No. 19-755

IN THE

Supreme Court of the United States

ROBERT C. STEINER AND WENDY STEINER-REED,

Petitioners,

v.

UTAH STATE TAX COMMISSION,

Respondent.

On Petition for Writ of Certiorari to the Supreme Court of the State of Utah

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

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INTEREST OF *AMICUS CURIAE*

Council On State Taxation ("COST") is a nonprofit trade association based in Washington, D.C. COST was 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 550 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multi-jurisdictional business entities.

COST members are extensively engaged in interstate commerce and most are also heavily engaged in international commerce. The membership has a vital interest in ensuring states do not impede the rights of all businesses to engage in commerce in the international market. To that end, it is important to COST members that states either equitably apportion or provide credits for income subject to tax in jurisdictions within the United States and abroad. The Utah Supreme Court's denial of tax credits for individual residents' foreign source income creates a regime of double taxation and impedes businesses from participating in the international market. The Foreign Commerce Clause prohibits multiple or discriminatory state and local taxation of income earned in international commerce. *Amicus* believes all taxpayers, including a state's resident individual income taxpayers,

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[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. The parties received timely notice of *amicus*'s intent to file this brief and written consent of all parties to the filing of this brief has been filed with the Clerk of this Court.

should not suffer double taxation on income earned in foreign commerce.

COST has a history of submitting *amicus* briefs to this Court when it is considering state and local tax issues. Beginning with the Court's 2014 term, COST submitted *amicus* briefs in three significant state tax cases decided by the Court: *Comptroller of the Treasury of Maryland v. Wynne*, 135 S. Ct. 1787 (2015); *Alabama Department of Revenue v. CSX Transportation, Inc.*, 575 U.S. 21 (2015); and *Direct Marketing Ass'n v. Brohl*, 575 U.S. 1 (2015). Most recently, COST filed as *amicus* brief in the 2019 state estate tax case, *North Carolina Department of Revenue v. The Kimberly Rice Kaestner 1992 Family Trust*, 139 S. Ct. 2213 (2019). As a long-standing representative of large multi-jurisdictional taxpayers, COST is uniquely positioned to provide this Court with background information and reasons the Foreign Commerce Clause protects all foreign income from duplicative state income taxation.

STATEMENT OF THE CASE

Utah imposes a net income tax on the worldwide income of its residents. Utah allows resident taxpayers to claim a credit for taxes paid on income earned in other states but does not allow a credit for taxes paid on income earned in other countries (at the national or subnational level). Utah Code § 59-10-1003.

During the 2011 through 2013 tax years, Robert C. Steiner and Wendy Steiner-Reed (the "Petitioners") owned shares in an S corporation. As a "pass-through" entity, the S corporation's business income was treated as the Petitioners' individual business income for

income tax purposes, a significant portion of which was derived from the foreign operations.[2]

After exhausting their administrative appeal rights, the Petitioners filed an appeal to the Utah Tax Court, asserting the State's tax regime violated the Commerce Clause of the United States Constitution because it discriminated against foreign commerce. Agreeing with the Petitioners, the Utah Tax Court concluded the Court's reasoning in *Wynne*, that the "Commerce Clause protections afforded to C corporations also apply to S corporations and their shareholders," was controlling. Pet. App. 37a. Specifically, the Utah Tax Court determined that as applied to the Petitioners' foreign business income, Utah's taxing scheme violated the internal consistency test and the Foreign Commerce Clause. *Id.* at 41a. The Utah Tax Court determined that an adjustment was warranted to the Petitioners' income earned in foreign commerce and subject to tax in those jurisdictions.[3] *Id.*

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[2] Unlike most passive investment income, which many states only tax based on an individual's domicile, business income earned by an individual is often subject to tax both on where the income is earned and where the individual is domiciled. The domicile state generally credits, not to exceed the domicile state's income tax liability, the business income taxes paid on such income by an individual taxed in another state. Hellerstein, Hellerstein & Swain, *State Taxation § 20.10 Credits for Taxes Paid to Other States* (Thomson Reuters/Tax & Accounting, 3rd ed. 2001, with updates through December 2019), (online version accessed on Checkpoint (www.checkpoint.riag.com), last visited Jan. 8, 2020).

[3] The Utah Tax Court, driven by constitutional concerns, made an "equitable adjustment" based on Utah's tax law, Utah Code § 59-10-115(2). Pet. App. 6a-7a.

