Caught in the Crosshairs: U.S. Constitutional Challenges When a Jurisdiction Targets a Specific Taxpayer

A taxpayer should explore all colorable arguments to a state or local tax that unfairly targets its business.

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A state or locality in need of revenue, or possibly seeking a narrow policy goal, may enact a statute or ordinance (or adopt an administrative policy) imposing a tax that targets a specific company and applies to no other taxpayer. In this article, we evaluate the merits of challenging taxes that target a single company on U.S. constitutional grounds. Specifically, we provide an overview of the minimum requirements to challenge a state or local tax provision under the Equal Protection Clause and the Eighth Amendment, as well as the relevance of the "tax" versus "fee" distinction in this context.

"Class-of-One" Equal Protection Challenges

The Equal Protection Clause of the Fourteenth Amendment of the U.S. Constitution prohibits the states from making unreasonable classifications for tax and other purposes. The Equal Protection Clause provides: "[N]or shall any State . . . deny to any person within its jurisdiction equal protection of the laws." A classification neither involving a fundamental right nor proceeding along suspect lines will be upheld against an equal protection challenge, so long as there is a rational relationship between the disparity of treatment and some legitimate government purpose. On the other hand, "arbitrary and irrational discrimination" violates the Equal Protection Clause even under this deferential standard.
Because state tax statutes do not ordinarily involve a fundamental right or a suspect group that gives rise to heightened scrutiny under the Equal Protection Clause, states have wide discretion in making classifications to produce reasonable systems of taxation. Accordingly, when no interests other than the state's power to classify are implicated, a tax statute is constitutionally valid if: "there is a plausible policy reason for the classification, the legislative facts on which the classification is apparently based rationally may have been considered to be true by the governmental decisionmaker, and the relationship of the classification to its goal is not so attenuated as to render the distinction arbitrary or irrational." 

Delineation of "class-of-one" in Olech

The Equal Protection Clause extends to protect individuals from so-called class-of-one discrimination, where a government singles out one person for poor treatment. The U.S. Supreme Court first articulated the class-of-one equal protection doctrine in Village of Willowbrook v. Olech. In Olech, the Court held that a class-of-one claim may be alleged where the plaintiff has been "intentionally treated differently from others similarly situated and there is no rational basis for the difference in treatment." Although much of the equal protection class-of-one decisions discussed herein are outside the tax context, the Court stated in its Olech holding that it had previously "recognized" successful class-of-one cases, citing two real property tax cases.

At issue in Olech was whether the Equal Protection Clause gives rise to a cause of action where the plaintiff does not allege membership in a class or group. The plaintiff, a homeowner in the Village of Willowbrook, Illinois, sought to have her home connected to the Village water supply. The Village at first conditioned the connection on the plaintiff granting a 33-foot easement, which was significantly larger than the Village typically requires for such tasks.

The plaintiff sued the Village, claiming, in part, that the easement demand was "irrational and wholly arbitrary," and that the demand was motivated by ill will resulting from the plaintiff's previous filing of an unrelated, successful lawsuit against the Village. Because the plaintiff had alleged "irrational and wholly arbitrary" discrimination, the majority held that the plaintiff had stated a viable equal protection claim. The majority concluded that "[t]hese allegations, quite apart from the Village's subjective motivation, are sufficient to state a claim for relief under traditional equal protection analysis."

Fearing that class-of-one cases would create a flood of litigation, Justice Breyer, in a concurring opinion, explained that the presence of "subjective ill will" in Olech was "sufficient to minimize any concern about transforming run-of-the mill zoning cases into cases of constitutional right." However, the majority did not
require subjective ill will for class-of-one claims and left the terms "irrational" and "wholly arbitrary" undefined.

This ambiguity has led to inconsistent results among the lower courts. Specifically, courts are divided as to whether a class-of-one plaintiff must allege and prove ill will. Additionally, some courts have imposed exacting burdens on plaintiffs to demonstrate similarity in class-of-one cases.

Is "subjective ill will" required?

