No. 06-1228

IN THE

Supreme Court of the United States

FIA CARD SERVICES, N.A., FKA MBNA AMERICA BANK, N.A.,

Petitioner,

v.

TAX COMMISSIONER OF THE STATE OF WEST VIRGINIA

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

BRIEF OF AMERICAN BANKERS ASSOCIATION AS *AMICUS CURIAE* SUPPORTING PETITIONER

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INTEREST OF AMICUS CURIAE

Amicus Curiae American Bankers Association ("ABA") is the principal national trade association of the banking industry in the United States.[1] ABA has members in each of the fifty states and the District of Columbia, more than 1,000 of which are national banks. ABA member banks hold

[1] This brief is filed with the written consent of Petitioners and Respondents. Pursuant to Rule 37.6, counsel certifies that no counsel for any party authored this brief in whole or in part, and no person or entity, other than ABA and its members, made a monetary contribution to the preparation or submission of the brief.

approximately 90% of the domestic assets of the banking industry in the United States. ABA frequently appears in litigation as a party or amicus where the issues raised in a case are of widespread importance and concern to the industry.

Banks and other financial institutions, like any other for-profit business, are subject to state taxes. In a modern economy, financial institutions may have customers located in states where the financial institution itself has no physical presence. Consequently, questions about which states may tax a financial institution, how such tax would be imposed, and the amount of such tax are of great importance to the commercial banking and financial services industries.

The issues raised in the petition urgently require this Court's review. If allowed to stand, the West Virginia Supreme Court's abandonment of this Court's well-established requirement that a taxpayer have a physical nexus to the taxing jurisdiction has the potential to unfairly subject out-of-state businesses to unconstitutional taxation merely because they have customers in the taxing state. This negation of the normal "bright-line" test has injected an unacceptable level of uncertainty into the process of business planning, making it difficult to predict whether contacts with a state or locality may subject a business to taxation.

ABA joins the arguments submitted by Petitioner regarding the clear unconstitutionality of the West Virginia statute; any move to abandon a "physical presence" test for state taxation in favor of any of the various amorphous "economic presence" tests would be an extraordinary expansion of state taxing authority, with consequences well beyond the facts presented in this case. Rather than provide briefing on issues

that have already been addressed by Petitioner, this brief will discuss the ways in which the imposition of constitutionally-questionable standards for state "business activities taxes"[2] is creating uncertainty within the financial services industry that affects the ability of publicly-traded banks and other businesses to reliably report their tax liabilities (and therefore, their financial condition) as required by law.

ABA respectfully urges that the Court grant Petitioner's request for review. A decision rejecting the West Virginia Supreme Court's holding would lend clarity and certainty to the issue and would provide businesses with a bright-line test for knowing when they are subject to state and local taxation.

REASONS WHY THE WRIT SHOULD BE GRANTED

I. A BUSINESS ACTIVITIES TAX AND ITS RELIANCE UPON VAGUE "ECONOMIC NEXUS" FOR JURISDICTION OVER A TAXPAYER CREATES UNACCEPTABLE UNCERTAINTY.

As one commentator has noted, "[i]t is not an exaggeration to note that since the first state business activity tax was imposed, taxpayers have never been certain as to what activities will subject them to the taxing jurisdiction of any particular state or local authority."[3] Prior to the advent of the

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[2] A "business activities tax" as referred to in this brief includes any tax imposed by a state or local jurisdiction where authority to tax is premised upon the amount of, or the economic results of, business or related activity conducted in the taxing jurisdiction. These taxes expressly or implicitly abandon the traditional requirement that a business have some physical nexus with the jurisdiction.

[3] Testimony of Douglas L. Lindholm, Esq., President and Executive Director, Council on State Taxation (COST), before the United States (...continued)

economic nexus-driven business activities tax model for state and local taxation, the process of determining where a corporation was subject to tax was relatively straightforward: states and businesses alike looked to where the company had offices, employees or other similar physical presence within a particular jurisdiction. This reliance upon physical connection to a jurisdiction corresponds with the Court's long-standing analysis (reaffirmed most recently in *Quill Corp. v. North Dakota*)[4] that physical presence within a locale is a constitutional prerequisite for establishing jurisdiction over a taxpayer under the Commerce Clause.

