Section on Taxation

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Determining Massachusetts Sales Tax Nexus in Virginia

By Aaron Moshiashwili, J.D., LL.M. Candidate

Introduction

On October 25, 2017, Crutchfield Corporation filed suit challenging the constitutionality of a Massachusetts law that went into effect at the start of that month, asserting nexus over Internet sellers with at least $500,000 in transactions in Massachusetts.[1] The Massachusetts law is the next step for states trying to overcome *Quill*[2] and, as such, is a fairly ordinary step in the evolution of the law in this area. However, the manner in which the case was brought is anything but ordinary and, depending on how the case plays out, could lead to a major shift in state tax law.

What makes this case procedurally unique is that Crutchfield did not bring suit to invalidate the Massachusetts law in a Massachusetts court. Instead, it filed in a Virginia court, under the provisions of an unusual 2004 law, Virginia Code § 8.01-184.1 ("Declaratory judgment to adjudicate constitutional nexus"). This law has never been cited in any court case and has only appeared in two articles, each broad overviews. It gives the power to the Circuit Courts of Virginia to issue declaratory judgements as to whether or not a particular state unduly burdens interstate commerce when it requires a Virginia company to collect and remit taxes.

Normally, the place one starts with nexus determinations is the state's own court system — the Anti-Injunction Act[3] disallows moving to a federal court, which might be considered more neutral. But a law which allows suit in a Virginia court gets around home-state bias. It also raises a host of fascinating questions. Many of those questions may seem to have a simple answer, which is: "This law can't possibly work."

But if the Virginia law survives scrutiny, it could completely rewrite dormant commerce clause litigation. Venue matters - and what company (if the choice turns out to be constitutionally possible) would sue in a state's own courts when they could sue in Virginia, a state that has been shown to be hostile to other states' broad nexus claims? But before we get there, §8.01-

Sales Tax Nexus continued on page 5

Message from the Chair

Shamik Trivedi

Dear Members of the Federal Bar Association Section on Taxation,

I am honored to be the chair of the Section for the 2017-2018 year and pleased to update you all on the busy year the Section has had thus far, and will continue to have. It is my hope that this year will be the most consequential yet for the Section.

Significantly, the Section has made great inroads to the tax community outside Washington. The Section has long strived to benefit members across the country, and this year has been a successful one for the Section in that regard. The Beyond the Beltway committee, led by former chair Ryan Kelly of Alston & Bird LLP, has held events in Dallas, Atlanta, New York, Chicago, and Miami. These events have attracted many current and future members of the Section and have hosted Tax Court judges, government officials, and renowned private practitioners.

In Washington, the Section continues to have its monthly steering committee meetings. Please reach

Chair continued on page 2

IN THIS ISSUE

Chair continued from page 1

out to me if you'd like to attend. In addition, the Section continues its efforts to attract younger members and has held happy hours and career panels to do just that. The Section has also made an effort to give back to the community and has planned a volunteer morning at the DC Central Kitchen—an event organized by Community Outreach chair Marissa Rensen of the I.R.S. Office of Chief Counsel have put together an incredible day of programming.

Last but not least, the Section also looks forward to hosting its 42nd Annual Tax Law Conference, which will be held on March 9 at the Ronald Reagan Building in Washington. This year's conference is likely to be the most significant yet as the tax community grapples with tax reform and its implementation. Private Sector Chair and former Section chair, Andrew Strelka of Latham & Watkins and public sector chair Drita Tonuzi of the I.R.S. Office of Chief Counsel.

This year is on track to be the Section's best yet. But, I ask each of you for a favor. To our experienced, veteran members, I ask that you get involved in the Section for the benefit of our younger members, many of whom are just a couple years out of law school. Your experiences and guidance are invaluable to them. And to our younger members, remember, involvement in the Section can drive your career, help you meet future colleagues and competitors, and will overall be a good experience.

Please do not hesitate to contact me at 202-521-1511 or at Shamik.Trivedi@us.gt.com if you'd like to get more involved or just want to talk. ⌘

Best regards,
Shamik Trivedi
Chair, Section on Taxation (2017-2018)

Social Events

Atlanta

FBA Tax Atlanta sponsored a well-attended breakfast seminar on December 19, 2017, entitled "An Update on Conservation Easements & Other Year-End Hot Topics" at Jones Day's office. The speakers included David Aughtry, Esq. of Chamberlain Hrdlicka, Anson Asbury, Esq. of Asbury Law Firm, and Chuck Hodges, Esq. of Jones Day and current Chair of FBA Tax Atlanta. The panel discussed recent cases involving I.R.S. challenges of conservation easements as well as tax reform relating to businesses.

