No. 24-333

In the
Supreme Court of the United States

THE WALT DISNEY COMPANY AND CONSOLIDATED SUBSIDIARIES,

Petitioner,

v.

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

Respondents.

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

REPLY BRIEF

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REPLY BRIEF

The New York Court of Appeals held that, as a direct result of Tax Law §208.9(*o*)'s "plain terms," Disney owed millions of dollars more in state taxes solely because its foreign affiliates declined to submit to New York's jurisdiction. That is textbook facial discrimination: State laws that "explicitly deprive[]" private parties of "beneficial tax treatment" because of their foreign status "violate the cardinal requirement of nondiscrimination." *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 274 (1988). Thus, New York should have been put to the "extremely difficult burden" of showing that §208.9(*o*) "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 581-82 (1997); *Or. Waste Sys., Inc. v. Dep't of Env't Quality of Or.*, 511 U.S. 93, 101 (1994). That burden would be not just daunting, but fatal, as New York belatedly joined 17 other states in addressing the perceived problem through nondiscriminatory means. The Court of Appeals avoided that result (and the governing federal-law test for textually evident discrimination) by (mis)"appl[ying] the so-called '*Salerno* standard,'" BIO.15; *see United States v. Salerno*, 481 U.S. 739, 745 (1987), and placing the burden on *Disney* to show "that no set of circumstances exists under which [§208.9(*o*)] would be valid," App.12. That was a fundamental category mistake. Despite concluding that §208.9(*o*) draws geographic distinctions *on its face*, the court held that it is "not facially discriminatory" because not every application results in "differential [tax] treatment" to the corporate group as a whole. App.16.

Remarkably, the Court of Appeals is not the only state court of last resort to make this grave mistake. The decision below exacerbates an acknowledged split on whether a state law can facially discriminate with impunity as long as a few hypothetical applications produce neutral tax treatment.

The state's efforts to insulate the decision below from review serve only to confirm its outlier status. New York emphasizes that no other state adopted its facially discriminatory approach, but that is presumably because other states understand this Court's Commerce Clause jurisprudence. The fact that other states, and even New York in more recent years, closed the same perceived "loophole" without resorting to facial discrimination is a (fatal) merits-stage bug, not a cert-stage feature. While New York trumpets §208.9(*o*)'s replacement as a reason to deny certiorari, it never denies that hundreds of millions of dollars in ill-gotten tax revenue remain in dispute because of the snail's pace of New York refund proceedings. Worse still, the Court of Appeals' conflation of *Salerno* and the proper standard for evaluating laws that discriminate on their face will remain the law of New York unless and until this Court grants review. This Court's caselaw makes state laws that facially (i.e., textually) discriminate against interstate or foreign commerce the most difficult for states to defend. The Court of Appeals' misapplication of *Salerno* makes them the most difficult to challenge. That is no small conflict, and the decision below is not alone in making the mistake. This Court should grant review and make clear that laws that facially discriminate in favor of in-state commerce demand exacting scrutiny, not a free pass.

I. The Decision Below Conflicts With This Court's Clear And Longstanding Precedent.

New York never denies that §208.9(*o*) allowed corporate taxpayers to deduct royalty income from affiliated entities if, but only if, their affiliates subjected themselves to "the Powers That Be, up in Albany." *Bd. of Educ. of Kiryas Joel Vill. Sch. Dist. v. Grumet*, 512 U.S. 687, 732 (1994) (Scalia, J., dissenting). Nor could it: The Court of Appeals squarely held that §208.9(*o*) "[b]y its plain terms" "disallow[ed] [the] deduction for royalty payments from a corporation that does not do business in New York." App.10; App.31 (Wilson, C.J., concurring). That should end all debate about whether §208.9(*o*) discriminated on its face. "'[D]iscrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Or. Waste Sys.*, 511 U.S. at 99.

In trying to avoid that straightforward conclusion, the state argues that §208.9(*o*) did not discriminate because a corporate taxpayer's foreign affiliates could always just register with New York tax authorities, in which case the corporation would owe less in state taxes. BIO.14-15. That is an admission, not a defense. This Court has squarely held that conditioning a benefit on submitting to the state's jurisdiction *is discrimination* that triggers heightened Commerce Clause scrutiny. *Bendix Autolite Corp. v. Midwesco Enters., Inc.*, 486 U.S. 888, 894-95 (1988).