The inquiry is *not* as clear-cut where a state or local authority seeks to impose a "business activity tax" that is premised upon a taxpayer's "economic nexus" to a state or local jurisdiction, generating both legal as well as practical uncertainty. At the most basic level, companies with customers in scattered across several states are faced with the task of complying with an expanding patchwork of state statutes and regulations that frequently set vague and unpredictable criteria for establishing when an entity is deemed to have an "economic" nexus to a state. Even unintentional or *de minimus* business activity within a jurisdiction can have significant and unintended implications for the taxpayer. Taxpayers frequently cannot predict when and in which jurisdictions they will be deemed subject to taxation – that determination may be triggered in some instances upon factors totally beyond the control of the taxpayer, such as the migration of a small number of a

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(...continued)
Senate Committee on Finance, Subcommittee on International Trade (July 25, 2006).

[4] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

company's existing customers into different jurisdictions.[5] State and local tax expense[6] is a significant issue for the financial services industry. Banks, finance companies, and other service providers continue to require a "bright-line" standard that allows a modicum of certainty regarding where their activities will subject them to a tax.

Second, and more profoundly, there is a growing need to conclusively reaffirm the Court's reasoning in *Quill* in order to settle the constitutional controversy that has been provoked by state or local jurisdictions that choose to assert taxing authority over a foreign corporation based on its "economic nexus" to a locality. Once believed to be settled, the issue of whether income taxes may be based upon "economic nexus" to a jurisdiction is being (and has been) litigated in a piecemeal fashion. The need for a settled, nationwide rule is especially acute in the banking industry where millions of dollars of income-based taxes can turn on whether a constitutionally-recognized nexus with a

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[5] For example, the West Virginia statute at issue in this case presumes that for purposes of the business franchise tax a foreign corporation is "regularly engaging in business" in the state if it "obtains or solicits business with *twenty* or more persons" within the state or if the "sum of the value of its gross receipts attributable to sources" in West Virginia exceeds $100,000. W.Va. Code § 11-23-5a(d)(1996) (emphasis added). Similarly *de minimus* standards are used to assert jurisdiction over foreign corporations for the West Virginia corporation net income tax. W. Va. Code § 11-24-7b(d)(1996).

[6] "Business activities taxes" also provoke thorny issues concerning the apportionment of taxable income between the various jurisdictions. Due Process concerns are raised in situations where this allocation of income operates "unreasonably and arbitrarily" and attributes a percentage of income to a particular jurisdiction that is "out of all appropriate proportion to the business transacted by the appellant in that State." *Hans Rees' Sons, Incorporated v. North Carolina, ex rel Maxwell,* 283 U.S. 123, 135 (1931).

jurisdiction exists. In the absence of a clear statement of the law by the Court, banks and other financial service providers are left to navigate the uncertain waters of constitutionally-suspect state taxation schemes that devolve into confusion spawned by potentially inconsistent outcomes in litigation.[7]

ABA respectfully submits that there is a strong need for an authoritative statement from the Court reaffirming once and for all the preeminence of the Court's Commerce Clause analysis in *Quill* and *Complete Auto Transit Inc. v. Brady* and *Complete Auto Transit Inc., v. Brady.* [8] Until the Court agrees to take up the issue, it is the widely-held perception within the banking industry that the issue remains contested and unresolved; in a word, uncertain. As will be discussed in the next section, this uncertainty has had a disruptive effect upon how financial institutions account for their tax expense, and, in turn, how these entities report their financial condition.

II. THE "ECONOMIC NEXUS" STANDARD THREATENS THE ABILITY OF A FINANCIAL INSTITUTION TO RELIABLY REPORT ITS TAX LIABILITIES (AND THEREFORE, ITS FINANCIAL CONDITION) AS REQUIRED BY LAW.

Financial markets and the investing public require reliable information about the fiscal health of publicly traded companies. As discussed in the prior section, the banking

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[7] *Compare, J.C. Penney National Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999) (physical nexus upheld) and *Tax Commissioner of the State of West Virginia v. MBNA America Bank, N.A.*, 640 S.E.2d 226 (W.Va. 2006) (economic nexus upheld).