The Utah Tax Commission appealed the Utah Tax Court's decision to the Utah Supreme Court. The Utah Supreme Court reversed the Utah Tax Court's decision. *Id.* at 3a. It concluded that it would not "break new ground" in dormant Commerce Clause cases and declined to extend the Court's Commerce Clause precedent "into new territory—even in ways that might seem logical in other jurisprudential realms." *Id.* at 41a. The Utah Supreme Court then determined that the dormant Foreign Commerce Clause is limited to corporate income taxes and does not apply to individual business income taxes. *Id.* at 25a-27a. The Utah Supreme Court dismissed this Court's contrary ruling in *Wynne*, *id.* at 22a, which held the Commerce Clause equally protects both individuals and corporations. *Wynne*, 135 S. Ct. at 1797 ("it is hard to see why the dormant Commerce Clause should treat individuals less favorably than corporations."). The Utah Supreme Court also rejected this Court's internal consistency test as unworkable in an international context. Pet. App. at 24a. Finally, the Utah Supreme Court refused to defer to this Court's holding in *Kraft General Foods, Inc. v. Iowa Department of Revenue & Finance*, 505 U.S. 71 (1992), which provides that a state may not discriminate against foreign commerce and that federal foreign tax credits do not sufficiently ameliorate the double taxation imposed by a state. *Id.* at 26a-27a n.18.

SUMMARY OF THE ARGUMENT

The Utah Supreme Court's failure to properly analyze and apply this Court's long-standing precedents undermines the American judicial system and jeopardizes the role of this Court. The Utah Supreme Court determined that without a case with the exact same fact pattern, its hands were tied. Its conclusion that

the Foreign Commerce Clause only applies to corporate income tax, but not to individual income tax, is a perversion that this Court cannot let stand. This Court's decisions in *Wynne* and *Kraft* are keenly relevant. Unlike the Utah Supreme Court, the Utah Tax Court correctly decided that the Foreign Commerce Clause applied to business income taxed under the individual income tax and that Utah's tax scheme was discriminatory.

Unless this Court intervenes, state taxpayers will likely be increasingly stonewalled by state courts that determine the Utah Supreme Court's approach was acceptable. And, due to the procedural limitations imposed on access to lower federal courts by the Tax Injunction Act and the comity doctrine, state taxpayers will have to continually petition this Court as their only viable option for reviewing United States constitutional claims outside the state court system.

Further, the issue of state taxation of foreign commerce has never been more important. State conformity with several recently enacted provisions of the federal Tax Cuts and Jobs Act significantly expanded state taxation of foreign source income without providing adequate apportionment factor representation or credits for taxes paid to other countries. While the federal government is not limited by the Foreign Commerce Clause, states are. This protection may wither away unless state courts are held accountable for appropriately interpreting and enforcing this Court's precedents.

ARGUMENT

I. CIRCUMVENTION OF THIS COURT'S PRECEDENTS NECESSITATES REVIEW.

This Court made clear in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), that the four-prong test in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), which requires that a state's tax must be internally consistent under the fair apportionment and non-discrimination prongs, also applies to foreign commerce.[4] In fact, the Court emphasized that foreign commerce has broader protection than interstate commerce by adding two additional elements: first, whether a tax "creates a substantial risk of international multiple taxation; and second, whether the tax prevents the Federal Government from speaking with one voice when regulating commercial relations with foreign governments." *Japan Line*, 441 U.S. at 451.

The Utah Supreme Court decision is diametrically opposed to this Court's ruling in *Japan Line,* providing taxpayers with less protection for foreign commerce than for interstate commerce. By asserting a lack of explicit direction from this Court in applying *Wynne* to income earned from foreign sources, the Utah Supreme Court determined it was not compelled to extend Foreign Commerce Clause protections to resident individuals with business income taxed under the State's individual income tax. By so doing, the Utah

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[4] U.S. Const. art. I, § 8, cl. 3. *Complete Auto* requires before a state can impose its taxing authority upon an interstate activity that: 1) the activity must be sufficiently connected to the state to justify the tax, 2) the tax must be fairly apportioned, 3) the tax does not discriminate against interstate commerce, and 4) the tax is fairly related to the benefits provided to the taxpayer. *Complete Auto*, 430 U.S. at 287.