Plaintiffs bringing class-of-one claims should consider whether it is necessary to plead and prove that the government's actions were motivated by subjective ill will. In the aftermath of Olech, courts have struggled with whether class-of-one claims require proof of such motivations. For example, the Tenth Circuit has suggested that a class-of-one claim requires a showing that the plaintiff was "singled out for persecution due to some animosity." Similarly, the Ninth Circuit has observed that, in a class-of-one case, a plaintiff must allege "that the defendants simply harbor animus against her in particular and therefore treated her arbitrarily."

Other decisions—including those from the Circuits just cited—have held that these motivations are not required. For instance, the Second Circuit has declared that: "To be sure, proof of subjective ill will is not an essential element of a class-of-one equal protection claim." This uncertainty is perhaps best demonstrated by a recent decision of the Seventh Circuit. In Del Marcelle v. Brown County Corp., the plaintiff alleged that law enforcement officers in a Wisconsin county had denied him equal protection of the laws by failing to respond to complaints that motorcycle gangs were continuously harassing him and his wife. The U.S. District Court for the Eastern District of Wisconsin dismissed the suit for failure to state a claim, finding that states are not required by the Fourteenth Amendment to provide adequate police protection against private violence.

On appeal, a three-judge panel of the Seventh Circuit noted that the plaintiff's claim could be construed as a class-of-one equal protection claim. However, the plaintiff did not allege that the defendants' actions were the result of personal animosity toward the plaintiff or his wife. After deciding to hear the case en banc, the Seventh Circuit failed to reach a majority decision regarding whether a plaintiff must plead and prove an illegitimate motive or improper purpose in class-of-one litigation. Additionally, the court split evenly on whether to remand the case to allow the plaintiff to replead. Because it takes a majority to reverse a judgment, the lower court's dismissal of the plaintiff's claim was affirmed.
On the issue of motive, Judge Posner, writing for four members of the court, concluded that plaintiffs should be required to plead and prove discriminatory intent, articulating the following test: the plaintiff must show that "he was the victim of discrimination intentionally visited on him by state actors who knew or should have known that they had no justification, based on their public duties, for singling him out for unfavorable treatment—who acted in other words for personal reasons, with discriminatory intent and effect." Judge Easterbrook concurred in the judgment, arguing that motive or intent "has no role at all" in class-of-one litigation. Finally, Judge Wood authored a dissenting opinion, writing for five members of the court, arguing that personal animus or other improper motives were not elements of class-of-one claims, but were merely illustrative that the defendant's action lacks a rational basis.

Addressing the "similarly situated" requirement

In an attempt to rein in class-of-one litigation, some courts have imposed exacting standards for demonstrating similarity in these cases. For example, the Tenth Circuit has explained that it is "imperative for the class-of-one plaintiff to provide a specific and detailed account of the nature of the preferred treatment of the favored class." Similarly, the Second Circuit requires a plaintiff to demonstrate that "no rational person could regard the circumstances of the plaintiff to differ from those of a comparator to a degree that would justify the differential treatment on the basis of a legitimate government policy . . . ." The Seventh Circuit has insisted that plaintiffs demonstrate that the compared persons' circumstances are "prima facie identical." Additionally, as explained by the Tenth Circuit, class-of-one claims necessarily require a higher burden for proving similarity because the plaintiff is bringing a claim on behalf of one person or entity, instead of as a member of a large class: "[T]he degree of similarity an equal protection plaintiff needs to show will vary inversely with the size of the relevant class. If a plaintiff belongs to a large class, a systematic difference in treatment probably is not caused by individualized differences or statistical aberrations. But when the class consists of one person or entity, it is exceedingly difficult to demonstrate that any difference in treatment is not attributable to a quirk of the plaintiff or even to the fallibility of administrators whose inconsistency is as random as it is inevitable. Accordingly, courts have imposed exacting burdens on plaintiffs to demonstrate similarity in class-of-one cases. Accordingly, plaintiffs may need to overcome a heavy burden while demonstrating similarity in class-of-one cases and should proceed carefully when bringing such claims.
Eighth Amendment Protections Against Excessive Fines

