No. 08-310

IN THE

Supreme Court of the United States

POLAR TANKERS, INC.,
Petitioner,

v.

CITY OF VALDEZ, ALASKA,
Respondents.

On Writ of Certiorari to the Supreme Court of Alaska

BRIEF OF *AMICUS CURIAE* COUNCIL ON STATE TAXATION IN SUPPORT OF PETITIONER

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INTEREST OF *AMICUS CURIAE*

This brief *amicus curiae* in support of Petitioner ("Polar Tankers") is filed on behalf of the Council On State Taxation ("COST").[1] COST is a non-profit trade association formed in 1969 to promote equitable and nondiscriminatory state and local taxation of

[1] No counsel for a party authored this brief in whole or in part, and no person or entity other than *amicus curiae* has made a monetary contribution to the preparation or submission of this brief. Written consent of all parties to the filing of this brief has been filed with the Clerk of this Court.

multi-jurisdictional business entities. COST represents more than 600 of the largest multistate businesses in the United States; companies from every industry doing business in every state. COST's members are concerned that Valdez's apportionment formula, which taxes vessels in its port by disregarding time the vessels spend in other locations, will create a dangerous precedent and subject taxpayers to inconsistent and unconstitutional taxation. COST's members are concerned that if left unchecked, Valdez's reliance on an unbalanced apportionment formula will lead states and other localities to adopt similarly unsound theories of taxation, exacerbating multiple taxation of the same income or value.

The Court has granted *certiorari* on this important case to review two issues. The first issue is whether the imposition of the tax violates the Tonnage Clause. The second issue is whether the method used by Valdez to apportion the tax violates the Commerce Clause. While we believe the Alaska Supreme Court clearly erred in concluding that the tax did not violate the Tonnage Clause, the greatest concern of the COST membership is the court's conclusion that the apportionment formula used to apply the tax did not violate the Commerce Clause. COST represents multijurisdictional businesses that routinely pay apportioned taxes, and our members are alarmed by the possibility that a town or state can apply an apportionment formula that is designed to increase its own tax collections by manipulating activity occurring entirely outside of the jurisdiction. Certainty and protection against apportionment methods such as the one used by Valdez are critically important issues to all of COST's membership.

STATEMENT OF THE CASE

In 2000, Valdez adopted a personal property tax (the "Vessel Tax") to compensate for its declining oil and gas property revenues. The Vessel Tax did not apply to all ships arriving in the town harbor, but instead Valdez imposed its Vessel Tax only on vessels 95 feet or greater in length that docked at facilities in the town. The town imposed the Vessel Tax on the "full value" of the vessel, but the value was apportioned by using a fraction where the numerator was the number of days a vessel was docked in Valdez and the denominator was the number of days the vessel was docked in any port in which the vessel could be taxed. The unbalanced Valdez apportionment formula completely disregarded time the vessel was not in a port or when the vessel was in a port where it could not be taxed, which necessarily caused the denominator to fall well short of an expected day-based denominator of 365 days. Not surprisingly, disregarding the days spent away from taxable ports greatly increased Valdez's share of the apportioned property value.

Shortly after Valdez adopted the Vessel Tax, several vessel owners filed a suit attacking its validity. In a 2004 decision, the Alaska Superior Court held that the Vessel Tax violated the Tonnage Clause of the U.S. Constitution without addressing the Due Process and Commerce Clauses. In 2005, the Alaska Superior Court reconsidered and vacated its 2004 decision and ruled, without addressing the Tonnage Clause issue, that the Vessel Tax's apportionment method violated the Due Process and Commerce Clauses of the U.S. Constitution. In 2006, the Superior Court issued its final judgment and held that the Vessel Tax did not violate the Tonnage

Clause but that its apportionment formula, as applied to Polar Tankers, violated the Due Process and Commerce Clauses.