It makes no difference that "[a] company with foreign [royalty-paying] subsidiaries would gain nothing" more "by rechartering those [subsidiaries] in New York" than it would by having them submit to

New York's regulatory apparatus. *Contra* BIO.14. The state seems to think the only discrimination that violates the Commerce Clause is discrimination based on domicile or incorporation. That is simply wrong. It is no less unconstitutional to condition a benefit on in-state presence or jurisdictional-submission than it is to condition a benefit on in-state incorporation. *See NextEra Energy Cap. Holdings, Inc. v. Lake*, 48 F.4th 306, 322 (5th Cir. 2022) (discussing cases).

That gives the lie to New York's effort to brush aside the conflict with *Kraft General Foods v. Iowa Department of Revenue & Finance*, 505 U.S. 71 (1992). In the state's telling, *Kraft* is different because the law there distinguished "between in-state and out-of-state economic interests." BIO.14. But as this Court has held time and again, a state discriminates against foreign commerce if it requires foreign firms to submit to the state's jurisdiction in order to secure a benefit. *See* Pet.22-23. And as New York concedes, §208.9(*o*) conditioned the availability of a multimillion-dollar tax deduction on having a foreign affiliate "fil[e] a New York tax return," even if the affiliate earned no New York–taxable income. BIO.14-15.

New York cannot escape its admission by claiming that "New York taxpayers were treated the same as non-New York taxpayers" under §208.9(*o*) "at the corporate group level." BIO.14. For one thing, this "corporate group" argument works (if at all) only if one takes as given that every taxpayer's subsidiary should submit to New York's jurisdiction—in other words, only by assuming the Constitution does not apply. For another thing, the argument overlooks that not every entity that is part of a corporate family is *ipso facto*

part of the corporate group for tax purposes. The state obfuscates that reality, but the proof—and the evident discrimination—is in the pudding: The judgment of the Court of Appeals is that Disney owes *millions of dollars more in taxes* just because its royalty-paying affiliates did *not* become "New York taxpayers." *See* Pet.7-11. That is the opposite of treating firms "the same" notwithstanding geography. In fact, it is exactly what Chief Judge Wilson said it is: A law under which a valuable benefit turned textually "on a geographic distinction." App.39.[1]

Unable to deny that reality, New York resorts to blaming Disney for seeking a "windfall." BIO.8-9, 21. But it is not a windfall to be excused from paying an unconstitutional tax. What *is* a windfall, by contrast, is collecting millions of dollars in tax revenue via an expressly discriminatory law.

Finally, the state cries waiver, but its argument simply underscores its confusion, mirrored in the decision below. New York claims Disney "fail[ed] to brief an as-applied challenge in the Court of Appeals." BIO.23. That utterly ignores that this refund action is the ultimate as-applied challenge: It is a product of a yearslong slog through the state administrative system, and lightyears away from the kind of pre-

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[1] New York's "whole corporate group" argument does, however, make its insistence that this case not be held pending the petition in *Zilka v. City of Philadelphia*, No. 23-914 (U.S. 2024), exceedingly strange. "*Zilka* asks … whether the Commerce Clause requires States to consider a taxpayer's burden in light of the state tax scheme as a whole when crediting a taxpayer's out-of-state tax liability." BIO.25 (citing *Zilka*, Pet. for Cert. at i (Feb. 20, 2024)).

enforcement facial challenge that is the domain of *Salerno*. Disney does not—and could not—seek relief for anyone else (which helps explain why IBM pursued its own refund action). As Disney explained in its petition: That Disney's argument is, and always has been, that §208.9(*o*) is unconstitutional as applied to Disney because it discriminates against out-of-state taxpayers on its face—i.e., textually—*does not convert this case into a facial challenge*. Pet.11-12, 16-19.

