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Amicus Curiae Brief: VFJ Ventures, Inc. vs. G. Thomas Surtees

February 23, 2009

Interest of *Amicus Curiae*

Pursuant to Rule 37 of the Rules of this Court, Tax Executives Institute, Inc. respectfully submits this brief as *amicus curiae* in support of the petition for a writ of certiorari.1 Tax Executives Institute (hereinafter "TEI" or "the Institute") is a voluntary, non-profit association of corporate and other business executives, managers, and administrators who are responsible for the tax affairs of their employers. TEI was organized in 1944 under the laws of the State of New York and is exempt from taxation under section 501(c)(6) of the Internal Revenue Code (26 U.S.C.). The Institute is dedicated to promoting the uniform and equitable enforcement of the tax laws, reducing the costs and burdens of administration and compliance to the benefit of both the government and taxpayers, and vindicating the Commerce Clause and other constitutional rights of all business taxpayers.

The issue presented is whether the State of Alabama's "add-back" statute, which denies a deduction for ordinary business expenses paid to corporations located outside Alabama, discriminates against interstate commerce in violation of the Commerce Clause. Alabama is not alone among the States in enacting legislation that reaches beyond its borders to tax extraterritorial values in contravention of the Commerce Clause. Indeed, Alabama's "add-back" statute is just the latest effort to distend the Court's decisions in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), *Hunt-Wesson, Inc. v. Franchise Tax Board*, 528 U.S. 458 (2000), and other cases by unconstitutionally using a State's taxing authority to exact from multijurisdictional taxpayers that which is not its due.

TEI has more than 7,000 members who represent more than 3,200 of the leading corporations in the United States, Canada, Europe and Asia, including many domiciled or doing business in Alabama. TEI members represent a cross-section of the business community whose employers are, almost without exception, engaged in interstate commerce. TEI has a keen interest in the resolution of issues relating to the constitutionality of Alabama's "add-back" statute, not only with respect to its members whose companies are taxed by Alabama but also in respect of those in the approximately 20 other States with "add-back" statutes. The disposition of this case will have a direct bearing on the permissibility of the "add-back" device across the Nation and, indirectly, States' other efforts to tax beyond their borders.

Summary of Agrument

1. The core issue presented by this case is whether the State of Alabama's "add-back" statute violates the Commerce Clause of the Constitution. It is well settled that a State may not tax value outside its borders. Such taxation is forbidden because the "fun- damental purpose of the [Commerce] Clause is to assure that there be free trade among the several States," *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 335 (1977), and because extraterritorial taxation offends fundamental notions of due process and constitutes an "unreasonable clog upon the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935).

2. Like many States, Alabama imposes a corporate income tax on corporations doing business within its borders. Alabama has chosen to impose its corporate income tax on a "separate company" basis. A direct consequence of that policy choice is the requirement that Alabama must recognize the separate existence of individual corporations. It is within this separate company

reporting context that Alabama's "add- back" statute must be tested by and withstand the scrutiny of the Commerce Clause and the Due Process Clause. Alabama's "add-back" statute fails that test.

3. Alabama's "add-back" statute, like those of many other States, requires corporate taxpayers to "add- back" otherwise deductible interest and intangible expenses paid to or incurred with respect to related members. This "add-back" does not apply, however, to interest and intangible expenses to the extent the related corporation is subject to tax in a State that mandates separate company filing for corporate taxpayers and that taxes intangible income such as royalties. As a result, the amount of interest and intangible expenses taxable in Alabama fluctuates based on the taxing scheme in the States in which the recipient does business — not on the taxpayer's level of activity in Alabama.

4. In *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), this Court established a four-prong test for determining whether a state tax statute violates the Commerce Clause — that is to say, whether it impermissibly reaches extraterritorial values. These four tests are not wholly independent of one another, but rather represent four ways of answering the same question — whether a State is attempting to tax "value outside its borders." *See Connecticut General Life Ins. Co*. *v. Johnson*, 303 U.S. 77, 80-81 (1938). Alabama's "add-back" statute does not satisfy the requirements of *Complete Auto Transit.*

5. Alabama's "add-back" statute does not pass the fair apportionment test. Fair apportionment necessitates a "rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-37 (1980). The failure to provide factor representation is "inherently arbitrary," *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920), and cannot help but produce a result that reflects neither "a reasonable sense of how [the] income [was] generated" (as required by *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 169 (1983)) nor "the relative contribution of the activities in the various States [specifically, Alabama] to the production of total unitary income" (*Butler Brothers v. McColgan*, 315 U.S. 501, 509 (1942)). Because the amount of royalty income taxable in Alabama under its "add-back" statute is controlled by the taxing choice of other States, there is no rational relationship between the royalties Alabama seeks to tax and a taxpayer's activities in Alabama. Alabama may not constitutionally cherry pick items of income or expense (to include or exclude) in order to increase the taxes it exacts from multijurisdictional companies without making correlative adjustments to the formula used to apportion the income among Alabama and the other States.

