Does the City of Valdez's Tax on Oil Tankers Violate the Tonnage Clause?

by Ferdinand P. Schoettle

PREVIEW of United States Supreme Court Cases, pages 365–369.

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Three Constitutional provisions are invoked in this case:

(1) The Tonnage Clause of the United States Constitution, Art. I, § 10, Cl. 3: "No State shall, without the Consent of Congress, lay any Duty of Tonnage * * *."
(2) The Commerce Clause of the United States Constitution, U.S. Const. Art. I, § 8, Cl. 3: "The Congress Shall have the Power * * * To Regulate Commerce * * * among the several States * * *." and
(3) The Due Process Clause of the Fourteenth Amendment to the United States Constitution: "[N]or shall any State deprive any person of life, liberty, or property, without due process of law * * *."

Issues

Does a municipal personal property tax that falls exclusively on large vessels using the municipality's harbor violate the Tonnage Clause of the Constitution, art. I, § 10, Cl. 3?

Does a municipal personal property tax formula violate the Commerce and Due Process Clauses of the Constitution?

Facts

The Trans Alaska Pipeline System transports oil from Prudhoe Bay on Alaska's North Slope to Valdez, Alaska, the northernmost ice-free port in North America. At Valdez there is a terminal, owned and operated by a consortium of oil companies, at which tankers can dock and take on oil.

The joint appendix prepared by the parties details the City of Valdez's need for revenue and the genesis of the taxing scheme that is being challenged in this case. In short compass, the State of Alaska's con-

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Polar Tankers, Inc. v. City of Valdez, Alaska
Docket No. 08-310

Argument Date:
April 1, 2009
From: The Supreme Court of Alaska

Case at a Glance

Owners of oil tankers which come to Valdez, Alaska, the terminus of the Trans Alaska Pipeline System, challenged the constitutionality of Valdez's targeted property tax, which levies substantial taxes on 24 oil tankers and only four other vessels. The Supreme Court of Alaska held in favor of the City of Valdez. The Supreme Court of the United States agreed to hear the case.

tributions to Valdez diminished and left the city with the need for additional funds. The City of Valdez enacted Ordinance Number 99-17, which provided

> Boats and vessels of at least 95 feet in length for which certificates of documentation have been issued under the laws of the United States are subject to taxation at their full and true value unless the vessel is used primarily in some aspect of commercial fishing or docks exclusively at the Valdez Container Terminal where it is subject to municipal dockage charges.

Within the reach of the statute were 24 oil tankers and four other vessels. This, the only such property tax in the City of Valdez's arsenal, was unambiguously aimed at the oil tankers.

Part B of the ordinance provided for taxation on an apportioned basis:

> Vessels operated in intrastate, interstate or foreign commerce that have acquired a taxable situs elsewhere, shall be assessed on an apportionment basis. The assessor shall allocate to the City the portion of the total market value of the property that fairly reflects its use in the City. The assessor shall establish formulas for calculating the proportion of the total market value allocated to the City. The assessment formula shall be approved by the city council.

The Valdez city council approved a port-day apportionment formula. The formula proscribes

> A vessel owner will pay the personal property tax based on 100 percent of the assessed value, times a ratio determined by the number of days spent in Valdez divided by the total number of days spent in all ports, including Valdez, where the vessel has acquired a situs for taxation.

Exempted from the calculation were "periods when a vessel is tied up because of strikes or withheld from the Alaska service for repairs."

The apportionment formula contained an escape clause by which a taxpayer could petition for another formula:

> If a taxpayer claims that in a particular case the apportionment formula approved in this Resolution does not reasonably represent the portion of the total value of the vessel that should be apportioned to the taxing situs of Valdez, the taxpayer may petition, or the assessor may require, the use of another apportionment formula that will more fairly represent how the value should be apportioned among Valdez and other taxing jurisdictions.

After the city council approved the apportionment resolution, Polar Tankers, among others, filed suit in Superior Court claiming that the city tax violated the Due Process, Commerce, and Tonnage Clauses of the federal Constitution. The complaint recited:

1. The apportionment method, which assigns the value of a tanker according to a formula based on days in various ports, violates the Due Process and Commerce Clauses of the U.S. Constitution.

2. "The City further violates the Commerce Clause because the ordinance discriminates against vessels engaged in interstate commerce. The ordinance directly and through its exemptions attempts to impose the tax only on vessels engaged directly or indirectly in the transportation of crude oil, which transportation is wholly interstate in nature."

3. The Valdez ordinance violates the United States Constitution's Duty on Tonnage Clause because "The ordinance exempts from taxation smaller vessels (such as pleasure craft), vessels engaged in commercial fishing and those that exclusively use the City-owned container terminal (such as container barges and cruise ships). The effect of those exemptions is to impose a fee, in the form of the tax imposed only upon vessels engaged in interstate commerce, for the privilege of entering the port of Valdez."