Supreme Court has practically begged this Court to review this case.[5]

A. *Wynne* is Equally Applicable to Foreign Commerce.

Without explicit authority from this Court (or directly from Congress), the Utah Supreme Court found it could simply ignore the "dormant" or "negative" Commerce Clause as applied to foreign commerce. As noted by the majority decision in *Wynne*, "[u]nder our precedents, the dormant Commerce Clause precludes States from "discriminat[ing] between transactions on the basis of some interstate element." *Wynne* at 1794 (citing *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 332, n. 12 (1977)). Although Utah abides by the Commerce Clause as applied to domestic commerce (by allowing a credit for taxes paid to other states) it refuses to do so as applied to foreign commerce (by denying a credit for taxes paid to foreign countries).[6]

There is nothing in *Wynne* that suggests this Court's holding—that the Commerce Clause applies equally to business income taxed under the individual income tax and the corporate income tax—is limited

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[5] *See* Pet. App. 31a ("The Steiners have raised some plausible arguments and identified some potential policy concerns with the tax regime enacted by the State of Utah. . . . *We do not see this as our role*. We uphold the constitutionality of the Utah tax provisions at issue on the ground the that Steiners have identified no basis in *controlling precedent* for striking them down." (emphasis added, footnote omitted)).

[6] *See* Pet. App. 24a ("In seeking to extend *Wynne* to foreign commerce, the Steiners attempt to apply the internal consistency test."). The Utah Supreme Court refused to apply the internal consistency test to the Petitioners' foreign source income.

to interstate and not to foreign commerce. This Court determined in *Wynne,* applying its refined test for internal consistency from *Oklahoma Tax Commission v. Jefferson Lines, Inc.,* 514 U.S. 175, 185 (1995), that the taxation of all of a resident's income (both in-state and out-of-state) without credit for taxes paid to all other jurisdictions combined with the taxation of a non-resident's in-state income fails the internal consistency test and is facially discriminatory.[7] In *Wynne*, Maryland was required to respect those protections and apply a fair apportionment methodology (in that case a credit for taxes paid) to its resident taxpayers' interstate income.[8] Similarly, in this case, Utah (and other states) must be directed by this Court to apply Foreign Commerce Clause protections to a resident taxpayer's foreign income, regardless of the legal form an entity engages in business. The Utah Supreme Court's refusal to apply *Wynne*—alone—warrants granting certiorari.

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[7] *Wynne* at 1803 (citing *Jefferson Lines*, 514 U.S. at 185 ("[The internal consistency] test, which helps courts identify tax schemes that discriminate against interstate commerce, looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate.")).

[8] As stated by the majority, "the internal consistency test reveals what the undisputed economic analysis shows: Maryland's tax scheme is inherently discriminatory and operates as a tariff." *Wynne* at 1804. And commenting on Justice Scalia's dissent, the majority notes that "he [Justice Scalia] does not explain why, under his interpretation of the Constitution, the Import-Export Clause would not lead to the same result that we reach under the dormant Commerce Clause." *Id*. at 1807.

B. *Kraft* Established a Clear Precedent That Utah's Tax Scheme Discriminates Against Foreign Commerce.

While *Wynne* made clear that all entities (*e.g.*, individuals, pass-through entities, or corporations) are entitled to Commerce Clause protections, this Court's holding in *Kraft* further solidifies that Utah's tax treatment "facially discriminates against foreign commerce and therefore violates the Foreign Commerce Clause." *Kraft*, 505 U.S. at 82. At issue in *Kraft* was Iowa's taxing scheme that allowed a dividends-received deduction for dividends received from United States-based subsidiaries but denied a similar deduction for dividends received from foreign subsidiaries. *Id.* at 72. Similar to the Utah Supreme Court, the Iowa Supreme Court refused to hold that Iowa's taxing scheme was unconstitutionally discriminatory. *Id.* at 75.

This Court clarified that dividends received from foreign subsidiaries constitute foreign commerce and that Iowa's taxation of those dividends but not dividends received from United States-based subsidiaries impermissibly discriminated against foreign commerce. *Id.* at 82. The Petitioners are similarly situated. Instead of their foreign dividends being treated unfavorably, however, it is their flow-through business income derived from foreign commerce that is being treated in a discriminatory manner because it is included in the tax base without any credit for foreign taxes paid on the same income. The net effect, however, is the same as Iowa's tax scheme in *Kraft*; Utah (and other states with similar laws) should be prohibited from favoring interstate commerce over foreign commerce.