Boston

The Boston group of the FBA Section on Taxation

had a reception on October 17, 2017, at Society on High in downtown Boston. Local tax LL.M. students and practitioners enjoyed drinks and hors d'oeuvres compliments of the FBA Tax Section and Ropes & Gray LLP. The Boston group of the FBA Section on Taxation looks forward to its next event in early 2018.

Chicago

On April 4, 2017, FBA Tax Chicago sponsored an event in Chicago for Judge Joseph R. Goeke. Approximately 45 tax practitioners from the public and private sector attended the event. Judge Goeke joined Tricia Rexford of

Baker & McKenzie and Lauren May of I.R.S. Chief Counsel in an interesting panel discussion about the dos and don'ts of Tax Court litigation. Before the panel discussion, Tax Court Judge Goeke attended a meet and greet for the event attendees.

On October 18, 2016, the Section on Taxation held an event at Northwestern University School of Law in Chicago for United States Tax Court Judge Joseph W. Nega. Approximately 30 Tax LL.M. students, government attorneys, and private sector tax practitioners attended the event. Judge Nega provided a brief presentation about his perspectives from the Tax Court before taking questions from the audience about pre and post-trial briefing, best practices, and Tax Court clerkships. Judge Nega joined the networking reception for attendees before and after sharing his remarks.

Dallas

On November 28, 2017, FBA Tax Dallas together with the Dallas Bar Association Taxation Section held an event at the Belo Mansion for United States Tax Court Judge Cary D. Pugh. Approximately 25 in-house, government, and private sector tax practitioners attended the event. Judge Pugh entertained questions from attendees and participated in the networking reception. It was a fun evening and a great opportunity for attendees to get to know Judge Pugh.

Miami

FBA Tax Miami and PricewaterhouseCoopers LLP hosted a happy hour reception for Tax Court Judge Joseph R. Goeke on Tuesday December 5th. Judge Goeke spoke about current events in the Tax Court, followed by networking and socializing.

New York

On April 4, 2017, the Section on Taxation sponsored an event in New York for Tax Court Judge Albert G. Lauber. Approximately 30 tax practitioners from the public and private sector attended the event. Judge Lauber provided an interesting discussion about handling cases before the Tax Court, his recent opinion in the Amazon case, and tax reform. After concluding his remarks, Judge Lauber attended a meet and greet for the event attendees.

On November 13, 2017, the Section on Taxation held an event at MetLife, Inc. for United States Tax Court Judge Joseph Gale. Approximately 25 in-house, government, and private sector tax practitioners as well as students from Fordham Law School's JD program attended the event. Judge Gale gave a presentation that included educating the attendees on how new Tax Court procedural rules are proposed and passed. A lively question and answer period followed. Judge Gale joined the networking reception and graciously spoke with attendees before and after sharing his remarks. A wonderful time was had by all. z

Publication Opportunity: The Federal Lawyer

The FBA's Section on Taxation has been asked to assist in the creation of the FBA Convention: NYC themed edition of *The Federal Lawyer,* for release in August of 2018. *The Federal Lawyer* is a national publication that is circulated to more than 18,000 legal practitioners across the country.

We are seeking seven authors to draft feature length tax articles between 3,000 and 8,000 words each. The writer's guidelines for *The Federal Lawyer* can be found at www.fedbar.org/TFLwritersguidelines and the guidelines explain in greater detail the typical articles that are published in *The Federal Lawyer.* The deadline for submission of an article is **April 1, 2018.** Please reach out to Publications Coordinator, Zebley Foster at zfoster@fedbar.org if you are interested.

Massachusetts Sales Tax continued from page 1

184.1 has to survive and its survival seems questionable at best.

The hurdles the Virginia law faces are a maze of obscure constitutional provisions. But it's worth taking a moment—and a few pages—to walk through the process Crutchfield has begun, and explore some lesser-travelled areas of constitutional law along the way.

The Virginia Law

Passed in 2004, the Virginia law grants Virginia's trial-level courts jurisdiction to hear cases:

- brought by companies organized or qualified to do business in Virginia ("Virginia companies");
- Against government officials from a non-Virginian state or locality ("foreign officials")
- Which is trying to get the Virginia company to collect sales or use tax ("foreign tax")
- For business occurring wholly or partially in Virginia
- Requesting declaratory judgment as to whether or not the foreign tax unduly burdens interstate commerce, and thus would violate the Commerce clause.

A year later, the Virginia legislature amended the law to add an additional provision, extending the personal jurisdiction of Virginia courts—"to the extent permitted by the Constitution of the United States"—to the relevant foreign officials.