On appeal to the Alaska Supreme Court, Polar Tankers argued that the Vessel Tax violated the Tonnage and Commerce Clauses of the U.S. Constitution. The Alaska Supreme Court ultimately rejected both arguments. According to the Alaska Supreme Court, the Vessel Tax is a fairly apportioned property tax and consequently is not in violation of U.S. Constitution's Tonnage Clause. Additionally, the court held that the Vessel Tax's apportionment method poses no risk of duplicative taxation and therefore is not in violation of the fair apportionment requirement of the U.S. Constitution's Due Process and Commerce Clauses.

SUMMARY OF ARGUMENT

In its application, the Valdez apportionment formula creates situations where a taxpayer's Valdez tax liability can vary not based upon its Valdez activities, but based entirely upon its activities outside of Valdez. Such overreaching by Valdez is not fair apportionment and should not survive constitutional scrutiny. The Valdez Vessel Tax violates this Court's extraterritorial principle by inextricably linking the amount of Valdez tax to the amount of time a vessel might have spent in areas in which a tax cannot be collected. Increasing Valdez tax liability simply because another jurisdiction cannot or chooses not to tax a vessel is an unconstitutional enactment of an extraterritorial law.

The issue of extraterritorial taxation arises not only in Valdez, but also in other areas of state and local taxes. We think it is important to bring to the Court's attention the Vessel Tax reaches beyond the

Valdez town limits, and the ultimate resolution of the issue could greatly influence other state and local taxes well beyond the boundaries of one Alaskan municipality.

ARGUMENT

I. THE VALDEZ VESSEL TAX IMPERMISSIBLY TAXES EXTRATERRITORIAL VALUE AND IS NOT FAIRLY APPORTIONED IN VIOLATION OF THE COMMERCE AND DUE PROCESS CLAUSES

The Petitioner has made sound and logical arguments as to why the application of an apportioned Vessel Tax to property that has not obtained a situs violates the Commerce Clause.[2] We agree with the petitioner's conclusions and will not restate those arguments here. Rather, this brief will focus solely on the extraterritorial encroachment of the Valdez Vessel Tax.

A. The Valdez Vessel Tax Violates the Extraterritoriality Principles Embodied in *Gore*.

During the last term, this Court took the opportunity to reiterate its long-standing principle that "[t]he Due Process and Commerce Clauses forbid the States to tax 'extraterritorial values.'" *Mead-Westvaco Corp. v. Illinois Dept. of Revenue*, 128 S.Ct. 1498, 1502 (2008). Indeed, this court has acknowledged that the taxation of interstate commerce "provide[s] the opportunity for a State to export tax burdens and import tax revenues." *Trinova Corp. v. Mich. Dep't Treas.* 498 U.S. 358, 374 (1991). The Valdez Vessel

[2] We also support the Petitioners arguments on the Tonnage Clause, and see no reason to restate those arguments here.

Tax violates this extraterritorial prohibition and exports tax burdens by inextricably linking the amount of Valdez tax to the amount of time a vessel might have spent in areas in which a tax cannot be collected. Increasing Valdez tax liability simply because another jurisdiction cannot or chooses not to tax a vessel is an unconstitutional enactment of an extraterritorial law.

This dispute began when Valdez imposed its 20 mill property tax on the full value of vessels 95 feet and longer while they are docked at the Port of Valdez. Cruise ships, military vessels, and commercial fishing boats are exempt from the levy. In order to address Constitutional uncertainties that had arisen during the initial stages of litigation, Valdez decided to apportion the Vessel Tax rather than impose the tax on the full value. A logical and fair method of apportionment would be to consider the number of days a vessel spends in Valdez as compared to the total number of days in a year. However, Valdez adopted an apportionment formula that bases the tax on the number of days a vessel spends in the Port of Valdez divided by the total days it spends in all ports in which the vessel could be taxed. The apportionment formula effectively excludes all days a vessel spends at sea, days the vessel spends outside of a port waiting to unload its cargo, and days the vessel spends in ports in which it could not be taxed. By dramatically lowering the denominator used in the calculation, Valdez was able to substantially increase the amount of the ship's value apportioned to Valdez, thereby increasing Valdez's tax revenue.