The Eighth Amendment provides: "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." The Eighth Amendment prohibits the imposition of "excessive fines" and thus limits the government's power to punish through the extraction of payments, whether in cash or in kind. The burden of proof required to invalidate a fine on this basis is substantial: "We observe initially that only the clearest proof could suffice to establish the unconstitutionality on such a ground." There is a two-part test: (1) whether the levy is a "fine"; and (2) if a fine, whether the levy is grossly disproportional to the offense.

What is a "fine"?

In order to be considered a fine within the purview of the Eighth Amendment, a levy must be considered a "punishment." Punishments can take the form of criminal or civil sanctions. To determine whether a fine satisfies this test, courts examine whether it is remedial or punitive.

In *Helvering v. Mitchell*, the U.S. Supreme Court held that a civil fraud penalty in the Internal Revenue Code was remedial, explaining that the penalty was "provided primarily as a safeguard for the protection of the revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud." Similarly, in *Little v. Commissioner of Revenue*, the Ninth Circuit held that penalties assessed against a taxpayer for negligence and substantial understatement of tax were remedial, noting that "[t]he additions to tax at issue in the present case are purely revenue raising because they serve only to deter noncompliance with the tax laws by imposing a financial risk on those who fail to do so."

In *Wilson v. Commissioner of Revenue*, however, the Minnesota Supreme Court held that the personal assessment of taxes, with penalties and interest, against a corporate officer of a company employing a delinquent taxpayer after the company willfully failed to honor a wage levy served a punitive purpose. In holding that the assessment was punitive, the court explained that "[t]he treatment as remedial of additional assessments to recoup the costs of investigation and enforcement makes sense when levied against the delinquent taxpayer, but not when levied against a corporate officer for an amount far in excess of that which was owed under the wage levy." The court concluded that "[i]t follows that this imposition of a significant financial risk on a third party other than the original delinquent taxpayer can only be explained as also serving retribution and deterrent purposes."
Proportionality

The U.S. Supreme Court has explained, "[t]he touchstone of the constitutional inquiry under the Excessive Fines Clause is the principle of proportionality: The amount of the forfeiture must bear some relationship to the gravity of the offense that it is designed to punish."48 A punitive forfeiture violates the Eighth Amendment if it is "grossly disproportional to the gravity of a defendant's offense."49 There is no set of factors that must be considered when evaluating whether a fine is grossly disproportional; the test is based on facts and circumstances.

Although the U.S. Supreme Court has established a standard for determining whether a fine is excessive, the question of what constitutes a proportional fine remains unanswered. In general, 100%-300% penalties appear to be permissible. For example, the U.S. Court of Appeals for the Federal Circuit has held that a civil penalty of approximately three times the value of the underlying claim was "well within constitutional limits."50 Similarly, the Eighth Circuit upheld a civil penalty imposed on government contractors for accepting kickbacks in violation of the Federal Anti-Kickback Act, where the penalty was equal to two times the amount of the kickbacks received by the contractors.51 On the other hand, the New York Supreme Court, Appellate Division, held that a $2,000 civil fine for removing any quantity of metal placed on a curbside for collection was grossly disproportional to the underlying offense.52

Relevance of the "Tax" Versus "Fee" Distinction

A class-of-one equal protection claim, or especially an Eighth Amendment claim, could also arise in a regulatory or licensing situation involving a fee, or where the jurisdiction disguises a "tax" as a "fee" by nominally stating the levy is equivalent to some benefit conferred. Federal and state courts regularly analyze whether a given levy is a "tax" or "fee" in substance, notwithstanding the enacted body's mere nomenclature for the levy.53 But, in general, courts apply the following factors to determine the nature of a levy: Is the levy imposed by an agency (fee), or the legislature (tax)? Is the levy imposed on those it regulates (fee), or the community as a whole (tax)? Is the purpose of the levy to pay regulatory costs (fee), or for general revenue-raising purposes (tax)?54

