No. 24-332

IN THE

Supreme Court of the United States

INTERNATIONAL BUSINESS MACHINES CORPORATION AND COMBINED AFFILIATES,

Petitioner,

v.

NEW YORK STATE TAX APPEALS TRIBUNAL AND NEW YORK STATE COMMISSIONER OF TAXATION AND FINANCE,

Respondents.

On Petition for Writ of Certiorari to the New York Court of Appeals

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

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INTEREST OF *AMICUS CURIAE*

The Council On State Taxation ("COST") is a non-profit trade association based in Washington, D.C. COST was originally formed in 1969 as an advisory committee to the Council of State Chambers of Commerce.[1] Today COST has grown to an independent membership of approximately 500 major corporations engaged in interstate and international business. COST's long-standing objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

COST members are extensively engaged in interstate and international commerce and share a vital interest in ensuring states do not impede the rights of all businesses engaged in both interstate and international commerce. To that end, it is important to COST members that states impose their taxes in a manner consistent with the protections provided by the U.S. Constitution's Commerce Clause.[2] This case addresses the Commerce Clause prohibition of imposing discriminatory taxes upon interstate and foreign commerce by a state. It provides the Court with the opportunity to clarify the application of the internal consistency test to state tax schemes that impermissibly interfere with the free flow of interstate and foreign commerce by placing a heavier burden on

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[1] No counsel for any party authored this brief in whole or in part, and no person or entity aside from amici and its counsel funded its preparation or submission. The parties received timely notice of *amici*'s intent to file this brief.

[2] The Commerce Clause "regulate[s] commerce with foreign nations, and among the several states, and with the Indian tribes." U.S. Const. art. I, § 8, cl. 3.

transactions that occur in interstate and foreign commerce.[3]

The New York Department of Taxation and Finance, Division of Taxation ("Division of Taxation") disallowed International Business Machine Corporation ("Petitioner") a deduction from taxable income for royalty payments received from foreign affiliates not subject to New York corporate franchise tax while allowing such a deduction for royalty payments received from affiliates subject to New York's corporate franchise tax. The Division of Taxation denied the royalty payments deduction under former New York Tax Law § 208.9(o). The result of the Division of Taxation's action, affirmed by New York's highest court, its Court of Appeals, was the denial of Petitioner's refunds and the assessment of additional corporate franchise tax.

COST has a long history of submitting *amicus* briefs to this Court when significant state and local tax issues impacting businesses operating in multistate and international commerce are under consideration. COST has submitted *amicus* briefs in significant state tax cases considered by this Court including: *Comptroller of the Treasury of Maryland v. Wynne*, 575 U.S. 542 (2015); *Alabama Department of Revenue v. CSX Transportation, Inc.*, 575 U.S. 21 (2015); *Direct Marketing Association v. Brohl*, 575 U.S. 1 (2015); and *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust*, 139 S. Ct. 2213 (2019). More recently, COST filed *amicus* briefs in *Steiner v. Utah State Tax Commission*, 449 P.3d 189

[3] *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983).

(Utah 2019), *cert. denied*, 140 S. Ct. 1114 (2020);. *Ferrellgas Partners, L.P. v. Director, Division of Taxation*, 251 A.3d 760 (N.J. 2021), *cert. denied*, 142 S. Ct. 1440 (2022); *Washington Bankers Association, v. State of Washington, Department of Revenue,* 495 P.3d 808 (Wash. 2021), *cert. denied*, 142 S. Ct. 2828 (2022); *United States ex rel. Schutte v. SuperValu, Inc., United States ex rel. Proctor v. Safeway, Inc*., 30 F.4th (7th Cir. 2022), 143 S. Ct. 1391 (2023); *Quad Graphics, Inc. v. North Carolina Department of Revenue*, 382 N.C. 356 (N.C. 2022), *cert. denied*, 143 S. Ct. 2638 (2023); and *MMN Infrastructure Services, LLC v. Michigan Department of Treasury,* 512 Mich. 594 (2023) *cert. denied* 144 S. Ct. 427 (2023).

