ALABAMA TAX TRIBUNAL

BLACK EAGLE MINERALS, LLC,	§	
Taxpayer,	§	
		DOCKET NOS. BIT. 11-975-JP
v.	§	BIT. 12-1229-JP
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND FINAL ORDER

Black Eagle Minerals, LLC ("Taxpayer"), challenges final assessments of business income tax entered against the Taxpayer by the Alabama Department of Revenue for years 2008, 2009, 2010, and 2011. The assessments are based on the Taxpayer's failure to make composite tax payments on behalf of its members that are not Alabama residents.

Facts

The Taxpayer was formed in 1992 as a Virginia limited liability company. In 1996, the Taxpayer qualified to do business in this state by registering with the Alabama Secretary of State's office. (That registration still is in effect.) The Taxpayer earned income in Alabama from three sources: income from the loading of mined mineral deposits; royalties from the mined minerals; and rent from an unrelated third party that rented a portion of the Alabama facility. No Taxpayer employees worked at the Alabama facility during the years at issue.

During the years 2008 through 2010, the Taxpayer had three owners; two individuals and a family limited partnership that had been organized in Virginia. In 2011, one of the two individual owners transferred his membership interest to a new Virginia limited liability company named Crimson Eagle, LLC. None of the owners of the Taxpayer

were physically present in Alabama during the years at issue, except for two or three brief visits to the Alabama facility by one of the two individual owners and one partner in the family limited partnership. Also, the parties stipulated that none of the owners owned property in Alabama or individually engaged in business in Alabama during the years at issue.

Alabama's Composite Return and Composite Payment Requirements

In 2009, the Alabama legislature passed House Bill 69, which was signed into law by Governor Bob Riley as Act 2009-144. The Act was named the "Entertainment Industry Incentive Act of 2009," and its purpose was to allow Alabama to develop its "potential in terms of attracting the entertainment industry to the state" by offering tax incentives for the making of movies, soundtracks, videos, interactive websites, and such in this state.

To offset the cost of the tax incentives, the Act added §§ 40-18-24.2 and -24.3 to the Alabama Revenue Code. Both of those sections became effective for tax years beginning after December 31, 2008. (Act 2009-144, § 15(b).)

Section 40-18-24.2(b)(1) requires a pass-through entity, such as a partnership or limited liability company, to file a composite income tax return with the Department "on behalf of its nonresident members" and to pay income tax "'on the nonresident members' distributive shares of the income of the pass-through entity. . ." The term "nonresident" is defined in § 40-18-24.2(a)(2) as "[a]n individual who is not a resident of or domiciled in this state. . . ;" a nonresident trust or estate; a foreign corporation that is "not commercially domiciled in this state. . . ;" and "a Subchapter K entity or business trust that is created or organized under the laws of a jurisdiction other than this state and that is not commercially

domiciled in this state." The term "member" is defined in § 40-18-24.2(a)(1) to include "a member of a limited liability company." If the pass-through entity does not comply with the composite reporting and payment requirements, the entity becomes liable for the tax, plus penalties and interest. But the entity is not liable to any member for complying with the requirements. § 40-18-24.2(c)(1).

Any nonresident member that was included in a composite return has the option of filing its own Alabama income tax return for that year. § 40-18-24.2(b)(2). If it does so, the member receives credit for the income tax that was paid on its behalf by the pass-through entity.

There are certain exceptions to the composite reporting and payment requirements, such as when the Department determines that a nonresident member's income is exempt from Alabama income tax or when the pass-through entity is a certain type of partnership that provides the Department with identifying information regarding its nonresident owners. §40-18-24.2(c)(3). Also, the reporting and payment requirements do not apply to nonresident members of a qualified investment partnership or to the qualified investment partnership itself with respect to the nonresident's share of interest, dividends, distributions, gains, or losses from qualifying investment securities owned by the entity, if the nonresident member does not actively participate in the day-to-day management of the entity. § 40-18-24.3(a). By rule, the Department has listed other exceptions. *See* Ala. Admin. Code r. 810-3-24.2-.01(2)(q).

