No. 08-310

IN THE

Supreme Court of the United States

POLAR TANKERS, INC.,
Petitioner,
v.
CITY OF VALDEZ, ALASKA
Respondent.

On Writ of Certiorari to the Supreme Court of Alaska

BRIEF OF BROADBAND TAX INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF *AMICUS CURIAE* [1]

This brief *amicus curiae* in support of petitioner is respectfully submitted on behalf of the Broadband Tax Institute ("BTI"). BTI is a non-profit corporation formed in 1986 to facilitate communication and

[1] Both parties have filed blanket consents with this Court to the filing of briefs by *amicus curiae*. No counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *amicus curiae*, its members, or its counsel made a monetary contribution to its preparation or submission.

cooperation among its members on issues and developments in all areas of tax practice, including property, sales and use, and income taxes that affect the cable and telecommunications industry. BTI is currently composed of approximately 250 industry members and associate consultants, and represents major cable and telecommunications businesses in the United States that are engaged in interstate and international commerce.

This Court has granted *certiorari* in this important case to review the validity of the City of Valdez's *ad valorem* property tax applicable to large vessels engaged in interstate commerce that use the City's docking facilities. Petitioner asserts that the City's port-days apportionment formula (in general, the number of days the vessel is in the City's port divided by the number of days the vessel is in any port during the taxable year) inevitably produces a tax on the value of petitioner's vessel that reflects periods the vessel is in use elsewhere (e.g., on the high seas) and thereby violates the Due Process and Commerce Clauses of the U.S. Constitution.[2]

BTI's members, while not subject to the tax at issue here, are subject to taxes with similarly flawed apportionment rules. Like the formula used by Valdez, the formulas to which BTI's members are subject incorporate a similar geographically-based "throwout" rule. (A throwout rule is a rule that "throws out" of the denominator of the apportionment formula amounts attributable to activities under-

[2] The validity of the apportionment formula is one of the two Questions Presented on which this Court granted review. The other issue – whether the Valdez tax violates the Tonnage Clause – will not be addressed by *amicus*.

taken in certain locations, which increases the resulting apportionment in favor of the taxing jurisdiction and thereby systematically attributes extraterritorial value to that jurisdiction.)

Like petitioner, BTI's members believe they are subject to unconstitutional state and local taxation wherever they are subject to a throwout rule. A decision in this case addressing the constitutionality of the Valdez apportionment formula will significantly influence the determination whether other throwout rules will be considered constitutionally infirm.

Amicus is concerned that if the Valdez formula is left unreviewed, or is reviewed without regard to the broader universe of similar throwout rules, its members will continue to be burdened by existing throwout rules and other jurisdictions will be emboldened to adopt similarly inappropriate apportionment methods. The increasing use of throwout rules in other tax areas accentuates the ramifications of the outcome in the instant case.

SUMMARY OF ARGUMENT

The use of a geographically-based "throwout rule" in a taxing jurisdiction's apportionment formula inexorably leads to the attribution of extraterritorial values to that jurisdiction. For that reason, any formula with a throwout rule cannot bear a rational relationship to the activities carried on by the taxpayer in the taxing jurisdiction. Such a formula is therefore facially unconstitutional under the Due Process and Commerce Clauses of the U.S. Constitution. The Valdez port-days rule is a quintessential example of such a formula.

Numerous taxing jurisdictions have adopted varying forms of throwout rules for property taxes, as well as for corporate income and franchise taxes. The Valdez apportionment formula contains a geographically-based throwout rule under which the denominator of the apportionment formula takes into account only total active in-port days and consequently excludes days at sea and days in port for repairs. By "throwing out" of the denominator the number of days at sea, the apportionment formula permits an appropriation by Valdez of a portion of the vessel's value properly associated with the vessel's operations elsewhere. Other apportionment formulas adopt throwout rules with similar effects. These formulas first define the factors that determine the geographical attribution of the tax base (e.g., in-state sales divided by all sales) and then require the disregard (or throwout) of some portion of the denominator *based solely on some other criterion.* The exclusion of such amounts from the denominator of the formula inevitably permits the taxing jurisdiction to tax extraterritorial values. Any such formula should be struck down as constitutionally infirm.

