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LEGAL ALERT

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Tax Injunction Act Does Not Bar a Levy Imposed on a Single Entity

On June 20, 2011, the U.S. Court of Appeals for the Fourth Circuit ruled that the federal district court for the District of Maryland has jurisdiction to adjudicate a case involving the constitutionality and validity of a carbon dioxide emissions levy (Emissions Levy) enacted in 2010 by Montgomery County, Maryland (County). *GenOn Mid-Atlantic, LLC v. Montgomery County*, No. 10-1882 (Fourth Circuit, U.S. Court of Appeals) (June 20, 2011). The court's opinion sends a clear message to local jurisdictions considering targeted and discriminatory fees—that the Tax Injunction Act may not be used to enjoin federal court review. (Click here for the opinion). As stated by the Fourth Circuit:

> We cannot overlook the fact that the absence of federal jurisdiction in this case would turn what are truly interstate issues over to local authorities. Applying the Tax Injunction Act might encourage punitive financial strikes against single entities with national connections, for the federal courts would be unavailable to protect companies against local discrimination, preempted state laws, and other federal constitutional violations. The implications of allowing localities to impose financial extractions exclusively upon single entities of national reach with no accountability in federal court are profound, and we decline to foreclose these federal claims with a jurisdictional bar.

Background

On May 19, 2010, Montgomery County Council passed Expedited Bill 29-10, which imposed a $5-per-ton levy on carbon dioxide emissions of major emitters. The County defined "major emitter" as "any person who owns or operates any stationary source of carbon dioxide located in the County that emits more than 1 million tons of carbon dioxide in any calendar year." Montgomery County Code § 52-96(b). The County set the emissions threshold for major emitters such that GenOn was the only major emitter in Montgomery County, and thus the only entity subject to the Emissions Levy.

In addition to targeting GenOn, the County structured the Emissions Levy such that once GenOn exceeded 1 million tons of carbon dioxide emissions, GenOn was required to pay the Emissions Levy retroactively on each ton of emissions, going back to the first ton emitted, not just on those tons exceeding the 1 million ton threshold. Thus, GenOn was the only entity in Montgomery County subject to the Emissions Levy. Furthermore, the County was aware that GenOn would be unable to pass this cost on to its customers because its power is bought and sold on a competitive auction. The projected annual revenue of $11.7 to $17.6 million raised from the Emissions Levy was expected to be split, 50% for the County's general use and 50% for funding greenhouse gas reduction programs.

GenOn challenged the Emissions Levy as violating both the Maryland and U.S. Constitutions in the U.S. District Court for the District of Maryland. After a hearing on the question of jurisdiction, the U.S. District Court found that the Tax Injunction Act barred subject matter jurisdiction because the Emissions Levy constituted a tax. GenOn appealed to the Fourth Circuit.

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The Tax Injunction Act Does Not Bar Federal Court Jurisdiction Over the Emissions Levy Because It Is a Fee and Not a Tax.

The Tax Injunction Act provides that "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." The Tax Injunction Act represents Congress's acknowledgment that if taxpayers were able to challenge state taxes in federal courts, they might be able to disrupt the jurisdiction's flow of revenue.

At issue in *GenOn Mid-Atlantic v. Montgomery County*, was the first element of the Tax Injunction Act—whether the Emissions Levy constituted a tax or a fee. To determine if a levy is a tax or a fee, courts generally ask whether the charge is levied primarily for revenue-raising purposes, making it a "tax," or whether it is assessed primarily for regulatory or punitive purposes, making it a "fee." Three factors are analyzed to make this determination: (1) what entity imposes the charge; (2) what population is subject to the charge; and (3) what purposes are served by the use of the monies obtained by the charge.

The Fourth Circuit rejected the County's arguments that the Emissions Levy was a tax because it was enacted via the same process by which taxes are enacted and because it was expected to generate significant revenue. Although the court found these facts to be relevant, the court stated "those features are, in this case, mere masks that cannot be used to disguise what is in substance a punitive and regulatory matter." (Slip Op. at 5.) The court instead focused on the imposition of the Emissions Levy on a single company and its regulatory purpose.

The Emissions Levy Is Imposed Only Upon GenOn.

Pursuant to the second factor, what population is subject to the charge, the court found that the biggest problem with the Emissions Levy was that it was imposed on GenOn alone: "The fact that this charge affects the narrowest possible class is compelling evidence that it is a punitive fee rather than a tax." The court noted that the County was unable to point to any other exactions imposed on a single entity that were considered to be taxes, and that "taxes generally apply to at least more than one entity." The conclusion that the Emissions Levy constituted a punitive fee rather than a tax was bolstered by the fact that GenOn itself must bear the cost of the Emissions Levy because it would be unable to pass the charge on to its customers. The court noted that the sponsoring Councilmember hailed this fact as a selling point when seeking passage of the legislation.

The Purpose of the Emissions Levy Is to Regulate Carbon Dioxide Emissions.

The court also found it compelling that the Emissions Levy was enacted as part of a broader regulatory effort to reduce greenhouse gas emissions. The court noted that the County Council made this regulatory intent clear, and dismissed the County's argument that the Emissions Levy is not regulatory because it did not compel a standard of conduct or limit the amount of carbon dioxide a particular entity could emit. The court stated that: "This carbon charge, which targets a single emitter and is located squarely within the County's own 'programmatic efforts to reduce' greenhouse gas emissions…is a punitive and regulatory fee over which the federal courts retain jurisdiction." (Slip Op. at 9.)

Sutherland Observation: The *GenOn* decision is significant because it sheds light on the crucial distinction between what is a fee and what is a tax for purposes of the Tax Injunction Act. The Fourth Circuit makes it clear that state and local jurisdictions cannot disguise regulatory fees by calling them taxes and instructing the court to focus upon the revenues that will be raised. The federal courts will look through to the substance of the levy and retain jurisdiction over cases that involve punitive fees.

Montgomery County Council Passed Expedited Bill 24-11 to Repeal the Emissions Levy and Refund Money Previously Collected.

On July 19, the Montgomery County Council held a public hearing and voted unanimously to pass Expedited Bill 24-11, which repeals the Emissions Levy and refunds all money collected under it to GenOn, with interest. The legislative materials accompanying Expedited Bill 24-11 state: "The imposition of the County's Carbon Dioxide Emissions Tax is no longer feasible under *GenOn Mid-Atlantic v. Montgomery County*, No. 10-1882, U.S. Court of Appeals (4th Cir.), June 20, 2011." Legislative Request Report (Expedited Bill 24-11). The County Executive signed Expedited Bill 24-11 on July 19, which took effect immediately.

Sutherland Observation: The *GenOn* decision is a reminder that taxpayers should always consider whether federal court jurisdiction is available when challenging levies. The federal court system is often the most favorable forum for obtaining a determination of whether the imposition of a levy is constitutional. As the Fourth Circuit made clear, the federal courts will not tolerate punitive legislation, and will protect taxpayers against legislation that is discriminatory, unconstitutional, and preempted by federal laws.

The case was handled jointly by Sutherland's Litigation and SALT Practice Groups.

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