The Taxpayer's Challenges to the Final Assessments

First, the Taxpayer appealed the final assessments that were entered for years

2008, 2009, and 2010. Those appeal notices were prepared as separate documents, but were filed simultaneously and appear to be identical except as to the year in issue and except as to whether the members of the Taxpayer consented to personal jurisdiction for those years. Later, the Taxpayer appealed the final assessment that was entered for 2011. That appeal notice was identical to the Taxpayer's prior appeal notices, with the noted exceptions.

In its appeals, the Taxpayer argued that the tax at issue in the assessments violated the Due Process and Commerce Clauses of the U.S. Constitution. In its first Due Process Clause argument, the Taxpayer claimed that the "'person, property or transaction' sought to be taxed are the individual owners of Black Eagle Minerals." According to the Taxpayer, because the Taxpayer's owners had no connection to Alabama other than their ownership interest, the tax violated the Due Process Clause's requirement that there be "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax," citing *Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 777 (1992), and *Shaffer v. Heitner*, 433 U.S. 186 (1977).

In its second Due Process Clause argument, the Taxpayer stated: "Even if it is determined that the State of Alabama had tax jurisdiction over Black Eagle Minerals so as to require payment of the composite taxes, the tax assessment must still be abated under the Due Process Clause because the State of Alabama lacked tax jurisdiction over the owners of Black Eagle Minerals. Having taxing jurisdiction over the pass-through entity and income in a state is insufficient to support the imposition of tax where the state lacks tax jurisdiction over the party sought to be taxed. There can be no question that the legal

and economic incidence of the composite taxes . . . lies with the owners of Black Eagle Minerals." Thus, according to the Taxpayer, Alabama's composite-payment requirement violated the Due Process Clause.

Concerning the Commerce Clause, the Taxpayer argued that the composite-payment requirement is unconstitutional because "the owners of Black Eagle Minerals – the individuals sought to be taxed – lacked any nexus with the State of Alabama," citing *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). The Taxpayer also argued that the tax "discriminates against interstate commerce. Specifically, the requirement that composite tax payments be made for nonresidents, but not for residents, discriminates against interstate commerce because nonresidents are without use of the money withheld unless and until they seek a refund from the State of Alabama. A pass-through entity would not be required to remit composite tax payments with respect to owners residing in the State of Alabama. This disparate treatment . . . is a clear violation of the Commerce Clause."

The Taxpayer also asserted a Commerce Clause violation "because the taxes at issue are not fairly related to the services provided by the State of Alabama to the owners of Black Eagle Minerals. While the State of Alabama may provide certain services and benefits to Black Eagle Minerals . . . , no such services are provided to the owners of Black Eagle Minerals residing in the Commonwealth of Virginia."

In its initial brief, the Taxpayer argues that § 40-18-24.2(b)(1) "is unconstitutional as applied to Black Eagle," stating that the statute "requires all pass-through entities with nonresident owners to pay Alabama business income tax." The Taxpayer reiterates the Department's position that the statute requires the Taxpayer itself to pay the tax, but states

that "Black Eagle would not have incurred this tax liability if it were wholly owned by Alabama residents. The discriminatory effect of [the statute] was to impose an additional tax burden on Black Eagle for the Period based solely on the fact that its investors were nonresidents. As a result, and as discussed more fully herein, the application of [the statute] to the facts of this case reflect a clear violation of the Commerce Clause of the U.S. Constitution."