Crutchfield's case… and Crutchfield's problems

Crutchfield makes two main claims: that the Massachusetts law is unconstitutional as applied to Crutchfield under *Quill* or, alternatively, that the law is unconstitutional generally for unduly burdening interstate commerce and is preempted by the Internet Tax Freedom Act.

a. ITFA claim is improperly filed

It is hard to see how the second claim could survive a demurrer motion, should Massachusetts file one. Whether or not Crutchfield has a valid claim under the ITFA, the language of the Virginia statute expressly grants jurisdiction to issue declaratory judgment only for the purpose of determining whether or not the claim violates the Commerce Clause. Crutchfield's ITFA/Supremacy Clause argument needs to be saved for another forum.

b. Personal jurisdiction over the defendant

However, there is a bigger problem if Crutchfield is trying to sue Massachusetts. Whether or not the subject matter jurisdiction is valid, the Virginia legislature saw the clear need to actually have a defendant in the cases it was authorizing—hence the 2005 amendment. The amendment gives courts personal jurisdiction over foreign officials, but only to the extent allowed by the constitution. The problem with that is that the extent allowed by the constitution is likely "none at all."[4]

Right off the bat we're facing the first real strangeness of this law. Cases that can teach us about the jurisdictional limits here—cases where a state official or agency appears before another state's court—fall into three general categories. Far and away the most common situation is where the state is the plaintiff, attempting to enforce a state action against an out-of-state defendant using the second state's courts, which is not analytically useful for our purposes. The second situation occurs when a state agency is being sued for injuring an out-of-state person. These cases are not particularly illuminating either; jurisdiction is not often a serious issue because the action in the case took place in the second state. As an example, in *Hall v. University of Nevada*,[5] the Supreme Court of California noted the question of *in personam* jurisdiction is relevant in a case where a private party is suing a representative of one state in another state's court. However, the California court held that personal jurisdiction was clearly appropriate in the circumstances of this case, in which the plaintiff was traveling in California as part of his official duties as a University of Nevada employee.

The third type of case is far and away the rarest and is the one at issue here; where a state agency is sued in a foreign state court, but the actions underlying the case did not reach into the foreign state. Cases like this seem to be incredibly rare[6] but, surprisingly, the personal jurisdiction analysis seems to turn on the same issues regardless of whether the party in question is a state or an individual.

In *International Shoe*,[7] the Supreme Court laid down the constitutional limits of state "long arm" statutes like this one. *International Shoe* said that personal jurisdiction can be exerted by a state over those who are domiciled in it; who consent to its jurisdiction; who are physically located within it; or who have "minimum contacts" with it. It seems extremely unlikely that the foreign officials will coincidentally live in Virginia, or that they will consent to such a suit; and while it's possible that the plaintiff could simply wait in ambush until the foreign official happened to be in Virginia, this seems like poor litigation strategy. This leaves "minimum contacts," which turns out to be the issue that the cases we do have turn on.

Unfortunately, these cases still do not shed much light on the problem. In *McDonnell v. State*[8] the New Jersey Supreme Court glossed over the issue, finding that Illinois "clearly" had minimum contacts in New Jersey for the purpose of an age discrimination claim. Of course, as any legal writing teacher will tell you, "clearly" is a code word for "we're not including a legal argument here because we don't actually have one."

Kuklok v. Workforce Safety & Insurance[9] analyzes a very similar issue but declines to exercise jurisdiction, concluding that, to the extent the North Dakota agency might have activities in the local venue (California), the agency failed the *International Shoe* test because its California-based activities were not related to the action at issue.

Moving along, the minimum contacts analysis breaks down into two categories. The first category is "continuous and systematic" contacts, which are broad enough to establish general jurisdiction (that is, jurisdiction for all purposes). It seems unlikely that a foreign official will have that kind of contact with another state, except in rare circumstances. Most of the time, at best, a foreign official may fall into the second category, which is "sporadic or casual" activity. Such activity is sufficient to establish "specific jurisdiction" for the one legal issue before the court, but only if the sporadic activity in question is directly related to the action at hand. So a court would have to find that the foreign official's work, when applied to Virginia companies, is sufficiently directed at the state of Virginia so that dragging the foreign official into a Virginia court would not "offend traditional notions of fair play and substantive justice."