Without this Court's review, Utah and other states will be emboldened to further discriminate against

foreign commerce. *Kraft* made clear that states cannot impose disparate tax treatment based on the location or nature of a business's activity. *Id*. at 76. By granting certiorari, this Court will have the opportunity to fully review this case on the merits and clarify the extent the Foreign Commerce Clause applies to all taxpayers.

While trying to mask the precedent provided by this Court in *Kraft* and *Wynne*, the Utah Supreme Court inappropriately applied a different rationale. Citing *Barclays Bank PLC v. Franchise Tax Board of California*, 512 U.S. 298 (1994), the Utah Supreme Court asserted that Congress has acquiesced to this discriminatory treatment by failing to preempt Utah's and other states' laws. Pet. App. at 27a. Therefore, the court reasoned that Congress has implicitly authorized Utah (and other states with similar tax laws) to impose a discriminatory tax against foreign commerce. *Id*. Thus, the Utah Supreme Court determined the State's more favorable treatment of income earned in the United States than of income earned in foreign countries was constitutionally sound. *Id.* This passive approval principle, however, does not apply to discrimination challenges. Respectfully, the Utah Supreme Court analysis is wrong—discriminatory state taxes are reviewed under a "virtually *per se* rule of invalidity" standard, require the "strictest scrutiny," and the burden is "so heavy that facial discrimination by itself may be a fatal defect." *Or. Waste Sys. v. Dep't of Envtl. Quality*, 511 U.S. 93, 100-101 (1994) (internal quotes omitted), s*ee also Bacchus Imps. v. Dias,* 468 U.S. 263, 271 (1984) ("we need not guess at the legislature's motivation . . . the effect of the exemption is clearly discriminatory"); *New Energy Co. v. Limbach,* 486 U.S. 269, 274 (1988) ("state statues that clearly discriminate against interstate commerce are routinely struck down").

The Utah Supreme Court provided an alternative rationale, which is nothing more than a red herring, that the federal tax credit mitigates any such discrimination of the State's taxing of foreign income without providing a credit. While it is important for compliance purposes and is administratively convenient to both state tax administrators and taxpayers that states generally use the same income tax base as that used at the federal level, it is a significant misrepresentation by the Utah Supreme Court to hold a tax credit at the federal level resolves this issue.

Kraft makes clear that states are not required to follow the federal tax code.[9] Within constitutional constraints, states have the power to tax the same income taxed at the federal level; however, they are subject to constitutional limits pursuant to the Commerce Clause and are precluded from imposing discriminatory taxes against other states and foreign countries.[10] State taxation is distinctly separate from federal taxation. Utah, and other states, cannot, without proof, justify that a federal tax credit actually mitigates potential constitutional infirmities. As noted in *Wynne*, a state could choose to tax all a resident's

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[9] *Kraft* at 82 ("Iowa need not adopt the federal definition of taxable income.").

[10] As noted in *Wynne*, "it is hardly surprising that these early state ventures into the taxation of income included some protectionist regimes that favored the local economy over interstate commerce. What is more significant is that over the next century, as our Commerce Clause jurisprudence developed, the States have almost entirely abandoned that approach, perhaps in recognition of their doubtful constitutionality." *Wynne* at 1801.

income without providing any credit, so long as it is not discriminatory.[11] *Wynne* at 1806.

Utah's tax scheme, however, creates a "heads I win and tails you lose" situation by seeking to tax 100 percent of a resident's foreign income and also imposing a tax on non-residents deriving income from Utah. The result is that a business entity, individual or other legal entity, could be subject to double taxation on income derived from foreign sources, as it is in the Petitioners' situation.[12] The federal tax credit is irrelevant because each state's taxing scheme must independently pass muster under the prongs laid out in *Complete Auto* and *Japan Line,* specifically in this case the fair apportionment prong and the need for a state's tax to be internally consistent.

C. The Growth in Business Income Subject to State Individual Income Taxes, and Not State Corporate Income Taxes, Reinforces the Importance of This Court's Review of the Case.

Lastly, the application of a different set of constitutional rules for business income taxed under a state's individual income tax rather than a state's corporate income tax is particularly troubling given the significant growth in share of business activity over the last

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[11] While not formally approved by the Court because the issue was not before it, a state that only imposed a tax on its individual residents and did not tax income earned by non-resident individuals would pass muster under the internal consistency test.