6. To survive constitutional challenge a State tax must not discriminate against interstate commerce. The prohibition on discrimination was borne of a fear of "economic protectionism — that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *New Energy Co. v. Limbach*, 486 U.S. 269, 273-74 (1988). This Court has defined "discrimination" for purposes of Commerce Clause analysis as "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste Systems, Inc. v. Department of Environmental Quality of Oregon*, 511 U.S. 93, 99 (1994). Most recently, in *Hunt-Wesson, Inc. v. Fran- chise Tax Board*, 528 U.S. 458 (2000), this Court struck down a California statute requiring the reduction of a taxpayer's interest deduction by the amount of its nontaxable income without regard to whether the interest expense was related to the nontaxable income. Holding the interest offset provision unconstitutional, the California trial court noted that the statute resulted in treating corporations differently solely based on the corporation's "state of commercial domicile, which difference results in increased taxes for foreign corporations." *Hunt-Wesson, Inc. v. Franchise Tax Board*, No. 976628, Cal. Superior Ct., City and County of San Francisco, Dep't 17, June 6, 1997, *rev'd,* No. A079969, Cal. Ct. App., 1st Dist., Div. 3, Dec. 11, 1998 (unpublished). This Court unanimously agreed and struck down the statute. Here, Alabama's statute is equally infirmed. Under Alabama's "add-back" statute, royalties do not need to be "added-back" if they are paid to related parties doing business in either Alabama or other States whose taxation of royalty income mirrors that of Alabama. Thus, the "add-back" statute unconstitu- tionally discriminates in favor of royalties paid to related parties doing business in either Alabama or other States whose taxation of royalty income mirrors that of Alabama. Accordingly, Alabama's "add-back" statute should be struck down.

Argument

Background

VFJ Ventures, Inc. ("VFJ") is a domestic manufacturer and seller of jeans that are sold under the brand names of Lee® and Wrangler®. During the tax year at issue, VFJ had two distribution facilities and a "cutting" facility in Alabama with approximately 600 employees. VFJ licensed the use of several trademarks from the H.D. Lee Company, Inc. ("Lee") and Wrangler Clothing Corp. ("Wrangler") in its national manufacturing and marketing operations. Lee and Wrangler are among the direct and indirect subsidiaries of VF Corporation, headquartered in Greensboro, North Carolina, and are related subsidiaries to VFJ. They also serve as intangible management companies that, among other things, maintain, protect, and regulate the Lee and Wrangler

trademarks. For the tax year at issue, Lee and Wrangler charged VFJ an arm's-length royalty for the right to use their trademarks, and Lee and Wrangler also licensed those trademarks to third parties. On its 2001 Alabama corporate tax return, VFJ claimed a deduction for the royalty payments paid to Lee and Wrangler.

On audit, the Alabama Department of Revenue invoked the Alabama "add-back" statute, Ala. Code 1975 § 40-18-35(b), and asserted that the Lee and Wrangler royalty payments — properly deducted in the computation of VFJ's separate company federal taxable income — were subject to add-back and therefore includible in Alabama taxable income. Further, the Department determined that the statutory exceptions to the "add-back" requirement were inapplicable.

Although the trial court ruled in VFJ's favor, the Alabama Court of Civil Appeals reversed. VFJ appealed to the Alabama Supreme Court on the ground that the "add-back" statute violated the Commerce Clause of the Constitution because it was discriminatory and did not fairly apportion VFJ's income. The Alabama Supreme Court rejected VFJ's constitutional challenges and affirmed the judgment of the Alabama Court of Civil Appeals. *Ex Parte VFJ Ventures, Inc. (Surtees v. VFJ Ventures, Inc.)*, No. 1070718 (Ala. Sept. 19, 2008).

