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CONUNDRA ON THE TUNDRA: WILL THE U.S. SUPREME COURT EXERCISE LIBERTY AND PROVIDE JUSTICE FOR ALL IN *POLAR TANKERS V. CITY OF VALDEZ, ALASKA*?

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On April 1, 2009, the Supreme Court will hear arguments in *Polar Tankers v. City of Valdez*—the first state tax case to come before the Court in the aftermath of the credit and economic crises. Many taxpayers, tax practitioners, and *amici curiae* will be on hand hoping the Supreme Court will address the scope of the "rational relationship" requirement that justifies the apportionment of a tax on a nondomiciliary taxpayer. While the Court's decision may be confined to an analysis of the rarely invoked Tonnage Clause, which prohibits taxes that "operate to impose a charge for the privilege of entering, trading in, or lying in a port," the case carries broader Commerce Clause implications as well.

The Commerce Clause generally prohibits the states from imposing taxes on out-of-state activities and values. And because the Commerce Clause is not confined to activities at ports, any decision in this case that applies the Commerce Clause, or that simply borrows its standards will be watched closely by taxpayers and taxing jurisdictions across the country. Indeed, *Polar Tankers'* implications are particularly important today as the economic crisis pressures state and local taxing jurisdictions to find new sources of revenue. Increasingly, taxing authorities have sought to expand revenue by looking to out-of-state taxpayers. Interstate rivalries for business and jobs often pit taxing authorities against nondomiciliary companies, and against each other. In this economic environment, the court's role of prohibiting economic injustice of extraterritorial taxation becomes even more important.

The prohibition of extraterritorial taxation is the core constitutional concept of the Commerce, Import-Export, and Tonnage Clauses of the U. S. Constitution. To ensure fairness among the states, the Constitution grants the U. S. Congress, not individual states or localities, the authority to regulate interstate commerce and to impose import, export, and tonnage duties.

States have greater authority over intrastate commerce. Generally, a taxpayer's domicile state has broad authority to impose a tax if the tax is fairly apportioned. Taxation of nondomiciliary taxpayers, however, requires higher scrutiny. A nondomiciliary state must have sufficient nexus to the taxpayer and the activities it seeks to tax, as well as a rational relationship to those in-state activities.

Given the Court's appreciation of the current economic conditions, it may well seize this opportunity to rein in state and local governments' temptation to view interstate business and travelers as a passing source of tribute. The facts of *Polar Tankers* readily lend themselves to that purpose.

Valdez' Tax On Vessels Likely To Be Owned Out-Of-State

The City of Valdez, Alaska sits at the south terminus of the Trans-Alaska Pipeline. Since completion of the pipeline, nearly 20 percent of the U.S. domestic oil supply has been loaded onto tankers in Valdez for transport to refining facilities in California and elsewhere.

In 1999, the City adopted a personal property tax on certain vessels that docked at its three ports. The record indicates that the tax was motivated by what the Alaska Supreme Court described as "a serious erosion of the City's tax base." The new property tax was carefully described in both its reach and its exemptions. First, the tax applied only to U.S. flagged vessels in an apparent effort to avoid invalidity under the Import-Export Clause. Second, the tax applied only to ships 95-feet long and longer, and exempted any ships used primarily in some aspect of the commercial fishing business, virtually all of the locally-owned shipping fleet that would otherwise be reached by the tax. To the extent the ordinance did not already betray its intentions to single out the interstate oil shipping business, it explicitly excluded any vessel that docked exclusively at the local terminal.

The City was not merely aggressive in its decision to apply the tax primarily to non-residents, it was also aggressive in how the tax was applied. The City's apportionment method looked to the total numbers of days in port, using Valdez days in port as the numerator, and compared it to the total days in port overall, excluding all days when the ship was actually at sea or was in port for repairs or because of a strike. In practice, the tax was generally based on how quickly the ship departed Valdez and how long it could linger in home or other non-Valdez ports. If, at the end of the year, a ship had spent only 20 days "in port" outside of Alaska, an eye-popping 33% of the vessels' total value would be taxed in Valdez if it spent as little as ten days in port in Valdez. Delays in port in Valdez would almost always inure proportionately to the tax revenue benefit of local interests.