As a long-standing business organization representing multijurisdictional taxpayers, COST is uniquely positioned to provide this Court with the analytical underpinnings for why the New York Court of Appeals affirming the Division of Taxation's denial of Petitioner's refund requests and the issuance of a corporate franchise tax deficiency violates the Commerce Clause and should be reviewed by this Court.

STATEMENT OF THE CASE

This case concerns a decision by the New York Court of Appeals holding the State's former corporate franchise tax statute, New York Tax Law § 208.9(o), did not discriminate against interstate and foreign commerce in violation of the Commerce Clause of the U.S. Constitution.[4] *In re Walt Disney Co. & Consol. Subsidiaries v. Tax Appeals Tribunal of the State*, Nos. 34, 35, 2024 NY Slip Op 02127 (N.Y. April 23, 2024).

[4] U.S. Const. art. I, § 8, cl. 3.

Petitioner is a publicly traded multinational technology and consulting company organized and founded in New York. Since 1949, IBM World Trade Corporation ("WTC"), a subsidiary of Petitioner, has marketed Petitioner's products and equipment outside the United States. To facilitate the marketing of the products and equipment, Petitioner granted WTC a non-exclusive license under certain patents. WTC operates in foreign countries where it contracts with third-party non-U.S. customers to sell Petitioner's products. Additionally, WTC sublicenses the right to distribute Petitioner's products in over 170 countries to locally incorporated subsidiary companies ("Foreign Affiliates"). During the tax years 2007 through 2012 ("Period at Issue"), the Foreign Affiliates paid royalties to WTC for the right to distribute and/or market Petitioner's software programs and for certain services, economic rights, patents, and trademarks to manufacture and sell petitioner's computer hardware.

New York imposed a corporate franchise tax on the allocated portion of a corporation's net income earned in New York. New York Tax Law § 210.1. The starting point for the computation of New York tax is federal taxable income with certain modifications. In 2003, the New York statute was amended to enact a royalty expense addback provision which required taxpayers to "addback" to their federal taxable income (i.e. disallow a deduction) certain royalties paid by non-New York members to a related member. New York Tax Law § 208.9(o)(2)(A). At the same time the New York statute allowed taxpayers to deduct royalties received from New York related members.[5] New York

[5] For purposes of both the royalty expense addback and the royalty exclusion provisions, the term "related member" was defined in relevant part as a corporation that owns at least

Tax Law § 208.9(o). Thus, per the statute if the royalty payor was subject to New York corporate franchise tax the recipient would exclude the royalty income from its taxable income base. For the Period at Issue, Petitioner was subject to and filed New York corporate franchise tax returns. Pursuant to the statutory provision that permitted a taxpayer to exclude from New York taxable income royalties received from related members, Petitioner deducted the royalty payments received from the Foreign Affiliates. The Division of Taxation subsequently denied Petitioner's exclusion of royalty income because its Foreign Affiliates that paid the royalties were not subject to New York's corporate franchise tax.

The New York Tax Appeals Tribunal upheld the Division of Taxation's denial concluding Petitioner could deduct the royalty payments only if the related royalty payor was also a New York taxpayer. The New York Court of Appeals, Appellate Division, affirmed the Tax Appeals Tribunal holding the Division of Taxation's interpretation of the royalty income exclusion did not violate the internal consistency requirement of the dormant Commerce Clause and the dormant Foreign Commerce Clause of the U.S. Constitution. The New York Court of Appeals affirmed the Court of Appeals, Appellate Division, stating that any burden on interstate or foreign commerce created by the New York tax scheme was incidental and did

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30% of the stock of another corporation. New York Tax Law § 208.9(o)(1)(A)-(B).

not violate this Court's dormant Commerce Clause internal consistency test.[6]

ARGUMENT

I. THE COMMERCE CLAUSE PROHIBITS STATES FROM DISCRIMINATING AGAINST INTERSTATE AND FOREIGN COMMERCE.

Congress is affirmatively granted the power to "to regulate Commerce with foreign Nations and among the several States." U.S. Const. art. I, § 8, cl. 3. Although, states have broad discretion in designing their tax structures, this Court has long held that the Commerce Clause contains a negative command that prohibits a state from either taxing a transaction more heavily when it crosses state lines than when it occurs within the state by providing a direct commercial advantage to local business, or by subjecting interstate commerce to multiple taxation. *Wynne*, 575 U.S. at 548–50. To determine if a tax violates the dormant Commerce Clause, the tax must satisfy a four-part test. A tax will pass Commerce Clause muster so long as it "(1) applies to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services the State provides." *South Dakota v. Wayfair, Inc.*, 585 U.S. 162, 174 (2018) (citing *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)). When foreign commerce is involved, as is the case in this matter, the Court has added heightened protection adding two additional tests.