Statutory Overview

A. Determining State Taxable Income

Under the Constitution, States enjoy considerable latitude in developing their taxing schemes. Each policy choice a State makes, however, carries with it certain limitations and restrictions to ensure its constitutionality. For example, a State may elect to combine "unitary business enterprises" generally without regard to the group's structure. In calculating the portion of the group's income subject to tax within its border, however, the State must subject that unitary tax base to a constitutionally permissible apportionment formula. Alternatively, a State may adopt a "separate company" reporting scheme that respects the separate existence of the individual members of a corporate group.

Alabama has followed this latter course. Thus, all corporations doing business in Alabama must gener- ally file separate company corporate income tax returns in the State — even if the corporation is included in a consolidated federal income tax return. Ala. Code 1975 § 40-18-39(a). More specifically, Alabama has chosen not to allow or require "the filing of a combined income tax return under the unitary business concept." Ala. Code 1975 § 40-18-39(i).2

Instead, pursuant to Alabama's separate company reporting methodology, the Alabama taxable income of each member of a corporate group is calculated independently. As a direct consequence of this policy decision, transactions with affiliated corporations that would generally be "eliminated," *i.e.*, offset, in a federal consolidated income tax return (and in unitary combined returns required by other states), are not eliminated in the computation of a corporation's Alabama separate company taxable income. Ala. Code 1975 § 40-18-31.

Computation of "taxable income" for state corporate income tax purposes generally commences with a taxpayer's federal taxable income, followed by various additions and subtractions peculiar to each State's taxing regime. After the adjustments, the State applies its particular apportionment and allocation formula to determine its respective share of the corporation's taxable income. States vary considerably in the type and extent of the adjustments made to federal taxable income as well as in their apportionment formulae.

Alabama follows this general approach to the calculation of state taxable income. Specifically, "the term 'taxable income' means federal taxable income without the benefit of federal net operating losses plus the additions prescribed and less the deductions and adjustments allowed by this chapter and as allocated and apportioned to Alabama." Ala. Code 1975 § 40-18-33.

B. Alabama's "Add-Back" Statute

Ala. Code 1975 § 40-18-35(b) requires corporate taxpayers to "add-back" to their federal taxable income otherwise deductible interest and intangible expenses paid to or incurred with respect to related members. Specifically:

> For purposes of computing its taxable income, *a corporation shall add back otherwise deductible interest expenses and costs and intangible ex- penses and costs directly or indirectly paid, accrued or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions, with one or more related members***,** except to the extent the corporation shows, upon request by the commissioner, that the corresponding item of income was in the same taxable year: a. subject to a tax based on or measured by the related member's net income in Alabama or any other state of the United States or b. subject to a tax based on or measured by the related member's net income by a foreign nation which has in force an income tax treaty with the United States, if the recipient was a "resident" (as defined in the income tax treaty) of the foreign nation. (Emphasis added.) 3

Applying its "add-back" statute, Alabama denied VFJ a deduction for the arm's-length royalties paid to Lee and Wrangler as "certain intangible expenses and interest expenses with a related member."

The Alabama Add-Back Statute Vioates the Commerce Clause by Impermissibly Taxing Income Beyond Alabama's Constitutional Reach

Within boundaries established by the Commerce Clause and Due Process Clause, a State is free to construct its own taxing system. U.S. Const. art. I, § 8, cl. 3 and U.S. Const. amend. XIV, § 1. Once chosen, however, States must operate within and be consistent with the confines of that structure and the limitations imposed by this Court's rulings. Some States have chosen to adopt taxing regimes under which a taxpayer's entire unitary group of corporations is required to be included in a single combined corporate tax report. *See e.g.,* California (Cal. Rev. & Tax Code § 25101); Maine (Me. Rev. Stat. Ann. § 5220(5)). Under a unitary combined system, all members of a unitary group of taxpayers (including those without nexus in the state) are included in a combined report and intercompany transactions between group members are eliminated. Other States have enacted systems under which each corporation must file a separate state return regard- less whether the corporation files a consolidated federal return. *See e.g.,* Maryland (Md. Code Ann. Tax-Gen. § 10-811); Pennsylvania (72 P.S. § 7404).

Alabama, as is its right, has adopted a state taxing regime that imposes corporate income tax liability on a "separate company" basis. A direct consequence of that policy choice is the requirement that Alabama must recognize the separate existence of individual corporations. Additionally, it is within this separate company reporting context that Alabama's "add- back" statute must be tested by and withstand scrutiny under the Commerce Clause and Due Process Clause. Regrettably, Alabama's "add-back" statute fails that scrutiny.

