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 a Writ of Certiorari to the New York State Court of Appeals

REPLY TO BRIEF IN OPPOSITION

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New York defends the tax scheme at issue on the ground that it simply ensured that royalties within a corporate family would be taxed "once—and only once." Opp.2. That is *almost* right. The scheme ensured that royalties would be taxed "once—and only once" *by New York*, regardless of whether it was the payor or the recipient that was subject to New York taxation. And while that may seem sensible at first blush, it presents a classic internal inconsistency: If every jurisdiction took that approach, any transaction crossing jurisdictional lines would be double-taxed, whereas those confined to one state would be taxed just once. That is discrimination, plain and simple—akin to a tariff on interstate commerce. *Comptroller of Treas. of Md. v. Wynne*, 575 U.S. 542, 565 (2015). It is not an incidental byproduct of different, consistent schemes, but the inevitable consequence of each state insisting on taking its own bite at the apple.

As the petition explained, at least three other states' courts have recognized as much. New York tries to avoid the conflict by distinguishing intra-corporate *royalties* from intra-corporate *dividends*. The concept is exactly the same, however, as the New York court admitted in calling New Hampshire's dividend regime "virtually identical" to the provisions challenged here. Pet.App.16a-17a. Regardless of the type of income at issue, it is internally inconsistent for a state to hinge a deduction on whether the income was already taxed *by that state*. And make no mistake, that is precisely what § 208.9(o) did. New York emphasizes that the deduction was available so long as the payor was a New York *taxpayer*—but since only companies that do business in New York are New York taxpayers, that *is* an illicit "geographic" distinction. Opp.16-19 & n.8.

New York makes no serious attempt to reconcile its regime with this Court's precedents. Indeed, it *never even applies the internal consistency test*. Instead, it insists this case is a bad vehicle. Just the opposite. As in *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), the repeal of the challenged provisions neither renders the case moot nor diminishes the importance of the legal principle; if anything, it minimizes the disruption that reversal would cause. And while foreign rather than interstate commerce is at stake here, the internal consistency doctrine applies equally in both contexts, as New York admitted below. Given that doctrine's importance, the Court should grant review, especially if it denies *Zilka v. Tax Review Board* (23-914).

I. NEW YORK FAILS TO DISTINGUISH THE CONFLICTING STATE COURT DECISIONS.

Courts in at least three states have invalidated tax provisions that hinged deductions for intra-corporate transfers on whether the payor was a taxpayer. *See* Pet.12-15; *Miss. Dep't of Rev. v. AT&T Corp.*, 202 So. 3d 1207 (Miss. 2016); *D.D.I., Inc. v. State ex rel. Clayburgh*, 657 N.W.2d 228 (N.D. 2003); *Farmer Bros. Co. v. Franchise Tax Bd.*, 108 Cal. App. 4th 976 (2003); *Ceridian Corp. v. Franchise Tax Bd.*, 102 Cal. Rptr. 2d 611 (Cal. App. 2000). As those courts concluded, that approach offers a shield from double taxation only where the payor-affiliate subjects itself to the state's taxing jurisdiction, thereby placing a unique burden on interstate commerce. But New York's Court of Appeals (Pet.App.16a) instead followed a contrary decision from New Hampshire, *Gen. Elec. Co., Inc. v. Comm'r, N.H. Dep't of Rev.*, 914 A.2d 246 (N.H. 2006), which New York *admits* "conflicts" with those state-court decisions (Opp.21).

New York's main response is to claim that the other cases are distinguishable because they involved intra-corporate *dividends*, not intra-corporate *royalties*. It says dividends are different because they "cannot be deducted" by the payor and so "would not be subject to an add-back." Opp.18. But the bottom-line effect of no-deduction/no-add-back is that the income is taxed at the payor level. So too of royalties under § 208.9(o), which "shift[ed] the incidence of tax … to the [royalty] payor." Opp.6. The discrimination is thus identical: Like Mississippi, North Dakota, and California, New York would ordinarily tax the payor—but if the payor is beyond its grasp, it would tax the recipient instead. That is why the court here admitted that New York's scheme was "virtually identical" to New Hampshire's dividends regime in *General Electric*. Pet.App.16a.

