1085 (credit for corrective action costs for underground storage tanks); -1086 (credit for alternative fuel vehicles); -1086.01 (credit for vehicle refueling apparatus and infrastructure); -1086.02 (credit for alternative fuel delivery systems); -1087 (credit for employment of temporary assistance for needy families recipients); -1088 (credit for contribution to charitable organization that provides assistance to the working poor); -1088.01 (credit for technology training); -1089 (credit for contributions to school tuition organization); -1089.01 (tax credit; public school fees and contributions); -1089.02 (credit for donation of school site); -1090 (credit for solar hot water heater etc.); 16-954(B) (credit for contributions to Citizens Clean Election Fund).

[8] A.R.S. §§ 43-1122 through -1130.01.

tax.[9] If, as the Ninth Circuit believes, the Act were limited to cases in which litigation would hinder tax collection, then federal court jurisdiction would turn on whether a given state policy was implemented in the form of a selective tax or a selective tax exemption, deduction, or credit.

For example, if a State wished to impose a tax on dividends, but not dividends from corporations doing most of their business in the State, it could do so in two ways. First, it could enact a tax on dividends received from corporations doing less than half of their business in the State. Alternatively, it could enact a tax on all dividend income, with a deduction or subtraction for dividends received from corporations doing at least half of their business in the State. Under the Ninth Circuit's interpretation of the Tax Injunction Act, taxpayers could not challenge the first provision in federal court because an injunction against the enforcement of the deduction would increase revenues. The challenge to the second provision, on the other hand, which reflects precisely the same state policy, could be brought in federal court. This Court has recognized in the Commerce Clause context that there is no meaningful distinction between a tax credit given to favored taxpayers and a tax penalty imposed on disfavored taxpayers. *See Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 579 (1997) (invalidating tax

[9] For example, the statute defining the tax on retail sales specifically excludes fifty-three categories of receipts and provides for more than twenty-five deductions. A.R.S. § 42-5061(A), (B), (E), (K) and (L). Under the Ninth Circuit's interpretation of the Act, each of these categories could be challenged in federal court.

scheme granting tax exemptions to in-state taxpayers; no distinction between deprivation of the tax benefit as compared to the imposition of "taxes targeting out-of-staters alone"); *see also Maryland v. Louisiana*, 451 U.S. 725, 756 (1981) (state tax scheme "unquestionably discriminates against interstate commerce . . . as the necessary result of various tax credits and exclusions."). There is no reason to import one into the Tax Injunction Act, as the Ninth Circuit has done here.

Moreover, the Ninth Circuit's proposed rule would invite taxpayers who do not want to go through the normal state tax proceedings to obtain federal court jurisdiction by clever pleading. For example, in the Ninth Circuit, a taxpayer challenging a state tax deduction as discriminatory under either the Equal Protection Clause or the Commerce Clause can go to federal court and seek injunctive relief against the allowance of the deduction to its competitors. If successful, it could then use the judgment as the basis for a tax refund claim in a state court proceeding. Avoiding this type of jurisdictional gamesmanship in tax disputes is one reason why the Tax Injunction Act is given a broad interpretation. *Cf. United States Brewers Ass'n, Inc. v. Perez*, 592 F.2d 1212, 1214 ("The requested injunction . . . could be framed in two ways, either by ordering the state not to collect the tax increase or by requiring the state to levy the tax hike on exempt as well as nonexempt parties.").

Finally, a rule that distinguishes between challenges to state taxes that adversely affect state revenue and those that do not is inherently unmanageable. In this case, the Ninth Circuit jumped to the conclusion that invalidating a tax credit will necessarily *enhance* the State's ability to collect revenue, so that a challenge to a tax credit does not

implicate the Tax Injunction Act. Pet. App. 20. But, as the Fifth Circuit noted in *Bridges*, "it is not necessarily true that declaring the exemptions to be unconstitutional will result in the State collecting more taxes." 334 F.3d at 421. "[T]he State may resolve any putative constitutional problems created by the challenged statutes by exempting more entities and therefore collecting less taxes." *Id.* This is a case in point. A tax credit ruled unconstitutional on Establishment Clause grounds might be stricken altogether, increasing state tax revenue, or it might be cured by expanding the credit (for instance, by expanding the tax credit for donations to public schools), with the result that state tax revenue would decrease. In any event, the invalidation of a tax credit may result in a host of other litigation that affects a State's ability to raise revenue. In short, it may be impossible to know at the outset of litigation precisely how a successful challenge to a tax credit (or any other feature of a state tax scheme) will affect state revenue collection. There is no reason to think that Congress intended federal court jurisdiction to turn on that elusive factor.

The Court should interpret the Tax Injunction Act consistent with its language and purpose to provide clear guidance to the federal courts and litigants concerning the scope of federal court jurisdiction over state tax matters. Because this lawsuit falls within the prohibition of the Tax Injunction Act, the Court should order it to be dismissed.

### C. The Principles of Comity Preclude the District Court from Granting Respondents Injunctive and Declaratory Relief that Interfere with State Tax Administration.