A State may not tax value outside its borders. *E.g., Connecticut General Life Ins. Co. v. Johnson*, 303 U.S. 77, 80-81 (1938). Such taxation is forbidden because the "fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several States," *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 335 (1977), and because extraterritorial taxation offends fundamental notions of due process and constitutes an "unreasonable clog upon the mobility of commerce," *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935).

In *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), this Court established a four-prong test for determining whether a state tax statute violates the Commerce Clause — that is to say, whether it impermissibly reaches extraterritorial values. Specifically, a tax will be sustained only if (1) it is applied to an activity with a substantial nexus with the taxing State, (2) it is fairly apportioned, (3) it does not discriminate against interstate commerce, and (4) it is fairly related to the services provided by the State. *Id.* at 279. Three decades later, *Complete Auto Transit* remains the decisional framework for determining whether a tax unduly infringes on inter- state commerce. *See, e.g., Trinova Corp. v. Michigan Department of Treasury*, 498 U.S. 358, 372-73 (1991); *Exxon Corp. v. Department of Revenue*, 447 U.S. 207, 227-28 (1980).

The four tests enunciated by the Court in *Complete Auto Transit* are not wholly independent of one another, but rather represent four ways of answering the same question — whether a State is attempting to tax "value outside its borders." *See Connecticut General Life Ins. Co*., 303 U.S. at 80-81. Thus, while VFJ itself clearly had "substantial nexus" with the State of Alabama, that finding alone does not give the State license to deny VFJ a deduction for the arm's-length royalties it properly paid to Lee and Wrangler. Rather, a review of *Complete Auto Transit*'s other tests is required.

Applying the fair apportionment test can be problematic. This Court has rightly observed that dividing income among the several States bears some resemblance to "slicing a shadow." *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 192 (1983).4 Absolute consistency, even among taxing authorities using the same apportionment formula, "may just be too much to ask," *id.*, but there are constitutional limits on a State's use of an apportionment formula. In other words, a balance must be struck between the State's power to tax and the taxpayer's legitimate right to protection from overreaching taxing authorities. It is for this Court to ensure that the balance is a reasonable one.5 If the State has not "given anything for which it can ask return" in respect of the person, property, or transaction it seeks to tax, *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940), the Commerce Clause and Due Process Clause operate as a constitutional brake upon the State's raw power to tax. To pass constitutional muster, the apportionment formula must, first and foremost, be fair. *Container Corp.*, 463 U.S. at 169. And there must be internal consistency: "[T]he formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed." *Id.* There must also be external consistency: "[T]he factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Id.*

Alabama's "add-back" statute fails the test of fair apportionment because its denial of VFJ's deduction for royalties paid to Lee and Wrangler effectively taxes value outside the State. To be

sure, Alabama could have included that royalty income in the tax base by enacting a taxing scheme requiring combined reporting, but if it did, it would have also had to take into account the various items of income and expense of all members of the taxpayer's corporate group. Having made a policy choice to tax corporations on a separate company — as opposed to a combined — basis,6 Alabama may not constitutionally cherry pick items of income or expense (to include or exclude) in order to increase the taxes it exacts from multi-jurisdictional companies without making correlative adjustments to the formula used to apportion the income among Alabama and the other States.

Indeed, *amicus* TEI submits that an apportionment method that fails by design to take into account the factors that generated the apportioned income is constitutionally flawed because there can never be a "rational relationship between the income attributed to the State and the intrastate values of the enter- prise." *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-37 (1980). The failure to provide factor representation is "inherently arbitrary," *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920), and cannot help but produce a result that reflects neither "a reasonable sense of how [the] income [was] generated" (as required by *Container Corp.*, 463 U.S. at 169) nor "the relative contribution of the activities in the various States [specifically, Alabama] to the production of total unitary income" (*Butler Brothers v. McColgan*, 315 U.S. 501, 509 (1942)). This Court's prior holdings teach this con- clusion and common sense confirms it.