[12] *See* Michael S. Knoll and Ruth Mason, *Why the Supreme Court Should Grant Cert in Steiner v. Utah* (December 21, 2019) (available at SSRN: https://ssrn.com/abstract=3508040) (for more discussion on internal consistency and the mechanics of double taxation in this fact pattern).

three decades conducted by S corporations, partnerships and sole proprietors, which are primarily subject to the states' individual income taxes. In 1980, 11 percent of all state and local taxes paid on business income was collected under the individual income tax compared to 89 percent collected under the states' corporate income taxes.[13] By contrast, in 2018, 43 percent of all taxes paid on business income was collected under the states' individual income taxes as compared to 57 percent under the states' corporate income taxes.[14] Stated in dollar amounts, $1.7 billion in state and local taxes on business income was collected under the individual income tax in 1980, compared to $49.7 billion in 2019.[15] In terms of the actual number of business entities, the discrepancy is even larger with businesses taxed under the individual income tax accounting for 95 percent of all business entities in 2013 (up from 83 percent in 1980).[16] Thus, if Foreign Commerce Clause protections are afforded only to businesses taxed under a state's

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[13] Ernst & Young LLP internal analysis of IRS Statistics of Income data for 1980.

[14] *See* Andrew Phillips & Caroline Sallee, Ernst & Young LLP, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2018* (2019), https://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/1909-3269660_50-state-tax-2019-final.pdf.

[15] *Supra* notes 13-14.

[16] *See* Andrew Lyon et al., PricewaterhouseCoopers LLP, *Corporate and Pass-Through Business State Income Tax Burdens: Comparing State-Level Income and Effective Tax Rates* 1 (2017), https://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/etr-study---pwc-stri-combined.pdf.

corporate income tax, over 90 percent of all businesses could be denied protection from double taxation on income earned in foreign commerce.

The importance of granting certiorari in this case is further accentuated by the large number of states (other than Utah) that provide individual income tax credits for domestic commerce but not for foreign commerce. Thirty three of the forty three states that impose an individual income tax (77 percent) fail to provide a full credit for taxes paid to foreign jurisdictions.[17] Similar to Utah, those states provide no individual income tax credit for foreign taxes paid while providing a full credit for individual income taxes paid to other states.

II. THE ABSENCE OF A GOOD FAITH EFFORT BY THE UTAH SUPREME COURT TO APPLY THE DORMANT COMMERCE CLAUSE IS PARTICULARLY TROUBLING IN STATE TAX CASES WHERE ACCESS TO FEDERAL COURTS IS EXTREMELY LIMITED.

The Utah Supreme Court's lack of good faith in enforcing the United States Constitution, as interpreted by this Court, is not only a circumvention of this Court's precedents, but constitutes an unacceptably narrow approach given the unique procedural requirements imposed upon state tax controversies that are decided almost exclusively by state courts.

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[17] *See* Brief for Multistate Tax Commission as *Amicus Curiae* Supporting Appellee/Cross-Appellant Utah State Tax Commission, *Steiner v. Utah State Tax Comm'n*, 449 P.3d 189 (2019) at App. A-1-A-3 (note that a few states allow an individual income tax credit for taxes paid to Canadian provinces, but not for taxes paid to any other foreign government).

There are two constraints that severely limit lower federal courts from adjudicating state and local tax matters: the Tax Injunction Act and the comity doctrine. The Tax Injunction Act, which is jurisdictional, bars suits in federal court to "enjoin, suspend or restrain" the "assessment, levy or collection" of state taxes, except where no "plain, speedy and efficient remedy" is available in state court. 28 U.S.C. § 1341. Under a similar but distinct limitation, the comity doctrine, "federal courts refrain from 'interfer[ing] . . . with the fiscal operations of the state governments . . . in all cases where the Federal rights of the persons could otherwise be preserved unimpaired.'" *Direct Marketing Ass'n*, 575 U.S. at 15 (citing *Levin v. Commerce Energy, Inc.*, 560 U.S. 413, 422 (2010)).

Both the Tax Injunction Act and the comity doctrine constrain taxpayers' access to lower federal courts in state tax litigation. Such jurisdictional restrictions are unique to state tax controversies. Other statutory or constitutional disputes involving environmental, health care, voting rights, or educational issues have no similar impediment. As a result, state taxpayers must rely almost exclusively on state courts to arbitrate potential federal constitutional challenges of state taxes. In the same vein, state courts are singly responsible for upholding their constitutional obligation to enforce federal law and giving this Court's precedents full effect.