[8] 430 U.S. 274 (1977).

industry is laboring under a growing cloud of uncertainty caused by the inability to dependably predict where they may be deemed subject to state or local "business activities taxes" and as well as the more fundamental question of whether these taxes are ultimately unconstitutional and, hence, unenforceable. One area that is directly affected by the confusion spawned by the proliferation of constitutionally suspect standards for asserting local and state taxing authority is the ability of banks and other businesses to reliably report their tax liabilities (and therefore, their financial condition) under the accounting rules set forth by the Financial Accounting Standards Board ("FASB"). While FASB is not a government agency, publicly-traded entities including national banks are required to comply with FASB's rules (including FIN 48 described below), and enforcement of these rules is carried out by (among others) the Securities and Exchange Commission and the Department of Justice.

The lack of a settled "bright-line" test for determining whether an out-of-state business has a tax obligation to a jurisdiction other than those states where it employs its labor and capital has created a situation where a business can no longer reliably determine its tax liability under the current FASB rules. In order to understand the reasons that this Court is the only judicial body that can eliminate this uncertainty, a brief explanation of the FASB rules is required.

In 1992, FASB established financial accounting and reporting standards regarding how companies account for and report the financial statement effects of income taxes that result from an enterprise's activities. This standard – FASB Statement of Financial Accounting Standards No. 109 ("SFAS 109") – requires accounting and reporting for income taxes in order to recognize (a) the amount of taxes payable or refundable for the current year and (b) deferred

tax liabilities and assets for the future tax consequences of events that have been recognized in an enterprise's financial statements or tax returns.

FASB subsequently acknowledged that SFAS 109 was being applied inconsistently from enterprise to enterprise and that there was a need to clarify the manner in which companies accounted for uncertainty in income taxes recognized on their financial statements. In order to address these issues, FASB adopted Interpretation No. 48 (FIN 48) in June of 2006. [9] FASB subsequently issued an interpretation of FIN 48 (FASB Staff Position No. FIN 48-1) on May 2, 2007.[10]

FIN 48 recognizes that the basis for taking a particular tax position may not be completely settled, and the resulting uncertainty has created a lack of uniformity and reliability in financial reporting:

> In principle, the validity of a tax position is a matter of tax law. It is not controversial to recognize the benefit of a tax position in an enterprise's financial statements when the degree of confidence is high that that tax position will be sustained upon examination by a taxing authority. However, in some cases, the law is subject to varied

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[9] FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes–an interpretation of FASB Statement No. 109,* http://www.fasb.org/pdf/fin%2048.pdf. FIN 48 is effective for fiscal years beginning after December 15, 2006.

[10] FASB Staff Position No. FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48* (May 2, 2007). A copy of this interpretation may be found at: http://www.fasb.org/fasb_staff_positions/fsp_fin48-1.pdf

> interpretation, and whether a tax position will ultimately be sustained may be uncertain. [FASB] Statement 109 contains no specific guidance on how to address uncertainty in accounting for income tax assets and liabilities. As a result, diverse accounting practices have developed resulting in inconsistency in the criteria used to recognize, derecognize, and measure benefits related to income taxes. This diversity in practice has resulted in noncomparability in reporting income tax assets and liabilities.[11]

FIN 48 prescribes a comprehensive model for the recognition, measurement, presentation and disclosure of income tax uncertainties regarding positions taken (or expected to be taken) in an enterprise's income tax return(s). FIN 48 prescribes a two-step process and analysis (recognition and measurement) for the financial statement accounting of every tax position taken or expected to be taken in a tax return. A "tax position" includes the decision *not* to file a tax return.

The first step – recognition – requires that an enterprise must first conclude that it is more likely than not (*i.e*, greater than 50%) that the tax position taken will be realized/upheld upon examination, including the resolution of any related appeals or litigation process based on the technical merits of the tax position, before it can recognize all or a part of the benefits of the tax position in the enterprise's financial statements. If a tax position fails to meet the "more likely than not" threshold, the benefit of that position cannot be recognized in the financial statements and 100 percent of the potential liability must be reserved.

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[11] FIN 48, at *Summary*.