As a secondary distinction, New York contends that the other states discriminated based on "geography" whereas § 208.9(o) supposedly did not. *See* Opp.18-20. Again, the laws are precisely parallel. The Mississippi statute, for instance, allowed a deduction only if the payor-affiliate was "doing business in Mississippi" and thus "file[d] a Mississippi Income Tax Return." *AT&T*, 202 So. 3d at 1210. That amounted to discrimination based on "the geographic footprint" of the affiliate. *Id.* at 1226; *see also D.D.I.*, 657 N.W.2d at 233 (deduction only if "payor's income was subject to North Dakota corporate income tax"); *Farmer Bros.*, 108 Cal. App. 4th at 986 (deduction for "corporations doing business in California"). Here too, New York admits that the deduction extended only to royalties from "New York tax filers"—and companies only need to file New York returns if they do "business" "in this state." Opp.19 & n.8. That is *exactly the same* "geographic" limit.

As to *D.D.I.*, New York argues that the court limited its analysis to whether a discriminatory tax was offset by a compensatory one. Opp.19. But the court went on to address "the 'internal consistency' doctrine," and held that the North Dakota regime violated it because its deduction did "not avoid double taxation for out-of-state corporate income" even as it shielded "in-state income" from the same burden. *D.D.I.*, 657 N.W.2d at 234. Exactly the same holds true here.

Finally, New York claims an "inconsistency" within California appellate precedent. Opp.21. But the case it cites, *Fujitsu IT Holdings, Inc. v. Franchise Tax Bd.*, 120 Cal. App. 4th 459 (2004), did not address the legal issue here. Rather, it evaluated whether "California's combined water's-edge method of apportioning the combined income of a unitary business group," *id.* at 483, is discriminatory under *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance*, 505 U.S. 71 (1992). IBM did not challenge New York's method of apportionment in this litigation.

In all events, to the extent there is a conflict not only *between* states but also *within* them, that is hardly a reason to deny review. It merely underscores the need for this Court's clarification of the legal principles.

II. New York Fails To Defend Its Internally Inconsistent, Discriminatory Regime.

New York courts got wrong what Mississippi, North Dakota, and California courts got right: Conditioning a tax deduction on whether an affiliate does business in the state is discriminatory, and if replicated universally would impose duplicative taxation on cross-border transactions alone. That is a plain violation of this Court's precedents.

The Solicitor General's recent brief in *Zilka* explains how to apply the internal consistency test: The Court must "hypothetically assume that every State has the same tax structure in order to see whether the challenged tax's identical application … would place interstate commerce at a disadvantage as compared with commerce intrastate." Br. for U.S. at 11, *Zilka v. Tax Rev. Bd. of Phila.* (23-914) (cleaned up); *see also Wynne*, 575 U.S. at 562. This is not hard to do.

Remarkably, however, New York's brief *does not apply the internal consistency test*. Likely because doing so would lay bare the regime's flaw. If every jurisdiction adopted § 208.9(o)—taxing whichever side of a transaction allows it to collect tax, to a maximum of once—the discriminatory effect would be manifest. Interstate or foreign payments would be taxed twice: once as added-back income for the payor and again as non-deductible income for the recipient. Intrastate transactions, by contrast, would face only a single tax. This is exactly what internal consistency prohibits. With no valid defense, New York resorts to a series of distractions. Each can be readily dismissed.

First, New York repeats the argument that its law did not discriminate based on geography. As already explained, that is plainly wrong. *Supra* at 3. Section 208.9(o) limited the deduction to situations where the payor-affiliate filed New York taxes—*i.e.*, did business in New York. Opp.19 & n.8. That is why Chief Judge Wilson's concurrence explicitly acknowledged "the tax deduction *does* depend on a *geographic distinction* between New York and non-New York taxpayers." Pet.App.40a (emphases added). There is no avoiding the facial geographic discrimination here.