ARGUMENT

Throwout Rules Like the One Adopted By Valdez Are Facially Unconstitutional Under the Due Process And Commerce Clauses Because Such Rules Systematically Tax Extraterritorial Values.

The Due Process and Commerce Clauses prohibit a taxing jurisdiction from taxing extraterritorial values and from taxing value that is not rationally related to the taxpayer's activities in the taxing jurisdiction.

The Due Process Clause requires that there be "some minimum connection" (*Miller Bros. v. Maryland*, 347 U.S. 340, 344 (1954)) between the taxing jurisdiction and the property or activities it seeks to tax and, more importantly for present purposes, a rational relationship between the values that the jurisdiction seeks to tax and taxpayer's intrastate property or activities. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-37 (1980); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978). This Court has found that the minimum connection requirement is met when a taxpayer avails itself of the privilege of conducting business in the state. *Mobil Oil*, 445 U.S. at 437. The more exacting requirement of the Due Process Clause emanates from the mandate that the tax have a rational relationship to the taxpayer's presence in the state.

A. An Apportionment Formula With a Throwout Rule Fails On Its Face To Reflect a Rational Relationship To Values Connected With the Taxing Jurisdiction.

This Court has made it clear that "[a]ny [apportionment] formula used must bear a rational relationship, both on its face and in its application, to property values connected with the taxing State." *Norfolk & W. R. Co. v. Missouri State Tax Comm'n*, 390 U.S. 317, 325 (1968) (citing *Fargo v. Hart*, 193 U.S. 490, 499-500 (1904)); *see also Moorman Mfg. Co.*, 437 U.S. at 273 ("the income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State,'" (*quoting Norfolk & W.*, 390 U.S. at 325)).

A throwout rule is intentionally designed to "soak up" value from outside the taxing jurisdiction. This

absorption of extraterritorial value cannot be rationally related to the taxpayer's activity in the taxing jurisdiction. Throwout rules systematically create a mismatch between the portion of the tax base assigned to the taxing jurisdiction and the activity actually conducted in that jurisdiction by systematically reassigning to the taxing jurisdiction a portion of the tax base that exists outside that jurisdiction.[3] When an apportionment formula, such as the one at issue here, fails to align the scope of the factors used to apportion the tax base with the realities of that tax base, there ceases to be a rational relationship between the apportioned value being taxed and the activities that generated that value.

Applying the foregoing principles here, respondent may tax that portion of the value of petitioner's ship that fairly reflects its connection to the City (i.e., that fairly reflects the time the ship is in the Valdez port) – but it cannot permissibly tax any greater value. As another example, if the ship is in port in Valdez on 10 different days over the course of a taxable year, Valdez would have a rational claim to tax 2.7% of the ship's value (10 /365 = 2.7%). If, however, the City is allowed to throw out of the denominator certain of the days when the ship has no

[3] For example, if a vessel spent 25 days in port in Valdez, 25 days in port in Los Angeles and 315 days on the high seas, a formula that assigned value based on the geographic location of the tax base would assign roughly 7% of the tax base (25/365) to Valdez, 7% to Los Angeles and 86% to the high seas. The Valdez formula throws out the days at sea to take advantage of the fact that there is no taxing jurisdiction for the high seas. The result is to reassign 43% of the tax base to Valdez because its apportionment factor becomes 25/50, thereby allowing it to assert a tax on 50% of the vessel's value even though the vessel was in port there only 7% of the year.

connection to the City (e.g., the days it is on the high seas), the apportionment factor could change dramatically (e.g., 10 /50 = 20%, assuming the ship spends 315 days on the high seas). The exclusion of all non-port days from the apportionment denominator allows the City to capture for itself a substantial portion of the value of the ship even though the ship had contact with Valdez for only 10 days during the year.[4]

The same analysis applies, and the same systematic mismatch between the taxing jurisdiction and the attribution of the tax base occurs, in the context of corporate income tax throwout rules. A corporate income tax throwout rule, like those in New Jersey[5]

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[4] As this Court has noted in admonishing a taxpayer to consider the totality of its true value, "[b]usiness men do not pay cash for property in moonshine or dreamland." *Adams Express Co. v. Ohio*, 166 U. S. 185, 222 (1897). Days on the high seas are not days in moonshine or dreamland.