The unbalanced Valdez apportionment formula necessarily increases the amount of tax Valdez collects depending entirely on the activities of a vessel outside

of Valdez. By asserting that Valdez will only consider activity to the extent a vessel is in another taxable port, Valdez has essentially taxed activity outside of Valdez and other taxable ports. It is simply not within Valdez's jurisdiction to assess tax outside of its borders.

A simple scenario illustrates the extraterritorial nature of the Valdez Vessel Tax. Consider the pure example of a vessel that carries the same amount and type of cargo every year. The vessel loads some cargo in Valdez, and during the last two years it had the exact same activities in Valdez. Each year it spent 40 days loading cargo in Valdez. During the first year, the vessel carried its cargo over great distances and spent only 40 days in other taxable ports unloading its Valdez cargo—or perhaps loading and unloading cargo at other ports. During the second year, the vessel made a series of shorter hauls outside of Valdez, which resulted in the vessel spending 80 days in other taxable ports. Although the vessel's contact with Valdez was consistent from year to year, the vessel's tax liability varied dramatically. In year one, the Valdez apportionment formula would assign 50% of the ships value to Valdez. In year two, the apportionment formula would assign only 25% of the value to Valdez.

A vessel operator with consistent and unchanged operations in Valdez, but with increased activity in other ports, might expect to see its tax liability in the other ports change. However, it is certain that the same vessel operator would also unexpectedly see its Valdez tax change solely because of its activities outside of Valdez. In effect, the Valdez apportionment formula creates situations where a taxpayer's Valdez tax liability can vary not based upon

its Valdez activities, but based entirely upon its activities outside of Valdez. Such overreaching by Valdez should not survive constitutional scrutiny.

In a series of cases not involving taxes, this Court has crafted careful limits on the ability of a state or locality to control activities beyond its borders. These cases support a conclusion that neither the activities of businesses in other localities nor the taxing policies of other localities are the proper subject of a Valdez ordinance. While "Congress has ample authority to enact such . . . polic[ies] for the entire Nation, it is clear that no single State [much less a municipality] could do so, or even impose its own policy choice on neighboring states." *See Bonaparte v. Tax Court*, 104 U.S. 592, 594 (1881) ("No State can legislate except with reference to its own jurisdiction. . . ."). *See also BMW of North America, Inc. v. Gore*, 517 U.S. 559, 571 (1996) (stating that while Congress has the authority to enact policies for the entire nation "it is clear that no single State could do so, or even impose its own policy choice on neighboring States"); *Bigelow v. Virginia*, 421 U.S. 809 (1975) (finding that while Virginia had a legitimate interest in maintaining the quality of medical care services provided within its borders, it had no authority to regulate such services provided in New York); and *New York Life Ins. Co. v. Head*, 234 U.S. 149, 161 (1914) (finding that to permit the statutes of one state to operate beyond the jurisdiction of that state would remove "the constitutional barriers by which all the States are restricted within the orbits of their lawful authority and upon the preservation of which the Government under the Constitution depends. This is so obviously the necessary result of the Constitution that it has rarely been called in question and hence authorities directly

dealing with it do not abound"). The "Commerce Clause . . . precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State." *Edgar v. MITE Corp.*, 457 U.S. 624, 642-43 (1982).

As *Gore* and its precedents make clear, the fact that other states or localities cannot impose tax on a vessel in port or at sea is not an act Valdez can correct. As the leading Constitutional treatise notes, "the Court has articulated virtually a *per se* rule of invalidity for extraterritorial state regulations—i.e., laws which directly regulate out-of-state commerce, *or laws whose operation is triggered by out-of-state events*." Laurence H. Tribe, American Constitutional Law § 7-8 at 1064 (3d ed. 2000) (emphasis added). It is undisputed that the Valdez Vessel Tax can increase or decrease because of events occurring outside of Valdez, events which have absolutely no relationship to a taxpayer's business activities in Valdez, and have no relationship to the measurement of a vessel's value reasonably attributable to Valdez.