Looking at these cases, it seems unlikely that Crutchfield could, in fact, establish jurisdiction over a Massachusetts official under the Virginia law's long arm statute. However, if the Virginia court follows the example of New Jersey, Crutchfield should be in good shape - after all, the obvious reason Crutchfield is suing in Virginia instead of Massachusetts is because it feels it will get a better ruling in the Old Dominion. So, *arguendo*, we'll presume that Crutchfield overcomes the jurisdictional hurdle and gets a ruling under the Virginia Law saying that the Commerce Clause does not allow Massachusetts to tax it. What next?

c. Full faith and credit

Crutchfield, presumably, will then take the Virginia ruling to Massachusetts and attempt to use it. It seems likely that the Massachusetts Department of Revenue will simply ignore it, leading Crutchfield to sue to enforce the Virginia ruling. At that point, it runs into its second major problem. Generally, a litigant can rely on the Full Faith and Credit clause[10] (and the enacting statute, the Full Faith and Credit Act) which requires that each state respect other states' laws as well as judgments rendered by other states' courts.[11]

Crutchfield will be relying on the second part there—judgments of other states' courts—to do a lot of work. There is a fairly high bar for exceptions to the rule that judgments be respected. Despite this high bar in its favor, though, Crutchfield will have a hard time making its case. From *Baker v. General Motors*,[12] in 1998, Justice Ginsburg tells us that "[o]rders commanding action or inaction have been denied enforcement in a sister State when they purported to accomplish an official act within the exclusive province of that other State . . . ." It's possible that a court might not view the determination of nexus under the Commerce Clause as an "official act" of the state. On the other hand, it's hard to imagine a ruling which finds that the determination of nexus is a state act, but nevertheless far enough away from the core of that state's "official acts" that it is proper to let another state intervene.

If Crutchfield stands any chance of winning, it will do so by relying on *Bradford Electric Light Co. v. Clapper*.[13] Clapper, a Vermont resident, was employed by Bradford Electric in Vermont. While travelling to New Hampshire for work, he was killed on the job. Suit was brought in New Hampshire, but Bradford Electric objected, saying that under the Vermont workman's compensation act, both parties are bound to use the workman's comp system, blocking common law tort suits unless one of them affirmatively waives the system. This provision explicitly applied to injuries received outside the state, and no such waiver was made. New Hampshire's workman's compensation act, on the other hand, did not block the injured worker from suing. New Hampshire courts found that it was inappropriate to give extraterritorial power to Vermont laws and that, in New Hampshire, it was New Hampshire's rule that applied. The Supreme Court reversed, finding that full faith and credit required New Hampshire to respect the Vermont law, based as it was on a contractual relationship that began in Vermont and was agreed to by both parties, with minimal involvement of New Hampshire.

Bradford Electric, though, is a hard sell. The Court explicitly pointed out situations when full faith and credit isn't appropriate – and chief among them is when "enforcement of the right conferred would be [obnoxious] to the public policy of the forum."[14] The Vermont law was different from the New Hampshire law, but not in direct conflict with it. However, a finding that Massachusetts lacks nexus with Crutchfield would be, presumably, the opposite result from Massachusetts' law, which Massachusetts would likely find untenable.

Massachusetts, on the other hand, will attack not the judgment, but the law underlying it. For a state to choose not to extend full faith to another state's laws is a lower bar than is presented by its judgments; a court will weigh the sovereign interests of the states and determine which law should prevail.

I am not going to pretend that it is easy to answer how the states' sovereign interests should be weighted. As Justice O'Connor said in *California Franchise Tax Board v. Hyatt*,[15] "the question of which sovereign interest should be deemed more weighty is not one that can be easily answered," and if Justice O'Connor cannot, I am not going to try. But, unlike that case—a tort claim made in Nevada against a California agency—

the Virginia law seems to be attempting to reach into another state's tax collection processes and substitute its opinion for that state's own.

Specifically, the Supreme Court has held that "[f]ull faith and credit does not . . . enable one state to legislate for the other or to project its laws across state lines so as to preclude the other from prescribing for itself the legal consequences of acts within it."[16]

So what does that mean? Well, as Justice O'Connor's comment signifies, this is not a well-explored area of law. Most full faith and credit cases involve one state refusing to enforce laws or rulings of another state against a third party and not against the state itself. But some cases are instructive. In 1951, the Supreme Court struck down a Wisconsin law holding that wrongful death suits could only be brought in Wisconsin if the wrongful death happened in Wisconsin.[17] Wisconsin courts, reading the law as therefore barring suits under any law brought for deaths outside Wisconsin, refused to entertain a wrongful death suit brought under Illinois law for a death that happened in Illinois caused by a Wisconsin resident. The Court decided 5-4 that full faith and credit prevents Wisconsin from excluding the laws of other states in this way.