Immediately after its opening Commerce Clause argument in brief, the Taxpayer acknowledged that the Tribunal "lacks jurisdiction to declare a state statute facially unconstitutional," but instead asserts that its claim constitutes an as-applied challenge. The Taxpayer acknowledged that the Commerce Clause challenges it raised in its separate Notices of Appeal were identical, and then stated: "Each of these arguments lends itself to both a facial and an as-applied challenge under the Commerce Clause. In this appeal, Black Eagle is not requesting that the Tribunal adjudicate the facial constitutionality of [the statute]. Black Eagle maintains that the Department's application of [the statute] to the facts of this case violates the Commerce Clause under settled precedent of the United States Supreme Court. As a result, [the statute] provides the Tribunal with the requisite jurisdiction to decide this dispute." (emphasis in original) The Taxpayer proceeded to make various arguments in support of its Commerce Clause challenge.

In its reply brief, the Taxpayer reiterated its claim regarding the Tax Tribunal's jurisdiction and its Commerce Clause arguments. But, the Taxpayer made no argument in either brief that the assessments violated the U.S. Constitution's Due Process Clause.[1]

[1] Section 40-18-24.2(b)(1) took effect for all years beginning after 2008. In their briefs, both parties state that the sole authority for the assessments at issue, which includes the

Analysis

In creating the Alabama Tax Tribunal, which is an executive-branch agency, the legislature stated the following concerning its jurisdiction regarding constitutional issues:

> The Alabama Tax Tribunal shall decide questions regarding the constitutionality of the application of statutes to the taxpayer and the constitutionality of regulations promulgated by the Department of Revenue, but shall not have the power to declare a statute unconstitutional on its face.

§ 40-2B-2(g)(5). This prohibition against decisions concerning facial unconstitutionality comports with § 43, Alabama Constitution of 1901, regarding the separation of powers of the branches of our state government:

> In the government of this state, except in the instances in this Constitution hereinafter expressly directed or permitted, the legislative department shall never exercise the executive and judicial powers, or either of them; the executive shall never exercise the legislative and judicial powers, or either of them; the judicial shall never exercise the legislative and executive powers, or either of them; to the end that it may be a government of laws and not of men.

Here, as stated, the Taxpayer argues that § 40-18-24.2(b)(1) violates the Commerce Clause because the tax burden placed upon the Taxpayer by the statute is "based solely on the fact that its investors were nonresidents" and that "Black Eagle would not have incurred this tax liability if it were wholly owned by Alabama residents." The Taxpayer's factual premises are correct; *i.e.*, its tax burden is predicated on the fact that it had nonresident members (for whom the Taxpayer did not make composite tax payments), and the Taxpayer would not have had such filing and payment obligations if its members were Alabama residents only.

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assessment for the 2008 year, is § 40-18-24.2(b)(1). However, neither party raises the question or even mentions how the statute applies to a tax year that preceded the statute's effective date.

But the facts which trigger these obligations are found in the express wording of the statute that is being challenged. In other words, the tax obligations complained of by the Taxpayer and the facts which trigger these obligations are found on the face of § 40-18-24.2(b)(1). (By comparison, the U.S. Supreme Court considered a Commerce Clause challenge to a state statute that expressly provided a property tax exemption to charitable institutions incorporated in that state, but that expressly provided a reduced exemption to charities that operated principally for the benefit of nonresidents. In analyzing the challenge under its facial-discrimination jurisprudence, the court stated that "[i]t is not necessary to look beyond the text of this statute to determine that it discriminates against interstate commerce." *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 575-76 (1997).)

Therefore, a ruling here by the Tax Tribunal would be a ruling on the facial constitutionality – or lack of constitutionality – of Alabama's statute. But the legislature has expressly prohibited such action. And although the Taxpayer states that it asks for a ruling only as to the application of the statute to itself, the overarching effect of such a ruling would bring the ruling within the legislature's prohibition. Simply stated, there is nothing particular about this Taxpayer's fact situation that would distinguish it from the facts of other taxpayers who also are subject to Alabama's composite reporting and payment requirements. This Taxpayer is subject to those requirements because it has nonresident members. If other entities are subject to the statute's requirements, it is because those entities have nonresident members. And to come within the scope of those requirements, one need look no further than the face of the statute. *See Camps Newfound/Owatonna.*

As stated, the Taxpayer acknowledged in its brief that each of its "arguments lends itself to both a facial and an as-applied challenge under the Commerce Clause." And the Department's primary argument in brief is that "[t]he Taxpayer's challenge is a facial challenge," and thus the Tribunal lacks jurisdiction to consider it. In support, the Department quotes *Ex parte Tulley*, 199 So.3d 812, 822 (Ala. 2015): "A 'facial challenge' … is defined as '[a] claim that a statute is unconstitutional on its face – that is, that it *always* operates unconstitutionally.'" (emphasis in original) (citations omitted).