The Trial Court's Ruling: The Apportionment Scheme Is Unconstitutional

Polar Tankers and several others filed suit in 2000, raising a series of constitutional challenges to this new property tax. In particular, Polar Tankers claimed that both the tax and the apportionment methodology violated due process and discriminated against foreign commerce under the four part test of *Complete Auto Transit v. Brady*. [1] That Supreme Court decision permits a state tax on non-residents only where there is (1) a sufficient nexus between the taxpayer and the state; (2) fair apportionment; (3) no discrimination between out-of-state and in-state taxpayers; and (4) a fair relation between the tax and the services provided to the taxpayer by the state. Polar Tankers also argued that the tax violated the Tonnage Clause of article I, section 10 of the Constitution.

[1] 430 U.S. 274 (1997).

After several years of litigation, most of the shippers settled with the City. Polar Tankers, however, pressed on and ultimately prevailed on summary judgment. The trial court initially struck down the tax in full on the theory that it operated as an unconstitutional duty on tonnage. The trial court withdrew that ruling following the City's motion for reconsideration. After additional briefing, the trial court again sided with Polar Tankers, though more narrowly. In its second decision, the court confined its analysis to the Due Process and Commerce Clauses, leaving the Tonnage Clause out of the analysis. The court concluded that the days-in-port apportionment denied due process and discriminated against interstate commerce. Following yet another motion by the City, the court confirmed that the tax did not also violate the Tonnage Clause in spite of its earlier decision to the contrary—though it assumed the tax was fairly apportioned for purposes of its analysis of the Tonnage Clause.

The judgment permitted the City to levy the vessel tax promptly upon adoption of a constitutional apportionment formula. The trial court denied a motion for clarification but stayed operation of its judgment and ordered that the City could not "levy against Plaintiffs any amount of tax beyond the amount that would be due using this apportionment formula: Days in Valdez/365," with any amounts to be paid into a court-supervised account until the decision of the Alaska Supreme Court.

The Alaska Supreme Court Ruling: The Tax And The Apportionment Scheme Are Constitutional

Both parties appealed to the Alaska Supreme Court. Polar Tankers challenged the Tonnage Clause ruling; the City challenged the apportionment decision.

Polar Tankers devoted most of its argument to the idea that the City's apportionment formula created a risk of duplicative taxation because it did not account for all of the days in the year and thus impinged on the rights of the vessel's home port state—California—to impose its own tax. The Alaska Supreme Court rejected that multiple tax argument and found that conclusion largely dispositive of all of the issues in the case, claiming support for its decision in *Japan Line, Ltd. v. County of Los Angeles*.[2] The Alaska Supreme Court read *Japan Line's* rejection of the home port doctrine as not only opening vessels (and other instruments of interstate commerce) to the prospect of some form of tax outside the domiciliary state, but also to permit an apportionment method that would reach the value of the vessel when it had no specific tax situs. Thus, according to the Alaska Supreme Court, the value of the vessel while it was at sea was fair game for Alaska (or any other state), despite the absence of any rational connection to the City at that point, so long as the actual tax imposed was tied to the days in an Alaskan port.

The Court cited two other U.S. Supreme Court decisions as having approved apportionment effects on vessels used in interstate commerce similar to the scheme employed by the City. Significantly, however, neither of those cases dealt with a state's effort to tax value beyond the reach of any particular state. The first case, *Braniff Airways v. Nebraska State Board of Equalization & Assessment*,[3] involved a tax on

[2] 441 U.S. 434 (1979).

[3] 347 U.S. 590 (1954).

aircraft apportioned based on the percentage of total landings. Of course, aircraft, by their nature, land and come to rest in some state or country (and maybe more than one) every day. *Ott v. Mississippi Valley Barge Line Co.*,[4] the second case the Alaska Supreme Court cited, involved a tax on barges used along the Mississippi River and apportioned for tax purposes according to the percentage of miles traveled in each state's waters. The tax in *Ott* was apportioned on total usage of the barge while it was within the territorial jurisdiction of the state. It did not exclude any percentage of the overall value of the vessel from the denominator in order to increase the claim of the taxing jurisdiction.