In *Mobil*, the Court acknowledged that the factor representation issue could be one of constitutional import, but did not decide the issue. 445 U.S. at 434, 441 n.15, 449. Justice Stevens, however, found the issue dispositive, concluding it was constitutionally improper to "lump huge quantities of investment income that have no special connection with the taxpayer's operations in the taxing State into the tax base" without taking into account the factors that produced that income. 445 U.S. at 459 (Stevens, J., dissenting). Justice Stevens explained:

> Unless the sales, payroll, and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will *inevitably* cause Mobil's Vermont income to be overstated.

Id. at 461 (*emphasis added*). Eleven years later, the Maine Supreme Court addressed this issue directly and held that the lack of factor representation was constitutionally fatal to a taxing scheme:

> [Without factor representation,] [t]he ineluctable result is that more of the business activity of the unitary business is attributed to [the State] than is the actual case. Thus, the income taxable by [the State] under the Assessor's formula does not truly reflect [the corporation's] connection with [the State] and fails to meet the test of fairness required by the due process clause.

Tambrands, Inc. v. State Tax Assessor, 595 A.2d 1039, 1044 (Me. 1991).

The lack of a rational relationship between VJF's activities in Alabama and the royalty income that Alabama is seeking to tax is underscored by the amount of income subject to tax under Alabama's "add-back" statute being dependent on where the recipient of the relevant royalty payments is located and the taxing regime in place in that jurisdiction. For example, if Lee and Wrangler were located in Maryland (a separate company reporting jurisdiction that taxes royalties) and apportioned all of their income to Maryland, the royalties paid by VFJ to Lee and Wrangler would not be subject to Alabama's add- back statute — effectively reducing VFJ's income subject to tax in Alabama. Because Lee and Wrangler operate in Delaware (a State that exempts royalty income from state income taxation), however, Alabama seeks to tax those same royalties by adding them back in the calculation of VFJ's income. This increase in income subject to tax has no relationship to VFJ's activities in Alabama.

In short, States must accept both the benefits and burdens of the tax policy choices their legislatures have made. They may not adopt a "one from column A and one from column B" approach to state taxation in order to tax value outside their borders. The Commerce Clause demands more.

Under the third prong of *Complete Auto Transit*, to survive constitutional challenge a State tax must not discriminate against interstate commerce. This prohibition on discrimination was borne of fear of "economic protectionism — that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *New Energy Co. v. Limbach*, 486 U.S. 269, 273-74 (1988).

This Court has defined "discrimination" for Commerce Clause purposes as "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste Systems, Inc. v. Department of Environmental Quality of Oregon*, 511 U.S. 93, 99

(1994). Where a state statute is found to be discriminatory, it is "virtually *per se* invalid." *Id.* A discriminatory statute will only pass constitutional muster if it "advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *Id.* at 101 (internal quotation marks omitted).

This Court has struck down laws in several states, including Alabama, on the ground that they discriminate against interstate commerce. *See e.g., South Central Bell Tel. Co. v. Alabama*, 26 U.S. 160 (1999) (invalidating a state franchise tax that unconstitutionally favored Alabama corporations over out-of- state corporations); *Oregon Waste Systems, Inc. v. Department of Environmental Quality of Oregon*, 511 U.S. 93 (1994) (finding unconstitutional a waste disposal surcharge imposed at different rates for waste generated within and without the State).

Most recently, in *Hunt-Wesson, Inc. v. Franchise Tax Board*, 528 U.S. 458 (2000), California imposed a corporate franchise tax on businesses for the privilege of doing business in the State. Taxpayers were required to deduct business interest expense from business income in calculating net taxable income. California also required taxpayers to offset their business interest expense, dollar for dollar, with non-business income not allocable to the State. Thus, out-of-state corporations were compelled to reduce their interest deduction by the amount of their nontaxable income, without regard to whether the interest expense was related to the nontaxable income.

In striking down the interest offset, the trial court in *Hunt-Wesson* succinctly put the matter this way: "[T]he offset provisions treat two corporations in an identical business transaction differently based solely on their state of domicile, which difference results in increased taxes for foreign corporations." *Hunt- Wesson, Inc. v. Franchise Tax Board*, No. 976628, Cal. Superior Ct., City and County of San Francisco, Dep't 17, June 6, 1997, *rev'd,* No. A079969, Cal. Ct. App., 1st Dist., Div. 3, Dec. 11, 1998 (unpublished). This Court unanimously agreed: "Because California's [interest deduction] offset provision is not a reasonable allocation of expense deductions to the income that the expense generates, it constitutes impermissible taxation of income outside its jurisdictional reach." 528 U.S. at 468. Consequently, the Court held that the provision "violates the Due Process and Commerce Clauses of the Constitution." *Id.*

Here, Alabama's statute is equally infirmed. The "add-back" statute unconstitutionally discriminates in favor of royalties paid to related parties doing business in either Alabama or other States whose taxation of royalty income mirrors that of Alabama. For example, if a taxpayer pays a royalty to a related corporation doing business in Wyoming, that royalty must be added back in the calculation of the taxpayer's Alabama taxable income since Wyoming does not impose a corporate income tax. If that same taxpayer paid those same royalties to a related corporation doing business in Alabama, no add-back would be required under Alabama's statute.