The plain terms of the Tax Injunction Act are enough to resolve this dispute. But even if the Tax Injunction Act did not preclude Respondents' federal-court action, the principles of comity would. In rejecting this alternative argument, the Ninth Circuit again relied on a supposed distinction between federal-court "litigation that interferes with the ability of the states to raise necessary tax revenues" and federal-court litigation that does not. Pet. App. 26. That holding ignores the crucial federalism underpinnings of the Court's comity decisions and the disruptive effect on state tax administration that could result if the district court granted the relief that Respondents request. Because Respondents seek equitable relief that interferes with state tax administration, the principles of comity bar this lawsuit.

1. The Court has long recognized that principles of comity between federal courts and state governments guide federal courts of equity to withhold injunctive relief where state law affords an adequate remedy. *Matthews v. Rodgers*, 284 U.S. 521, 525 (1932). Because of the role of states as co-sovereigns within our federal system, comity requires federal courts to exercise "scrupulous regard for the rightful independence of state governments . . . and a proper reluctance to interfere by injunction with their fiscal operations." *Id.*

That expansive principle is broader than the terms of the Tax Injunction Act, and applies even in cases that are not covered by the Act. For instance, in *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293, 299 (1943),

the Court relied on comity to hold that federal courts may not exercise their equitable discretion to grant declaratory relief as to the constitutionality of state tax laws – even if the language of the Tax Injunction Act does not bar such suits. In *Rosewell,* the Court recognized that "even where the Tax Injunction Act would not bar federal-court interference in state tax administration, principles of federal equity may nevertheless counsel the withholding of relief." 450 U.S. at 525 n.33. Later, in *Fair Assessment*, the Court held that the principles of comity bar taxpayers' suits in federal court for 42 U.S.C. § 1983 damages to redress allegedly unconstitutional administration of a state tax system, provided there is an adequate state-law remedy. 454 U.S. at 116. Although the Tax Injunction Act did not specifically prohibit damage actions, the Court concluded that "[n]either the legislative history of the Act nor that of its precursor, 28 U.S.C. § 1342, suggests that Congress intended that federal-court deference in state tax matters be limited to the actions enumerated in those sections." *Id.* at 110. Because the Court found that damage actions would be as disruptive to state tax administration as equitable relief, it concluded that the damage actions were also barred by comity. *Id.* at 113-14.

In all of these cases, the Court has applied the principles of comity expansively to avoid disruption to state tax administration. The Ninth Circuit takes the view that because *Great Lakes* and *Fair Assessment* concerned litigation that could interfere with state revenue collection, the rationale of those cases is limited to concerns about tax collection. Pet. App. 23-26. That is incorrect. The Court's primary concern in those cases was to avoid disruption to the states' tax administration system and prevent federal-court intrusion in matters that are of

particular state concern. As the Court stated in *Fair Assessment*, "federal court restraint in state tax matters was based upon the traditional doctrine that courts of equity will stay their hand when remedies at law are plain, adequate, and complete." 454 U.S. at 108; *see also Great Lakes*, 319 U.S. at 298 ("It is in the public interest that federal courts of equity should exercise their discretionary power to grant or withhold relief so as to avoid needless obstruction of the domestic policy of the states."). The same rationale applies here.

2. The Ninth Circuit failed to appreciate not only the scope of the principles of comity but also the extent to which they would be undermined by the relief requested by Respondents. The court below was confident that Respondents' federal-court action would not disrupt Arizona's tax administration in the slightest. Pet. App. 26. That is not so. Respondents request a declaration that the tax credit in A.R.S. § 43-1089 is unconstitutional on its face and as applied. Joint App. 15. They also request an injunction that prohibits the State from allowing taxpayers to utilize the tax credit for payments to STOs that make tuition grants to children attending religious schools and ordering the State to inform those same STOs to return all unexpended funds to the state general fund. *Id.* A court order preventing the State from allowing some credits authorized by state law and leaving others in place is inherently disruptive and will prevent the State from determining the final tax obligation of thousands of taxpayers until the litigation is ended. If an injunction is issued, the State will have to notify all taxpayers of the uncertain nature of the credit, and will probably receive thousands of protective claims for refund from taxpayers who want to preserve their rights to the credit while the

case is still pending. If the injunction is overturned, the State will have to expend monies processing refunds and paying interest. It is also unclear whether, if Respondents prevail on the merits, the State would have to disallow credits carried over from one year to the next, credits for taxpayers audited in the future for prior years, and credits claimed on returns filed for prior years. Any of these issues could raise equal protection problems if similarly situated taxpayers are treated differently.

Moreover, striking down Arizona's STO tax credit would result in precisely the type of harm and disruption the principles of comity are designed to prevent. The Arizona Supreme Court has already ruled on the issues raised by Respondents. *Kotterman*, 972 P.2d at 610, 616. A contrary ruling by the federal district court and the Ninth Circuit would create a direct conflict with the Arizona Supreme Court. The conflicting rulings would require the State either to treat similarly situated taxpayers differently (that is, allowing the parties to the state litigation to use the credit but not permitting the parties to the federal ruling to use the credit) or to follow the state or federal decision in defiance of the other court's ruling. In either event, the result would be uncertainty for Arizona's taxpayers and tax administrators that could only be resolved by another petition to this Court.

Because Respondents' litigation attacks a fundamental element of Arizona's tax administration and Respondents have an adequate state law remedy, the Court should hold that the principles of comity bar this lawsuit.

## CONCLUSION

For the foregoing reasons, this Court should reverse the decision of the Court of Appeals for the Ninth Circuit and remand to the district court to dismiss this matter.

Respectfully submitted,

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