New York remarkably claims that the bedrock distinction between facial discrimination (disfavored state action present here) and facial challenges (disfavored litigation conduct absent here) "is not based on any decision of this Court." BIO.23. That assertion just reinforces New York's confusion, as multiple decisions of this Court explicitly recognize that facial/textual discrimination in the Commerce Clause context triggers strict scrutiny (including in as-applied challenges) and does not mean that the statute triggers and flunks the *Salerno* standard. Pet.13-16. Take, for example, *Hughes v. Oklahoma*, 441 U.S. 322 (1979), which made clear that a state law that "on its face discriminates against interstate commerce … invokes the strictest scrutiny," *id.* at 336-37. Or, better yet, take *Maine v. Taylor*, 477 U.S. 131 (1986), in which the Court agreed that "Maine's import ban discriminates on its face against interstate trade," *id.* at 138, but *upheld it anyway* because it "satisfied" "the *Hughes* test," i.e., strict scrutiny, *id.* at 140-52. This Court's decision upholding a statute that it found facially discriminatory is proof-positive that *Salerno*, which condemns a law subject to a facial challenge if and only if it is unconstitutional in all applications, is

not the correct test for Commerce Clause facial discrimination.

All of that should suffice to illustrate why the decision below is so badly mistaken—and why this Court's intervention is so sorely needed. The Court of Appeals definitively construed the "plain terms" of §208.9(*o*) to allow corporate taxpayers to deduct IP-royalty income received from an affiliated entity if, *but only if*, the affiliate subjected itself to New York's jurisdiction. App.10. That "construction" of state law from "the highest court of a State" is binding. *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 344 n.6 (1987). And, so construed, §208.9(*o*) is the very definition of facial discrimination. *See* Pet.16-23.

The state thus should have been required to shoulder the heavy burden of proving that its law "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Or. Waste Sys.*, 511 U.S. at 101. It could not hope to carry that burden because 17 states (and New York itself belatedly) have demonstrated the viability of a reasonable nondiscriminatory alternative. Indeed, New York affirmatively celebrates that no other state replicated its discriminatory regime. BIO.17. Thus, had the Court of Appeals followed this Court's precedent, this would have been a straightforward case—and Disney would be entitled to its refund.

Instead, the Court of Appeals "appl[ied] the so-called '*Salerno* standard,'" BIO.15, thus making the most obvious of Commerce Clause violations the most difficult to challenge. That perverse result defies bedrock principles, decades of caselaw, and common

sense. It betrays a fundamental—and, as New York's opposition underscores, apparently endemic—misunderstanding about what a facial challenge is. And it squarely conflicts not only with *Kraft*, but also with *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984) (per curiam), a decision condemning earlier discrimination *by New York itself*. The petition named and explained that close-to-home conflict. Pet.22. Yet, incredibly, the state's opposition never even mentions *Westinghouse*. That is presumably because there is simply no denying the conflict.

II. The Split Among State Courts Of Last Resort Is Real And Intractable.

The decision below exacerbates a conflict among state courts of last resort on an issue of first principles. The New York Court of Appeals followed the misguided lead of the New Hampshire Supreme Court in holding that, to show that a state law discriminates against interstate or foreign commerce on its face, a challenger must show that there is no set of circumstances under which the law would operate evenhandedly. *See* App.16, 19-20; *Gen. Elec. Co. v. Comm'r*, 914 A.2d 246 (N.H. 2006); *see also* Pet.27-29. On the other hand, the high courts of Ohio, New Mexico, and Rhode Island have all adhered to this Court's teachings and rejected the argument that *Salerno* swallows decades of Commerce Clause doctrine, as have two intermediate appellate courts in California. *See* Pet.24-27 (discussing, *inter alia*, *Emerson Elec. Co. v. Tracy*, 735 N.E.2d 445, 447-48 (Ohio 2000); *Conoco, Inc. v. Tax'n & Revenue Dep't of N.M.*, 931 P.2d 730, 736-38 (N.M. 1996); *Dart Indus., Inc. v. Clark*, 657 A.2d 1062, 1064-66 (R.I. 1995)). This

issue has been fully ventilated in state high courts, and the division is real and intractable. Indeed, the New Hampshire high court acknowledged the split and chose not to follow the latter set of correct decisions only because (like the New York court here) it badly conflated facial discrimination and facial challenges. *See Gen. Elec.*, 914 A.2d at 259.