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[6] In addition, the Court of Appeals held the tax was not discriminatory against interstate or foreign commerce. *In re Walt Disney Co. & Consol. Subsidiaries*, Nos. 34, 35 Slip Op. 02127 (N.Y. April 23, 2024),

Specifically, a tax that "seeks to tax instrumentalities of foreign" commerce will not pass dormant Foreign Commerce Clause muster if there is a substantial risk of international multiple taxation, or if the tax prevents the federal government from speaking with one voice. *Japan Lines, Ltd. v. Cnty. of Los Angeles*, 441 U.S. 434, 451 (1979). To determine if a tax will meet these constitutional standards, it must be both internally and externally consistent. *Oklahoma Tax Cmm'n v. Jefferson Lines Inc.*, 514 U.S. 175, 185 (1995).

A. The New York Tax Scheme Fails The Internal Consistency Test Because It Provides A Direct Commercial Advantage To New York Businesses.

The Court in 1983 delineated the constitutional guidelines for determining whether a state income tax apportionment formula passed constitutional muster. Specifically, the Court stated an apportionment formula must be fair. *Container Corp. of Am. v. Franchise Tax Board*, 463 U.S. 159, 169 (1983). To establish fairness the formula has to be internally consistent – "if applied by every jurisdiction it would result in no more than all of the unitary business income being taxed." *Id*. Additionally, the formula must be externally consistent, *e.g.* "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how the income is generated." *Id*. While the internal and external consistency analysis initially was applied to state tax apportionment schemes, the internal consistency test was extended to also determine if a state tax discriminates against interstate commerce in violation of the Commerce Clause. *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984). The New York statute fails the internal consistency test.

Internal consistency, as explained by the Court "is present when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would also not bear." *Jefferson Lines Inc.,* 514 U.S. at 185. The Court has made it clear "[t]his test asks nothing about the economic reality reflected by the tax but simply looks to the structure of the tax at issue to see whether its imposition in every State in the Union would place interstate commerce at a disadvantage compared to intrastate commerce." *Id.* If a state tax fails the internal consistency test, as a matter of law the tax discriminates against interstate commerce in violation of the Commerce Clause. The Division of Taxation's interpretation, and subsequent courts' affirmations, of the royalty deduction statute fails the internal consistency test because it provides an advantage to New York businesses that is not provided to non-New York businesses.

The New York tax scheme provides a deduction from New York taxable income for royalty income received from a related member (the "Royalty Deduction"). New York Tax Law § 208.9(o)(3).[7] Additionally, the statute modifies New York taxable income by requiring a taxpayer who is paying royalties to a related member and deducting the royalty expense to add back the royalty payment to the extent it was deducted from

[7] The starting point for computing New York taxable income is federal taxable income. For years prior to 2015, the statute provided ". . . a taxpayer shall be allowed to deduct royalty payments directly or indirectly received from a related member during the taxable year to the extent included in the taxpayer's federal taxable income unless such royalty payments would not be required to be added back under [Tax Law § 208.0(o)(2)]. Or other similar provisions of this chapter." New York Tax Law §208.9(o)(3).

federal taxable income (the "Royalty Addback"). New York Tax Law § 208.9(o)(2)(A).[8] The New York Royalty Deduction and Royalty Addback scheme imposes a tax on whichever party New York is allowed to tax. If the entity paying the royalty is subject to New York tax, then it is (indirectly) taxed on the royalties because it is required to add the royalty expense back to taxable income. The recipient of the royalties would in turn exclude the royalty income from its New York taxable income. However, if the royalty payor was not subject to New York corporate franchise tax, then the recipient could not deduct the royalty income from taxable income. In the instant case, Petitioner received royalty payments from Foreign Affiliates that were not New York taxpayers. The Division of Taxation interpreted the Royalty Deduction and Royalty Addback in concert to deny Petitioner's Royalty Deduction based solely on the fact the related member paying the royalty was not subject to New York corporate franchise tax, *e.g.* the related member was not a New York taxpayer. This denial of Petitioner's royalty deduction directly contravenes the internal consistency test as the denial provides a commercial advantage for in-state royalty payors that is not provided to the Foreign Affiliates, and on its face, discriminates against both foreign and interstate commerce.