The Utah Supreme Court's overly narrow construction of this Court's precedents constitutes a failure to responsibly exercise its duty and this Court is the last remaining backstop to prevent the withering away of

important constitutional protections.[18] Left unchecked, the Utah Supreme Court potentially has a powerful tool to insulate its actions from the purview of the United States Constitution—by simply limiting its application of constitutional principles to only those fact patterns that are identical to previous ones litigated before this Court. If other state courts follow suit, guided by the Utah Supreme Court's actions, the legal process applied to state tax controversies would be significantly damaged. Further, taxpayers' confidence in what is largely a voluntary compliance tax system would be eroded. We urge this Court to accept certiorari to correct the Utah Supreme Court's significant misstep and to forestall any future damage its precedent might cause.

III. CONCERNS WITH STATE EVISCERATION OF THE FOREIGN COMMERCE CLAUSE ARE AMPLIFIED BY THE EXPANSION OF STATE TAXATION OF FOREIGN SOURCE INCOME RESULTING FROM THE FEDERAL TAX CUTS AND JOBS ACT.

The problem of treating foreign commerce less favorably than domestic commerce is not limited to the individual income tax, but extends to the corporate

[18] In contrast to Utah, South Dakota is an example of a state's highest court respecting this Court's precedent. *Cf. State v. Wayfair Inc.*, 901 N.W.2d 754, 761 (S.D. 2017) ("However persuasive the State's arguments on the merits of revisiting the issue, *Quill* has not been overruled. . . . We are mindful of the Supreme Court's directive to follow its precedent when it 'has direct application in a case' and to leave to that Court 'the prerogative of overruling its own decisions.'" (citing *Rodriguez de Quijas v. Shearson/American Exp., Inc.*, 490 U.S. 477, 484 (1989))).

income tax as well. While states utilize credits for taxes paid to avoid Commerce Clause discrimination for purposes of individual income taxes, apportionment of income is primarily used to avoid Commerce Clause discrimination for purposes of corporate income taxes. Recently, however, a troubling pattern has emerged, whereby states are failing to apply equitable apportionment principles to income earned in foreign commerce. This is in contravention of this Court's holding in *Kraft*. Although states generally provide comprehensive apportionment factor representation of income for domestic commerce, virtually all of the states have provided limited or no factor representation for foreign source income newly subject to tax as a result of the federal Tax Cuts and Jobs Act, Pub. L. No. 115-97 ("TCJA").

When Congress enacted the TCJA in 2017, it added several provisions aimed at taxing newly defined categories of foreign source income. These included new taxes on global intangible low-taxed income ("GILTI") under 26 U.S.C. § 951A, and on foreign source income deemed repatriated under 26 U.S.C. § 965 ("Section 965 Repatriated Income").[19]

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[19] GILTI generally includes in the income tax base the current earnings of foreign subsidiaries of domestic corporations in excess of a 10 percent rate of return on their depreciated fixed assets, less a 50 percent deduction allowed under 26 U.S.C. § 250. For many domestic corporations, particularly those engaged in manufacturing overseas with older (depreciated) facilities or outsourced production, or those in the service, digital and financial industries, GILTI adds most or all of the corporations' foreign source income to the tax base (subject to the deduction provided under 26 U.S.C. § 250). *See* Joseph X. Donovan et al., *State Taxation of GILTI: Policy and Constitutional Ramifications*, 90 State Tax Notes 315 (2018). The new tax on Section 965 Repatriated Income generally imposes a one-time tax on 30 years of accumulated but

To date, approximately one-half of the states have conformed in part to GILTI and approximately one-third of the states have conformed in part to Section 965 Repatriated Income for purposes of their corporate income tax base. In many states, conformity with these provisions constitutes a significant expansion of the state taxation of foreign source income that previously centered on including a modest percentage (typically 25 percent) of foreign source income on a deferred, not current, basis in the corporate income tax base only when foreign dividends were issued to United States shareholders.[20]

Regrettably, this recent expansion of the state corporate income tax base to include foreign source income taxed on a current basis has been coupled with a blatant failure of the states to apportion such income (or provide an adequate tax credit) in a nondiscriminatory manner similar to the methodologies used for comparable domestic source income. None of the states that tax a portion of GILTI have enacted statutes or published guidance since the TCJA that allows taxpayers to use foreign factor representation (*e.g.*, foreign sales, property or payroll) to apportion GILTI. Rather, these states allow either no factor representation, or at best the "net" GILTI income (not the receipts that produce the income or other factors depending on the apportionment formula) to be included in the denominator of receipts factor.[21] The outcome is nearly identical

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undistributed earnings of the foreign subsidiaries of domestic corporations. *Id*.