New York neither denies nor dispels the existence of this serious and intractable split. Instead, it says that this case does not implicate the split, by invoking a textbook distinction without a difference: "*Those cases* all involved statutes that taxed *dividends* paid by a corporation to its affiliate," whereas *this case* involves a statute that taxed "*royalties* paid by a corporate affiliate." BIO.17 (emphases added); *see also* BIO.18-19. To state the obvious: Nothing in the Commerce Clause (or anything else in constitutional law) turns on a distinction between dividends and royalties. In fact, given that the split goes to the basic methodology for evaluating facial discrimination in the Commerce Clause context, the fact that it arises in such closely analogous tax regimes is striking.

The legal questions in this case and the others involved in the split are whether a state may condition a taxpayer's ability to take a deduction on submitting to the state's jurisdiction, and whether discrimination on the face of a state law is insulated from review by "the so-called '*Salerno* standard.'" BIO.15. Whether the deduction is for dividends, royalties, or gifts to the state library system makes exactly zero difference to the former or the latter.

III. This Case Is An Ideal Vehicle To Address These Important Issues.

New York collected a decade's worth of unconstitutional taxes. Nevertheless, it claims that it should be insulated from review because no other state employed New York's discriminatory approach and the legislature eventually repealed §208.9(*o*). BIO.12. That is backwards. Because New York has already followed other states' lead in adopting a nondiscriminatory law to close the same perceived loophole, there can be no doubt that a more tailored, nondiscriminatory approach that still advanced New York's "legitimate local purpose" was available. *Or. Waste Sys.*, 511 U.S. at 101; *see* Pet.6-7, 32-33. That makes the Court of Appeals' refusal to apply strict scrutiny dispositive. It also means that, unlike in other state tax disputes, there is no risk of further developments mooting this refund action. Pet.31 n.6. And despite the repeal, hundreds of millions of dollars in ill-gotten tax revenue remain in dispute, while the misplaced *Salerno* standard lies around like a loaded revolver to be employed by the state in defense of other facially (i.e., textually) discriminatory laws.

The state next contends that this case "presents a poor vehicle" because Disney supposedly "failed" to "meet a prerequisite" supposedly "required by *General Motors Corp. v. Tracy*, 519 U.S. 278, 300 (1997)." BIO.20. That is nonsense. To be sure, *Tracy* recognized that it can sometimes be difficult to discern whether a law treats entities differently because they are actually different (e.g., Company *A* serves a captive retail market, but Company *B* does not) or because the law is discriminatory. 519 U.S. at 300.

But New York itself admits that the only reason Disney is out millions of dollars is that its royalty-paying foreign affiliates did not become "New York taxpayers." BIO.13-14. There is no nondiscriminatory way to spin that result. Regardless, it is not "an essential element of a violation of the Foreign Commerce Clause" to show that a foreign comparator was treated "more favorably." *Kraft*, 505 U.S. at 79.

Doubling down on its misguided waiver theory, New York contends that Disney's citation below to a state-law case holding that "a taxpayer challenging the constitutionality of a New York statute must carry the 'high burden' of 'establishing unconstitutionality beyond a reasonable doubt,'" somehow meant that Disney conceded *Salerno*'s application. BIO.22. That makes no sense. The requirement to establish unconstitutionality beyond a reasonable doubt applies equally to as-applied challenges and facial challenges.

New York has no answer to the reality that, given 28 U.S.C. §1341's anti-tax-injunction prohibition, not only is this refund action the quintessential as-applied challenge, but this Court is the only federal court that can provide relief in the face of such critical errors of federal constitutional law. Pet.13, 33. Instead, New York insists that review would "require the Court to analyze … other obsolete tax provisions." BIO.13. That is doubly mistaken. First, the Court of Appeals definitively construed §208.9(*o*) and how it worked within the "whole scheme of taxation," BIO.13, and definitively construed it to make massive tax liability turn on whether the taxpayer submitted to the jurisdiction of revenue agents in Albany. There is no need to consider any aspect of the tax system beyond

that definitive construction of New York law. Second, the dispositive issue below had nothing to do with the details of the state tax regime and everything to do with the Court of Appeals' mistaken invocation of a federal standard for facial challenges to circumvent established federal law condemning laws that facially discriminate in favor of in-state commerce. That undeniably erroneous and consequential federal-law error cries out for this Court's review and correction.[2]

CONCLUSION

The Court should grant the petition for certiorari.

Respectfully submitted,

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[2] New York's internal-consistency arguments, *see* BIO.24, are wrong for the reasons explained in IBM's reply in No. 24-332.