Second, New York protests that it was just trying to "*avoid* double taxation." Opp.13. But what it really means is that it wanted to ensure that New York taxed royalties *at least once*—while ignoring whether there was double taxation when accounting for other taxing jurisdictions. That is the same unconstitutional move the Court struck down in *Armco* and *Tyler Pipe*, where exemptions were permitted only if the state itself had already taxed the good at another stage in the supply chain. *See Armco Inc. v. Hardesty*, 467 U.S. 638, 642 (1984); *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Rev.*, 483 U.S. 232, 240 (1987). The consequence there, as here, was to expose interstate commerce uniquely to double tax. The function of the internal consistency test is to smoke out such discrimination.

If New York had really had sought to avoid double taxation, there was a simple way to do that: allow the deduction whenever the payor's income was taxed by *any* jurisdiction. *See Tyler Pipe*, 483 U.S. at 245 n.14. Instead, New York conditioned the deduction on doing business in New York. That was unconstitutional.

Third, New York asserts that IBM "ignores that the corporate group level is the one that matters." Opp.14. Not at all. Again, the internal consistency test frames the issue. If every jurisdiction adopted New York's regime, *corporate groups* with foreign affiliates would be taxed twice on royalties. Only if all of the affiliates did business in New York would they escape.

Fourth, New York claims IBM is merely objecting to the reality that "more than one State or country may tax a transaction" that crosses jurisdictional lines. Opp.14. In fact, however, IBM's petition expressly acknowledged that double taxation can result from

two internally consistent, non-discriminatory systems. Pet.9. There is no constitutional defect when tax laws "result in double taxation" for interstate transactions "only as a result of the interaction of two different but nondiscriminatory and internally consistent schemes." *Wynne*, 575 U.S. at 562. For example, if New York chose to tax the recipient of royalties while allowing payors to take deductions, while the United Kingdom made the opposite choice, then a royalty sent from London to Manhattan would be taxed twice—and there would be no constitutional defense.

But that is not what happened here. New York did not make a consistent, geographically neutral choice to tax *either* the payor *or* the recipient. It tried to have it both ways, taxing the payor—unless the payor was beyond its jurisdiction, in which case it would tax the recipient. That created an internally inconsistent system and thus fell outside *Wynne*'s allowance for "two different but nondiscriminatory and internally consistent schemes." *Id.* No wonder New York never engages the internal consistency test.

Finally, New York objects that IBM did not prove *actual* double taxation—*e.g.*, by showing that one of its foreign affiliates was taxed on royalties sent to New York. Opp.15. Of course, IBM had no basis to create a "record" on that (Opp.8), because § 208.9(o) rendered it *irrelevant*. The deduction was available only if the payor was taxed on the royalties *in New York*. That is precisely the internal consistency problem. And New York once again elides the internal consistency test by trying to shift the focus to *other states'* tax regimes. Only New York's regime is relevant here, and the only question is whether, if replicated, it would function to discriminate against foreign commerce. It would.

Indeed, longstanding precedent makes clear that what matters for internal consistency purposes is the *risk* of multiple taxation, not the happenstance of a law's effect on a particular taxpayer in a particular case. *See, e.g.*, *J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307, 311 (1938) ("Interstate commerce would thus be subjected to the risk of a double tax burden to which intrastate commerce is not exposed"); *Gwin, White & Prince Inc. v. Henneford*, 305 U.S. 434, 439 (1939) (invalidating tax that imposed on interstate commerce "the risk of a multiple burden to which local commerce is not exposed"); Jerome R. Hellerstein & Walter Hellerstein, State Taxation ¶ 4.16[1][e] (3d ed. 2023) ("[T]he internal consistency doctrine reinforces the principle that it is the *risk* rather than the actuality of multiple taxation or discrimination that is the test for evaluating the constitutionality of facial attacks on state statutes under the Commerce Clause."). Or, as this Court put it in *Wynne*, the doctrine asks whether a state tax law "inherently discriminate[s] against interstate commerce *without regard to the tax policies of other States*." 575 U.S. at 562 (emphasis added).

For the same reason, New York's assertion that IBM seeks a "windfall" (Opp.7-8) is not only unsupported factually (since IBM's royalty practices long predate enactment of § 208.9(o), *see* Pet.7); it is also misguided legally. Just as two internally consistent systems can interact to cause double taxation in a particular case, so too can two internally consistent systems generate the "windfall" of no taxation for a given transaction. What matters is not a particular case's outcome, but whether the challenged system is internally consistent and nondiscriminatory. New York's royalty regime was neither.