[5] New Jersey enacted a throwout rule that excludes from the sales factor denominator sales that are made to purchasers in jurisdictions where the taxpayer is not subject to tax. N.J. Rev. Stat. § 54:10A-6 (2007) This rule is effective for periods beginning on or after January 1, 2002, but repealed for periods beginning on or after July 1, 2010. N.J. Rev. Stat. § 54:10A-6 (2008). The New Jersey Tax Court upheld the facial constitutionality of the throwout rule on May 29, 2008, but reserved making a determination on the constitutionality of the throwout rule as applied. *Pfizer, Inc. v. Director, Division of Taxation*, 24 N.J.Tax 116 (2008). The New Jersey Supreme Court granted a plaintiff leave to file an interlocutory appeal to the New Jersey Court of Appeals before the Tax Court rules on constitutionality as applied. *Pfizer, Inc. v. Director, Division of Taxation*, 196 N.J. 590 (2008). That appeal is pending.

and West Virginia,[6] systematically disregards all sales made to states in which no tax is due, even though the income from those sales has its geographic situs there. Such a rule has the inexorable effect of reassigning income that is geographically associated with other states to states adopting a throwout rule. This reassignment bears no relation to the taxpayer's in-state presence, its use of in-state services and resources, or the benefit it generally derives from the state. Whether or not a taxpayer is taxed in another jurisdiction bears no relation to the value it creates within the taxing state.[7] A state does not gain greater power to tax a nonresident taxpayer merely because the taxpayer's out-of-state activities may not bear any tax in that other state. As has been stated with respect to the port-days formula in the income tax context:

> It is a non sequitur to contend that, because income is not taxable on the high seas, it is "therefore" taxable in the states. States do not acquire the power to tax income earned elsewhere merely because the income is not taxable where it is earned.

J. Hellerstein & W. Hellerstein, State Taxation ¶ 10.03[5] at 10-32 to 10-33 (3d ed. 2001-2005). The validity of an apportionment formula based on time,

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[6] West Virginia excludes from the sales factor denominator sales that are made to purchasers in jurisdictions where the taxpayer is not subject to tax. W. Va. Code § 11-24-7(e)(11)(B).

[7] This Court has recognized that one state's tax choices in determining the division of income does not bear on the constitutionality of other states' choices. *See Moorman*, 437 U.S. at 278 ("some risk of duplicative taxation exists whenever the States in which a corporation does business do not follow identical rules for the division of income").

mileage, location of property, or location of sales should not be affected by the tax policies of other jurisdictions.[8]

B. A Throwout Rule Deliberately and Systematically Includes Extraterritorial Values in the Tax Base.

In the absence of federal action, this Court has subjected state taxing statutes to a four-pronged analysis in determining their constitutionality under the Dormant Commerce Clause:

1. Is the tax applied to an activity with substantial nexus with the state;
2. Is it fairly apportioned;
3. Does it discriminate against interstate commerce; and

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[8] See *Mobil Oil Corp. v. Commissioner*, 425 U.S. 425, 444 (1980) ("the constitutionality of a Vermont tax should not depend on the vagaries of New York tax policy"). The Multistate Tax Commission ("MTC") has proposed throwout rules that exclude geographically identifiable values from apportionment factor denominators (*e.g.*, exclusion from the property factor of telecommunications property with situs in non-taxing jurisdictions). MTC Model Regulation IV.17; MTC's Proposed Model Regulation for the Apportionment of Income from the Sale of Telecommunications and Ancillary Services § (3)(ii)(I). The MTC was created by the Multistate Tax Compact, and is an intergovernmental state tax agency that works to assist states in administering taxes that apply to multistate and multinational enterprises. MTC Homepage – About the MTC, http://www.mtc.gov/About.aspx?id=40. Also as part of his proposed 2010-2011 budget, Maine Governor John Baldacci proposed inclusion of a sales factor throwout rule similar to the rules enacted by New Jersey and West Virginia. Sarah H. Beard, *Maine Governor Proposes Sales Factor Throwout Rule*, January 29, 2009, at 17-6.