The second step – measurement – requires a company to determine the amount of benefit to recognize in its financial statements. The tax benefit is measured as being the "largest amount of benefit that is greater than 50 percent likely of being realized upon settlement."[12] The difference between the tax position taken in a tax return and the amount that is recognized in the financial statements represents a tax reserve the company is required to maintain. The company is required to record and maintain reserves for every uncertain tax position until it is either audited or until the statute of limitations expires. In addition to the tax, the rules require that interest and penalties must also be included in the reserve.

Recognizing that considerable time can elapse before the validity of a tax position is determined with legal finality, FASB's rules attempt to create a reporting convention that allows a financial statement to reflect this uncertainty. The company creates a reserve against the possibility that its tax position may not be sustained, and the amount of the reserve is based upon the size of the benefit conveyed by its tax position and management's assessment of whether the tax position will ultimately be upheld.

While FASB intended that the issuance of FIN 48 would "result in increased relevance and comparability in financial reporting of income taxes because all tax positions...will be evaluated for recognition, derecognition, and measurement using consistent criteria," one area where this ambition clearly has not been met is the accounting treatment of uncertain tax positions connected to state business activities

[12] FIN 48, as amended by FASB Staff Position No. FIN 48-1, paragraph A1(a).

taxes. The divergence of legal opinions and the swirl of litigation that has surrounded the issue of whether business activities taxes are constitutional have stymied attempts to accord consistent reporting treatment on this issue. One enterprise may receive a legal opinion that any standard for state taxation that does not require physical presence is unconstitutional; another enterprise in a similar tax position may obtain an opinion of counsel that reaches the opposite conclusion. The recent staff interpretation of FIN 48 highlights the need for authoritative direction from the Court by recognizing the fact that a previously "settled" tax position may be "no longer considered effectively settled" where the taxing authority decides to litigate "any aspect of the tax position..."[13]

The existence of such divergent legal opinions (and the uncertainty that this divergence creates) can have a significant impact: under SFAS 109 and FIN 48, one company may decide not to file a return in a locality with a business activity tax and be required to reserve 100 percent of the tax benefit associated with not filing as a result of a legal opinion that such a tax is constitutional, while another enterprise will have a reserve that is substantially lower due to receipt of a legal opinion that the tax is not constitutional. Complicating the issue further is the fact that because statutes of limitations applicable to state taxes generally do not begin to run until a party files a return, these reserves can become a perpetual fixture on the entity's financial statements.

In real world terms, this means that tax professionals and their advisors are required to attempt to discern (1) whether this Court will grant a petition for review to clarify whether physical presence is required for the imposition of business activities taxes, and (2) whether this Court will ultimately

[13] FASB Staff Position No. FIN 48-1, paragraph 10B.

find that such taxes are unconstitutional. Given that billions of dollars in tax positions likely turn on this analysis, it is incumbent on this Court to grant certiorari in order to clarify the law and allow financial institutions and others to report their financial condition in the most accurate and transparent manner.

CONCLUSION

While "[r]elatively few disputes are resolved through litigation, and very few are taken to the court of last resort,"[14] ABA submits that this case presents a situation where it is necessary for the unquestioned "court of last resort" to eliminate an area of substantial uncertainty that plagues the financial services industry. The legacy of litigation and legal uncertainty spawned by the refusal of state and local authorities to follow established constitutional precedent by imposing "business activities taxes" threatens the relevance, reliability and consistency of financial statements across the banking industry (and all public markets). This seriously hampers the ability of businesses to provide accurate financial accounting for their shareholders and the banking public. It is necessary for the Court to take action in order to halt the erosion of one of the legal bulwarks against overreaching state or local taxation that is the essence of the Commerce Clause. Any other result will inevitably lead to continued confusion, formidable accounting reliability issues, burdensome compliance problems, and continued costly litigation over the degree of nexus that is constitutionally required before a state has the requisite jurisdiction to tax. ABA urges the Court to grant the petition in order to provide needed clarity and reaffirm the unquestioned primacy of the

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[14] . FASB Staff Position No. FIN 48-1, paragraph A3.

Court's Commerce Clause analysis that was most recently expressed in *Quill.*

For the foregoing reasons, as well as for those set forth in Petitioner's petition for certiorari, the Court should grant the petition and reaffirm the validity of the physical presence standard set forth in *Quill.*

Respectfully submitted,

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