However, a strong dissent by Justice Frankfurter refers to a line of cases that goes back all the way to the early days of the country. The 1831 case of *Hawkins v. Barney's Lessee* pertains to a compact between Virginia and Kentucky, which was made when Virginia ceded certain lands to the newly-established Kentucky and required that Virginia law be used to judge property rights to said land. The Court ruled that the compact fixed the rights to the land under Virginia law at the time, but for Virginia law to rule in perpetuity in that area of Kentucky would reduce that state to a "state of vassalage," which the court viewed as repugnant to the Constitution. That seems to be the situation here - and in this case, Virginia does not even have the benefit of an interstate compact agreed to by Massachusetts.

So, the Virginia law seems to be on pretty shaky grounds when it comes to the Full Faith and Credit Clause—although when the only directly relevant case law is almost two hundred years old, things can always change. But presuming that Massachusetts fails on its full faith and credit argument, it still has a full hand of constitutional cards to play.

d. Other possible issues

Massachusetts has so much to choose from. While this case does not seem to directly implicate the Supremacy Clause, it's axiomatic that states cannot usurp federal Constitutional power. Even though there is no Federal law directly controlling the issue of nexus, a court could easily find that for Virginia to attempt such a determination is a constitutionally impermissible power grab. On a related front, a court could also determine that this statute directly interferes with interstate commerce in a way forbidden by precedent on the Dormant Commerce Clause. State comity, while similar to full faith and credit, is a slightly different analysis which could also be brought up. Sovereign immunity could also be an issue, although *Nevada v. Hall*[18] makes it a fairly difficult defense for Massachusetts.

Which court? And who brings the case?

Okay, now that we have got the easy stuff out of the way, we get into hardcore issues of the justiciability of this law. Who could strike it down? Under what circumstances? In what court? There are so many possibilities here – and the "proper path" is so murky in this odd case – that all we can do is talk about some of the possibilities.

a. State court

The law could certainly be struck down during the course of the *Crutchfield* case itself. Indeed, if Massachusetts does wind up litigating it would make sense to make the constitutionality of the law its key point. If it does, and a Virginia court winds up striking the law down, it seems likely that would stop the case cold. If, on the other hand, a Massachusetts court were to refuse to enforce a Virginia decision—reasoning that the decision was based on an unconstitutional law—it would set up a further struggle.

b. Federal court

The case could wind up in federal court in one of two ways. Under normal circumstances, the Anti-Injunction Act would prevent a state tax case from being removed to federal court. However, this could certainly be a case where a federal court could choose to take a case under the enjoyably dire exception laid out in *Younger v. Harris* for a statute "flagrantly and patently violative of express constitutional prohibitions in every clause, sentence, and paragraph, and in whatever manner and against whomever an effort might be made to apply it." Alternately, if a Virginia court were to render a decision for Crutchfield and Massachusetts were to decline to enforce it, either Crutchfield or Virginia itself could try to obtain a writ of mandamus in a federal court to compel enforcement. The Eleventh Amendment may come into play here and bar Nevada from the federal courts.

c. The Supreme Court

This case has two paths to the Supreme Court as well. The first would be through one of the normal paths – one party litigates either to a state supreme court or a federal court of appeals, and then applies for certiorari. The more exciting way, of course, would be direct state-on-state conflict; that rare situation in which the Supreme Court retains original jurisdiction.

Massachusetts could sue Virginia under the Court's original jurisdiction to nullify the law or, alternately, Virginia could go after Massachusetts to enforce it.

Unfortunately, about 40 years ago, in *Arizona v. New Mexico*,[19] the Court reiterated that its original jurisdiction was not mandatory, that such jurisdiction should be invoked only sparingly and when there was no other forum for the dispute, and that—and I will admit to paraphrasing broadly here—the Court didn't want to be bothered with stupid childish squabbles and that the states should come back when they had a real case.

On the other hand, five years later the court accepted *Maryland v. Louisiana*,[20] which had somewhat similar facts. Here, the Court pointed out that, unlike *Arizona*, this case brought up "important concerns of federalism" which it needed to work out. So while it is never wise to bet that the Court will take any particular case, here at least there's a chance that the Court might decide that this was an important and interesting issue on which it had not yet ruled.

Conclusion

The simplest conclusion is this: it seems hard to imagine the Virginia law having the slightest real impact. Virginia threw the law out there, a clever lawyer caught it and tested it and, in the end it will likely be nothing more than some fun food for legal theorists, a pile of lawyers' fees, and a good try but a loss for Crutchfield. However, considering the possible effects of a win, it is worth taking the time to think through those legal theories and, in the process, dust off some areas of the Constitution that tax lawyers rarely investigate.

Oh, and Massachusetts? Pro tip: win or lose, browser "cookies" aren't physical objects. ⌘

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Endnotes:

[1]On January 15, 2018, Massachusetts filed its initial response. Virginia circuit court documents are not available electronically.