The Alaska Supreme Court also rejected Polar Tanker's remaining Due Process and Commerce Clause arguments invoking the third and fourth prongs of *Complete Auto*—discrimination against foreign commerce and proportion to local benefits—on the basis that those issues had been inadequately briefed. The Court went on briefly to address and reject these issues anyway, potentially freeing the U.S. Supreme Court to reach such issues as well. In fact, despite the putative waiver of those arguments, the Alaska Supreme Court's analysis of the Tonnage Clause addressed these same discrimination and local benefits issues at lengths which may well form the basis of a reversal in the U.S. Supreme Court, should it be inclined to address Due Process or Commerce Clause issues.

The Alaska Supreme Court disposed of the Tonnage Clause arguments by studying the form—and eschewing the intent and substance—of the tax. Polar Tankers urged that the tax was drawn so as to apply only to foreign vessels and thus constituted an unlawful tax on "entering, trading or lying in port." The Alaska Supreme Court pointed to its own conclusion that the tax operated as a validly apportioned ad valorem tax and thus was imposed on the value of the ship and not on the privilege of entering, trading or lying in port. The Court dismissed the arguments that no other personal property was so assessed, and that the tax was drawn so as to apply largely if not entirely to those ships arriving from outside the state, as coincidental and justified by the services made available to Polar Tankers and others at the port of Valdez.

The Implications Of The Supreme Court's Decision

The record here is unusually revealing in that the City's intention seems clear to single out transitory, out-of-state business as a source of special revenue. The City might just as readily have imposed a toll on pipes 48 inches in diameter regardless of what they carry and dismissed as coincidence that the only such pipe in town is the one that provides 17 percent of the energy to the lower 48 states. Viewed through the lens of interstate commerce, the docks at Valdez, Alaska are an essential facility. A property tax that reaches only the ships that land there for the purpose of being loaded with oil stocks bound for the other states is highly suspect.

Reversal in the Supreme Court seems probable, though it could come in any number of forms. The Court's simplest path—and the one being urged by Polar Tankers as its lead argument—is to strike the tax under the Tonnage Clause, as the trial court did in its original summary judgment decision. The direct precedential value of such a

[4] 336 U.S. 169 (1949).

decision would be limited, however, by the Tonnage Clause's obvious limited geographic reach to ports.

The apportionment issue has drawn considerable attention from the amici curiae supporting Polar Tankers, who note apportionment implications in other jurisdictions and in other pending litigation. They urge the Court, in the case of the Broadband Institute, to condemn, or in the case of the Committee On State Taxation, to at least be aware of, the ongoing practice of "throw out" forms of apportionment by which New Jersey and other jurisdictions, like Valdez, purport to increase the exposure of non-resident taxpayers by manipulating the apportionment formula to reach what the taxing jurisdiction believes is untaxed extra-territorial values. New Jersey, for example, adopted (but recently repealed, effective for periods beginning after June 30, 2010) a sales factor rule that excludes from the denominator of the sales factor any sales made in a state that does not tax the seller. This "throw out" rule is the subject of ongoing litigation, as are like schemes elsewhere. A U.S. Supreme Court decision emphatically rejecting "throw out" as unprincipled and ungrounded in the principles that justify taxation in the first place would obviously streamline the existing controversies, like those in New Jersey, and discourage the proliferation of similar rules in other states.

A decision taking up the broader Commerce Clause issues and reinvigorating the third and fourth prongs of *Complete Auto*—*i.e*., the prohibition against discrimination against foreign commerce and the need for any tax to reasonably relate to in-state services—would be applicable to state and local governments across the country and would be particularly timely given the aggressive inclinations of many jurisdictions to look to out-of-staters to make up for budget shortfalls. Unfortunately, the Alaska Supreme Court found that Polar Tankers had waived these issues below. While the U.S. Supreme Court is not bound by that finding, it may well rely on waiver should it otherwise be inclined to write a much narrower Tonnage Clause opinion. With any luck that opinion will borrow directly from the *Complete Auto* standard in the process of rejecting the practice of "throw out" as it is employed in Valdez, and thus suggest that the same practice elsewhere is doomed under a direct application of the Commerce Clause. In all events, a narrow, Tonnage Clause opinion should at least do no inadvertent harm to those who are actively litigating the issue in the lower courts.

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