In *Gore*, this Court rejected Alabama's imposition of economic sanctions to induce BMW to change a nationwide policy. The Supreme Court held that the amount of a state punitive damages award could not be based on BMW's failure to disclose presale repairs in other states. Although not a tax case, the similarity to the Valdez Vessel Tax is striking. That is, just as Alabama sought to impose economic sanctions to discourage BMW from nondisclosure of presale repairs in other states, Valdez contends that it may penalize taxpayers who do not pay similar taxes in other ports or while at sea.

In finding Alabama's punitive damages award unconstitutional in *Gore*, the Court held that a "State's power to impose burdens on the interstate market . . . is not only subordinate to the federal power over interstate commerce, but is also constrained by the need to respect the interests of other States." *Gore*, 517 U.S. at 571 (citation omitted). While modern commerce may be conducted in such a way that blurs strict geographical boundaries, the boundaries on Valdez's ability to impose tax remain crystal clear. Valdez simply is not permitted to enact an ordinance that is triggered by out-of-state events.

B. The Valdez Vessel Tax Violates This Court's Rulings Specific to Other State Taxes Because it is Not Fairly Apportioned

In addition to contradicting this Court's logic in *Gore*, the Valdez Vessel Tax also runs counter to this Court's established standards for examining the constitutionality of apportioned state taxes. The deliberate use of extraterritorial values to measure the Valdez Vessel Tax violates the Due Process Clause of the Fourteenth Amendment of the United States Constitution because the Due Process Clause requires that when a state taxes an interstate business "the income attributed to the State for tax purposes must be rationally related to values connected with the taxing state." *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978) (internal quotation omitted). A tax that varies depending on whether a taxpayer is subject to tax in another port or at sea can never be rationally related to values connected with Valdez.

The deliberate extraterritorial reach of the Valdez Vessel Tax also necessarily results in a violation of the fair apportionment requirement of the Commerce Clause because it intentionally increases a taxpayer's Valdez tax liability based upon whether tax was paid in other ports. Although the states are given significant discretion in determining how to apportion income, the "central purpose behind the apportionment requirement is to ensure that each State taxes only its fair share of an interstate transaction." *Goldberg v. Sweet*, 488 U.S. 252, 260-61 (1989). The Valdez Vessel Tax violates the Commerce Clause by purposefully exceeding its "fair share" of a vessel's value related to interstate activities and by ignoring objective measures of activities outside of Valdez.

The Valdez Vessel Tax also violates the external consistency requirement of fair apportionment. *See Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 165 (1983). The requirement of "external consistency" in an apportionment formula specifically looks to "whether a State's tax reaches beyond the portion of value that is fairly attributable to economic activity within the taxing State." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995). Accordingly, Valdez's taxing scheme violates the external consistency requirement by deliberately reaching beyond the portion of a ship's value that is fairly attributable to economic activity within Valdez.

II. A RULING BY THIS COURT ON WHETHER THE VALDEZ APPORTIONMENT FORMULA VIOLATES THE COMMERCE CLAUSE WILL HAVE RAMIFICATIONS WELL BEYOND THE VALDEZ TOWN LIMITS.

The central issue with respect to the application of the Commerce Clause to the Valdez apportionment method is whether the town impermissibly taxed extraterritorial values. Valdez is not alone in its extraterritorial reach, and other states and localities try to tax extraterritorial values and activities. Similar to the Valdez Vessel Tax, these taxes rely on activities or competing tax policies well beyond the borders of the taxing state in order to justify an increased in-state tax liability. These taxes are indeed extraterritorial in nature and a ruling on the Vessel Tax by this Court could very well affect the application of these taxes and ongoing litigation.