[2]*Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

[3]There are actually two statutes commonly referred to as the "anti-injunction act" – 28 USC § 2283 prevents a federal court from issuing injunctions against state courts, and 26 USC § 7421, the Tax Anti-Injunction Act, prevents a federal court from hearing cases restraining "the assessment or collection of any tax." Either one could apply here.

[4]This is, in fact, a major point of contention in Massachusetts' reply brief. Even serving the Massachusetts officials was apparently an issue in the case.

[5]8 Cal.3d 522 (1975). This case would end up at the Supreme Court as did *Nevada v. Hall*, which is a key case on the issue of sovereign immunity.

[6]My intuition is that cases in this category are not actually rare *per se* and that state trial courts are littered with cases brought against out-of-state agencies by *pro se* claimants, but that these cases do not survive long enough to end up in any type of searchable reporting system.

[7]*International Shoe v. State of Washington*, 66 S.Ct. 154 (1945).

[8]319 N.J. Super. 324.

[9]2014 WL 6982638 (N.D. California 2014). *See also Marshall v. Washington*, 89 F.Supp.2d 4, *Dodge v. Manchester Police Department*, 2014 WL 4825632. Note that these cases are all in federal court; the federal courts seem much more respectful of *International Shoe* than the state courts.

[10]Article IV, Section I of the Constitution

[11]Full faith and credit is obviously a two-way street, with each state required to respect the others' laws and decisions. Limited space requires us to restrict our examination to one side of that argument.

[12]118 S.Ct. 657 (1998).

[13]52 S.Ct. 571 (1932).

[14]*Id.* at 160.

[15]123 S.Ct. 1683 (2003).

[16]*Pac. Employers Ins. Co. v. Indus. Accident Comm'n of State of California*, 306 U.S. 493.

[17]*Hughes v. Fetter*, 71 S.Ct. 980 (1951).

[18]99 S.Ct. 1182 (1979) (holding generally that while states have immunity from suit in their own courts unless they waive it, that does not apply to suits in the courts of other states).

[19]96 S.Ct. 1845 (1976).

[20]101 S.Ct. 2114 (1981).

The DOL's Fiduciary Duty Role in Universities

By Matt Belenky

Introduction

On November 27, 2017, the Department of Labor (DOL) announced an 18-month extension for the special transition period for the new key provisions of the fiduciary rule.[1] Although the fiduciary rule went into effect on June 9, 2017, this 18-month delay delays the need to fully comply with all of the rule's new exemptions. The key provisions include, and will move, the Fiduciary Rule's Best Interest Contract Exemption (BICE) and the Principal Transactions Exemption, from the previous date of January 1, 2018, to a compliance date of July 1, 2019. By seeking an updated analysis of the "likely impact" of the fiduciary rule on retirement information and financial advice, President Trump is just buying time for the inevitable—to essentially eliminate a key part of the rule. The repeal is significant in that it does not ensure that financial advisers and their firms are accountable for providing sound advice to retirement savers.

The Employee Retirement Income Security Act of 1974, otherwise known as (ERISA), stipulates that a "fiduciary" includes any person or entity that renders "investment advice" for a fee or other compensation (a Fiduciary).[2] Fiduciaries are required to act for the exclusive benefit of a specific retirement plan or IRA and is supposed to avoid non-exempt prohibited transactions such as self-dealing.[3] In general, a fiduciary is a person who owes a duty of care and trust to another and must act primarily for the benefit of the other in a specific activity.[4] The DOL's "review" will include whether possible changes to the exemptions are necessary in response to the comment record of state insurance commissioners and the Securities and Exchange Commission (SEC). Although the effect of the delay will not be delved into in this article, the fiduciary duty rule will. In particular, the fiduciary duty's role in university breaches, those dealing with fiduciaries of "jumbo" 401(k) and 403(b) retirement plans maintained by large universities, will be analyzed.

The Rise of Fiduciary Duty Lawsuits

In August 2016, St. Louis based law firm Schlichter Bogard & Denton LLP began the litigation ambush against university retirement plans by filing a class action suit against 12 schools. The lawsuits allege that the university fiduciaries have breached their fiduciary duties under ERISA by charging high investment management fees to be charged to people's 401(k) and 403(b) accounts. A new lawsuit, filed against Washington University in St. Louis, challenges the school's decision to offer the CREF Stock Account and the TIAA Real Estate Account, which as investment options, were consistently outperformed by lower-cost alternative plans.[5] A retirement plan for a school like Washington becomes significant when you factor in that the school has $3.8 billion in assets and covers over 24,000 people. The lawsuit, filed in June in the U.S. District Court for the Eastern District of Missouri, also takes aim at TIAA and Vanguard's poor record-keeping tactics, which include having multiple record keepers, each of which charges a fee to investors. The other schools facing a class action suit include private universities like Yale, Cornell, NYU, and MIT. Had the plans removed the lengthy investment options and instead used the bargaining power to lower costs, the complaints for these schools argue that plaintiffs would have saved tens of millions of dollars.[6]