In 2004 the Superior Court granted the plaintiffs' motion for summary judgment and held that the vessel tax was an unconstitutional duty on tonnage. The city moved for reconsideration, which the Superior Court granted. The Superior Court vacated its earlier ruling and in January 2005 held that the apportionment method violated the Due Process and Commerce Clauses. The court did not rule on the Tonnage Clause issue at this time. In January 2006, however, the Superior Court issued its final judgment, which added to its January 2005 holding a holding that the tax did not violate the Tonnage Clause.

The lower court ruled that the city could not levy any tax beyond the amount that would be due using an apportionment formula that divides the number of days in Valdez by 365. The court ordered this amount paid into a court-supervised account until the appeal was terminated by agreement of the parties or decision of the Supreme Court.

Both the city and the tankers appealed. The Supreme Court of Alaska denied all of Polar Tankers' claims. The Court held that the

apportionment formula did not violate the Due Process Clause or the Commerce Clause. The Court found that there was a substantial nexus between the taxed activity and the city, that the tax was fairly apportioned, and that "Polar waived claims of discrimination against interstate commerce and fair relation between the tax and services provided." This final finding was based on the fact that "On appeal, Polar only devotes a single sentence to the third element of the *Complete Auto test*—whether the tax discriminates against interstate commerce—stating in its brief, 'unfair apportionment itself is a form of discrimination against interstate commerce.' Given the cursory nature of Polar's failure to argue this issue separately, we consider it waived."

Case Analysis

The tanker owners have not taken the usual approach to challenging the constitutionality of the city's property tax.

The normal constitutional approach in this case would be to attack the City of Valdez's tax as an unlawful burden on interstate commerce. The plaintiffs would argue as follows. The ships are picking up material being exported from Alaska. The tax falls not on households in Alaska but on consumers of the material being transported. The purpose of the tax is to "burden" interstate commerce for the fiscal advantage of the City of Valdez, Alaska. In the language of an economist, the tax burden is being "exported."

The two most relevant cases held Pennsylvania's efforts to tax interstate commerce as unconstitutional efforts to export its tax burdens. Pennsylvania stretches from the Delaware River on the east end of the state to Lake Erie on the west. Because of this geography a great deal of interstate transportation going west must pass through Pennsylvania. In both cases, *Case of the State Freight Tax,* 82 U.S. (15 Wall.) 232 (1873), and *American Trucking Associations v. Scheiner,* 483 U.S. 266 (1987), the tax statutes were facially neutral, an added difficulty which is not a problem in the current case.

The property tax in the present case seems unambiguously targeted at tankers. *American Trucking*'s facts are somewhat similar. There, Pennsylvania's tax was levied at six dollars per axle on trucks weighing more than 26,000 pounds, a weight specification that apparently focused the tax on interstate trucks. For fiscal year 1982–1983, the yield of Pennsylvania's tax was $136 million, with $107 million being derived from trucks registered in states other than Pennsylvania. The 1873 case had a similarly lopsided yield.

A standard applied in *American Trucking* was the "internal consistency" test of *Container Corp. of America v. Franchise Tax Board,* 463 U.S. 159 (1983). That test asks whether the challenged tax could be fairly applied by every jurisdiction. The answer in the current case would be "no, such a tax should not be repeated by other states." It therefore seems likely that the Supreme Court will find the challenged property tax unconstitutional on those grounds. If every state could identify ships involved in exporting goods from the state, design a property tax statute to target them and levy such a tax, interstate commerce would suffer.

Polar Tankers also attacks the tax scheme's apportionment formula. To refresh the reader's memory, the apportionment formula provides for a tax "on 100 percent of the assessed value, times a ratio determined by the number of days spent in Valdez divided by the total number of days spent in all ports."

This formula might make some sense if one were reporting income, but in this case it is being applied to a tax on value for use of a port. Under this formula, for instance, if a very large cruise ship spent one day in the port of Valdez, but otherwise at other ports the cruise ship anchored out rather than in port, the cruise ship would pay a tax on 100 percent of its value. If the cruise ship entered a second port, however, the tax would go down from 100 percent to 50 percent of the ship's value. In each hypothetical, the use of the port of Valdez was the same. If states are to levy taxes of any sort on interstate commerce, the taxes must be rational. According to the petitioners, the Valdez apportionment formula discriminates in arbitrary ways. It is not a true effort to match the tax, which is focused on one class of ships, with those ships' use of the port.

Currently there are seven standards used by the Supreme Court of the United States to test the constitutionality of a challenged tax.

In *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977), the Supreme Court mentioned four of the tests that constitutional attacks on a tax should consider. One should determine whether
1. The tax is applied to an activity with a substantial nexus with the taxing State;
2. The tax is fairly apportioned;
3. The tax does not discriminate against interstate commerce; and
4. The tax is fairly related to the services provided by the State.

Then, in *Container Corporation of America v. Franchise Tax Board,*

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463 U.S. 159 (1983), the Court summarized two other tests that income taxes must meet: (1) an external consistency test; and (2) an internal consistency test (the fifth and sixth tests on this current count). Finally, the Court in *Container Corp.* referred to a test that invalidates a state tax if the income attributed to the state is out of all proportion to the business conducted in the taxing state. This is a standard with ample precedent. As the Court said:

> The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' incomes being taxed. The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not 'invalidat[e] an apportionment formula whenever it *may* result in taxation of some income that did not have its source in the taxing State.…' Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted … in that State,' or has 'led to a grossly distorted result.'"