The Taxpayer argues, however, that "*Tulley* provides no insight on how to distinguish between facial and as-applied constitutional challenges." On the contrary, our Supreme Court expressly stated that a facial constitutional challenge is one where it is claimed that a statute "*always* operates unconstitutionally." *Id*. Such is the effect here, because the facts that triggered this Taxpayer's obligations (having nonresident members) are the same facts that trigger all other taxpayers' obligations.

Instead, the Taxpayer argues that "the nature of the constitutional challenge is defined by the specific remedy sought by the claimant," quoting *Citizens United v. Fed'l Election Comm'n*, 558 U.S. 310, 331 (2010), as follows:

> [T]he distinction between facial and as applied challenges is not so well defined that it has some automatic effect or that it must always control the pleadings and disposition in every case involving a constitutional challenge. The distinction is both instructive and necessary, for it goes to the breadth of the remedy employed by the Court, not what must be pleaded in a complaint.

First, earlier in that opinion, the court expressed doubt as to "even if a party could somehow waive a facial challenge while preserving an as-applied challenge …" *Id*. at 330. Then, as quoted by the Taxpayer, the court noted that the distinction between a facial and

an as-applied challenge "goes to the breadth of the remedy employed by the Court, not what must be pleaded in a complaint." *Id*. at 331. Here, the effective remedy that would be granted by the Tribunal in a ruling in the Taxpayer's favor would be to strike the statute because of facial unconstitutionality. However, neither our state constitution nor our legislature has given the Tribunal such breadth.

The Taxpayer's citation of *Am. Fed. Of State, County and Mun. E'ees Council 79 v. Scott*, 717 F.3d 851 (11th Cir. 2013), likewise is unpersuasive. In that case, the plaintiff initially argued that an executive order from the Governor of Florida was unconstitutional on its face. Later, though, the plaintiff conceded that the executive order had a constitutional field of operation as to a certain subset of government employees. Nevertheless, the district court granted broad relief to the plaintiff that was consistent with a finding of facial unconstitutionality. The appeals court, which cited *Citizens United v. Fed'l Election Comm'n*, vacated the district court's order and remanded the case "for the district court to more precisely tailor its relief to the extent the Executive Order may be unconstitutional." *Am. Fed*. at 870. That case simply has no application to the restriction at issue here.

Conclusion

Therefore, the Tax Tribunal lacks jurisdiction to rule on the constitutional issue raised by the Taxpayer concerning § 40-18-24.2(b)(1). Because the Taxpayer raised no other issues, the final assessments are affirmed. Judgment is entered against the Taxpayer for 2008, 2009, 2010, and 2011 tax, penalties, and interest of $4,948.03, $22,934.52, $18,620.68, and $83,383.08, respectively, plus applicable interest. This Opinion and Final Order may be appealed to circuit court within 30 days, pursuant to Ala.

Code § 40-2B-2(m). [2]

Entered January 23, 2018.

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JEFF PATTERSON
Chief Judge
Alabama Tax Tribunal

jp:dr
cc: Michael J. Bowen, Esq.
H. Saxon Main, Esq.
Ralph M. Clements, III, Esq.

2 This opinion is not intended to suggest that the statute at issue is constitutional or unconstitutional – either facially or as applied. Instead, the opinion acknowledges that, if the Tribunal accepted the Taxpayer's arguments, the effect of the Tribunal's ruling would be to declare the statute unconstitutional on its face.