4. Is it fairly related to the services provided by the state.

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 282 (1977).

In the Commerce Clause context, analysis of the constitutionality of the Valdez apportionment formula necessarily implicates the "fair apportionment" requirement. In articulating this requirement, this Court has observed that an apportionment formula must be both internally and externally consistent. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 169 (1983).[9] The "external consistency" requirement bears on the question of whether a state's tax is fairly attributable to economic activity carried on in the taxing state. With regard to "the second and more difficult requirement" *id.*, of fair apportionment, this Court has declared that "external consistency" requires that "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Id.*

The Valdez apportionment formula, and all geographically-based throwout rules, flunk the external consistency test because throwout rules systematically result in the taxation of extraterritorial value.

As noted above, the Valdez apportionment formula is applied to determine how much of the vessel's value should be attributed to, and taxed by, respondent. In calculating this apportionment, a fraction is computed based on the number of days the taxpayer's vessel is in port in Valdez divided by the number of days the vessel is in port anywhere.

[9] There is no issue here of "internal consistency."

The formula's numerator thereby represents the taxpayer's presence in the port of the taxing jurisdiction and the formula's denominator represents the taxpayer's presence in all ports. Excluded from the denominator are days the vessel spends at sea. Respondent's exclusion of days at sea results in a smaller denominator and thus a larger apportionment in its favor. The increased apportionment attributable to the exclusion thus reflects an increase in taxable value associated entirely with days spent *away* from the taxing jurisdiction – i.e., an extraterritorial value. If intentionally appropriating some portion of value associated with the vessel's presence in another taxing jurisdiction constitutes unconstitutional extraterritorial taxation, as it plainly would, intentionally appropriating some portion of value associated with the vessel's presence on the high seas likewise constitutes unconstitutional extraterritorial taxation.

Assume, for example, under the Valdez port-days formula, that identical Boats A and B have a taxable value of $1 million and are in use for 320 days during the year. Boat A spends 10 days in Valdez and 20 days docked in all ports (including Valdez). Boat B spends 10 days in Valdez and 200 days docked in all ports (including Valdez). Boat A would be taxed by Valdez on *50%* of its value (10 /20 x $1 million = $500,000), while Boat B would be taxed by Valdez on only *5%* of its value (10 /200 x $1 million = $50,000). Thus, Boat A's tax would be 10 times the amount of Boat B's tax even though the two boats have the exact same tax base and have spent the exact same amount of time in the taxing jurisdiction. The only difference is that Boat A spent less time in all ports and more time on the high seas. The extraterritorial reach of the Valdez formula is self-evident.

A formula with a throwout rule is not designed to measure a taxpayer's in-state value. Rather, it is deliberately designed to overstate in-state values. While this Court has given leeway to the states to craft apportionment formulas and has not struck down an apportionment formula because its use might "occasionally" result in the taxation of extra-territorial values, *see Moorman Mfg. Co.*, 437 U.S. at 273, this Court has not previously been confronted with an apportionment formula that is specifically designed to tax extraterritorial values. This type of systematic extraterritorial taxation goes far beyond the minor flaws that are overlooked in a "rough approximation" analysis. *See Trinova Corp. v. Michigan Dept. of Treasury*, 498 U.S. 358, 382 (1991). Rather, like a tax that discriminates against inter-state commerce, a tax attributable to an unfair apportionment formula that, on its face, can be seen as inevitably producing deliberate and systematic extraterritorial taxation should not be allowed to survive, irrespective of the amount of extraterritorial taxation that may be involved. *See Associated Indus. of Missouri v. Lohman*, 511 U.S. 641, 650 (1994).

CONCLUSION

For all of the foregoing reasons, the apportionment formula used by Valdez in calculating its *ad valorem* tax should be invalidated as facially unconstitutional under the Due Process and Commerce Clauses.

Respectfully submitted,

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