One can fairly say that of the seven tests announced by the Supreme Court, the City of Valdez's tax on Polar Tankers fails four of them:
– the apportionment formula seems arbitrary and not fairly apportioned;
– the tax targets and discriminates against interstate commerce;
– the apportionment formula is arbitrary and is not fairly related to services provided; and
– that such a targeted tax falling only on interstate commerce is not an internally consistent tax to be adopted by every jurisdiction.

As stated above, the arguments in this case are not normal. A normal constitutional argument would use the seven standards set out above. In this case, however, in the briefs filed supporting Polar Tankers the word "discriminates" appears only five times, all in the petitioner's brief. On the other hand, the word "Tonnage" from the constitutional provision prohibiting taxes on tonnage appears 257 times. It is to that argument we now turn.

Article 1, Section 10 provides that "No State shall, without the Consent of Congress, lay any duty of Tonnage." Tonnage concerns the weight of a vessel or perhaps more accurately the water that the vessel displaces. A vessel must displace its weight in tons of water or sink.

Polar Tankers and its supporters hope in this case to expand the constitutional prohibition on tonnage taxes to include the challenged property tax on Polar Tankers. A relevant paragraph in Polar Tankers' brief reads:

> "The Tonnage Clause has fallen into relative obscurity in modern times, in part because it has been generally successful in effectuating the Framers' goal of discouraging levies that have the effect of taxing vessels for the privilege of using a harbor. But the meaning of the Clause is settled. A duty of tonnage is "a charge for the privilege of entering, or trading, or lying in, a port or harbor." *Transp. Co. v. Parkersburg,* 107 U.S. 691, 696 (1883). By enacting the Tonnage Clause, the Framers sought "to guard against local hindrances to trade and carriage by vessels," *Packet Co. v. Keokuk,* 95 U.S. 80, 85 (1877), which "never ceased to be a source of dissatisfaction & discord" under the Articles of Confederation. J. Madison, Preface to Debates in the Convention of 1787, in 3 M. Farrand, The Records of the Federal Convention of 1787, at 542 (1911).

Fees for the use of harbors have a long history. For instance in 1827 the Maryland legislature authorized wharfage fees in Baltimore:

> The mayor and city council of Baltimore shall be, and they are hereby, empowered and authorized to regulate, establish, charge and collect, to the use of the said mayor and city council, such rate of wharfage as they may think reasonable, of and from all vessels resorting to or lying at, landing, depositing, or transporting goods or articles other than the productions of this State, on any wharf or wharves belonging to said mayor and city council, or any public wharf in the said city, other than the wharves belonging to or rented by the State.

For a report that recites the above history and considers the tax that Baltimore enacted, see *Guy v. Baltimore,* 100 U.S. 434 (1879), a case that does not mention the Tonnage Clause. Cited in *Guy v. Baltimore* are other similar cases. The Supreme Court has not invoked the Tonnage Clause except in instances in which there is an actual tax on tonnage.

The record in this case does not contain any factual support for Polar Tanker's assertion that "The

Tonnage Clause has fallen into relative obscurity in modern times, in part because it has been generally successful in effectuating the Framers' goal of discouraging levies that have the effect of taxing vessels for the privilege of using a harbor." Given that there are thousands, perhaps millions of boats in the United States and not much more harbor space in the 21st century than there was in the 18th century, fees for use of a harbor might be assumed to be at least as prominent as they were in 1827 when Maryland authorized fees in Baltimore and in 1879 when the Supreme Court decided *Guy v. Baltimore.*

It seems very doubtful that the Supreme Court would change a centuries-long understanding of the application of the Tonnage Clause to decide this case. Fees for the use of harbors are somewhat analogous to parking meters and have a centuries-long history. Also, the reader should realize that this case is truly unique, an effort to tax oil tankers carrying exported oil. Fees for harbor use could not normally depend upon a value formula, but would be a set fee for harbor use based on some objectively observed criteria such as length, beam, or the like. For instance, can the reader imagine a harbormaster appearing to quiz the captain of a vessel, be it pleasure or commercial, about the value of the vessel and then about where the vessel had been for the previous year in order to determine a fee for harbor use based on a formula-determined percentage of value?

Significance

This is unlikely to be a significant case, as it can be decided according to settled principles. If decided under the Tonnage Clause, however, the decision would be a very significant broadening of the prohibitions of that Clause.

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Amicus Briefs

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National Federation of Independent Business, Small Business Legal Center, (Karen R. Harned (202) 314-2061)

Tropical Shipping and Construction Co. Ltd (Jonathan F. Mitchell (703) 993-8848)

World Shipping Council and Cruise Lines International Association (Marc J. Fink (202) 463-2500)

In Support of Respondent City of Valdez, Alaska

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