The internal consistency test is used by this Court to "identify tax schemes that discriminate against interstate commerce." *Wynne*, 575 U.S. at 562. In applying the test, one must look "to the structure of the tax at issue to see whether an identical application by every state in the Union would place interstate

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[8] The term "related member" is defined in relevant part as "a corporation that owns at least 30% of the stock of another corporation." New York Tax Law § 208.9(o)(1)(A)-(B).

commerce at a disadvantage as compared with commerce intrastate." *Id.* The internal consistency analysis assumes every state has adopted the same tax scheme.

If every state adopted the New York Royalty Deduction and Royalty Addback tax scheme, the payment of royalties by an entity engaged in foreign or interstate commerce would be double taxed. The royalty payor's jurisdiction would not allow the royalties to be excluded because the recipient was not a taxpayer thus, subjecting the royalty income to tax. That same royalty income would be taxed a second time because the royalty recipient could not exclude the royalty income from its taxable income because the payor was not taxable in that jurisdiction. In contrast, the payment of royalties between entities subject to tax in the same jurisdiction would be subject to tax only once on the royalty income, *e.g.* the royalty payor would be required to add the royalty expense back to taxable income and pay tax and the royalty recipient would then exclude the royalty income. It is clear if every state adopted the New York tax scheme, then multistate and multinational taxpayers would incur a greater tax burden than taxpayers engaged in intra-state commerce because of the denial of the Royalty Deduction. The increased burden placed on interstate and foreign commerce violates the Commerce Clause.

B. The New York Decision Ignores This Court's Internal Consistency Test.

The New York Court of Appeals' analysis flies in the face of this Court's holdings in *Armco*, *supra.*, *Tyler Pipe Industries, Inc. v. Washington Department of Revenue,* 483 U.S. 232 (1987), and most recently *Wynne, supra.* The Court in 1984 applied the internal consistency analysis to the West Virginia business and occupation tax scheme. *Armco,* 467 U.S. at 644-645. The tax was imposed on specific taxable business activities including wholesaling and manufacturing at varying rates. A company that performed both wholesaling and manufacturing in West Virgina was provided with a "multiple business activities" exemption resulting in only a tax on its manufacturing activities in the State.[9] This statutory provision allowed a West Virginia wholesaler/manufacturer to avoid payment of the tax on its wholesaling receipts. In contrast, a business that performed one of the same activities outside of West Virginia was required to pay tax on both its manufacturing receipts and its wholesaling receipts. This Court concluded the tax scheme failed the internal consistency test because if every state adopted a similar tax structure, then a taxpayer that manufactures in one state and makes wholesale sales in another state would pay tax in both states. *Id*. at 644. In contrast a wholly in-state manufacturing and wholesaling business would pay a single manufacturing tax. *Id.* The result was a higher tax burden placed on businesses engaged in interstate commerce.

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[9] The West Virginia manufacturing activities tax rate was 0.88% and the wholesale tax rate was 0.27%. *Armco*, 467 U.S. at 641.

Three years after *Armco*, the Court applied the internal consistency test to the Washington business and occupation tax, finding an exemption for manufacturer-wholesalers discriminated against interstate commerce in *Tyler Pipe, supra.* Like West Virginia, Washington had a multiple activities exemption which exempted local manufacturers-wholesalers from the State's wholesaling tax. Thus, an in-state manufacturer-wholesaler would pay only one tax. The Court concluded the Washington tax scheme "expose[d] manufacturing or selling activity outside the State to a multiple burden from which the only activity of manufacturing in-state and selling in-state is exempt." *Tyler*, 483 U.S. at 248. The Washington multiactivity exemption "effectively placed interstate commerce at a disadvantage." *Id.* at 243. The Washington business and occupation tax scheme put an interstate manufacturer-wholesaler at a competitive disadvantage to a wholly in-state manufacturer-wholesaler.