The Tenth Circuit explains, "a classic tax includes an income tax, imposed by the legislature to defray general state expenses (even though a portion may go to defray the administration of the income tax collection system), while a classic fee might be an entry charge imposed by a state park authority to regulate park usage and support only the upkeep of the park."55
Indeed, a jurisdiction may label a "tax" as a "fee" for political or legal purposes, but it may prove beneficial to the above arguments that the levy is a tax so as to broaden the similarly situated class, to establish subjective ill will, or to show the punitive nature of the levy where there is no direct benefit in return. Additionally, taxes and fees are sometimes subject to different constitutional limitations and therefore the characterization of a particular levy must be carefully considered before challenging the levy on constitutional grounds.56

Conclusion

In a typical state or local tax matter, a taxpayer faces a daunting test when challenging a tax or fee based on the Equal Protection Clause or the Eight Amendment, based on the tests articulated by the U.S. Supreme Court.57 Coupled with the deferential standard applied in equal protection claims, for example, a class-of-one equal protection challenge against a general state tax provision necessitates an even more targeted fact pattern in light of the potential "subjective ill will" requirement and the difficulty in establishing a similarly situated class. Notwithstanding the judicial constraints placed on Equal Protection Clause and Eighth Amendment challenges to tax provisions, a taxpayer should explore all colorable arguments to a state or local tax that unfairly targets its business, whether for substantive or strategic purposes. Particularly with respect to local taxes or local fees, these arguments may provide opportunities for success on the merits or additional leverage for settlement.

1 When bringing a claim under the federal Equal Protection Clause, a best practice is to include an argument under the applicable state's uniformity or equality provision, if this clause is applicable to the tax at issue. Almost all state constitutions contain provisions requiring state taxes to be uniform, equal, or both. For example, the Pennsylvania Constitution provides that: "All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be collected under general laws." Pa. Const. art. VIII, § 1. Additionally, a state's uniformity or equality provision can provide greater protection than the federal Equal Protection Clause. See, e.g., Searle Pharms., Inc. v. Dept of Revenue, 512 N.E.2d 1240, 1245-1248 (Ill. 1987) (holding that the Illinois Constitution's uniformity clause provides greater protection than the federal Equal Protection Clause).

2 U.S. Const. amend. XIV, § 1.


5 Armour at 2081 (holding that a city's adoption of a new system for funding sewer improvement projects did not violate the Equal Protection Clause, where homeowners who previously paid the assessment in a lump sum received no refund and homeowners who elected to pay in installments were under no obligation to
make further payments); *Retail Indus. Leaders Ass’n v. Fielder*, 435 F. Supp. 2d 481 (D. Md. 2006), aff’d, 475 F.3d 180 (4th Cir. 2007) (holding that a Maryland statute requiring employers with at least 10,000 employees that spend less than 8% of total wages on health insurance to pay the difference to the state was preempted by ERISA, but did not violate the Equal Protection Clause); *but see Wal-Mart Puerto Rico, Inc. v. Zaragoza-Gomex*, 174 F. Supp. 3d 585, 645-647 (D.P.R.), aff’d, 834 F.3d 110 (1st. Cir. 2016) (holding that an alternative minimum tax statute that represented a 325% increase in taxes for multistate corporations violated the Equal Protection Clause).

6 *Armour* at 2080 (internal quotation marks omitted).

7 528 U.S. 562 (2000).

8 *Olech* at 564.

9 *Id.*, citing *Alleghany Pittsburgh Coal, Co. v. County Comm’n of Webster County*, 488 U.S. 336 (1989); *Sioux City Bridge Co. v. Dakota County*, 260 U.S. 441 (1923).

10 *Id.*

11 *Id.* at 563.

12 *Id.*

13 *Id.*

14 *Id.* at 565.

15 *Id.*

16 *Id.* at 566.