[20] *See* Donovan et al., *supra* note 19 at 319.

[21] Karl A. Frieden & Joseph X. Donovan, *Where in the World Is Factor Representation For Foreign-Source Income*, 92 State Tax Notes 199 (2019) at 203-205. Jared Walczak & Erica York, Tax Foundation, *GILTI and Other Conformity Issues Still Loom for*

in connection with Section 965 Repatriated Income, where only one state (New Mexico) has published guidance that allows taxpayers to use foreign factor representation in connection with this category of foreign source income.[22]

What is most striking about the states' approach to apportioning GILTI and Section 965 Repatriated Income is how completely out of sync it is with the long-established methods the states have utilized to apportion taxable net income. For decades, the foundation of state apportionment has been using factors that are related to the production of the income subject to tax. As Jerome and Walter Hellerstein wrote in their treatise on state taxation: "The factors that are employed to apportion income among the states should reflect the factors that produce the income being apportioned. This virtually axiomatic proposition is also a principle of constitutional law."[23] This principle was affirmed by in *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983), which provided that "[t]he factor or factors used in the apportionment formula must actually

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States in 2020, Fiscal Fact No. 682 (Dec. 2019), https://files.taxfoundation.org/20200106114522/GILTI-and-Other-Conformity-Issues-Still-Loom-for-States-in-20202.pdf.

[22] New Mexico Taxation and Revenue Department, *New Mexico Bulletin B-300.17: New Mexico Corporate Income Tax on Deferred Foreign Income Pursuant to IRC Section 965* (2018) (available at: http://www.tax.newmexico.gov/forms-publications.aspx).

[23] Hellerstein, Hellerstein & Swain, *State Taxation § 9.15 The Relationship Between the Apportionment Factors and the Apportionable Tax Base: Factor Representation* (Thomson Reuters/ Tax & Accounting, 3rd ed. 2001, with updates through December 2019), (online version accessed on Checkpoint (www.checkpoint.riag.com), last visited Jan. 8, 2020).

reflect a reasonable sense of how income is generated." *Id.* at 169.

Today, we face a state income tax scheme that does not provide fair apportionment, via factor representation (or provide an adequate tax credit) for foreign source income. There is no constitutional justification for states to limit full factor representation to similarly situated income earned in the United States. This flagrantly discriminates against foreign commerce in violation of the Commerce Clause.

By granting certiorari in this case, this Court can provide needed guidance to the states and taxpayers regarding the constitutional restrictions that apply to the state taxation of foreign commerce under the *Kraft* precedent. This guidance is urgently needed to determine whether the tax schemes of states that either provide no credit for foreign taxes paid under the individual income tax and/or limited or no apportionment for foreign source income under the corporate income tax meet constitutional muster.

CONCLUSION

This case presents the Court with the opportunity to clarify both that *Wynne* extends Commerce Clause protection for businesses taxed under the individual income tax to foreign commerce and that *Kraft* applies to both tax base inclusion of foreign income and to how that income is apportioned or foreign taxes paid on it are credited. Without review of the Utah Supreme Court's decision, state taxing authorities, state legislatures, and state courts will be encouraged to undermine the application of the Commerce Clause to businesses under both the individual income tax and the corporate income tax. A clear message must be sent to the Utah Supreme Court and other state courts

that this Court will not tolerate the evisceration of the Foreign Commerce Clause protections and of this Court's precedents.

The need for review is particularly compelling given the heightened scrutiny that this Court has previously accorded to Foreign Commerce Clause discrimination cases. As the Court stated in *Kraft*, "the constitutional prohibition against state taxation of foreign commerce is broader than the protection afforded to interstate commerce . . . in part because matters of concern to the entire Nation are implicated." *Kraft* at 79 (citing *Japan Line* at 445-451).

Respectfully submitted,

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