The Role of 403(b) Plans

The amusing part about the lawsuits is the important role that the retirement savings market, or 403(b) plans, play. As part of the Internal Revenue Code, a 403(b) plan, also known as a tax-sheltered annuity (TSA) plan, is a retirement plan for specific employees of public schools and employees of certain tax-exempt organizations (i.e. universities, hospitals).[7] Individual accounts in a 403(b) plans may include an annuity contract (a contract provided through an insurance company), a retirement income account set up for church employees, and a custodial account (an account invested in mutual funds).

Contributing to a 403(b) plan has three main benefits attached to it. First, you do not owe an income tax on allowable contributions until you begin making withdrawals from the plan, which is typically after you retire. Allowable contributions to a 403(b) plan are either excluded or deducted from your income. Second, the earnings and gains on amounts in a 403(b) account are only taxed once you withdraw them. Third, you may be eligible to take a credit for elective deferrals put into your 403(b) account.[8]

Despite its benefits, the design and implementation of 403(b) has also been a big reason why universities are facing class action lawsuits the past few years. In specific, in defense, many universities and their fiduciaries have attempted to differentiate 403(b) plans from 401(k) plans by saying that 403(b) plans solely deal with annuity products. The fact that these universities had 403(b) plans with multiple record-keepers is a result of 403(b) plan participants taking their annuity products with them when they switched jobs. This causes them to have the record keeper from both the ole job and a new one. Any flaw in the 403(b) plans is significant given that total 403(b) assets, as of March

2017, amount to $932 billion, roughly 70 percent of which is made up of the higher education (large public and private universities) and health care (large hospital systems and organizations) sector.

The market needs the most work on during the DOL's fiduciary rule delay are the public school district K-12 plans, which include 403(b) plans that are exempt from ERISA, making the investment standards shoddy at best. Other higher education institutions are also guilty of questionable non-ERISA based practices that do not involve prudent oversight and investment advice to employers. The non-ERISA 403(b) plans market accounts for close to 57% of the $900 billion total.[9] Rather than delay and most likely eliminate the fiduciary rule, the Trump administration should look to expand the rule to strengthen how schools design plans so that they're included under ERISA and so that employers are not taken advantage of by investment professionals garnering high fees for illegitimate reasons.

Tibble v. Edison International

One of the more notable fiduciary rule cases came within the last few years in *Tibble v. Edison International.*[10] In 2015, the Supreme Court ruled on a case involving whether ERISA's six-year statute of limitations for breach of fiduciary duty claims prevented a claim when the initial challenged investment decisions were made more than six years before the lawsuit had been filed. Oddly, the Court sidestepped answering this question and stated that under basic trust law a fiduciary has an on-going duty to monitor its investment decisions and eliminate imprudent investments. The Court remanded the case back to the lower court to answer whether a breach had taken place.

The background of the case is that Edison International ("Edison") is a holding company for several electric utilities and it provided a 401(k) plan for 20,000 employees valued at $3.8 billion. As is the case with many lawsuits being filed against universities, the plaintiffs, representing current and former 401(k) plan beneficiaries, claimed that Edison violated ERISA's fiduciary duty of prudence by offering high priced "retail class" shares of mutual funds in place of cheaper "institutional shares" of shares from the same funds. Under ERISA, a plaintiff must bring a claim for breach of fiduciary duty with no more than six years after "the date of the last action which constituted a part of the breach or violation."[11] One of the more curious parts of the decision was that, although the Court disagreed with the Ninth Circuit's assertion that only significantly "changed circumstances" could give rise to a new, separate branch falling within the repose period, the Court did not offer any definition as to what "duty to monitor" means or how it can be interpreted.

The *Tibble* decision is puzzling in that, from one perspective it widens the scope of ERISA fiduciary duties as they relate to retirement plan investments and may make it difficult for imprudent investment claims to get dismissed based on timeliness grounds where a breach of duty to monitor those investments occurs. On the other hand, the Court refused to give guidance on how to evaluate ongoing fiduciary duties not encapsulated by the Uniform Prudent Investors Act. Moreover, the Court failed to give guidance to the Ninth Circuit as to how to apply ERISA's monitoring duty to the plaintiffs funds in the Edison plan, leading to a scenario where the Ninth Circuit could find that the duty to monitor was not violated in the first place here. More prudently, the Ninth Circuit should and could provide a decision on what role the fiduciary plays with regard to specific investments. The fact that the Supreme Court ignored such a key question in this case, even further brings to light how important it is to implement a DOL Fiduciary Rule that outlines these grey areas that courts are forced to wrestle with.