New York's limitation of the Royalty Deduction to only royalties received from New York businesses is nearly identical to the West Virginia and Washington multiple business activities exemptions that have been held to discriminate against interstate commerce. As with both the West Virginia and Washington tax schemes, New York's application of its Royalty Deduction provides in-state businesses with a commercial advantage that is not provided to interstate and international businesses. This commercial advantage discriminates against interstate commerce in violation of the Commerce Clause.

The New York Court of Appeals in reaching the conclusion the Royalty Deduction tax scheme passes constitutional muster ignores this Court's holding in

Wynne, *supra.* The Court made it clear that the "total tax burden on interstate commerce" must be examined. 575 U.S. at 567. The Court in *Wynne, supra,* rejected the argument that the tax burden analysis is based on the amount of tax revenue received. Rather, "[T]he critical point is the total tax burden on interstate commerce is higher, not that Maryland would recover more or less tax revenue from a particular taxpayer." *Id.* The New York Court of Appeals ignored this point when it attempted to salvage the Royalty Deduction tax scheme by pivoting to the way taxable income is apportioned concluding "because of the system of allocation, allocating intellectual property to New York could increase, decrease, or have no effect on a company total taxable income depending on factors entirely independent of the add back scheme," Pet. App. 19a**.** In direct contravention of the holding in *Wynne, supra,* the Court of Appeals reasoned "because with each additional foreign dollar added, the portion of that company's income attributable to New York State will decrease." Pet App. 20a. The Court of Appeals erroneously concluded that because the inclusion of the royalty income dilutes the apportionment of Petitioner's taxable income there is no violation of the internal consistency test.

The Court of Appeals' insertion of apportionment into the internal consistency analysis is flawed in that it completely ignores this Court's prior holdings. First, in relying on the apportionment provisions to determine if a tax identical to the one in question was imposed by every other state or nation would burden interstate commerce more than intrastate commerce, the Court of Appeals failed to consider that the internal consistency test would require every state or nation to make the same adjustment to the denominator of the sales factor. Thus, the dilution relied upon

as justification for the Court of Appeals' conclusion would occur in every state or nation. More importantly, as stated by this Court in *Wynne*, *supra,* it is not the amount of revenue received by New York that determines if a tax discriminates against interstate commerce. Rather, it is the total tax burden that is borne by interstate commerce that is the critical factor in determining if the tax scheme provides an advantage to in-state businesses. As with the West Virginia and Washington multiple activity exemptions, the limitation of the Royalty Deduction to royalties paid by New York businesses unconstitutionally grants a commercial advantage to a New York business. Applying the internal consistency analysis to the New York Royalty Deduction and Royalty Addback tax scheme results in only one conclusion, the tax scheme provides an advantage to New York businesses and places a heavier burden on interstate and foreign commerce in violation of the Commerce Clause.

CONCLUSION

While states have broad discretion in designing a tax structure, their tax structures cannot tax a transaction more heavily when it crosses state lines than when it occurs within a state. Nor can a state impose a tax which discriminates against interstate commerce by providing a direct commercial advantage to local business, or by subjecting interstate commerce to multiple taxation. This Court's internal consistency test is a mechanism to determine when a state tax scheme runs afoul of the Commerce Clause. A state tax structure must be internally consistent, and if the tax is not, the tax scheme discriminates against interstate commerce. The New York Royalty Addback and Royalty Deduction tax scheme patently fails the

internal consistency test. The New York Court of Appeals consolidated decision in this case upholding New York's tax scheme, directly contravenes this Court's Commerce Clause guidance. For that reason, this Court should grant review of Petitioner's Petition for Writ of Certiorari and reverse the judgment of the New York Court of Appeals.[10]

Respectfully submitted,

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[10] For the reasons set forth herein this Court should also grant review in the *Walt Disney Co. v. New York Tax Appeal Tribunal*, No. 24-333 (Docketed Sept. 24, 2024).