A close corollary to the Valdez apportionment formula is the "throwout rule" in New Jersey. The New Jersey Corporation Business Tax is computed on "entire net income," which is "total net income from all sources, whether within or without the United States. . . ." N.J. Stat. Ann. 54:10A-5(c)(1), -4(k) (2008). The apportionment formula, in effect for over 50 years until 2002, apportioned the tax base using a three-factor formula that divided in-state property by "property wherever situated," in-state sales by "the total amount of the taxpayer's receipts," and in-state compensation by compensation of employees and officers "within and without the State." N.J. Stat. Ann. 54:10A-6 (2001). Thus, the portion of a taxpayer's entire net income (and, formerly, entire net worth) attributable to New Jersey was determined

based on the ratio of the taxpayer's in-state activities to its activities everywhere that contributed to the income or value.

In 2002, New Jersey enacted the Business Tax Reform Act of 2002. L. 2002, c. 40, §§ 1 to 33. The "BTRA," as it is commonly called, made a change to the definition of the sales fraction to exclude certain sales from the denominator of the sales fraction. L. 2002, c. 40, § 8 (amending N.J. Stat. Ann. 54:10A-6(B)). Specifically, as amended by the BTRA, the denominator of the sales fraction is now:

> [T]he total amount of the taxpayer's receipts, similarly computed, arising during such period from all sales of its tangible personal property, services, rentals, royalties and all other business receipts, whether within or without the State; provided however, that if receipts would be assigned to a state, a possession or territory of the United States or the District of Columbia or to any foreign country in which the taxpayer is not subject to a tax on or measured by profits or income, or business presence or business activity, then the receipts shall be excluded from the denominator of the sales fraction.

N.J. Stat. Ann. 54:10A-6(B) (2008) (as amended by the BTRA; underscoring shows additional language added by the BTRA).

Thus, a taxpayer affected by this change will have its entire net income apportioned to New Jersey by reference to less than all of the receipts that generated that income. In some cases, this results in a relatively small increase in a taxpayer's factor. In others, it results in a huge increase in the factor. Regardless of the degree of numerical effect of

throwout, taxpayers argue that the throwout rule is unconstitutional because it violates the basic constitutional premise of formulary apportionment.

New Jersey recently repealed its throwout rule, but litigation is still ongoing for the years in which it was operative. *Pfizer, Inc. v. Division of Taxation*, 24 N.J. Tax 116, *appeal granted,* 960 A.2d 388 (N.J. 2008); N.J. Assmb. Bill A2722 (2008). Moreover, the use of throwout in other contexts has started to gain steam. For example, the Multistate Tax Commission has recently approved a model apportionment regulation that removes from the denominator all sales into a jurisdiction in which the taxpayer is not taxable. Massachusetts is currently considering adopting that rule. The Maine Governor has also proposed a throwout rule in his recent 2010 – 2011 biennial budget. Therefore, a ruling by this Court concerning an extraterritorial reach of the Valdez could very well influence these other taxes.

CONCLUSION

In its application, the Valdez apportionment formula creates situations where a taxpayer's Valdez tax liability can vary not based upon its Valdez activities, but based entirely upon its activities outside of Valdez. Such overreaching by Valdez should not survive constitutional scrutiny. The Valdez Vessel Tax violates this Court's extraterritorial principle by inextricably linking the amount of Valdez tax to the amount of time a vessel might have spent in areas in which a tax cannot be collected. Increasing Valdez tax liability simply because another jurisdiction cannot or chooses not to tax a vessel is an unconstitutional enactment of an extraterritorial law.

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RELIEF REQUESTED

The Council On State Taxation respectfully requests that this Court reverse the decision of the Alaska Supreme Court. This Court's guidance on the limits of extraterritorial taxation will prevent businesses from being subject to multijurisdictional taxation on the same value.

Respectfully submitted,

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