17 *See, e.g., Del Marcelle v. Brown County Corp.*, 680 F.3d 887, 892-893 (7th Cir.), cert. denied, 133 S. Ct. 654 (2012) (collecting cases); *Jicarilla Apache Nation v. Rio Arriba County*, 440 F.3d 1202, 1209 (10th Cir. 2006) (same).

18 *Mimics, Inc. v. Vill. of Angel Fire*, 394 F.3d 836, 849 (10th Cir. 2005).

19 *Lazy Y Ranch Ltd. v. Behrens*, 546 F.3d 580, 592 (9th Cir. 2008) (emphasis in original).

20 *See, e.g., SECSYS LLC v. Vigil*, 666 F.3d 678, 689-690 (10th Cir. 2012); *Gerhart v. Lake County*, 637 F.3d 1013, 1022 (9th Cir. 2011); *Stotter v. Univ. of Tex. at San Antonio*, 508 F.3d 812, 824 n.3 (5th Cir. 2007).

21 *Jackson v. Burke*, 256 F.3d 93, 97 (2d Cir. 2001).

22 680 F.3d 887, 888 (7th Cir.), cert. denied, 133 S. Ct. 654 (2012).

23 *Del Marcelle* at 889.

24 *Id.* at 888-889.

25 *Id.*
U.S. Const., amend. VIII. When bringing a claim under the Eighth Amendment, taxpayers should also consider bringing a Bill of Attainder claim. Article I, Section 10 of the U.S. Constitution provides "No state shall ... pass any Bill of Attainder." For a statute to qualify as a bill of attainder it must: (1) specify the affected person or group; (2) impose punishment by legislative decree; and (3) dispense with a judicial trial. Selective Serv. Sys. v. Minnesota Pub. Interest Research Group, 468 U.S. 841 (1984). Accordingly, the Bill of Attainder Clause may provide protection in extreme circumstances where the state legislature enacts a law that imposes a punitive tax or fee without a trial or hearing. Additionally, similar to the federal Equal Protection Clause's state-level counterparts, some state constitutions also prohibit bills of attainder or "special laws." See, e.g., Alaska Const. art. I, § 15; Arkansas Const. art. 2, § 17.
For example, federal courts may analyze the nature of a levy for jurisdictional purposes under the Tax Injunction Act, 28 U.S.C. § 1341 (1998), which bars federal courts from enjoining, suspending, or restraining "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." State courts may review a levy to determine whether it was properly enacted by the legislature pursuant to state constitutional restrictions on new tax legislation. See, e.g., Audubon Ins. Co. v. Bernard, 434 So. 2d 1072 (La. 1983) (holding the levy at issue was a new "tax" enacted during a regular session in an odd-numbered year, and without the required two-thirds majority vote of each chamber of the legislature, in violation of the Louisiana State Constitution).

See, e.g., San Juan Cellular Telephone Co. v. Public Service Commission, 967 F.2d 683 (1st Cir. 1992); Home Builders Ass'n of Mississippi, Inc. v. City of Madison, 143 F.3d 1006, 1010 (5th Cir. 1998).

Hill v. Kemp, 478 F.3d 1236, 1246 (10th Cir. 2007) (internal quotation marks omitted).

See, e.g., Commonwealth Edison Co. v. Montana, 453 U.S. 609, 622 n.12 (1981) (distinguishing Commerce Clause restraints on taxes from those on user fees); Barnhill Sanitation Service, Inc. v. Gaston County, 362 S.E.2d 161 (N.C. Ct. App. 1987), cert. denied, 366 S.E.2d 856 (N.C. 1988) (holding that a charge imposed on commercial, industrial, and municipal haulers was a fee rather than a tax and therefore was not subject to the state's constitutional uniformity requirements).

Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 526-527 (1959) (explaining that the Equal Protection Clause "imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to reasonable schemes of state taxation . . . [a state] is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference to composition, use or value "); see generally Hellerstein, State Taxation, ¶ 3.03 Supreme Court Decisions Under the Equal Protection Clause (WG&L Dec. 2016).