Conclusion

For the foregoing reasons, the Court should grant the petition for a writ of certiorari and reverse the decision below.

*   *   *

1 Pursuant to Rule 37.6, amicus Tax Executives Institute, Inc. states that no counsel for a party has written this brief in whole or in part and that no person or entity, other than amicus, its members, or its counsel, has made a monetary contribution to the preparation or submission of this brief. Pursuant to Rule 37.2(a), counsel of record for both parties received timely notice of the intent to file an amicus brief under this rule and both parties have consented to its submission in letters filed with the Clerk.

2 Although not required, groups of corporations meeting the definition of an "Alabama affiliated group" may elect to file a consolidated Alabama corporate income tax return that includes only those affiliated corporations having nexus in Alabama. Ala. Code 1975 § 40-18-39(c). "However, under no circumstances may the Department of Revenue compel a taxpayer to file an Alabama consolidated return if the taxpayer has not so elected." Ala. Code 1975 § 40-18-39(c)(1).

3 Similar provisions have been enacted in approximately 20 other states. *See* Ark. Code Ann. § 26-51-423(g)(1) ("A deduction . . . for interest or intangible-related expenses paid by the taxpayer to a related party shall be allowed only if: (A) The interest or intangible-related income received by the related party is subject to income tax imposed by the State of Arkansas, another state, or a foreign government . . . ."); *accord* Ga. Code Ann. § 48-7-28.3(d)(2); 35 Ill. Comp. Stat. 5/203(a)(2)(D-18); Ind. Code § 6-3-2-20(c)(2); Ky. Rev. Stat. Ann. § 141.205(3)(b); Mich. Comp. Laws § 208.1201(2)(f)(ii); Ohio Rev. Code Ann. §§ 5733.042, 5733.055(A)(2); Va. Code Ann. § 58.1-402(B)(8)(a)(1). Several jurisdictions allow the deduction only if the related payments are subject to tax above a certain rate. See Conn. Gen. Stat. § 12-218(c); D.C. Code § 47-1803.03(a)(19)(B); Md. Code Ann. Tax-Gen. § 10-306.1(c); Mass. Gen. Laws ch. 63, § 31I; 830 Mass. Code Regs. 63.31.1; R.I. Gen. Laws § 44-11-11(f)(3). Two States allow the deduction

only if the related payments are subject to tax in those States. See N.J. Stat. Ann. § 54:10A-4.4; N.J. Admin. Code § 18:7-5.18(b)(3); N.C. Gen. Stat. § 105-130.7A.

4 Although the terms "allocation" and "apportionment" are often used interchangeably in respect of the division of income among various jurisdictions, "allocation" properly refers to the "attribution of a particular type of income to a designated State, [and] 'apportionment' refers to the division of the tax base by formula." JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION I: CORPORATE INCOME AND FRANCHISE TAXES ¶ 9.01, at 9-7 n.2 (3d ed. 2008). A typical "three-factor" formula — similar to the one used by the State of Alabama in this case — compares (i) the taxpayer's property, payroll, and sales (receipts) within the taxing State to (ii) the taxpayer's total prop- erty, payroll, and sales. UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT (U.L.A.) §§ 9-15.

5 See Boston Stock Exchange, 429 U.S. at 329 (the Court has a duty "to make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers").

6 Rather than requiring related corporations engaged primarily in the management of intangible assets to file or to be included in an Alabama corporate income tax return, the State conjured a similar result by denying an in-state operating company a royalty deduction for payments made to an intangible management company. This type of corporate combination is expressly prohibited by Alabama statute. Ala. Code 1975 § 40- 18-39(c)(1) ("under no circumstances may the Department of Revenue compel a taxpayer to file an Alabama consolidated return if the taxpayer has not so elected").

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