III. NEW YORK'S VEHICLE ARGUMENTS LACK MERIT.

In lieu of defending its statute or Court of Appeals, New York opens and closes its opposition with vehicle arguments. None is persuasive.

New York's lead argument against review is that § 208.9(o) has been repealed. Opp.12-13. That was North Carolina's argument against review in *Fulton*, too. *See* Resp.'s Reply in Supp. of Mot. to Dismiss Writ of Cert., *Fulton Corp. v. Faulkner*, 1995 WL 385768, at *2, *4 (June 20, 1995) (asserting that because of repeal, the issue has no "continuing importance anywhere in the Nation" and "it makes little sense for the Court to devote its resources to the resolution of an issue that almost certainly will not recur"). But this Court rejected the argument. *See Fulton*, 516 U.S. at 327 n.1. New York correctly does not claim that the repeal renders this case moot; as in *Fulton*, it does not, as the repeal "does not affect the tax years at issue in this litigation." *Id.* Nor does New York dispute that the internal consistency doctrine presents an important and recurring legal issue—especially once the artificial distinction between royalties and dividends is set aside. Pet.27-29; *see also* COST.1-2.

In short, § 208.9(o) may be a thing of the past, but the constitutional rule that it violated remains critical. If anything, the fact that New York repealed the law suggests it recognized the constitutional infirmity. And for this Court's purposes, the repeal means only that granting review and reversing the decision below would cause only limited practical disruption.

Next, New York points out that the burden here was borne by *foreign* rather than *interstate* commerce, because IBM's domestic affiliates were included on its

New York return. Opp.22-24. But New York did "not dispute" in the Court of Appeals that "the internal consistency test applies to international commerce." Pet.App.33a n.5. Rightly so, given that the "internal consistency test was formally introduced more than three decades ago," in a case that itself involved foreign commerce. *Wynne*, 575 U.S. at 563 (citing *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 163 (1983)).

New York argues that state laws burdening foreign commerce trigger "two additional factors" on which IBM "did not make a record." Opp.23. But the case it cites, *Japan Line, Ltd. v. Cnty. of Los Angeles*, 441 U.S. 434 (1979), makes clear those are *additional ways* a state law can violate the foreign Commerce Clause—*on top of* the rules applicable to interstate commerce. *See id.* at 451 ("*In addition* to answering the nexus, apportionment, and nondiscrimination questions …, a court must *also* inquire" into these two other factors (emphasis added)). IBM made no record on those "additional considerations," *id.* at 446, since they were not the requirements that New York's law violated. So they are irrelevant to whether this Court should grant review on the issue IBM *did* press.[1]

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[1] New York also asserts that that if every jurisdiction adopted its scheme, IBM's foreign affiliates would avoid double taxation because they had no federal taxable income under U.S. law. *See* Opp.22-23. This reflects a fundamental misunderstanding of the internal consistency test. The test assumes every jurisdiction adopts the *same scheme*, meaning a foreign country would impose its own deduction and add-back regime on income taxable *under its laws*, not on *U.S.* taxable income. Under that replication of the New York scheme, IBM would indeed be taxed twice; the payor would have to add-back the royalties to its foreign taxable income, and the recipient could not deduct them in New York.

Third, New York claims that IBM did not satisfy a "prerequisite for applying the internal consistency test," because it "fail[ed] to identify an interstate or foreign market in which the New York statute burdened competition." Opp.21. But the case it cites for this supposed "prerequisite," *General Motors Corp. v. Tracy*, 519 U.S. 278 (1997), has nothing to do with the internal consistency test; it never even mentions it. Much less did it require proof of a specific market burden to apply the test. *General Motors* addressed a different issue: whether local natural gas utilities and interstate marketers were "similarly situated" for purposes of a Commerce Clause analysis. *Id.* at 298-300. (They were not.) That has no bearing here.

* * *

This Court should grant the petition.

DECEMBER 30, 2024

Respectfully submitted,

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