Henderson v. Emory University

This past May, in *Henderson v. Emory University*, the U.S. District Court for the Northern District of Georgia issued the first ruling in the university breach of fiduciary duty cases that have flooded the courts. The court refused to dismiss most claims against Emory, adding that a plan can breach its duties by offering higher-cost retail share classes even when the same institutional share classes are available at a lower cost. As the case proceeds to discovery and possibly trial, the judge did dismiss the fact that an offering of too many investment options can count as a fiduciary breach. In fact, he argued the opposite in saying that having several options provides opportunities to choose investments of an employee's choosing. The counterargument to the judge's point is that how is an employee supposed to parse through the plethora of investment options and find which one is best for them? Increasing the number of options only complicates—not simplifies—matters, particularly if the investor is getting duped by a negligible fiduciary or has little knowledge about the investment plans in general. The court agreed with the plaintiffs on a number of other fronts, however, including the fact that Emory's 403(b) plan offered more than 100 mutual funds (111 in this case) at higher costs than other cheaper alternatives, that the fiduciaries failed to monitor revenue-sharing fees charged by the plan record keeper, and that the use of multiple costly record keepers was sufficient enough to bring a claim for relief for a breach of fiduciary duty based on excessive fees. Finally, the plantiff's allegation that the lack of competitive bidding caused the plan to pay fees in excess of what was reasonable was also sufficient to state a claim for relief.

It will be interesting to follow how other colleges, like NYU, Duke, and MIT, which deal with the same issue as Emory, look to this court's decision in analyzing schools offering many investment options in its retirement plan

at excessive fees for recordkeeping and administrative services. Although this case dealt with 403(b) plans more so than the 401(k) plans in *Tibble*, the issues overlapped in a similar way—excessive fees are being charged to employees on their retirement plans, and they're being taken advantage of with little oversight.

Conclusion

For the opposite reason than what President Trump likely wants, the delay in implementing the DOL's fiduciary rule should provide enough time to address several of these problems appearing in courts over the past decade. In coordination with the SEC, the DOL should come up with concrete ways to protect employees covered by both ERISA and non-ERISA plans, and participating in 403(b) or 401(k) plans, from excessive fee structures and poor investment advice from their respective fiduciaries. These employees fall under a nearly trillion dollar industry that should be a sufficient reason to take the retirement plan safety of these employees seriously. As we saw in *Tibble* and *Emory*, employees may be taken advantage under poor oversight in various work environments and courts are still confused on how to interpret fiduciary duties under ERISA. Instead of, or perhaps in addition to, widening the scope of what a fiduciary is, the DOL, in the next year and a half, should take time to define what constitutes proper fiduciary activity or advice and what does not. Holding fiduciaries to a higher standard about the investment products they're selling will save companies millions in potential class action suits and protect employees from losing money on their retirement plans. Analyzing the issues of the two cases in this article will be a good starting point.

Matt Belenky graduated from the University of Pittsburgh School of Law in 2017 and is a current Tax LL.M. student at Georgetown University Law Center. During his J.D. studies, he externed with the IRS Office of Chief Counsel. While at Georgetown, he externed in the business tax group at McGuireWoods during the fall and is presently a volunteer extern in the Department of Labor's ERISA group. In his spare time, Matt likes watching movies and playing tennis.

Endnotes:

[1]https://www.dol.gov/newsroom/releases/ebsa/ebsa20171127-0.

[2]https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/publications/exemption-procedures-under-federal-pension-law.pdf.

[3]https://www.goodwinlaw.com/publications/2017/06/06_08_17-erisa-fiduciary-rule-impact-on-unregist.

[4]https://www.irs.gov/retirement-plans/retirement-plan-fiduciary-responsibilities.

[5]*Davis v. Wash. Univ. in St. Louis* , E.D. Mo., No. 4:17-cv-01641.

[6]https://www.nytimes.com/2016/08/10/your-money/mit-nyu-yale-sued-4013b-retirement-plan-fees-tiaa-fidelity.html?mtrref=www.google.com.

[7]https://www.irs.gov/publications/p571

[8]*Id.*

[9]https://www.ici.org/pdf/ppr_16_dcplan_profile_403b.pdf.

[10]https://www.supremecourt.gov/opinions/14pdf/13-550_97be.pdf.

[11]29 U.S.C. § 1113.

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